Education & Skills Funding Agency

Investigation Report

Bournville College

July 2019

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Executive summary

1. Further education and sixth-form colleges are operated by statutory corporations which are responsible for the effective and efficient use of resources, the solvency of the college and the safeguarding of its assets. The Department for Education's (DFE) regulatory framework[1] administered by the Education and Skills Funding Agency (ESFA) underpins the statutory responsibilities of college corporations. The regulatory framework sets out expectations of governing bodies for oversight of regularity (i.e. what the college spends money on), propriety (i.e. the manner in which decisions are made), and value for money (i.e. the basis for making decisions). This report describes practices at Bournville College between 2011 and 2015 which clearly fell significantly short of these expectations in terms of the oversight and control of expenditure. Evidence suggests those practices included, but were not limited to, the appointment of relatives of senior managers to positions within the college without declarations in the college's Register of Interests, overseas activity with no approved budget nor fully specified business case, and the procurement of large contracts - often without a formal tender process and occasionally with no evidence of goods or services actually being delivered. The report also highlights changes made to the regulatory framework since the issues were identified, and provides college governing bodies with a set of recommendations to support them in guarding against poor practice.

2. At the time of the events described in this report, Bournville College was a medium-sized further education college, serving around 15,000 learners in Birmingham. In late 2013, the college requested Exceptional Financial Support funding from the former Skills Funding Agency[2] (SFA) as it was unable to meet its financial commitments. As a result, the college was subject to intervention by the SFA and the Further Education (FE) Commissioner. This intervention led to significant changes in the executive leadership and governance of the college, and a change of strategic direction for the college. However the college was unable to reverse its financial decline and following the Birmingham and Solihull FE Area Review the governing body agreed to dissolve the corporation in order to merge with South and City College Birmingham. The total amount of Exceptional Financial Support provided to Bournville College between December 2013 and the merger in August 2017 was £26.5 million, none of which was repaid to the government.

3. In May 2015, the FE Commissioner raised concerns with the Minister for Skills about potential misuse of public funds and potentially fraudulent activity by the former Principal, who had left the college in December 2014. The FE Commissioner's concerns

[1] The regulatory framework includes the DfE's funding agreement with colleges, the college accounts direction and the post-16 audit code of practice.

[2] The responsibilities of the Skills Funding Agency now sit with the Education and Skills Funding Agency.

were based on discussions with members of the college's then Senior Management Team and Governing Body, and did not involve a detailed review of evidence. The Minister for Skills requested that these areas be followed up by way of a detailed investigation, in relation to which the SFA engaged KPMG LLP (KPMG) to review evidence covering the four academic years from August 2011 to July 2015. The objectives of the KPMG investigation were to establish the factual accuracy of the concerns raised, which were:

- that the former Principal had operated outside the college's financial regulations and beyond his delegated authorities
- that if the former Principal did operate outside of the financial regulations, he operated fraudulently
- that other members of staff and governors were complicit in the arrangements.

4. The report that the SFA received in December 2016 from KPMG identified instances where:

- there was a failure of senior managers and governors over the four years for which evidence was reviewed to comply with the relevant version of the college's Financial Regulations in relation to procurement processes and financial controls
- expenditure on key corporate hospitality and marketing events showed breaches of the college's Financial Regulations and Anti-Bribery Policy, including failing to update the Register of Interests in a timely way and to declare potential conflicts of interest
- the college's review process for the expenses incurred by the former Principal and other senior staff was non-compliant with its Financial Regulations, and there was little evidence of challenge to the former Principal by successive Chairs of Governors on individual items of expenditure
- there was limited evidence of any control over costs of overseas travel. Reports provided to the corporation were incomplete and excluded overseas travel expenses from the activity costs presented. There was little evidence that governors challenged the lack of information, or sought justification for time spent and college funds used, on introducing commercial organisations to overseas contacts without formal partnership arrangements in place. There was no entry on the Register of Interests for the former Principal or governors regarding their directorships in a joint company that was set up with another body, Trans Data Management, which is a breach of the Financial Regulations and the college's Anti-Bribery Policy

- relatives of senior managers were appointed without declarations in the Register of Interests. Pay increases for senior post holders and some senior managers were approved over and above those paid to all college staff during a period of decline in financial performance of the college

- overall, monitoring of expenditure by governors was at a high rather than a detailed level and there was use of exception reporting for retrospective approvals. This limited governors' ability to disallow the expenditure or consider reasonableness and value for money prior to the services being procured.

5. While not part of the KPMG findings, it is worth noting that according to the college's annual reports for three of the years in question the college's external auditors provided an unmodified regularity audit opinion. It was the responsibility of the auditors to provide assurance to both the governing body and the SFA that the college's expenditure and income had been used for the purposes intended by Parliament, and that the college's financial transactions complied with relevant rules, including the college's own financial regulations. The unmodified opinion means that the auditors agreed with the governing body's own view that it was discharging satisfactorily its responsibility for the proper conduct of the college's financial affairs, and as a result the SFA had no reason to question the financial procedures of the college. For the year ending July 2015, the college's external auditors were aware of the KPMG review of evidence and therefore did not provide a regularity audit opinion. The college's external auditors were RSM Tenon Audit Ltd for 2011/12, Baker Tilly Audit Ltd for 2012/13, Baker Tilly Audit UK LLP for 2013/14 and RSM UK Audit LLP (formerly Baker Tilly Audit UK LLP) for 2014/15.

6. On the question of whether the former Principal had operated fraudulently, the SFA referred the KPMG report to the West Midlands Police who decided not to pursue a criminal prosecution.

7. The KPMG findings in this report and the underpinning KPMG report of the review of evidence have been shared with the former Principal and a former Chair of Governors, neither of whom have provided any factual corrections to the reports.

8. The preparation of this report has taken a significant amount of time since the receipt of KPMG's findings in December 2016 due to concerns about the potential impact of publication on actions that might be taken by other agencies. Following the decision by West Midlands Police not to pursue a criminal prosecution, the KPMG findings were shared with the Charity Commission for consideration of regulatory action. Initial discussions with the Charity Commission suggested that it would be preferable for the findings to remain confidential while under consideration. ESFA received confirmation in February 2019 that the Charity Commission would not be taking any action on the basis of the KPMG report. Subsequent due process has been undertaken to allow for factual accuracy checking and internal review. ESFA is now reviewing procedures for referrals to other agencies to ensure that findings from investigations can be made public as soon as

possible, without putting at risk any further action that might be taken against individuals or organisations.

9. At the time of the events described in this report, government policy was to encourage colleges to respond flexibly to local and national priorities for education and training. This was supported through relaxation of prescriptive requirements and the removal of government controls that had previously been in place, relying instead on governing bodies to discharge their statutory responsibilities. While the majority of governing bodies have done this well, in the light of the failings in the Bournville case and experience elsewhere DfE and ESFA have recognised that the regulatory framework can be improved to better support robust governance. A number of changes have been made since 2015, including:

- setting out in 2015 standard terms of reference for the regularity assurance engagement for college corporations to clarify the duty of care owed by the external auditor to the funding body under the tripartite agreement

- providing guidance in 2015 for external auditors on how to approach the regularity assurance engagement at college corporations and emphasising in 2018 that they may approach ESFA for a summary of any matters relevant to regularity

- updating the regularity self-assessment questionnaire for college corporations and confirming in 2018 that they must share their completed regularity questionnaires with their external auditors

- recognising the Association of Colleges’ Code of Good Governance in 2015 and the Charity Governance Code in 2018 as alternatives to the UK Corporate Governance Code, one of which colleges must follow on a comply or explain basis

- introducing an early intervention strategy in 2015 so that intervention can begin when financial decline is first identified, rather than waiting to the point of financial failure

- reiterating expectations in letters from the chief executive of the SFA/ESFA to college accounting officers in June 2016 and April 2017

- expanding the role of the FE Commissioner in 2017 so that they can undertake diagnostic assessments on colleges identified by ESFA as triggering early intervention

- extending the triggers for formal intervention in 2019 to specifically include evidence of action taken by an accounting officer and/or governors outside of the college or departmental controls/policies.

10. DfE has provided support for governing bodies more broadly during this period through the establishment of National Leaders for Governance for FE, and the publication of the governance guide for further education and sixth-form college corporations.

11. Events at Bournville College have shown that even where a college is delivering good or outstanding educational performance as assessed by Ofsted, robust oversight of financial management by governors is vital to secure the future of the education provision. DfE and ESFA will now consider how best to reflect this in the operation of the new college oversight regime as published on 1 April 2019 and the regulatory framework.

12. Strengthening the regulatory framework will support governing bodies to discharge their responsibilities, but it cannot guarantee that events such as those described in this report will not happen again. This will need the commitment of college governors and executive teams to the highest standards of behaviour, and vigilance in identifying and challenging activity or conduct that appears inappropriate. The recommendations below are provided by ESFA for consideration by all college governing bodies, and reiterate previous messages set out in letters to the sector from the FE Commissioner and in DfE and ESFA guidance:

- governing bodies should not rely only on the flow of information provided by the Principal as this may restrict their ability to provide challenge as well as support. Governing bodies should ensure they have the right skills mix amongst their members to recognise financial deterioration and challenge the actions of the executive where a college is facing difficult financial circumstances. They should ensure that they have sufficient access to other members of staff and use external sources of data, such as the financial dashboards provided by ESFA, to triangulate the information that they receive

- governing bodies should ensure there is a detailed cost-benefit analysis and board level scrutiny of new initiatives before any such proposal is taken forward. This should include how the initiative contributes to the core mission of the college, both financially and in terms of the curriculum. Once a new initiative is established it should continue to be reported separately until it regularly meets financial and performance indicators set by the governing body

- governing bodies should use a range of information to ensure that expenditure provides value for money. ESFA provides access to a financial benchmarking tool for colleges in collaboration with the Association of Colleges which enables comparison of a large number of metrics by college size and region

- governing bodies should ensure that their Audit Committee discharges its duties, as required under the post-16 audit code of practice to advise the Corporation on the adequacy and effectiveness of assurance arrangements, framework of governance, risk management and control processes for the effective and efficient use of resources, solvency of the institution and the safeguarding of its assets. Governing bodies should consider whether a transaction is regular and proper using the tests set out in the post-16 audit code of practice

- governing bodies should use ESFA's regularity self-assessment questionnaire to challenge their own practices in relation to regularity, propriety and compliance. They must share this with their external auditor to inform the regularity assurance engagement. External auditors should ensure the corporation's self-assessment is supported by sufficient and relevant evidence.

Background

13. Bournville College was, at the time of the investigation, a standalone medium sized general further education college, serving around 15,000 students on a purpose-built campus on the former MG Rover site at the heart of the Longbridge redevelopment area in Birmingham. The campus was substantially completed in October 2011 at a cost of £69 million financed by a capital grant from the former Learning and Skills Council (LSC), plus commercial borrowing by the college. The commercial loan was larger than the college had originally intended due to a lower level of grant funding than expected following over-commitment by the LSC of its capital budget, and lower than expected receipts for the sale of the college's former site.

14. From 2010 the college faced the same challenges as the rest of the FE sector in relation to changes in government policy leading to reductions in expected income. The college developed a growth strategy to address the decline in income and the need to service the commercial debt. However, by 2013 it was experiencing severe liquidity problems resulting in a request to the SFA for financial support. This led to intervention by the SFA, which was escalated by referral to the FE Commissioner in line with the intervention policy at the time. The FE Commissioner's recommendations were published in a summary report in August 2014.

15. In November 2014, following a review of progress by the FE Commissioner, coupled with 'going concern' issues expressed by the college's external auditors, governors resolved to change substantially the college's optimistic growth strategy, address lack of cost and expenditure controls and to focus on delivery of a financial recovery plan. The Principal (who had been in post since 2002) was suspended in November 2014 and his employment with the college ended in December 2014.

16. In May 2015, one of the FE Commissioner's advisors undertook a detailed review of the college's financial recovery plan. During this review, the advisor had discussions with a number of senior managers and governors at the college and as a result raised concerns about potential misuse of funds and potentially fraudulent activity during the period of office of the former Principal. The FE Commissioner raised these concerns with the Minister for Skills who requested they be followed up by way of a detailed investigation, in relation to which the SFA engaged KPMG LLP (KPMG) to review evidence covering the four academic years from August 2011 to July 2015. The report from KPMG was received in December 2016.

17. Bournville College was unable to reverse the financial decline that had led to the intervention by the SFA and FE Commissioner from 2014, and as a result the corporation dissolved in August 2017 in order to merge with South and City College Birmingham following the Birmingham and Solihull Further Education Area Review. The total amount of Exceptional Financial Support provided to Bournville College between December 2013 and the merger in August 2017 was £26.5 million, none of which was repaid to the government.

Objectives and scope of KPMG review of evidence

18. The objective of the investigation by KPMG was to establish the factual accuracy of concerns raised in relation to Bournville College. In summary, these concerns were:

- that the former Principal operated outside the college's financial regulations and beyond his delegated authorities
- that if the former Principal did operate outside of the financial regulations, he operated fraudulently
- that other members of staff and Governors were complicit in the arrangements.

19. The methodology for the review of evidence by KPMG included analysis of college documentation, together with interviews with senior managers and key governors at the college, apart from the Chair of the Audit Committee who was not available at any time during the review of evidence.

20. The scope of the investigation work by KPMG covered the college's period of operation from August 2011 to July 2015 (the period of review) and included the following areas:

- the procurement and payment arrangements for transactions with Smartphone Media and related companies
- the college's expenditure on corporate entertaining and marketing
- the authorisation and approval of the former Principal's expenses
- the arrangements for authorising and monitoring expenditure on the college's overseas activity
- the college's arrangements for approving pay increases and other emolument payments for the former Principal and other senior managers
- the arrangements over the appointment of staff.

21. The KPMG findings in this report and the underpinning KPMG report of their review of evidence have been shared with the former Principal and a former Chair of Governors, neither of whom have provided any factual corrections to the reports.

Findings from the review of evidence undertaken by KPMG

Procurement and payment arrangements for transactions with Smartphone Media and related companies

22. During the period for which evidence was reviewed by KPMG, the college had commercial relationships with the company called Smartphone Media and its related companies (i.e. subsidiaries or companies under common control or with common directorships) including Learner Destinations, Collegiate Media, B-Smart, Birmingham Independent, The Education News UK Ltd, NRH Media, Apprenticeship Media Company, and My TV Online. These organisations collectively provided the college with a range of services including corporate hospitality, marketing and application development.

23. The college's tendering and procurement processes were included in its Financial Regulations, of which there were five versions during the period reviewed by KPMG (June 2011, October 2011, October 2012, June 2013, and October 2014). These set out the procurement and approval requirements for banded values and the reporting requirements to the Executive/Senior Management Team and to the corporation's Employment, Policy & Finance (EP&F) Committee. Whilst changes were made at each iteration of these Financial Regulations, KPMG found that there remained for each period a clear set of requirements.

24. According to all versions of the college's Financial Regulations, expenditure greater than £50,000 was required to go through a tendering process or use an agreed procurement framework. The KPMG review was not able to establish how services were procured from Smartphone Media and its related companies. KPMG could not identify any evidence of tender or procurement framework processes or signed contracts for the expenditure to Smartphone Media and its related companies up to a value of £899,035 between 2011 to 2012 to 2014 to 2015. There was no evidence identified by KPMG to suggest that Smartphone Media or related companies were unique in the provision of corporate hospitality and marketing services, therefore the absence of procurement processes being followed constitutes a breach of the Financial Regulations.

25. Where a tendering process was not followed, the college's Financial Regulations required the submission of a Financial Regulation Exception Report to the EP&F Committee stating the amount of the expenditure and the reasons why a tender was not undertaken. Two Financial Regulation Exception Reports for £110,000 and £180,000 were identified by KPMG where approval subsequent to the expenditure being incurred was given by the EP&F Committee for corporate hospitality and marketing expenditure with Smartphone Media and related companies. One invoice amounting to £82,406 was identified by KPMG where no approval was obtained from the EP&F Committee. In addition, there were two standing orders in favour of Smartphone Media totalling

£196,980 between June 2012 and January 2015, where there was no evidence identified by KPMG of approval by the Corporation or its committees.

26. KPMG identified that a supplier form produced in September 2013 relating to a three year arrangement with Smartphone Media included a draft Joint Venture Document setting out a proposal for the development of applications for the education sector that would generate income to the college from an investment of £288,000. There was no evidence identified by KPMG that this was considered by the Audit Committee as a strategic investment, but rather included in a broader partnership report and the minutes recorded an equally broad approval of the listings in the partnership report requiring waiver of the Financial Regulations. A proposal for a Joint Venture as a strategic investment should have been referred to the Corporation under the Financial Regulations with an associated business plan including market need, resource requirements, financial evaluation and risk assessment. There was no evidence identified by KPMG from Corporation minutes that this was presented or considered.

27. KPMG's review did not identify any overall and consolidated report to the Corporation or any of its committees covering the college's contracts with Smartphone Media and related companies, or actual payments to Smartphone Media and related companies, over the period of review. Consequently there was no opportunity for the Corporation to challenge the processes of procurement, the outputs expected from the contracts, or the value for money of the overall expenditure committed.

Expenditure on corporate hospitality and marketing

28. KPMG identified instances of expenditure on key corporate hospitality and marketing events that show various breaches of the college's Financial Regulations and the college's Anti-Bribery Policy, including failing to update the Register of Interests in a timely way and to declare potential conflicts of interest.

29. KPMG identified that invoices paid to Smartphone Media and its related companies (including one that was dormant at the time) were for exactly, or slightly less than, the relevant annual budget for corporate hospitality which was £50,000 for each year approved by the Corporation. Invoices were brief in their description of services supplied and there were no associated purchase orders available, therefore it was not possible for KPMG to determine whether these represented value for money as required by the college's Financial Regulations and by the Financial Memorandum with the SFA at the time.

30. KPMG identified that in 2011, retrospective purchase orders were raised shortly after receipt of two invoices for attendance at several high profile sporting events. Corporate hospitality records for two of the years reviewed by KPMG showed that the director of Smartphone Media attended up to eight high profile sporting events with the former Principal, Deputy Principal or Chair of Governors. Records for the other years were not available for KPMG to review. Additional expenditure beyond the £50,000

corporate hospitality budget was incurred through the former Principal’s expenses, which are covered in more detail below.

31. Examination by KPMG of marketing invoices for the four years for which evidence was reviewed showed that there was a persistent absence of evidence of goods or services supplied to support payment of invoices, or indications that the requirement of the college’s Financial Regulations for a minimum of three quotations had been applied. KPMG identified that a number of invoices from Smartphone Media and related companies exceeded the £50,000 band and should have been the subject of tenders.

32. In addition to the expenditure noted above, significant events were hosted at the college: an opening event at the new college campus in October 2011 and a college centenary celebration in October 2013. Information gathered by KPMG from interviews during the review indicated that the delivery of the opening event was put out to tender and three companies were shortlisted, from which one was chosen. No documentary evidence was available to KPMG to confirm the tender process. There was no evidence found by KPMG that the budget for this event was approved or that invoices were reported to the Corporation or any of its committees which, given its total value of £132,000, constitutes a significant breach of the college’s Financial Regulations.

33. Similarly, for the centenary celebration event, interviews conducted by KPMG indicated that the delivery of the event was put out to tender; the same company was awarded the contract as for the campus opening event. KPMG established that the total expenditure was slightly short of £150,000, which exceeded the budget of £90,000 set for the celebration. KPMG found no evidence that the budget, the contract award or the final expenditure were recorded in the Corporation minutes as having been reported or approved. This is a significant breach of the college’s Financial Regulations.

34. Review by KPMG of Corporation and its committees’ minutes indicated that there was no evidence of corporate hospitality budget or spend being discussed, and reporting was consolidated into reporting of management accounts. Similarly, there was no evidence found by KPMG that the Corporation received or reviewed the corporate hospitality register.

Arrangements for authorising and approval of the former Principal’s expenses

35. The college’s Financial Regulations set out the various ways in which expenses might be incurred by staff (including the Principal) and governors, and reimbursed. In addition to a college credit card, the former Principal had access to the petty cash system, claimed mileage and expenses, and had access to his own cost centre against which to commit expenditure. KPMG established that expenditure against these routes for the former Principal over the four years for which evidence was reviewed totalled over £208,000.

36. KPMG undertook a comparison of costs for the former Principal and other staff on the same overseas trip in October 2014, which suggested that the former Principal's credit card charges, on that occasion at over £17,000, were well in excess of the authorised budget of £10,000, and also disproportionately higher than the budgeted cost of £15,000 in total for all four other members of staff.

37. KPMG found evidence that Authorisation of Foreign Travel forms were generally signed as required, but the rationale for most trips was brief, and there was no evidence of an event or annual reconciliation between estimated costs, authorised budget and actual costs. There were repeated findings by KPMG that no attempts were made to ensure value for money for example by seeking more economical flights or accommodation, or earlier bookings. This was contrary to the college's Financial Regulations.

38. There was evidence reviewed by KPMG that the former Principal's credit card expense forms were signed by the relevant Chair of Governors over the period, but the Chairs interviewed by KPMG stated that they did not perform a detailed review of expenses incurred, and in particular relied on budget holders to decide on expenditure, provided it remained within overall approved budget limits.

39. There was no evidence from the sample available to KPMG that credit card expense claim forms for the Assistant Principal were signed by a line manager. This is in breach of the Financial Regulations. The total credit card expenses incurred by the Assistant Principal during the four years for which evidence was reviewed was found by KPMG to be in excess of £100,000. There was evidence identified by KPMG that the former Principal was the sole signatory for several overseas travel expenses claims from the Assistant Principal. KPMG suggest that this should have required third party oversight given the nature of the relationship between the former Principal and the Assistant Principal that was declared in the college's Register of Interests.

40. No evidence was available to KPMG to show that credit card expenditure was reviewed or reported to the appropriate Corporation committee for 2011/12, 2012/13 or 2013/14, or that overspends on travel budgets were challenged either by senior managers or by governors.

Arrangements for authorising and monitoring expenditure on the college's overseas activity

41. In 2011, the governors of Bournville College agreed a growth strategy for the college based in significant part on the development of overseas activity through local offices and institutions. Reference to pay and non-pay costs for international related activity was included in the financial plan as approved by the corporation, with periodic reporting on budget variances. The KPMG review found little evidence of challenge by governors regarding the financial plan for international related growth or actual costs. During the four years for which evidence was reviewed by KPMG, the college established

overseas operations through an Indian subsidiary and offices in Malaysia and South Korea.

42. KPMG identified that governors approved the former Principal's recommendation to set up an incorporated company in India at their meeting in July 2011 and the company was established by December 2011. The former Principal was managing director and board chair of the company and the Deputy Principal was a director. There was no evidence found by KPMG of an approved budget for the enterprise or a fully specified business case with performance indicators agreed by the Corporation. KPMG identified that a report to the Corporation in December 2013 showed an operating deficit of £87,000, but governors were advised that income streams were picking up. In January 2015, the Corporation resolved to cease trading the company and it was dissolved.

43. KPMG found that governors were informed in December 2011 that a regional office had been opened in Malaysia. No evidence of prior approval has been identified by KPMG, although this may have pre-dated the period for which evidence was reviewed. At the December 2012 Corporation meeting, the former Principal reported on a further development to establish a Bournville College campus with a local partner. KPMG identified that a memorandum of understanding for this development had already been signed in August 2012, although there were no performance indicators or milestones against which to measure progress or success. No reporting schedule was set out or requested by governors and no financial reporting on the development has been identified by KPMG, other than a note in 2013 to 2014 that the partnership had generated little more than £400 after expenses. KPMG were unable to identify any further records that reported on the partnership until the Corporation noted at its meeting in March 2015 that the local partner had sought to end the contractual relationship with Bournville College.

44. Other developments in Malaysia identified by KPMG included an agreement between a company called Trans Data Management and Bournville College which was signed in August 2013. Bournville College would employ staff to support Trans Data Management opportunities locally in return for a revenue percentage from successful consequent operations. There was no reference found by KPMG in Corporation or committee minutes to approvals for this arrangement.

45. Evidence identified by KPMG from the period June 2013 to July 2014 suggests that the former Principal took a personal shareholding in Trans Data Management with the potential for proxy shares. KPMG also found indications of an agreement with the managing director of Trans Data Management to set up a new company called E&IP (UK) Ltd. KPMG identified that in July 2014, the Bournville College Chair of Audit confirmed to the former Principal, the Chair of Governors, and the managing director of Trans Data Management that the new company had been set up. KPMG were unable to establish whether he was acting in his capacity as an appointed auditor for the new company or as a college governor. The shareholder agreement for E&IP (UK) Ltd reviewed by KPMG makes no reference to Bournville College. KPMG found that none of

the former Principal, Chair of Audit or Chair of Governors declared their directorships in this company in the college's Register of Interests.

46. KPMG established that in December 2013, the Corporation received a report from its Audit Committee raising concerns about risk with the international activity and requesting advance reports on all college companies. This followed a requirement from external auditors for an adjustment to the college accounts to reflect the consolidation of the Indian company. A subsequent report to the Audit Committee in October 2014 was identified by KPMG as the first to bring together for governors a composite breakdown of the costs of overseas activities. The detail in the report for each country of activity indicated only one had made a small surplus in 2013/14 with all others showing deficits, some significant. KPMG found that costs coded to budget centres relating to expenses for overseas travel by the former Principal, governors, staff and others were not included in the report to governors.

Arrangements for approving pay increases and appointment of staff

Remuneration

47. KPMG established that the former Principal and Deputy Principal received pay awards seven times between July 2011 and August 2014, on four occasions in line with the pay award agreed for all staff and on three occasions specific to the individuals. On two of these occasions, governors approved a general pay award to these two senior post holders on top of their individual awards. Pay awards to two other senior post holders followed a similar pattern of individual pay award plus the general pay award to all staff.

48. At no point did KPMG find evidence that the former Principal advised governors of the affordability of general pay increases, or that governors considered the findings of the annual Association of Colleges salaries survey when considering pay awards for senior post holders. This would have shown that both the former Principal and Deputy Principal were paid above the upper quartile for similar sized colleges in the Midlands.

49. Corporation and committee meeting papers reviewed by KPMG indicated that individual and general pay awards to staff were approved repeatedly, at the same time that governors were receiving adverse financial reports including:

- July 2011 - general pay award was approved alongside report of £873,000 annual deficit
- March 2012 - individual senior post holder pay awards were approved alongside a greater than planned forecast deficit and breach of bank covenants
- July 2013 - individual senior post holders and general pay awards were approved alongside a budget forecasting a deficit

- July 2014 - individual senior post holders and general pay awards were approved at a time when the college had a critical cashflow position (and was relying on Exceptional Financial Support from the SFA), income below financial plan, and inadequate financial health, with a review by the FE Commissioner expected.

Appointment and remuneration of family members

50. KPMG found that the former Principal recorded his marriage to a member of staff in the college's Register of Interests in March 2010. His spouse had been employed at the college since 2002. No evidence was available to KPMG for any entry made relating to a relationship before March 2010.

51. KPMG established that in 2012, as part of a significant restructuring by the former Principal, his spouse was promoted to the Senior Management Team. Promotion and pay awards at this level were the responsibility of the former Principal, although the minutes of the governors' Remuneration Committee meeting in March 2012 reviewed by KPMG indicated that members suggested he consider appropriate representation of the International Office on the Senior Management Team.

52. KPMG found that in July 2014 the Corporation approved a further restructuring by the former Principal which brought his spouse into the Executive Leadership Team with a substantial pay increase of 22% (as well as general pay awards mentioned above), but no evidence of changes to responsibilities or rationale for the increase. There was no evidence found by KPMG of a potential conflict of interest recorded in committee or Corporation minutes where the role or salary of the former Principal's spouse was considered.

53. The former Principal's daughter was appointed to the college following recruitment to an externally advertised post. There was no evidence found by KPMG to suggest that the former Principal was involved in the recruitment or appointment process, although there was no disclosure identified in the Register of Interests of his daughter working at the college, and governors were not actively made aware of the relationship. There was no declaration found by KPMG in the Register of Interests that the Deputy Principal's son worked at the college or that his daughter worked for a supplier of corporate hospitality to the college.

Conclusions from the review of evidence by KPMG

54. Following receipt of concerns from the FE Commissioner about potential misuse of public funds and potential fraudulent activity by the former Principal of Bournville College, the SFA commissioned a review of evidence by KPMG which identified instances where:

- there was a failure of senior managers and governors to comply with the relevant version of the college's Financial Regulations in relation to procurement processes and financial controls, over the four years for which evidence was reviewed

- expenditure on key corporate hospitality and marketing events shows breaches of the college's Financial Regulations and Anti-Bribery Policy, including failing to update the Register of Interests in a timely way and to declare potential conflicts of interest

- the college's review process for the expenses incurred by the former Principal and other senior staff was non-compliant with its Financial Regulations, and there is little evidence of challenge to the former Principal by successive Chairs of Governors on individual items of expenditure

- there was limited evidence of any control over costs of overseas travel. Reports provided to the Corporation were incomplete and excluded overseas travel expenses from the activity costs presented. There was little evidence that governors challenged the lack of information, or sought justification for time spent and college funds used, on introducing commercial organisations to overseas contacts without formal partnership arrangements in place. There was no entry on the Register of Interests for the former Principal or governors regarding their directorships in a joint company that was set up with another body, Trans Data Management, which is a breach of the Financial Regulations and the college's Anti-Bribery Policy

- relatives of senior managers were appointed without declarations in the Register of Interests. Pay increases for senior post holders and some senior managers were approved over and above those paid to all college staff during a period of decline in financial performance of the college

- overall, monitoring of expenditure by governors was at a high rather than a detailed level and there was use of exception reporting for retrospective approvals. This limited governors' ability to disallow the expenditure or consider reasonableness and value for money prior to the services being procured.

55. While not part of the KPMG findings, it is worth noting that according to the college's annual reports for three of the years in question the college's external auditors

provided an unmodified regularity audit opinion. It was the responsibility of the auditors to provide assurance to both the governing body and the SFA that the college's expenditure and income had been used for the purposes intended by Parliament and that the college's financial transactions complied with relevant rules, including the college's own financial regulations. The unmodified opinion means that the auditors agreed with the governing body's own view that it was discharging satisfactorily its responsibility for the proper conduct of the college's financial affairs, and as a result the SFA had no reason to question the activities of the college. The regularity audit opinion provided assurance to both the governing body and the SFA under a tripartite agreement. The college's external auditors were RSM Tenon Audit Ltd for 2011 to 2012, Baker Tilly Audit Ltd for 2012 to 2013, Baker Tilly Audit UK LLP for 2013 to 2014 and RSM UK Audit LLP (formerly Baker Tilly Audit UK LLP) for 2014 to 2015.

56. On the question of whether the former Principal had operated fraudulently, the SFA referred the KPMG report to the West Midlands Police who decided not to pursue a criminal prosecution.

57. The KPMG findings in this report and the underpinning KPMG report of the review of evidence have been shared with the former Principal and a former Chair of Governors, neither of whom have provided any factual corrections to the reports.

58. The preparation of this report has taken a significant amount of time since the receipt of KPMG's findings in December 2016 due to concerns about the potential impact of publication on actions that might be taken by other agencies. Following the decision by West Midlands Police not to pursue a criminal prosecution, the KPMG findings were shared with the Charity Commission for consideration of regulatory action. Initial discussions with the Charity Commission suggested that it would be preferable for the findings to remain confidential while under consideration. ESFA received confirmation in February 2019 that the Charity Commission would not be taking any action on the basis of the KPMG report. Subsequent due process has been undertaken to allow for factual accuracy checking and internal review. ESFA is now reviewing procedures for referrals to other agencies to ensure that findings from investigations can be made public as soon as possible without putting at risk any further action that might be taken against individuals or organisations.

Changes to the regulatory framework since 2015

59. Further education and sixth-form colleges are operated by statutory corporations which are responsible for the effective and efficient use of resources, the solvency of the college and the safeguarding of its assets. The DfE regulatory framework administered by ESFA, which includes DfE's funding agreement with colleges, the college accounts direction and the post-16 audit code of practice, underpins the statutory responsibilities of college corporations. The regulatory framework sets out expectations of governing bodies for oversight of regularity (i.e. what the college spends money on), propriety (i.e. the manner in which decisions are made), and value for money (i.e. the basis for making decisions).

60. At the time of the events described in this report, government policy was to encourage colleges to respond flexibly to local and national priorities for education and training. This was supported through relaxation of prescriptive requirements and the removal of government controls that had previously been in place, relying instead on governing bodies to discharge their statutory responsibilities. While the majority of governing bodies have done this well, in the light of the failings in the Bournville case and experience elsewhere DfE and ESFA have recognised that the regulatory framework can be improved to better support robust governance. A number of changes have been made since 2015 including:

- setting out in 2015 standard terms of reference for the regularity assurance engagement for college corporations to clarify the duty of care owed by the external auditor to the funding body under the tripartite agreement
- providing guidance in 2015 for external auditors on how to approach the regularity assurance engagement at college corporations and emphasising in 2018 that they may approach ESFA for a summary of any matters relevant to regularity
- updating the regularity self-assessment questionnaire for college corporations and confirming in 2018 that they must share their completed regularity questionnaires with their external auditors
- recognising the Association of Colleges' Code of Good Governance in 2015 and the Charity Governance Code in 2018 as alternatives to the UK Corporate Governance Code, one of which colleges must follow on a comply or explain basis
- introducing an early intervention strategy in 2015 so that intervention can begin when financial decline is first identified rather than waiting to the point of financial failure

- reiterating expectations in letters from the chief executive of the SFA/ ESFA to college accounting officers in June 2016 and April 2017
- expanding the role of the FE Commissioner in 2017 so that they can undertake diagnostic assessments on colleges identified by ESFA as triggering early intervention
- extending the triggers for formal intervention in 2019 to specifically include evidence of action taken by an accounting officer and/or governors outside of the college or departmental controls/policies.

61. DfE has provided support for governing bodies more broadly during this period through the establishment of National Leaders for Governance for FE, and the publication of the governance guide for further education and sixth-form college corporations.

62. Events at Bournville College have shown that even where a college is delivering good or outstanding educational performance as assessed by Ofsted, robust oversight of financial management by governors is vital to secure the future of the education provision. DfE and ESFA will now consider how best to reflect this in the operation of the new college oversight regime as published on 1 April 2019 and the regulatory framework.

Recommendations made by ESFA

63. Strengthening the regulatory framework will support governing bodies to discharge their responsibilities, but it cannot guarantee that events such as those described in this report will not happen again. This will need the commitment of college governors and executive teams to the highest standards of behaviour, and vigilance in identifying and challenging activity or conduct that appears inappropriate. The recommendations below are provided by ESFA for consideration by all college governing bodies, and reiterate previous messages set out in letters to the sector from the FE Commissioner and in DfE and ESFA guidance:

- governing bodies should not rely only on the flow of information provided by the Principal as this may restrict their ability to provide challenge as well as support. Governing bodies should ensure they have the right skills mix amongst their members to recognise financial deterioration and challenge the actions of the executive where a college is facing difficult financial circumstances. They should ensure that they have sufficient access to other members of staff and use external sources of data, such as the financial dashboards provided by ESFA, to triangulate the information that they receive

- governing bodies should ensure there is a detailed cost-benefit analysis and board level scrutiny of new initiatives, before any such proposal is taken forward. This should include how the initiative contributes to the core mission of the college both financially and in terms of the curriculum. Once a new initiative is established it should continue to be reported separately until it regularly meets financial and performance indicators set by the governing body

- governing bodies should use a range of information to ensure that expenditure provides value for money. ESFA provides access to a financial benchmarking tool for colleges in collaboration with the Association of Colleges which enables comparison of a large number of metrics by college size and region

- governing bodies should ensure that their Audit Committee discharges its duties as required under the post-16 audit code of practice to advise the Corporation on the adequacy and effectiveness of assurance arrangements, framework of governance, risk management and control processes for the effective and efficient use of resources, solvency of the institution and the safeguarding of its assets. Governing bodies should consider whether a transaction is regular and proper using the tests set out in the post-16 audit code of practice

- governing bodies should use the ESFA's regularity self-assessment questionnaire to challenge their own practices in relation to regularity, propriety and compliance. They must share this with their external auditor to inform the regularity assurance engagement. External auditors should ensure the corporation’s self-assessment is supported by sufficient and relevant evidence.

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