Stow 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 Stow 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 or to disclose errors that are not material in relation to the financial statements.

- This report has been prepared solely for use by the Board of Management of Stow College and the Auditor General for Scotland.

- The approval of the financial statements was delayed until 29 March 2010 pending discussion with SFC on the clawback of prior year grant funds following the judgement of ineligibility of the funding of two College programmes. The appeal process is not yet complete however a provision for £2.885 million has been reflected in the financial statements as a prior year adjustment being the College's best estimate of the amount repayable to SFC.

- We have completed our audit work in respect of the financial statements for the year ended 31 July 2009 and issued unqualified audit opinions 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 Stow 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 Stow 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, and in particular the operating and financial review, are in general in compliance with the requirements of the 2007 SORP: Accounting for Further and Higher Education.

- 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. Stow 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.

- One of the key areas of emphasis within the 2007 SORP that has had an impact on the College is:

  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 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 £2,438k as at 31 July 2009 which has now been shown as a liability on the balance sheet. The College had previously included a provision relating to early retirals unfunded benefits of £935k. This has been transferred into the FRS 17 liability.

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 financial statements and the required working papers were available for audit on 5 October 2009, in line with the agreed timetable. The working papers supplied to us were of good quality.

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 29 March 2010 our audit report expressed 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 £12,000, 0.1% of total income (2007/08: £158,000 and 1.1%) in respect of the year ended 31 July 2009. The sector average for 2006/07 was 1.6%.

Income

- Total income increased by £1,250,000 (9.8%). Significant movements include an increase of £1,315,000 in SFC grants and a reduction in the deferred capital grant release of £340,000 due to full depreciation of the capitalised lease in the prior year. This is now being treated as an operating lease from the SFC going forward at an annual rental of £110k.

- 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	10,791	9,816	77%	77%
Tuition Fees and Education Contracts	2,471	2,286	17%	18%
Other Grant Income	290	144	2%	1%
Other Operating Income	432	377	3%	3%
Endowment and Investment Income	60	171	<1%	1%
Total Income	**14,044**	**12,794**	**100%**	**100%**

- A large percentage of total income is received from SFC with the various sources of income remaining relatively consistent with 2007/08. The college is more dependent on SFC Grants than many other Colleges delivering over 45,000 WSUMs. From review of the 2007/08 SFC performance indicators, total SFC grant income is normally in the region of 76% for colleges in this category.

Expenditure

- Total expenditure increased by £413,000 (3.0%) in comparison to 2007/08. The most significant movements are detailed below:

  - An increase in staff costs of £376,000;
  - Increased energy costs of £68,000; and
  - Increased childcare expenses of £166k due to additional student demand and funding being received.

- 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	9,142	8,766	65%	64%
Other Operating Expenses	3,897	3,526	28%	26%
Depreciation	935	1,327	7%	10%
Interest payable	58	-	<1%	-
Total Expenditure	**14,032**	**13,619**	**100%**	**100%**

- Proportionately expenditure remains consistent with 2007/08 with the exception of depreciation, which has fallen due to the fact that the modular building (capitalised and written off over a three-year period), which is leased from the SFC, was fully-written down at the beginning of the year. This resulted in a £432k fall in the depreciation charge. The building is now being treated as an operating lease on an ongoing basis.

Balance sheet

- Net assets at 31 July 2009 are £4,500,000 (31 July 2008: £5,696,000 restated).
- The balance on the income and expenditure account carried forward as at 31 July 2009 is a deficit of £2,392,000 as a result of the pension liability of £2,438,000 (31 July 2008: £1,591,000 restated deficit).
- The balance on revaluation reserve carried forward as at 31 July 2009 is a surplus of £5,205,000 (31 July 2008: £5,359,000).
- The balance on deferred capital grants carried forward as at 31 July 2009 is £1,687,000 (31 July 2008: £1,928,000).

Cash Flow

- During 2008/09 the College experienced a net outflow of cash of £138,000 (2007/08: inflow of £1,043,000).

Financial Forecasting

- The 2008-09 budget forecast a surplus of £79k. The main movements are in relation to additional income for specific projects from the Funding Council announced after the completion of the budget and FFR process, and increased operating costs in relation to grant funded expenditure and utility costs. In addition, the adoption of FRS 17 for the disclosure of the pension liability has resulted in an £64k additional expense to payroll and interest that had not been factored into the forecast.

Financial Forecasting

	2008/09
	£'000
2008-09 forecast outturn	79
Increased SFC grant income	351
Increased tuition fees and education contracts	34
Decreased project grants	(76)
Decreased investment income	(35)
Decreased release of deferred capital grants	(121)
Increased payroll costs	(96)
Increased operating costs	(255)
Decreased depreciation	188
Increased interest payable	(58)
Other	1
2008/09 actual outturn at 31 July 2009	**12**

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

	£'000
Income	13,769
Expenditure	13,743
Forecast surplus for the year ending 31 July 2010	26
Cash balance at 31 July 2009	2,433
Forecast movement in cash during 2009/10	236
Resulting cash balance at 31 July 2010	2,669

- College income and expenditure are expected to fall in 2009/10. The College has forecast a fall in SFC Grant income, in relation to additional grants received in 2008/09 which may not be awarded in 2009/10.
- Cash at bank and in hand has been forecast to rise over the next year per the above figures. This may change depending upon the repayment of grant to the SFC as a result of the SUMs clawback.

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 29 March 2010.

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.

- Whilst Stow College lags behind in terms of income and expenditure percentages in comparison to other Colleges within its Group (Income base > £10m-£15m) and the Sector, it has a healthy current ratio.

	Stow College Factor 2008-09	Stow College Factor 2007-08	Group Average Factor 2007-08	Sector Average Factor 2007-08
Underlying operating surplus % of total income	0.1%	-6.4%	2.0%	2.9%
Operating surplus % of total income	0.1%	-0.6%	1.6%	1.3%
Designated plus I&E reserves % of total income	20%	29.5%	10.6%	22.9%
Historical cost surplus/ (deficit) % of total income	1.2%	-4.7%	9.4%	8.9%
Current assets: Current liabilities	2.2	2.2	1.8	1.7
Interest Cover	1.21	N/A	4.6	3.9

Corporate Governance Framework and Statement

- The Board of Management has six formally constituted committees which have specific terms of reference and act with delegated authority from the Board.

- We reviewed the College's corporate governance arrangements. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of the organisation. The college has a responsibility to put in place arrangements for the conduct of its affairs, ensure the legality of activities and transactions and to monitor the adequacy and effectiveness of these arrangements in practice.

- From our review of Corporate Governance arrangements within the College we do not believe the Corporate Governance statement to be misleading or inconsistent with other information made available to us during the audit process.

System of Internal Control

- A review and assessment of the College's corporate governance arrangements was carried out. This assessment included a review of the College's committee minutes and completion of a number of standard checklists. The checklists cover issues relating to systems of internal control, arrangements for the prevention and detection of fraud and corruption, standards of conduct, issues of legality and the College's financial position.

- The College, in accordance with the Accounts Direction, has included in its financial statements, a statement covering the responsibilities of the Board of Management in relation to corporate governance.

- Our review of the statement concluded that it complies with guidance and is not inconsistent with other information we are aware of from our audit.

Prevention and detection of Fraud and Corruption

- The College's arrangements for preventing and detecting fraud and corruption were assessed during the audit. This assessment showed the arrangements to be operating satisfactorily. No frauds were identified by the College in 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 Wylie & Bisset. An assessment was made of the adequacy of the internal audit input and it was concluded that we as external auditors were able to place reliance on the work of internal audit. Accordingly a certain amount of reliance was placed on the work of internal audit in the following areas during 2008/09.

  - Student Support Funds – Bursary/EMA System
  - Finance System – Controls & Procedures
  - Creditor management & payment authorisation
  - Project bidding & costing
  - Value For Money – Travel expenses
  - VAT
  - Value For Money – Marketing Services

In November 2009, Wylie & Bisset issued the internal audit report for the year ended 31 July 2009. This concluded that subject to the issue of full cost recovery in relation to Home Learning College collaborative courses, the College had adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives.

Misstatements

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

Accounting and Internal Control System Weaknesses

- There were no internal control weaknesses identified during the course of our audit.

Qualitative Aspect of the College's Accounting Practice and Financial Reporting

- Our overall assessment, based on our work undertaken, is that the financial procedures of the College are adequate to enable annual financial statements to be produced in the prescribed form.

FRS 17 – Retirement Benefits

- This standard was published in November 2000 introducing significant changes to the way in which colleges should account for defined benefit pension schemes. Full implementation of FRS17 – 'Retirement Benefits' was mandatory 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. Management took the view this year that its share of the assets and liabilities in the SPF scheme could be reliably identified and accounted for its share of the fund on a defined benefits basis. Actuaries provided information on the College's interests in the scheme as at 31 July 2007, 2008 and 2009. This change in accounting policy required a prior year adjustment to the college accounts. The 2007/08 results have been restated in order to incorporate an FRS 17 pension liability of £1.407m onto the balance sheet as at 31 July 2008 with the income and expenditure account result for the year ended 31 July 2008 being adjusted positively by £77k.

- The pension liability calculated with reference to FRS 17 at 31 July 2009 was £2.438m (31 July 2008: £1.407m).

SFC Review of Fundability

- In November 2008, SFC carried out a review of fundability of certain Stow College programmes. SFC raised issues concerning the fundability of two of these programmes and has requested repayment of £2.885m. A provision for this amount has been included within provisions for liabilities in the balance sheet. As £983k of this amount related to 2008, the 2008 results in the Income and Expenditure Account were restated with the balance of £1.9m being adjusted against opening reserves.

New Campus Glasgow Project

- In conjunction with three other colleges in Glasgow, the College was involved in the New Campus Glasgow project. The College withdrew from the project in March 2009 as the Board of Management concluded that the project had changed to such an extent that it was no longer in the interests of their stakeholders. Any costs incurred by the College in relation to this project have been written off to income and expenditure account in the year to 31 July 2009.

ESF Income

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

Sums achievement

- The College delivered 51,842 WSUMS but did not achieve its WSUMS target of 53,978 for the 2008/09 academic year. As the College was not within the 2% band allowed by SFC, it will be liable to refund grant of £169,839 during 2009/10. This has been reflected in the financial statements.

5 Other Matters

- We have no other matters to report.

BDO LLP

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29 March 2010