Reid Kerr College

Annual Audit Report to the Board of Management and Auditor General for Scotland

Audit for the year ended 31 July 2010

CONTENTS

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EXECUTIVE SUMMARY

Financial Highlights

The College achieved a surplus of £307k (2009 £151k) on its income and expenditure account for the year prior to FRS17 adjustments for the Strathclyde Pension Scheme (SPF). On 22 June 2010 the Chancellor announced a change in the methodology for calculating future pension increases which are now being linked to the Consumer Price Index (CPI). In accordance with the treatment recommended by Hymans Robertson LLP, the effect of this change has been taken through income and expenditure account as a negative past service cost of £954k. The net effect of the FRS17 adjustments in total is a credit of £682k (2009 debit of £106k) to income and expenditure account taking the overall surplus for the year to £989k (2009 £45k).

The financial statements disclose total reserves of £8.283m (2009 £7.812m). The 2010/11 financial forecast return anticipates a surplus of £429k, excluding adjustments in relation to FRS 17.

Corporate Governance

From our review of Corporate Governance arrangements within Reid Kerr College ("the College"), we believe the Corporate Governance statement to be neither misleading nor inconsistent with other information made available to us during the course of the audit process. The Corporate Governance statement does not disclose any significant weaknesses in the systems of internal control. Internal audit (Deloitte) concluded that "On the basis of work undertaken in the year ended 31 July 2010, we consider that the College has an adequate framework of control over the systems we examined during the year".

The Operating and Financial Review provides a comprehensive account of the College's activities and meets the requirements of the Statement of Recommended Practice: Accounting for Further and Higher Education 2007 ("SORP 2007").

Management letter points have been raised on the following issues:

- the Register of Interests was not up-to-date at the date of our onsite visit. We recommend that this is updated annually.
- the Board of Management's self-evaluation was postponed and ultimately did not occur during the course of the year. We recommend that the Board evaluates its performance at least annually.

Financial Statement Audit

We have completed our audit work in respect of the financial statements of the College and are satisfied that they present a true and fair view of its financial position for the year ended 31 July 2010. Following approval of the financial statements by the Board of Management on 10 December 2010 our audit report will express unqualified opinions on (i) the financial statements of the College for the year ended 31 July 2010 and (ii) regularity.

In preparing the Financial Statements on a going concern basis, the Board of Management is satisfied that the SFC will provide sufficient funding to enable the College to operate for at least 12 months from the date of signing the Financial Statements.

Management provided draft financial statements and supporting working papers in line with the agreed timetable and they were complete and of a good standard.

The 2009/10 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.

OVERVIEW, SCOPE AND INDEPENDENCE

Overview

• The purpose of this report is to highlight and explain key issues arising from our audit of the financial statements of Reid Kerr College ('the College') for the year ended 31st July 2010.

• This report covers those matters we believe to be material in the context of our work. It was prepared from general information obtained during the audit process, including management accounting information and discussion with management and staff of the College. It has been prepared solely for the use of the College and the Auditor General for Scotland and should not be shown to any other person without our express permission in writing. We do not accept responsibility for this report to any other person and we hereby disclaim any and all such liability. We do not, in preparing this report, accept or assume responsibility for any other purpose or to any other person to whom it is shown or into whose hands it may come save as expressly agreed by our prior written consent. If others choose to rely on the contents of this report, they do so at entirely their own risk.

• 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 2010. 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.

Significant Accounting and Audit Issues

Detailed on pages 16 to 19 are the key accounting and audit issues identified during our work:

- YMCA Refurbishment Costs
- Electricity Provision
- Dilapidations Provision
- SUMs achievement
- Additional Fee Waiver - Non-Recognition of Debtor
- Property valuation - Abercorn
- FRS 17 - CPI

Unadjusted Audit Differences

We are required by International Standard on Auditing (UK & Ireland) 260 to bring to your attention audit adjustments that we have identified and which the Board of Management is required to consider. A schedule of such adjustments is included in Appendix 1. We have not included items under £2,360 which we consider to be clearly trivial. Total unadjusted audit differences identified by our audit work would reduce the surplus of £989k by £98k and would increase net assets of £15.164m by £5k. The Board will need to consider the materiality of these identified misstatements in the context of the financial statements taken as a whole.

OVERVIEW, SCOPE AND INDEPENDENCE
Continued...

Key areas	Summary
Scope	The accounting rules and regulations applying to Further Education Colleges are specifically laid out in various documents as discussed on page 8 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. We can confirm that 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. The audit of Reid Kerr 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.
Independence	Under Auditing and Ethical Standards, we are required as auditors to confirm our independence to "those charged with governance". In our view this term refers to the Board of Management and we confirmed our independence to them in a letter on 20 April 2010. Our internal procedures are designed to ensure that all partners and professional staff are aware of relationships that may be considered to bear on our objectivity and independence as auditors. The principal statements of policies are set out in our Conduct of Professional Services Manual. In addition, we have issued supplementary written guidance and embedded the requirements of the Standards in our internal training programmes. The procedures require that audit engagement partners are made aware of any matters which may reasonably be thought to bear on the firm's independence and the objectivity of the audit engagement partner and the audit staff. We confirm that the firm complies with the APB Ethical Standards and, in our professional judgment, is independent and objective within the meaning of those Standards. In our professional judgement the policies and safeguards in place ensure that we are independent within the meaning of all regulatory and professional requirements and that the objectivity of the audit engagement partner and audit staff is not impaired. Should you have any comments or queries regarding this confirmation we would welcome their discussion in more detail.

AUDIT FRAMEWORK

Audit Framework

Audit Framework

BDO 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 year was the fourth of the five-year appointment. This report to the College Board of Management and Auditor General for Scotland provides our opinion and highlights issues arising from our work in relation to our audit work for 2009/10 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 .

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 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.

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 economic, 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.

AUDIT FRAMEWORK (Continued…)

Audit Framework

Auditor's 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.

AUDIT FRAMEWORK (Continued…)

Audit Framework

College Guidance

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. Our audit procedures identified no factors that would lead us to believe that the college does not comply with the terms and conditions of the Financial Memorandum.

Accounts Direction

In preparing its annual Financial Statements 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

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.

FINANCIAL HIGHLIGHTS

Key areas	Summary
Financial Highlights	• **Income and Expenditure Account:** The College achieved an operating surplus of £989k, 3.9% of total income in respect of the year-ended 31 July 2010 (2008/09: £45k and 0.2%, Forecast: £190k and 0.8%). This increase represented a £944k increase on the prior year and a £799k increase on forecast. The main reason for the increased surplus compared to the original budget relates to the incorporation of the FRS 17 adjustments for the Strathclyde Pension Scheme which resulted in a credit to Income and expenditure account of £682k. Other positive variances arose due the increased SFC grant funding through an economic downturn grant, and increased European project activity. • **Balance Sheet:** The financial statements report net assets at 31 July 2010 of £15.2m, reflecting an increase of £1,188k over 2009. The increase is attributable to the £989k surplus generated in the year, an increase in deferred capital grants of £717k as at 31 July 2010 and an actuarial gain in respect of the pension scheme of £363k. The land and buildings were revalued by Graham & Sibbald Chartered Surveyors at £25.703m, which resulted in a £881k downward valuation. The balance on the Revaluation Reserve carried forward as at 31 July 2010 is a surplus of £10.2m (31 July 2009: £11.3m).
Cash Flow	During 2009/10, the College experienced a net inflow of cash of £735k (2008/09: inflow of £399k).
Financial Forecast	The initial 2009/10 financial plan forecasted a surplus of £190k (after FRS 17 adjustments). The difference between that which was the forecast and the surplus achieved can be explained by an increase in SFC grant income (economic downturn grant), a rise in European funding and the impact of FRS 17 pension adjustments all of which were partly offset by a rise in European project costs and an increase in premises costs. The forecast of income, expenditure and cash balances for the College for 2010/11 shows that both income and expenditure are expected to fall in 2010/11, resulting in a surplus of £409k (before FRS 17 adjustments).

FINANCIAL HIGHLIGHTS
Income and Expenditure Account

Income

- The table below summarises the main sources of income for 2009/10 and 2008/09.
- The College's WSUMs target for 2009/10 was 84,870 and the College delivered 85,007. As a result, the College will not be liable to repay any recurrent grant to the Scottish Funding Council in 2010/11.
- A significant proportion of income is received from the Scottish Funding Council, however the proportion of income from this source has fallen from 74% in 2008/09 to 72% due to increases in other income streams.
- Total SFC Grant income is normally in the region of 73% of total income (2007/08: 72%), based on the 2008/09 statistics for colleges in this category.
- An increase in SFC grant income of £615k. This is a result of an additional £433k of core grant, £351k of estates capital funding and £335k of economic downturn grant partly off-set by the absence of/reductions in other one-off grants obtained in 2008/09.
- An increase in other sources of income of £837k. Contributing to this are increases in European Social Fund (ESF) income relating to the arrangement with Renfrewshire Council, nursery income (unspent bursary grant income reallocated to childcare), income for the creative arts funding and income from open university courses that are facilitated from the College.

Income and Expenditure Account	31 July 2010 £'000	31 July 2009 £'000	Variance £'000
Scottish Funding Council Grants	18,151	17,536	615
Tuition Fees and Education Contracts	2,660	2,640	20
Other Income	4,455	3,618	837
Investment Income	5	18	(13)
Total Income	**25,271**	**23,812**	**1,459**
Expenditure (see analysis on next page)	**(24,282)**	**(23,767)**	**(515)**
Surplus	**989**	**45**	**944**

FINANCIAL HIGHLIGHTS
Income and Expenditure Account (continued…)

Expenditure

Total expenditure increased by £515k (2.2%), in comparison to 2008/09, to £24.28m. The table below summarises the main categories of expenditure for 2009/10 and 2008/09. The most significant movements are as follows:

- a reduction in staff costs of £947k due mainly to FRS 17 credit adjustment of £835k primarily resulting from the change in the methodology for calculating future pension increases which are now being linked to the Consumer Price Index (CPI). In accordance with the treatment recommended by Hymans Robertson LLP, the effect of this change has been taken through income and expenditure account as a negative past service cost.; and
- an increase in other operating expenses of £1.4m as a result of a £340k increase due to the refurbishments of the YMCA building to prepare it for use by the Creative Arts Department which moved in during the year and the £100k dilapidations provision made for the cost of returning the Mile End building to a suitable state after the college moved out at the start of the year. In addition, there was a £360k increase in electricity costs up to £405k, which is mainly as a result of a £390k accrual for electricity costs relating to unbilled electricity usage since 2005. The Scottish Power meter in the main Renfrew buildings of the College has not worked properly over the past 5 years and so the College may have been significantly undercharged for that period. There was also £265k paid over to Renfrewshire Council relating to European Funding grants received.
- an increase in interest payable due to the £153k finance cost associated with the defined benefit pension (compared to a credit in the prior year) partly offset by the £43k reduction in bank loan interest charged – due to the lower loan balances outstanding in the year.

Expenditure Analysis	31 July 2010 £'000	31 July 2009 £'000	Variance £'000
Staff Costs	16,196	17,143	(947)
Other Operating Expenditure	6,568	5,204	1,364
Depreciation	1,085	1,086	(1)
Interest Payable	433	334	99
Total Expenditure	**24,282**	**23,767**	**515**

FINANCIAL HIGHLIGHTS
Balance Sheet

The balance sheets shows an increase of £1,188k in net assets as at 31 July 2010 compared to the previous year end. Significant movements include:

- A decrease in tangible fixed assets of £1.2m as a result of various factors: there were fixed asset additions of £785k, less the depreciation charge for the year of £1.09m. Graham & Sibbald Chartered Surveyors revalued the land and buildings which, in addition to the impairment of both the St Mirren building and Inchinnan Tower, resulted in a further reduction in fixed assets of £881k.
- An increase in debtors of £103k. This is a result of an increase in the European funding accrued income by £422k on the prior year netted off against a reduction of £253k in the prepayments / accrued income balance on the prior year. The European funding balance has increased, partly due to the arrangement that the college has with Renfrewshire Council. The remaining increase in European Funding is due to an increase in applicable project activity carried out by the College. The reduction in the prepayments/ other accrued income is mainly due to the absence of accruals in the current year for the Saudi contract (£66.6k in 2009) and for a variety of miscellaneous invoices (£73k in 2009).
- An increase in cash of £735k as a result of increased, and unbudgeted income to the College.
- A decrease in creditors due within one year of £678k. This is a result of a £554k reduction in taxation and social security due to June's HMRC liability being paid late in the prior year following cash flow issues, in addition to repayment of the AIB and Bank of Scotland loans in the year, offset by a new loan from the Clydesdale Bank. These downward creditor movements are partially offset by a net £301k increase in accruals which reflects the £390k provision for electricity costs for unbilled usage since 2005 (there was a £nil balance in the prior year) and a £100k provision for dilapidation costs at the Mile End building (there was a £nil balance in the prior year) partly offset by a £202k reduction in the various purchase ledger accruals.
- A decrease in creditors due after one year of £382k. This is as a result of repayment of the AIB and Bank of Scotland loans in the year, offset by a new loan from the Clydesdale Bank.
- An increase of £23k in the early retirement provision which is now consistent in terms of actuarial assumptions with the FRS 17 valuation of the Strathclyde Pension Fund.
- A decrease in the pension liability of £1m, which has been brought about by changes in mortality rates and past service gains resulting from using CPI in FRS 17 calculations.

FINANCIAL HIGHLIGHTS
Balance Sheet (continued…)

Balance Sheet Category	31 July 2010 £'000	31 July 2009 £'000	Variance £'000
Fixed Assets	26,749	27,930	(1,181)
Stock and Debtors	1,695	1,598	97
Cash	191	1	190
Creditors: Amounts falling due within 1 year	(4,381)	(5,059)	678
Creditors: Amounts falling due after 1 year	(4,591)	(4,973)	382
Provisions for Liabilities and Charges	(1,612)	(1,589)	(23)
Pension Liability	(2,887)	(3,932)	1,045
Net Assets	**15,164**	**13,976**	**1188**

FINANCIAL HIGHLIGHTS Financial Forecasts

Financial Forecasting

- The initial 2009/10 financial plan forecasted a surplus of £205k (excluding FRS 17 adjustments). The table below shows the reconciliation between the forecast outturn and the actual amount generated during the course of the year. The main reasons for the movement from the forecast to the actual outturn were as follows:
  - increase in SFC grant income partly related to the unbudgeted economic downturn grant being received during the course of the year.
  - increase in European grant income due mainly to the latest Renfrewshire Council projects being firmed up after the submission of the FFR at the end of June (no impact on surplus due to offsetting rise in costs).
  - increase in other operating expenditure due to a rise in premises costs (£340k refurbishment of the YMCA building, £390k electricity accrual, an increase of £378k on forecast for total other income generating costs the majority of which relates to European project costs, an increase of £426k in administration costs and an increase in teaching activity costs of £275k (which mainly relates to an increase in SQA fees and Studio equipment costs).
  - FRS 17 adjustments impacted by a past service cost credit of £945k.

Forecast vs. Actual	31 July 2010 £'000	31 July 2009 £'000
Forecast outturn per budget (excluding FRS 17 adjustments)	**205**	**366**
Increase in SFC grant income	921	230
Increase (/decrease) in other income	1,093	(246)
Decrease in payroll costs	181	178
(Increase) in other operating expenditure	(2,093)	(377)
Actual outturn at year end (excluding FRS 17 adjustments)	**307**	**151**
Forecast outturn per budget (including FRS 17 adjustments)	**190**	**366**
Movements explained above	**102**	**(215)**
Decrease/ (increase) in FRS 17 costs	**697**	**(106)**
Actual outturn at year end (including FRS 17 adjustments)	**989**	**45**

FINANCIAL HIGHLIGHTS
Financial Forecasts (continued…)

Financial Forecasting

- The table below summarises the forecast income, expenditure and cash balances for the College for 2010/11.
- Both income and expenditure are expected to fall in 2010/11, resulting in a reduced surplus. The reduction in income will be due to the sector-wide cut in SFC grant funding in addition to a fall in tuition fee income. College expenditure will have to be closely monitored, in particular staff costs, in order to achieve the forecasted surplus.

Forecast Income, Expenditure and Cash Balances for 2010/11	£'000
Income	24,398
Expenditure	(23,989)
Forecast surplus for the year ending 31 July 2011	**409**
Cash balance at 31 July 2010	191
Forecast movement in cash during 2010/11	(1,442)
Resulting cash balance at 31 July 2011	**(1,251)**

KEY ACCOUNTING AND AUDIT MATTERS
From the Audit Planning Memo & Other Matters

YMCA Refurbishment Costs

- The college has incurred around £340k of costs which largely relate to the cost of refurbishing the rented YMCA building into which the Creative / Performing Arts Department moved in the year. In line with FRS 15 expenditure of this nature would normally be capitalised and amortised over the term of the lease. Management decided not to capitalise these costs on the basis that any new walls / floors etc will be removed when the College vacates the building. Furthermore, as the refurbishment was all grant funded and therefore the decision of whether or not to capitalise these costs ultimately has no impact on either the Income and Expenditure Account or the Balance Sheet.

BDO Conclusion

- While acknowledging that in this instance the departure from FRS 15 has no impact on either the Income and Expenditure Account or the Balance Sheet we recommend that the College takes cognisance of generally accepted accounting practice when accounting for similar expenditure in the future.

Electricity Provision

- The college has created a provision of £390k within accruals for the estimated cost of unbilled electricity usage in the main Renfrew and Renfrew North buildings since 2005. While the College has not at this stage received any written communication from Scottish Power it is understood that Scottish Power is aware of a fault in a meter which has caused recorded usage to be understated and has installed equipment to allow it to assess the extent of the under-billing. The College has commissioned an independent assessment in order to assist it in discussions and negotiations with Scottish Power. Total electricity costs charged through the Income and Expenditure Account over the last five years (excluding the £390k accrual) were £384k and College management have used this as a basis for estimating the potential under-billing.

BDO Conclusion

- Based on information available and in the absence of an assessment from Scottish Power or the results of the College’s own review of the potential liability it is not possible to determine a reliable estimate but we have accepted the need for a provision and management’s rationale in quantifying the amount.

KEY ACCOUNTING AND AUDIT MATTERS
From the Audit Planning Memo & Other Matters (Continued...)

Dilapidations Provision

- A provision of £100k has been recorded for the costs of restoring the Mile End building to a reasonable state after the lease came to an end during the year. On the instructions of the College Graham & Sibbald have assessed the extent of dilapidation works required and have estimated a cost of £70k. Management believe that £70k is an accurate and acceptable estimate of the cost but on the grounds of prudence have recorded a provision of £100k in the Financial Statements.

BDO Conclusion

- We are satisfied with the basis for and quantum of management's estimated of the dilapidation costs on respect of this building.

SUMs Achievement

- SFC require the College to achieve total SUMs within 2% of its target for the year to avoid being in a clawback position.

BDO Conclusion

The College's audited certificate to SFC shows a WSUMs total for the year to 31 July 2010 of 85,007. This figure is in excess of its target for the year of 84,870 and accordingly there should be no clawback of SFC grant for non achievement of SUMs target.

KEY ACCOUNTING AND AUDIT MATTERS
From the Audit Planning Memo & Other Matters (Continued…)

Unrecorded Additional Fee Waiver Income

- With respect to fee waiver the College is not in a claw-back position with regards to 2009/10, and due to the high level of demand amongst students the College is in a position to receive an additional fee waiver grant. Calculations were agreed showing that the College may receive an additional fee waiver grant of £257,000 However, due to the economic downturn and the resultant increase in the number of students with fee waiver needs across the college sector, SFC may not be able to meet the demand from all colleges for additional fee waiver grant due to funding constraints. The potential additional fee waiver income has not been recognised in the financial statements.

BDO Conclusion

- We agree with management’s prudent treatment of non-recognition of the additional fee waiver grant due to the doubt over whether the grant is recoverable as SFC have indicated that they cannot guarantee payment.

Property valuation – Abercorn Building

- The total downward revaluation of properties at 31 July 2010 of £881k has been recorded in the Statement of Recognised Gains & Losses and as a reduction in the Revaluation Reserve brought forward from previous years. Within the total is an amount of £103k in respect of the Abercorn Building for which there is insufficient Revaluation Reserve brought forward against which to make this reduction. Consequently this adjustment should be recorded as a charge to Income & Expenditure Account.

BDO Conclusion

- We have included this figure on the Schedule of Unadjusted Audit Differences at page 26.

KEY ACCOUNTING AND AUDIT MATTERS
From the Audit Planning Memo & Other Matters (Continued…)

FRS 17 - CPI

- On 22 June 2010 the Chancellor announced a change in the methodology for calculating future pension increases which are now being linked to the Consumer Price Index (CPI) rather than the Retail Prices Index (RPI) which was previously used. The effect of this change on the Reid Kerr College share of the Strathclyde Pension Fund (SPF) comes through as a negative past service cost of £954k. The key question is whether this credit should be taken through income and expenditure account or taken to the statement of total recognised gains and losses. The Financial Reporting Council issued Urgent Issues Task Force information sheet number 90 entitled 'Accounting implications of the replacement of the Retail Prices Index with the Consumer Prices Index for Retirement Benefits' on 13 October 2010. The issue is whether the change gives rise to a different benefit (a change in benefit) or whether a different assumption is being applied to an unchanged benefit (a change in assumption). FRS 17 'Retirement Benefits' requires that a change in scheme liabilities arising from a change in benefit be recognised in the income and expenditure account. In contrast, it requires that a change in the scheme liabilities arising from a change in an assumption is part of actuarial gains and losses which should be recognised in the statement of total recognised gains and losses.
- The College has taken the view that the credit of £954k should be taken to income and expenditure account in accordance with actuarial advice from Hymans Robertson LLP.

BDO Conclusion

In this case the draft guidance is capable of interpretation either way and the accounting treatment hinges in part on whether there is a constructive obligation to pay pension increases linked to RPI in the SPF. We are satisfied that the College's accounting treatment of the £954k can be supported by reference to the draft UITF guidance and the advice given by Hymans Robertson LLP.

The consultation period for comments on the UITF draft abstract expired on 10 November 2010 and a final UITF document will be issued in due course and will hopefully provide clarity on the issue. If the final document requires that such credits be taken to the statement of total recognised gains and losses rather than the income and expenditure account, then the College accounting treatment will need to be adjusted next year by restating the comparative figures on the income and expenditure account. The balance sheet figures are unaffected.

CORPORATE GOVERNANCE

Corporate Governance

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.

The corporate governance arrangements of an organisation are the means by which strategy is set and monitored, managers are held to account, risks are managed, stewardship responsibilities are discharged and institutional sustainability is ensured. The Code of Audit Practice requires that auditors review and report on the College's corporate governance arrangements as they relate to:

- the College's reviews of its systems of internal control, including reporting arrangements;
- the prevention and detection of fraud and irregularity;
- standards of conduct and arrangements for the prevention and detection of corruption; and
- its financial position.

The Board of Management is required to report on its compliance with the ***"Combined Code on Corporate Governance (June 2008)".*** Looking forward we would draw your attention to the revised Corporate Governance Code published in June 2010 called ***"The UK Corporate Governance Code"*** and also to the Consultation Draft issued by CIPFA in May 2010 called **"Delivering Good Governance in Scotland's Colleges: A Framework"**.

Board of Management: has nine formally constituted committees which have specific terms of reference and act with delegated authority from the Board (including the Strategic Planning Committee, Audit Committee, Business & Enterprise Committee, Finance Committee, HR Committee, Remuneration Committee, Estates Committee, Student Affairs Committee and the Learning and Teaching Committee).

- ***Composition:*** the Board is comprised of 15 members as at 31 July 2010; hence, the Board has no more than the recommended maximum of 16 members. The skills of the members of the Board include relevant expertise in education, management consultancy, human resources, finance and accountancy. The College representatives include the Principal, a member of the teaching staff, a member of the support staff and a member of the students' body. The College follows the principle that the Board has a majority of members who are external and independent (i.e. neither staff nor student of the College). The College Clerk to the Board of Management is A. Nelson, who meets the best practice requirement that the role is held by an individual who is independent of College management. The recommended maximum period of office for board members of 12 years has been adhered to.
- ***Timing:*** met the recommendation for meeting not less than 4 times during the year, with 4 meetings throughout 2009/10. Therefore, the Board met at sufficiently regular intervals during the course of the year in order discharge its duties effectively.

CORPORATE GOVERNANCE
(Continued…)

Corporate Governance (continued…)

Board of Management (continued…)

- ***Responsibilities:*** It was noted that no one individual has unfettered powers of decision-making. Arrangements are in place to enable the Chairman to hold meetings with the other non-executive governing body members without executives present when deemed appropriate. Protocols are in place to ensure that the impact of senior staff undertaking positions on external governing bodies is fully considered.
- ***Development and Evaluation:*** Management is aware of the importance of ensuring that new Board members are provided with a timely induction and appropriate development programme. However, there is no formal process to ensure that the Board reviews its effectiveness nor has it undertaken a formal and rigorous evaluation of its own effectiveness and that of its committees at regular intervals. A management letter point has been raised regarding this.

Audit Committee: is comprised of 2 members as at 31 July 2010. The committee, with both members being non-executives, meets the recommendation that there be at least 2 independent non-executive members. In addition, with one member being a qualified accountant, the Board has satisfied itself that it has met the recommendation that at least one member of the committee has recent and relevant financial expertise. While the Chair of the Board of Management was not also a member of the Audit Committee it is noted that the Chair of the Finance Committee is also a member of the Audit Committee. This is not in line with Corporate Governance best practice.

Remuneration Committee: is comprised of 3 members as at 31 July 2010. It is recommended that if the Chair of the Board of Management is a member of the Remuneration Committee he or she should not chair the committee – the College follows this recommendation.

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.

CORPORATE GOVERNANCE (Continued…)

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 Deloitte. An assessment was made of the adequacy of the internal audit output and it was concluded that we as external auditors were able to use the work of internal audit in planning our own procedures. Accordingly cognisance was taken of the work of internal audit in the following areas during 2009/10:

- Review of Information Security
- Financial Controls Assessment
- Annual Audit Report
- Risk Management
- Follow-Up Report
- SUMs Audit
- Bursary and Hardship Audit

On 11 November 2010, Deloitte issued its annual internal audit report for the year ended 31 July 2010. This concluded that, the College has an adequate framework of control over the systems examined during the year.

Risk Management

The Board has responsibility for the identification and management of risks facing the College. A risk assessment matrix of the exposure to risk, and the extent to which these risks are controlled, including implementation of actions to mitigate risk, is updated and presented to the Board of Management annually to review the College's response to identified risks. This identifies, prioritises and assesses risks to the College according to the likelihood and the impact of each risk.

CORPORATE GOVERNANCE (Continued…)

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. The College has in place a comprehensive fraud prevention policy, in addition to a more specific whistle-blowing policy. Both of the policies are readily available to staff on the College's intranet and are also published on the College's website. The fraud prevention policy also includes a plan on the response to any frauds identified. No frauds were identified by the College in 2009/10. In addition to the aforementioned policies, the College has also implemented tendering and procurement procedures to mitigate the risk of financial irregularity.

Operating and Financial Review (OFR)

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. Reid Kerr College has not included this level of detail in its OFR. The college may wish to consider how it can best implement the recommendations within this guidance going forward in order to present data that best reflects the key performance indicators being measured against targets set.

MANAGEMENT LETTER POINTS

Key Areas	Issue and impact	Recommendations	Management Reponses
Register of Interests	At the time of the audit, the Register of Interest has not been updated since March 2009 – this should be performed annually. Although the declaration of interests is a standing issue on the board agenda, the college should still ensure that the register of interests is completed and signed on an annual basis to ensure that related parties are being adequately disclosed.	The College should ensure that board members sign the Register of Interests on a timely basis.	Agreed
Board of Management Self-Evaluation	The Board of Management's self-evaluation day was postponed and ultimately did not occur during the course of the year. The self-evaluation should address each committee's effectiveness, individual member's performance, the Chair's performance, and an assessment of the committee's responsibilities and resources.	We recommend that the Board of Management evaluates its performance annually. The Board should introduce formalised self-assessment procedures to determine how effectively it is discharging its responsibilities.	Agreed
Committee membership	The chair of the Finance committee is also a member of the Audit Committee. This is not in line with Corporate Governance best practice.	Ideally there should be exclusivity of membership between Finance and Audit Committees however the College may wish to consider inviting the Chair of the Finance Committee to meetings of the Audit Committee without being a member of that committee.	Not agreed

PREPARATION OF THE FINANCIAL STATEMENTS

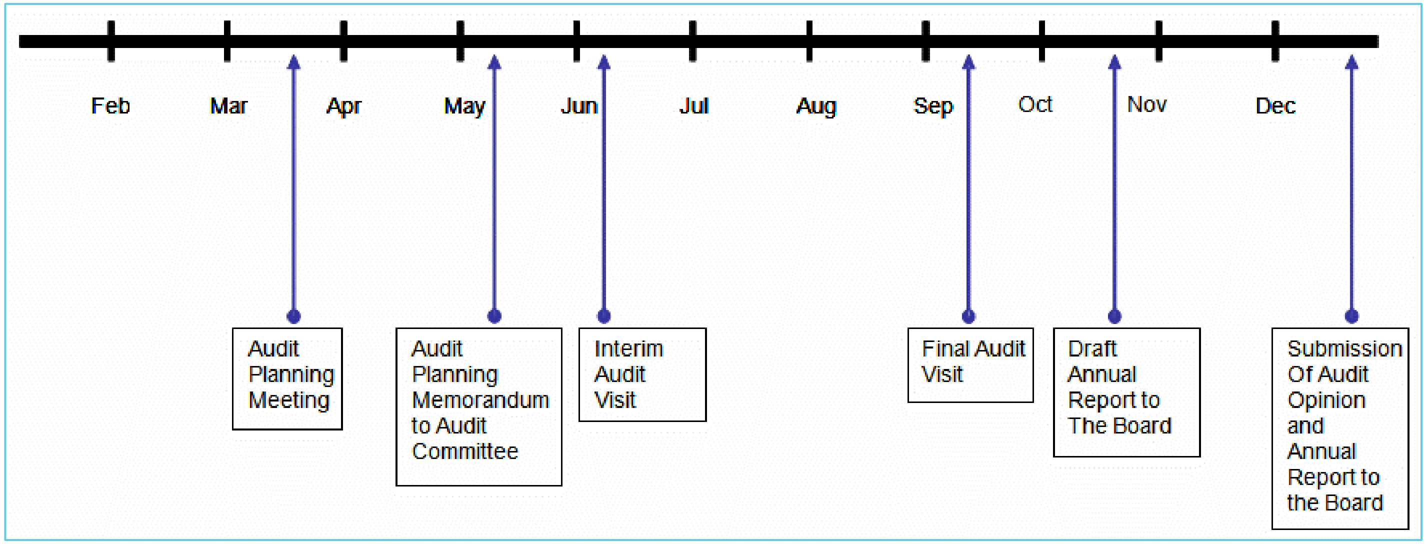
Preparation of the Financial Statements

Our Audit Planning Memorandum, issued to the College in April 2010, outlined the various stages of the audit process, as set out in the timetable below. In relation to the key factors of the production of the financial statements, our assessment was as follows:

Completeness of Draft Financial Statements: We received a set of draft financial statements on 20th September 2010, the first day of audit fieldwork. The draft financial statements were of excellent quality. Most issues were resolved by the end of fieldwork and a revised draft received on 12th October 2010. Any outstanding matters were satisfactorily resolved prior to receipt of the final Financial Statements and audit sign off.

Quality of Supporting Documentation: Prior to the beginning of our audit fieldwork, we issued an "Information to be Prepared by Client" request setting out the required supporting documentation to be in place for the beginning of audit field work. The supporting documentation that was received was of an extremely high standard with little requirement to obtain additional schedules from the Finance staff

Response to Audit Queries: As in prior years, management provided good quality and timeous responses to all of the audit queries that were raised with them.



APPENDIX 1
Unadjusted Audit Differences

Unadjusted Audit Differences

We are required by International Standards on Auditing 260 "Communication of matters to those charged with governance" to communicate all uncorrected audit differences, other than those we clearly believe to be trivial.

Total unadjusted audit differences identified by our audit work would reduce the reported surplus of £989k by £98k and would increase reported net assets of £15.164m by £5k. The Board of Management will need to consider the materiality of these identified misstatements in the context of the financial statements taken as a whole. These are set in the table below:

		Income & Expenditure Account		Balance Sheet	
Unadjusted Audit Differences	**£'000**	**DR £'000**	**CR £'000**	**DR £'000**	**CR £'000**
Surplus for the Year before Audit Adjustments	989				
Removing credit balances from debtors listing				26	26
Removing debit balances from creditors listing				29	29
Correction for double counting of accrual	8		8	8	
Correction to early retirement pension provision	(8)	8			8
Accrual of invoice for agents commission (Smart Specialists) relating to Libyan students	(26)	26			26
Reallocation of PILON paid to A. Easton		25	25		
Abercorn impairment incorrectly charged to STRGL	(103)	103			
Late sales invoices to be accrued	31		31	31	
Adjustment to revaluation reserve transfer				10	10
Total Adjustments	**98**	**162**	**64**	**104**	**99**
Surplus for the Year after Audit Adjustments	886				

The matters raised in our report prepared in connection with the audit are those we believe should be brought to your attention. They do not purport to be a complete record of all matters arising. This report is prepared solely for the use of the company and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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