Scott-Moncrieff

Stow College

Annual External Audit Report to the Board of Management and the Auditor General for Scotland 2011/12

February 2013

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Executive Summary

Finance

Our audit of Stow College ("the College") is complete. We audit the financial statements of the College under the Further and Higher Education (Scotland) Act 1992.

College financial year end

During the audit, Audit Scotland queried whether, in 1999/2000, the required changes were made to the 1992 Act to amend the financial year end of all colleges in Scotland from March to July. In response to this query, the Scottish Government has been unable to provide a copy of the formal order that effected this change to the Act. However, in January 2013 further evidence came to light and all auditors in the sector have agreed, in conjunction with Audit Scotland, that this evidence is sufficient to indicate that such an order was in fact made. The evidence includes the minute of a Lifelong Learning Committee meeting in October 1999 and legal representation from the Scottish Government.

We therefore now conclude that the financial statements have been prepared in accordance with the requirements of the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.

Financial position

The College has recorded a surplus of £60,000 in 2011/12. This was broadly in line with the College's 2011 Financial Forecast Return (FFR) submitted to the Scottish Funding Council (SFC) which projected a surplus of £33,000 in 2011/12.

During 2012/13 the College faces further reductions in grant funding as well as the impact of lost income from overseas students. The College has a savings programme in place, including the reduction in staffing resource and cost cutting measures. In delivering these savings, the College has forecast a breakeven position for 2012/13.

Governance

The College's Corporate Governance Statement confirms that the College has been fully compliant with the key principles of the UK Corporate Governance Code during 2011/12. We have reviewed the College's statement and can confirm that this is in line with the SFC's guidance and is not inconsistent with our understanding of the College's governance arrangements based on the information gathered as part of our normal audit work.

We did not identify any areas of concern from our review of the College's corporate governance arrangements in so far as they relate to prevention and detection of fraud and irregularity or standards of conduct and prevention and detection of corruption.

Looking forward

In September 2012, the College formally agreed to proceed with a merger process and explore the possible merger with John Wheatley and North Glasgow colleges.

As no formal decision to merge has been taken, the College's operational and financial plans remain based on continuing as a single institution. We are aware that the College is working with John Wheatley and North Glasgow in exploring the possible merger and this is being facilitated through a number of work streams including finance and workforce.

We are satisfied, from the audit work performed as detailed above, that the proposed merger has been disclosed appropriately in the 2011/12 financial statements. We will continue to monitor the situation with regards on-going merger developments.

Conclusion

This report concludes the 2011/12 audit of Stow College. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards.

This report has been discussed and agreed with the Principal. We would like to thank all members of the College's management and staff who have been involved in our work for their co-operation and assistance during our audit.

Scott-Moncrieff
February 2013

Introduction

1. This report gives a summary of the findings from our audit of Stow College ("the College") in 2011/12. The scope of our audit was set out in our External Audit Strategy and Plan which was presented to the Audit Committee on 29th May 2012. Our audit has focused on the financial statements and governance arrangements at the College.

2. Our plan summarised six key issues in relation to the 2011/12 audit:

   - Financial Position and the effect that the decrease in the Main Recurring Grant from the Scottish Funding Council (SFC) has had on the College's ability to meet its outflows
   - Strategic Partnerships and the proposed merger with John Wheatley College and North Glasgow College
   - Voluntary severance scheme
   - Pension fund liabilities.
   - Loss of the College's license to recruit international students
   - Claw back of SFC funding during 2011/12

3. This report includes our findings in relation to these key issues.

4. The report is also addressed to the Auditor General for Scotland and will be published on Audit Scotland's website, www.audit-scotland.gov.uk.

Finance

5. This section of the report summarises our findings in relation to the College's financial performance for the year and its position at 31 July 2012. We also discuss any significant issues identified during our audit.

6. It is the responsibility of the College to conduct its financial affairs in a proper manner. It is our responsibility to audit the financial statements and to consider the College's governance arrangements in relation to the College's financial position.

Financial year end

7. We audit the financial statements of the College under the Further and Higher Education (Scotland) Act 1992. We are required to give an opinion as to whether the financial statements have been prepared in accordance with the requirements of the 1992 Act and directions made thereunder by the Scottish Funding Council.

8. Schedule 1 of the 1992 Act originally stated that a Scottish college's financial year runs from 1 April to 31 March. In December 1999, the Scottish Further Education Funding Council (SFEFC) issued a direction to Scottish colleges changing the college sector's financial year end from 31 March to 31 July. For colleges' 1999/2000 financial statements this resulted in 16 month accounts to facilitate this transition.

9. Any amendments to the Act require Ministerial approval. In October 2012 Audit Scotland identified that the direction issued by SFEFC in December 1999 did not, by itself, have the requisite statutory authority to amend the Act and queried whether the required Ministerial approval had been obtained.

10. In response to Audit Scotland's query, the Scottish Government has been unable to provide a copy of the formal order, signed by a Scottish Minister, that effected the change to the Act in respect of college year ends. However, in January 2013, the Scottish Government provided other evidence indicating that such an order had in fact been made. This evidence includes the minute of a Lifelong Learning Committee meeting in October 1999 and legal representation from the Scottish Government. All auditors in the sector have agreed, in conjunction with Audit Scotland, that this evidence is sufficient to indicate that the required order was made.

11. We therefore conclude that the financial statements have been prepared in accordance with the requirements of the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.

12. Resolving this national issue has caused a delay to the normal deadline of 31 December for submitting signed annual accounts to the Scottish Funding Council. In December 2012 the Scottish Funding Council formally extended this deadline for the 2011/12 accounts, through an amendment to the Accounts Direction, to allow time for the issue to be resolved.

13. The signed financial statements will now be submitted to the Scottish Funding Council and Audit Scotland, who will pass them to the Scottish Government for laying before the Scottish Parliament.

Financial position

The College has reported a surplus of £60,000 for the year to 31 July 2012 despite a 4.2% fall in income

14. In line with the rest of the Sector, the College has suffered a reduction of income in core teaching and fee waiver income from the SFC. The College is preparing for a further reduction of 10.8% in the main recurring grant for 2012/13.

15. Income in 2011/12 has reduced by £0.563 million (4.2%) compared to 2010/11. The reduction included decreases in the SFC revenue support and strategic change grants as well as reduction in European project income. The decrease in income was offset by an increase in tuition fees and education contracts.

16. Expenditure has also reduced in the year by approximately £0.349 million. This reduction is mainly due to the reduction in staff costs as a result of a voluntary severance scheme that has taken place over recent years.

Balance sheet

The College has a healthy net asset position, holding significant cash balance and reserves

17. The College has reserves of £3.5 million at 31 July 2012 (£3.9 million as at 31 July 2011) and holds £1.44 million of deferred capital grants (£1.9 million at 31 July 2011). The net reserves position has reduced due to the increase in the pension liability of £0.392 million. The Income and Expenditure reserve was £0.617 million at 31 July 2012 with the vast majority of the net reserves balance being attributable to the revaluation reserve balance held.

Financial forecasts

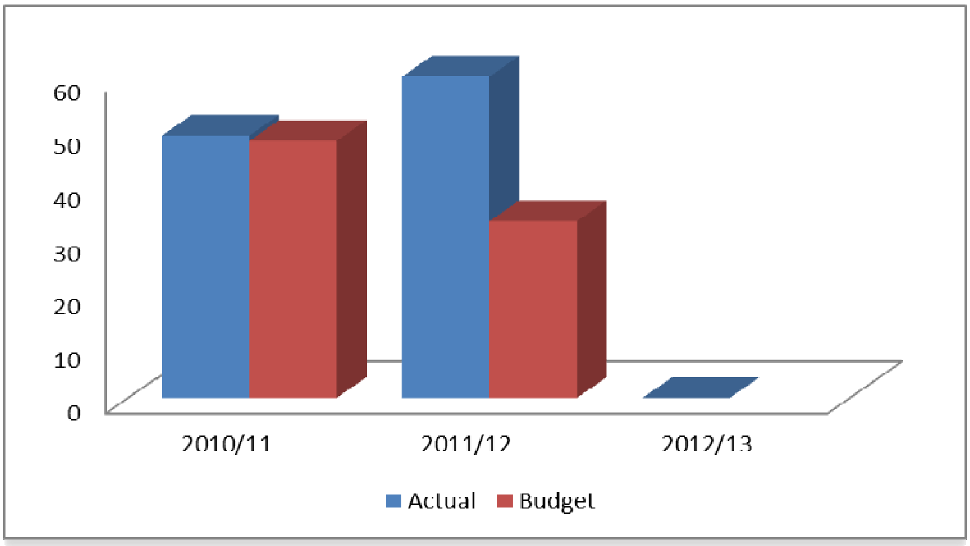
SFC funding has been confirmed for 2012/13 and a break even position has been forecast

18. The College has returned the 2012/13 Financial Forecast Return (FFR) to the Scottish Funding Council (SFC). SFC uses the FFR to assess the financial position and performance of individual colleges and the sector as a whole.

19. Regular budget monitoring and reporting is conducted by Stow College in order to closely monitor budgets. During our audit we gained assurance that Stow College has sufficient budget monitoring controls in place to effectively manage budgets.

20. We reviewed the College's budgets and Financial Forecast Return (FFR) for 2012/13 and are satisfied that the College has taken sufficient steps to ensure that the reduction in SFC will not impact on the going concern status of the College. Diagram 1 below compares the actual results with FFR forecasts and sets out projections for 2012/13.

Diagram1: Actual performance and FFR forecast of surplus



Source: Financial Forecast Return

21. The diagram shows that the College has continued to perform well in recent years, achieving a surplus exceeding the forecast for 2011/12 despite the pressures of funding reductions. Stow College is forecasting a break even position for 2012/13. It is likely that the College will face further reductions in SFC funding, which will be financially challenging for the College in the forthcoming years.

Overseas Students

22. UKBA did not renew the Highly Trusted Sponsor licence (HTS) for the College and the College is unable to recruit international students for 2012/13. The College is able to submit an application for a new licence six months after the previous renewal was declined and an application was submitted in September 2012. The impact of the loss of HTS status will mean that fee income will reduce by approximately £0.5m. This loss in income can be netted off against direct recruitment costs of approximately £0.4m

23. Stow College has budgeted for the loss in international income for 2012/13, and is optimistic over additional income from sources including the Skills Development Scotland (SDS) Programme and consultancy contracts to offset the loss. Based on the performance of the SDS programme and the forecast increase in consultancy contracts, the college could expect income of up to £0.27m to offset the loss in international income.

Sustainability

24. Although there is a continuing reduction in the SFC grant into 2012/13, Stow College has forecast to increase commercial income, as well as forecasting further income from the new Skills Development Scotland programmes. These increases coupled with planned reductions in staffing costs through further voluntary severances in 2012/13 and other operating cost savings, should enable delivery of a breakeven position in 2012/13.

25. With the ongoing regionalisation developments across the FE sector and changes to funding methodology, there is some uncertainty over future levels of funding for the College or subsequent merged institution. The College plans to monitor developments over the coming year and the potential impact that this may have on service offering.

Financial planning and monitoring arrangements

The financial management arrangements at the College are strong

26. As part of our audit, we considered the College's financial standing, including the arrangements in place for financial planning, budgetary control and financial reporting. It is important that such arrangements are adequate in order to properly control the College's operations and use of resources.

27. The Board established the Finance and General Purposes Committee who met quarterly throughout the year. Budgets are devised and approved at the start of the year and are updated during the year to take account of new information. Budget Monitoring Reports showing forecast year end positions against budget are presented to the Committee and the Board, these reports are prepared on a monthly basis. The Performance Monitoring Committee (PMC) consisting of senior management, board members and student representatives meets monthly and receives financial monitoring information.

28. In our opinion the College has strong financial management arrangements in place.

Financial statements preparation

29. We are grateful to the Principal, the Assistant Principal, the Finance Manager and the finance staff for their assistance and support during the course of the audit. We found the draft accounts and supporting working papers to be of a very high standard.

30. In addition, we found that the College has adequate resource available in the Finance Department to meet the College's financial management and reporting needs.

Audit adjustments

31. SFC notified Colleges on the 28th September of a change to the accounts direction requiring the inclusion of HE childcare funding within the main accounts. This required to be adjusted for in the draft financial statements which were completed prior to this notification.

	Income and Expenditure		Balance Sheet	
	£'000s	£'000s	£'000s	£'000s
Dr HE Childcare – Expenditure	133			
Cr HE Childcare – Allocation received		133		
Being the disclosure of HE childcare allocation and expenditure				
Net impact on income and expenditure during 2011/12			**0**	

32. We are pleased to report that there were no unadjusted audit differences.

Review of accounting systems

33. During our audit work we have considered the College's accounting systems and internal controls. We identified one control issue during our audit of the accounting systems relating to journal authorisation procedures; this have been documented under Appendix 1 – Action Plan. However, in general, the College's systems of internal financial control appear to be adequate, well designed and operating effectively.

Other issues of significance in the 2011/12 audit

Voluntary severance scheme

34. To deliver a balanced budget for 2011/12 and 2012/13 the College has identified the need to reduce activity levels and operate more efficiently. The College continued to offer the voluntary severance scheme during 2011/12.

35. *Guidance on severance arrangements to senior staff in Scottish further education colleges* produced by the Scottish Funding Council provides guidance to colleges on managing severance schemes. As part of our audit we reviewed severance settlements for staff to confirm that severance arrangements conformed to the guidance.

36. We are satisfied, from the audit work performed as detailed above, that the voluntary severance scheme has conformed to guidance and has been accounted for and disclosed correctly in the 2011/12 financial statements. During 2012 a total of 12 staff accepted voluntary severance agreements during the year incurring restructuring costs of £0.280 million. We are satisfied that these costs have been appropriately recorded within the financial statements.

Pension Fund Liabilities

37. The College's employees belong to two principal defined benefit pension schemes; the Scottish Teachers' Superannuation Scheme (STSS) for teaching staff and the Strathclyde Pension Fund (SPF) for non-teaching staff.

38. The STSS is a multi-employer, notionally funded scheme and the College is unable to identify its share of the underlying assets and liabilities of the scheme. In line with Financial Reporting Standard 17 – Retirement Benefits (FRS 17), the College does not recognise any asset or liability relating to the STSS and the scheme is effectively accounted for as if it was a defined contribution scheme.

39. The SPF is also a multi-employer scheme but the College can identify its share of underlying assets and liabilities and has therefore recognised a net liability on its balance sheet. The College reported a liability of £2.519m as at 31 July 2012, an increase on the £0.392m equivalent position as at 31 July 2011.

40. We reviewed the College's accounting for the pension liability to confirm that it complies with the requirements of FRS 17 and that the disclosure is consistent with the actuaries' valuation. We also confirmed that the actuarial assumptions underpinning the valuation are reasonable and reflective of the College's circumstances.

41. We are satisfied, from the audit work performed as detailed above, that the pension fund liabilities have been accounted for and disclosed correctly in the 2011/12 financial statements.

Strategic Change Grant and SFC Claw-back of grant funding

42. In 2009, the SFC deemed that an element of the College's activities were ineligible for funding and that the College had therefore previously recognised income to which it was not entitled. Subsequently the College agreed a repayment programme with SFC totalling £2.8 million over five years. A total of £0.323 million was repaid during the year with a balance due to SFC as at 31 July 2012 of £0.774 million. The repayments have been incorporated into the Colleges financial plans to ensure that they have adequate resource available to meet payments as and when they fall due.

43. To enable the College to facilitate the organisational change required to operate sustainably within the reductions in levels of SUMs funding due to the removal of these activities, SFC agreed to provide the College with strategic change grant funding of £2.950 million over a five year period. The College is phasing out the associated costs of delivering the SUMs activities over a five year programme and subsequently recognises grant income as and when required over the period. During 2011/12, the College recognised a total of £0.667 million of grant funding income. The funding has been utilised to enable the College to continue to deliver a small forecast surplus in the year.

Governance

44. It is the College’s responsibility to ensure that it has adequate governance arrangements in place. It is our responsibility to review and report on these arrangements as they relate to:

- the College’s review of its systems of internal control, including reporting arrangements
- the prevention and detection of fraud and other irregularities
- standards of conduct and arrangements for the prevention and detection of corruption
- the College’s financial position.

45. We reported on the corporate governance arrangements in relation to its financial management in the Finance section of this report. This section includes our comments on other aspects of the College’s arrangements.

Corporate Governance

The College’s governance arrangements remain strong

46. Colleges are required to include in their annual accounts a statement covering the responsibilities of their Board of Management in relation corporate governance arrangements. The statement should describe the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management, and report on the College’s compliance with the UK Corporate Governance Code.

47. The College’s Corporate Governance Statement for 2011/12 states that the College was fully compliant with the UK Corporate Governance Code throughout the period in so far as they apply to the further education sector.

48. We reviewed the Corporate Governance Statement by:

- checking the statement against SFC and Audit Scotland guidance
- considering the adequacy of the process put in place by the Principal and Board of Management to obtain assurances on systems of internal control
- assessing whether disclosures in the statement are consistent with our knowledge of the College.

49. We are satisfied that the statement is consistent with SFC and Audit Scotland guidance and that the contents are not inconsistent with information gathered during the course of our normal audit work.

Risk management

Good risk management system is in place

50. Risk management is important to the establishment and regular review of systems of internal control. The College's annual accounts outline the principal risks and uncertainties of the College and confirm that mitigating controls are in place in response to these risks.

51. The College's approach to risk management has been formally approved by the Board, including clarifying respective roles and responsibilities within the College. Senior management regularly review and consider risks and associated systems of internal control and report any further risks identified. Management is also responsible for implementing policies of internal control to ensure risk is managed appropriately. The Board Governance and Audit Committee have an oversight role with the full risk register and any changes to action plans being reported to the Board via the Board Governance and Audit Committee.

Internal audit

52. The internal audit service is a key component of the College's internal control framework. As part of our corporate governance responsibilities, we have considered the College's arrangements to ensure that the work of internal audit is sufficient in quality and volume and complies with best practice. Our review was performed in accordance with the Code of Audit Practice and *International Standard on Auditing 610: Considering the work of internal audit* (ISA 610).

Considering the work of internal audit

53. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the College's total audit resource. For 2011/12 the internal audit service has been provided by Wylie and Bisset LLP. We have considered internal audit findings as part of our audit and have sought to minimise duplication of effort, to ensure the total audit resource to the College is used efficiently and effectively.

54. Wylie and Bisset LLP concluded in their annual report that Stow College has adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives. We are grateful to Wylie and Bisset for their assistance during the course of our audit work.

Prevention and detection of fraud and irregularity

55. As part of our audit we consider how the College ensures compliance with all relevant guidance and regulations. This includes a consideration of the College's arrangements for the prevention and detection of fraud and irregularity.

56. The College has a fraud policy in place, which includes procedures for fraud prevention, fraud detection and reporting and response planning. There were no frauds identified during the year.

57. All SFC and other guidance and circulars are received by the Principal's Secretary. All relevant regulatory information is distributed to the appropriate members of staff. All Circulars raised are acted upon by Senior Management at the appropriate Committee meetings.

58. We identified no issues of concern in relation to the arrangements for the prevention and detection of fraud, with regard to the legality of transactions or in relation to compliance with relevant guidance and regulations.

Standards of conduct

59. We are required to consider the arrangements made by management in relation to standards of conduct and prevention and detection of corruption. Propriety requires that public business is conducted with fairness and integrity. This includes avoiding personal gain from public business, being even-handed in the appointment of staff, letting contracts based on open competition and avoiding waste and extravagance. Guidance on standards of conduct, accountability and openness has been issued by the Scottish Government.

60. Our work in this area included a review of the arrangements for adopting and reviewing standing orders, financial instructions, registers of interest and schemes of delegation and complying with national and local Codes of Conduct. We also considered arrangements in place for ordering, procurement and disposal of assets.

61. We are pleased to report that our audit identified no issues of concern in this area.

Looking Forward

Financial position

62. There is increasing uncertainty over the level of future funding that will be provided to the sector. Indications from the Scottish Government are that the reductions in funding experienced in 2011/12 may continue over the next few years. Coupled with increasing cost pressures this will result in significant financial challenges for the College and the sector as a whole.

63. Income for Stow College is expected to fall by £1.5m, which includes the reduction of the SFC grants and strategic change grants and the loss of international income. Costs are expected to fall by equal amounts from the savings from the recent voluntary severance schemes and subsequent drops in operational budgets from the lower WSUMs count. Overall, the college expects to have a net reduction in funding of £0.545m.

International financial reporting standards

64. The College's financial statements are still prepared on the basis of UK accounting standards (UK GAAP) which the Statement of Recommended Practice: Accounting for Further and Higher Education (SORP) Board believes continues to be appropriate for colleges.

65. Colleges will continue to converge with international financial reporting standards (IFRS) as UK GAAP converges with IFRS. It appears likely that full implementation of IFRS will not take place before 2013/14.

66. As we have previously noted, the conversion process requires sufficient and appropriate information to be available to support the production of comparator balances. Effectively, this means work to produce full IFRS-compliant financial statements will begin at least one year before the actual implementation date. In some areas, such as in relation to fixed assets and component accounting, the earlier the work begins the more straightforward the conversion process may be and we endorse any moves the College may make to work towards IFRS transition in a structured and well-planned way.

Regionalisation

67. In September 2011, the Scottish Government released '*Putting Learners at the Centre: Delivering Our Ambitions for Post-16 Education* '. This paper proposes the regionalisation of the college sector within Scotland. In response, the College is currently exploring options to align working relationships with other colleges within Glasgow. This includes a proposed merger with North Glasgow and John Wheatley colleges.

68. In September 2012, the College formally agreed to proceed with a merger process and explore the possible merger with John Wheatley and North Glasgow colleges.

69. As no formal decision to merge has been taken, the College's operational and financial plans remain based on continuing as a single institution. We are aware that the College is working with John Wheatley and North Glasgow in exploring the possible merger and this is being facilitated through a number of work streams including finance and workforce.

70. We are satisfied, from the audit work performed as detailed above, that the proposed merger has been disclosed appropriately in the 2011/12 financial statements. We will continue to monitor the situation with regards on-going merger developments.

Appendix 1 – Action Plan

Our annual report action plan details the financial control weaknesses and opportunities for improvement that we have identified during our audit visit in addition to any reportable matters arising from our review of performance and governance systems. There is one external audit recommendation arising in 2011/12.

The action plan details the officers responsible for implementing the recommendations and implementation dates. The College should assess the recommendation for their wider implications before approving the action plan. Following submission of this report to the Audit Committee, we will send a copy to the Auditor General.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist.

Grading

To assist the Board in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been graded. The grading structure is summarised as follows:

Grade 5	Very high risk exposure - Major concerns requiring Board attention.
Grade 4	High risk exposure - Material observations requiring management attention.
Grade 3	Moderate risk exposure - Significant observations requiring management attention.
Grade 2	Limited risk exposure - Minor observations requiring management attention
Grade 1	Efficiency / housekeeping point.

Issues arising from our 2011/12 audit

No	Title	Issue identified and recommendation	Management response
1	**Segregation of duties for journal authorisation**	We found that a senior member of the finance team is able to both input and authorise journal entries into the general ledger. These entries are not subject to review. Inadequate segregation of duties presents a higher risk of human error or fraud. While we are aware that the college has limited staffing resource available to enable review all journal entries we recommend that a review of journals posted is undertaken by a member of staff who is not involved in the processing of journals to ensure that these appear appropriate and reasonable. ***Grade 2***	The College will run a journal transaction report each month as part of the monthly checklist and this will be authorised by the Assistant Principal. This action will be back dated to August 2012. **To be actioned by:** Assistant Principal **No later than:** 30 November 2012

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