



Reid Kerr 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 Reid Kerr College ('the College') for the year ended 31st 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 Reid Kerr 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 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.

Conclusion

- 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.

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 Reid Kerr 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. The following areas, as laid out in the model financial statements, could be further enhanced, in terms of the level of content, by the College during 2009/10:
 - Performance indicators;
 - Principal risks and uncertainties
- Additional guidance on the content of the operating and financial review (OFR) was issued by the Scottish Funding Council on 2 October 2009, which was after the audit had begun. 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. At this stage 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. Following review of this guidance our recommendation would mirror those identified in the paragraph above.

4 Audit Findings

Preparation of Financial Statements

- The financial statements and the required working papers were ready for audit on 30 September 2009, in line with the agreed timetable.

Audit Opinion

- We are satisfied that the financial statements of the College present a true and fair view of its financial position as at 31 July 2009. Following approval of the financial statements by the Board of Management on 11 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 summarises the main financial features and key movements from the prior year.

Income and expenditure account

- The College made an operating surplus of £45k, 0.2% of total income in respect of the year ended 31 July 2009 (2007/08: £210k and 0.9%). The sector average for 2007/08 was 1.3%.

Income

- Total income increased by £870k (3.8%) on prior year. The increase is primarily due to an increase in Funding Council Grant Income of £1,097k which is offset by a decrease in other income of £824k.

- 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	17,536	16,439	74%	72%
Tuition Fees and Education Contracts	2,640	2,805	11%	12%
European Grant Income	1,456	499	6%	2%
Other Income	2,162	2,986	9%	13%
Investment Income	18	213	0%	1%
Total Income	23,812	22,942	100%	100%

- A significant proportion of income is received from the Scottish Funding Council and the various sources of income remain relatively consistent with 2007/08 other than the Recurrent Grant in Aid Funding which has increased from £14,950k in 07/08 to £15,501k in 08/09. The College's level of dependency on SFC Grants is comparable with other colleges delivering over 80,000 WSUMs from review of the 2007/08 Scottish Funding Council performance indicators. Total

Funding Council Grant income is normally in the region of 73%, based on the 2007/08 statistics for Colleges in this category. The College is also in line with the sector average of 72% of total funding from the Funding Council.

Expenditure

- Total expenditure increased by £1,035k (4.6%) in comparison to 2007/08. The increase in expenditure is higher than the increase in income and consequently the reported surplus is £165k less than last year. The increase in expenditure is, in the main, due to an increase in other operating expenses. The most significant movements are detailed below:
 - An increase in other operating expenses of £725k with significant increases in premises, administration and other costs alike. All cost increases are linked to increases in the level of income received; and
 - An increase in staff costs of £475k;
 - These increases in spend are offset by reductions in interest payable and depreciation by £110k and £73k respectively.

It should be noted that impact of the FRS 17 adjustments form part of the increases noted above. FRS 17 adjustments resulted in increased expenditure of £106k in 08/09 (07/08: decrease of £182k).

- The table below summarises the main expenditure categories for 2008/09 and 2007/08.

	2008/09	2007/08	2008/09	2007/08
	£'000	£'000	%	%
Staff costs	16,913	16,438	71%	72%
Future Pension Provisions	230	212	1%	1%
Other Operating Expenditure	5,204	4,479	22%	20%
Depreciation	1,086	1,159	5%	5%
Interest payable	334	444	1%	2%
Total Expenditure	23,767	22,732	100%	100%

- Proportionately expenditure remains consistent with 2007/08.

Balance sheet

- Net assets at 31 July 2009 are £7,812k (after deferred grants) (31 July 2008: £10,728k)
- The balance on the Income and Expenditure Account carried forward (excluding pension) at 31 July 2009 is a surplus of £417k (31 July 2008: £86k surplus).

- The balance on the Revaluation Reserve carried forward as at 31 July 2009 is a surplus of £11,315k (31 July 2008: surplus £11,495k).
- The balance on the Pension Reserve carried forward as at 31 July 2009 is a deficit of £3,932k (31 July 2008: deficit £865k)
- The balance on the Designated Reserve carried forward as at 31 July 2009 is a surplus of £12k (31 July 2008: surplus £12k).

Cash Flow

- During 2008/2009 the College experienced a net inflow of cash of £399k (2007/08: inflow of £1,150k).

Financial Forecasting

- The 2008-09 financial plan forecast a surplus of £366k. There were various movements on budget as set out below. Fluctuations in income have been offset by a careful monitoring of costs. The decrease in surplus can primarily be attributed to the decrease in other income which has been partly offset by increases in grant income and reductions in staff costs. The increase in other costs can be attributed to unbudgeted increases in teaching activities, premises and administration costs.

Financial Forecasting	2008/09
	£'000
2008-09 forecast outturn per budget	366
Increase in SFC grant income	230
Decrease in Tuition fee income	-30
Increase in European grant income	656
Decrease in other income	-857
Decrease in investment income	-15
Reduction in staff costs	408
Increase in other costs	-607
<u>Pension related entries not budgeted</u>	
FRS17 adjustment	-106
2008/09 actual outturn at 31 July 2009	<u>45</u>

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

	£'000
Income	23,257
Expenditure	23,067
Forecast surplus for the year ending 31 July 2010 *	190
Overdraft balance at 31 July 2009	(1,231)
Forecast movement in cash during 2009/10	111
Resulting overdraft balance at 31 July 2010	<u>(1,120)</u>

* Includes estimated FRS 17 adjustments.

- Both income and expenditure are expected to decrease in 2009/10. The decrease in income is mainly a result of an expected decrease in one off grant income. College expenditure will have to be monitored accordingly, in particular staff costs, in order to remain in surplus.

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 11 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 reserve. The college must also generate sufficient cash to finance its operations and meet its liabilities; regular operating surpluses would ensure this.
- Under the terms of the financial memorandum between SFC and the College, it is the responsibility of the governing body "to ensure that the institution strives to achieve best value from its use of public funds from all sources". It is intended that the financial performance indicators used by the Funding Council, when set alongside other performance data, will support the college in seeking best value.
- The table on page 11 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>Reid Kerr College Factor 2008-09</u>	<u>Reid Kerr College Factor 2007-08</u>	<u>Group Average Factor 2007-08</u>	<u>Sector Average Factor 2007-08</u>
Underlying operating surplus/ (deficit) % of total income	0.2%	0.9%	3.1%	2.9%
Operating surplus/ (deficit) % of total income	0.2%	0.9%	1.5%	1.3%
Historical cost surplus/ (deficit) % of total income	0.9%	1.7%	3.4%	8.9%
Current assets: Current liabilities	0.3	0.2	1.6	1.7
Designated plus I&E reserves % of total income	1.8%	0.4%	26.5%	22.9%
Interest Cover	1.1	1.5	3.6	3.9

- The SFC published statistics which showed that the College's average WSUMS per FTE for 07/08 was 467 compared to a group average of 420 and a sector average of 373. In addition, the College's unit cost for 07/08 was £201 compared to a group average of £215 and a sector average of £228.

Grant in Aid Funding

- The College's WSUMS target for 2008/09 was 81,711 and the College has met its target for the year. As a result the College will not be liable to refund any amounts received in 2009/10. The College has a clawback of approximately £46k on its fee waiver. Based on initial expectations an amount of £39k was provided for in the financial statements.

Corporate Governance Framework and Statement

- The Board of Management has nine 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

- Our review and assessment of the College's corporate governance arrangements 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 are provided by Deloitte. Deloitte replaced Wylie & Bisset in the current year as internal

auditors. 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. As this was Deloitte's first year acting as internal auditors we considered it appropriate to review their internal audit working papers as part of our assessment of their audit input. Our assessment resulted in a certain amount of reliance being placed on the work of internal audit in the following areas during 2008/2009.

- Review of Financial Budgetary Control, Monitoring and Management Accounting.
- Financial Controls Self Assessment.

Misstatements

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

Accounting and Internal Control System Weaknesses

- No internal control weaknesses were identified during the course of our audit. Following the 2007 audit one internal control weakness was identified and implementation of our recommendation is now complete. This is discussed in Section 5.

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

- 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 therefore continue to account for its participation on a defined benefit basis.

Early retirement provision

- Included in the balance sheet is a provision for the cost of providing for enhanced pensions. The College have calculated this early retirement based on information and advice obtained some years ago from their actuaries. Following a review of the calculation by our own actuaries we questioned the appropriateness of the basis in which the carrying value of the provision has been determined. The assumptions used in the calculation are out of line with those prescribed within the FRS 17 valuation, leading to an inconsistency of approach. In addition, we found that the calculation bears no regard to individual members.
- In response to our findings the College's management team recalculated the provision with reference to each individual member and they also incorporated the assumptions prescribed by the FRS 17 valuation. The results of this calculation showed that the provision on the balance sheet would be understated by £128k on this basis. No adjustment

has been made for the potential understatement above, but this is not considered material in terms of the overall financial statements.

- As a result we would recommend that the College apply an approach going forward that is consistent with the assumptions used for FRS 17 purposes and takes into account the characteristics of individual members.

Valuation of Land and Buildings

- The College's land and buildings were revalued at 31 July 2009. This was an interim valuation carried out in accordance with the requirements of FRS15 '*Tangible Fixed Assets*'. From discussion with College management this valuation will not be incorporated into the financial statements as they deem the difference between this value and the value in the accounts to be immaterial. The valuation was £27,310k which is £1,158k lower than the carrying value of £28,468k. A full five year valuation of the land and buildings will be conducted for the 2010 financial statements and the results incorporated.

5 Internal control systems weakness

Findings from 2009 audit

- No recommendations have been made in 2009.

Recommendations made during 2008 audit process

- No recommendations were made in 2008.

Recommendations made during 2007 audit process

Annual declaration of Member's interests

Findings

- We reviewed the College Board of Management's annual declarations of member's interests. We found that these were up to date however this was only by discussion with appropriate College management. There was no date or signature applied to these to indicate when they were last updated or that the member's agreed with the declarations made. The declarations were typed up by the College based on information submitted to them by individual Board members.

Recommendation

- We recommend the College ensure all annual declarations are signed and dated by the appropriate Board member on completion.

Management Response at 31 July 2007

- Agreed

Status during 2008 audit process

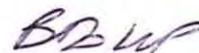
Findings

- This recommendation has been partially implemented during the year under review. Some, but not all, of the 2008 declarations have been signed and returned.

Status during 2009 audit process

Findings

- This recommendation has been fully implemented during the year under review. All of the 2009 declarations have been signed and returned.



BDO LLP

11 December 2009