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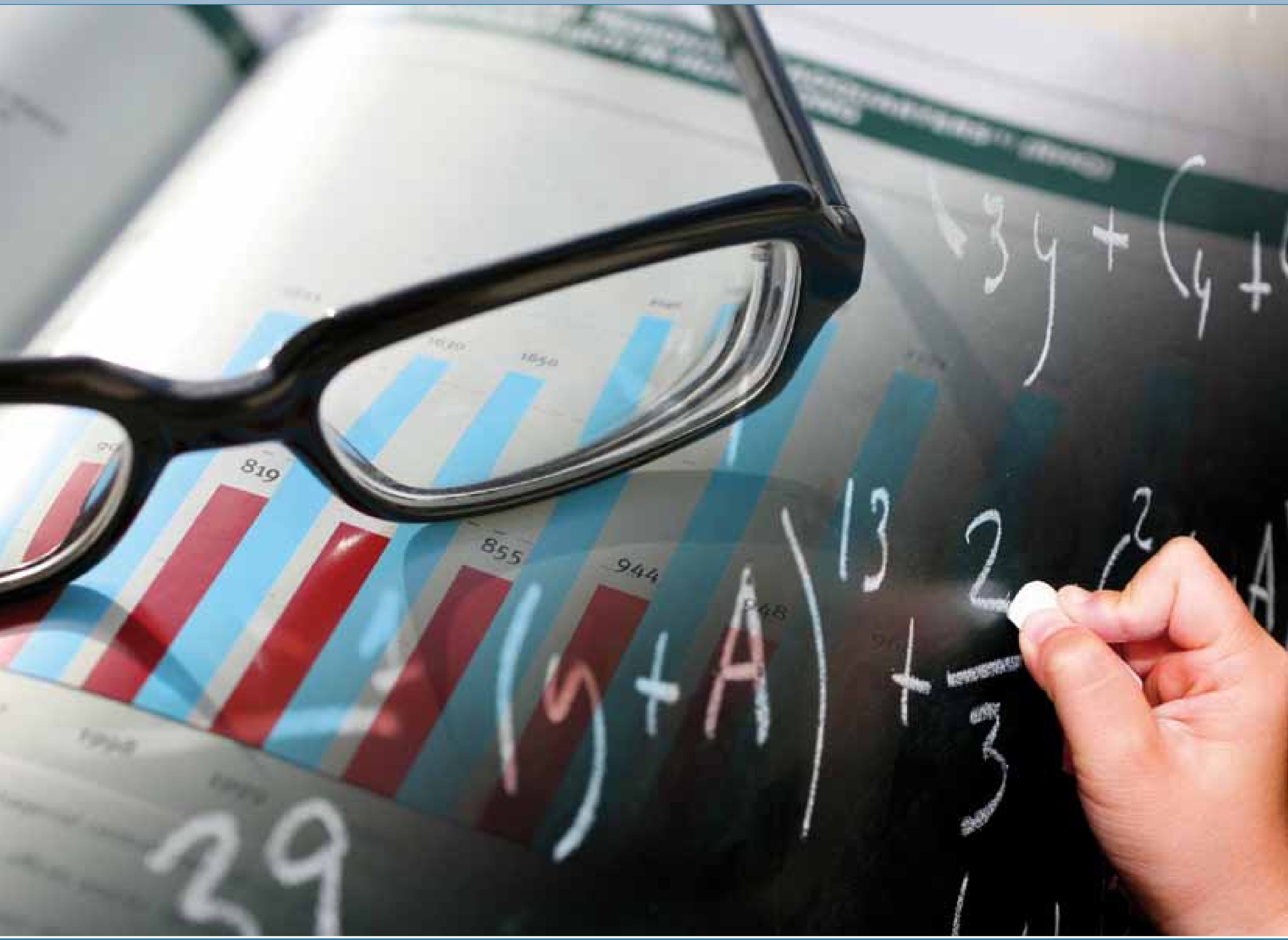
Northern Ireland Audit Office

Review of Financial Management in the Further Education Sector in Northern Ireland from 1998 to 2007

Governance Examination of Fermanagh College of Further and Higher Education



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

NIA 98/08-09 25 March 2009

Northern Ireland Audit Office

Report by the Comptroller and Auditor General for Northern Ireland

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This report has been prepared under Article 8 of the Audit (Northern Ireland) Order 1987 for presentation to the Northern Ireland Assembly in accordance with Article 11 of that Order.

J M Dowdall CB
Comptroller and Auditor General

Northern Ireland Audit Office
25 March 2009

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Review of Financial Management in the Further Education Sector in Northern Ireland from 1998 to 2007

Abbreviations

BIFHE	Belfast Institute of Further and Higher Education
BMC	Belfast Metropolitan College
CDP	College Development Plan
DFP	Department of Finance and Personnel
FE	Further Education
FEC	Further Education College
FLU	Funded Learning Unit
FTE	Full Time Equivalent
SIC	Statement on Internal Control
NIA	Northern Ireland Assembly
NIAO	Northern Ireland Audit Office
PFI	Private Finance Initiative
SPUR	Student Powered Unit of Resource
WBL	Work Based Learning
WTE	Whole Time Equivalent

Glossary

Audit Code - The guidance contained in this Code embodies the Department's requirements in relation to funding and specifically the audit function. It also provides a framework within which further education colleges and Governing Bodies should operate.

Funding Formula - the main source of income for the colleges is the recurrent grant funding. The Department allocates this funding through a funding formula known as Student Powered Unit of Resource (SPURS) which determines the share of the recurrent further education budget to be received by each college. The Funding Formula is based on student recruitment, attendance and outcome, i.e. successful completion of course and qualification.

College Principal - The Principal is responsible for ensuring the college maintains, to the satisfaction of the Department, an appropriate system of financial management, which should take account of any advice issued by the Department. He/she should ensure that there are adequate procedures, controls and structures within the college which conform to the requirements of propriety and of economical, efficient and effective financial management.

Statement on Internal Control (SIC) - From 2001-02, Government departments were required to prepare Statements on Internal Control to cover all controls, including financial, operational, compliance and the management of risk. Previously these statements only referred to financial controls.

Financial Recovery Plans – Colleges whose financial performance deteriorates are required to provide the Department with a financial recovery plan setting out their planned response. The Department issued "Guidance on Colleges in Recovery" to all colleges in April 2003 which addressed the issues of benchmarks to be used in assessing the need for a recovery plan, the content of the plan, and suitable timetables.

Efficiency Reviews - Where a college's recovery plan is not satisfactory the Department has powers to carry out its own efficiency review "designed to improve the economy, efficiency and effectiveness of the management or operation of an institution of further education".

FE Estates Strategy - In April 2004, the Department issued the FE Estate Strategy Circular[1] to FE Colleges. The purpose of the circular is to provide guidance to the Further Education sector on the development of Estate Strategies, the value and use of their accommodation, life cycle maintenance, and regular review of accommodation needs to reflect changing business objectives and demands.

Operating Surplus/(Deficit) – Operating surpluses/(deficits) represent the financial results for the year after taking into account all costs including depreciation based on the revalued amount of the fixed assets.

Historic Surplus/(Deficit) - The historic surpluses/(deficits) represent the financial results for the year after taking into account all costs excluding the difference between the depreciation calculated on the historic cost of the assets and the actual charge for the period calculated on the revalued amount of the fixed assets.

1 *FE Estate Strategy*, Department for Employment and Learning, 5 April 2004, Circular Number FE 03/04

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Executive Summary

Executive Summary

1. Further Education Colleges (FECs) have an important role in providing education and training programmes in Northern Ireland. They attract a diverse community of learners on a voluntary basis, with different educational backgrounds, abilities, aspirations and needs. In the 2006-07 year, the FECs had income totalling £231 million.

2. We last reported on the Further Education sector in 1999, after its reorganisation in 1998[2]. At that time, NIAO recognised the sector's vulnerability to financial health problems and we recommended ways to improve financial management and control. Appendix 3 to this report summarises our recommendations in the 1999 report.

3. The colleges subsequently had mixed financial fortunes with some of them at times experiencing serious financial problems in the period we are now reporting on: 1 April 1998 to 31 July 2007. We review the Department for Employment and Learning's oversight of the sector and its key interventions in colleges.

4. Issues raised with some of the former colleges included, for example, budgetary controls and the quality of financial reporting to senior management. These are basic elements of management, and ones which we had highlighted in our 1999 report.

5. On 1 August 2007 the Further Education sector was restructured and the 16 existing colleges were merged to form six larger area-based colleges (see Figure 1 on page 3). In view of the importance of the sector to Northern Ireland, the amount of money it spends each year, and new arrangements for the Northern Ireland Audit Office (NIAO) to audit the colleges, this report reviews the governance arrangements and financial stewardship of the 16 former colleges. It also draws out lessons to be learned by the new colleges going forward.

6. The lifetime of the former colleges, between 1998 and 2007, was a period when there were significant and sustained developments in governance arrangements in public bodies in Northern Ireland. This largely mirrored developments in large private sector bodies. By and large, the Further Education sector reflected these. Occasional significant lapses illustrate that it is not sufficient to have governance structures in place: they need to operate intelligently and effectively.

7. This report also flags up likely future challenges for the sector. We highlight that it has seen tens of millions of pounds of new investment and associated financial obligations under the Private Finance Initiative. In common with the rest of the public sector, it has also seen new arrangements to account for pension liabilities which make them more transparent than was previously the case. Colleges will operate new funding arrangements to meet these financial challenges, and we emphasise the need to have strong financial management and accountability to ensure they proceed on a sound financial footing.

Figure 1 - Location of the 16 existing Further Education Colleges and groupings for the six Area Based Colleges

*Indicates more than one campus in this town

Southern Regional College
Armagh College of Further & Higher Education
Newry & Kilkeel Institute of Further & Higher Education
Upper Bann Institute of Further & Higher Education

Belfast Metropolitan College
Belfast Institute of Further & Higher Education (BIFHE)
Castlereagh College of Further & Higher Education

Northern Regional College
Causeway Institute of Further & Higher Education
East Antrim Institute of Further & Higher Education
North East Institute of Further & Higher Education

South Eastern Regional College
East Down Institute of Further & Higher Education
Lisburn Institute of Further & Higher Education
North Down & Ards Institute of Further & Higher Education

South West College
East Tyrone College of Further & Higher Education
Fermanagh College,
Omagh College of Further Education

North West Regional College
Limavady College of Further & Higher Education
North West Institute of Further & Higher Education

Part One: Introduction

Part One: Introduction

1.1 The 16 Further Education Colleges (FECs) in Northern Ireland provide a wide range of education and training programmes. In 2006-07 just over 151,000[3] students were enrolled on vocational courses at these colleges of which 79 per cent were part time.

1.2 Unlike the school and university sectors whose student numbers are relatively constant, the majority of enrolments, approximately 70 per cent, in the further education sector are for one year or less. The colleges must identify and provide courses and services at different levels, in different modes, and in a variety of locations. The colleges attract a highly diverse community of learners on a voluntary basis, with different educational backgrounds, abilities, aspirations and needs. Colleges both compete and collaborate with other providers in their areas such as schools, higher education institutions, private providers, community groups, in-house company training, and other colleges.

1.3 Each college is managed by a Governing Body which assumed ownership and control of all the assets and liabilities at the date of transfer. The Governing Body is responsible for ensuring the college has a sound system of internal control, including safeguards against theft and fraud.

1.4 On 1 August 2007 the FE sector was restructured and the existing 16 colleges were merged to form six larger area-based colleges (see Figure 1 on page 2). The Department's rationale for this was to enable the provision of leading edge facilities which can better meet skills training required by the rapidly changing economy. This report focuses on the financial management of the further education sector up to 31 July 2007, prior to the mergers.

Progress since previous NIAO Report on Corporate Governance and Financial Management in Colleges of Further Education

1.5 Following publication of the NIAO report Corporate Governance and Financial Management in Colleges of Further Education, the Department wrote to all colleges in February 2000 asking them to review their position in relation to the recommendations made in the report. Appendix 3 outlines the key recommendations made in the report and the main areas that colleges had not fully addressed.

Audit and Accounting Arrangements

1.6 Colleges are required to prepare a statement of accounts for each financial year ending 31 July.

1.7 In accordance with Article 19 (2) of the Further Education (Northern Ireland) Order 1997, the accounts are audited in the manner directed by the Department, with the approval of the Department of Finance and Personnel (DFP). Since the incorporation of the sector, the Department has directed the Governing Bodies to appoint their own external auditors.

3 Source: DEL Tertiary Education and Analytical Services Branch - full year enrolment data for the further education colleges

Similar arrangements apply in England and Wales but in Scotland the Auditor General has been responsible for securing the audit of all FECs since 1 April 2000. Each college has appointed external and internal auditors from commercial accountancy firms.

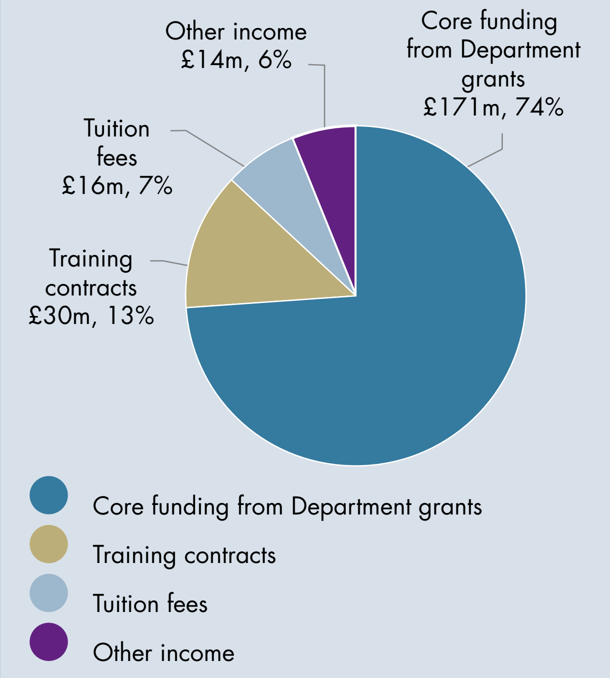
1.8 The Comptroller and Auditor General (C&AG) therefore did not audit the accounts of the 16 further education colleges but as auditor of the Department, had right of access to the books, accounts and records of college governing bodies.

1.9 The Further Education (Northern Ireland) Order 1997 required the governing body of an institution of further education to prepare accounts and have them audited in such a manner as the Department may, with the approval of DFP, direct. For financial years prior to 2007-08 the Code of Guidance on Audit for the Governing Bodies of Further Education Colleges issued by the Department required governing bodies to appoint their own external auditors. Following reorganisation of the colleges, the Department proposed that the C&AG should be appointed external auditor with effect from the 2007-08 accounts. DFP obtained the Assembly's approval and made the necessary Order in December 2008.

1.10 The Governing Body of each College is required to appoint an Audit Committee to take responsibility for the appointment and terms of reference for the internal auditors.

Income

1.11 During 2006-07 the 16 colleges recorded a total income of £231 million. The source of this income was:



- *Core funding from Department grants* - Allocated using the funding formula.
- *Training contracts* - Funded by Department for training and courses other than those defined as 'further education', for example Jobskills and New Deal.
- *Tuition fees* - These are collected from students or, in the case of students entitled to financial assistance, from the Student Loans Company.
- *Other income* - includes EU funds and investment income.

Part One: Introduction

Role of the Department for Employment and Learning

1.12 The relationship between the Department and the colleges was governed by a Financial Memorandum. This is the official financial guide for the Governing Bodies and managers of Further Education Colleges. It complements, but does not override, relevant education legislation for Institutions of Further Education. It provides guidance for colleges on managing their finances and sets out the terms and conditions for the payment of grants by the Department to the Governing Bodies.

1.13 The Department issued a Code of Guidance on Audit for Governing Bodies of Further Education Colleges, known as the Audit Code, for the use of internal and external auditors, senior managers in the college, and members of the Governing Bodies, particularly those appointed to the Audit Committee. The Department is also responsible for reviewing the systems and controls to ensure that high standards of financial management are in place, public finances safeguarded and value for money achieved.

Role of the College Principal

1.14 Under the colleges' Articles of Government the college principal is the chief executive of a college. The chief executive of each Further Education College is appointed as the accounting officer of their college by the Departmental Accounting Officer and is responsible to the Departmental Accounting Officer and the Northern Ireland Assembly for the proper stewardship of expenditure.

1.15 Against this background this report examines:

- financial stewardship since incorporation (Part 2);
- financial health of the sector since incorporation (Part 3);
- departmental monitoring and oversight systems (Part 4); and
- recent developments in the sector (Part 5).

Part Two:
Financial Stewardship in the FE Sector

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Completion of Accounts and Audits

2.1 The Department relies on the governance controls operated by each of the colleges and reviews the associated outputs, that is, the Audit Committee's annual report, Internal Audit reports and annual report and external auditors management letters. These are reviewed to identify any major issues such as weak governance, non compliance with guidance, and failure to operate procedures.

2.2 The Financial Memorandum and Audit Code state that the Governing Body of each college is required to submit to the Department a copy of its audited accounts for the financial year ended 31 July as soon as possible after the financial year end and no later than 30 November.

Timeliness of Accounts

2.3 The accounts of North East Institute for the three financial years, 2000-01, 2001-02 and 2002-03 were not signed until November 2003. The financial difficulties of North East are examined in the Case Study in Appendix 2.

2.4 The Department recognised that it should have been more proactive in enforcing the requirements of the Financial Memorandum to submit accounts against a specified timetable and wrote to all Colleges in February 2004 reminding them of the timetable for submission of draft and audited accounts.

2.5 The accounts of Fermanagh College for both the 2004-05 and 2005-06 financial years were only signed in February 2007 and the audits completed in May 2007. The Department has advised that the delay in the accounts being signed was due to the finalisation of the College's agreement of how to repay £1.1 million of Work Based Learning funding to the Department.

2.6 All of the sixteen college accounts for 2006-07 were received by the Department by the 30 November deadline.

Auditors' Opinions on the Accounts

2.7 Since the incorporation of the colleges in 1998 none of the colleges' accounts have been qualified.

External Audit

2.8 The external auditors report to and agree their audit findings with the colleges, and the management letters are copied to the Department. A summary of the main issues arising in the sector is prepared by the Department and issued as a circular to the Directors, Principals, and Finance Officers of each college. A copy is also issued to the Chairs of each college's Audit Committee.

2.9 Common issues raised by external auditors over the last few years included:

- absence of strong financial management and budgetary controls;
- inaccurate financial reporting to senior management which contributed to a significant deficit at one college not being identified until after the end of the financial year, and to two College deficits not receiving the required approval;
- failure to comply with procurement guidance;
- failure to complete key reconciliations (e.g. bank, accounts receivable and supplier statements);
- poor linkages between business planning and financial planning;
- failure to fill finance vacancies despite the Department having provided the funding;
- outstanding debtors not being regularly reviewed and pursued;
- appropriate numbers of tenders not being obtained and non compliance with purchasing thresholds detailed in the Financial Memorandum;
- lack of robust business continuity/ disaster recovery plans; and
- poor controls over fixed assets and the associated register.

Governance and Internal Control

Internal Control and Management of Risk

2.10 As the Department developed its own corporate governance arrangements, it required the Accounting Officers of the colleges to submit an annual stewardship statement to support the Department's Statement on Internal Control (SIC). The aim of these statements is to provide the Department's Accounting Officer with assurance in respect of compliance, governance and risk management within each college and details of any exceptions.

2.11 The sector as a whole was slow to embed risk management fully and the NIAO recommended that the Department should closely monitor full implementation. The Department accepted the recommendation and by 2003-04 all colleges but one, North East, had confirmed full compliance with DFP guidance in their 2003-04 accounts. The North East did have the appropriate risk management structures in place but had not accurately reflected this in its accounts.

Specific opinions on Corporate Governance arrangements

2.12 The Department recognised that Internal Auditors were not addressing the effectiveness of corporate governance arrangements. In 2002-03 colleges were reminded of the requirement to include self-assessment of governance as part of the internal audit programme. There were seven assurances provided in 2002-

Part Two: Financial Stewardship in the FE Sector

03 but this decreased to only three in 2006-07. The Department told NIAO that colleges normally have an internal audit plan based on their audit needs assessments which operate over a three year period. The review of governance arrangements is included within this planning cycle and is not normally required to be carried out annually.

Audit Committees

2.13 It is a responsibility of the Audit Committee of each College to provide additional assurance regarding the quality and reliability of financial information of the Body as well as financial statements issued by the college.

Deadlines for Annual Reports

2.14 Each Audit Committee was required to meet at least biannually and to submit to the Department an annual report on its activities. Only 10 of the 16 colleges submitted their 2004-05 Audit Committee Annual Reports by mid March 2005, with two of the colleges submitting their reports in November 2006 (Causeway) and January 2007, (Lisburn), over eight months after the Departmental deadline. This improved by 2006-07, with 15 of the 16 colleges submitting their reports by mid March 2008 and one, (Castlereagh) preparing a "statement of affairs" rather than a report. The statement of affairs was submitted on 31 March 2008. Following a NIAO recommendation, the new arrangements have now been incorporated in the revised Audit Code.

Audit Committee Membership

2.15 Best practice[4] is that the Audit Committee membership should have an appropriate skill mix to allow them to be effective in their function and they should hold regular meetings, at least four times per year.

2.16 The new merged colleges are of a much more significant scale in comparison to the 16 former colleges. The new colleges should fully comply from the outset with both the revised Audit Code and best practice[4] guidance issued to the colleges, advising of the requirement to provide a full and complete opinion to comply with the Audit Committee Handbook. The Department told NIAO that the key principles set out in Treasury, DFP and NIAO guidance on the role, membership, scope, operation and performance of Audit Committees, has been incorporated within the updated Audit Code. This includes the provision of a model terms of reference, model engagement letter for auditors and a requirement that each committee should provide an annual report on its work and how it has discharged its responsibilities. In addition, a Departmental representative will attend Audit Committee meetings to observe proceedings.

Internal Audit Annual Assurance

2.17 The internal auditors issue reports to the colleges on each system audited and, at the end of each financial year, provide an annual report to the colleges' Audit Committees summarising the work

4 Treasury Audit Committee Handbook (October 2003) and Audit Committee Handbook (March 2007)

Figure 2: Internal Auditors Annual Assurances

Assurance	For year ended 31 July:					
	2007	2006	2005	2004	2003	2002
Full	0	0	0	0	0	0
Substantial/High	12	11	6	5	5	4
Reasonable/Adequate/Partial	3	3	7	8	9	6
Limited/Reduced	1 [2]	1 [2]	2 [2]	2 [2]	2 [2]	5
No assurance	0	0	0	0	0	1 [5]
Total	16	15 [1]	15 [3]	15 [4]	16	16

1 Causeway Institute did not secure an internal audit service in 2005-06.
2 2006 & 2007 – Fermanagh, 2005 - Fermanagh and Upper Bann, 2003 & 2004 – North East and Castlereagh.
3 The Internal Auditors report for North East did not provide an annual assurance, it was more of a progress report.
4 The Internal Auditors annual report for Armagh was not available for NIAO review.
5 The internal auditor for Castlereagh did not provide any assurance as they felt that the one audit performed was not representative of the entire work of the college and due to going concern issues.

performed and providing an assurance on the systems of internal control. All internal audit reports are copied to the Department.

Follow up procedures for adverse opinions

2.18 Of the 16 colleges, the Internal Auditors offered varying opinions on the systems of internal control. Figure 2 summarises the assurances provided. The number of colleges receiving a substantial assurance increased from four in 2001-02 to 12 in 2006-07.

2.19 After reviewing the Internal Audit reports, the Department issues the colleges with a 'Main Issues' report, summarising the key findings so that lessons learnt can be applied to all Further Education Colleges. It was noted that the issues arising from the 2001-02 reports were only sent out to the FECs in February 2004, in a combined report with the 2002-03 issues.

2.20 In August 2004 NIAO recommended that the Department takes action if a college has received a 'limited' assurance or less from their Internal Auditors. The Department accepted this recommendation and confirmed in October 2004 that it had already introduced a follow-up system. However, due to staff shortages and the need to prioritise work the Department did not implement the agreed follow up procedures. Although the 2004-05 Internal Audit reports were received by the Department in January 2006 these reports were only starting to be assessed in February 2007.

Part Two:
Financial Stewardship in the FE Sector

2.21 On receipt of the Causeway Institute's 2005-06 accounts in November 2006, the Department discovered that the college did not have in place an internal audit service for 2005-06 or 2006-07. In addition, the College Audit Committee had met only once in 2005-06, whereas the Audit Code requires it to meet at least twice. As a result of a prolonged absence of a key member of Departmental monitoring staff and a backlog of work which had accumulated, it was April 2007 before the Department contacted the college requesting explanations for the omission of these corporate governance arrangements.

Internal Audit Risk Assessments

2.22 Following a review of the 2003-04 and 2004-05 internal audit programmes and reports, NIAO identified that one internal auditor provided the same approach at seven colleges. The Department was unaware of this until we brought it to its attention. Whilst it is acknowledged that there are many common systems of internal control across each of the colleges, it is likely that each of these systems will have its own inherent strengths and weaknesses. Therefore, it was surprising that risk assessments performed at these seven colleges could arrive at the same conclusions on risk and result in a very similar, or in some cases identical, audit programme.

2.23 The Department should be issuing guidance to the college Accounting Officers, Directors and Audit Committee members on the need for a full and proper risk assessment when determining the internal audit needs. It is also recommended that in 2007-08, the first year of the new area based colleges, Internal Audit should review the corporate governance arrangements of the new entities and that this should be followed up each year thereafter. Further, the Department should consider having its own internal auditors review the effectiveness of the audit approaches adopted by the new colleges' internal auditors periodically and, in particular, in their first year.

The Department told NIAO that the updated Audit Code issued to the new colleges contains detailed advice on the formulation of internal audit plans including the requirement that they are risk-based. It also requires the internal audit process to be carried out in line with the Government Internal Audit Standards which require risk-based planning. The Department also noted that Government Internal Audit Standards recommend that the internal audit service should be subject to external quality review. The Department has arranged for its own Internal Audit Service to carry out this review in the current year.

Part Three:
Financial Health of the Further Education Sector

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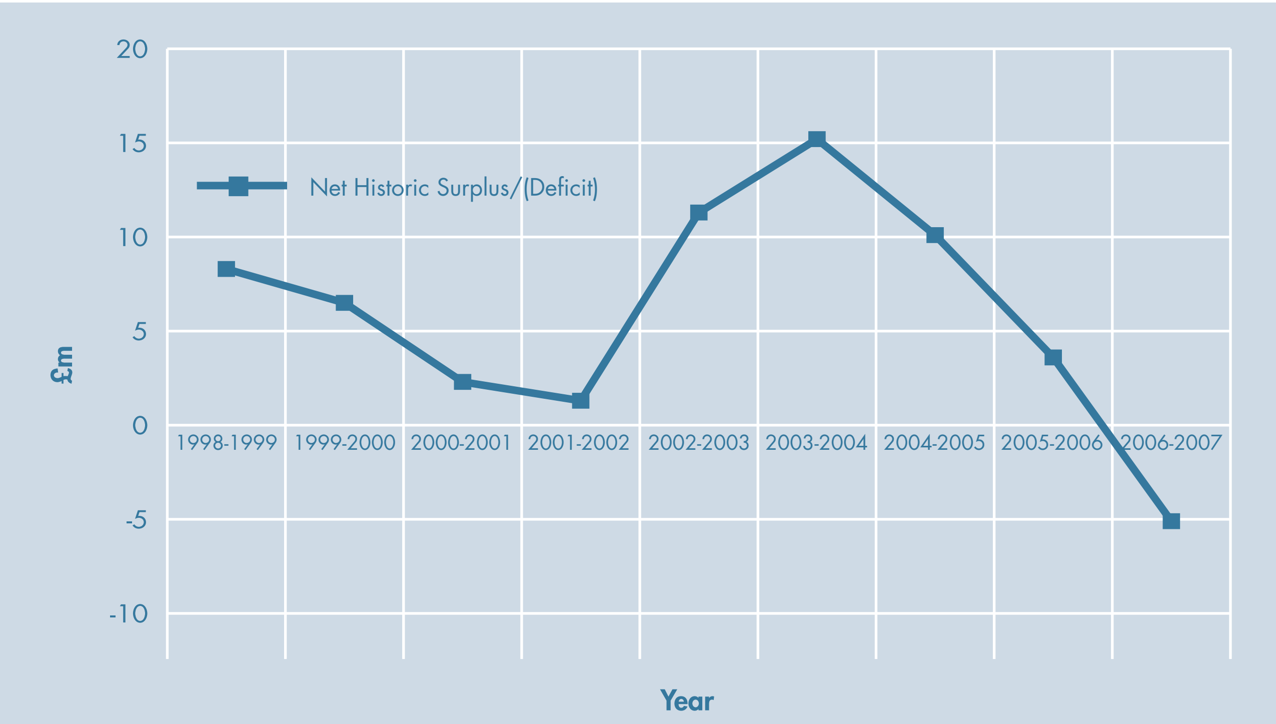
Financial Objectives of the Colleges

3.1 In broad terms, Colleges are required to break even each year in order to maintain their financial solvency. Although colleges may incur financial deficits in pursuit of longer-term objectives, they are required to clear any accumulated deficit by the end of the third financial year after the year in which the deficit began to accumulate.

Financial Results since Incorporation

3.2 At the date of incorporation (1 April 1998) six colleges had inherited deficits. Special arrangements were made for these colleges, with the Department providing advances to cover the inherited deficits. At 31 July 2007 three of these colleges had repaid the advances in full. The three remaining colleges, now part of three separate area-based colleges, will continue to repay loan advances to the Department; one is on target to repay its loan by 31 March 2009 with the other two colleges expect to repay by February

Figure 3: FE Sector Financial Performance since Incorporation



Source: NIAO (taken from the Department's College Circulars)

Note: The first accounts were for the sixteen month period April 1998 to July 1999.

and March 2010 respectively. At the date of the merger the combined value of the outstanding repayments was £1.3 million, of which £0.8 million relates to one college, North West.

3.3 As shown in Figure 3 above, the sector as a whole saw declining surpluses in the three years up to 31 July 2007. The sector moved from a position in 2003-04 of having an annual net historic surplus of £15.2 million and no colleges in deficit, to a position in 2006-07 where there was an annual net historic deficit of £5.1 million and a total of eight of the 16 colleges contributing to a gross deficit of £8.9 million. Three colleges incurred a combined deficit of £6.8 million; BIFHE, Newry, and Castlereagh.

3.4 In the financial memorandum issued to the colleges, advanced approval was required for any colleges expecting to incur a deficit. However, this memorandum did not specify whether this meant an operating deficit or a historic deficit (see glossary of terms). This left this requirement open to interpretation. In practice, colleges appeared to use the operating deficit figure, however, the financial memorandum has since been updated and specifically asks for approval only where a historic deficit has been incurred. Therefore, throughout this report there are references to both operating and historic figures.

Figure 4: Colleges that have experienced serious financial difficulties

College financial year	Annual historic cost surplus/(deficit)						
	BIFHE £'000	Castlereagh £'000	East Antrim £'000	Fermanagh £'000	Lisburn £'000	North East £'000	North West £'000
1998-1999	452	152	210	655	309	266	1,190
1999-2000	(176)	(224)	318	576	(345)	241	1,161
2000-2001	1,414	(276)	321	549	(448)	(200)	(1,835)
2001-2002	2,413	(205)	(58)	350	238	(1,097)	(1,721)
2002-2003	4,658	908	192	275	395	(151)	971
2003-2004	3,806	785	211	416	517	792	1,139
2004-2005	2,630	171	(335)	(788)	592	838	1,620
2005-2006	(582)	(287)	(153)	(306)	251	222	640
2006-2007	(2,451)	(1,022)	132	(935)	207	(459)	(69)

Source: NIAO (taken from the Department's College Circulars)

Part Three: Financial Health of the Further Education Sector

Colleges in Serious Financial Difficulties (Figure 4)

North East

3.5 In 2000-01 the North East got into significant financial difficulty and went on to incur significant deficits for three financial years in succession. The circumstances giving rise to these deficits are considered in the Case Study in Appendix 2.

Castlereagh

3.6 On 1 December 2006 Castlereagh College was granted approval to incur an operating deficit of £637,000 for 2006-07. Reasons given by the college for the deficit included:

- unanticipated cut of £347,000 in SPURS funding coupled with additional staffing appointments in anticipation of a budget increase; and
- cost of living and inflationary pressures in staffing and non-staffing costs.

The Department only became aware that the college's deficit had increased significantly, on receipt of the draft accounts in October which showed an expected operating deficit of £1,329,000. At the audit committee meeting on 13 November 2007 a final draft account was presented for the college and it was noted that the operating deficit had increased from £637,000 to £1,207,000 (historic deficit of £1,022,000). Approximately £102,000 of this related to a non cash adjustment for uplift in pension costs. Allowing for the uplift in pension costs, the college was £468,000, or 5.5 per cent, of total income in excess of the approval granted by the Department.

3.7 In 2005-06 the College made an operating deficit of £472,000. No approval was granted for this deficit.

East Antrim

3.8 East Antrim experienced financial difficulties in 2004-05 and 2005-06, resulting in deficits of £335,000 and £153,000 respectively. The Department met with college representatives in August 2006 to ascertain the reasons for this deficit financial position.

3.9 The Department continued to monitor the financial position of East Antrim closely. The accounts showed a historic surplus to 31 July 2007 of £132,000 which increased reserves to £604,000. The Department recommended that colleges maintain reserves at a level of between 5 per cent and 10 per cent of income; given that East Antrim's income for 2006/07 was £10,814,000, £604,000 is within this range.

Fermanagh

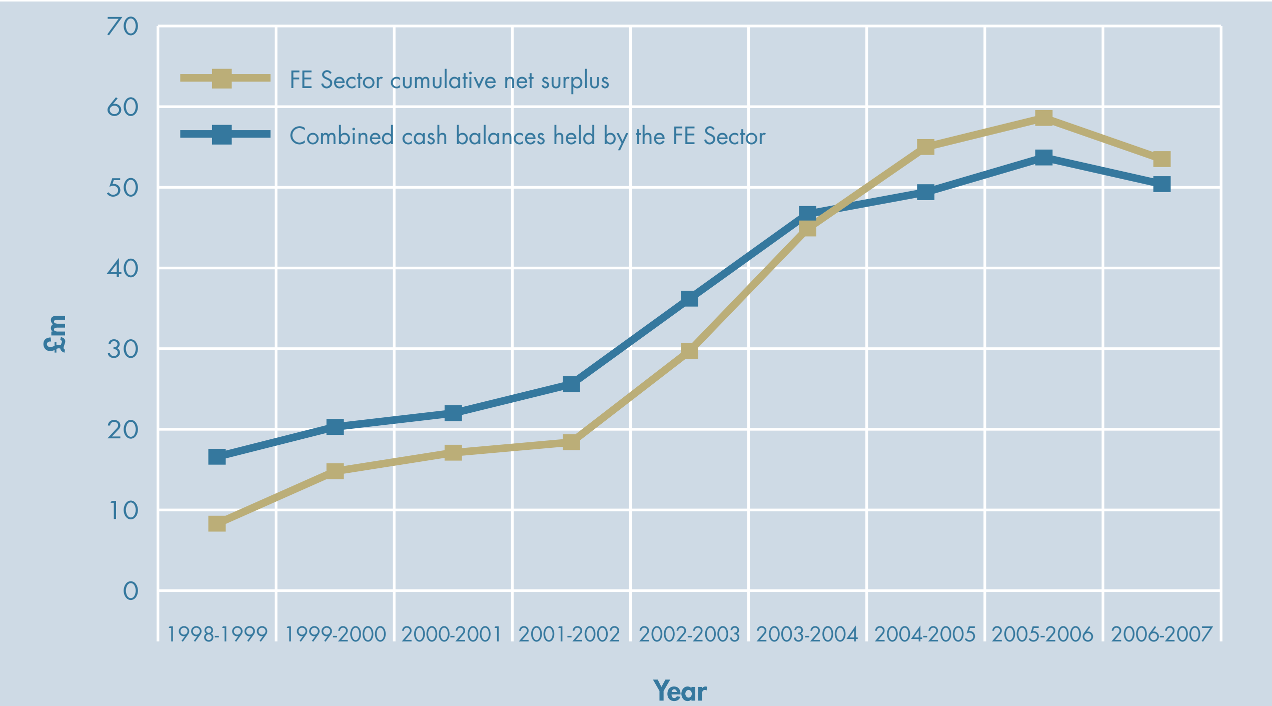
3.10 Fermanagh College reported a historic deficit of £788,000 in 2004-05 followed by deficits of £306,000 in 2005-06, and £935,000 in 2006-07. The main reason for the deficits in 2004-05 and 2005-06 was late adjustments made for Work Based Learning funding incorrectly claimed of £1.1 million, received over the first two years, which had to be repaid to the Department. The main reason for the deficit in 2006-07 was the clawback of £600,000 in relation to Republic of Ireland (RoI) residency issues.

BIFHE

3.11 In 2005-06, BIFHE sought approval from the Department for a projected deficit of £1 million. Subsequently, the Department notified all college Directors of a miscalculation in the funding calculation. This error was corrected by a revision of the in-year budget allocation requiring funding to be redistributed throughout the sector. This reduced BIFHE's budget allocation by £1.3 million. The College subsequently applied to the Department in November 2005 and received deficit approval of £2.3 million. Due to actions taken by BIFHE management, including redundancies, the actual year-end operating deficit was reduced to £1.4 million (historic deficit £0.6 million).

In 2006-07 BIFHE incurred an operating deficit again of £3.2 million (historic deficit £2.5 million). Approval had been sought from the Department for the anticipated deficit but the amount approved was £1.2 million less than the actual deficit incurred.

Figure 5: FE accumulated net surplus and combined cash balances



Part Three: Financial Health of the Further Education Sector

3.12 The steps taken by the Department to monitor and ensure the ongoing financial health and stability of colleges projecting and reporting deficits are covered in Part 4.

North West

3.13 In 2000-01 and 2001-02 the North West incurred significant deficits. The circumstances surrounding this are dealt with in paragraphs 4.6 to 4.8.

Accumulation and Retention of Cash Reserves

3.14 Despite a number of colleges facing serious financial difficulties, some colleges have accumulated significant cash balances as a result of the sector overall being in a net surplus position each year up until 2005-06. These surpluses have been retained mainly as cash balances within the colleges' accounts.

3.15 At the end of the first year of incorporation of the colleges as independent bodies, the combined cash balances held by the FE Sector were £16.6 million. This represented 9.5 per

Figure 6: Combined cash balances held by FE Colleges

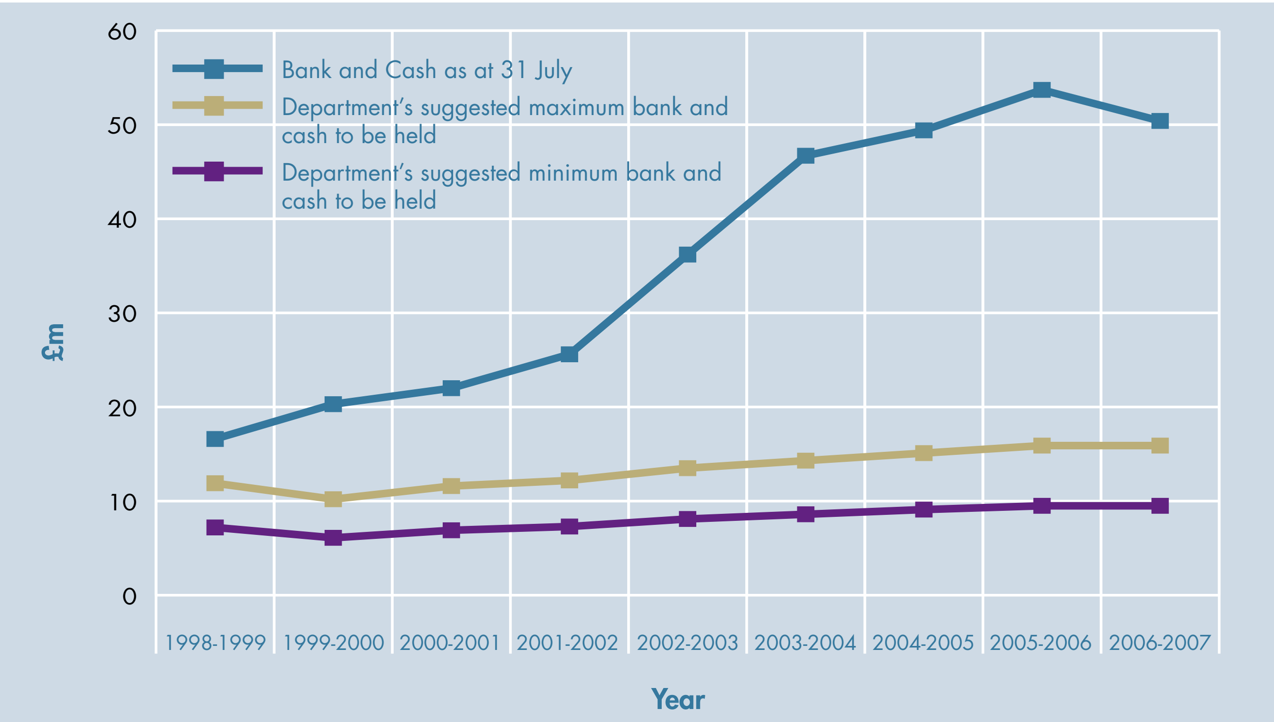


Figure 7: Cash balances held by FE Colleges against Income for 2005-06

College	2005-06 Income (£'000)	Cash at bank (£'000)	Cash/Income (%)
Limavady	8,303	4,439	53.46
Newry	17,718	8,673	48.95
Causeway	8,433	2,990	35.46
Lisburn	7,861	2,589	32.93
Upper Bann	14,046	4,336	30.87
Armagh	7,570	2,219	29.31
East Down	8,872	2,305	25.98
East Tyrone	9,080	2,170	23.90
BIFHE	47,885	11,028	23.03
North Down	18,645	4,228	22.68
Fermanagh	9,554	1,810	18.94
North East	16,345	2,774	16.97
Castlereagh	8,965	989	11.03
Omagh	10,655	1,086	10.19
East Antrim	10,293	785	7.63
North West	27,555	1,247	4.53
Total	**231,780**	**53,668**	**23.15**

Source: NIAO (taken from the Department's College Circulars)

cent of annual income which was in excess of the Department's recommended range of 4.11 per cent - 6.85 per cent. As shown in Figure 5, the level of cash reserves held increased steadily over the years broadly in line with college's accumulated net surpluses to a level of £53.7 million by 2005-06, representing 23.15 per cent of annual income. In effect, at the end of the 2005-06 year, the combined FE sector held £37.8 million of cash in excess of that recommended by the Department (Figure 6). The cash balances reduced to £50.4 million in 2006-07.

3.16 In particular Newry College and Limavady College had accumulated significant cash balances by the end of 2005-06 relative to income. Newry held £8.7 million in cash reserves, which represented 49 per cent of its annual income, well in excess of the Department's recommended maximum of

Part Three: Financial Health of the Further Education Sector

£1.2 million or 6.85 per cent. Limavady had cash reserves of £4.4 million which represented 53 per cent of its annual income compared to the Department's recommended maximum of £569,000 or 6.85 per cent.

Department's response

3.17 The Department has stated that the main purposes for accumulating cash in the sector were as follows:

a. the need for a contingency /working capital to ensure that the college would have enough cash to meet payments;

b. to protect against fluctuations in Student Powered Unit of Resource (SPUR) allocations – as funding was based on activity from two years previously, if a college expanded, reserves provided a cushion to allow them to finance their growth until the SPURS funding "caught up"; and

c. colleges would put money aside and earmark it to carry out periodic maintenance programmes or capital development.

3.18 The Department said that it has monitored the cash position and that is why in 2005 the decision was taken to move to a new funding formula for 2007-08. With the change in funding approach, this has removed the need to protect against fluctuations in SPUR allocations and the Department is actively working to reduce excess cash balances. In future, colleges will be permitted to retain reserves of a specific amount to fund approved development and as a contingency. The Department told NIAO that the Financial Memorandum now requires the new colleges to seek approval if they are anticipating a historic surplus in excess of two per cent of income as well as a deficit. The Financial Memorandum also now requires colleges to provide an explanation for any uncommitted reserves in excess of 10 per cent of their income.

3.19 Over the next three years the Department has made a commitment under the Comprehensive Spending Review to reduce the level of cash and reserves in the sector. The Department is currently looking at ways of 'means' testing the award of funding and as part of this, the reserve and cash position of the colleges will be considered.

Part Four:
Departmental Monitoring and Oversight Systems

Part Four: Departmental Monitoring and Oversight Systems

Financial Monitoring Arrangements

4.1 Since incorporation the Department has had in place the following arrangements to monitor the financial health of colleges:

- annual College Development Plans (CDPs) that contain financial forecasts for a three year period;
- quarterly financial statements in December, March and June of each year;
- draft Annual Accounts in September of each year;
- audited Annual Accounts in November of each year;
- analysis of financial returns for trends and performance against financial ratios; and
- review of Internal Audit reports and Annual Reports, External Auditors management letters, and Audit Committee Annual Reports.

4.2 Although the financial monitoring controls are important, their effectiveness is conditional on the reliability and accuracy of the financial information submitted by the colleges and how the Department uses this.

4.3 These monitoring systems have not always been fully effective in providing early warning of financial pressures or non-compliance with best practice in Good Governance. Examples noted are:

- The Department was only made aware in September 2001 that the North West deficit for 2000-01 was three times the budgeted deficit and that the college was in serious financial difficulties. This was due to inaccurate quarterly financial information provided.
- The Department did not receive any quarterly financial returns from Fermanagh College from September 2005 to July 2007.
- At the Causeway Institute there was no provision of an Internal Audit service in the college during 2005-06 and 2006-07, and the Audit Committee met only once during 2005-06.
- During 2005-06, East Antrim held only one audit committee meeting. The Audit Code in place at the time required at least two meetings during the year.
- In 2006-07 BIFHE and Castlereagh significantly exceeded their deficit approvals by £1.2million and £0.5million respectively.
- As noted in Figure 5, the cash reserves of the FE Sector have increased significantly since incorporation, to levels in excess of limits recommended by the Department.

Colleges with Financial Recovery Plans

4.4 Since incorporation seven of the 16 colleges have been required to prepare and submit formal recovery plans to the Department:

1998-1999 – Limavady, North West, East Antrim and Omagh (these were inherited deficits on incorporation)
1999-2000 – Castlereagh
2000-2001 – Lisburn
2001-2002 – North East, North West

4.5 The financial results for 2002-03 showed that the colleges with recovery plans were meeting their targets to eliminate the deficits. At the beginning of the 2006-07 academic year, six colleges had recovery plans in place. These recovery plans forecast that the individual colleges would take between three and seven years to eliminate the deficit.

North West

4.6 North West budgeted a planned deficit of £0.7 million in 2000-01 and this was approved by the Department. However in September 2001 the Department was notified for the first time of a deficit of £2 million in the draft accounts. As a result the Department appointed consultants to evaluate the financial systems, records and procedures at the college and to identify the causes of the year-end deficit.

4.7 The consultants report highlighted:

- deficiencies in the financial reporting and budgeting system;
- financial reports not issued to the senior management team;
- significant overspends in part-time lecturers and overtime costs of £1million; and
- failure of the College to claim Jobskills income of £0.6 million to which it was entitled.

4.8 North West Institute worked with consultants to prepare a recovery plan which was forwarded to the Department. North West has actioned the recovery steps included in the recovery plan and has returned to a stable financial position.

Fermanagh

4.9 Fermanagh College's Governing Body, following advice, guidance and assistance from the Department, commissioned consultants in February 2006 to carry out a comprehensive review of financial management within the College. Fermanagh College is to repay in excess of £1million of Work Based Learning (WBL) funding it incorrectly claimed. The background and conclusions on WBL provision is examined in detail in the NIAO Report on 'Governance Examination of Fermanagh College of Further and Higher Education'.

Efficiency Review

4.10 In addition to the work at the North West Institute and Fermanagh College, the Department carried out an efficiency

Part Four: Departmental Monitoring and Oversight Systems

review at the North East Institute in December 2002 as a result of financial difficulties.

4.11 In January 2002 North East was requested to prepare and submit a recovery plan to the Department by 31 July 2002. The independent assessment of the recovery plan by consultants concluded that it was of poor quality and was not explicit enough to indicate where savings would be made.

4.12 The Efficiency Review report identified a number of areas contributing to the Institute's financial difficulties. These included weaknesses in the management and governance arrangements. Further details are included in Appendix 2.

Causes of Deficits - Common Themes

4.13 The main reasons for deficits were:

- poor financial controls;
- inadequate financial systems;
- insufficient information provided to management or Governing Body to enable decisions to be made;
- poor linkages between business planning and financial planning; and
- failure to appoint a Finance Officer despite the Department having provided the funding.

Lessons Learned

4.14 There are common lessons resulting from the reviews carried out of the colleges in recovery which have highlighted a number of preventative measures that colleges should consider. These include:

- ensuring that the Governors have the requisite mix of skills and experience needed, combined with receiving both appropriate induction training and regular training updates;
- considering the viability of courses;
- properly costing all changes in course provision;
- the need for good quality accounting and support staff;
- the need for good quality management information which is both accurate and timely;
- more detailed information being issued to the Governing Body and the Finance Committee[5];
- the need for contact teaching hours to be benchmarked against the sector average to identify if there is any spare teaching capacity being funded but not fully utilised;
- ensuring that any inefficiencies in the estate are dealt with promptly;

5 Departmental circular FE 2/2000

- the setting of a strict timetable for colleges to complete and submit a recovery plan;
- ensuring that all colleges have the experience and expertise to prepare a robust recovery plan first time; and
- ensuring the commitment and support of the senior management team in the college to the recovery process.

4.15 The Department has built on the experience of the recovery process in the various colleges and has recognised that the lack of appropriate expertise in recovery within colleges needs to be addressed, by requiring colleges to draw on external skills as appropriate, and providing financial support for the process as necessary.

Part Five:
Recent Developments

Part Five: Recent Developments

Review of Further Education Strategy – FE Means Business

5.1 In 2002, the Department embarked on a major policy review of the statutory further education sector. This followed a report on Education and Training for Industry published by the Assembly Committee for Employment and Learning. A key milestone was the publication, in February 2004, of a strategy document - *Further Education Means Business.*

5.2 The paper identifies key areas requiring action, including:

- a need to strengthen the contribution of the sector to economic development;
- a need for a sharper focus on performance outcomes. Some colleges are more successful than others in helping learners gain qualifications. The variation in success rates across the colleges ranges from an overall 57 per cent to 84 per cent;
- a need to promote greater collaboration both within the sector and with other institutions, such as the universities, schools, training organisations and the voluntary and community sectors;
- a need to consider the size and structure of the sector to take full advantage of economies of scale and to have sufficient critical mass to support greater specialisation, expertise and excellence; and
- strengthening financial management and accountability through improved governance structures.

Restructuring of Colleges and Changes to FE Funding Formula

5.3 The government's future strategy for further education *(Further Education Means Business)* has led to the merger of the existing 16 colleges on 1 August 2007 to create six larger and more influential area-based colleges.

5.4 From September 2007 the Department also introduced a new funding model for the FE sector based on Funded Learning Units (FLUs). This replaced the current SPURS funding formula. The changes to the funding model are the direct result of the review of FE funding, which was one of the projects within the FE programme, established in 2005 to implement *Further Educatiion Means Business.*

5.5 The new method sets a standard course or unit funding at £3,400, which equates approximately to a full-time course. (Full-time courses can vary slightly in duration, in terms of taught hours.) Part-time courses are "rolled up" to a unit of funding, based on the number of taught hours. Weightings are then applied to the unit of funding to reflect the course level and the economic priority of the skill area. At a college level, those colleges in disadvantaged areas will also receive a higher weighting.

FE Estate Strategy

5.6 The existing 47 FE campuses have remained when the 16 colleges merged into six, as the new colleges aim to promote increased collaboration across all 47 campuses and to bring greater choice and ease of access for learners.

5.7 Colleges are required to develop an estate strategy which should be linked to the College Development Plan. The Department will seek evidence from colleges, on at least an annual basis, of progress made in implementing proposals. Departmental capital funding will only be made available where the college has a formal estates strategy in place and can demonstrate the link to capital renewal and re-investment.

Private Finance Initiative (PFI) Contracts in Colleges

5.8 The estates strategies help inform all accommodation investment decisions, including PFI deals. These typically commit colleges to financial obligations over periods of 25 to 30 years. There are currently seven PFI contracts either in place or being developed in the FE college sector in Northern Ireland (see Figure 8).

Pension Liabilities

5.9 From 2006-07 the Colleges were required under Financial Reporting Standards to disclose in their annual accounts their share of the assets and liabilities of the defined benefit pension schemes to which they contribute. Prior

Figure 8: PFI Contracts Awarded in the FE Sector

College	Capital Value £M	Status of Contract	Date property available for use
North West	10	Completed	February 2001
BIFHE	20	Completed	August 2002
Omagh	17	Completed	November 2006
East Tyrone	18	Completed	March 2007
East Down	40	Joint deal – contract now signed	From June 2010*
Lisburn			
Belfast Met	44	At procurement stage	January 2011*
Total	**149**		

Source: Department

* Dates are approximate

Part Five: Recent Developments

to this the colleges only accounted for the pension contributions they paid as expenditure in the Income and Expenditure Account.

5.10 The pension liability shown in the 2006-07 accounts is £15 million. BIFHE, the largest college, had a liability of £4.4 million.

Pay Dispute by Further Education College Lecturers

5.11 The further education college lecturers are currently in a long running pay dispute. The lecturers are seeking pay parity with school teachers. The University and College Union (UCU), representing the lecturers, claims that on average lecturers earn £3,400 a year less than teachers in schools for doing similar work.

5.12 In April 2006 the lecturers voted in a secret ballot for industrial action. Since then, 1,800 lecturers across the 16 colleges have had seven strike days which has caused severe disruption to college administration as a result of the lecturers working to rule.

5.13 In order to facilitate an end to the lecturers' pay dispute, the Department, in September 2007, appointed Sir Joseph Pilling, a former Permanent Secretary at the Northern Ireland Office, to chair talks between college management and unions with the aim of brokering a pay agreement which would be acceptable to both sides.

5.14 In the event the proposed settlement was narrowly rejected by the wider UCU membership, when put to the vote.

Belfast Metropolitan College Efficiency Review

5.15 Significant deficits were anticipated in July 2008 for four FECs for 2007-08. A combined operating deficit of £9.7 million is projected, with only two of the six colleges projecting a surplus (North West Regional College - £249,000 and South West College - £601,000). These figures exclude exceptional items such as redundancy and restructuring costs which could amount to over £10 million.

5.16 In particular, Belfast Metropolitan College (BMC) as at 11 June 2008, was projecting a total deficit of £6.6 million. At this point, DEL wrote to BMC to ensure that management have been preparing and monitoring cash flow projections. As at 31 July 2007, BMC had £7.8 million in cash reserves which would be reduced significantly with the in-year deficit. As a result, following discussions with the Governing Body, the Department has initiated an efficiency review which is aimed at returning the College to financial health and stability.

Resignations of Further Education College Chairmen and Developments in Appointment Procedures and Training

5.17 As at 1 August 2008 four out of six chairmen in the newly merged further education colleges have resigned. One resigned within months, one left in June 2008 and two more stepped down at the end of July 2008, after spending two years setting up the new bodies. The Department told NIAO that in response to these resignations, the Minister announced the intention to carry out a fundamental review of the governance arrangements within the sector. The terms of reference for the review were consulted upon and it will commence early in 2009.

5.18 The Department noted that new procedures were put in place to identify and appoint the chairs and governing bodies of the merged further education colleges. These open public appointment competitions were aimed at ensuring that governors with the necessary knowledge, skills and experience were identified and tested through a formal interview process which was monitored and approved by the Office of the Commissioner for Public Appointments (NI).

5.19 The Department provided bespoke induction training for all chairs and governing body members in governance and accountability issues. At the invitation of the Department, NIAO contributed to this training. This induction training was supplemented by specially tailored training for audit committee members.

Appendices

Appendix One: Financial Performance by Further Education Colleges in 2006-07 grouped by the merged colleges effective from 1 August 2007

COLLEGE	INCOME 2006/2007 £'000	HISTORIC SURPLUS/ (DEFICIT) 2006/2007 £'000	NUMBER OF STUDENT ENROLMENTS				
			Professional & Technical			Non-vocational	Overall Total
			Full-time	Part-time	Total		
Southern Regional College							
Armagh	7,255	(153)	1,160	4,473	5,633	1,350	6,983
Newry	16,483	(3,314)	2,305	8,833	11,138	4,879	16,017
Upper Bann	12,997	(539)	1,624	7,118	8,742	3,475	12,217
Total	**36,735**	**(4,006)**	**5,089**	**20,424**	**25,513**	**9,704**	**35,217**
North West Regional College							
North West	27,403	(69)	3,789	9,784	13,573	5,330	18,903
Limavady	7,206	779	1,073	2,656	3,729	988	4,717
Total	**34,609**	**710**	**4,862**	**12,440**	**17,302**	**6,318**	**23,620**
South West College							
East Tyrone	10,488	1,373	991	3,033	4,024	6,267	10,291
Fermanagh	9,130	(935)	1,203	4,200	5,403	2,626	8,029
Omagh	12,156	280	1,669	5,391	7,060	747	7,807
Total	**31,774**	**718**	**3,863**	**12,624**	**16,487**	**9,640**	**26,127**
Northern Regional College							
East Antrim	10,814	132	1,484	6,744	8,228	2,875	11,103
North East	16,247	(459)	2,290	7,866	10,156	2,586	12,742
Causeway	7,833	48	1,105	3,979	5,084	3,220	8,304
Total	**34,894**	**(279)**	**4,879**	**18,589**	**23,468**	**8,681**	**32,149**
Belfast Metropolitan College							
BIFHE	47,716	(2,451)	6,847	31,330	38,177	12,036	50,213
Castlereagh	8,445	(1,022)	1,106	4,959	6,065	4,062	10,127
Total	**56,161**	**(3,473)**	**7,953**	**36,289**	**44,242**	**16,098**	**60,340**
South Eastern Regional College							
East Down	10,070	87	1,529	4,699	6,228	2,420	8,648
Lisburn	8,655	207	1,415	3,731	5,146	1,059	6,205
North Down	18,155	980	2,076	10,824	12,900	1,537	14,437
Total	**36,880**	**1,274**	**5,020**	**19,254**	**24,274**	**5,016**	**29,290**
TOTAL	**231,053**	**(5,056)**	**31,666**	**119,620**	**151,286**	**55,457**	**206,743**

Sources: DEL College Circulars and Tertiary Education Analytical Services Branch

Appendix Two: Case Study: North East Institute

Case Study: North East

Financial Situation

Financial Year	Historic Surplus/(Deficit) [1] £ '000	Accumulated Surplus/(Deficit) £'000
1998-1999	266	617
1999-2000	241	858
2000-2001	(200)	658
2001-2002	(1,097)	(439)
2002-2003	(151)	(590)
2003-2004	792	202
2004-2005	838	1,040
2005-2006	4	(1,113) [2]
2006-2007	(459)	(235) [3]

1 Figures taken from College Accounts Circular for year ended 31 July 2007 (Appendix 2a).
2 Includes pension deficit of £2,155,000.
3 Includes pension deficit of £1,113,000 and actuarial gain of £1,337,000.
The annaul accounts for 2000-01, 2001-02 and 2002-03 were not signed until November 2003.

Causes/Underlying Problems

The Efficiency Review indicated that:

- for 2000-01 and 2001-02 financial years the budgets set by the College provided for operational deficits;
- the unit costs in the college per Whole Time Equivalent (WTE) were 38 per cent higher when compared to a benchmark college;
- inadequate management information was provided to the Governing Body and Senior Management Team;
- the actions of the Senior Management Team and Governing Body were not in accordance with best practice. No serious attempts were made by senior management to control spending on the staffing

Appendix Two: Case Study: North East Institute

budget. No significant attempts were made to invest in reshaping the curriculum of the college to maximise income received from SPURS. Several issues, such as the need for an estates strategy and the restructuring of senior management, should have been addressed much earlier and not left to the recovery planning process; and

- The Governing Body's ability to monitor rigorously was constrained by the lack of timely reliable financial information. It was not involved in the corporate planning of the College and it only expressed interest in the final stages of budget setting.

Recovery Plan

In January 2002 the College was requested to prepare and submit a recovery plan to the Department by 31 July 2002. The original recovery plan was independently assessed by consultants as being of poor quality, was not explicit enough to indicate where savings would be made, and assurance could not be provided to the Department that the plan was robust and would return the College to a sound financial basis in a reasonable period of time.

Efficiency Review

The Department advised the College in December 2002 that an Efficiency Review was to be carried out, under Article 18 of the 1997 Order. In July 2003 a report was issued by the independent consultants appointed by the Department to carry out the review.
Following the outcome of the efficiency review the College was required to resubmit a revised recovery plan by 31 March 2004. This deadline was not met and a further extension was granted to 31 May 2004. The plan was evaluated by independent consultants and the Recovery Plan has been broadly endorsed, but it was recommended that certain contingency arrangements within the plan should be strengthened. Officials from the Department were content with this recommendation and have met with the Accounting Officer from the College, along with the Chair of the Governing Body, and agreed the way forward based on the strengthened recovery plan.

Findings of the Efficiency Review

2000-01 and 2001-02 financial years:
- Actual deficits substantially higher than budgeted deficits;
- Significant overspends in staff costs, mainly teaching, in the region of £0.9million;
- Depreciation charges under-estimated by £303,000 in 2000-01 and by £412,000 in 2001-02.

2002-03 financial year:
- Annual income and expenditure budgets agreed by Governing Body differs from budget return sent to the Department, both were understated, income by £1.7 million and expenditure by £1.3million;
- Unrealistic budget projections, for example the Institute provided for the sale of a piece of land at £1.2million that did not materialise;
- Block grant from the Department advanced a month early to ease cash flow position;
- Some cost cutting measures were introduced.

Financial Information
Concerns were expressed about:
- the College's failure to develop course provision in line with the Department's strategy meant that it was unable to take advantage of various incentives within the funding formula. For example the College's underperformance in deliveries of vocational part-time courses and adult training had reduced the funding that could have been secured through the funding formula;
- the timeliness and accuracy of financial reports for monitoring by budget holders;
- the quality of management information provided to the Governing Body and Senior Management Team;
- the financial controls and the need for improvements to permit management to monitor, control and report the financial position of the College more effectively;
- the financial information being presented to the Governing Body was not in a format which they all understood;
- information presented in monthly reports was not perceived as accurate by users;
- no clear linkage between strategic planning and financial planning;
- lack of ownership of budgets.

Estates Management
- Optimum use was not being made of the College's estate; 74 per cent more full time equivalent (FTE) students could be accommodated.

Expenditure
- Overheads were too high;
- Significant number of academic staff who do not have any contact time with students;
- Number of support staff had increased significantly since incorporation and were above benchmark levels;
- Costs of the Directorate and the Corporate Management Team were higher than benchmark partners.

Observations
- Excessive delays were experienced in the first half of 2002 in progressing the recovery plan process to meet the Department's initial deadline of 31 July 2002;

Appendix Two: Case Study: North East Institute

- Despite the Governing Body illustrating a strong commitment to the recovery plan process it did not subsequently fulfil its responsibilities in ensuring an approved and credible recovery plan was forwarded to the Department;
- The recovery process may not have been as inclusive of staff members as in other colleges.

Conclusions of the Efficiency Review
Due to concerns about the content of the recovery proposals, including the accuracy of financial information and the ability of Senior Management to deliver, the Governing Body was unable to support the recovery plan.

Inherent weaknesses were identified in the financial management system. Improvements are needed to the existing systems to enable management to monitor, control and report on the financial position of the Institute more effectively.

Current Recovery Position

The North East's Director retired in early 2003 and a new Director took up post at the start of February 2004.

A group within the college was appointed to take forward the preparation of the recovery plan and the implementation of the recommendations from the Efficiency Review. Consultants were appointed with the responsibility for advising on the preparation of the recovery plan. A strengthened Recovery Plan was agreed by the Department and formally accepted in November 2004.

The consultants completed stages 1 and 2 of the monitoring process in June 2005 which involved an initial assessment of the College position and identification of the key challenges facing the college in achieving the desired outputs of the Recovery Plan. Stage 3 of the process involved quarterly reviews of the performance of the college in implementing the Recovery Plan. The final review was completed in April 2006 and showed that the college was on course to meet its key milestones as set out in the Recovery Plan.

Overall, the financial position of the College has shown significant improvements since the implementation of the plan. At the end of the 2002-03 year, the college reported a historic deficit of £151,000 with reserves showing a deficit of £590,000. With the implementation of the Plan, during 2003-04 and 2004-05 the financial position of the college improved markedly and, even with an operating deficit in 2005-06, the college accounts show a historic cost surplus of £222,000 with reserves of £1,262,000 at the end of that year.

Lessons Learnt

- When in a recovery position, the college needs to address the issue as a matter of urgency. The first stage is the identification of the financial difficulties, followed by the prompt commissioning and the timely submission of a recovery plan. The financial position of a college can deteriorate very rapidly if there are delays in preparing the recovery plan. In this case the process was too long.
- Once in a recovery position expenditure needs to be restricted to essential items only;
- Good financial management and timely and accurate management information is a key requirement;
- Accommodation needs must be considered in the context of agreed curriculum being offered;
- Top management structures should reflect the needs of the curriculum;
- A competency framework should exist for Senior Management coupled with a performance appraisal system for principals. This was recommended by the authors of the efficiency review. NIAO had made the same recommendation two and a half years earlier.
- Governing Bodies need to agree and document their annual training requirements and subsequent attendance at training events.

Appendix Three: Recommendations from NIAO Corporate Governance and Financial Management in Colleges of Further Education report

1. In December 1999, following the incorporation of the colleges as independent bodies, NIAO published a report on Corporate Governance and Financial Management in Colleges of Further Education (NIA 5)[6]. At that time NIAO recognised the vulnerability of the sector to financial health problems and a number of recommendations were made to improve financial management and control. Key recommendations were:

   i. Colleges should draw up comprehensive guidelines to enable budgets to be prepared on a sound basis;

   ii. Performance information on the principal areas of college activity should be compiled and reported regularly in a focussed way to governing bodies for more effective internal accountability;

   iii. Explicit links between development plans and the financial planning process are developed by all colleges to ensure that resource allocations are made in line with identified college business priorities;

   iv. Every college governor should receive a report on the financial position of their college each term

   v. The reappointment of college governors to be subject to a formal appraisal against a set of specific objectives given on appointment;

   vi. Governing Bodies to regularly review their own training needs;

   vii. Governing Bodies should establish self-assessment procedures to determine how effectively they are discharging their responsibilities; and

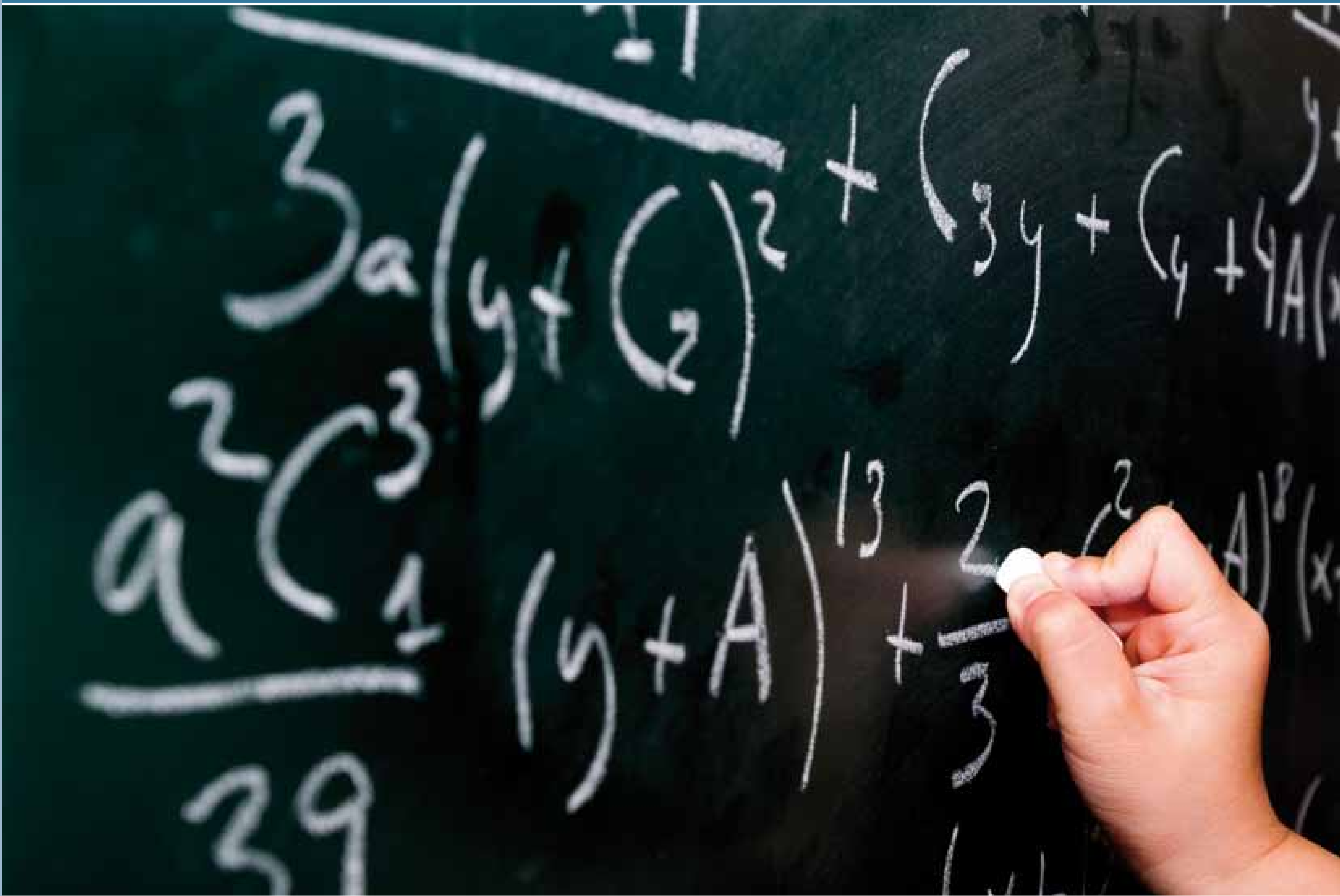
   viii. Governing Bodies should have formal procedures in place for the regular appraisal of principals' performance.

2. Following publication of the NIAO report, the Department wrote to all colleges in February 2000 asking them to review their position in relation to the recommendations made in the report. From the responses received from the colleges, the Department identified that there were three main areas that colleges had not fully addressed, points vi to viii above. The table below sets out the additional steps taken by the Department to address the original report recommendations.

6 *Corporate Governance and Financial Management in Colleges of Further Education,* Northern Ireland Audit Office, December 1999, NIA 5.

Outstanding Recommendations Not Addressed by the FE Sector	
NOT ADDRESSED	**ACTION TAKEN**
Regular review of governing bodies of their training needs. Establishment by governing bodies of self-assessment procedures.	• A Service Level Agreement has been signed by the Department and the Learning and Skills Development Agency for training of governing body members using a self-assessment model based on Further Education National Training Organisation standards for governors.
Procedures for the regular appraisal of principals' performance.	• The Directors' Negotiating Committee agreed on a new performance related pay scheme for principals that will include performance appraisal. • The first payments under the new scheme were made in September 2004 when performance for the 2003-04 academic year was assessed. • Each College's Governing Body has a Remuneration Sub-Committee which is responsible for the performance appraisal. • Training has already been provided to these governors on their responsibilities and how the new scheme will operate.

Governance Examination of Fermanagh College of Further and Higher Education



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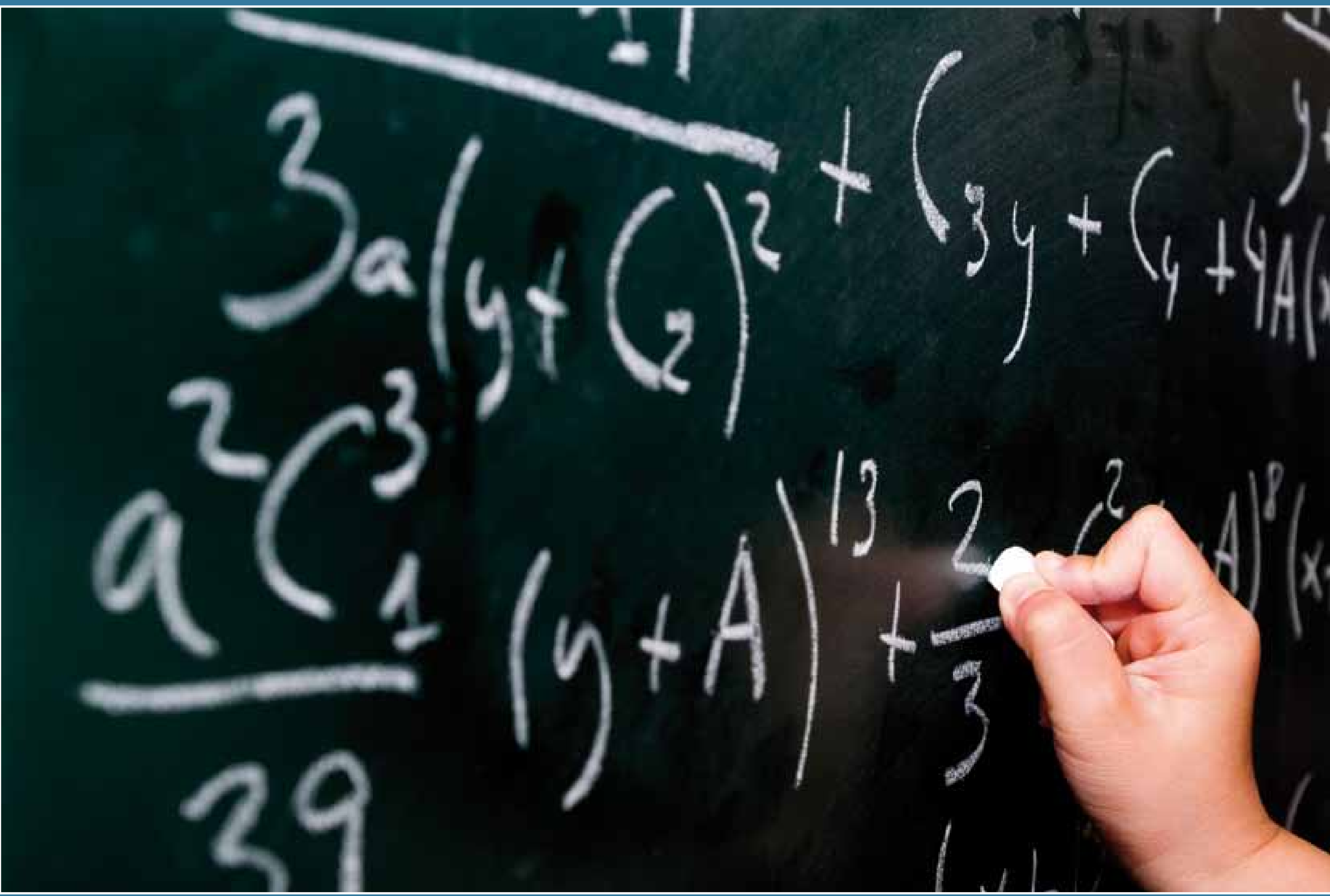
Abbreviations

CDP	College Development Plan
DEL	Department of Employment and Learning
DEL SPURS	Student Powered Unit of Resources
ETI	Education and Training Inspectorate
EU	European Union
FE	Further Education
GT	Grant Thornton
HEFCE	Higher Education Funding Council for England
LSDA	Learning and Skills Development Agency
MIS	Management Information Systems
NATFHE	National Association for Teachers of Further and Higher Education
NIAO	Northern Ireland Audit Office
SMT	Senior Management Team
WBL	Work Based Learning

Introduction



Introduction

1. Under the Further Education (NI) Order 1997 the sixteen further education colleges were transferred from the control of local Education and Library Boards on 1st April 1998. They became independent corporate bodies, managed by governing bodies, and assumed ownership of their assets and liabilities. The Governing Body appointed for each college is accountable for the financial health and good management of the college and the proper use of public funds entrusted to it.

2. The Legislation also places a duty on the Department for Employment and Learning (DEL) to secure effective execution of its policy in respect of the provision of further education in Northern Ireland. The Department has a range of monitoring and control arrangements to enable it to ensure that appropriate frameworks exist within which the Governing Body can control the operations of the college.

3. The Comptroller and Auditor General did not audit the accounts of these sixteen further education colleges but, as auditor of the Department, he had access to the books, accounts and records of college governing bodies. In our report on Corporate Governance and Financial Management in Colleges of Further Education (NIA 5, Session 1999-2000) we assessed how well the colleges had, in their first year as incorporated bodies, established frameworks of corporate governance and financial management. We also made recommendations to assist the Department and colleges in developing their frameworks and raising standards of public accountability.

4. In 2005 and 2006 a number of Departmental and consultancy reviews in Fermanagh College of Further and Higher Education (Fermanagh College) highlighted serious failings in financial management and raised concerns over the regularity and propriety of the use of public funds. The findings included:

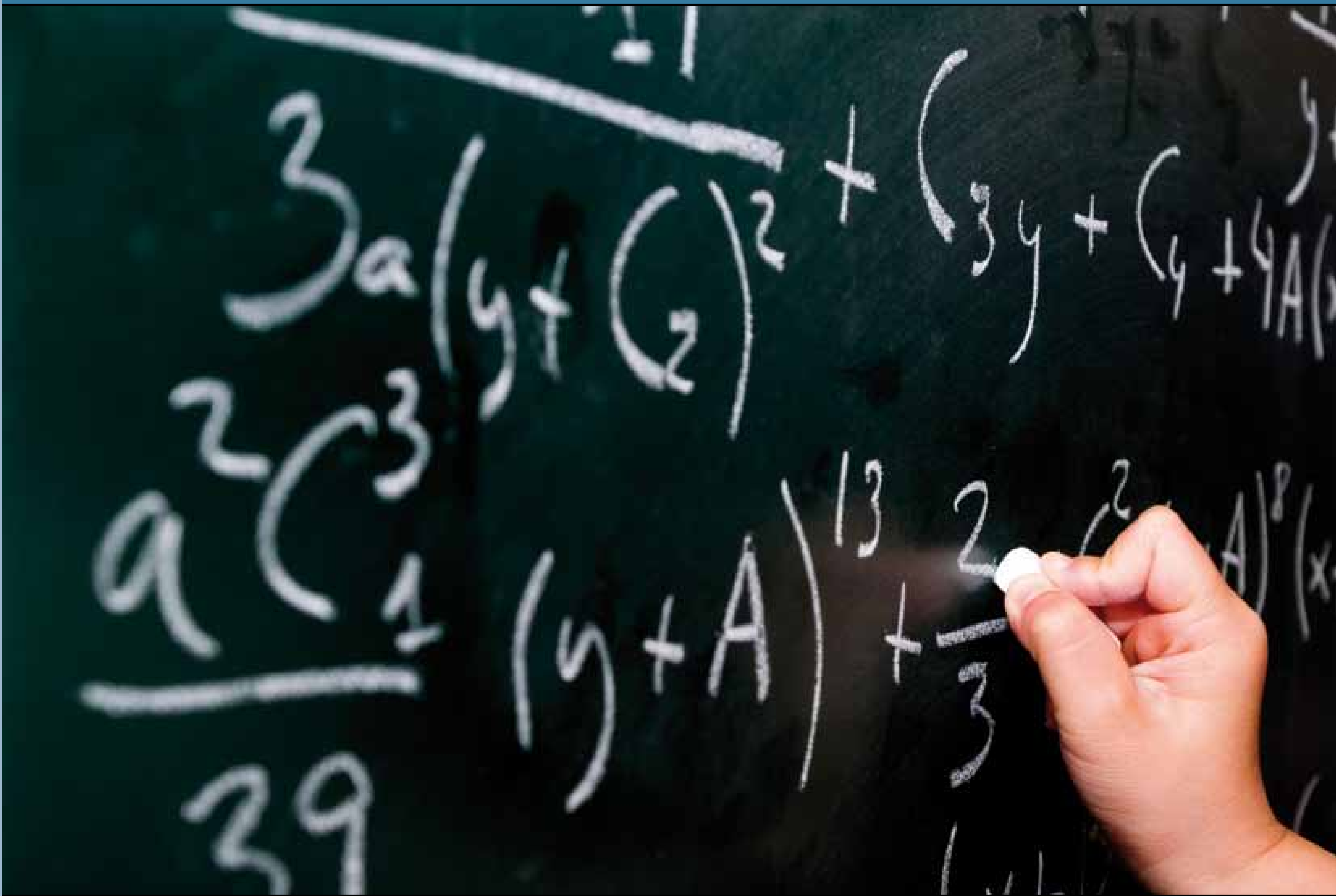
   - significant weakness in corporate and business planning and financial planning and budgeting;
   - an absence of financial controls;
   - an unreliable management information system;
   - a lack of challenge from corporate governance systems;
   - a lack of organisational structure in the Senior Management Team, discord between management and academic staff, and fundamental breaches in complying with Departmental circulars and Governing Accounting requirements; and
   - a need to secure the necessary leadership and a significant corporate change programme

5. Following a major review of further education in Northern Ireland, the Minister for Employment and Learning announced in September 2005 that the

sixteen colleges would merge to form six new area colleges. As part of this process, Fermanagh College merged with East Tyrone and Omagh in August 2007.

6. NIAO considered that the creation of a new college structure would be an appropriate time to review the problems identified at Fermanagh College to see what general lessons could be learned by the colleges and the Department. We have made extensive use of the findings of the various consultancy reports, in particular the review of financial management carried out by Deloitte and Touche LLP (Deloittes) in 2006. We also examined the adequacy of the Department's accountability for, and governance arrangements over, Fermanagh College and assessed the adequacy of these arrangements.

Part One



Part One

An Examination of Work Based Learning Courses Provided by Fermanagh College

1.1 In October 2001 the Department issued guidance on the provision of Work Based Learning (WBL) courses for employers (Circular FE 19/01). This training was to consist of three key elements (skills training, underpinning knowledge and understanding, and support and assessment) which could be delivered in different combinations by the college and the employer. The Funding to be provided by DEL for these courses would be determined by the particular combination applied.

1.2 In November 2001, Fermanagh College advised the Department of a proposal to provide training in conjunction with a range of retail companies for which the College would provide two of the key elements. DEL's circular made no provision for third party involvement in the training, but the College entered into an agreement with a company (Company A) principally involved in the provision of training and employment services to young people, to deliver the programme. Workbooks were to be supplied by another company, (Company B). The Department in its response noted that, on the basis of the information supplied, the course appeared to meet the criteria for funding on the assumption that the College would be providing the underpinning knowledge and understanding and support and assessment elements. The Principal consistently stated in writing and orally, that there was no third party involvement but payments of £0.6million were made to Company A in the three years up to 31 July 2005.

1.3 In October 2003, the Department commissioned the Education and Training Inspectorate (ETI) to carry out a sector-wide survey of the WBL provision. The survey report was submitted in November 2004 and DEL identified findings that Fermanagh College was drawing down a high proportion of its WBL allocation and that the mode of delivery was not consistent with other colleges. The Department sought specific assurance from Fermanagh College that the WBL provision complied with Circular 19/01. Correspondence and oral communication between DEL and the Principal, between February and June 2005, proved inconclusive. When Departmental officials made a pre-arranged visit to the College in June 2005 to inspect books and records pertaining to the WBL delivery, they were told that the records were not available. The Department told us that, following this, it had sufficient information to become concerned and it sought clarification from the Principal on the role of the College in WBL provision. By August 2005 DEL had not received adequate responses to resolve its concerns, it therefore brought the matter to the attention of the Governing Body. The Governing Body told us that it had not had sight of the ETI report and was unaware of the WBL issue until the Department raised the matter with it in August 2005. The Governing Body consequently engaged its external auditors, Grant Thornton (GT), in September 2005 to investigate the issues.

1.4 GT reported in November 2005 and highlighted the following problems:

- College staff were not delivering the project;
- the College had no previous experience working with Company A and the company had limited previous experience of delivering a WBL programme;
- there was a lack of effective financial management and no formal system of monitoring and controlling the programme;
- in contravention of the requirements of Government Accounting, payments of £70,000 had been made to Company A in 2002 before the liability had matured;
- no formal reconciliations were carried out between actual payments made to Company A and actual students recruited which would have clarified if over or under payments had been made. Invoices submitted in 2003 did not represent actual students recruited at the invoice date and therefore represented further advance payments;
- GT carried out a reconciliation of payments made to Company A and found that there had been an over payment of £31,755 in respect of 219 students. Given the scale of the reconciliation required, GT considered that the management information system was inadequate as a tool for effective monitoring and control;
- there was no formal written agreement with Company B for the fees to be paid for workbooks. In 2002 the books were supplied at a discounted rate of £25 but the fee rose to £50 from March 2003 and to £75 from April 2005;
- initial correspondence between the College and the Department stated that each retail outlet would pay a fee of £300 to the College. However, these payments were actually paid to Company B to cover liaison with retailers and the recruitment of new students. The amount and frequency of the payments is not known. From 2005 the College decided to appoint its own operational manager to liaise and recruit but fees were never invoiced or collected from retailers, thus representing a shortfall in monies due to the College.

1.5 Following consideration of the GT report on the role of the college in delivering WBL training, and representations from the Governing Body, the Department wrote to the Governing Body in April 2006. It indicated that since the recruitment, delivery, assessment and contact with the learner had been undertaken by a third party and the College's role had been purely

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administrative, the criteria set out in Circular 19/01 had not been fulfilled. The College agreed to repay funding of £1.14 million. The Governing Body was asked to develop an action plan to address the issues in the GT report, including how it would assure the Department that the issues identified were not systemic across the College. Fermanagh College has complied with this request and is currently repaying, in full, the funding previously claimed for WBL provision.

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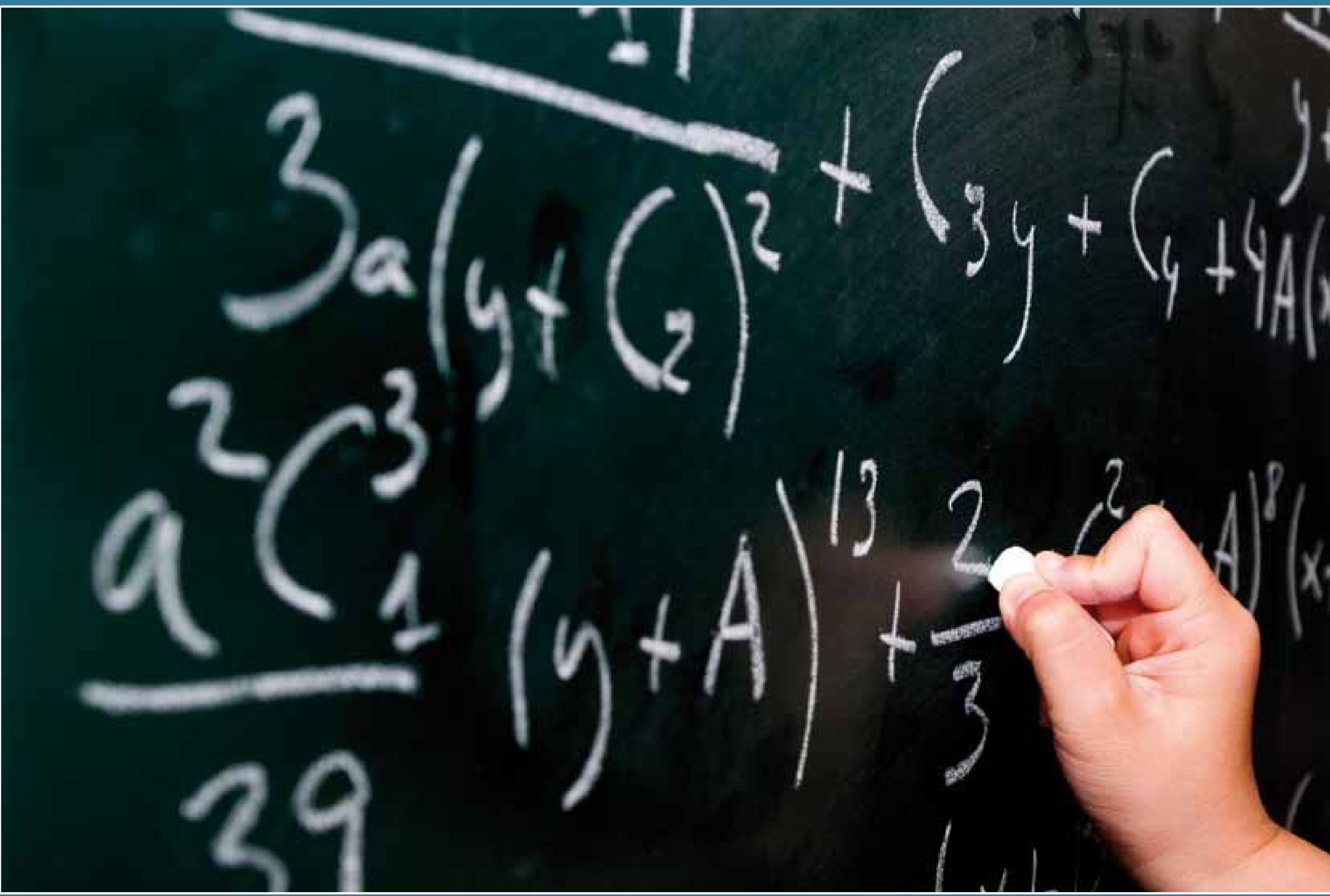

Part Two

Comprehensive Review of Financial Management in Fermanagh College

2.1 In view of concerns that the deficiencies identified within the Work Based Learning Review might extend to other areas of College business, the Governing Body, following advice, guidance and assistance from the Department, commissioned Deloitte and Touche LLP in February 2006 to carry out a comprehensive review of financial management within the College. In this part of the report we summarise the main issues arising from that review. It should be noted that the scope of Deloitte's work was limited by the fact that two key stakeholders, namely the Principal and the Finance Director, were unavailable for interview during the review.

Corporate Governance

2.2 Although the Terms of Reference of the review did not include the role and performance of the Governing Body, significant weaknesses were identified in the Corporate Governance environment. These included a need for the Governing Body to:

- provide the strategic direction for the College in line with Departmental policy together with the strategic parameters for corporate and financial planning;
- ensure that finances are allocated to the strategic priorities established by the College through its development planning process;
- develop a formal risk management strategy which was not in place for the College;
- formally specify governors' training requirements;
- ensure that the Board is provided with accurate, timely financial reports in a form that would facilitate an effective monitoring and challenge function; and
- set clear targets and objectives and professional development assessments for the Senior Management Team.

The Governing Body told us that the entire Corporate Governance section of Deloitte's report had been removed from the final version because it had challenged the accuracy of a number of the issues identified as weaknesses. For example, it did not accept that it had not developed strategic parameters for corporate and financial planning or that a challenge function in terms of budget variances was not in place. The Governing Body also told us that it had challenged the manner in which some of the "evidence" had been adduced and therefore its reliability, and had concerns that criticism of the Governing Body could be prejudicial to the ongoing disciplinary action (see paragraph 2.21).

Corporate and Business Planning

2.3 In our previous Report on Colleges of Further Education[1] (1999 Report) we said that one of the main elements of sound corporate governance is an effective planning regime. Corporate governance provides a framework within which a college operates to achieve its objectives. It guides the operation of the college, provides the basis of assessing performance and ensures that the governing body and staff are working to achieve college goals. The Further Education (NI) Order 1997 requires each college to develop an annual plan covering a rolling three year period. DEL established a process for this to be done and provided guidance on the information the Plans should contain, including a request that the issues identified in the 1999 Report should be addressed (see paragraph 4.4).

2.4 Significant weaknesses were identified in the corporate and business planning process and the latest Fermanagh College Development Plan for 2005-08 was found to be deficient in a number of areas. In particular there was a need for:

- the development of a set of Specific, Measurable, Attainable, Results focused and Timely objectives;
- the development of robust indicators;
- the linkage of operational plans to objectives set in the College Development Plan;
- assignment of responsibility for the achievement of objectives;
- linkage between strategic and financial planning; and
- monitoring of the achievement of CDP objectives by the Governing Body on a quarterly basis.

Financial Planning and Budgeting

2.5 In part four of our 1999 Report we emphasised the importance of sound financial planning and budget management. A financial planning framework provides a college with a mechanism to make resource allocations in line with its priorities and provides a basis for assessment as to whether resources are being administered efficiently and effectively. We recommended that there needed to be explicit links between development plans and the financial planning process and the Department included this requirement in its guidance to colleges.

2.6 Deloittes report identified significant weaknesses in the financial planning and budgetary process at Fermanagh College, in particular:

- there was no clear linkage between strategic planning and financial planning;
- there was confusion regarding the roles and responsibilities for budget

1 Corporate Governance and Financial Management in Colleges of Further Education, December 1999, NIA 5

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planning, setting and development, and these had not been documented;

- budget management was centrally driven and budget managers appeared to have only a token role in financial management. Financial targets had not been communicated to them at the start of the financial planning process and communication between budget holders and the Finance Department appeared to be minimal;

- the Finance Department was not involved in the setting of individual EU project budgets with the result that unrealistic and largely meaningless budgets had been set for some areas; and

- there were no formal structures for assessing budget holder competencies and providing training for any gaps identified.

Financial Control

2.7 In part five of our 1999 Report, we considered the various aspects of internal financial controls that are required to safeguard and account for public funds. Deloitte's findings in relation to some of these are as follows:

- some key financial information was not provided to members of the Governing Body or was not provided in a format which they could understand or consider useful. The users were not confident that information presented in monthly reports was accurate;

- whereas the meetings of the Audit Committee were in line with Departmental guidance, best practice would suggest that they should have met on at least a quarterly basis, and following receipt of significant audit findings;

- with the exception of its annual report, there was no formal reporting mechanism between the Audit Committee and the Governing Body;

- no performance measures were in place for internal and external audit services;

- there was no formal monitoring of the implementation of the internal audit recommendations by the full Governing Body;

- recommendations arising from the Internal Audit review of payroll systems had not all been implemented;

- there was no defined procedure for debt collection within the College;

- banking arrangements had not been tendered on a regular basis;

- permanent amendments to the payroll had not been verified and approved by the Human Resource manager; and

- not all assets were tagged or given a unique asset number. Asset numbers were not recorded on the asset register and there was no regular asset verification audit carried out by the Finance Department.

Management Information Systems

2.8 The data held on the student management system is used to determine the level of funding the College will receive from the Department in a given academic year. An audit of the 2002-03 data extraction carried out in June 2004 on behalf DEL, failed the College on all 17 funding criteria requirements. A number of serious issues were reported, in particular missing registers and a lack of information to verify particular types of enrolment. For the 2003-04 data extraction, which would inform the funding for 2005-06, documentation could not be produced to support the student numbers claimed for, which represented an over claim of £1.4 million. However, as a result of detailed investigation work initiated by the Acting Principal which included producing appropriate supporting documentation that was not available at the time of the DEL audit, the overpayment was reduced to £194,000, following a further audit by DEL, and this amount was recouped from the College.

2.9 In February 2006, DEL's Financial Audit Support Team carried out an audit of the Essential Skills Fund claims for 2003-04 and 2004-05. The Team reported that, as a result of poor and inaccurate management information, enrolment figures included in the claims had been overstated. This required a further £194,000 to be repaid and this was recovered in full by the Department.

2.10 A range of Earmarked Funds are provided by the Department each year to be used for specific purposes. The College returned £48,000 in respect of the 2004-05 year because it was unable to allocate the funds for the purpose intended. Deloittes reported that roles and responsibilities in relation to the monitoring and control of Earmarked Funding had not been defined or documented within College procedures.

2.11 An independent consultant was appointed by the college in November 2004 to carry out a review of the Management Information System (MIS) and to assist staff with the validation of data. He continued through to September 2005 during which time he issued 33 reports covering each component of the MIS process. In February 2006, at the request of the Acting Principal, a review of MIS was carried out by the Association of Northern Ireland Colleges Business Support Manager and, during its review in 2006, Deloittes had access to these reports and sought the views of academic and administrative staff on the problems experienced with MIS. As a result, a range of inherent weaknesses were identified, the main areas of concern being as follows:

- there was no single ownership of MIS to ensure that appropriate checks

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were made within the system and that staff were held to account for their individual roles. This had led to inaccurate data being held within the system, which had a direct impact on the College's funding entitlement;

- there were no agreed and documented roles and responsibilities between teaching and administrative staff;
- a clear process for data capture and management had not been documented leading to inconsistencies in approach;
- there was no system in place to ensure data was input on a regular and timely fashion, no regular reporting or challenge function and no robust system of checks to ensure, for example, that enrolments could be verified to appropriate source documentation;
- the accuracy of recording had not been emphasised with staff and security of registers had not been seen as a priority; and
- the management information systems had not been implemented to their full capacity.

Third Party Relationships

2.12 The Deloittes review noted the following:

Third Party Relationships have been operated by the College without signed contractual documents. For example, the College rented accommodation from Fermanagh University Partnership Board which is a venture established to advance economic development through education in County Fermanagh. The Principal was one of the Directors of this partnership. A draft, unsigned, lease indicates that an office on the second floor of the Intec Centre was to be rented for three years from the 1st December 2002 at an annual rent of £12,600. The College's Working for Business Unit subsequently took accommodation on the ground floor of the centre in Enniskillen and annual rent increased to £25,000 but no contractual documentation could be produced to support this amount. There was confusion among college staff regarding the accommodation they were entitled to use and when rooms were used in another centre for course delivery between 2002 and 2004 the college was invoiced for another £39,000. This amount was disputed by the Finance Director but the invoices were subsequently authorised by the Principal. It was noted that the College does not hold a Register of Interests for members of the management team nor is there a policy for dealing with conflicts of interest.

Senior Management Team

2.13 Deloittes review of the Senior Management Team (SMT) identified a lack of structure in its operation. Meetings were ad hoc and minutes were either not kept or, if produced, were vague with no decisions or action points recorded. Staff remarked that there was no clear sense of there being a Senior Management Team in place within the College.

2.14 The Department has informed us that "changes have been made since the appointment of the Acting Principal in 2005. Since then there has been a clearly identified SMT comprising the Principal, Vice Principal and heads of faculty which meets regularly and all meetings are minuted and actioned".

2.15 Part of the Deloittes review was to consider the performance of the Principal, Vice Principal and Finance Director in fulfilling their responsibilities in financial management of the College between August 2002 and July 2005.

The Principal

2.16 The Principal was appointed to his post in September 1995 and was the designated Accounting Officer for the College during the period under review, except for the period from December 2003 to April 2004 when he was on sick leave. He had further periods of sick leave from 17 January to 1 March 2005 and from 22 August 2005 until his retirement on health grounds with effect from 1 May 2006. He retained his Accounting Officer status during these absences up to 3 October 2005 when the Governing Body appointed an Acting Principal.

2.17 The key responsibilities of the Principal are clearly set out in the Articles of Government of the College, the Financial Memorandum between DEL and the College, and in the formal Accounting Officer designation letter from DEL. His financial management responsibilities were therefore clear. Deloitte's noted that the Principal failed, however, to deal appropriately as Accounting Officer with the significant financial management weaknesses within the College. Because of his extended sick leave, Deloittes were unable to interview him about the issues they wished to investigate.

2.18 In our 1999 report we recommended that, in order to ensure College principals continued to fulfil their roles effectively, governing bodies should have formal procedures in place for the regular appraisal of principals' performance. Prior to 2003-04 there was no performance appraisal of the Principal by the Governing Body. A performance pay scheme for Directors of FE Colleges was introduced with effect from 1 September 2003 and under this the Governing Body was required to establish a Remuneration Sub-Committee. This committee met for the first time in April 2004 and by June had set criteria on which the Principal's performance would be judged. Records show, however, that in March 2005 the committee noted that it would "consider setting objectives for the Principal the following year". The Committee made

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recommendations on the Principal's pay to DEL in November 2004 following an assessment of his performance based on material supplied by him. DEL deferred a determination of the recommendation pending the outcome of the Work Based Learning investigation. As a result, the Principal's salary was held at its September 2003 level. No assessment was made in the 2004-05 year and the Principal retired on health grounds with effect from 1 May 2006.

The Vice Principal

2.19 The Vice Principal was appointed in September 2002. He was Acting Principal on three occasions during the Principal's sickness absences (December 2003 to April 2004, January and February 2005 and August to October 2005). His job description for Vice Principal includes, under "strategic management", a requirement to "liaise closely with the Finance Director to ensure that financial procedures and budgets fully support the teaching and learning provision". In his full time capacity as Vice Principal this was the limit of his role in financial management. As Acting Principal, it is recognised that he had limited periods to address the weaknesses and there was no evidence that he had received any training or support to enable him to discharge these duties effectively. His Contract of Employment states that he is required to participate in an appraisal scheme but his performance had not been appraised since his appointment.

The Finance Director

2.20 The Finance Director was initially appointed as Finance Officer in February 1997. No records were available in the College to support her salary level or the process and timing of her promotion to Finance Director. It was also not possible to find an agreed job description. Objectives were not established and therefore performance could not be measured against agreed targets. Deloittes noted that it appeared that the Finance Director was directly accountable to the Principal as Accounting Officer and to the Governing Body for the College's financial information and administration systems as well as estates management, "therefore, she shares responsibility for the weaknesses identified in financial management and control…"[2].

2.21 We asked the Department to comment on the lack of availability of records to support the Finance Director's employment. The Department told us that "The Finance Director was initially employed by the Western Education and Library Board. She transferred to the employment of Fermanagh College on 1 April 1998, at incorporation. The Department understands that all personnel records relating to staff moving from the Boards to the colleges were transferred at that time. It is the responsibility of the Governing Body to ensure that all procedures, and their application, in relation to the appointment and remuneration of senior staff, comply with industrial relations and equal opportunity requirements. This includes the preparation

2 The Finance Director has informed us that she considers that this conclusion by Deloitte and Touche LLP on her personal performance is erroneous, possibly due to a lack of evidence at the time.

of a job description upon the occurrence of a vacancy. In the case of staff, other than senior staff, all matters relating to the recruitment, appointment, promotion and grading, are delegated to the principal.

2.22 In our 1999 report we emphasised the importance of appointing Secretaries to Governing Bodies who would be independent of the college systems. The Department told us that it had received assurance from the College that this recommendation had been implemented. However, the Finance Officer acted as Secretary from April 1998 to July 2003 for which she received additional remuneration. It was clearly inappropriate for a member of the Senior Management Team to hold such a position because she was insufficiently detached from day-to-day management to give independent advice.

2.23 Following receipt of Grant Thornton's report on Work Based Learning the Governing Body requested disciplinary meetings with both the Principal and the Finance Director. The Principal advised that due to his ill health he could not attend. The Governing Body placed the Finance Director on precautionary suspension from the 2 December 2005 under the College's Disciplinary Procedures. A disciplinary hearing was arranged for April 2006 but had to be postponed when she also became ill. Because of this sick leave Deloittes were unable to interview her about the issues arising from their review. The Finance Director was dismissed with effect from 20 November 2006 but was later successful in her appeal to the Labour Relations Agency. The Independent Appeal Hearing decided that her responsibility should be seen in the context of general management deficiencies and the well documented efforts she had made to try to improve management and financial management reporting procedures. This, together with the fact that other managers who may have contributed to the problems were not disciplined, led to the decision that summary dismissal was not appropriate and a more appropriate penalty would have been a written warning.

NIAO Comment

2.24 In Great Britain in the late 1990s, a number of cases of incompetence and serious financial mismanagement were identified in further education colleges[3]. As a result, the Committee of Public Accounts[4] emphasised the need for colleges to guard against weak governance and poor financial control. In our 1999 Report we drew attention to the specific lessons identified at that time in order to highlight the potential problems that can occur. DEL told us that it had written to all colleges asking them to ensure that all recommendations contained in this report were implemented. In addition, many of the recommendations were included in subsequent guidance issued to the colleges and further reviews of the accountability arrangements were undertaken. It is therefore a matter of great concern to us that so many of the

3 Financial Management and Governance at Gwent Tertiary College, National Audit Office, March 1999, HC 253 and Investigation of Alleged Irregularities at Halton College, National Audit Office, April 1999, HC 357.

4 Investigation of Alleged Irregularities at Halton College, Committee of Public Accounts thirty-seventh Report, September 1999, HC 413 and Management of Growth in the English Further Education Sector, Committee of Public Accounts, sixty-third Report, October 1997.

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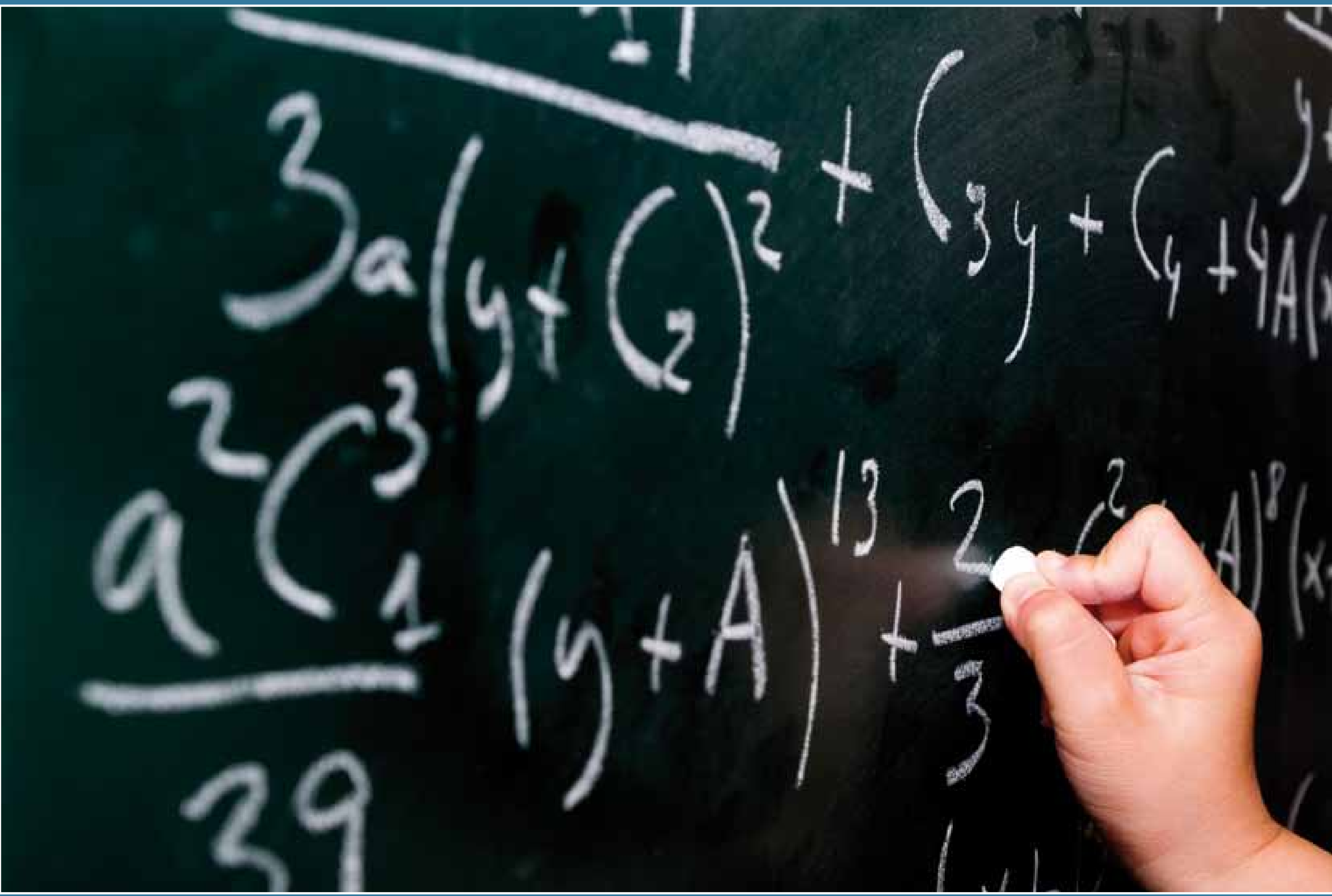
failures found in Fermanagh College are exactly the same type of issues identified in our 1999 report. We have included, in Appendix 1, the recommendations of the Committee of Public Accounts on Halton College[3], which we had originally appended to our report. The recommendations and issues raised in this report are clearly relevant to those experienced at Fermanagh College.

2.25 In Appendix 2 we have summarised the main recommendations made by Deloittes to address the weaknesses identified in governance and financial controls. We concur fully with these recommendations and since they have general application across the sector, they should be included in guidance issued by the Department to the new area Colleges.

3 Financial Management and Governance at Gwent Tertiary College, National Audit Office, March 1999, HC 253 and Investigation of Alleged Irregularities at Halton College, National Audit Office, April 1999, HC 357.

Part Three



Part Three

Whistle-blowing Allegations

3.1 In August 2005, DEL received an anonymous letter purported to come from "a group of support and lecturing staff". The letter alleged deficiencies in management and leadership; abuse of appointment procedures in the filling of three head of faculty posts; and improper use of the College's hospitality budget and overtime payments. Subsequently the Department received a letter from an employee at the College who was acting under the terms of "whistleblowing" safeguards. This letter appeared to substantiate many of the allegations made in the original anonymous letter but also alleged a lack of accountability in relation to staff, finance and the use of resources; inappropriate appointment of, and payments to, a consultant; and adjustment of enrolment figures to justify increases in pay for the Principal and Vice Principal.

3.2 The College's external auditors, Grant Thornton, were engaged in September 2005 to investigate seven of the issues raised and other issues were examined by members of the Governing Body.

Overtime Payments

3.3 On the question of overtime payments Grant Thornton found that £16,158 had been paid to a member of staff in March 2004. The hourly rate used in calculating the amount paid was found to be higher than it should have been and it had been applied at time-and-a-half. In any case, this member of staff had not been entitled to overtime payments under their contract of employment. The Governing Body decided that £11,570 should be recovered from the member of staff and wrote to the person accordingly in July 2006. The member of staff's union responded on their behalf in September claiming that the payment received equated to an honorarium which had been accepted in good faith. Legal advice indicated that, due to the time lag, there would be little prospect of being able to secure a court order for repayment and proceedings were therefore not recommended. Based on this opinion the Governing Body decided that there was no point in pursuing the matter further. As a result, the Department has advised the College that, in accordance with the Financial Memorandum and Government Accounting, they must now apply to the Department for approval to write-off the overpayment.

Hospitality and Entertainment Expenses

3.4 On the issue of hospitality and entertainment expenses it was found that controls within the College were not sufficient to avoid abuse of this expenditure, which averaged some £9,000 a year. There was a lack of supporting documentation which made it impossible to assess the relevance of the expenditure to furthering the College's aims or to determine whether there had been abuse or not. Grant Thornton recommended that a procedures document should be produced to clarify the circumstances under which these funds could be used and the requirements for prior approval. It also recommended that written terms and conditions should be produced to detail authorisation procedures for credit card payments.

Payments to a Consultant

3.5 On payments to a consultant, it appeared that not all work carried out by this person had been subject to the correct tender process and payments had been made for him to appraise projects which he had been involved in preparing. This highlighted possible shortcoming in the tendering process and it was recommended that the Governing Body should review the governance process around this area.

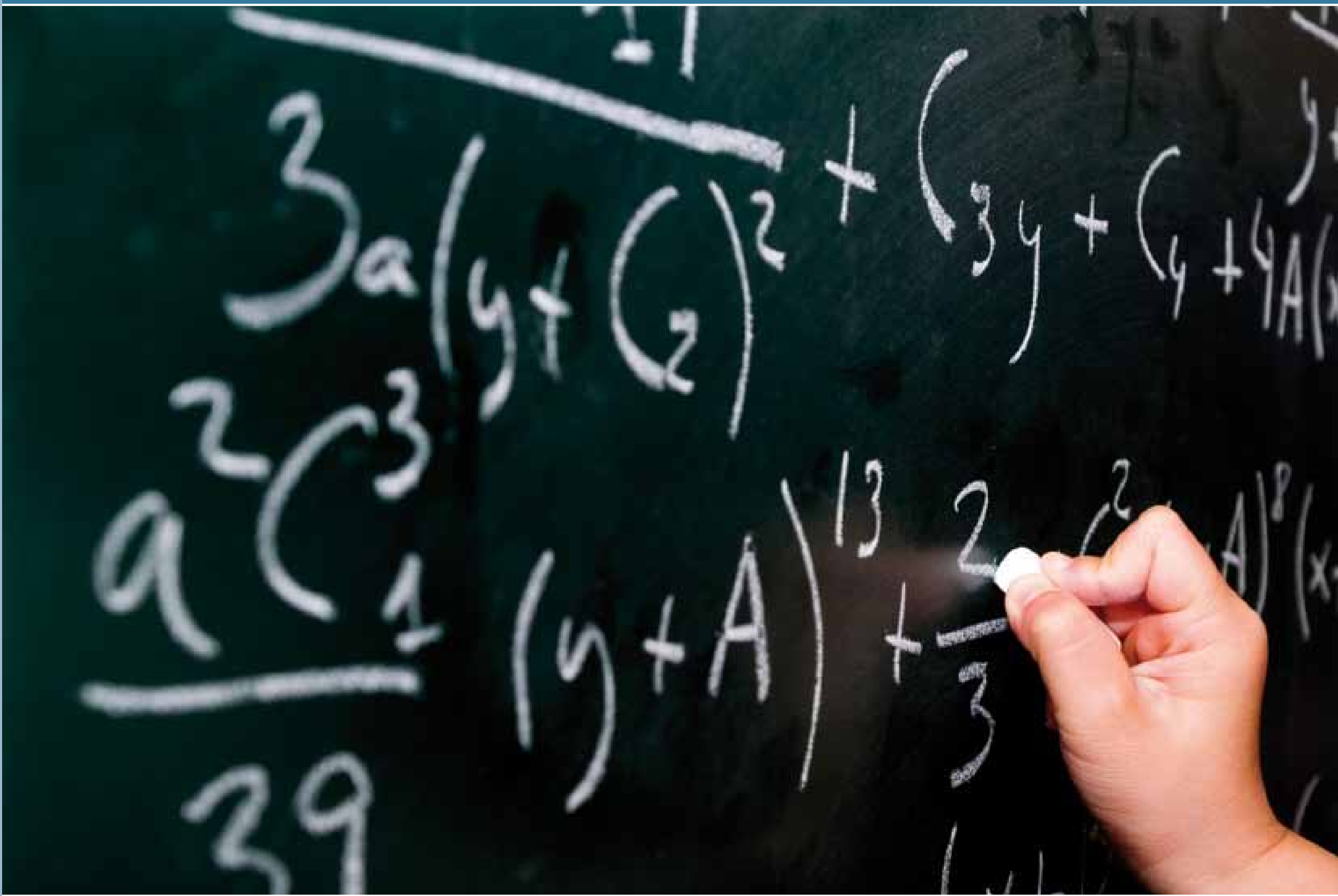
Payment in Advance

3.6 A payment in advance of £30,000 was made in March 2005 for 500 Exercise and Fitness Workbooks for a "fit to run" course. The College's Finance Department expressed reservations about the costs and benefits of such a course and no documentation could be produced to indicate whether it had been approved by the Academic Board. By mid 2006, less than 200 of the workbooks had been used and part of the remaining stock was being used for a different course.

Outcome

3.7 The Governing Body informed the Department in August 2006 that, having examined all the findings, it had "concluded that, other than the overtime payment issue, there were no major areas of concern identified as a result of the various investigations into allegations contained within the anonymous letter". Of the issues raised in the employee's whistle-blowing letter it was determined that only one, the pay upgrade of the Principal and Vice Principal, required further investigation. The Department carried out an assessment of the Grant Thornton review on this matter and confirmed that the salaries were correct. We asked DEL what its view was of the allegations and the investigations and what action, if any, it took as a result. DEL told us that it had been monitoring the situation and had ensured that all recommendations identified through the reviews and investigations undertaken, had been incorporated into an action plan which was being implemented by the Governing Body and monitored by the Department. It also noted that the Governing Body had engaged a Corporate Change Manager in September 2006 to oversee the implementation of recommendations in all reports in a composite action plan over the next 18 months. A regular report on progress is being made to the Department and is being monitored by departmental officials.

Part Four



Part Four

The Department's Accountability Control Environment for Further Education Colleges

4.1 In this part of the report we consider the Department's role and accountabilities in its relationship with the further education colleges.

4.2 DEL's Accounting Officer is responsible and accountable to Parliament for:

- ensuring value for money in the utilisation for resources distributed to colleges;
- monitoring compliance with any terms and conditions attached to the issue of grants to colleges;
- ensuring that the financial and other management controls applied by DEL are appropriate and sufficient to safeguard public funds; and
- satisfying themselves that:

  a. the procedures, controls and structures being applied within colleges conform with the requirements of propriety and good financial management; and

  b. that the colleges observe the arrangements and conditions set out in the Financial Memorandum for the payment of grants.

4.3 The main ways in which the Department has sought to provide governance, monitoring and control arrangements are outlined in Appendix 3. The key guidance documents provided for FE colleges are:

- the Guide for Governors, issued January 2005, which describes the main powers and responsibilities of the Governing Body and provides advice on such matters as the proper conduct of business, staff management and financial management;
- the Financial Memorandum which sets out the terms and conditions for the payment of grants by DEL. This includes the responsibilities of the Department and the College, especially with regard to the planning, budgeting and control of resources; and
- the Audit Code which provides guidance for the responsibilities of the Audit Committee and the requirements for internal and external audit arrangements.

4.4 The Department told us that, following the NIAO 1999 Report, it wrote to all colleges to advise them of the findings and to ask them to ensure that the recommendations were implemented. A seminar was arranged to present the findings and a working group was established to take forward training requirements. An Audit Issues Workshop was held to cover procurement and asset management. From this work the publishing of key performance indicators was initiated by the Department. Follow-up seminars were arranged for principals and Chairs of Governing Bodies to cover audit and financial management responsibilities. An accountability framework was put in place whereby College Development Plans would be prepared and submitted to the Department each year for review. This included a request to specifically address the issues identified in the 1999 Report. DEL provided feedback to the colleges on the quality of their content and on how improvements could be made. The Department told us that a recent review had identified improvements to this already useful regime. As a result, the Department is moving to a process for the setting of objectives for the colleges to achieve and will enhance the links with the level of resources they receive. This process will be in place for the 2007-08 academic year.

4.5 The colleges operate at arms-length from the Department. DEL told us that "this approach is as a result of the independent and incorporated nature of the Governing Bodies, which is enshrined in legislation and reflects the approach in Great Britain. Under incorporation, the onus is on the Governing Body to have responsibility for the effective management of the college and to have in place adequate controls to ensure probity, regularity and appropriate governance and accountability". However, in our view, the Departmental responsibilities outlined in paragraph 4.2 above are demanding and unequivocal and there is a need for a balance to be struck between the colleges' independence and DEL's overall accountability for funding of some £150 million to the sector.

4.6 DEL told us that

"The Department fully accepts its responsibilities, as set out in paragraph 4.2 above. In addition, the Department must respect the independent status of the College, as defined in legislation. In practice this means that, while the Department has overall responsibility for corporate governance and accountability, as noted in paragraph 4.5, the Governing Body has specific responsibilities in respect of its college. To enable it to fully discharge its responsibilities, the Department has monitoring arrangements in place, to ensure that the Governing Body meets its commitments, or that corrective action can be taken to protect public funds, where it fails to do so. The systems currently in place to achieve this are fully in line with HM Treasury guidance and best practice in Great Britain".

A balance has to be struck between the arms-length status of the colleges and the Accounting Officer's responsibilities and we recognise that the Department had given this careful consideration. However, in our view, this case suggests that there was a degree of over reliance on the performance of the governance arrangements at each college and on the leadership of the Governing Body, Principal and Senior Management Team. The balance struck between fulfilling the Department's responsibilities and the Colleges' independence was not sufficiently effective and its monitoring arrangements would have benefited from greater intervention especially in the early

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years of incorporation. In our opinion, the Accounting Officer was not able to obtain sufficient assurance over the responsibilities in paragraph 4.2 on the basis of the approach adopted. We have therefore reviewed the adequacy of the Department's arrangements in light of the issues arising in Fermanagh College.

The Work-based Learning Investigation

4.7 The Department had concerns in April 2003 about Fermanagh College's use of third parties to provide WBL courses. It appeared that the College was acting largely as management agent and was generating Departmental funding at least possible cost and effort to itself. DEL told us that it had received assurances from the Principal at that stage that the terms of Circular 19/01 (see paragraph 1.1) were being adhered to. However, the Education and Training Inspectorate's report in November 2004 (see paragraph 1.3) alerted the Department to potential breaches of the Circular and DEL told us that these had to be investigated to confirm that this was, in fact, the case. It was not until August 2005 that, following discussions with the Governing Body, the Board engaged Grant Thornton, the external auditors of the College, to fully investigate the issues. In April 2006, the Department wrote to the Chairman of the Governing Body informing him that the College's participation in the delivery of the WBL programme did not meet the requirements of the Circular and a sum of £1.14 million would have to be repaid.

4.8 We note that the Department had considerable difficulty eliciting information from the College management and had received conflicting information from the Principal. On one occasion in June 2005, officials made a pre-arranged visit to the College to inspect books and records pertaining to the WBL delivery but were told by the Principal that these were not available. DEL told us that "this failure by the Principal to comply with the request to provide information and access to the books and records resulted in the Department reporting its grave concerns to the Governing Body".

4.9 We are concerned that it took three years to decide that the College was not entitled to WBL funding and that the Department did not exercise a more active challenge function when there was reason to believe that it was not acting appropriately. DEL told us that it was not involved in a three year investigation into WBL at Fermanagh College, nor was it unwilling to exercise its challenge function. It was only when it encountered difficulties in eliciting the required information that it became concerned and, in line with the model of incorporation, engaged the Governing Body and outlined the potential liability.

Whistle-blowing Allegations

4.10 In August and September 2005, the Minister and the Department received 'whistleblowing' letters alleging serious deficiencies in leadership and financial management in the College (see paragraph 3.1). The Chairman of the

Governing Body wrote to DEL seeking clarification of his understanding of the role of the Department and the College in relation to the anonymous letter, namely that;

- "the Department has not directed the Governing Body to investigate the allegations but is rather suggesting that an investigation may be necessary"; and

- "it is the Department's view that it is a matter for the Governing Body to determine what action it takes". Therefore "it is for the Governing Body to determine the appropriateness of the investigation, the terms of reference of any investigation, the conduct of any investigation and any action arising therefrom".

4.11 The Governing Body decided to conduct discrete inquiries into the substance of the allegations and engaged its external auditors, GT, to investigate seven of the issues. Having examined the findings they concluded that other than the repayment of £11,570 overtime (see paragraph 3.3), there were no major areas of concern.

4.12 We are surprised that, in the light of the serious failures emerging from the WBL investigation, the Department was prepared to pass the whistle-blowing letters over to the College and leave it to the Governing Body to decide what action it should take. One of the points made in the anonymous letter was that previous complaints made to the Board about a named individual had not been investigated. In our view, some of the issues arising from the allegations (outlined in Part 3) are indeed matters for concern and indicators of potential weak governance and control which the Department should have pursued more directly. The Department told us that it was following the advice of the Departmental Solicitor that the Chairman of the Governing Body should be approached and asked to investigate the claims. In its letter to the Chairman, DEL stated "any such investigation must be transparent in its approach, and conducted in a manner which is clearly independent of any influence by the Board. The outcome of the investigation should also be made available to the Department."

Deloitte & Touche Review

4.13 The Department has the power to commission an efficiency review of a college where it appears necessary as a result of mismanagement. It has done this on one occasion since 1998. Following the WBL investigation and whistle-blowing allegations, there appears to have been good cause for DEL to have commissioned a full review of governance and financial management in Fermanagh College. Instead, it again left it to the Governing Body to commission a review. The Department told us that it had worked closely with the Governing Body in drawing up the terms of reference but we note that Corporate Governance was not included. In its original draft report Deloittes identified significant

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weaknesses in the Corporate Governance environment but this section was removed from the final report. The Department told us that the recommendations made as a result of Deloitte's findings on Corporate Governance had still been included in the action plan that had been prepared by the Governing Body and this was being monitored by the Department.

We asked DEL whether the recommendations in the composite action plan (see paragraph 3.7), raised in the Deloitte's report of February 2006 and the other earlier reports, had been satisfactorily implemented. The Department told us that the key recommendations in the composite action plan have been implemented and work on the others is continuing. DEL has been attending regular meetings with the Acting Principal, the Chair of the Governing Body, the Corporate Change Manager, and the Vice Principal of Fermanagh College, to monitor the College's progress against implementation of the recommendations. The Department confirmed that it will work with the Director of the new area college to ensure that these issues are taken forward and that any remaining recommendations in the composite action plan are adequately addressed.

4.14 It is a matter of some concern that the findings in Fermanagh College remained undetected by the Governing Body. We note that new arrangements were introduced for the recruitment of members of the six new Governing Bodies who take up duty from the merger date of 1 August 2007. This process involves an interview to test the applicant's experience in a profession, business or industry, experience of effective corporate governance and experience in managing business or organisational change. We consider it essential that the training needs of the new governors are identified and documented and DEL must maintain and build on the training it has arranged in the past to ensure that all these requirements are met. The Department should also consider if it would be useful to have an observer and assessor attend at least the initial meetings of the new governing bodies to ensure that the members are fully aware of their roles and responsibilities.

Internal and External Audit Arrangements

4.15 The Department relies heavily on internal and external auditors to monitor financial management and governance arrangements at the colleges. However, as indicated in our 1999 Report, paragraph 5.36, experience in Great Britain has been that such monitoring has sometimes failed to detect and prevent poor governance and financial mismanagement. The Committee of Public Accounts Report on Halton College (37th Report, Session 1998-99) noted that one of the causes of failings at the College had been the weak performance of its internal and external auditors. It should be noted that, at Halton College, both internal and external audit services were provided by one private firm.

4.16 The HELM Corporation provided the internal audit service for Fermanagh College and operated a service to management by measuring and evaluating the effectiveness of the internal audit control systems. HELM were first appointed in 1998 and have continued through to their current three year contract which ended in July 2007. For each of the years 2001-02, 2002-03 and 2003-04, HELM gave a substantial level of assurance on the College's systems of internal control. This had included audits of Corporate Governance and Budgetary Control in 2001-02. Corporate Governance was not examined again until 2004-05, by which time problems at the College had begun to emerge. In this year HELM gave an overall limited level of assurance which included audits of Corporate Governance and Management Control.

4.17 External audit services are provided by Grant Thornton who were also first appointed in 1998 and their current three year contract is due to end in 2008. The £1.14 million over claimed by the College for WBL arose from data produced in 2002-03 (resulting in an over claim of £0.51 million in 2004-05) and data in 2003-04 (resulting in an over claim of £0.63 million in 2005-06). The accounts for 2002-03 and 2003-04 were unaffected by the incorrect data. The 2004-05 and 2005-06 accounts were finally completed in February 2007 and signed by the College and Grant Thornton in March 2007 receiving unqualified opinions following recognition of the above overclaims. From our review of the management letters issued following GT's audits from 2001-02 to 2003-04, we found that none of the issues that subsequently came to light regarding governance, financial control and management information systems, had been identified in these audits.

4.18 In the course of the audit of the 2005-06 financial statements, the Department was informed that serious concerns had been raised by Grant Thornton in relation to procurement activity. The Department carried out an investigation and found that the standard and level of documentation retained by the College fell far short of what would be required in relation to the award of tenders. Indeed, there was practically no documentation available at all for review. Total spend in this area amounted to £2.4 million over a five year period but the tendering and procurement procedures, as prescribed by the Financial Memorandum, had not been followed from 1998-99 until the appointment of the Acting Principal in October 2005.

4.19 The Department told us that its biggest concern was that the problems in Fermanagh College had not been identified by internal or external audit. It requested the Audit Committee, through the Governing Body at Fermanagh College, to carry out a review of the reasons why the failures took place and why they were not identified. The resulting report of 26 March 2007 is provided at Appendix 4. In summary the Governing Body concluded that:

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"There are clearly lessons to be learned, both by the Governing Body and the Department, from the Fermanagh College experience.

From the Governing Body's point of view, it fully accepts its statutory and other responsibilities for the good governance of the College. For a Governing Body to properly fulfil those responsibilities, however, there has to be a good flow of information from the Principal and his or her senior staff, and sound accountability protocols in place. Fermanagh College Governing Body now acknowledges, with the benefit of hindsight and based on all that it has learned from the various investigations over the past eighteen months, that there were serious shortcomings on both fronts, the greatest impediment of all being the fact that it was "kept in the dark" on issues of strategic and operational significance. There also have to be robust audit systems in place. The fact that its internal and external auditors, and the DEL and ETI audits, all failed to highlight any issues of significance, gave the Governing Body a false sense of assurance that 'all was well'".

We asked the Department what its response was to the Governing Body's assessment of the reasons for the financial failures identified. The Department told us that it was not prepared to accept the document produced as a valid review.

"As is obvious from the comments and recommendations in the review, the Governing Body appears to have been operating under a fundamental misunderstanding of its role and responsibilities, and has also displayed a particular, and significant, lack of understanding of the nature of audit functions. This document must be considered as a first draft and, in normal circumstances, it would have been subject to a number of iterations, with the Department suggesting significant amendments." "It is unfortunate that, due to the demise of the Fermanagh Governing Body on 31st July 2007, this process cannot be completed."

We have attached, in full, the Department's response of 30 July 2007 to the review by the Governing Body at Appendix 5. The Governing Body told us it unreservedly rejected the Department's assertion that it had a fundamental misunderstanding of its role and responsibilities and was aggrieved that it had been denied the opportunity to formally defend its position.

4.20 We noted that where the same firm is involved in the internal audit of different colleges, the audit plans tend to be the same which suggests that they are not addressing the particular risks of each college. DEL told us that it is carrying out a review of internal audit provision in all colleges and will investigate these to ensure that they are prepared on an appropriate risk basis. DEL also told us they are reviewing plans for the provision of external audit.

4.21 In our view the Department should also take steps to monitor closely the operation of college audit committees. For example, it should ensure that committees have the appropriate skills and at least one member who is a financial expert. Additional training should be provided as necessary so that members are fully equipped to comply with all aspects of the Audit Code and financial guidance such as the Treasury Audit Committee Handbook. Committees must ensure that audit plans are prepared following a full risk assessment and that effort is focused on key control areas such as Corporate Governance. They must establish, and monitor achievement against, performance measures for internal and external audit services. The Department should also consider having its Internal Auditor carry out a sample review of the internal audit arrangements throughout the sector to assess whether they are rigorous and reliable.

4.22 DEL told us that it carries out a detailed review of all internal audit reports and external audit management letters every year. Any significant issues are identified and a circular summarising any items of mutual interest or application is issued to all colleges. The Articles and Instruments of Government are being amended to allow the Department right of attendance at audit committee meetings.

Strengthening the Department's Monitoring Arrangements

4.23 The Department told us that it had commissioned consultants to carry out a review of the governance and financial position of all colleges prior to the merger. It has asked the Temporary Executive Committee of each new group to engage independent consultants to carry out due diligence reviews. It has recommended that these should encompass a comprehensive investigation and examination of each existing college's records and systems including the financial position, an assessment of financial and internal control systems and identification of any areas where the colleges are not adhering to any prevailing procedures, regulations, statutes or circulars. The Department has offered to provide a significant amount of funding for these investigations but again we note that it is asking the groups to advise if they are content to undertake a review rather than directing that one should be carried out. Also, it would have ensured greater consistency in approach and coverage if DEL had commissioned the reviews. For example, we note with concern that the suggested terms of reference do not include an examination of corporate governance arrangements.

4.24 The Department told us that it had been its original intention to manage these exercises internally. However, there was not sufficient manpower available to devote to establish, tender, administer, monitor and review six large Due Diligence exercises. The terms of reference were drawn up by DEL to concentrate on key issues. As the current colleges were to cease to exist in a short period it was considered that a review of their governance procedures would not be a priority at present and would

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not represent an effective use of public funds. A detailed review of this will be undertaken as part of new annual review procedures which are being drawn up by the Department.

4.25 As required by the 1997 Order, the colleges produce annual Development Plans covering a three year period on a rolling basis. The Plans include information such as a mission statement, strategic aims, key issues for action, a review of performance against objectives and targets set in previous plans, and student numbers and achievements. In our 1999 report we made recommendations on the structure and content of the Plans.

4.26 Development Plans provide one of the main sources of information for the Department when considering the needs, type and range of provision, capability and financial health of the sector. The colleges also benefit from having a robust plan in place that will enable them to make informed strategic decisions and manage their resources in accordance with strategic priorities. Each year DEL provides the sector with information on Government policies, strategic objectives, and priority areas and prepares guidance to assist colleges in formulating the plans.

4.27 The Department has not had an approval role for Development Plans in the past but with effect from 2007-08 it is intended that the Plans will be established as the key planning and reporting tool between the colleges and the Department. They will set out what the colleges will deliver in key areas and identify agreed performance indicators which will be used as a contract to underpin funding. We welcome this action.

4.28 The main funding provided by DEL to the colleges is based on a measured unit known as the Student Powered Unit of Resource. This takes account of student activity in the areas of recruitment, learning and achievement. The Department carries out an annual audit of the data submitted by the colleges to validate the information and to ensure that there is no double funding against other college activity. The Department told us that, with the reduction in the number of colleges, there may be an opportunity to increase the range of activities covered in this audit. We would strongly recommend that the Department does widen the scope of its audits to review the operation of corporate governance and strategic management.

4.29 In Appendix 3 (paragraphs 7, 9 and 11) we have outlined the information routinely provided to DEL by the colleges. These returns are reviewed by the Department to monitor financial performance and to ensure that all necessary action is being taken to address, for example, audit recommendations. Any issues of general interest or lessons to be learned are circulated to all colleges. The Department is considering what further information the colleges should be asked to provide in these returns in order to enhance the effectiveness of its reviews.

4.30 In response to the Committee of Public Accounts reports[3] on the Management of

3 Financial Management and Governance at Gwent Tertiary College, National Audit Office, March 1999, HC 253 and Investigation of Alleged Irregularities at Halton College, National Audit Office, April 1999, HC 357.

Growth in the English Further Education Sector and the Investigation of Alleged Irregularities at Halton College, the Higher Education Funding Council for England (HEFCE) introduced additional monitoring arrangements for colleges. In our 1999 report we recommended that the Department should ensure that it incorporated developing best practice in England and Wales into its arrangements for monitoring and reviewing institutions' performance regarding governance and financial management.

4.31 The Department told us that "following the 1999 NIAO report, best practice was investigated in the rest of the UK, and incorporated into the accountability framework which was developed. Furthermore, the Review of Accountability Arrangements, commissioned by the Department in December 2002 to examine emerging best practice in England, Scotland and Wales, as well as other sectors in NI, and the outcome was incorporated into the final recommendations, which were implemented in full. The Department has given a very high priority to ensuring that developments in accountability arrangements are being monitored and used to inform improvements in procedures in NI and recognises the need to keep itself informed with the developments in England and Wales."

Appendices

Appendix One: Recommendations of the Committee of Public Accounts on the Investigation of Alleged Irregularities at Halton College

Overclaims of Grant

Halton College was able to claim almost £14 million more in grant from the Funding Council than was justified, despite a range of controls for ensuring the accuracy of funding claims including audit by the College's external auditors. The Funding Council are still investigating six other colleges where overclaims might have arisen. We find it difficult to understand how unjustified claims on this scale could have evaded the financial controls in place, that it has taken so long to finalise the figure at Halton, and that other potential cases are still not resolved. We look to the Funding Council to review again their financial controls and checks over grant claims to ensure that any future overclaims are picked up before payments are made.

Governance and Management of Further Education Colleges

The problems at Halton arose from a combination of a strong Principal, a weak audit process and a governing body that was not on top of the situation. We have seen similar failings in other colleges. Given that further education colleges receive over £3 billion of public funds each year, we welcome the new measures announced to strengthen governance and audit arrangements throughout further education colleges. These should go some way to prevent further cases and re-establish the credibility of the sector. But we look to the Funding Council to follow through on all of these issues in their cyclical audit and inspection work at colleges.

In more detail our conclusions and recommendations are:

1. It is highly unsatisfactory that Halton College overclaimed almost £14 million, and that to a large extent these claims evaded the financial controls in place at the College and the Funding Council. One immediate impact of the need to repay this money is that 114 people will lose their jobs, and this will cost the taxpayer £1.8 million. Whilst the Department and Funding Council have assured us that further education provision to the people of Widnes and Runcorn will be protected, the College will need to go through major and painful changes in order to put the core business of the College into a sound footing.

2. We are deeply concerned at the extravagant spending particularly on overseas trips by the Principal and Deputy Principal. Apart from the total cost – over £210,000 – and excessive individual expense items, the absence of these two senior managers from the College for almost 12 months over five years can only have added to the management problems there.

3. We agreed with the Department that the failings at Halton arose through a combination of a strong-willed principal, a weak audit process and a governing body that was not on top of the situation. In particular, we are surprised that the governors of Halton College met only three or four times a year and question whether this was sufficient for them to discharge their duties effectively.

4. The Principal and Deputy Principal were suspended in May 1998, but it

took almost a year before any further disciplinary action was taken against them. During that time, they continued to receive full pay of £200,000. We note the intention of the Department to propose limitations to the period over which any future suspension in the sector on full pay can last.

5. We are concerned that the College did not disclose to us until after our hearing that the Board had agreed to pay £12,000 towards the Principal's and Deputy Principal's legal costs, so depriving us of the opportunity to pursue the matter in public. The decision to fund even part of the Principal's and Deputy Principal's legal costs was extraordinary, and could have resulted in the College paying for action being taken against it and the Funding Council. This support may also have contributed to the delays in publication of the Funding Council's report and in taking disciplinary action against the Principal and Deputy Principal, and consequently to the period over which they received full pay while suspended.

6. We note that taking legal advice, the governing body of the College have decided not to pursue compensation from the Principal and the Deputy Principal because any action could be complex, and could quickly become uneconomic.

7. We welcome the steps taken by the Funding Council and the College to improve governance, internal control, management and audit arrangements at Halton College. We look to the Funding Council to monitor the College closely to ensure that these changes work in practice, especially at a time when the College will be going through restructuring, staff reductions, management changes and the appointment of new governors.

8. We note the concerns of the Department, the Funding Council and the College about the performance of the College's internal and external auditors, Deloitte and Touche. We note that the governing body has decided not to take legal action against the auditors in respect of shortcomings in their audit work because their legal advice is that any such action would be complex and costly, and might not succeed. The Board decided that it would not be a prudent use of public funds to risk large amounts of public money, initially £150,000 plus VAT, against the prospect of small financial rewards.

What is being done to ensure that similar problems have not occurred elsewhere?

9. We strongly support the positive response of the Department to the problems uncovered at Halton and at Bilston Community College on which the Funding Council has recently published a highly critical report. The newly announced package of improvements to governance and audit arrangements should go some way towards preventing further cases and re-establishing the credibility of the sector.

10. We note the steps taken by the Funding Council to identify those colleges with similar features to Halton, who might

Appendix One: Recommendations of the Committee of Public Accounts on the Investigation of Alleged Irregularities at Halton College

therefore also be over claiming public funds. We urge the Council to complete its investigations as soon as possible, and to let us know the outcome.

11. The National Audit Office and Funding Council found that weaknesses in financial controls at Halton over procurement and travel expenses might also exist at many other colleges. While the Funding Council have sent a copy of their report to every college, and drawn their attention to the weaknesses found, we look to the Funding Council to follow through on all these points in the cyclical audit and inspection work at colleges.

12. We welcome the steps taken by the Funding Council to strengthen the audit of grant claims, and to separate responsibility for internal and external audit. However, we are concerned by the Funding Council's conclusion that internal audit could not be relied on in about a fifth of colleges. We look to them to ensure that internal audit arrangements throughout the sector are rigorous and reliable.

Appendix Two: Summary of Action Required to Address Weaknesses in Governance and Financial Controls

Governance and Corporate Planning

1. The Governing Body must provide the strategic direction and parameters for corporate and financial planning.

2. The Governing Body must provide an effective challenge function to ensure the delivery of financial and non-financial targets. It must ensure that it is provided with accurate and timely information in a form which meets its needs, to regularly monitor performance.

3. Key performance indicators should be established.

4. A Governors' training needs analysis should be prepared at least on an annual basis.

5. The Governing Body should satisfy itself that there is an efficient and effective staff appraisal system.

6. The Audit Committee should meet at least quarterly in line with best practice. A formal reporting process should be established between this committee and Governing Body.

7. The College Development Plan objectives should be Specific, Measurable, Attainable, Results focused and Timely and it should include all the information specified by the Department.

8. Business, financial and corporate plans should be closely linked and operational plans should be linked to the strategic objectives.

Financial Planning and Budgeting

9. The roles and responsibilities of budget holders should be established and clearly articulated. Their competency should be assessed and appropriate training provided.

10. Budget holders should be given clear financial targets at the start of the financial planning process and they should be involved in all stages of the budgeting process.

11. There should be clear line management responsibility for budget holders and their performance should be monitored.

Authorisation and Management of Expenditure

12. Procedures, roles and responsibilities should be defined for all financial management processes.

13. Permanent amendments to the payroll should be verified and approved by the Human Resource Manager.

14. All assets should be numbered and included in the Asset Register and there should be a regular process of asset verification.

Financial Reporting

15. The information needs of the Governing Body (both financial and non-financial) should be specified and as a minimum

Appendix Two: Summary of Action Required to Address Weaknesses in Governance and Financial Controls

should meet the requirements of Departmental circular FE2/2000.

16. The content and timing of reports should be agreed between the Finance Director and recipients.

Audit

17. A full risk assessment should be carried out involving members of the Governing Body and members of the Senior Management Team. The adequacy and coverage of the audit plan should be considered in light of this assessment.

18. The Governing Body should ensure as part of the tendering process, that internal and external audit have appropriate quality management systems in place. Performance measures for both services should also be established.

19. At least one member of the Audit Committee should have financial expertise.

20. Implementation of audit recommendations should be monitored by the Governing Body.

Management Information Systems

21. Cross departmental teams should be involved in the establishment of individual business area needs, the services provision and reporting requirements, the roles and responsibilities, and monitoring and review procedures for an integrated Management Information System.

Management of Recurrent, Earmarked and External Funding

22. There should be a clearly defined strategy for funding from third parties. Applications for funding should only be initiated when they have been evaluated by Senior Management and approved by the Governing Body.

23. Roles and responsibilities in relation to the ownership, management, internal reporting and monitoring and control of projects should be defined.

24. Finance staff should attend monthly project meetings to review spend and performance against budget.

25. The Senior Management Team and Finance Committee should be provided with a monthly status report for each project which includes explanations for variances and any corrective action taken.

Third Party Relationships

26. Legally binding contracts must be in place for all third party relationships. As a minimum these should specify terms and conditions; performance indicators and quality standards; performance monitoring and review arrangements; and contract management and invoice approval arrangements.

27. A register of interests should be maintained for all members of the Governing Body and members of the

Senior Management Team and there should be a policy to deal with conflicts of interest.

Senior Management Team

28. There must be job descriptions for all members of the Senior Management Team and an efficient and effective staff appraisal system throughout the College.

Appendix Three: The Department's Governance, Monitoring and Control Arrangements

The Further Education (Northern Ireland) Order 1997 places a duty on the Department for Employment and Learning to secure effective execution of its policy in respect of the provision for further education in Northern Ireland. The main ways in which the Department has sought to provide governance, monitoring and control arrangements in order to pursue this duty are as follows:

1. The provision of initial training and guidance for the Governing Bodies, for example, all Governors were offered two induction seminars focusing primarily on corporate governance and financial management/public accountability. Governor training material packs were issued and courses arranged to cover specific needs such as Child Protection legislation.

2. The development of a funding formula based on student activity and achievement to encourage colleges to improve their efficiency and effectiveness in line with government policy.

3. Subjecting colleges to independent review by the Education and Training Inspectorate who report on the quality of teaching provision.

4. The approval of College Articles and Instruments of governance which set out the constitution of the Governing Body and the way it conducts its activities. This is supplemented with periodic circulars and other guidance as appropriate. In particular the Financial Memorandum issued to each college is the official financial guide for Governing Bodies and management of colleges and sets out, inter alia, a range of accountability measures, the planning, reporting and control framework, and arrangements for audit.

5. The college principal/director is appointed as Accounting Officer for his/her own college. The principal is required to provide an annual assurance statement to the Departmental Accounting Officer on the college's internal control and risk management arrangements.

6. Each college is required to submit a rolling three year Development Plan to the Department annually in September, outlining its planned activities and linking the main elements of provision with Departmental priorities.

7. Governing Bodies are required to submit regular financial statements to the Department which set out financial performance in the year to date and forecast outturn for the year compared with plan. This is normally done on a quarterly basis, but may be required more often if necessary (for example if a college is in financial difficulties).

8. Each year the Department issues an Accounts Direction which sets out the required format of the college's annual accounts and specifies the supporting information to be provided.

9. Draft annual accounts are required to be with the Department by the end of September each year and fully audited accounts by the end of November.

The quarterly and year end financial information is used by the Department to monitor the financial position of the sector and the individual colleges. Circulars are issued summarising financial performance and drawing attention to items of general interest.

10. Each college is required to have an audit committee of the Governing Body to oversee the external and internal audit arrangements. All college accounts are audited by an independent external auditor. The Department seeks assurance on the consistency and adequacy of the audit approach by sending a questionnaire to each auditor seeking information on the audit approach and findings.

11. The Department receives copies of all internal audit reports and external audit management letters. Each college audit committee is required to submit an annual report which includes the main issues arising from audit and how they were dealt with together with an opinion on the reliance which can be placed on the internal control systems. The Department reviews the documentation to ensure that all necessary action is being taken and circulates any lessons learned or issues of general interest to the sector.

12. The Department retains wide-ranging powers to take further action if necessary as a result of mismanagement, including:

- the commissioning of an efficiency review with power to direct implementation of any recommendations,
- the removal of Accounting Officer status from the College Principal, and
- the removal of any or all of the members of a College Governing Body.

Appendix Four: Report from College Governing Body to the Department on the Outcome of its Internal Review

Fermanagh College

REPORT FROM
FERMANAGH COLLEGE GOVERNING BODY
TO THE
DEPARTMENT FOR EMPLOYMENT AND LEARNING
ON THE OUTCOME OF ITS
INTERNAL REVIEW

1.0 Introduction

Fermanagh College Governing Body, in a letter dated 4 December 2006 from the Department for Employment and Learning, was requested to:

"Identify the circumstances and reasons why the problems which have beset the College in recent months were able to occur. "

This report is the Governing Body's response to the Department's request. The format of the report, for ease of reading, has been kept as simple and succinct as possible.

2.0 Approach to the Assignment

A Working Group, chaired by the Chairman of the Audit Committee, Mr John Breen, was set up to take forward this review. Membership of the Working Group comprised:

- Mr John Breen (Working Group Chair and Chair of Audit Committee)
- Councillor Robert Irvine (Audit Committee Member)
- Councillor John O'Kane (Audit Committee Member)
- Mr Alan Cecil (Governing Body Chair)
- Mr Sam Robinson (Governing Body Vice Chair)
- Mr Peter Duffy (Staffing Committee Chair)
- Dr Gordon Byrne (Acting Principal)

Mrs Elizabeth McSorley, Clerk to the Governing Body, acted as Clerk to the Working Group.

The Working Group met on three occasions, namely 2, 9 and 16 March 2007, for the purposes of this assignment and formally reported to the Governing Body on Monday 26 March 2007.

3.0 How Problems were first Identified

The Governing Body's first indication that there were potential problems within the College came in August 2005. This originated from two different sources, namely:

- An anonymous letter dated 5 August 2005 sent to the then Minister for the Department for Employment and Learning, Mrs Angela Smith, purportedly by a 'group of lecturing and support staff'. This contained a number of allegations relating to the management of the College.

- A letter dated 10 August 2005 from the Department for Employment and Learning to the Principal, with a copy to the Chairman of the Governing Body. This raised a number of concerns about the delivery of Work Based Learning provision by the College.

These letters were closely followed by (a) a whistle-blowing letter sent to the Department for Employment and Learning in September 2005 by a member of the College staff alleging a number of incidents of misconduct and maladministration on the part of named senior managers and (b) complaints from NATFHE about non teaching staff regradings and other issues.

The Governing Body commissioned a number of investigations on foot of the above correspondence and complaints and copies of these reports, and the associated action plans, have already been submitted to the Department.

4.0 Findings as to the Circumstances and Reasons for the Problems

4.1 There was a culture within the College of undermining management's authority - it is the Governing Body's opinion that the anonymous letter was triggered by a person or persons who did not agree with the new faculty structure being introduced at the time and the appointments which resulted from this and that they therefore deliberately set out to destabilise the College. In the case of the whistle-blowing letter, this was written by a person with a grievance against the College in relation to the new structure and, furthermore, was written after the Governing Body had been alerted by the Department to its concerns about the delivery of Work Based Learning. This person was provided with information by an individual implicated in the Work Based Learning investigation. None of this information had previously been brought to the attention of the Governing Body.

Appendix Four: Report from College Governing Body to the Department on the Outcome of its Internal Review

4.2 Respect for authority and effective team working were not properly developed and nurtured across the organisation. There has been an improvement under the leadership of the Acting Principal, Dr Gordon Byrne who was appointed on 3 October 2005.

4.3 On the basis of the findings from the various investigations that have been undertaken in recent months, the Principal clearly did not exert the level of strong and consistent leadership that was required of his position. This was masked by his charismatic personality. He also over delegated and placed too much trust in others, particularly, for example, in the area of finance where he appeared to have had insufficient expertise.

4.4 Under existing protocols a Governing Body, which is largely made up of volunteers, has no option but to rely on the integrity of the Principal and his senior officers that they are properly exercising their executive responsibilities and that they are keeping governors appropriately informed. It is clear, from the findings which have emerged from the various investigations, that there were serious shortcomings in the performance of the executive function and that the Governing Body was "kept in the dark" about matters of strategic and operational significance which should have been brought to its attention.

4.5 The position of Secretary to the Governing Body, up until July 2004, was held by two different members of the senior management team - the Finance Director from April 1998 to July 2003 and the Vice Principal from July 2003 to July 2004. This meant that the Secretary to the Governing Body was not in a position to act independently of the Principal in terms of the type and level of information, and advice, that was given to the Governing Body.

The current Instrument of Government, which is based on the Model Instrument of Government, expressly provides for appointment to the position of Secretary to the Governing Body from within the College which, it is believed, is contrary to NIAO guidance issued in 1999 that Secretaries should be independent of College systems.

It should be noted that a professionally qualified, independent Clerk, who reports directly to the Governing Body, through the Chair, has been in post in Fermanagh College since August 2004.

4.6 The anomalous situation whereby the Accounting Officer has a direct reporting role to the Permanent Secretary, effectively bypassing the Governing Body on matters for which it has overarching responsibility. The Governing Body, for example, does not have the right to sight of the annual Statement of Internal Control which is submitted by the Accounting Officer direct to the Department.

4.7 There is inadequate formal communication between the Department and the Governing Body. Most communications with the College have been through the Principal.

4.8 The three levels of audit assurance relied on by the Governing Body, namely internal audit, external audit, and the DEL audits, either failed to highlight, or, in the case of DEL audits, to highlight in a timely fashion, irregularities which could have alerted the Governing Body to problems or potential problems.

The fact that there have been clawbacks in a number of other Colleges in recent years would indicate that DEL's own audit function may not be as robust as it should be.

4.9 A favourable ETI focused inspection report (January 2004), relating to an inspection carried out in September/October 2003, informed the Governing Body that "all was well".

4.10 The Department did not alert the Governing Body until August 2005 that it had concerns about Fermanagh College's involvement with Work Based Learning despite having raised concerns with the Principal at least two years earlier and there having been ongoing communication with him on the matter since around 2001. When the Chairman of the Governing Body was first alerted to the issue in August 2005, he was not alerted by direct contact but through a copy of a letter sent to the Principal.

4.11 There was a less than rigorous approach towards compliance with DEL circulars and procedures, the interpretation and application of the Work Based Learning circular being a case in point.

4.12 The Governing Body is of the view that the Principal's ill health situation contributed to some of the problems that have been highlighted above. It is also of the view that the current arrangement under Paragraph 20 of the Financial Memorandum in relation to temporary periods of unavailability by the Accounting Officer is unsatisfactory and needs to be reviewed.

5.0 Recommendations

The Governing Body, based on its analysis of the Fermanagh College situation, has formed a number of recommendations for the Department's consideration. These are detailed in paragraphs 5.1 - 5.20 below.

5.1 College Accounting Officers, and College Vice Principals from an Acting Accounting Officer perspective, should be required to undertake formal financial and other training to enable them to effectively discharge the responsibilities attached to this position.

5.2 Paragraph 20 of the Financial Memorandum should be reviewed to ensure that more satisfactory arrangements to cover the Accounting Officer's unavailability for a period of up to four weeks are put in place. It is recommended that, as a trigger mechanism in the

Appendix Four: Report from College Governing Body to the Department on the Outcome of its Internal Review

case of sickness absence, there should be a requirement that when medical certificates are submitted to the College, copies should contemporaneously be submitted to the Department's Accounting Officer.

5.3 There should be some formal mechanism for linking the direct reporting relationship between the Accounting Officer and the Department into a triangular structure which links back to the Governing Body.

5.4 A senior Departmental representative (preferably the Director of Further Education) should attend Governing Body meetings on a regular basis, say quarterly. This may provide a mechanism for the linking of the reporting relationships referred to at 5.3 above.

5.5 Following good risk management principles, the Department should communicate simultaneously with the Principal and the Chairman of the Governing Body on any matter of a serious or potentially serious nature so that the Governing Body is in a position to take timely, corrective action.

5.6 Similarly, the Department should alert the Chairman of the Audit Committee to all potential and actual clawbacks so that the reason for these can be properly investigated and appropriate action taken. Simply taking the money back is not addressing the root cause.

5.7 The Department should ensure that effective procedures are put in place to improve the policing of its own circulars, possibly through the audit process, so that problems in either interpretation or application can be identified and corrected at an early stage - not four years down the line as in the case of Work Based Learning Provision (Circular FE 19/01) in Fermanagh College.

5.8 There needs to be an independent relationship between auditors and Audit Committees and a more extensive and robust internal and external audit function, and a strengthening of DEL's own audit function. The latter is particularly important in view of the present multi faceted, complex funding structure which the Department operates. Such a funding structure either needs to be simplified or backed up by an enhanced audit function.

5.9 Consideration should be given to the audit function, particularly external audit, being completely independent of Colleges following, for example, a system similar to that operated within local government.

5.10 Internal audits should be as much about testing whether a particular system is the right system as it is about the way in which the system works. It should also take an overarching view of the College's internal control systems as opposed to the compartmentalised approach which it currently adopts.

5.11 The Department should develop a model executive structure incorporating robust accountability protocols, particularly in relation to financial management, for each of the new College groupings.

5.12 The governance and executive functions, to operate effectively, need to co-exist within a culture of "trust and verification" which is underpinned by a robust system of staff appraisal.

5.13 Model terms of reference for the operation of all Committees should be incorporated within the new Articles of Government.

5.14 There should be a requirement that minutes of all Governing Body and Committee meetings are submitted to the Department, for scrutiny purposes, on a monthly basis. This arrangement is currently in place for minutes of Finance Committee meetings.

5.15 In addition to the ETI inspection process, other arrangements should be put in place for external assessment of the executive and governance functions. Furthermore, there should be a requirement that the reports of all such inspections and assessments should be forwarded to the Governing Body, through the Chair.

5.16 Governing Bodies need to have a firm control on the strategic development and review of local policy so that management operates within a framework of clearly defined and agreed policy boundaries. Models of best practice can be found within local government with many Councils employing dedicated Policy Officers.

5.17 Specifically, Governing Bodies should be required to approve in advance all contract and project work not covered by DEL funding. This is now the case in Fermanagh College.

5.18 The Clerk to the Governing Body should be an external appointment directly accountable to the Governing Body, through the Chair. This should be prescribed within the new Instrument of Government. Furthermore, the post of Clerk to the Governing Body should be at a professional level (as in the case of Fermanagh College), and the postholder should undergo regular, appropriate in-service training.

5.19 The Governing Body Chair and Vice Chair, and Committee Chairs, supported by the Clerk to the Governing Body, should meet with the Principal on a regular basis in information sharing sessions. This arrangement is now in place in Fermanagh College.

5.20 Briefing meetings between the Principal and the respective Chairs should take place immediately prior to every Governing Body and Committee meeting. This arrangement is now in place in Fermanagh College.

A minority view was that there should be formal provision for a structured and unstructured process of engagement between the Governing Body and the College stakeholders.

Appendix Four: Report from College Governing Body to the Department on the Outcome of its Internal Review

6.0 Conclusion

There are clearly lessons to be learned, both by the Governing Body and the Department, from the Fermanagh College experience.

From the Governing Body's point of view, it fully accepts its statutory and other responsibilities for the good governance of the College. For a Governing Body to properly fulfil those responsibilities, however, there has to be a good flow of information from the Principal and his or her senior staff, and sound accountability protocols in place. Fermanagh College Governing Body now acknowledges, with the benefit of hindsight and based on all that it has learned from the various investigations over the past eighteen months, that there were serious shortcomings on both fronts, the greatest impediment of all being the fact that it was "kept in the dark" on issues of strategic and operational significance. There also have to be robust audit systems in place. The fact that its internal and external auditors, and the DEL and ETI audits, all failed to highlight any issues of significance, gave the Governing Body a false sense of assurance that "all was well".

It is hoped that the Department will find this paper of benefit, particularly in the context of the forthcoming merger, in ensuring that a more robust system of governance is put in place. It is suggested that this will require a much greater commitment from governors than the six Governing Body meetings per annum that applicants for the new Governing Bodies have been lead to believe will be required of them. Fermanagh College, based on the experience of the past eighteen months, regards six meetings per annum as being wholly inadequate and believes that there has been a misrepresentation of the commitment that members of the new Governing Bodies will be required to give to the proper discharge of their duties and responsibilities.

ALAN CECIL
Chairman of Governing Body
26 March 2007

Appendix Five: Letter from the Department to the Chairman of the Governing Body of Fermanagh College

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30 July 2007

Mr Alan Cecil
Chairman of the Governing Body
Fermanagh College
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Dear Alan

INTERNAL REVIEW

We have reviewed the Internal Review carried out by the Governing Body and I must apologise for the delay in replying to you. Overall, we have major concerns in relation to many of the findings and recommendations made in the course of the review. There appear to be a number of areas where the Governing Body has a fundamental misunderstanding of its own role and responsibilities, and those of the Department, particularly in relation to the types of audit function carried out. There also seems to be a lack of awareness that the Governing Body is ultimately responsible for the effective management of the college.

The following paragraphs provide the Department's response to the detailed findings and recommendations of the internal review. Obviously, the Fermanagh College Governing Body will cease to exist from 1 August 2007, but we will follow up these issues with the new South West College, as appropriate.

Yours sincerely

BERNIE O'HARE

Copy: Victor Refausse, Principal of Fermanagh College
Pat O'Kane, Chair Designate of South Western College

Appendix Five: Letter from the Department to the Chairman of the Governing Body of Fermanagh College

Paragraph 4.3 and 4.4

In this section, it is disappointing to note that the Governing Body appears to be putting the blame for the ineffective management of the college entirely onto the former Principal. Whilst it is clear that the Principal did not fully discharge his duties in line with his status as Accounting Officer, it is ultimately the legal responsibility of the Governing Body, as set out in Article 13 of the Further Education (NI) Order 1997,

"to secure the efficient and effective management of the institution."

It is the responsibility of the Governing Body to challenge, question and examine all elements of the operation of the college and its senior management team and have an adequate system of controls, checks and balances in place to ensure effective management. It is apparent that the Governing Body failed to carry out this vital responsibility adequately or effectively.

Whilst the review notes that members of the Governing Body are volunteers, this should in no way lessen their responsibilities in relation to ensuring the effective management of the college.

Paragraph 4.5

Whilst it is accepted that the current Instrument of Government is ambiguous on the point of the required status of secretaries to the Governing Bodies (which has now been amended) following the issue of the NIAO Report in 1999 on Corporate Governance and Financial Management in Colleges of Further Education, all Colleges were written to by the Department to request that the recommendations of the Report were fully implemented, including the requirement that secretaries should be independent. At that time, Fermanagh College responded to the Department to confirm that it was implementing all recommendations. It would now appear that its reply to the Department was inaccurate.

Paragraph 4.6

It would be ineffective for the Department to deal with all day to day operational issues through the Governing Body. The Statement of Internal Control (SIC) which is completed by the Accounting Officer forms part of the annual accounts of the college which are required to be signed off, in their entirety, by the Chairman on behalf of the Governing Body. As a result, the Governing Body will have sight of the SIC prior to its issue to the Department.

Paragraph 4.7

The Department will deal with the Principal and senior management team in relation to all day to day operational issues. To deal directly with the Governing Body on these issues would be an ineffective and inefficient method of operation. Any contentious, or potentially serious, matter is escalated to the Governing Body by the Department.

Paragraph 4.8
In this paragraph, the Governing Body mentions 3 levels of "audit", internal, external and DEL audits. This paragraph demonstrates the Governing Body's fundamental lack of understanding of the purpose of these reviews, in particular the DEL audit. The Governing Body is responsible for arranging the internal and external audit provision for its college. These are key controls to provide assurances over the internal control systems in operation and that public funding is being spent in line with the aims and objectives of the organisation.

The review notes that:

"The fact that there have been clawbacks in a number of other Colleges in recent years would indicate that DEL's own audit function may not be as robust as it should be."

This statement again illustrates that the Governing Body does not understand the nature or purpose of the DEL audits. These audits are carried out on behalf of the Department in order to ensure that the information that the college is supplying to the Department, on which funding is based, is accurate and reliable. In the last few years these audits have found the quality of information management and record keeping to be poor, and this information has been notified to the college. Indeed, as a result of the deficiencies, funding has been clawed back from the college. This indicates that the DEL audits are extremely robust.

Paragraph 4.10
The statement that the Department did not alert the Governing Body of any potential problems until August 2005 is misleading. The Department was aware of Fermanagh College's involvement in Work Based Learning and had received assurances from the Principal that the terms of the relevant Circular were being adhered to. It was only after an inspection visit in June 2005, and subsequent correspondence, that the Department became concerned about the level of co-operation of the Principal and alerted the Governing Body.

Paragraph 4.11
The internal review notes that:

"There was a less than rigorous approach towards compliance with DEL circulars and procedures, the interpretation and application of the Work Based Learning circular being a case in point."

Whilst the onus is on college management to ensure such compliance, the internal audit function of the college should be reviewing these areas, as set out in the Government Internal Audit Manual (GIAM). In particular, this requires that the internal auditors should measure and evaluate the effectiveness of the internal control system with particular reference to:

"….compliance with applicable policies, procedures, laws and regulations."

Appendix Five: Letter from the Department to the Chairman of the Governing Body of Fermanagh College

This responsibility should have been clearly outlined to the internal auditors and reviewed by the Audit Committee.

Paragraph 4.12
It is not clear how the Fermanagh College Governing Body considers the current requirements of the Financial Memorandum can be improved.

Paragraph 5.1
The Governing Body suggests that all Principals and Vice Principals should be required to receive formal financial training. The Department considers this to be an unusual statement, as it is the responsibility of the Governing Body, as the employers, to have systems in place to ensure all the college staff have received the appropriate training to allow them to effectively carry out all their duties.

Paragraph 5.2
It is difficult to understand how the suggested approach to managing the absence of the Principal will be more effective. The current arrangements are considered to be adequate. Unfortunately, the Governing Body only notified the Department on **one** of the several occasions when the Principal was on extended sick leave.

Paragraph 5.3
It is unclear as to what formal reporting relationships the Governing Body is referring, which take place between the Accounting Officer and the Department. It is the responsibility of the Governing Body to ensure it has an appropriate reporting structure with all relevant external organisations, including the Department.

Paragraph 5.4
The Department would be happy to have officials attend meetings of governing bodies, when requested, to discuss specific issues. Otherwise, it is important, given the incorporated nature of the colleges, that their independence is seen to be maintained and that any Departmental officials attend purely as observers to proceedings.

Paragraph 5.5
The Department would agree that all serious matters should be notified to the Governing Body, in a timely fashion, and this process is already in place; indeed it is through this process that the Fermanagh College Governing Body was alerted to the concerns over the Work Based Learning issue.

Paragraph 5.6
Details of the overall findings of the annual DEL SPURS audit are reported to college principals and chairs of Audit Committees. Details of clawbacks from individual colleges would be communicated

to the Principal. This information should be clearly identifiable in financial reports provided to the Governing Body. However, in future, the Department will consider reporting details of clawbacks to the Governing Body directly.

Paragraph 5.7
The Governing Body suggests that the Department should make arrangements for "policing" compliance with its own circulars. The responsibility for this clearly lies with the college, and its own audit procedures should be sufficiently robust to ensure compliance is monitored. To attempt to shift responsibility onto the Department for monitoring this key requirement, shows a lack of understanding of the responsibilities of the Governing Body.

Paragraph 5.8
It is concerning that the Governing Body notes that there should be a more robust internal and external audit function – it is the responsibility of the Governing Body and its Audit Committee to ensure that a robust, risk based audit function is in place, and the Department has produced much guidance on these issues to assist governing bodies. It is disappointing to note that the Governing Body has indicated that this was not the case.

Again, the Governing Body includes the DEL funding audits as having an equivalent status and role as its own internal and external audits. As is noted previously, these audits are not designed to provide the Governing Body with assurance over its own operations, and are carried out on behalf of the Department to test the accuracy of the funding information being held within the College.

Paragraph 5.9
Having external audit carried out independently from college control is being considered.

Paragraph 5.10
The purpose and role of internal audit is clearly set out in the Audit Code which is provided by the Department to the FE college governing bodies. This statement appears to criticise the approach taken by the college internal auditors, an approach which would have been approved, reviewed and monitored by the Governing Body's Audit Committee.

Paragraph 5.11
The meaning of this paragraph is not immediately apparent. The executive structure of each college – which we presume means the senior staff team – is the responsibility of the Governing Body of each college to establish, in line with the strategic and operational needs of the college. The Department has established a wide range of controls, procedures, guidance, checks, and reviews to assist the accountability process.

Appendix Five: Letter from the Department to the Chairman of the Governing Body of Fermanagh College

Paragraph 5.13
The Department considers the Audit Committee to be the key committee in relation to governance and accountability, and has prescribed that all governing bodies should have one in place. Accordingly, we have produced model terms of reference for that body.

Paragraph 5.14
Whilst the Department would be content to receive minutes of Governing Body and committee minutes, as evidence that meetings are taking place, it is not our responsibility to scrutinise each item of business carried out. Such an approach would dilute the incorporated status of the Governing Body.

Paragraph 5.15
The results of all ETI Inspections, which cover the quality of teaching and learning, and management and leadership of the curriculum, are already provided to the Governing Body as a matter of course.

Paragraph 5.17
Colleges should have clear and approved internal procedures for all procurement or contracting arrangements with associated delegated limits.

Paragraph 5.18
See response to paragraph 4.5 above. The Governing Body should be aware that the Department has a contract with LSDA (NI) to provide training and support to college secretaries.

Paragraph 5.19 and 5.20
The Department would see these arrangements as good practice.

Paragraph 6.0
It is noted that the Governing Body has acknowledged it had a part in the corporate failings; however, the contents of this report illustrate that there was a fundamental lack of understanding and awareness of the key responsibilities of the Governing Body and those of the Department. The Governing Body has a statutory responsibility to secure the effective management of the college. Based on the findings of the Deloitte and NIAO Reports, this they failed to adequately provide.

Whilst it is clear that the internal and external audits were less than effective in flagging up the problems which were ongoing in the college, it is also the responsibility of the Governing Body and Audit Committee to ensure that a professional, comprehensive and robust service is provided. The Department has provided detailed guidance on establishing an Audit Committee, including model terms of reference, and for the engagement and management of internal and external auditors.

In relation to audits, the Department would take exception to the assertion that DEL audits were ineffective or inadequate. It needs to be reiterated that DEL audits were carried out by, and on behalf of, the Department in order to provide an assurance to our Accounting Officer that the information, on the basis of which funding was distributed, was accurate, adequate and robust. The fact that significant levels of funding were recovered from the college indicate that the audits were robust and effective and that failings were identified on the part of the college. The findings of these audits were always reported to the college, with the requirement that action be taken to address any concerns identified.

Overall, we are disappointed by the Governing Body's findings, as set out in its internal review, and consider that the approach taken is rather subjective with an unwillingness for self criticism.

The Governing Body of Fermanagh College will cease to exist from 1 August 2007 and, as a result, the Department will engage with the new South West College Governing Body and management team, to ensure all necessary action is taken to address the ongoing issues.

Appendix Six: Letter to NIAO from Grant Thornton, the external Auditors of the College

Grant Thornton

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22 February 2008

Dear Sir

1. Introduction

1.1 This letter sets out Grant Thornton UK LLP's (Grant Thornton) comments on the NIAO's Governance Examination of Fermanagh College of Further and Higher Education (the "Report").

1.2 We note that detailed reference is made in the Report to a number of other reports which we have not seen namely:

- The Education and Training Inspectorate "ETI" Report (November 2004)
- The reviews by an independent consultant into the College Management Information Systems (MIS) undertaken between November 2004 and September 2005
- The comprehensive review of financial management within Fermanagh College (the "College") by Deloitte & Touche in 2006 (the "Deloitte Report")
- A review of MIS by the Association of Northern Ireland Colleges Business Support Manager

1.3 In addition we are aware from the content of the Report that there has been correspondence between NIAO and the Department for Employment and Learning (DEL) and the then Governing Body of the College (Governing Body) in settling the Report. Grant Thornton received a copy of the Report on 2 January 2008.

1.4 We have not had any discussions or correspondence with the then internal auditors (The Helm Corporation ("Helm")).

1.5 Our comments and observations must therefore be read within the context of these limitations and, furthermore, we may have had additional or different comments to make had we had access to the aforementioned information. Accordingly, we reserve our rights in their entirety to the extent our observations and conclusions herein are varied at a later date.

1.6 Our comments are therefore restricted to the content of the Report including, in particular, Appendix 4, the Internal Review of the Governing Body dated 26 March 2007 (the "Internal Review") and Appendix 5 the response by DEL of 30 July 2007 (the "DEL Response"). Sub headings in this letter are references to the individual sections of the Report.

1.7 Notwithstanding our aforementioned observations, we recognize the role of the NIAO and the purpose of the Report; namely to assess and ensure the governance processes of the Education sector in Northern Ireland going forward.

1.8 We have therefore, for the most part, chosen not to focus on individual paragraphs of the Report save where there are comments which could be read as critical of Grant Thornton which, for the avoidance of doubt, we rebut.

2 Part 2

2.1 Part 2 of the Report contains in much detail the outcomes of the Deloitte Report. We would make the following points.

2.2 The College Development Plan (CDP) 2005-08 was included within the purview of the Deloitte Report and six deficiencies have been highlighted including, in particular, the linkage of operational plans to objectives set in the CDP. In the two prior years Grant Thornton undertook a desktop review of the CDP (2003 - 2006 and 2004 - 2007) not only of the College but of all the then sixteen Further Education Colleges. This linkage deficiency was highlighted by us to DEL in these reviews. Further, we were concerned that the exercise we undertook (on behalf of and commissioned by DEL) was limited to a desk top exercise only of the written CDP. We had no access to senior staff or other documentation which access would ordinarily have drawn out the other deficiencies highlighted by the Deloitte Report. We note we highlighted our concerns to DEL at the time of giving verbal feedback to them at the joint

Appendix Six: Letter to NIAO from Grant Thornton, the external Auditors of the College

meeting with DEL and ETI on 10 February 2004 and for subsequent years at similar meetings in 2005 and 2006.

2.3 We note at Paragraph 2.24 the reference to the investigation of Halton College and the subsequent Committee of Public Accounts report in September 1999.

2.4 We understand the reference to the Halton College Report especially in relation to the recommendations on Governance and Management of Further Education Colleges. However it is imperative to appreciate that at Halton College as referred to at Paragraph 4.15 of the Report the "audit process" (referred to in Paragraph 3 of Appendix I of the Report) was not separated; the internal and external auditors were the same firm. This is not the case here. Indeed, we draw attention to the last paragraph of Appendix I (Paragraph 12) which provides, inter alia, that, since the publication of the Halton Report, the internal and external auditors have come from separate firms with different key objectives for their respective work.

3 Part 4

3.1 In relation to Paragraph 4.15, we re-iterate our earlier point that at Halton College the internal and external auditors were the same firm. Grant Thornton as external auditors are independent from Helm the internal auditors.

3.2 We believe it is appropriate at this stage for us to draw your attention to our engagement letter for the College. At Appendix II under the heading: **"Accounting system and internal control"** we state:

"We shall obtain an understanding of the accounting systems so that we can asses its adequacy as a basis for the preparation of the college's financial statements and to establish whether proper accounting records have been maintained (including those held on a computer). We also obtain an understanding of the college's accounting system and internal control procedures sufficient to plan the audit. This understanding includes the design of relevant policies and procedures and whether they have been placed in operation to enable us to design appropriate audit procedures.

Should significant matters come to our attention in relation to the college's systems which we believe should be brought to the attention of the governors, we will report them in an appropriate way. We would point out that such matters will come to our notice during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements of the college. In consequence, our work will not encompass a detailed review of all aspects of the systems and cannot be relied upon necessarily to disclose defalcations or other irregularities or to include all possible improvements in internal control that a more extensive examination might develop".

3.3 We do not believe that the issues referred to in Paragraph 4.17 would have ordinarily come to light to us as external auditors unless or until "a more extensive special examination" such as the Deloitte Report was undertaken and therefore no adverse inference should be placed upon Grant Thornton.

3.4 The conclusion of the Internal Review of the Governing Body included at Paragraph 4.19 which we believe implies that our external audit was, in some sense, a failure is entirely without foundation and we rebut this contention absolutely.

3.5 As external auditors, Grant Thornton's role and reporting responsibilities are contained in the Code of Guidance on Audit for the Governing Bodies of Further Education Colleges (Audit Code). There is a new code issued in January 2008 (the New Code), however the then extant audit code (issued in 2002 and reissued in 2005) states at Paragraphs 80 and 81:

> *80 The basic objective of the college's external auditors is to report on the truth and fairness of the financial position of the college and any subsidiary companies shown in the financial statements. If the college is a limited company, the Companies Order requires the auditor also to form an opinion as to whether proper accounting records have been kept, whether the accounts are in agreement with those records, and to state that the accounts comply with the disclosure requirements of the Companies Order.*
>
> *81 In addition, where public money and other income restricted in its use is involved, the scope of the auditors' report must be extended for all colleges to cover the 'regularity' of transactions, i.e. that any terms and conditions attached to the funds have been complied with. The Department may require colleges to have the accuracy of specified statistical returns certified by the external auditor.*

3.6 At Paragraph 89 the audit code lays out the audit report requirement:

> *89 The external auditor will report whether:*
>
> - *the financial statements give a true and fair view of the state of the college's affairs and of its income and expenditure for the year, taking into account relevant statutory and other mandatory disclosure and accounting requirements and the requirements of the Department;*
> - *funds from whatever source administered by the college for specific purposes have been properly applied to those purposes and managed in accordance with the Financial Memorandum, relevant legislation and any other terms and conditions attached to them;*

Appendix Six: Letter to NIAO from Grant Thornton, the external Auditors of the College

- *funds provided by the Department have been applied in accordance with the Financial Memorandum and any other terms and conditions attached to them; and*
- *specified statistical returns are accurate and have been compiled in a manner consistent with the procedures set out by the Department.*

3.7 The £1.14 million over-claimed by the College for work based learning (WBL) arose from data produced in 2002-03 and 2003-04. However, the financial statements for these years were unaffected by the incorrect data. In accordance with correct procedure, the financial statements for the years 2004-05 and 2005-06 were finalized and signed by the College and Grant Thornton in March 2007. These financial statements included the adjustments necessary to reflect properly the repayments of the £1.14 million over-claim by the College. The financial statements therefore gave a true and fair view of the state of the College's affairs and of its income and expenditure for each year.

4 Appendix 4

4.1 We have not sought to criticise or comment directly on any of the parties who are the subject of this Report. However, there are circumstances concerning the process and finalisation of the Internal Review about which we believe we must comment.

4.2 The College was requested by DEL in December 2006 to *"identify the circumstances and reasons why the problems which have beset the College in recent months were able to occur"*.

4.3 A Working Group was set up which met three times in March 2007 culminating in the final report being signed on 26 March 2007. That day the 2004—05 and 2005-06 financial statements were approved and signed by the Governing Body and by Grant Thornton and Grant Thornton were re-appointed as auditors for the year ended 2006-07.

4.4 It is notable that neither at that meeting nor indeed at any time previously, did the Governing Body bring their review to our attention. Indeed, we were unaware of the existence of the Internal Review until it was forwarded to us by NIAO as Appendix 4 to the Report on 2 January 2008.

4.5 Had we known of the existence of the Internal Review at the time of its completion we would have had to consider whether it was appropriate to accept re-appointment as auditors for the 2006-07 financial statements on the grounds of a lack of confidence in the Governing Body's attitude in keeping information from us. Having accepted re-appointment, discovery of the Internal Review later would have led us to consider resigning our appointment for the same reason.

4.6 We consider that the failure by the Governing Body to communicate with Grant Thornton before finalising the report demonstrates a lack of proper understanding both of the role of the Governing Body in governance processes and of the external audit role provided by ourselves, the respective of which are clearly defined in the Audit Code.

4.7 Accordingly, the response by DEL to the Internal Review quoted at Paragraph 4.19 of the Report is, in our view, accurate when it says:

"As is obvious from the comments and recommendations in the review, the Governing Body appears to have been operating under a fundamental misunderstanding of its role and responsibilities, and has also displayed a particular, and significant lack of understanding of the nature of audit functions. This document must be considered as a first draft and, in normal circumstances it would have been subject to a number of iterations, with the Department suggesting significant amendments. It is unfortunate that, due to the demise of the Fermanagh Governing Body on 31 July 2007, that this process cannot he completed".

4.8 The allegation contained in Paragraph 5.8 that our external audit was neither independent nor robust is denied. Our audit planning, procedures and conclusions are designed precisely to provide a robustly independent view of the truth and fairness of the financial statements and to provide the Governing Body with a report on financial or control issues found by us that we consider should be brought to their attention. All matters that came to our attention as part of our audit work were so disclosed and discussed.

4.9 We confirm for the record that notwithstanding the above, our audit opinions would not have been withdrawn for any of the financial years 2004-05, 2005-06 and 2006-07 as the concerns it raises do not go to altering the audit opinion.

5 Appendix 5

5.1 We concur with the response by DEL in their penultimate paragraph. Since the demise of the Governing Body of the College we are unable to assist the Governing Body in a fuller understanding of the nature and content of audit roles.

6 Closing remarks

6.1 We recognize the role of NIAO and the purpose of the Report; namely to assess and ensure the governance processes of the Education sector in Northern Ireland going forward.

6.2 We believe we have demonstrated that, in the context of the work undertaken Grant Thornton provided the necessary service.

Yours faithfully

Grant Thornton UK LLP

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