

# Corporate Governance and Financial Management in the Scottish Further Education Sector



This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

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3 April 1998

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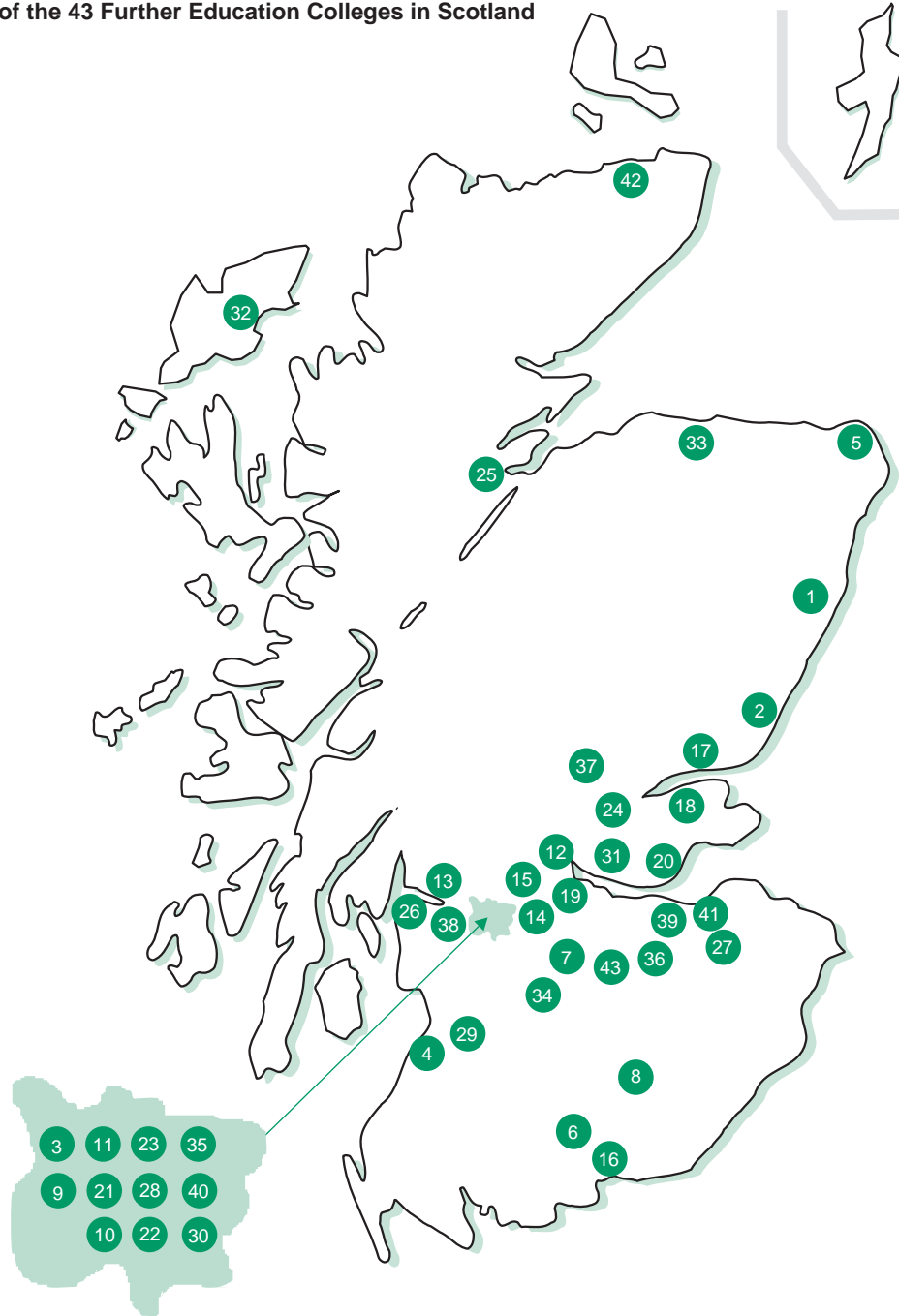
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**The location of the 43 Further Education Colleges in Scotland**



- |  |   |  |                           |                          |
|--|---|--|---------------------------|--------------------------|
| 1. Aberdeen College                            | 12. Clackmannan College of Further Education        | 21. Glasgow College of Building and Printing           | 29. Kilmarnock College    | 41. Telford College      |
| 2. Angus College                               | 13. Clydebank College                               | 22. Glasgow College of Food Technology                 | 30. Langside College      | 42. Thurso College       |
| 3. Annesland College                           | 14. Coatbridge College                              | 23. Glasgow College of Nautical Studies                | 31. Lauder College        | 43. West Lothian College |
| 4. Ayr College                                 | 15. Cumbernauld College                             | 24. Glenrothes College                                 | 32. Lews Castle College   |                          |
| 5. Banff & Buchan College of Further Education | 16. Dumfries and Galloway College                   | 25. Inverness College                                  | 33. Moray College         |                          |
| 6. Barony College                              | 17. Dundee College                                  | 26. James Watt College of Further and Higher Education | 34. Motherwell College    |                          |
| 7. Bell College                                | 18. Elmwood College                                 | 27. Jewel & Esk Valley College                         | 35. North Glasgow College |                          |
| 8. Borders College                             | 19. Falkirk College of Further and Higher Education | 28. John Wheatley College                              | 36. Oatridge College      |                          |
| 9. Cambuslang College                          | 20. Fife College of Further and Higher Education    |  | 37. Perth college         |                          |
| 10. Cardonald College                          |   |  | 38. Reid Kerr College     |                          |
| 11. Central College                            |   |  | 39. Stevenson College     |                          |
|  |   |  | 40. Stow College          |                          |

## Executive summary

**1** The 43 further education colleges in Scotland provide a wide range of education and training programmes for students from school age upwards. Further education colleges were transferred from local authority control in April 1993, becoming independent corporate bodies. Around two-thirds of funding for colleges comes from the Scottish Office Education and Industry Department as grant-in-aid (£282 million in 1996-97).

**2** This report sets out the results of examinations we undertook of the corporate governance and financial management arrangements at a sample of 12 colleges.

## Corporate governance

**3** The board of management of each further education college carry major responsibilities for the conduct of the college, including responsibility for the use of public funds. In recent years there has been an increased emphasis on the need for public bodies to conduct themselves with probity and openness, reinforced by the work of the Committee on Standards in Public Life. The colleges we visited were generally aware of, and were making good progress in implementing, best practice in their governance arrangements.

**4** Colleges' boards were properly constituted with the required levels of representation from business, staff and students and were supported by appropriate committees with generally clear terms of reference. Colleges had made good arrangements for ensuring that information about the activities of the board and its committees was available to staff, students and the wider public. Most boards had established appropriate arrangements for determining the pay and conditions of senior staff although there was scope for improving the quality of minutes kept by remuneration committees. We found evidence of good progress by colleges on providing support to the board through effective clerking arrangements.

**5** We also found a number of areas in the colleges we visited where there was scope for further improvements:

- eight colleges did not have a publicly available written appointment procedures governing the recruitment of new board members, and there was scope for colleges generally to improve their appointment procedures through more use of public advertisements and job and person specifications;
- three colleges had not prepared and adopted a code of conduct, which is an important means by which a board can advise its members on the standards of conduct and behaviour expected of them;
- while all colleges had, or were about to have, a register of interests for board members, the registers often did not include declarations from staff with significant financial responsibilities or from close family relatives of those included on the register- there was also scope for better guidance on types of interests to be declared;
- nine colleges had not prepared a whistleblowing policy - such a policy supports a culture of propriety and openness by allowing concerns of members of the board or members of staff, to be raised and investigated confidentially, inside and if necessary, outside the organisation;
- at only two colleges had the board established self-assessment procedures to determine how effectively they were discharging their responsibilities.

## **Development planning and financial management**

**6** Good development planning and sound financial management are essential if colleges are to achieve their educational and other goals. There should be explicit links between the development plan and the college budget so that the financial implications of important decisions are considered at a sufficiently early stage. A sound financial control environment is an important element of any college's financial management strategy.

**7** The Department have provided colleges with a framework within which they can undertake their development planning. All college boards we visited had set the overall mission and strategic aims of the college upon which the development plan was constructed. Most of the colleges had included specific, measurable objectives and related targets in their development plans. Most colleges' development plans were underpinned by lower-level plans drawn up by staff working in the areas concerned. Colleges' arrangements for ensuring that staff were aware of the key elements of the development plan were generally good.

**8** Monitoring the financial health of the college and taking appropriate action where it appears that the college's financial position is deteriorating, is an important responsibility for college boards and managers. Most colleges we visited were providing appropriate financial information to board members, managers and budget holders, although there was scope at some colleges to improve the information provided to the board on cashflow. Three of the colleges visited had prepared explicit financial strategies designed to improve the financial health of the college.

**9** A financial memorandum between the Secretary of State and the board requires the board to ensure that the college has a sound system of internal financial controls, including safeguards against fraud and theft. The board is also required to make arrangements for the internal audit of the college to ensure that internal control systems are effective. All the colleges we visited had comprehensive financial regulations although some colleges had not supported these with detailed financial procedures. They had all appointed internal auditors and were generally implementing recommendations in a timely and reasonable manner.

**10** We also found a number of areas where there was scope for further improvements:

- there was scope at four colleges for the board to play a more active role in the ongoing development plan process;
- at four colleges, boards were not regularly scrutinising the college's performance towards the achievement of development plan targets;
- although there were links between development plans and budgets, at most of the colleges there was scope to improve these links in nearly all cases;
- colleges should, where they have not already done so, ensure that they have up-to date comprehensive financial procedures and effective systems;
- six colleges had established companies to conduct trading, research and consultancy services. While they generally had made appropriate managerial and financial arrangements to govern the relationship between the college and the company, in one case we identified scope for improvements in the information provided to the board about the financial health of the company and in another we endorsed recent action taken by the college to clarify the financial and managerial arrangements between the college and its company.

## Recommendations

- 11** Our recommendations are that:
- a) Colleges should review the extent to which their governance arrangements reflect best practice, and in particular should ensure that:
    - they have open and transparent arrangements for recruiting new board members;
    - they adopt a code of conduct for board members;
    - their register of interests is up-to-date, covers members of the board and staff with significant financial responsibilities;
    - they introduce whistleblowing policies and procedures;
    - they establish self-assessment procedures to determine how effectively boards are discharging their responsibilities.
  
  - b) Colleges should review their development planning and financial management arrangements to ensure that they contribute effectively towards the achievement of colleges' educational and other goals, and in particular should ensure that:
    - boards play a more active role in the ongoing development planning process and in monitoring progress against strategic objectives;
    - objectives contained within the development plan are clearly defined providing timescales, responsibilities for implementing and criteria for success and there is systematic monitoring and review of objectives and targets during the year;
    - there are explicit links between the development plan and budgets to ensure that the financial implications of development objectives are considered at a sufficiently early stage;
    - the board receive sufficient, regular and reliable financial information, including information on cash flows against forecast, to enable them to assess the current financial health of the college;



- they have up-to-date and comprehensive financial regulations and procedures and that there are effective systems in place to ensure these regulations and procedures operate as intended; and
- in the case of any college companies, appropriate financial and managerial relationships exist between the college and the company.

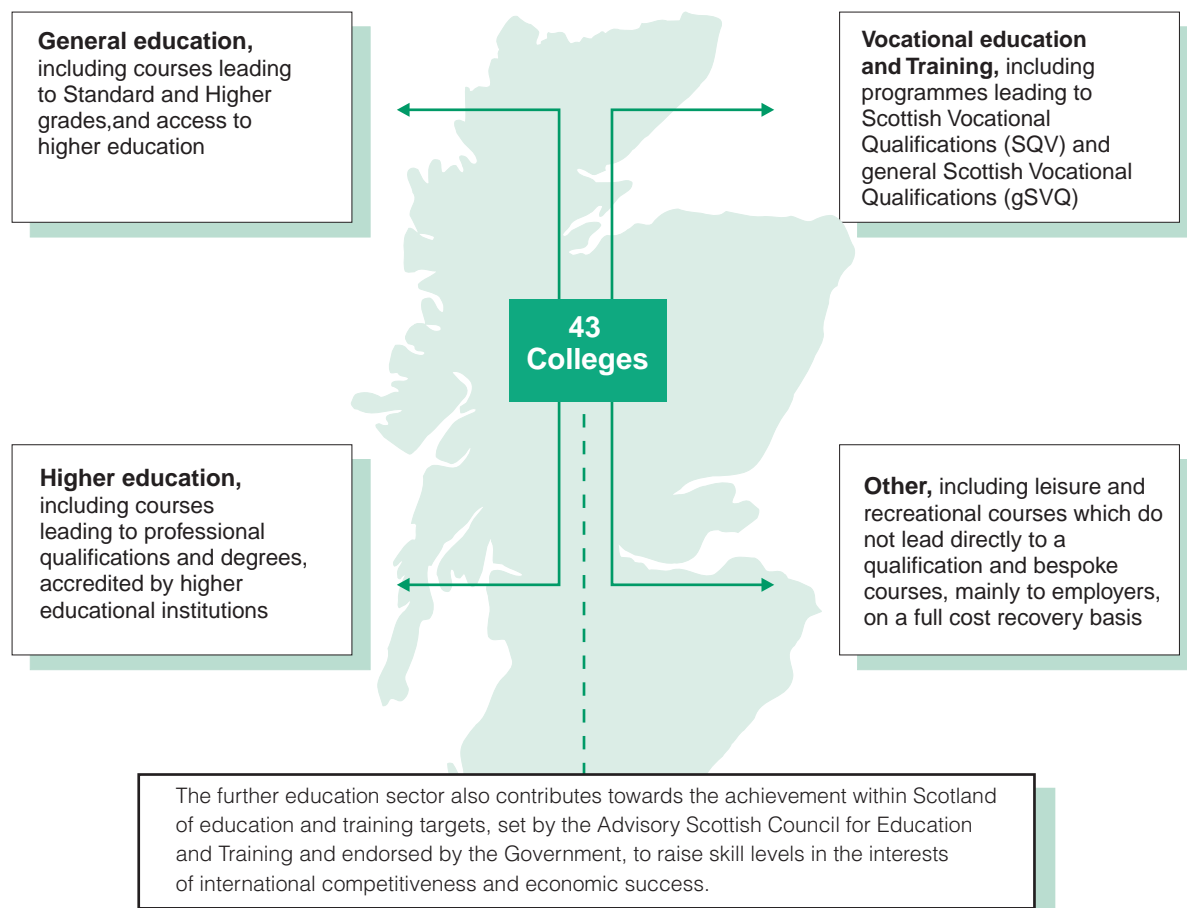
## Part 1: Introduction

### Background to the further education sector in Scotland

**1.1** The 43 colleges of further education in Scotland (listed at Appendix 1) enrol about 323,000 students a year. The sector offers a wide range of education and training opportunities (Figure 1). Individual colleges may be general in their provision or they may specialise in particular areas, such as agriculture, construction or food technology<sup>1</sup>.

**Figure 1**

**Education and training opportunities offered by colleges in the further education sector**



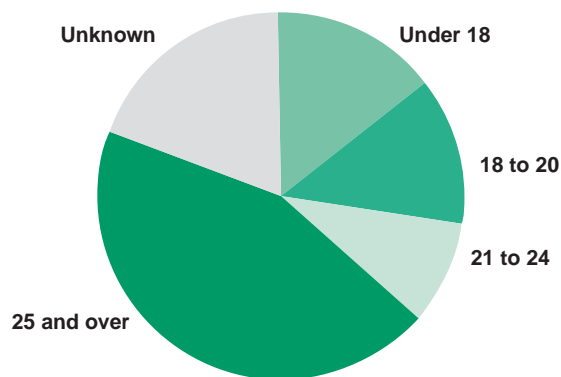
Source National Audit Office

<sup>1</sup> In addition to these 43 incorporated colleges, two small colleges in Orkney and Shetland are controlled by their local authorities and funded via grants from the Scottish Office.

**1.2** In 1995-96 further education accounted for about two-thirds of colleges' activity, with higher education accounting for the remainder. While the majority of students attend on a part time basis, part time courses only accounted for just over one-third of colleges' activity. Just over half of all students are aged 21 and over (Figure 2).

Percentage distribution  
of students by age  
1995/96

**Figure 2**



Source:  
Scottish Office Education  
and Industry Department

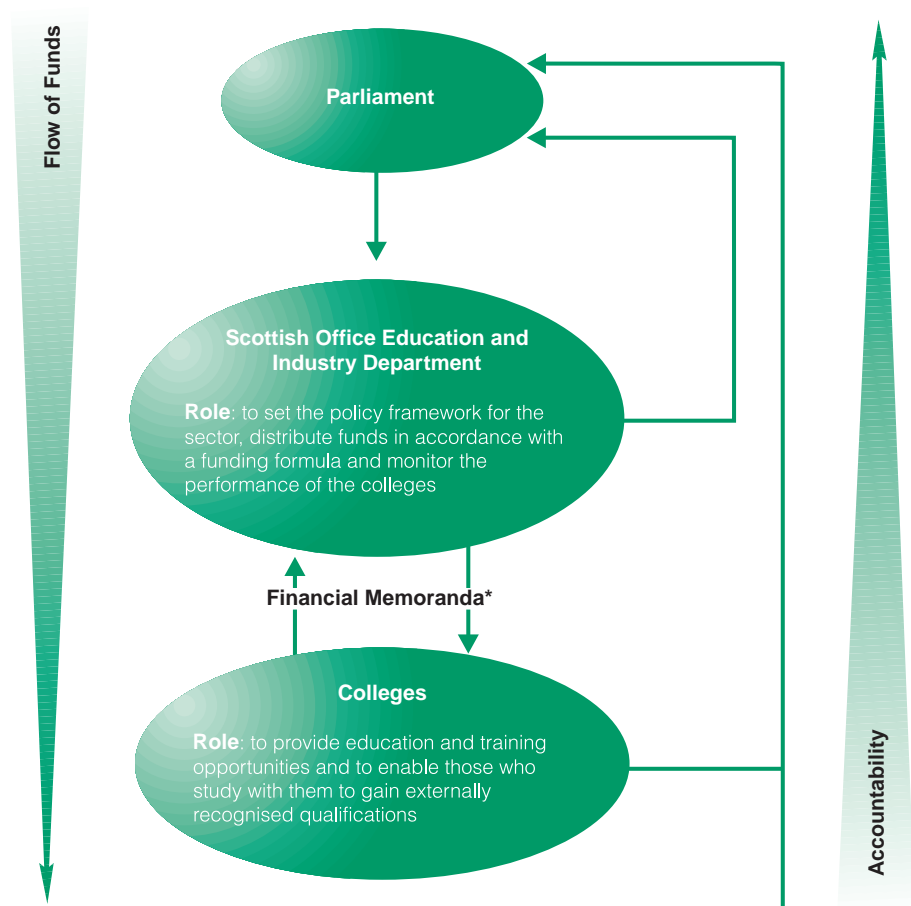
Figure 2 shows that just over half of all students attending further education colleges were aged over 21.

## Legislative framework

**1.3** Under the Further and Higher Education (Scotland) Act 1992 (the Act), further education colleges were transferred from local authority control on 1 April 1993. They became independent corporate bodies, known as Boards of Management, and assumed ownership of all their assets and liabilities at the date of transfer. Funding for further education is largely provided and administered by the further education funding division of the Scottish Office Education and Industry Department (the Department). The Act also made provision for a further education funding council to be established in Scotland but this has not been implemented. This contrasts with the position in England and Wales where similar legislation required the setting up of a funding council for further education in each country. Figure 3 summarises the respective roles of the Department and colleges.

Responsibilities and accountabilities in further education in Scotland

Figure 3



\*Financial memoranda set out the terms and condition on which funding is provided to colleges. Under the terms of the financial memoranda, the principal of each college is its accounting officer.

Source National Audit Office

## The Department's objectives

**1.4** Under the Act the Secretary of State has a duty to secure adequate and efficient provision of further education in Scotland. The Department's objective for the sector, as set out in the latest Departmental Report, is: "to maintain a cost-effective further education sector, increasing the output of students with non-advanced further education qualifications<sup>2</sup>."

2 Scottish Office Departmental Report: 1997-98 to 1999-2000.

**1.5** The Department have pursued their objective by:

- providing guidance on the governance of colleges;
- using a funding formula based on student activity to encourage colleges to improve their efficiency;
- requiring colleges to prepare annual development (strategic) plans to help inform expenditure needs;
- continuing to develop performance indicators for the sector;
- requiring colleges to improve their quality systems and subjecting colleges to independent review by Her Majesty’s Inspectors who report on the quality of teaching provision; and
- collecting and disseminating colleges’ financial and non-financial performance information.

In support of these activities the Department require colleges to provide annually the key information set out in Figure 4.

Information required by the Department from colleges each year

**Figure 4**

End April	End August	End September	End November
College Development Plans	Audited Accounts	Actual Levels Of Student Activity And Achievement	Annual Report
Forecast Levels Of Student Activity And Achievement			

Source: National Audit Office

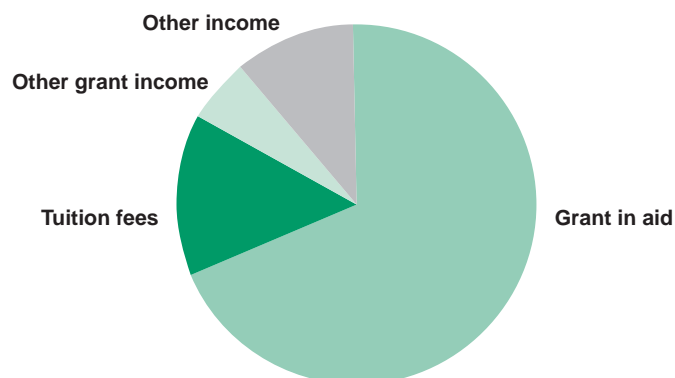
## Funding of colleges

**1.6** Colleges receive income from a number of sources (Figure 5):

- grants from the Department;
- other grants, mainly from Local Enterprise Companies and the European Social Fund;
- tuition fees, including those of students following higher education courses;
- residence and catering operations; and
- other income, including payments for courses provided on a full-cost recovery basis.

Sources of income for further education colleges in Scotland in 1996-97

**Figure 5**



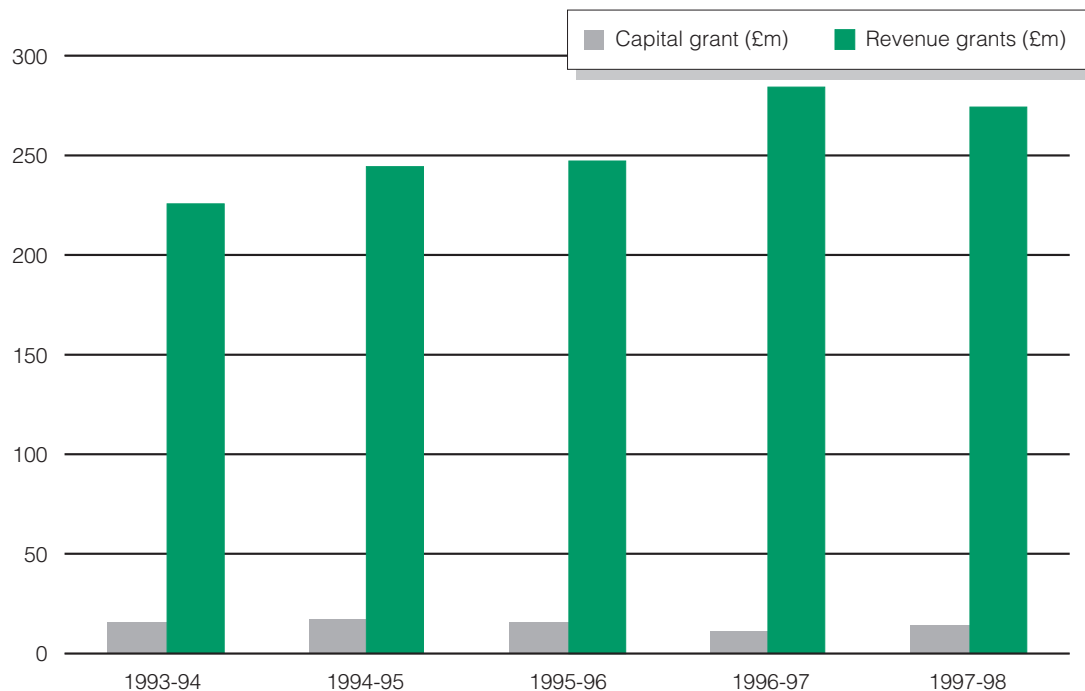
Source:  
Scottish Office Education  
and Industry Department

Figure 5 shows that the colleges receive some two-thirds of their income from the Department as grant-in-aid.

**1.7** In financial year 1997-98 the Department are providing funding of £289 million to the sector. Of this £282 million is grant-in-aid for colleges and the remainder is £7 million of capital funding. Figure 6 shows funding for the sector, in real terms, since 1993-94.

**Figure 6**

**College Funding 1993-94 to 1997-98**



Note: Revenue grant figures for 1996-97 and 1997-98 include £45 million in each year in respect of funding for bursaries to students, for which colleges took over responsibilities in April 1996.

Figure 6 shows that revenue grants allocated to colleges increased by 9 per cent in real terms between 1993-94 and 1995-96 but reduced in real terms thereafter (excluding bursaries). Resources allocated for capital grants reduced by 9 per cent in real terms between 1993-94 and 1997-98.

Source: Government Expenditure plans (1997-98 prices).

**1.8** A financial memorandum between the Department and each further education college sets out the terms and conditions on which funding is provided to colleges. It covers such matters as the requirement for good financial management including financial solvency, property acquisition and disposal, borrowing and leasing, accounting records and financial statements, audit arrangements, and the provision of information by colleges to the Department. Under the terms of the financial memorandum, each college principal is an appointed accounting officer.

## The financial performance of the sector

**1.9** Boards of management are responsible for maintaining the financial health of their college. Figures 7 and 8 provide an overview of the financial performance of the sector since incorporation, both in terms of colleges' success in generating surpluses and in maintaining adequate liquidity. They show that while the sector overall has maintained a reasonable financial position, there is a wide range of performance between individual colleges.

**Figure 7**

**Financial summary of further education colleges accounts: 1993-94 to 1997-98 (£ million)**

	1993-94 Actual	1994-95 Actual	1995-96 Actual	1996-97 Actual	1997-98 Forecast
<b>Operating account</b>					
Income <sup>(1)</sup>	326	346	358	416	414
Expenditure	322	354	372	430	423
<b>Surplus/ (Deficit) on continuing operations</b>	<b>4</b>	<b>(8)</b>	<b>(14)</b>	<b>(14)</b>	<b>(9)</b>
<b>Balance Sheet</b>					
Fixed Assets <sup>(2)</sup>	172	412	429	427	439
Net Current Assets	12	15	12	8	5
Long-term liabilities	(7)	(7)	(14)	(17)	(24)
Provisions	(4)	(13)	(22)	(30)	(28)
Deferred Grants	(5)	(14)	(24)	(28)	(34)
<b>Total Assets less Liabilities</b>	<b>168</b>	<b>393</b>	<b>381</b>	<b>360</b>	<b>358</b>

Notes: 1. From April 1996, colleges took over responsibilities for the administration of bursary payments to students. These payments were funded by additional grant from the Department (£45 million).

2. In 1993-94 not all colleges included in their accounts assets inherited from local authorities at 1 April 1993.

Colleges collectively broke even on their operations in 1993-94, and incurred modest operating deficits of two to four per cent of income between 1994-95 and 1997-98.

For many colleges operating deficits were incurred as a result of restructuring costs and provisions for early retirement and redundancies, which should help their future financial position. Nevertheless, operating deficits are potentially serious since colleges are now expected to generate the resources to maintain and renew their capital assets out of their recurrent income and external financing sources. Colleges can no longer rely on capital grants from the Department in order to support the renewal or development of assets. Only by generating net operating surpluses in the long run can the sector support its major assets such as buildings.

Sources: 1993-94, 1994-95, 1995-96, 1996-97: college final accounts 1997-98: College financial forecasts



**Figure 8**

**College operating deficits, reserves and days expenditure in reserve: 1993-94 to 1997-98**

	31 March 94 Actual	31 March 95 Actual	31 March 96 Actual	31 March 97 Actual	31 March 98 Forecast
Number of colleges with an operating deficit in financial year	12	27	27	34	39
Number of colleges with accumulated negative reserves	10	14	15	17	18
Total accumulated positive reserves (£ million)	12	14	18	18	18
Total accumulated negative reserves (£ million)	(3)	(5)	(11)	(14)	(13)
Average days expenditure in reserve	13.7 days	12.6 days	12.6 days	10.5 days	7.4 days

Notes: 1. Reserves consist of restricted reserves, designated reserves, and income and expenditure balance  
2. Days expenditure in reserve =  $365 \times \text{reserves} / \text{total expenditure}$

Sources: 1993-94, 1994-95, 1995-96, 1996-97: college final accounts 1997-98: College financial forecast

## Current developments in the further education sector

**1.10** At the time of our study a number of developments were under way in the further education sector in Scotland. Some had potentially far-reaching implications:

- On 25 February 1998, and following a review of their methodology for allocating funding to colleges, the Government announced funding for the FE sector in Scotland for 1998-99 based on changes made as a first stage towards a revised funding formula;
- the Department had commissioned a survey of aspects of governance at Scottish colleges, which was published in October 1997; and
- the Department were seeking to encourage colleges to implement the Ministerial announcement of 1 August 1997 which sought to shift the emphasis away from the competitive approach between colleges, which had characterised the first four years of the new sector, towards a more collaborative approach.

**1.11** In addition, the Report of the Inquiry into Higher Education chaired by Sir Ron Dearing (and chaired in Scotland by Sir Ron Garrick) recommended that a further education funding council for Scotland, linked to a higher education funding council by shared administration and chief executive, should be established. On 25 February 1998, the Government announced its plans to establish a Scottish Further Education Funding Council to have responsibility from April 1999 for the funding of Scotland's FE Colleges.

## **Scope of the National Audit Office's examination and methodology**

**1.12** The Comptroller and Auditor General is the auditor of the Department and has access to the accounts of colleges under Schedule 2 of the Act. Schedule 2 also refers to the examination of economy, efficiency and effectiveness which the Comptroller and Auditor General has powers to undertake under the National Audit Act 1983.

**1.13** The report covers our examination of

- corporate governance at colleges, including an assessment of compliance with statutory responsibilities and good practice. (Part 2)
  
- development (strategic) planning and financial management, including an assessment of colleges' development planning and budget setting; their monitoring of their financial health; their financial control arrangements. (Part 3)

**1.14** Appendix 2 sets out details of our methodology, which included visiting colleges, and examining information held by the Department on the performance of the sector. Between April and September 1997, we visited 12 of the 43 further education colleges in Scotland. The colleges were chosen to provide a geographical spread of institutions, of sizes and types, and with differing unit cost performances. The colleges we visited are highlighted in Appendix 1.

**1.15** At the same time we began a programme of examinations of key aspects of the colleges' performance, looking first at unit costs. We plan to report the outcome of this work shortly.

**1.16** We provided each college visited with a separate management report, including our findings, conclusions and recommendations for action. Each college agreed a plan of action to implement our recommendations which they are now putting into effect.

## Part 2: Corporate Governance at colleges

### Introduction

**2.1** The board of management of each further education college carry major responsibilities for the conduct of the college, including responsibility for the use of public funds. In recent years there has been increased emphasis on the need for public bodies to conduct themselves with probity and openness. The Eighth Report of Session 1993-94 of the Committee of Public Accounts, The Proper Conduct of Public Business, drew attention to the need to ensure that proper standards are maintained in the conduct of public business.

**2.2** The Second Report of the Committee on Standards in Public Life, Local Public Spending Bodies (May 1996), also covered the issue of governance at further education colleges. The Committee took evidence from a wide range of witnesses, including the chairmen of the board and principals of a number of Scottish colleges. The Committee's Second Report made several recommendations for improving governance at colleges in the following areas:

- appointments to, and composition of, the board;
- training and support for board members;
- openness;
- codes of conduct;
- conflicts of interests;
- whistleblowing procedures;
- annual reports;
- systems for independent resolution of disputes; and
- appropriate limits on items considered to be commercially confidential.

The detailed recommendations, along with the Government's response in respect of the further education sector in Scotland, are summarised in Appendix 3. The Fourth Report of the Committee, *Review of Standards of Conduct in Executive Non-Departmental Public Bodies*, NHS Trusts and Local Public Spending Bodies, was published in November 1997 and made a number of further observations relevant to the further education sector (see Appendix 3).

**2.3** Against this background, we examined the following aspects of corporate governance at colleges:

- the operation of their boards and key committees;
- the conduct of the board; and
- the support provided to the board.

**2.4** In February 1997 the Department commissioned a postal survey of chairmen, principals and board members which sought to review key aspects of governance at colleges. Responses were received from 84 per cent of principals (37 colleges), 61 per cent of chairmen (27 colleges) and 53 per cent of board members. The results of the Department's survey are referred to in later sections of this Part of the report.

## **The operation of colleges' boards and key committees**

**2.5** We examined whether colleges' boards:

- were properly constituted and supported by appropriate committees;
- were adopting the recommendations in the Second Report of the Committee on Standards in Public Life as regards arrangements for recruiting and appointing new board members;
- had established remuneration committees; and
- had established audit committees.

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**Colleges' boards were properly constituted with the required levels of representation from business, staff and students and were supported by appropriate committees with generally clear terms of reference.**

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**2.6** Schedule 2 of the Act sets out the requirements for the membership of boards. Boards should have between 10 and 16 members, not less than half of whom should have experience in commercial, industrial or employment matters. The principal, a student representative, and two staff representatives should also be board members. The Department's survey of chairmen of the board found that the majority of boards were of the maximum, or near the maximum, size allowed. All of the colleges we visited complied with the requirements of the Act, with the size of the board ranging from 11 (in one college) to 16.

**2.7** Most boards met three or four times a year. The Department's survey of chairmen found that attendance at board and committee meetings was generally high with almost all (92 per cent) being quorate and able to proceed.

**2.8** The Act provides a framework for the constitution and proceedings of college boards. The Act also permits boards to delegate the performance of any of their functions to their chairman, to any committee appointed by them or to any member of their staff. This contrasts with the situation in England, where college governing bodies are not permitted to delegate certain of their functions, such as approval of the annual estimates of income and expenditure.

**2.9** College boards should have a strategic oversight of the college's activities. They should monitor the performance of the principal, and through him or her the rest of the senior management team, and the colleges performance in achieving its strategic objectives. The principal, as Chief Executive and Accounting Officer, is responsible for the day to day management of the college. It is therefore good practice for the board to define as clearly as possible, within the context of the college for which they are responsible, the respective roles and responsibilities of the board, their committees and the principal.

**2.10** The distinction between the responsibilities of the board and the principal was clearly understood and observed at all the colleges we visited. Where boards had delegated matters to committees, seven of the colleges had prepared clear terms of reference outlining where the committees had authority to decide and where they had advisory powers. At a further four colleges terms of reference had not been prepared for some or all of the committees of the board. In the other college the Board had replaced their finance, estates and personnel committees with task groups which complicated the process and blurred responsibilities.

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**Colleges were generally adopting the recommendations in the Second Report of the Committee on Standards in Public Life as regards arrangements for recruiting new board members.**

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**2.11** The Committee on Standards in Public Life have highlighted the importance of public bodies having open and transparent procedures for recruiting new board members, particularly where, as in the case of further education colleges, they have the power to renew their own membership, subject to the requirements of the Act. The Department have also reminded colleges, most recently in February 1997, of the importance of following best practice in their procedures for recruiting new board members. The Committee on Standards in Public Life have recommended that best practice includes:

- a publicly available written appointments process;
- the preparation of job descriptions and person specifications;
- the use of advertising and/or consultation with interested bodies and other forms of canvassing;
- the encouragement of nominations (including self-nominations);
- the sifting of candidates by a nominations committee; and
- defined terms of appointment after which reappointment should not be automatic.

**2.12** Figure 9 summarises our findings and the Department's survey. At all of the colleges we visited, the boards were aware of the importance of having open and transparent recruitment procedures and had considered the recommendations of the Committee on Standards in Public Life. While there was scope for improvement, the colleges recognised this fact and were planning to take action to improve their recruitment procedures in line with best practice. Colleges' progress in implementing open and transparent recruitment procedures should be viewed in the context of a relatively low turnover of board members since incorporation.

**Compliance by Scottish Further Education Colleges with good practice in the recruitment of board members**

**Figure 9**

<i>Best practice in recruiting board members</i>	<b>Compliance with best practice</b>	
	<i>As reported in the Department's survey</i>	<i>At colleges visited by the National Audit Office</i>
Publicly available written appointment procedures	49%	25%
Use of job descriptions and person specifications	53%	17%
Use of advertisements	not specifically covered	25%
Use of consultation with interested bodies and other forms of canvassing and the encourage of nominations (including self nominations)	not specifically covered	100%
Sifting of candidates by a nomination or search committee	61%	50%

Sources: National Audit Office visits and Department survey

**Most boards had established appropriate arrangements for determining the pay and conditions of the principal and the senior management team although there was scope for improving the quality of minutes kept by remuneration committees**

**2.13** Under the terms of the financial memorandum between the Secretary of State and the board, colleges are required to appoint a remuneration committee to ensure that senior college staff are fairly rewarded for their contribution to colleges' overall performance.

**2.14** The Department's survey found that 84 per cent of colleges had established remuneration committees. Remuneration committees also considered the pay and conditions of some or all of colleges' senior management teams. At all of the colleges we visited the board had introduced arrangements for determining the pay and conditions of the principal in line with the Department's requirements. At eight colleges, the board had established a remuneration committee to consider such matters, while four others had delegated this task to another committee.

**2.15** Decisions on appropriate levels of remuneration for senior staff should be based both on information on comparable salaries within the sector and elsewhere, and also on an assessment of performance against objectives and targets previously set by the board. All of the boards we visited had used



information provided by the Association of Scottish Colleges on levels of remuneration within the sector to inform their decisions on appropriate salary levels. Five also formally assessed the performance of the principal against objectives and targets previously established by the board.

**2.16** The discussions and decisions of the remuneration committee, whilst necessarily of a confidential nature, should be comprehensively minuted. At six of the colleges we visited there was scope for improving the quality of minutes kept by remuneration committees, particularly on the criteria against which decisions were taken and, and on the decisions themselves.

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**All boards had established audit committees.**

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**2.17** Under the financial memorandum between the Secretary of State and individual boards, colleges are required to establish an audit committee to take responsibility for the appointment and terms of reference of the internal and external auditors and to receive reports from them. The audit committee should also report annually to the Board on the adequacy of colleges' internal financial control systems. All of the colleges we visited had established audit committees. At three of the colleges we recommended that they review the membership of their audit committee to ensure that, as far as possible, that membership was separate from membership of the finance committee. At one other college we recommended that the remit and terms of reference of the audit committee be reviewed.

## **The conduct of the board**

**2.18** In assessing the standards of conduct of the board at the colleges visited we examined whether boards had:

- adopted codes of conduct in line with the recommendations of the Committee on Standards in Public Life;
- appropriate registers of interest;
- appropriate arrangements for making information available about the operation of the board and its committees;
- established whistleblowing policies and procedures; and

- established self-assessment procedures to assess how effectively they were discharging their responsibilities.

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**Most college boards had adopted or were in the process of adopting codes of conduct in line with the recommendations of the Committee on Standards in Public Life.**

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**2.19** Developing and adopting a code of conduct is an important means by which a board can advise and guide its members on the standards of conduct and behaviour expected of them; on the obligations they undertake in carrying out their duties; and the way in which they deal with other members of the board and the principal. The Committee on Standards in Public Life have endorsed the preparation and use of codes of conduct.

**2.20** The Department's survey of chairmen of college boards found that 63 per cent of boards had adopted a formal code of conduct, a further 15 per cent intended to introduce one and 22 per cent considered a code of conduct unnecessary. At six of the colleges we visited the board had formally adopted a code of conduct. A further three had draft codes in place, but three colleges had no codes of conduct. The codes were often based on guidance provided by the Association of Scottish Colleges, tailored to the college's circumstances.

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**All boards had established registers of interests or were about to. There was scope for extending the registers to staff with significant financial responsibilities and for improving the guidance provided on categories and types of interest to declare.**

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**2.21** Board members are usually recruited because of the wide range of relevant skills, knowledge and experience they possess, such as financial or business experience. This may, however, place them in situations in which there is the potential for a conflict, or perceived conflict, of interests between their role as a board member and their other interests. A register of interests enables members to disclose relevant interests in a manner which is open and transparent and demonstrates to the public that such interests have not influenced the board's decision making process.

**2.22** In the Department's survey of all colleges, three-quarters of chairmen reported that their college had established a register of interests. At 10 of the colleges we visited the board had established a register of members' interests, and in the remaining two cases were planning to. At five, the registers were up to date with declarations from all board members; at two, the registers included all staff

with significant financial responsibilities; and at six colleges with registers, board members and college staff were encouraged to declare the interests of close family members. Figure 10 summarises the progress of colleges in establishing and maintaining appropriate registers of interests.

**Figure 10** Registers of interest

	College											
	1	2	3	4	5	6	7	8	9	10	11	12
Register of interests exists	X	✓	✓	✓	✓	✓	✓	✓	✓	X	✓	✓
Register includes all board members and is up to date	X	✓	✓	✓	✓	X	X	X	✓	X	X	✓
Register includes all staff with significant financial responsibilities	X	✓	X	X	X	X	X	✓	X	X	X	✓
Interests of close family relatives, and others likely to be perceived to have influence, declared	X	X	X	✓	✓	X	✓	✓	✓	X	X	X
Clear guidance on the types of interests to considering declaring provided	X	X	X	✓	✓	X	X	✓	X	X	X	X

Source: National Audit Office

**2.23** While it is the responsibility of board members and college staff included within the register to decide what interests should be disclosed, it is helpful if colleges provide clear guidance as to the categories and types of interests that should be considered when making a declaration. Four of the colleges we visited provided such guidance. The following example describes the clear guidance provided at one college.

**Good Practice  
Example 1**



**Guidance provided by a college on types of interest that board members should consider disclosing**

The college included within its code of conduct for board members guidance on the types of interest that members should consider entering in the college's register of interests. Board members were also invited to provide the same information, if known, in respect of close family members.

Relevant interests were defined as:

*"any interest, financial or otherwise, which is likely or would, if publicly known, be perceived as being likely to interfere with the exercise of a member's independent judgement should be declared to Board."*

Further guidance was provided as follows:

<b>Category of Interest</b>	<b>Information to be provided</b>
Paid Employment	Name of employer
Self Employment	Names of customers accounting for a significant proportion of individual or company income
Directorships of Commercial; Companies	Name of Companies
Significant Shareholdings	Names of Companies in which a member owns a significant proportion of issued share capital, for example over 5 per cent
Elected Offices	Name of Authorities
Public Appointments (paid or unpaid)	Names of Bodies or Organisations

**Colleges had generally made good arrangements for ensuring that information about the activities of the board and their committees was available to staff, students and the wider public.**

**2.24** A climate of openness and transparency about the decisions taken by college boards and committees, and the reasons behind them, is one means of ensuring that public business is undertaken with due regard to propriety. While there will always be occasions when a degree of management or commercial confidentiality is necessary, colleges should seek to provide as much information as possible about their activities, and regularly review any limitations that they do impose. Most of the colleges we visited had made good arrangements for making available information about the outcome of board and committee meetings by:

- posting agendas of forthcoming meetings on college notice boards;
- posting draft minutes of meetings as soon as they had been provisionally agreed by the chairmen on college notice boards;

- using staff newsletters and other forms of briefing; and
- making board agendas, minutes and reports available in college libraries.

**2.25** Colleges can also demonstrate their commitment to openness by holding an open annual meeting at which board members are available to be questioned by the public and press. One of the colleges we visited was planning to hold an annual general meeting of the board, which would be open to the public, as part of a college open day; another college had considered holding an annual board meeting open to the public but rejected the idea on cost grounds; and two further colleges had made provision in the standing orders of the Board for members of the public to be admitted to board meetings that discussed the college's annual report.

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#### **Few boards had established policies and procedures on whistleblowing.**

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**2.26** The Committee on Standards in Public Life have recommended that colleges should have whistleblowing policies and procedures. Such procedures support a culture of propriety and openness by allowing concerns of members of the board, or members of staff, to be raised and investigated confidentially inside, and if necessary outside the organisation.

#### **Good Practice Example 2**



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#### **A whistleblowing policy introduced by a College**

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The policy:

- made clear that individual members of staff had a right - and a duty - to raise any matters of concern which they might have about perceived malpractice (such as financial irregularities, breach of health and safety regulations or unethical practices) within the workplace;
- provided for informal discussions with other colleagues or management where staff were unsure of the best way of dealing with their concerns or needed to clarify their thoughts;
- stressed that the source of any information provided would be kept confidential;
- described how any complaints (whether informal or formal) would be investigated (e.g. through referral to internal or external auditors);
- explained that the outcome of the investigation would be notified to the complainant (but stressed that some information, such as the outcome of any resulting disciplinary procedures, would remain confidential);

continued...

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**Good Practice  
Example 2**

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**A whistleblowing policy introduced by a College continued**

- provided details of what further action staff could take if they were dissatisfied with the outcome of the investigation (including contact names, addresses and telephone number of other bodies, such as the internal and external auditors and the Department, to whom the member of staff might wish to raise their concerns);
- emphasised that the college would not tolerate the victimisation of staff who raised legitimate concerns; and
- made clear that unfounded and malicious allegations would be treated seriously.

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**2.27** At two of the colleges visited the board had formally adopted a policy on whistleblowing at the time of our visit. A further college had a draft policy awaiting board approval. The following example illustrates good practice.

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**Few boards had established self-assessment procedures to determine how effectively they were discharging their responsibilities.**

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**2.28** As independent corporate bodies college boards have significant responsibilities and duties. It is therefore appropriate that boards should periodically review and assess how well they perform their role and function and identify ways in which they can improve their effectiveness. Amongst the benefits that self-assessment can bring are: evidence on the extent to which board members understand their duties and responsibilities; information on whether all the potential strengths of the board, and individual members, are being fully utilised; and the identification of areas where board members feel they need further training and support. We therefore examined the extent to which the colleges visited had introduced formal self-assessment procedures. Two colleges we visited had introduced formal self-assessment procedures, and one college was actively planning to do so during 1997-98. Figure 11 illustrates the key steps we consider a college should take when undertaking a self-assessment exercise.

## **The support provided to the Board**

**2.29** We examined whether boards:

- had made appropriate arrangements for the role of clerk to the board; and
- were receiving appropriate levels of training and support.

## Board self-assessment procedures

**Figure 11**

Self assessment arrangements could involve:

- boards agreeing and defining the purpose of the self-evaluation exercise (for example, boards often decide to evaluate their own performance because they wish to improve the value they add to the college);
- boards agreeing and defining what is to be evaluated (for example: the duties and responsibilities of the board; its mission, strategic objectives and policies; the conduct of meetings; working relationships; the attributes, knowledge, commitment and attendance of the board collectively and individually; and the effectiveness of contributions from members);
- using structured questionnaires to assess the performance of the board (typical questions might include, 'are all members provided with adequate information to enable them to monitor and assess the academic and other standards of the college?', or 'do members take an active interest in the work of the college at a strategic level, understand the operating structure and know the roles of senior staff?');
- analysing and discussing the results;
- establishing targets for areas where members feel improvements are needed, and identifying any further training and support required to meet those targets; and
- repeating the exercise in future years to assess what improvements have been made.

Source: National Audit Office

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**Colleges had generally made appropriate arrangement for the role of the clerk to the board. There was scope for improving the clerk's job-descriptions to make it clear how any potential conflicts of interests between their role as clerk and their other management duties would be resolved.**

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**2.30** The clerk to the board is responsible for organising the proper conduct of the board's business. While the clerk should not participate in the discussions and decisions of the board, the postholder should have sufficient experience and knowledge of procedural and governance issues to offer advice and guidance when required. As the clerk is acting as a servant of the board, the postholder must in that capacity be able to preserve independence from the management of the college. Where the person undertaking the role of clerk to the board has other duties in the college, often as a member of the college's management, it is essential that the two roles are clearly differentiated. Each role should have a specific and separate job description. Appropriate training should also be arranged for the clerk.

**2.31** In nine of the colleges we visited, the board had appointed a member of the college's management team as clerk to the board. In these colleges the clerk was of sufficient seniority within the college to be able to provide appropriate advice and guidance to the board. We found scope in all but two of these colleges for improvements in the job descriptions of the post-holders in order to make it clear how to deal with any issues that raised a potential conflict of interest between the individual's role as clerk and his or her role as a senior college manager.

**2.32** In two of the colleges the clerk to the board was the principal's personal assistant, and their role was to provide administrative and secretarial support. Consequently, the boards relied heavily on the principal to provide the guidance and advice they required rather than on the independent advice and guidance on statutory and constitutional issues which a clerk should provide. One college visited had not appointed a clerk to the board, with the principal, depute principal and the principal's secretary fulfilling the role between them.

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**The levels of support by colleges for their boards were generally satisfactory, although there was scope for providing additional training for board members.**

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**2.33** Board members' understanding of, and involvement in, the key issues affecting their college is considerably enhanced when they receive good quality support from college staff. Such support can include training and induction for new board members, ongoing training on new developments within the further education sector, and the provision of good quality briefing papers and information to the board and its committees.

**2.34** The Department's survey of board members found that 19 per cent reported that they had not received any post-induction training, and only 45 per cent agreed that the training they had received was sufficient in range and quality.

**2.35** Most of the colleges we visited had made arrangements for ensuring that new board members received some initial briefing or training in areas such as the preparation of induction packs containing key information on the board, its constitution, committees and the college; briefings on the college given by the principal; and tours of the college. One college found that co-opting potential board members onto the board was an effective way of providing suitable induction to the role of a board member. Another invited new board members to meetings in advance of their appointment and found that this allowed them to participate more fully in board discussions and decisions from the outset.



**2.36** Seven of the colleges we visited also held regular training events to update board members on developments in the college and the further education sector. Such initiatives included an annual training day for board members, the use of guest speakers at board ‘away-days’ and seminars for board members of a number of local colleges on recent developments in the further education sector.

**2.37** While the quality of briefing reports, agendas and minutes varied between the colleges visited, they were generally of a reasonable to very good standard. In addition, chairmen of the board of management consistently told us that they were happy with the level of support and training provided to the board.

## Part 3: Development planning and financial management at colleges

### Introduction

**3.1** Good development planning and sound financial management are essential if colleges are to achieve their educational and other goals. To be fully effective, objectives within the development plan should be communicated to all levels of the organisation and should be monitored systematically. There should be explicit links between the development plan and the college budget so that the financial implications of important decisions are considered at a sufficiently early stage. A sound financial control environment is an important element of any college's financial management strategy.

**3.2** At the 12 colleges we visited, we examined how well they were responding to these challenges. We looked in particular at the colleges' approaches to the following activities:

- development planning and budget setting;
- monitoring financial health; and
- financial control.

### Development planning and budget setting at colleges

**3.3** The Department have provided a framework within which colleges undertake their development planning. Colleges submit their development plans, covering the next three academic years, to the Department by the end of April each year. The plans are required to contain a number of elements (Figure 12).

**3.4** The Department's framework also advises colleges that they should prepare their development plans and budgets concurrently, with information from the development plan shaping the budget and vice versa. Colleges are required to provide the Department with their budget, financial forecasts and annual cashflow statement by the end of May each year.

**Elements which the  
Department require to be  
included in college's  
development plans**

**Figure 12**

- a clear statement of corporate intent;
- a clearly-articulated set of strategic objectives and associated key targets;
- a review and evaluation of progress against targets set in previous development plans;
- a review of progress in the area of quality development;
- a summary of performance in the previous year against the Department's performance indicators;
- projected student numbers and activity; and
- any planned capital investment.

Source: Scottish Office Education  
and Industry Department  
Guidance

**3.5** We examined the most recent development plans and the underlying planning processes, including the setting of budgets, at the 12 colleges we visited. In doing so, we examined whether:

- boards of management were strategically involved in the development planning process;
- development plans contained measurable objectives and targets that were subject to systematic review by colleges and their boards;
- development plans were underpinned by lower-level plans drawn up by staff working in the areas concerned; and
- there were clear links between development plans and budgets.

**At all the colleges we visited, boards had set the overall mission and strategic aims and regularly approved the college development plan. However, there was scope for some boards to play a more active role in their colleges' ongoing development planning process.**

**3.6** Under the Act, the formal responsibility for submitting the college's development plan to the Department rests with the board of management. All of the boards of the colleges we visited had set the overall mission and strategic aims for the colleges for which they were responsible. For those colleges which were dealing with challenging issues, such as a difficult financial position or a potential merger, the board were closely involved in identifying or approving strategic options for the college.

**3.7** Four of the boards were actively involved in the early stages of the planning process, taking part in a development planning ‘away day’ with college senior managers at which the development plan was the main agenda item (see example below). A further four boards delegated greater involvement in the development planning process to one of their committees. Of these, two had been set up for the purpose while the other two included development planning as part of their remit. The remaining four boards were not actively involved other than by giving their formal approval to the completed development plan.

**Good Practice  
Example 3**



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**The role played by a board in the development planning process at a college**

The board, in conjunction with the college executive management team, established the development planning framework.

After the strategic direction had been set by the board and the college executive team, the development planning process was largely bottom-up, starting with detailed operational plans at team level. Sector managers produced sector plans by early January. The first draft of the overall development plan was then compiled and circulated to all sector and other functional teams by mid-January.

A second draft was produced, taking on board comments on the first draft. A strategic summary of the second draft was sent out on a consultative basis to the local authorities for the areas served by the college, the local enterprise company and the careers service. Comments from these bodies were sought within three weeks and incorporated into the overall plan.

A third working draft was then considered by the board and the college executive at their residential seminar in the spring. The board then discussed the plan rigorously, both at the residential seminar and also via its curriculum and student services committee, before approving it. During the year progress against development plan targets were reported regularly to the board.

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**Most of the colleges we visited had included specific, measurable objectives and related targets in their development plans. There was scope for colleges to improve their approach to the setting of objectives and the systematic review of progress towards them.**

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**3.8** The Department’s guidance to colleges specifies that development plans should contain “clearly-articulated strategic objectives and associated key targets”. The most recent development plans at nine colleges visited contained specific and measurable objectives and related targets. At the remaining three colleges, objectives were defined in vague terms and without targets which made it unclear how achievement would be assessed.

**3.9** We found clear evidence of systematic monitoring and review of progress towards objectives and targets at seven out of the 12 colleges visited. The systems evolved by two of the colleges were particularly noteworthy (Example 4).

Good Practice  
Example 4



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**Systems for monitoring and reviewing progress towards objectives at two colleges.**

At one college a team headed by the depute principal met weekly to review performance against target and to take corrective action where necessary. In the second case, the depute principal had developed a database containing all objectives and targets including responsibilities and deadlines for each. Information on progress was fed into the database which was reviewed regularly.

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**3.10** Having set the strategic aims for the college, boards also have an important role to play in reviewing their college's performance in achieving those aims. One of the ways in which boards do this is by requiring college managers to report regularly on progress towards the objectives set in the development plan. At the 12 colleges we visited, six of the boards were systematically doing this, either at meetings of the whole board or through their designated committees, and a seventh board reviewed progress on previous objectives as part of the new round of development planning. At the remaining five colleges, there was no evidence of the boards scrutinising college performance towards achievement of development plan objectives though at least one of these boards recognised the need for more systematic review by themselves of progress.

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**Most colleges' development plans were underpinned by lower-level plans drawn up by staff working in the areas concerned.**

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**3.11** At nine of the 12 colleges we visited, the development plan was underpinned by a series of plans drawn up by units within the college which, depending on the structure adopted by individual colleges, could be faculties, schools, departments, or sections. In most cases, there was an emphasis on building the development plan from the bottom up, with each unit contributing its detailed operational plan from which information was drawn and refined to form the overall plan.

**3.12** Two colleges used cross-college development planning groups to build their plans. These groups comprised representatives of all key areas of the college. The groups were also responsible for monitoring progress against objectives in their colleges' development plans.

**3.13** None of the colleges we visited had formally documented their development planning process, although most provided guidance to those involved. Written guidance would be beneficial to college staff involved in the process, particularly those responsible for drawing up lower-level plans who may be less aware of the college's wider corporate aims. We suggest that such guidance should include the following (Figure 13).

**Documenting the  
development planning  
process**

**Figure 13**

The elements which a college could include in documenting their development planning process are:

- the areas to be included in unit (faculty, school, department, section) plans and the types of information needed;
- guidance on how to define specific and measurable objectives and targets for all key areas with details of timescales, names of person(s) responsible and criteria for evaluating progress;
- the planning cycle timetable including key stages such as defining human and physical resource requirements, and costing each element of the plan; and final approval by the board;
- the linkage between development plan objectives and budgets; and
- the stages at which progress against objectives and targets should be reviewed.

Source: National Audit Office

**3.14** Almost all colleges we visited had sought to engender a sense of ownership by staff of the overall development plan or the relevant unit plan. Five colleges had taken the step of including development plan objectives and targets in the individual work plans of senior members of staff. Where colleges had not adopted this approach, their arrangements for ensuring that staff were aware of the key elements of the development plan were generally good. The arrangements included providing each member of staff with a copy of the plan, making copies of the plan available to staff via middle managers, preparing a development plan summary which was distributed to all staff, providing a brief synopsis in a college newsletter, and holding briefing seminars on the plan.

**Although there were links between development plans and budgets at most of the colleges we visited, there was scope to improve these links in nearly all cases by ensuring that the financial implications of important decisions reflected in plans are made more explicit. Colleges did not provide sufficient written guidance to staff on the budget process.**

**3.15** The Department asks colleges to prepare their development plans and budgets concurrently, with the one shaping the other (paragraph 3.4). Some of the colleges we visited expressed the view that the difference between financial years (April to March) and academic years (August to July) made the process of aligning development plans and budgets more complex. There is provision in the Act for the financial year for colleges to be brought in line with the academic year, as it has been in England and Wales, but this has not been implemented in Scotland.

**3.16** We found that all colleges we visited had based their budgets on the proposals in their development plans. The process in 10 colleges consisted of a review of the previous year's budget adjusted to take account of current development plan objectives. New or major initiatives in the development plan were normally budgeted using a zero-based approach, where the budget was built from scratch based on a realistic estimate of resource requirements.

**3.17** Two colleges used a completely zero-based approach in their latest budgeting round. One of them, which was in a difficult financial position, could not afford to rely on previous budgetary assumptions. Accordingly, they used the zero-based approach to estimate the resource requirements to deliver their development plan: this approach resulted in aggregate bids for resources significantly over those available and the final budget was adjusted to match available resources. At the second college, a breakdown in their financial systems meant that an incremental approach to budgeting, based on the previous year's outturn, was no longer practical. Using a zero-based approach enabled them to link the budget closely with development plan targets and with individual staff accountabilities.

**3.18** None of the colleges we visited had prepared formal documented guidance for their budget process, although some had provided support to budget holders when asking them to submit estimates of resource requirements to deliver their elements of the development plan. Such a document would prove useful to all those involved in development planning and budget setting, by enabling them to understand the mechanics and timing of the processes and the criteria on which budget allocations are made. An example of the elements we think the document might contain is given in Figure 14.

## **Monitoring financial health in colleges**

**3.19** Monitoring the financial health of the college, and taking appropriate action where it appears that the college's financial position is deteriorating, is an important responsibility for college boards and managers. While the sector overall has maintained a reasonable financial position, there has been a wide range of performance between individual colleges (Figures 8 and 9 - Part 1).

**3.20** The financial position of the colleges we visited reflected the overall position of the sector described in Part 1 of this report. Only two of the 12 colleges had generated a surplus on their income and expenditure account in 1996-97 (compared to eight of the 12 in 1993-94, four in 1994-95, and two in 1995-96). Six of the colleges visited had accumulated negative reserves as at 31 March 1997.

## Documenting the budget process

### Figure 14

The elements which a college could include in documenting their budget process are:

- the method for estimating each type of expenditure, including elements allocated according to planned numbers of students, zero-based elements and any fixed amounts set as a college policy;
- the method of estimating income, including projected numbers of students and income targets for subject areas and profit targets for commercial activities;
- proposals for making adjustments to budgets to match expenditure with income and determine use of surpluses;
- the basis on which allocations are made to budget holders;
- details of the timetable for reviewing budgets and any procedures for redistribution of allocations;
- procedures for making bids for capital items, including equipment and building works; and
- the budget timetable, alongside the development plan timetable, leading to final approval of both by the board.

Source: National Audit Office

**3.21** We therefore examined whether colleges were providing appropriate financial information on a regular basis to budget holders; the senior management team; and the board of management and committees to enable the college to maintain or improve their financial health.

**Most colleges were providing appropriate financial information to board members, managers and budget holders, although there was scope at some colleges to improve the information provided to the board in respect of cashflow information. Some colleges had prepared explicit financial strategies designed to improve the financial health of the college.**

**3.22** All colleges we visited provided regular information to the board, and to relevant committees of the board, on the financial health of the college. At seven of them we recommended that the college make improvements to the information provided to the board about their cash position, such as providing comparisons of actual cash flows against forecasts. The frequency with which colleges provided this information varied; some only did so when finance committees or boards were due to meet, while others sent summary income and expenditure account, balance sheet, and cash flow statements on a monthly basis to members of the colleges' finance committees or board. In addition to providing summary financial information to board and committee members, all the colleges had appropriate arrangements for providing regular financial information to their senior management teams.



**3.23** All colleges we visited had developed systems to produce regular budget reports for budget holders. One college had made use of graphic representations of budget out-turns in order to aid interpretation by managers with a non-financial background. Another college provided budget holders with access to the financial system so that they could examine information on the latest budget position at any time. This college also assessed budget holders' performance in managing their budgets as part of the college's individual appraisal system.

**3.24** Three of the colleges we visited, and who were in a relatively poor financial position, had prepared explicit financial strategies designed to improve their financial position. The following example outlines the business and financial recovery plan that one college had prepared.

**Good Practice  
Example 5**



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**A college business and financial recovery plan**

To improve their financial health, the college had prepared a business and financial recovery plan. The major issues the plan identified were the need to:

- reduce staff and non-staff unit costs to the sector average;
  - identify a balanced budget for 1997-98;
  - prepare for the withdrawal of safety-net funding in 1989-99;
  - plan to reduce the accumulated deficit from March 1998;
  - fund pay awards for staff through efficiency savings;
  - negotiate more flexible terms and conditions of employment for academic staff.
- 

## Financial control at colleges

**3.25** A sound financial control environment is a fundamental element of financial management. The financial memorandum between the Secretary of State and the board of management requires the board to ensure that the college has a sound system of internal financial controls, including safeguards against fraud and theft. The board is also required to make arrangements for the internal audit of the college to ensure that internal control systems are effective and to appoint external auditors to provide an opinion on the colleges' accounts. We therefore looked at whether colleges had:

- comprehensive, up-to-date and sound financial regulations and procedures;

- established an up-to-date asset register;
- appropriate borrowing and investment arrangements and policies; and
- established college companies, and if so, whether appropriate management and financial arrangements had been made.

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**All colleges visited had comprehensive financial regulations, although some colleges had not supported these with detailed financial procedures.**

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**3.26** Colleges generally had comprehensive, up-to-date and sound financial regulations, often prepared at the time of incorporation. At the time of our visits four colleges had yet to supplement these financial regulations with detailed financial procedures, although one of these colleges had prepared draft financial procedures.

**3.27** While preparing comprehensive, up-to date and sound financial regulations and procedures is an important element of an effective financial control environment colleges need to ensure, through normal management controls, internal audit coverage and other means, that these regulations and procedures are followed by staff. At two of the colleges visited, the colleges had recently found examples where non-compliance with procedures had led to financial problems (Cases A and B).

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**Case A Non-compliance with financial procedures at a college**

While the college had prepared detailed financial regulations and procedures there had been a number of occasions where they had not been followed, resulting in overspends on overtime by facilities staff and losses through the over-ordering of cleaning supplies. A special internal audit report found that the losses were because of:

- staff not following established ordering procedures;
- a lack of monitoring by the budget holder of purchases and overtime expenditure; and
- a lack of routine monitoring by the finance department of variances from budget.

Following the report the college took disciplinary action against the staff involved and from April 1997 introduced a monthly meeting between the deputy finance manager and all budget holders. The Department subsequently commented favourably on the professional manner and promptness with which the college dealt with the situation and the way in which the college had kept it informed.

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**Case B Inaccurate accounting for income at one college**

An investigation by a college, instigated by the principal following his concerns over the college's deteriorating cash position, identified a breakdown in the systems of financial bookkeeping at the college during 1996-97 which led to a significant inaccuracy in recorded income (around £200,000). The investigation revealed:

- a serious breakdown in the book-keeping system including a failure to process credit notes for students who did not start courses and a significant level of mis-postings in the general ledger;
- a lack of proper bank reconciliations and improper management of creditor payments, taken as a result of the college's deteriorating cash position;
- that the finance directorate lacked a complete set of financial policies and procedures and that some of the accounting practices in place required immediate amendment.

Following the investigation the college's finance director and finance controller both resigned. The college's new finance director has introduced a series of policies, some of which are temporary pending full review, whilst detailed financial policies and procedures are prepared. To aid its cash position the college arranged, with the Department's approval, an overdraft facility with its bankers. The Department also agreed to reschedule its 1997-98 grant-in-aid payments to the college.

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**3.28** All the colleges we visited had appointed internal auditors to review the internal control environment of the college. Colleges ensured that their audit committees discussed reports produced by their internal and external auditors and reviewed the response of the college management team to the reports. At eight, we found examples of the college implementing the auditor's recommendations in a positive and timely manner.

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**Few colleges visited had introduced comprehensive asset registers.**

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**3.29** Establishing an accurate asset register is an important element of financial control procedures. Figure 15 shows some of the important functions that we consider a comprehensive, accurate and up-to date asset registers can play.

**Functions of asset registers**

**Figure 15**

Asset registers can:

- form an important part of a college's procedures for ensuring that staff take responsibility for the safe custody of assets;
  - enable college management to undertake independent checks on the safe custody of assets;
  - help a college manage the effective utilisation of the college's assets, including avoiding unnecessary purchases, and to plan for the replacement of assets;
  - provide accounting information; and
  - support insurance claims in the event of fire or other disasters.
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Source: National Audit Office

**3.30** Four of the colleges we visited had introduced a comprehensive asset register, generally in a computerised form. Most of the other colleges maintained some information on their assets, often on information technology equipment. Two of the four colleges with asset registers had procedures for regularly undertaking physical verification checks of the assets included on the register, and a third college was planning to introduce such checks at the time of our visit. At the fourth college the management had rejected a similar recommendation from internal audit, believing that the college's size, coupled with close senior management knowledge of asset holdings, made such routine checks not cost-effective.

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**None of the colleges visited had found it necessary, to date, to prepare detailed investment or borrowing policies for board approval.**

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**3.31** The Act permits colleges to invest any sums not immediately required by the college. It also permits colleges to borrow subject to the written approval from the Secretary of State. We therefore looked at whether colleges had prepared appropriate investment and borrowing policies for board approval.

**3.32** The financial position of the colleges visited meant that few colleges had accumulated significant cash balances which would be available for investing over the longer-term. Instead all of the colleges visited made arrangements to invest any cash surpluses in short-term deposit accounts with their bank. As a consequence of the limited nature of investment activity, none of the colleges visited had prepared a detailed investment policy.

**3.33** While all of the colleges visited included in their financial regulations the requirement that approval should be sought from the board and the Secretary of State before any borrowing was undertaken by the college, none of them had prepared a more detailed borrowing policy for board approval.

**3.34** Most colleges told us that they had not considered it appropriate to prepare such a detailed policy for approval by the board as they had not, to date, found it necessary to borrow significant sums. However, the continuing financial pressures on the sector, the problems that some colleges have experienced in generating reserves to fund future capital investments, and the reduction in capital grant funding available from the Department all mean that borrowing by colleges may increase in the future. In all cases where the colleges visited had arranged borrowing, the approval of the college board and the Department had been sought and obtained in compliance with the colleges' financial regulations.

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**Where the colleges visited had established commercial companies they had generally made appropriate managerial and financial arrangements to govern the relationship between the college and the company.**

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**3.35** Colleges may choose to conduct trading, research and consultancy services through a college company either for commercial reasons or for taxation purposes. They may also invite or require staff to provide personal consultancy services through such a company. Colleges which establish companies should ensure that the college board is able to satisfy itself that the company has been properly constituted and that there are arrangements for the proper oversight of its activities to safeguard the financial interest and reputation of the college. Colleges may find it necessary to consider obtaining appropriate professional legal and financial advice before creating a company, particularly given the implications for a college's charitable status of significant trading activities.

**3.36** Six of the colleges visited had established college companies. In five of these cases the main reason for establishing a college company was to provide a means of managing the college's commercial activities, which were separate from the normal business of the college, without undermining the charitable status of the college. In the sixth case the college, in conjunction with another local college, had taken over the activities of their local council's training organisation which offered a range of vocational qualifications in areas complementary to the colleges' activities.

**3.37** One of the colleges we visited had invested £75,000 in a company providing training activities to a local authority; another college invested a similar sum. We identified scope for improvements in the information provided to the board about the financial health of the company, and recommended that the board obtain an independent professional review of the current and future financial health of the company prior to any decision to provide additional subsidies.

**3.38** In another case, a college had established three companies to undertake commercially based activities. One of the companies was placed in a charitable trust to distance company liabilities from the college; but this also had the effect of placing the company technically outside the control of the college. We endorsed recent action taken by the college to clarify the financial and managerial arrangements between the college and the company.

## Appendix 1

# Further education colleges in Scotland

College	Students 1995/96	<sup>1</sup> Grant 1995-96 £000	<sup>2</sup> Weighted SUMS 1995-96
<i>Colleges visited by National Audit Office are highlighted</i>			
Aberdeen College	19,256	17,536	107,004
Angus College	4,496	4,809	24,794
Anniesland College	6,687	4,965	33,706
Ayr College	4,139	5,692	33,629
Banff & Buchan College of Further Education	3,434	4,570	25,993
Barony College	631	1,425	5,983
Bell College	4,404	5,273	27,920
Borders College	5,761	4,886	28,377
Cambuslang College	3,985	4,700	29,996
Cardonald College	5,299	8,255	48,811
Central College	5,250	5,196	35,671
Clackmannan College of Further Education	3,253	3,118	15,134
Clydebank College	5,260	8,115	44,544
Coatbridge College	3,066	4,656	26,002
Cumbernauld College	3,526	4,025	19,890
Dumfries and Galloway College	6,896	6,224	34,752
Dundee College	14,945	12,639	67,859
Elmwood College	2,791	3,484	19,315
Falkirk College of Further and Higher Education	11,006	9,666	53,856
Fife College of Further and Higher Education	6,361	8,410	46,167
Glasgow College of Building and Printing	5,065	6,256	47,189
Glasgow College of Food Technology	4,393	3,973	21,789
Glasgow College of Nautical Studies	5,246	4,253	28,186
Glenrothes College	6,426	5,493	35,055
Inverness College	5,060	7,999	38,949
James Watt College of Further and Higher Education	7,711	9,974	71,720
Jewel and Esk Valley College	13,997	8,459	48,632
John Wheatley College	3,448	3,997	23,895
Kilmarnock College	4,048	6,746	38,629
Langside College	8,338	7,422	45,973
Lauder College	12,926	6,180	39,788
Lews Castle College	2,370	2,431	10,086
Moray College	5,542	6,463	31,747
Motherwell College	10,596	9,465	60,311
North Glasgow College	4,013	6,834	35,614
Oatridge College	1,018	2,087	10,850
Perth College	8,043	7,346	37,299
Reid Kerr College	9,206	9,726	59,470
Stevenson College	18,528	11,326	79,869
Stow College	3,377	5,335	34,832
Telford College	16,289	15,060	94,969

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<b>College</b>	<b>Students 1995/96</b>	<b><sup>1</sup>Grant 1995-96 £000</b>	<b><sup>2</sup>Weighted SUMS 1995-96</b>
Thurso College	3,288	3,002	15,755
West Lothian College	6,174	5,874	27,300

*Local Authority administered colleges*

Kirkwall College of Further Education  
Shetland College of Further Education  
Stromness Academy Further Education Centre

1. Source: College Annual Accounts; comprising grant-in-aid, restructuring fund grant and release of deferred capital grants.
2. Weighted SUMS are a measurement of units of student activity, weighted to reflect the varying costs of provision across different curriculum areas.

## Appendix 2

# National Audit Office Methodology

Our approach to the study reflected experience gained in auditing the further education sector in England. We visited the 12 colleges highlighted in Appendix 1.

During the visits, our teams carried out a structured set of tasks. They interviewed a range of key staff including:

- college principals;
- chairmen of Boards of Management;
- clerks to the Boards of Management;
- other members of the colleges' senior management team;
- finance directors or equivalent and their staff; and
- budget managers (e.g. estates managers) outside finance departments.

The teams carried out a programme of testing of financial controls and, as well as standard accounting documentation, examined key documents such as financial reports to managers, board members and the Department; college development plans; internal and external audit reports; financial regulations and procedures; budget documentation; reports to, and minutes of, the board of management and its committees.

Each college visited was provided with a management report, outlining our findings and conclusions. We made over 280 recommendations to colleges on areas where improvements could be made. The colleges responded with action plans, now being implemented, with over 260 action points being agreed.

In addition to the visits to colleges we analysed information collected by the Department on the financial health of the sector and educational performance and interviewed staff and examined relevant documents in the Department's Further Education Funding Division.



During the course of the study we also took advice from an expert panel, comprised of a senior representative of the Department, two college principals, a college director of administration, a principal of an English further education college, and a representative of the Scottish Further Education Unit (a body which offers support to the sector on a number of management and academic issues).

Our initial findings and conclusions from our visits to colleges were also presented to a meeting of college principals and chairmen for discussion.

## Appendix 3

# Recommendations and observations of the Second and Fourth Reports of the Committee on Standards in Public Life and the Government's response to the Second Report

Recommendations of the second report	Government response
The principles of good practice on appointments, training, openness, codes of conduct and conflicts of interest, set out here in our first report, should be adopted with suitable modifications across the sectors covered in this report	Accepted in full
Local public spending bodies should institute codes of practice on whistleblowing, appropriate to their circumstances, which would enable concerns to be raised confidentially inside and, if necessary, outside the organisation.	<p>The Government agreed that the question of how staff in these sectors should best be able to raise concerns in a timely and confidential manner is an important one.</p> <p>In Scotland, the question of whistleblowing is also under consideration by individual institutions.</p>
Appointments to the governing bodies of universities and colleges should be made on the basis of merit, subject to the need to achieve a balance of relevant skills and background on the board.	Such appointments are for individual institutions to consider. The principle of appointment on the basis of merit is however well established.
The automatic representation of the TECS and LECS on college governing bodies should be ended.	The Government decided on this statutory link to signal the importance they attach to colleges and LECS working closely together to meet local labour market needs. Such co-operation remains important and the retention of the link is desirable for this purpose.
Individual universities and colleges should be encouraged to set out key information to a common standard in their annual reports or equivalent documents where they do not already do so. Material on governance should be included in the annual reports or equivalents of further and higher education institutions. Representative bodies should take the lead in promoting this with the support of the funding councils.	The Scottish Office requires colleges to produce an annual report and has issued guidance on content, to ensure for example that reports set out consistent information on performance indicators. Colleges will be asked to secure compliance with the Committee's recommendation for the 1997 reporting year.
Representative bodies, with the help of the funding councils, should produce a common standard of good practice on the limits of commercial confidentiality and should encourage all institutions to be as open as possible subject to those limits. All institutions should have publicly available registers of interests.	The Scottish Office Direction on college accounts includes a requirement to list any material interest which board of management members may have in college contracts. The Association of Scottish Colleges has also issued a model Register of Members' Interests.

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**Recommendations of the second report**

Institutions of higher and further education should make it clear that the institutions permits staff to speak freely and without being subject to disciplinary sanctions or victimisation about academic standards and related matters providing that they do so lawfully, without malice, and in the public interest.

**Government response**

The Report's discussion of academic freedom and its compatibility with public accountability is welcome. It is for further education institutions to ensure that their staff may speak freely about academic matters within the constraints of the law.

Where it is absolutely necessary to include confidentiality clauses in service and severance contracts, they should expressly remind staff that legitimate concerns about malpractice may be raised with the appropriate authority (the funding council, the National Audit Office, Visitor, or independent review body as applicable) if this is done in the public interest.

This recommendation is for the institutions themselves to consider. Further education colleges are required to establish remuneration committees and in their accounts to disclose compensation payments for loss of office of senior staff.

The higher education funding councils, institutions, and representative bodies should consult on a system of independent review of disputes. A similar process of consultation should be undertaken by the equivalent further education bodies.

The Association of Scottish Colleges is considering how best to take this forward.

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**Observations raised in the Fourth Report of the Committee on Standards in Public Life**

- The funding and regulatory bodies should monitor and report on the ways in which good standards of conduct are communicated to staff, and understood by them.
  - The bodies responsible for institutions within the further education sector should look again at the recommendation which proposed a system of independent review of disputes.
  - Representative bodies should ensure that whistleblowing procedures are in place within institutions and allow staff appropriate external avenues in which to raise concerns about malpractice.
  - Responsible departments should disseminate guidance on good practice about payment of expenses to board members.
  - All members of boards, whether elected or appointed, should be appointed for fixed terms, and such terms should not normally exceed four years.
  - It is important that rules governing conflicts of interest are introduced across all sectors.
  - The funding and regulatory bodies should standardise governance information within annual reports in all sectors.
  - All organisations should re-examine their arrangements for publicising codes of practice, and whistleblowing arrangements, to ensure that staff are left in no doubt about these.
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