INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

John Wheatley College

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

Year ended 31 July 2010

13 December 2010

AUDIT

AUDIT ▪ TAX ▪ ADVISORY

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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 John Wheatley 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 issued an audit report expressing unqualified opinions on the financial statements of the College for the year ended 31 July 2010. The College's change in accounting policy to account for its participation in the Strathclyde Pension Fund on a defined benefit basis increased the surplus by £253,000 and decreased net assets by £540,000.

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

Use of resources

The College has produced the college plan for 2010-13 which covers financial forecasts for the 2010-11 financial year and the 2011-12 and 2012-13 financial years. This plan anticipates a £10,000 surplus for 2010-11, although a £100,000 contingency has been built into expenditure to reflect the uncertain further education economic climate.

Furthermore, the College has completed extensive scenario planning and sensitivity analysis for forthcoming years to ascertain the effects of decreases in funding, and strategies to deal with these decreases.

Corporate governance

Management and the audit committee continue to demonstrate their commitment to best practice through self-review and evaluation of corporate governance arrangements and audit committee performance.

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 has strong systems and procedures appropriate to its operations in the areas tested.*"

The operating and financial review provides a very comprehensive account of the College's activities.

The report of the board of management includes a detailed self-assessment of the College's arrangements to achieve Best Value against the Scottish Government's nine principles of Best Value.

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 John Wheatley 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.

Action plan

This report includes an action plan containing areas for development or improvement identified during our financial statements audit fieldwork.

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. We also note the continued high quality of the College's preparation for the audit and co-operation of the chief finance officer and his team.

Service overview; financial position

Introduction

The financial statements report an annual surplus of £314,000, which consists of an underlying surplus of £61,000 and £253,000 in net pension credit. The underlying surplus of £61,000 is an increase of 20% compared to the previous year and £11,000 higher than the projected outturn projected in the management accounts during the year. As at 31 July 2010, there are general reserves of £1.1 million.

Income

Income for the year has risen by £47,000 compared to 2008-09, an increase of 0.4%:

- Grants from the Scottish Funding Council ("SFC") have risen by £328,000, an increase of 3% from prior year. There are two reasons: firstly, because of an inflationary rise in the grant and, secondly, because of an increase in the level of weighted student units of measurement ("WSUMs") delivered by the College. As the College has a large level of school access activity in line with the Scottish Government's Lifelong Partners strategy, this leads to an extra 1,000 WSUMs.
- The SFC increase is partially offset by the decrease in tuition fee income, due to a lower level of course provision for the Glasgow East Regeneration Agency.

Expenditure

Prior to the adjustment to reflect the change in pensions accounting policy, in line with the increase in income, expenditure rose from £10.84 million in 2008-09 to £10.86 million, an increase of £37,000. The change in accounting policy decreased staff costs expenditure by £253,000 (2008-09: £18,000 increase), resulting in a net change compared to the previous year of £234,000. Other individually significant movements included:

- An increase in staff costs, before pensions adjustments, from prior year as a result of the pay rise received by staff of 1.5%/1.3% for teaching/support staff The number of staff has also increased due to an overall higher level of courses provided.
- The initial staff costs increase was partially offset by a decrease in other operating expenses. This is because the amount spent on revenue project costs is lower this year than in 2008-09. In the prior year the College invested a significant amount in refurbishing its Easterhouse campus, including replacing the lighting systems.

	2009-10 £'000	2008-09 £'000 (restated)
Income		
Scottish Funding Council grants	9,739	9,411
Tuition fees and education contracts	238	559
Other operating income	958	902
Investment income	7	23
	10,942	10,895
Expenditure		
Staff costs	6,498	6,474
Other operating expenses	3,288	3,644
Depreciation	789	744
Interest payable	53	-
	10,628	10,862

Service overview; financial position (continued)

The balance sheet shows an increase of £506,000 in net assets as at 31 July 2010 compared to the previous year end. Significant movements include:

- A decrease in tangible fixed assets of £239,000 is due to a low level of additions during the year (£352,000) outweighed by the depreciation charge of £789,000. This has been partly offset by a net upwards revaluation of the East End campus of £189,000.
- Debtors have decreased as the £138,000 outstanding from the Glasgow East Regeneration Agency ("GERA") for prior years has now been received and the amounts in respect of the 2009-10 financial year were received during the year.
- A significant improvement in the College's liquidity level. This £538,000 increase is because a significant amount of money has been received by the College in relation to course provision for 2010-11 which is recognised as deferred income.
- Within the creditors balance there has been an increase in deferred income of £467,000. This is for two reasons: firstly, SFC paid colleges a third of their capital allocation for 2010-11 within the 2009-10 financial year. Secondly, the College had received income from GERA for course provision in 2010-11 by year end.
- Net pension liabilities decreased by £601,000, consisting primarily of actuarial gains on pension assets and liabilities of £355,000 and a past service credit of £313,000.

	2010 £'000	**2009 £'000 (restated)**
Tangible fixed assets	21,275	21,514
Stocks	19	12
Debtors	368	481
Cash and short term investments	839	301
Creditors: amounts falling due within one year	(1,082)	(794)
Net pension liabilities	(683)	(1,284)
Net assets	**20,736**	20,230
Deferred capital grants	17,060	17,421
Revaluation reserve	3,110	2,973
General reserve	566	(164)
Total	**20,736**	20,230

Service overview; financial position (continued)

Accounting for pensions

The financial control committee in November 2010 approved a change in the College's pensions accounting policy to account for the College's participation in the Strathclyde Pension Fund on a defined benefit basis, the financial statements reflect a prior year adjustment, and restatement of the 2008-09 income and expenditure account and balance sheet, under the requirements of FRS 3 'reporting financial performance'.

The net impact of the prior year adjustment was a reduction in reserves at 1 August 2009 of £1,141,000 (2008: £197,000), consisting of the pension liability of £1,284,000 (2008: £333,000) and reversal of the unfunded provision previously recognised on the balance sheet of £143,000 (2008: £136,000). The net impact (surplus) on the income and expenditure account of recognising the net return / interest on pension assets and liabilities and the difference between pension contributions paid and the service cost was £253,000 (2008-09: £18,000 reduction in surplus).

In its June 2010 budget, the UK government announced that it intended for future increases in public sector pension schemes to be linked to changes in the consumer prices index ("CPI") rather than, as previously, the retail price index ("RPI"). The College has considered the Strathclyde Pension Fund scheme rules and associated members' literature and has concluded that, this change is a change in benefits and so has recognised the resulting credit (£313,000) in the Income and Expenditure Account. 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 an Abstract towards the end of 2010. Should the Abstract call for a different accounting treatment it may be necessary to reflect any change in the financial statements for the following year.

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 relies heavily on funding from the SFC, however there is uncertainty over the level of SFC grant income that will be available to colleges over the forthcoming financial years. The College has, however, conducted appropriate scenario planning to explore options which would enable it to continue to operate in a less favourable funding environment.

	£'000
Income	9,882
Expenditure	(9,872)
Forecast surplus	**10**
Cash balance at 31 July 2010	839
Forecast cash balance at 31 July 2011	535
Forecast movement in cash during 2010-11	**(304)**

2010-11 financial forecast

The forecast for 2010-11 is for the College to achieve a surplus of £10,000 which is down from the £50,000 surplus that has been achieved in previous financial years. This is in recognition of the challenging environment in which the College operates.

The College used a zero-based budgeting approach, based on a number of key assumptions and contextual issues. The table opposite details the breakdown of forecast income, expenditure and cash balances for the 2010-11 financial year. Expenditure includes a £100,000 contingency (achieved through efficiency savings) which the College has set aside to meet any immediate funding shortfall during the year. The College principal has announced that, provided there is no in-year reduction in the College's grant-in-aid, there will be no compulsory redundancies during the 2010-11 financial year.

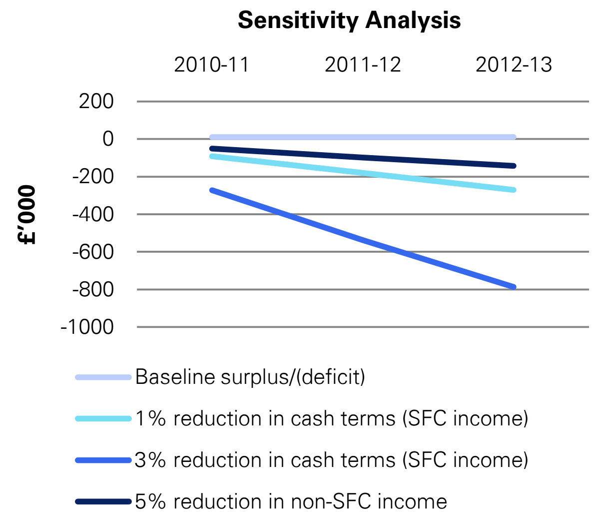
There is still some uncertainty as to whether SFC will be able to provide the full level of grants for the 2010-11 financial year, which has been intimated in the SFC grant funding circulars received by the College. This could lead to some in-year reduction in funding in the final four months of the year. The College is committed to achieving a further 2% efficiency saving.

Medium term financial planning

Within the plan, the College has attempted to complete financial forecasts for the medium term financial strategy for the 2011-12 and 2012-13 financial years. Due to the current uncertainty around SFC funding, management believe accurate financial forecasts are difficult to produce. To ascertain the effect of reductions in funding the College has completed scenario planning and sensitivity analysis to help inform their strategic decision making process. The diagram opposite shows the possible effect of differing levels of reduction in income to the surplus/(deficit) for the next three financial years. The Scottish Government's budget in November 2010, should provide a clear indication of medium term budgets within the sector.

Reserves policy

The board of management considers the College to be financially secure and financially sustainable, with general reserves at 31 July 2010 of £1.1 million. These have been "designated" by the board for the purpose of restructuring, unforeseen property maintenance or overspending on student support.



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 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 of management'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 full members and three co-opted members with relevant skills and expertise in capital and building management and accounting and finance. There are seven standing committees, including executive, financial control, audit, personnel and staffing, capital and information and communications technology and academic and general purpose. Each committee is formally constituted and has its own formal terms of reference. This comprehensive governance structure, which includes non-executive, student and academic representation, is demonstrative of best practice and exceeds the minimum requirements of SFC. The committee structure provides the board of management with the mechanisms to ensure appropriate oversight and monitoring of financial and academic activities.

In line with best practice, the audit committee formally evaluated its performance during the year and identified a small number of areas for improvement, which have subsequently been taken forward.

The College's 2008-11 corporate strategy identifies the values that are core to its operations and sets the tone of the organisation from senior management. The focus has been on Public Value and the wider social benefits that the College brings to the local community in addition to its base goal of providing education services. The college plan to 2010-13 lays down the strategic and operational objectives of the College, which includes corporate government objectives for the 2010-11 financial year. The plan also includes a framework which outlines how the College might respond to reductions in its core budget.

The quality review completed by Her Majesty's Inspectorate of Education (HMIe) in November 2009, and published in February 2010, concluded that there was "effective leadership and management at both the strategic and operational level". The College expects to undergo an annual engagement exercise with members of HMIe in session 2010-11.

Governance and risk management (continued)

Audit Scotland conducted the Role of Boards study during the 2009-10 session, in which the College agreed to be a participant. The report commented that board of management meeting agenda were lengthy, and it was felt that the board would be unable to give so many items the appropriate level of attention. Management have informed us that members of the Board were content with the level of detail provided at meetings of the Board and its Standing Committees and this matter had previously been considered by members who considered that they would prefer to be 'over informed'. The Audit Scotland report also identifies two examples of good practice in relation to corporate governance at the College in respect of the processes it has in place for recruiting new members and conducting stakeholder engagement.

The board of management welcomed CIPFA's Good Governance in Scotland's Colleges: A Framework, and has agreed to pilot this guidance in the 2010-11 session when its definitive form has been agreed.

Risk management

The College continues to adopt an approach to risk management based on guidance issued by the Chartered Institute of Public Finance and Accountancy ("CIPFA") for the further and higher education sectors in Scotland. The College's risk management strategy is owned by the board of management and all its standing committees. The risk register is a standing item on the board of management meeting agenda and is updated at meetings if additional risks are identified.

The College's risk management committee meets regularly to review the College's response to identified risks. Reports are distributed to the senior management team which detail key performance indicators and possible control issues which may be identified by early warning mechanisms embedded within the operational units. Risks are identified, prioritised and assessed according to the likelihood and consequence; where there is no mitigating control in place measures are taken to address and mitigate the risk.

Regularity

The board of management considers all incoming correspondence relevant to its strategic management role from SFC and other regulatory or advisory bodies, including organisations such as Scotland's Colleges and Audit Scotland. Relevant communication is also considered by the audit committee. This allows management to demonstrate the College's approach to considering incoming guidance and taking action where appropriate. The Board's audit committee also systematically reviews Audit Scotland's technical bulletins to identify risks, issues and good practice.

Prevention and detection of fraud and irregularity

The College's financial regulations detail measures to prevent instances of fraud, including a whistle-blowing policy. The College has a fraud policy available to all employees on the intranet, as well as policies and procedures in individual financial and operational areas. The principal writes to all senior and operational managers annually reminding them of their duty to report fraud or mis-use of College resources. As a result of these returns management has not reported any material instances of fraud or irregularity during 2009-10.

Governance and risk management (continued)

Internal audit

The approved internal audit programme for 2009-10 has been completed and the internal auditor's reports have been reviewed. These indicate a strong control environment, with minimal recommendations arising. Management has continued to report action taken in response to internal audit recommendations to the audit committee and requested internal audit complete a review of previous reports to assess the implementation of recommendations. Of the 13 recommendations, 10 have been fully implemented, one partially implemented and two were outstanding but not beyond date.

Internal controls

In accordance with our audit plan, we have drawn on the work performed by internal audit and performed detailed testing of both entity level controls and finance controls. The testing performed by internal audit on the financial controls identified no failures of controls and therefore no significant recommendations have were noted in the internal audit reports. Testing of the design and operation of controls over significant risk points confirms that controls are designed appropriately and are operating effectively. We did note one minor weakness in the controls around the information technology systems.

When a member of staff leaves the College the human resources department will inform the information technology department, who will remove the person's system access. The College does not complete an annual check to ensure that all members of staff with system access are still employees. Also differing levels of system access are granted to members of staff when the information technology department is informed by the various departments. There is no annual check to ensure that employees' levels of systems access is appropriate. There is a risk that inappropriate access could be obtained by current or previous members of staff of the College. It is noted that management is currently implementing a new virtualisation and email system for staff and students. It is recommend that, as these systems are developed, and the information technology policies are updated, management consider developing a process to annually check employee system access, to ensure good practice.

Recommendation one

Best Value / value for money

In accordance with the financial memorandum with SFC, the report of the board of management includes a comprehensive self-assessment of the College's arrangements to achieve Best Value against the Scottish Government's nine principles of Best Value. The Board uses this approach to evaluate its own effectiveness annually.

This includes extensive consultation with key partners, stakeholders, staff and its learners, which includes an annual public meeting. The *Langland's Report* on quality standards for public services has been adopted to ensure high ethical standards and continually assesses the quality of its governance. Use of options appraisal is widely used by management, and was used to conclude a 'do nothing' option on the possible construction of a new sports facility.

The College has a wide variety of joint working arrangements in place, and further developed these in 2009-10 by developing its relationship with the East Glasgow Community Health and Care Partnership (CHCP) to secure primary care services. Assistance from the Carbon Trust was secured to develop a carbon management plan in line with its climate change action plan. The College holds various equal opportunities accreditations, and has been praised for its inclusive nature.

The College has a well developed model of shared services with Glasgow Life in relation to library services (for students and members of the public). These arrangements have improved the quality of the service, however they yield no financial savings.

Action plan

Priority rating for recommendations		
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the College or systems under consideration. The weakness may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the controls to meet their objectives in any significant way. These are less significant observations than grades one and two, but we still consider they merit attention.

No.	Issue and recommendation	Management response	Officer and due date
1	The College does not complete an annual check to ensure that all members of staff with system access are still employees and there is no annual check to ensure that employees' levels of systems access is appropriate. There is a risk that inappropriate access could be obtained by current or previous members of staff of the College. It is recommended that, as new systems are developed, management considers developing a process to annually check employee system access, to ensure good practice. *(Grade three)*	Recommendation accepted.	Associate Principal (ICT) and Human Resources Manager 31 August 2011