Cumbernauld College

Annual Report to the Board of Management and the Auditor General for Scotland 2009/10

December 2010

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Executive Summary

Finance

Our audit of Cumbernauld College is now complete and our audit opinion on the truth and fairness of the financial statements and the regularity of transactions is unqualified.

The College has reported a surplus of £188,000 in 2009/10 (£26,000 in 2008/09). The budgeted surplus shown on the 2009 Financial Forecast Return submitted to the Scottish Funding Council was £98,000.

The 2010 Financial Forecast Return shows the College forecasting an operating surplus of £25,000 in 2010/11, and operating surpluses for 2011/12 and 2012/13 of £41,000 and £42,000 respectively.

The College is financially secure and the balance sheet as at 31 July 2010 is showing net assets of £9.766m including a bank balance, net of overdraft, of £1.882m.

Governance

The College's Corporate Governance Statement confirms that the College has been fully compliant with the key provisions of the 2008 Combined Code on Corporate Governance during 2009/10 apart from the Chair of the Board of Management also being the Chair of the Remuneration Committee. This non-compliance has been disclosed in the Corporate Governance Statement within the financial statements. We have reviewed the College's statement and can confirm that this is in line with the Scottish Funding Council's guidance and is not inconsistent with our understanding from the audit.

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

Conclusion

This report concludes the 2009/10 audit of Cumbernauld College. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards.

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

Scott-Moncrieff
14 December 2010

Introduction

1. This report summarises the findings from our 2009/10 audit of Cumbernauld College. The scope of our audit was set out in our External Audit Strategy and Plan which was presented to the Audit Committee on 16 September 2010. The main focus of our external audit has been on the financial statements and governance arrangements.

2. Our plan summarised the following key audit issue for 2009/10:

   - Valuation of Land and Buildings

3. This report sets out our findings in relation to this key issue. The report also includes a follow-up of issues identified during our previous audit.

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

Finance

5. In this section we summarise the key aspects of the College's reported financial position and performance to 31 July 2010. We also outline significant financial issues identified during the course of our audit. It is the responsibility of the College to conduct its financial affairs in a proper manner. It is our responsibility to audit the financial statements and to consider the governance arrangements in relation to the College's financial position.

Auditors' opinion

6. We are required to give an opinion as to whether the financial statements present a true and fair view of the financial position of the College as at 31 July 2010 and of its expenditure and income for the financial year. We are also required to include a regularity assertion in our independent auditors' report stating whether, in all material respects, expenditure and income were incurred or applied for their intended purposes and in accordance with guidance issued by the Scottish Ministers and the financial memorandum with the Scottish Funding Council (SFC).

7. Our audit is now complete and our audit opinion on the truth and fairness of the financial statements and on the regularity of transactions is unqualified.

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

Financial position

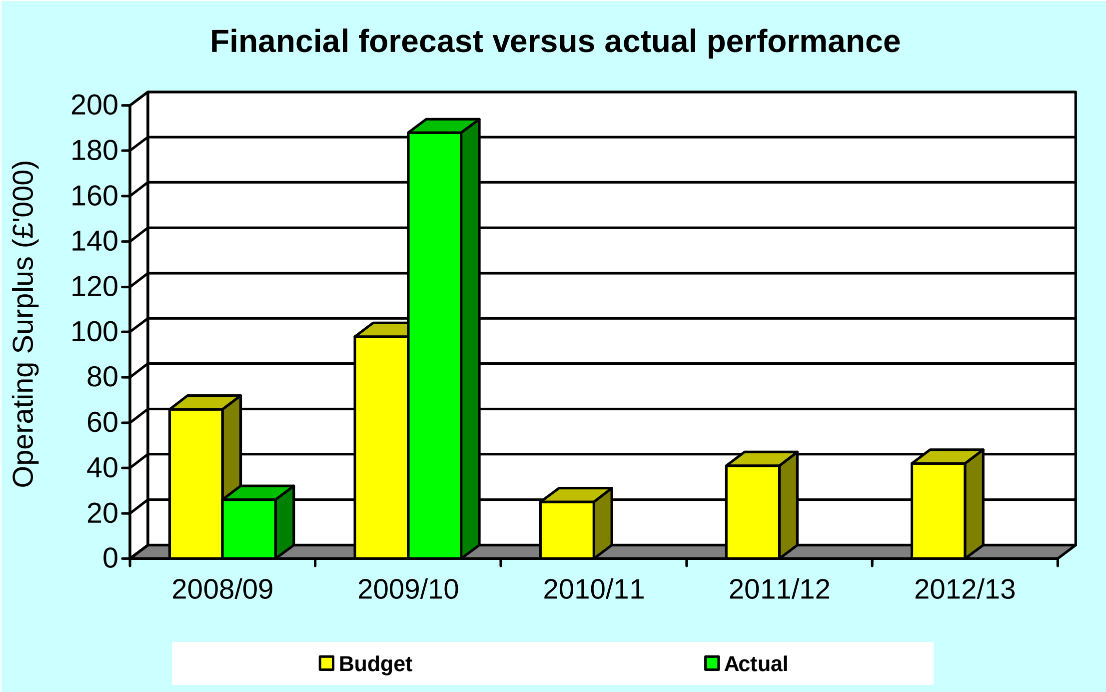
9. The College reported an operating surplus for the year to 31 July 2010 of £188,000.

10. The College is financially secure and the balance sheet as at 31 July 2010 is showing net assets of £9.766m including a bank balance, net of overdraft, of £1.882m.

Financial forecasts

11. The College submits annual Financial Forecast Returns (FFRs) to SFC for the current year and the next three years. SFC uses the FFRs to assess the financial performance of individual Colleges and of the sector as a whole.

12. The following graph compares the actual results for 2009/10 with the FFR forecasts and sets out future projections as contained within the 2010 FFR.



13. As shown above, the College is expecting to report surpluses in 2010/11, 2011/12 and 2012/13.

14. The College's original budget for 2009/10 per the 2009 FFR showed a surplus of £98,000.

15. A reconciliation between the forecast surplus and the actual surplus is set out below:

	£
Surplus per initial budget	**98,000**
FRS 17 adjustment **(paragraph 16)**	(83,000)
Economic Downturn Funding **(paragraph 17)**	189,000
Other income **(paragraph 17)**	229,000
Impact of future VAT rate increase on the Lennartz creditor **(paragraph 18 & 19)**	(54,000)
Student funding contribution **(paragraph 20)**	(105,000)
Total of other insignificant expenditure variances **(paragraph 21)**	(86,000)
Actual surplus per financial statements	**188,000**
Variance to original budget	**90,000**
Variance as percentage of total income	**0.78%**

16. The Board of Management can not, with reasonable certainty, quantify the annual effect of FRS 17 on the figures in the financial statements, or on the FFR, and as such no impact was anticipated at the time the FFR was prepared.

17. Additional funding from SFC in respect of economic downturn (£189k), coupled with increases in other grant income (£68k), SDS income (£56k) and business development income (£105k), led to income stream increases which were unforeseen at the date of preparation of the FFR.

18. Following the refurbishment of the main campus in 2007, the College was able to reclaim a significant amount of VAT using the Lennartz mechanism. This is effectively an agreed method that allows the College to reclaim the non-business element up front, on the condition that it is repaid to HMRC over a 10 year period. The repayments under Lennartz can vary and depend on two factors: the standard rate of VAT and the annual non-business calculation.

19. Following the April 2010 budget announcement that the VAT rate will increase to 20% as of 4 January 2011, this factor alone will result in the College repaying an additional £53,790 to HMRC (assuming no further change in VAT rate before the repayment date in July 2016). The financial statements have been adjusted to record the impact of the increase in the College's liability. This event was unforeseen as at the date of preparation of the 2009 FFR.

20. The College has made a contribution to student funding in the year totalling £105,000 which was unforeseen at the date of preparation of the FFR.

21. In all cases the College will take a prudent approach to budget setting, and following the economic downturn budget holders were encouraged to deliver efficiencies where possible.

Financial planning and monitoring arrangements

22. The College has a responsibility to conduct its financial affairs in a proper manner. As part of our audit, we are required to consider the College's financial standing, including the arrangements in place for financial planning, budgetary control and financial reporting. It is important that such arrangements are adequate in order to properly control the College's operations and use of resources.

23. Budgets are devised prior to the submission of the FFR which is approved by the Resources & General Purposes Committee. This committee meets four times a year. Management accounts showing actual against budget, as well as a projected forecast are presented to each Resources & General Purposes Committee.

24. In our opinion the College has very effective financial management arrangements in place, and has taken steps to proactively analyse and respond to the future funding challenges posed by the current economic climate.

Financial reporting framework

25. The principal elements of the College's financial reporting framework are:
    - Accounts Direction issued by the Scottish Funding Council
    - Further Education / Higher Education Statement of Recommended Practice (FE/HE SORP) 2007

26. We are pleased to confirm that the College's 2009/10 financial statements comply fully with the Accounts Direction and FE/HE SORP 2007 in all material aspects.

Financial statements preparation

27. We are grateful to the Finance Manager and the finance staff for their assistance and support during the course of the audit. We found the draft financial statements and supporting working papers to be of a very high standard.

28. We found that the College has adequate resources available in the Finance Department to meet the College's financial management and reporting needs.

Audit adjustments

Actual adjustments

29. Subsequent to the presentation of the financial statements for audit, the following adjustments to the financial statements were identified:-

1	Dr Exceptional staff costs	£340,000	
	Cr STRGL - Income and expenditure reserve		£340,000
	Being adjustment to disclosure of past service costs arising from change in assumption from RPI to CPI – (paragraph 39)		
2	Dr Other operating expenses	£54,000	
	Cr HMRC – Lennartz VAT < 1 year		£6,000
	Cr HMRC – Lennartz VAT > 1 year		£48,000
	Being increase in Lennartz creditor as a result of the increase in VAT rate (paragraphs 18 & 19)		

30. The table below outlines the impact of the adjustments on the outturn position:-

	£'000
Surplus per accounts originally presented for audit	**582**
Adjustments identified during the audit:	
Amendment to FRS 17 accounting (RPI/CPI movement): ***paragraph 39 for further details***	(340)
Impact of future VAT rate increase on the Lennartz creditor: **paragraphs 18 & 19 for further details**	(54)
Actual surplus per audited accounts	**188**

31. All other adjustments related to presentational and disclosure issues.

Potential adjustments

32. There were no potential adjustments noted as a result of the audit work performed.

Review of accounting systems

33. As part of our audit we assessed the accounting systems and internal controls operating at the College to ensure they formed an adequate basis for the preparation of the financial statements. We identified no major internal control weaknesses and, in our opinion, accounting systems are generally well designed and operating effectively.

Other issues of particular significance for the 2009/10 audit

34. In order to assist College members' understanding of the financial statements and our audit, we have summarised issues below which we believe are of particular significance to the 2009/10 financial statements, which have not already been discussed fully in our report.

Valuation of Land and Buildings

35. The last full valuation of the College estate took place in July 2007, and in accordance with Financial Reporting Standard 15 - "Tangible Fixed Assets" an interim valuation was performed as at 31 July 2010. The report highlighted a reduction in the value of land and buildings of £1,717,000, which following the release of accumulated depreciation of £787,000, reduced the revaluation reserve by £930,000. The valuation report obtained from CB Richard Ellis Limited was tested as part of our audit work. It was concluded that the accounting adjustments processed to record the outcome of the revaluation exercise were correctly reflected within the financial statements.

Breach of bank covenants

36. The Finance Manager brought it to the attention of audit staff that a breach of covenants had taken place in respect of the Clydesdale Bank loan, following the incorporation within the financial statements of the results of the interim valuation of land and buildings. The covenants in place stipulate that the Income and Expenditure reserve (excluding pension reserve) plus the revaluation reserve should not fall below £2.15m. Based on the year-end financial statements the reserves as defined within the agreement total £1,909,000. The breach has been reported to Clydesdale Bank PLC, and negotiations are in progress in relation to the potential re-wording of the covenants. ***Action plan point 1***

Pension Fund liabilities

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

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

39. The SPF is also a multi-employer scheme but the College can identify its share of underlying assets and liabilities and has therefore recognised a net liability in its balance sheet. In 2009/10, the College reported a liability in respect of the SPF of £1.287m. This was a significant reduction from the balance as at 31 July 2009 of £1.585m. The main reason for the reduction in the pension fund liability was that on 22 June 2010, the Chancellor of the Exchequer's Budget Statement outlined that future pension increases were to be linked to the Consumer Prices Index (CPI) rather than Retail Prices Index (RPI). There is a one-off adjustment in 2009/10 in favour of the College of £340,000 arising from this change which has been reflected in the College's Statement of Recognised Gains and Losses in the year.

40. We reviewed the College's accounting for the pension liability and confirmed that it complies with the requirements of FRS 17 and the FE/HE SORP, and that disclosure is consistent with the actuarial valuation report.

Governance

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

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

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

Corporate Governance

Current governance arrangements

43. Colleges are required to include in their financial statements a statement covering the responsibilities of their Board of Management in relation to corporate governance arrangements. The statement should describe the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management, and report on the College's compliance with the Combined Code.

44. The College's Corporate Governance Statement for 2009/10 explains that the College was compliant with all provisions of the 2008 Combined Code throughout the period, except for the fact that the Chairman of the Board of Management is also the Chairman of the Remuneration Committee. This exception is clearly disclosed within the Corporate Governance Statement in the financial statements. The College considers it appropriate to maintain this position as the Remuneration Committee does not determine remuneration for Board members but only for senior management. As a result the College considers that it remains compliant with the principles of the Combined Code.

45. We reviewed the Corporate Governance Statement by:

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

46. We are satisfied that the statement is consistent with the Scottish Funding Council's guidance and that the contents are not inconsistent with information gathered during the course of our normal audit work.

In 2010/11, the College will have to report against revised Corporate Governance standards

47. A new Corporate Governance Code was published in June 2010 and will apply to financial years beginning on or after 29 June 2010. The UK Corporate Governance Code, formerly known as the Combined Code, sets out standards of governance for listed companies. The Code is also applicable to publicly funded bodies that are required to prepare an annual statement on internal control or corporate governance for inclusion in their financial statements. The "comply or explain" provision is retained in this new version of the code.

48. We recommend that the College reviews its corporate governance arrangements against the new Code in preparation for making its Corporate Governance Statement in its 2010/11 financial statements. We have undertaken an analysis of the key changes applicable to education bodies and will be sharing this guidance with College management to help inform this assessment. ***Action plan point 3***

Risk management

49. Risk management is important to the establishment and regular review of systems of internal control. We have reviewed the College's risk management arrangements as part of our audit work on corporate governance.

50. The College has a Risk Management Policy and Risk Management Procedures in place. The College has a risk register, which is subject to regular review and update by the Risk Management Group. Procedures now ensure that risk management is reported as a standing item at each meeting of the Audit Committee. An up to date, electronic, full risk register is made available to members prior to each Audit Committee meeting. The Board consider all high level risks on a bi-annual basis.

Internal audit

51. Internal audit is a key component of the College's corporate governance arrangements. The College's internal audit service is provided by Wylie & Bisset.

52. To avoid duplication of effort and ensure an efficient audit process, we have made use of internal audit work where appropriate.

Internal audit's annual opinion statement

53. Internal audit has concluded in its annual report that the College has adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives.

54. We are grateful to Wylie & Bisset for their assistance during the course of our audit work.

Prevention and detection of fraud and irregularity

55. We are required to consider the arrangements made by management for the prevention and detection of fraud and irregularity. Fraud is defined as deception made for personal gain and irregularity is defined as transactions which do not comply with Scottish Ministers guidance.

56. The College has a fraud policy and a whistle blowing policy in place. These policies identify the appropriate persons to contact in the event of any fraud or irregularity. There were no frauds identified during the year.

57. All SFC and other guidance and circulars are received by the Principal's secretary. All relevant regulatory information is distributed to the appropriate members of staff. A database is held of all SFC circulars and responsible officers. All relevant guidance is presented to the Board of Management meetings ensuring that all those concerned have access to adequate and relevant information.

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

Standards of conduct

59. We are required to consider the arrangements made by management in relation to standards of conduct and prevention and detection of corruption.

60. Propriety requires that public business is conducted with fairness and integrity. This includes avoiding personal gain from public business, being even-handed in the appointment of staff, letting contracts based on open competition and avoiding waste and extravagance. Guidance on standards of conduct, accountability and openness has been issued by the Scottish Government.

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

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

Looking Forward

Financial position

63. There is increasing uncertainty over the level of future funding that will be provided to the sector and indications from the Scottish Government are that there will be no significant increases in future funding. Coupled with increasing cost pressures this will result in limited financial resources for the sector. Whilst College management have been making plans to react and respond to this situation, the true impact has yet to be confirmed and the College's assumptions underpinning its response have yet to be tested. Whatever the outcome, all indications are that the coming years will prove a time of more restraint for the FE sector than compared with recent periods.

International financial reporting standards

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

65. The Scottish Funding Council's expectation is that Colleges will continue to converge with International Financial Reporting Standards (IFRS) as UK GAAP converges with IFRS over the next few years. It appears likely that full implementation will not take place before 2013. Whilst this is some time away, the conversion process requires sufficient and appropriate information to be available to support the production of comparator balances. Effectively, this means work to produce full IFRS-compliant financial statements will begin at least one year before the actual implementation date. In some areas, such as in relation to fixed assets and component accounting, the earlier the work begins the more straightforward the conversion process may be.

66. We will continue to monitor developments in this area and ensure that the College continues to follow the appropriate accounting standards.

Appendix 1 – Action Plan

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

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

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

Grading

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

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

Issues arising from our 2009/10 audit

Action point	Issue identified and recommendation	Management response
1 **Breach of bank loan covenants**	The Finance Manager brought it to the attention of audit staff that a breach of covenant had occurred in relation to the Clydesdale Bank loan, following the incorporation within the financial statements of the results of the interim valuation of land and buildings. The bank covenant stipulates that the Income and Expenditure reserve (excluding pension reserve) plus the revaluation reserve should not fall below £2.15m. Based on the year-end financial statements the reserves as defined within the agreement total £1,909,000. The breach has been reported to Clydesdale Bank plc by the Finance Manager. We understand that negotiations are in progress on the potential re-wording of the covenant and that the initial meeting with the bank on 14 December 2010 to discuss this went well. On this basis we have graded this issue as moderate risk however we suggest that the Board monitor the issue closely to ensure that agreement is reached swiftly with the bank in order to mitigate the College's risk in relation to its loan facility. **Grade 3**	**Management response:** Agreed **Responsible officer:** Finance Manager **Implementation date:** Initial negotiations - December 2010
2 **Redundancy policy**	We raised this issue following our 2006/07 audit, at which time the College felt it was inappropriate to implement such a policy. Given the current economic climate, the reductions in funding which face the sector as a whole, and the fact that such a policy is deemed good practice within the sector, we would recommend that a redundancy policy is implemented. This would provide clarification to all parties as to the redundancy process, if ever such a situation occurred. **Grade 3**	**Management response:** Agreed **Responsible officer:** Depute Principal **Implementation date:** Consultations to commence January 2011

Action point	Issue identified and recommendation	Management response
3 **Corporate Governance Code**	The UK Corporate Governance Code, formerly known as the Combined Code, sets out standards of governance, against which publicly funded bodies are required to prepare a corporate governance statement. This replaces the 2008 Combined Code. To mitigate against the risk of non-compliance, we recommend that the College reviews its corporate governance arrangements against the new Code in preparation for making its Corporate Governance Statement in its 2010/11 financial statements. We have undertaken an analysis of the key changes applicable to education bodies and will be sharing this guidance with College management to help inform this assessment. **Grade 1**	**Management response:** Agreed **Responsible officer:** College Secretary **Implementation date:** January 2011

Follow-up of issues from previous year's external audit

None noted.

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