Inverness College

Annual Report for the Year Ended 31 July 2010
To the Board of Management and the Auditor General for Scotland

RSM Tenon

5 Kings Place
Perth
PH2 8AA

Issued: 1st December 2010

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1 EXECUTIVE SUMMARY

1.1 Financial Review

- The college incurred a deficit of £259,563 (previous year - surplus of £10,481). A surplus of £100,000 was originally budgeted. This deficit arose due to the unbudgeted claw-back of funds as the college did not achieve their student activity targets for the fee waiver grant and a provision made for further claw-backs considered likely, along with a significant drop in bank interest received. The aggregate effect of the claw-backs and year end provisions in respect thereof is £345,000.
- The college has a positive overall balance sheet with net assets of £22,091,043. The college also has net current assets of £596,203 at the year-end (previous year – current assets of £894,738) and this is proof of the financial stability of the college.
- The budget for 2010-11 predicts a surplus of £21,000.

1.2 Financial statements

- We have issued an unqualified audit opinion on the accounts of Inverness College for the year ended 31 July 2010.
- The only adjustment made to the financial statements during the audit process was the reallocation of the pension gain of £740,000 from investment income to the actuarial gain on the pension fund within the STRGL.

1.3 Corporate Governance

We have carried out an overall review of Corporate Governance arrangements. From a review of the Corporate Governance arrangements, the college appears to have a strong system in place to comply with Corporate Governance requirements

1.4 Action Plan

Recommendations arising from our audit are presented in section 6. No matters are raised which we consider to be particularly significant to the 2010 financial statements.

2 INTRODUCTION

This is the fourth year of our five-year audit appointment. The purpose of this report is to give a summary of our audit activity. It includes details of the more significant matters arising from the audit, sets out the respective responsibilities of management and external audit, and reports what action has been taken or is necessary by members or executive management.

2.1 Our audit of Inverness College for the year ended 31 July 2010 has been carried out in accordance with statutory requirements and follows the practices prescribed by the Code of Audit Practice and guidance issued by the Auditing Practices Board (APB). The Code of Audit Practice sets out fully the responsibilities of the College and its officers in relation to financial probity, control, preparation of accounts and the achievement of value for money in the provision of services. We are required under the Code to give an independent assessment of how the College has discharged its stewardship of public funds. A summary of our responsibilities is contained in Appendix 2.

2.2 We have summarised the Key Issues arising from our audit in Section One. In providing the summary, it can be difficult to strike a balance between recognising good performance when achieved and highlighting scope for improvement. The items referred to represent Key Issues for management attention and should not be taken out of the context of the remainder of this report, or the detailed reports covering individual reviews.

2.3 We invite Inverness College to receive this report and consider the recommendations we have made.

2.4 We would be grateful to receive the College's response to the issues we have raised.

3 FINANCIAL REVIEW

3.1 Introduction

The purpose of the financial review is to consider the general financial standing of Inverness College by looking back at financial performance in 2009/10 and to look ahead to the future financial position. Our review is aimed at helping College members understand the financial position of Inverness College at a particular point in time. It should not be regarded as definitive or comprehensive and the College should not seek to rely on this summary in isolation.

3.2 Financial Performance 2009-10

The college incurred a deficit of £259,563 (previous year - surplus of £10,481). A surplus of £100,000 was originally budgeted. This deficit arose due to the unbudgeted claw-back of funds as the college did not meet its student activity targets for the fee waiver grant and a provision made for further claw-backs considered likely, along with a significant drop in bank interest received. The aggregate effect of the claw-backs and year end provisions in respect thereof is £345,000.

The college has a positive overall balance sheet with net assets of £22,091,043 including cash of £3,517,704.

The college also has net current assets of £596,203 at the year-end (previous year – current assets of £894,738) and this is proof of the financial stability of the college.

3.3 Reserves

The college income and expenditure reserve continues to be in deficit although the deficit has again decreased in the year. The deficit as at 31 July 2010 was £708,354, (previous year - £1,728,693). The college also has a restricted reserve of £1,140,381 arising from the disposal of its Hedgefield property and this is to be used as part of the longer term strategic estates plan for development of the new campus.

The deficit on the pension reserve has decreased from £3,635,000 to £3,299,000. The principal reason for this is the change announced by the UK government during the year to change the basis for future pension increases from the Retail Price Index to the Consumer Price Index. Full detail of this matter and the current view as to the required accounting for this change are included as Appendix 3.

3.4 Financial Plan 2010-11

The forecast for 2010/11 predicts a surplus of £21,000.

3.5 Capital expenditure plans

Inverness College's operational plan for 2010-11 predicts significant capital expenditure principally due to the estates strategy and commencement of building a new college campus.

3.6 Recurrent grant allocation

The Scottish Funding Council (SFC) has confirmed recurrent Grant income of £7.6m (2009:£7.4m) and Fee waiver initial grant of £0.9m (2009: £1.2m) for the year to 31 July 2010.

4 FINANCIAL STATEMENTS

4.1 The respective responsibilities of the College and RSM Tenon Audit are summarised in Appendix 2. The purpose of this section of our report is to highlight and explain our formal opinion on the financial statements, and to comment on the main issues arising from our audit of the financial statements.

4.2 Audit opinion

We have issued an unqualified audit opinion on the accounts of Inverness College for the year ended 31 July 2010. A copy of our audit opinion is attached to this report at Appendix 1.

4.3 Independence

In accordance with auditing standards we can confirm that any relationships that may bear on the firm's independence and the objectivity of the audit engagement director and audit staff have been identified and assessed at the planning stage of our audit.

No independence issues have been identified that Board Members need to be aware of.

4.4 Timetable and procedures

The College is required to submit audited accounts to the Scottish Funding Council (SFC) by 31 December following the year end.

In order to achieve this deadline the accounts preparation procedures require good planning, commitment, and resources.

We discussed plans for the preparation and audit of the accounts with Niall McArthur, Director of Corporate Services, in a series of meetings.

We are pleased to report that the audited accounts will be submitted to the SFC and Audit Scotland by the due date of 31 December 2010. We are grateful to all of those in Finance and other departments who helped to achieve this. Special thanks go to Fiona Mustarde (Financial Services Manager) for her time, organisation and assistance which allowed for a smooth audit process.

4.5 Audit approach and materiality

Our audit planning was carried out taking account of the issues highlighted through a planning meeting with you, and our knowledge and understanding of the business.

In our planning, we have taken account of the reliance that can be placed on the work of the internal auditors, the regulation within the sector, and the results of our own risk assessment made in accordance with the guidance set by International Standards on Auditing (UK and Ireland).

- The level of materiality for making adjustments to the financial statements, as set out in the detailed planning memorandum, was calculated based on total income and the value of general reserves. This was updated once the financial statements' figures were received and was assessed at £143,000.

We are required to notify you of any potential adjustments identified during the course of our audit work unless they are clearly trifling. For the purposes of this report we have taken clearly trifling as being less than £2,000.

4.6 Accounting policies and practices

In preparing the financial statements of the College, Members are required under FRS18 to review the College's accounting policies on an annual basis to ensure they remain appropriate to the College's circumstances and are being properly applied.

- We have reviewed the accounting policies and practices selected by the College and are satisfied that the College operates acceptable accounting policies and practices for the purpose of determining whether the financial statements show a true and fair view.

Within this report we have summarised the main accounting issues that we have discussed with management and recorded (in section 4.7) the adjustments that have been made to the draft accounts as a result of matters arising during the course of the audit. Section 4.8 also summarises the errors identified during the course of the audit which remain unadjusted.

We draw the Members' attention to the following matters in particular:

- **Valuation of Longman Road and Midmills Campus**

It was agreed that the ongoing valuation of Longman Road Campus was appropriate as the final business plan and funding for the new site has not been agreed as yet. However, if the new campus funding is agreed, then a review of the valuation of both of these sites will need to be carried out. We have advised that it would be appropriate to revalue both of these properties at the expected selling price. Otherwise, we would expect they will be materially overstated within the financial statements. In assessing selling price, the College will require to consider whether a purchase would be for cleared land without the current buildings, as demolition costs are likely to be substantial.

- **Replaced capital items**

On review of the fixed asset additions, it was identified that there were a number of fixed assets that were replacements. However, there was no removal of assets from the fixed asset register that had been replaced. Niall McArthur had advised that as these items were of zero net book value, they had been left within fixed assets. This gives an overstated cost and accumulated depreciation position within fixed assets. We agree that this does not affect the truth and fairness of the financial statements, but it was advised that a thorough review of the fixed asset register should be carried out to remove all fixed assets which no longer have net book value.

- **Highland Council Superannuation Fund**

The College has benefitted from the change in the benefit structure of LGPS whereby future pension increases will be based on the Consumer Price Index rather than the Retail Price Index. Further details of this change are set out in Appendix 3.

- **International Financial Reporting Standards**

We would draw to your attention the information in Appendix 4 regarding potential conversion to the use of International Financial Reporting Standards. It is estimated that this will first impact the sector in the 2014/15 financial year.

Some of the issues raised above were identified as risks in our original audit plan, the other risks were identified during the course of the audit fieldwork. The audit plan was revisited on receipt of the draft accounts, and no further significant risks were identified. The other risk areas identified in our plan were satisfactorily dealt with as follows:

Issue	Audit risk	Planned audit approach	Conclusion
Funding The most pressing current issue surrounding colleges and other publically funded bodies is the impending funding cuts.	There is a potential risk that funding cuts may lead to going concern issues within colleges if sufficient action is not taken.	We will review committee minutes, latest management accounts and up to date budgets, along with SFC agreed grants for 2010/11.	At this stage there is uncertainty as to the level of cuts which will be made, and across what period of time. The finance team have prepared a prudent budget for the period ahead based on the knowledge available. The college is well run with a significant asset base and large levels of cash. There is no reason to believe that the college will not continue as a going concern for 12 months from the balance sheet date.
New Campus The new campus site has been agreed and there may be capital committed at the y/e which is not disclosed. Also, with public spending cuts there may be doubt as to the receipt of funding which would put the venture into question.	Capital commitments may be disclosed incorrectly.	We will review correspondence, business plans, minutes and discuss with the finance team	From our review of the information available, it was agreed that no capital commitment exists until the final business plan is agreed by the Scottish Funding Council and funding is therefore agreed.

FRS 17 Accounting for Pensions 2009/10 is the fourth year in which FRS17 has applied for the pension assets and liabilities related to the defined benefit schemes. The College has included a pension fund liability in its accounts as it was able to identify its own share of the assets and liabilities in the Local Government Superannuation Scheme. This complies with the requirements of FRS17. Audit Scotland's note for guidance, issued on further education financial statements for 2005/06, provided guidance on auditors' responsibilities in these cases	Disclosures and the accounting for pension costs and liabilities may not comply with FRS17 and the SORP Accounting in Further and Higher Education Institutions.	We will • Review college correspondence with, and the report of the actuaries in relation to the scheme • Review compliance with FRS17	Accounting and disclosure in relation to the pension scheme is consistent with the requirements of FRS17.

ADJUSTED AND UNADJUSTED ERRORS

4.7 Actual Audit Adjustments

The following adjustment was processed during the course of our audit.

	£'000
Surplus / (Deficit) per accounts presented for audit	480
Adjustments:	
Reallocate pension gain to STRGL	(740)
Surplus / (Deficit) per final accounts	(260)

4.8 Potential Audit Adjustments

The following potential adjustments have been noted during the course of our audit but have not been actioned.

Potential adjustments:	*£'000*
No non-trifling items identified	0
	0
	0
	0
	0
Net impact of potential adjustments on I&E account	0

Not included within the table above are a number of immaterial potential reclassifications between current assets and current liabilities.

4.9 Accounting and financial control systems

The College produced draft financial statements for our audit. As can be seen from the table at 4.7 there was only one adjustment which was required to be made following our audit testing, and this related to a specific technical matter on which a consensus only evolved during the course of our audit.. It is our aim, together with the director of Corporate Services and his staff to ensure that adjustments to draft accounts are kept to a minimum, ensuring a more efficient audit.

We found that, in general, all aspects of the College's financial systems that were reviewed to be well controlled, providing a good basis for the preparation of accounts.

- There were no matters of weakness identified during the audit that we wish to draw to your attention, other than those highlighted at 4.6 above.

4.10 Regularity audit

- We have issued an unqualified regularity opinion and there are no issues that we wish to draw to the Board's attention.

5 CORPORATE GOVERNANCE

5.1 Corporate Governance is concerned with structures and processes for decision making, accountability, control and behaviour at the upper levels of the organisation. The respective responsibilities of Inverness College and RSM Tenon Audit are summarised in Appendix 2. This section of our report comments on the main aspects of our work, and highlights particular issues which arose.

5.2 Statement on Corporate Governance

The College have included in their financial statements, a statement on Corporate Governance. The statement clearly sets out the College's arrangements under each aspect of the code, and is a valuable enhancement of public accountability.

Although we are not required to form an opinion on the adequacy and effectiveness of the College's Code of Corporate Governance, we are required to report where a statement does not comply with the requirements of SORP or other guidance, or if it is misleading or inconsistent with other information of which we are aware.

In our opinion the statement is not misleading or inconsistent with other information which we are aware of from our other audit work.

5.3 Severance payments

The College did not make any severance payments during the year.

5.4 Risk Management

Although the term "Risk Management" has become relatively common recently, the underlying principles – of identifying and assessing risks and taking action to minimise their occurrence and impact, are well established. The College's Committee structure, Financial Regulations, and Internal Audit functions are all examples of policies and procedures which address potential risks. However, it is now generally recognised that this process needs to become explicitly established as part of a management culture, and requires the implementation of consistent best practice through formal policies and procedures. The College have recently introduced a Risk Management policy, and a risk Register which is under continual review so as to maintain an up-to-date and accurate register.

5.5 Internal Audit

We adopt a managed approach in planning our audit work at your College. This means that we work closely with Internal Audit and place formal reliance on their work. This avoids duplication of effort and means that we can both direct our resources where they are most needed.

Our relationship with Internal Audit is governed by the International Auditing Standard ISA610 "Considering the work of Internal Audit".

It is the responsibility of management to determine the extent of the internal control system required. Internal Audit is an important element of the internal control system. Henderson Loggie C.A. provides the college's internal audit function.

Wherever possible we use the work of the internal auditor to assist us in our assessment of the effectiveness of the internal controls in the College's main financial systems. We review internal audit reports and use the work of the internal auditor to plan our work and to inform our own risk assessment. However, to enable us to rely on the work of Internal Audit, we need to be satisfied that the audit work has been properly planned, controlled, performed, recorded and reviewed in accordance with the Internal Audit Standards and ISA 610.

We are pleased to confirm that we were able to derive the planned assurance in the areas examined and that the Internal Audit Service was carried out generally in accordance with the SFC Code of Practice.

In 2009/10 we placed reliance on assignments carried out by Internal Audit in the following areas:-

- SUMS audit and audit of FES returns
- Internal controls

5.6 Systems of Internal Control

The respective responsibilities of the College and ourselves as auditors are set out at Appendix 2.

Through the results of our own testing, and our reliance on areas examined by Internal Audit, we have concluded that the fundamental key financial systems of the College are operating satisfactorily.

5.7 Other Governance responsibilities

Prevention and Detection of Fraud and Irregularities

The respective responsibilities of the College and ourselves as auditors are set out in Appendix 2. During the year, we have reviewed the overall arrangements through our review of systems.

The College also has in place a Fraud Policy and Response Procedure, as part of their financial Regulations.

In overall terms, we are satisfied that these arrangements are adequate.

Legality/Propriety

Again, the respective responsibilities of the College and ourselves as auditors are set out in Appendix 2.

Our review of the College's transactions and arrangements has revealed no areas of concern.

Standards of Conduct, Integrity and Openness

We have reviewed the College's arrangements which include:-

- Constitution and Standing Orders of the Board of Management
- A Register of Members' Interests
- Information regarding their appointment to outside bodies and organisations is disclosed in the financial statements.
- A Freedom of Information policy

In overall terms we are satisfied that these arrangements are adequate.

6 ACTION PLAN

6.1 Observations on the College's Regularity Framework and Overall Control Environment

	Subject	Grade
1	Review the fixed asset register for zero NBV items which are no longer owned by the college. Process a journal to remove these items from the accounts in the 2010/11 financial year.	**3**

We have used the following grading system to indicate the significance of the matters we have raised and the priority that we believe should be given to our recommendations:

Grade 1: We believe these observations are particularly significant and that management should take prompt action.

Grade 2: These observations are significant but of a less urgent nature than Grade 1 observations. We believe that action needs to be taken within the agreed timescale.

Grade 3: Observations that merit attention but are less significant than Grade 1 and 2 observations.

Issues noted

1		***Grade 3***
Issue *On review of the fixed asset additions, it was identified that there were a number of fixed assets that were replacements. However, there was no removal of assets from the fixed asset register that had been replaced.*		
Recommendation Review the fixed asset register for zero NBV items which are no longer owned by the college. Process a journal to remove these items from the accounts in the 2010/11 financial year.	*Management response* Agreed	*Action by whom* *Director of Corporate Services* *Deadline* 31 July 2011

Inverness College

Annual Report for the Year Ended 31 July 2010

Annexes for Management Information

RSM Tenon

Appendix 1

Independent auditor's report to the members of the Board of Management of Inverness College, the Auditor General for Scotland and the Scottish Parliament

We have audited the financial statements of Inverness College for the year ended 31 July 2010 under the Further and Higher Education (Scotland) Act 1992. These comprise the Income and Expenditure Account, the Balance Sheet, the Cash Flow Statement and Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out within them.

This report is made solely to Inverness College and to the Auditor General for Scotland the parties in accordance with sections 21 and 22 of the Public Finance and Accountability (Scotland) Act 2000. Our audit work has been undertaken so that we might state to those two parties those matters we are required to state to them in an auditor's report and for no other purpose. In accordance with the Code of Audit Practice approved by the Auditor General for Scotland, this report is also made to the Scottish Parliament, as a body. To the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than Inverness College or the Auditor General for Scotland, for this report or the opinions we have formed.

Respective responsibilities of the Board of Management, Principal and auditor

The Board of Management and the Principal are responsible for preparing the Annual Report and the financial statements in accordance with the Further and Higher Education (Scotland) Act 1992 and the Accounts Direction issued thereunder by the Scottish Funding Council which requires compliance with the Statement of Recommended Practice on Accounting in Further and Higher Education Institutions. They are also responsible for ensuring the regularity of expenditure and income. These responsibilities are set out in the Statement of the Board of Management's Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and with International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Auditor General for Scotland.

We report our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and the Accounts Direction. We also report if, in our opinion, the Report of the Board of Management is not consistent with the financial statements, if the body has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit. We also report whether in all material respects

- the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers;
- funds provided by the Scottish Funding Council have been applied in accordance with the Financial Memorandum dated 1 January 2006 and any other terms and conditions attached to them for the year ended 31 July 2010; and

- funds from whatever source administered by the college for specific purposes have been properly applied for the intended purposes.

We review whether the Corporate Governance Statement reflects the college's compliance with the requirements of the Scottish Funding Council. We report if, in our opinion, it does not comply with these requirements or if it is misleading or inconsistent with other information we am aware of from our audit of the financial statements. We are not required to consider, nor have we considered, whether the statement covers all risks and controls. Neither are we required to form an opinion on the effectiveness of the college's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Report of the Board of Management and the Statement of the Board of Management's Responsibilities for the Accounts .We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with the Public Finance and Accountability (Scotland) Act 2000 and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board as required by the Code of Audit Practice approved by the Auditor General for Scotland. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of expenditure and income included in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Board of Management and Accountable Officer in the preparation of the financial statements, and of whether the accounting policies are appropriate to the college's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error, and that in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

Financial statements

In our opinion

- the financial statements give a true and fair view, in accordance with the Further and Higher Education (Scotland) Act 1992 and the Accounts Direction, of the state of affairs of the college as at 31 July 2010 and of its surplus, total recognised gains and losses and cash flows for the year then ended; and

- the financial statements have been properly prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and the Accounts Direction made thereunder.

Regularity

In our opinion in all material respects

- the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers
- funds provided by the Scottish Funding Council have been applied in accordance with the Financial Memorandum dated 1 January 2006 and any other terms and conditions attached to them for the year ended 31 July 2010; and
- funds from whatever source administered by the college for specific purposes have been properly applied for the intended purposes.

RSM Tenon Audit Limited

5 Kings Place
Perth
PH2 8AA
Date

Appendix 2

Our respective responsibilities

Financial Statements
It is the responsibility of the College to:-

- *Ensure the regularity of transactions by putting in place systems of internal control.*
- *Maintain proper accounting records.*
- *Prepare financial statements which present a true and fair view of the financial position of the* College *and its expenditure and income in accordance with the SORP.*

We are required to give an opinion on:-

- *Whether the accounts present a true and fair view of the financial position of the College and its expenditure and income for the period.*
- *Whether the accounts have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.*

In carrying out this responsibility we provide reasonable assurance that, subject to the concept of materiality, the financial statements:-

- *Are free from material misstatements.*
- *Comply with the statutory and other requirements applicable.*
- *Comply with relevant requirements for accounting presentation and disclosure.*

Corporate Governance
Corporate Governance is concerned with structures and processes for decision making, accountability, control and behaviour at the upper levels of the organisation. Three fundamental principles apply:-
- *Openness*
- *Integrity*
- *Accountability*

We have a responsibility to review and, where appropriate, report findings on the College's corporate governance arrangements as they relate to:-
- *The College's review of its systems of internal control including its reporting arrangements.*
- *The prevention and detection of fraud and irregularity.*
- *Standards of conduct and arrangements in relation to the prevention and detection of corruption.*
- *The financial position of the College.*

Our work has focused upon our review of the College's Risk Management arrangements, systems of internal control, Internal Audit, consideration of the controls to prevent and detect fraud and corruption, and the audit of the final accounts.
In giving an opinion on the accounts our audit strategy requires us to ensure that the fundamental financial systems are adequately covered each year. Whenever possible, to avoid duplication of effort, we seek to rely on the work of Internal Audit.

However, our work cannot cover every financial activity and accounting procedure. We plan and perform our audit to give reasonable assurance that the financial statements are free from material misstatement and that they comply with statutory and other requirements.

Risk Management

The College's Responsibility

It is the responsibility of the College to identify and address its operational and financial risks and to develop and implement proper arrangements to manage them, including adequate and effective systems of Internal Control.

The Role of RSM Tenon Audit Limited

In planning our audit, we consider and assess your risk management arrangements as part of our assessment of audit risk. This helps us to tailor our audit plans so that they are both appropriate to your circumstances and directed to the areas of greatest risk.

Systems of Internal Control

The College's Responsibility

The College has a responsibility to develop and implement systems of internal control, including risk management, and systems of financial, operational and compliance controls.

Three components of a system of risk management are:-

- *Timely identification of key business risks.*
- *Consideration of the likelihood of the risks crystallising and the significance of the consequential financial or other impact.*
- *Establishment of priorities for the allocation of resources to control risk and the setting and communicating of key objectives.*

The monitoring of controls provides assurance that managers are assessing the existence of risk and the effectiveness of controls over the risks. The internal audit arrangements form an important part of management's monitoring and review of internal control arrangements, and in ensuring that appropriate monitoring of risks and controls takes place.

The role of RSM Tenon Audit Limited

In broad terms the external auditor is expected to assess the internal controls in the College's main financial systems and report on any significant control weaknesses identified. This does not absolve management from its responsibility for the maintenance of an adequate internal control system.

Prevention and Detection of Fraud and Irregularities

The College's Responsibility

It is the responsibility of the College to establish arrangements to prevent and detect fraud and other irregularity. It therefore needs to put in place proper arrangements for:-

- *Developing, promoting and monitoring compliance with standing orders and financial instructions.*
- *Developing and implementing strategies to prevent and detect fraud and other irregularity.*
- *Receiving and investigating allegations of breaches of proper standards of financial conduct or of fraud and irregularity.*

The Role of RSM Tenon Audit Limited
External audit is required to review the adequacy of the measures taken by the College, to test compliance, and to draw the attention of management to any weaknesses or omissions.

Legality
The responsibility for ensuring the legality of all activities and transactions rests with the College.

The responsibility of the external auditor is to review the legality of the College's transactions and to be aware of the requirements of statutory provisions.

Standards of Conduct, Integrity and Openness
Propriety is concerned with the way in which public business should be conducted. It is concerned with fairness and integrity. It must be recognised that the public view of propriety is as much about perception as reality.

The College's Responsibility
It is the responsibility of the College to ensure that its affairs are managed in accordance with proper standards of conduct. It needs therefore to put in place proper arrangements for:-

- *Implementing and monitoring compliance with appropriate guidance on standards of conduct.*
- *Expressing and promoting appropriate values and standards across the organisation.*
- *Developing, promoting and monitoring compliance with Codes of Conduct that advise Members, Officers or Managers of their personal responsibilities and expected standards of behaviour.*
- *Developing, promoting and monitoring compliance with standing orders and financial instructions.*

The Role of RSM Tenon Audit Limited
It is our role to consider whether the College has put in place adequate arrangements to maintain and promote proper standards of financial conduct and to prevent and detect corruption. We discharge this duty by reviewing and where appropriate examining evidence that is relevant to these arrangements.

Financial Position
The College's Responsibility
It is the responsibility of the College to conduct its affairs and put in place proper arrangements to ensure that the financial position is soundly based having regard to:-

- *Financial monitoring and reporting arrangements.*
- *Compliance with statutory financial requirements and achievement of financial targets.*
- *Levels of balances and reserves.*
- *The impact of planned future policies and known or foreseeable future developments.*

The Role of RSM Tenon Audit Limited
It is our role to consider whether the College has established adequate arrangements. We are also required to have regard to going concern as part of the audit of the financial statements. In carrying out this responsibility we consider:-

- *Financial performance in the year.*
- *Compliance with statutory financial requirements and financial targets.*
- *Ability to meet known statutory and other financial obligations actual or contingent.*
- *Responses to known developments which may have an impact on the College's financial position.*

Appendix 3

Accounting for pension liabilities – FRS 17

The Chancellor announced in his emergency budget on 22 June 2010 that, from April 2011, increases in public sector pensions will be linked to the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) which is currently used. The first pension increase based CPI will be effective at April 2011. Government has indicated that future pension increases will apply to both pensions earned to date and future accruals.

It is anticipated that CPI will be significantly lower than RPI and this will reduce the value of the pension liabilities and the provisions included within the financial statements.

Consumer Prices Index: The CPI is the main measure of consumer price inflation and is the basis for the government's inflation target that the Bank of England's Monetary Policy Committee is required to achieve. It is calculated according to European Regulations.

Retail Prices Index: The RPI is the most long standing measure of inflation in the UK and statistics are available from 1947. It is still used for a variety of purposes by both government and external users, including the indexation of various incomes and prices, index-linked gilts and, until this budget, indexing pensions and benefits.

Differences between indices: The main differences are as follows.

RPI includes elements of housing costs which make up to 25% of its constituents, including mortgage interest payments. The RPI can therefore be heavily influenced by the housing market, which dominated the periods when RPI fell below CPI in the early 90s and in 2009/10.

There is also a more persistent effect from a different method of calculation which biases RPI above CPI by around 0.5% pa. Historically RPI has been higher, mainly reflecting the importance of the formula effect. In the past 20 years RPI has exceeded CPI by 0.7% pa on average.

Accounting periods ending on or after 22 June 2010

For employers with an accounting period ending on or after 22 June 2010 (the date of the emergency budget) pension increases are assumed to be in line with CPI. The change, which represents a gain in the net pension reserve, is accounted for as a negative past service cost.

The rationale for treating the change as a negative past service cost is that this is a change to benefits – that is, pension scheme members will expect a lower benefit following the change than before the change.

However, the proposed accounting treatment has come under scrutiny from public sector organisations and auditors alike since there is no consensus over whether the change should be accounted through the Income and Expenditure Account (I&E) or through the Statement of Recognised Gains and Losses (STRGL). As a result the matter was referred to the Urgent Issues Task Force (UITF) to provide guidance.

UITF Draft Abstract Information Sheet 90 was issued on the 13 October and is available through the web link http://www.frc.org.uk/asb/uitf/pub2392.html.

Responses were requested by 10 November. The Final Abstract is envisaged to be published before the end of 2010 and will be the final determinant as to the accounting treatment required it is hoped.

The draft Abstract proposes that where there is a change in the obligation to the member, there is a benefit change which is accounted for as a past service cost. Where the obligation to the member is not changed, any change in the Scheme liabilities arises from a change in assumptions applied to measure those liabilities. The key to the accounting is whether there is a change in the members' obligation.

The UITF are proposing an approach that reflects the following:

- If the pension scheme rules/trust deed explicitly link pension increases to RPI and the scheme rules then change this to CPI, this should be treated as a change of benefit and any past service credit arising posted to I&E. *This change should be recognised in the accounting period when necessary consultations have been concluded. Consultations are concluded when the change has been agreed and announced, likely to be 2011*;

- If the scheme rules are silent on specifying an index but where there is a general presumption of an annual cost of living increase any change in measurement of inflation such as the change from RPI to CPI should be treated as a change of assumption with the credit taken through the STRGL;

- If the scheme rules are silent on specifying the index but where there is a constructive obligation to pay pension increases linked to RPI then the change to CPI should be treated as a change of benefit and any past service credit arising booked to I&E.

The key judgmental area therefore, if the Abstract is finalised as drafted, will be whether there is a '**constructive obligation**' for the college to pay RPI for pension increases. The key clauses within the appendix to the draft Abstract that cover this are:

> *A9. The UITF noted that the distinction between changes in benefits arising when a trust deed is specifically linked to RPI, compared to changes in benefits with an unspecified measure of inflation, should be considered in terms of whether the obligation to the member is being changed.*
>
> *A10. The UITF noted that a constructive obligation to the member for pensions linked to RPI could exist where the RPI is not embedded into the trust deed but where associated literature made reference to the RPI or where the general understanding of scheme members was that increases would be calculated using the RPI. The nature of any constructive obligation to members could vary and would depend on a number of factors, including the nature and content of the communications with members.*
>
> *Consideration would need to be given to whether any associated literature made reference to the RPI or whether the general understanding of scheme members was that increases would be calculated using the RPI.* ***However, a feature of a constructive obligation would be that the agreement of scheme trustees and/or members would generally be needed before any change could be made.*** *This change should be recognised in the accounting period in which the agreement of the scheme trustees and/or*

members was obtained, which for many colleges is unlikely to be year ended 31 July 2010.

Most if not all FE Colleges have their LGPS as the main scheme for providing non academic retirement benefits. These schemes in turn have the same legislative origin and share the same rules to all intents and purposes. These clearly do not have an explicit link to RPI but instead refer to the Pensions (Increase) Acts of 1971 and 1974 which ultimately lead to the annual Pensions Increase (Review) Orders issued by Statutory Instrument (SI) around the end of the year. It is these SIs that use the RPI at 30 September each year and are intended to use CPI hereafter.

The same cannot be said for the pension scheme literature that accompanies the LGPS in each area and which may form a key source of evidence for determining whether a constructive obligation has been created.

The criteria for a 'constructive obligation' are set out in Paragraph 20 of FRS17 which states:

"Defined benefit scheme liabilities should be measured on an actuarial basis using the projected unit method. The scheme liabilities comprise:

(a) Any benefits promised under the formal terms of the scheme;
and
(b) Any constructive obligations for further benefits where a public statement or past practice by the employer has created a valid expectation in the employees that such benefits will be granted."

Based on a sample of LGPS literature reviewed to date there is clear reference made to RPI and therefore in accordance with FRS 17 a constructive obligation established that would in normal circumstances see the credit adjusted through the I&E.

However, based on the clarifying definition contained within the UITF Abstract (highlighted in bold above) the change does not meet these refined terms and therefore the adjustment would be expected to be made through the STRGL.

Each college will have to examine its own circumstances and draw a conclusion as to whether there is a constructive obligation or not and present that case to their auditors. What will be paramount is that whichever treatment is adopted, then the rationale for that treatment should be explicitly summarised in the accounts of the College.

At the date of these financial statements, the Urgent Issues Task Force (UITF) is in the process of consulting widely on the accounting treatment for this change and is expected to issue a final Abstract towards the end of 2010. Should the Abstract call for a different accounting treatment it may be necessary to reflect any change as a prior period adjustment in the financial statements for the following year.

Appendix 4

International Financial Reporting Standards (IFRS) in Further and Higher Education

The Statement of Recommended Practice (SORP) for Further and Higher education institutions is based on UK General Accepted Accounting Practice (GAAP). At the moment the SORP has assumed that the education convergence to IFRS will follow that of UK GAAP, although it should be noted that under international standards there is no equivalent sector specific guidance such as SORPs and therefore more emphasis may be placed on a governing body such as the SFC to provide sector interpretation.

Whilst the Government sector has moved towards full implementation of international standards, there is currently no indication as to the date from which they will apply to the FE sector. The latest indications suggest an implementation in 2014/15.

The possible timeline for IFRS in Further and Higher Education

Year to 31 July 2014	Year to 31 July 2015
↓	↓
Comparative IFRS year end	**First IFRS year end**
2013/14 comparatives will need to be calculated	2014/15 Annual report (+ 2013/14 comparatives)

What does moving to IFRS mean for Further and Higher Education?

Significant differences	Some differences	No significant differences
Fixed assets Leases PFI Group accounts Format of accounts Employee benefits Financial instruments	Related party disclosures Impairment Intangible assets Investment properties Disclosure generally	Stocks Post balance sheet events Accounting for government grants Provisions