INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

Barony College

Annual audit report to Board of Management and the Auditor General for Scotland

Year ended 31 July 2010

20 December 2010

AUDIT

AUDIT ▪ TAX ▪ ADVISORY

Contents

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the Code").

This report is for the benefit of the Board of Management of Barony College and is made available to Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

Executive summary

Financial statements

We have issued an audit report expressing an unqualified opinion on the financial statements of the College for the year ended 31 July 2010. The financial statements for the year disclose a significant surplus mainly as a result of a change in the assumptions used to calculate pension liabilities.

Management provided draft financial statements and supporting work papers which were complete, of a high standard, and provided in line with the agreed timetable. A number of minor adjustments were made to the draft financial statements and there are no unadjusted audit differences.

Financial forecasts

The College has prepared its college plan for 2010-13, which sets the financial and operational context for the strategic objectives and priorities of the College for the financial years 2010-11 to 2012-13 on the basis of known or assumed financial parameters. A small surplus has been forecast for 2010-11, although this is reduced from prior years. The next few years are likely to be difficult for public sector organisations and College plans may require to be adapted to changing circumstances.

The level of cash has deteriorated since 31 July 2009 and a significant cash out flow is forecast for 2010-11; this will require utilisation of the overdraft facility to manage cash flow pressures and working capital.

Corporate governance

Although overall corporate governance procedures have not changed since the prior year, the retirement of the previous audit committee chairman in June 2010 has resulted in a reduction in financial expertise on the board of management.

The corporate governance statement is consistent with our understanding of the organisation and does not disclose any significant weaknesses in the system of internal control. There is a formal process in place to record, distribute and monitor action in response to key guidance and circulars.

Internal audit concluded that the College had *"adequate and effective risk management, control and governance processes to manage its achievement of its objectives".*

Scope

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("The *Code*"). This specifies a number of objectives for our audit.

Audit framework

This year was the fourth of our five-year appointment by the Auditor General for Scotland as external auditors of the Board of Management of Barony College ("the College"). This report provides our opinion and conclusions and highlights significant issues arising from our work. We outlined the framework under which we operate, under appointment by Audit Scotland, in the audit plan overview discussed with the audit committee earlier in the year.

The purpose of this report is to report our findings as they relate to:

- the **financial statements** and our audit opinions;
- our review of the College's **corporate governance arrangements** as they relate to its review of systems of internal control, the prevention and detection of fraud and irregularity, standards of conduct, prevention and detection of corruption, and its financial position; and
- aspects of the College's arrangements to manage its **performance** as they relate to economy, efficiency and effectiveness in the use of resources.

Responsibilities of the principal and board members and its auditors

External auditors do not act as a substitute for the board of management's own responsibilities for putting in place proper arrangements to account for the stewardship of resources made available to it and its financial performance in the use of those resources, to ensure the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the effectiveness of those arrangements and, through the accountable officer, to make arrangements to secure Best Value.

Acknowledgement

Our work continues to bring us into contact with a range of College staff and we wish to record our appreciation of the continued co-operation and assistance extended to us by College staff during our work.

Service overview; financial position

Introduction

The financial statements report a surplus for the year of £363,000, an increase of over 300% compared to the previous year and £345,000 higher than the projected outturn projected in the management accounts during the year. As at 31 July 2010, there are general reserves of £588,000 (2009: £135,000. The surplus in the year has been Impacted by a significant pensions credit in the year.

Income

Income for the year has risen by £530,000 compared to 2008-09, an increase of 11% due to increases in all main categories of income:

- Grants from the Scottish Funding Council ("SFC") have risen by £238,000, an increase of 8.4% from prior year due mainly to an increase in the number of projects receiving funding this year.
- Tuition fees and education contracts have increased £171,000 (28%) mainly due to an increased take up of short courses in forestry studies.
- Other operating income has increased by £148,000 since the prior year (10%) mainly as a result of increases in farm and canteen income.

Expenditure

- The staff costs for 2009-10 include a credit of £303,000 in relation to pensions past service costs as a result of the change in measuring pension increases from RPI to CPI (refer over page for more information). Underlying staff costs have increased by £313,000 as a result of pay increases and increases in employee numbers.
- Other operating expenses have increased by £198,000 as a result of a number of factors, but particularly as a result of increases in maintenance costs (up £128,000) and consultancy services (up £76,000).

	2009-10 £'000	2008-09 £'000
Income		
Scottish Funding Council grants	3,072	2,834
Tuition fees and education contracts	780	609
Other operating income	1,692	1,544
Investment income	-	27
	5,544	5,014
Expenditure		
Staff costs	2,750	2,740
Other operating expenses	2,167	1,959
Depreciation	264	255
	5,181	4,954

Service overview; financial position (continued)

Overall net assets have increased by £490,000 since the prior year. The key movements underlying this are as follows:

- fixed assets have increased by £389,000 as a result of the capital spend on the bio-mass boiler which was completed in the year, offset to an extent by depreciation of £264,000.
- Stocks have increased by £96,000 since the prior year mainly as a result of increases in livestock through both breeding and purchases.
- Debtors and accrued income have increased by £266,000, partly as a result of a number of individually large invoices outstanding at the year end and partly as a result of ERDF income accrued at the year end.
- Creditors due with in one year have increased by £210,000 since the prior year. There are a number of reasons for this: the timing of invoices received just prior to year end, increases in deferred capital grants and increases in development loans as a result of cash drawn down to fund the bio-mass boiler.
- Creditors falling due after more than one year have increased by £111,000 since the prior year also due to loans drawn down to fund the bio-mass boiler.
- The net pension liability has decreased by £280,000 since the prior year, mainly as a result of changes in the assumptions used to calculate the liabilities.

	2010 £'000	2009 £'000
Fixed assets	6,767	6,378
Stocks	606	509
Debtors and accrued income	456	190
Cash and short term investments	159	381
Creditors: Amounts falling due within one year	(1,018)	(808)
Net current assets	**203**	**272**
Creditors: Amounts falling due after one year	(700)	(589)
Net pension liability	(696)	(976)
Net assets	**5,574**	**5,085**
Deferred capital grants	1,436	1,279
General reserves	588	135
Revaluation reserve	3,550	3,671
Total	**5,574**	**5,084**

Following the UK Government's budget, it was announced that future pension increases will be linked to the Consumer Prices Index ("CPI") rather than the Retail Prices Index ("RPI"); CPI has historically been lower than RPI by 0.5% to 0.7% and this results in a significant (£303,000) pension credit in 2009-10. There is currently some debate in the accounting profession as to how the effect of this should be reflected through financial statements; either through the income and expenditure account or the statement of total recognised gains and losses. Management has reflected this in the income and expenditure account in the financial statements; this is inline with our experience in the rest of the FE sector. This may require to be adjusted next year once accounting guidance on the issue is finalised.

Financial forecasts

The College has prepared its college plan for 2010-13, which sets the financial and operational context for the strategic objectives and priorities of the College for the financial years 2010-11 to 2012-13. The College has been increasing the number of income sources in recent years, particularly European funding. However, in line with the rest of the sector, the College remains reliant on funding from the SFC. There is currently uncertainty over the level of SFC grant income that will be available to colleges over the forthcoming financial years.

	£'000
Income	5,679
Expenditure	(5,666)
Forecast surplus	**13**
Cash balance at 31 July 2010	159
Forecast cash balance at 31 July 2011	(23)
Forecast movement in cash during 2010-11	**(182)**

2010-11 financial forecast

The forecast for 2010-11 is for the College to achieve a surplus of £13,000 which is down considerably from the surplus in 2009-10, for reasons explained on the prior page, and also from that which has been achieved in recent financial years. This is in recognition of the challenging environment in which the College operates.

The College uses a zero-based budgeting approach, based on input from each of the 16 budget holders. This is based on expected activity in the coming year rather than activity in the prior year and takes into account expected income as well as expenditure (eg from specific projects being run, farming sales, etc).

The table opposite details the breakdown of forecast income, expenditure and cash balances for the 2010-11 financial year. Meeting the 2010-11 budget will require tight control of costs, in particular the supplies and services budget has been restricted in 2010-11.

Management has received verbal confirmation that the SFC will be able to provide the full level of grants for the 2010-11 financial year, however in the absence of written confirmation there is still some uncertainty. This could lead to reduced funding in the final four months of the year.

Future financial planning

The College, in line with much of the wider public sector, is facing significant uncertainty over future funding levels and the impact and scope of public sector cuts. As can be seen in the table above, the management has forecast a net cash outflow over the coming year of nearly £200,000 resulting in an overdrawn cash balance at 31 July 2011. The College has had access to an overdraft facility of £250,000 in recent years which has required annual renewal. Due to the differences in timing between income and expenditure it is likely that this facility will also be required during the year to manage cash flows. With these pressures in mind, management has initiated plans in a number of areas to mitigate risks going forward:

- During the year the board and other senior management initiated scenario planning, with assistance from Scottish Enterprise. This consisted of consideration of a number of possible future actions to generate income or reduce expenditure. Scenario planning anticipated a level of natural shrinkage of staffing levels which would have an impact on education provision. However, the SUMS outturn for 2009-10 indicates there is some scope for a managed reduction in student activity without impacting on income levels.
- A joint boards working group has been set up with other land based colleges in Scotland to identify efficiencies through cooperation between each. The first output from this will be research commissioned from Oxford Economics to forecast skills requirements in Scotland's land based industries. This will utilised by the group to ensure courses provided are targeted to specific areas of demand.

Governance and risk management

Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all bodies.

Through the College principal, the board of management is responsible for establishing arrangements for ensuring the proper conduct of College affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The *Code* requires auditors to review and report on corporate governance arrangements as they relate to:

- the Board's reviews of its systems of internal control, including its reporting arrangements;
- the prevention and detection of fraud and irregularity; and
- standards of conduct and arrangements for the prevention and detection of corruption.

Framework

The board of management comprises 16 members and includes members who provide a range of experience to the College, including education, funding, marketing, farming and other land based industries as well as student representatives. We note however that following the retiral of the previous audit committee chairman in June 2010 the board is operating with a reduced level of financial expertise. In the interests of transparency, the statement of corporate governance and internal control details the basis of appointment of each of the board members. Various powers and functions of the board are delegated through terms of reference to the seven standing committees in place, each of which meet quarterly. The internal audit plan for the year included a review of corporate governance procedures which resulted in six recommendations and found that *"systems used by the College are substantial in this area"*.

Risk management

The College has in place a risk policy and a risk strategy, both of which are available to all staff on the intranet. There is also a risk register which is split into College level strategic risks and operational risks. Both areas are standing items on the agenda and are considered at each audit committee meeting. There are presently four strategic level risks on the register in relation to income levels. This appropriate in the current economic climate though management should consider whether liquidity risks are appropriately recognised.

The financial statements include information on the processes in place to manage the principal risks and uncertainties as well as detailing the specific key risks.

Governance and risk management (continued)

Regularity

The Board of Management considers all incoming correspondence relevant to its strategic management role from the Scottish Funding Council and other regulatory or advisory bodies, such as Audit Scotland. The audit committee also considers any applicable correspondence. The College can therefore demonstrate that it considers all incoming guidance received from these bodies, and that appropriate action has been taken when required.

Prevention and detection of fraud and irregularity

A fraud policy was implemented in September 2007 following recommendation by internal audit. A whistle blowing policy has also been put in place detailing the procedures for staff to follow if they believe certain, listed events may have occurred. This makes it clear what the appropriate reporting lines are and the actions that should be taken. Both of these policies are readily available to all staff on the internet. No instances of fraud or irregularity were identified during the year.

Internal controls

In line with our audit plan, we have performed testing around entity level controls and financial controls where relevant as part of our audit approach to certain account captions in the financial statements. We have not identified any significant issues or concerns in these areas, which is in line with our findings in previous years. We believe the control environment at the College is appropriate to the size and nature of the organisation.

Internal audit

Internal audit completed all work scheduled for 2009-10 as detailed in the internal audit plan approved in August 2009. The annual internal audit report for 2009-10 concludes that the College had *"adequate and effective risk management, control and governance processes to manage its achievement of its objectives"*. A number of recommendations to improve processes and procedures at the College were raised by internal audit during the year but we note no "high" rated recommendations were raised. The current internal audit providers were recently re-appointed for a further three year period. College policy will require rotation of the internal audit provider after this period.

Best Value / value for money

The financial memorandum with the SFC requires that the board of management put in place processes and procedures to ensure the College strives to achieve best value from its use of public funds from all sources. Management believes that best value is embedded in the College's procedures through a stringent budget setting process and in recent years has utilised internal audit to perform work on value for money. In 2009-10, arrangements to ensure value for money in business development were reviewed. Two minor recommendations were raised and overall the report found that *"the systems and procedures in place at the College are strong in this area"*. As best value continues to be an area of focus, management should ensure that the College has appropriate procedures in place to demonstrate this.