INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

North Glasgow College

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

Year ended 31 July 2010

8 February 2011

AUDIT

AUDIT ▪ TAX ▪ ADVISORY

Contents

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About this report

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

This report is for the benefit of the Board of Management of North Glasgow 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 an unqualified opinion on the financial statements of North Glasgow College for the year ended 31 July 2010.

Management provided draft financial statements and extensive supporting documentation, all of which were completed to a high standard and were received in line with the agreed timetable. Changes to the financial statements to correctly reflect the College's participation in the defined benefit pension scheme were required.

Financial forecasts

North Glasgow College recorded a surplus of £736,000 for the 2008-09 financial year, against a forecast surplus of £30,000 and a deficit of £691,000 in the prior year. The significant increase in actual surplus against budget is mainly due to the the past service gain of £672,000 as a result of the change in measuring future pension increases with reference to the consumer prices index ("CPI") rather than the retail prices index ("RPI") as previously. The closing defined benefit pension liability has fallen by £775,000 compared with 2008-09.

The financial statements report retained general reserves of £5.2 million after inclusion of the net pension liability of £1.4 million.

The 2010-11 financial plan projects a small surplus of £50,000, largely due to an anticipated 2.5% fall in income. Management have undertaken a number of steps to consider potential funding cuts and completed scenario planning to indentify how the Collect can respond to changes in funding or resources.

A sum of £4.2 million was received in the year from HM Revenue & Customs in relation to input VAT incurred during the construction of 123 Flemington Street. The College took advantage of the 'Lennartz' regulations which allowed the claw back of the input VAT incurred as a lump sum which will then be repaid to HMRC over 10 years. In order to generate an income stream from this sum it has been placed on deposit at the best rate attainable by management in the current climate. Cash and creditors have both increased as a result of the receipt of the Lennartz cash during 2009-10.

Corporate governance

The corporate governance statement provides details of the College's processes and controls. Management highlight that the organisation is committed to exhibiting best practice in all areas of corporate governance. The College has applied the principles set out in the revised Combined Code on Corporate Governance, in so far as they apply to the further education sector, issued by the Financial Reporting Council in July 2003.

The corporate governance statement is collated using the results of the internal consideration of the arrangements in place. Management continue to review and implement policies and procedures in line with good practice to maintain a robust corporate governance framework and operating culture.

An internal audit review covering corporate governance and risk management was performed by Wylie & Bisset LLP in the year, the results of which found no major control weaknesses. The internal audit review concluded that the College "has substantial systems and procedures appropriate to its operations in the area of corporate governance".

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 North Glasgow 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.

Service overview; financial position

Introduction

The financial statements report a surplus for the year of £736,000, an increase of £1.4 million on the deficit of £691,000 recorded in the previous year and £705,000 higher than the projected outturn projected in the management accounts during the year. As at 31 July 2010, there are general reserves of £5.2 million.

Income

Total income has risen by £790,000 compared to 2008-09, an increase of 6% due to increases in most categories of income:

- Grants from the Scottish Funding Council ("SFC") have risen by £693,000, an increase of 6% from prior year due mainly due to the release of deferred capital grants associated with the additional depreciation charge in respect of the College's new building.
- Tuition fees and education contracts have increased £233,000 (12%) mainly due to income in respect of the Commonwealth Games Apprenticeship Initiative and strong student numbers, partially offset by reductions in part-time and day release courses sponsored by employers.

Expenditure

Total expenditure has fallen by £637,000 (4%) due to reduced operating expenses and staff costs, offset by increased depreciation.

- Staff costs have fallen by £519,000 (5%) which is mainly due to the past service gain of £672,000 as a result of the change in measuring pension increases from RPI to CPI, offset by a 1% rise in salaries year on year.
- Other operating expenses have reduced by £843,000 (22%) as a significant level of costs were incurred in 2008-09 which relate to the new building and the migration of facilities from the original site.
- Depreciation charged in the year has increased by £725,000 (74%) due to the effect of the first full year of depreciation charged in respect of the new building and equipment. As noted above, this is partially offset by an increased release of deferred capital grants to income.

	2009-10 £'000	2008-09 £'000
Income		
Scottish Funding Council grants	11,813	11,120
Tuition fees and education contracts	2,250	2,017
Other grant income	287	150
Other operating income	172	318
Investment income	26	153
	14,548	13,758
Expenditure		
Staff costs	9,127	9,646
Other operating expenses	2,979	3,822
Depreciation	1,706	981
	13,812	14,449

Service overview; financial position (continued)

Overall net assets decreased by £459,000 (1%) since the prior year. The key movements underlying this decrease are as follows:

- Fixed assets have decreased by £1.5 million as a result of the depreciation charge of £1.7 million in respect of the new building and assets offset by capital expenditure in 2009-10.
- Cash and short term investments have increased by £4.1 million. £3.7 million of this increase is due to the receipts from HMRC under the Lennartz scheme. There is a corresponding increase in creditors.
- Creditors have increased by £3.9 million. As above, £3.7 million of this increase is due to the receipt from HMRC under the Lennartz scheme. £440,000 of the total outstanding to HMRC is due within one year which is consistent with the expectation that the total amount will be repaid over the next 9 years.
- The net pension liability has fallen by £775,000 (35%), this is mainly due to the past service gain detailed below together with changes in actuarial assumptions.

	2010 £'000	**2009 £'000**
Tangible fixed assets	40,603	42,093
Stocks	3	3
Debtors	485	497
Cash and short term investments	6,897	2,733
Creditors: Amounts falling due within one year	(1,078)	(385)
Creditors: Amounts falling due after more than one year	(3,228)	-
Provisions for liabilities and charges	(1,823)	(1,848)
Net pension liability	(1,420)	(2,195)
Net assets	**40,439**	40,898

In its June 2010 Emergency 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"). Management considered the Strathclyde Pension Fund scheme rules and associated literature and concluded that there had been a constructive obligation to use RPI; the change to CPI therefore represents a change in benefits. In compliance with FRS 17 'retirement benefits', management's analysis and understanding concluded that employees were aware of the change in constructive obligation prior to 31 July 2010. Based on these conclusions, management reported the £672,000 past service gain as a credit in the income and expenditure account for the year ended 31 July 2010.

Financial forecasts

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 plan includes financial objectives to identify new sources of income to meet shortfalls in European and SFC grant income and increase commercial income. There is currently uncertainty over the level of SFC grant income that will be available to colleges over the forthcoming financial years.

2010-11 financial forecast

2010-11 financial forecast	£'000
Income	14,257
Expenditure	14,207
Forecast surplus for the year ending 31 July 2011	**50**
Cash balance at 31 July 2010	6,897
Forecast cash balance at 31 July 2011	6,054
Forecast movements in cash during 2010-11	**(843)**

The College is forecasting a small surplus of £50,000 for 2010-11 which is largely due to an anticipated 2.5% drop in total income. The forecast includes a contingency for expenditure of £250,000. The level of surplus forecast is a small increase compared to that forecast for 2008-09 (£31,000). The table opposite details the breakdown of forecast income, expenditure and cash balances for the 2010-11 financial year and excludes the potential impact of FRS 17 which resulted in a large increase in the surplus against forecast for 2009-10.

For the 2010-11 financial year, the SFC grants allocated to the College have fallen by 0.5% with total funding from all sources falling by around 2.5%. This equates to approximately £230,000 below that received in 2009-10. There is currently still some uncertainty on the level of grant funding that will be available to colleges in the last four months of 2010-11.

The closing cash balance is expected to reduce by £843,000 (12%) mainly due to the £440,000 required to be repaid to HMRC combined with the level of cash expected to be utilised in general operations.

Future financial planning

The College, in line with much of the wider public sector, is facing significant uncertainty over future funding levels and the impact and scope of public sector cuts. The College has a strong cash balance as a result of the Lennartz receipt and has placed the remaining funds on short term deposits with strongly rated high street banks to minimise investment risk. Given the significant risk and uncertainty over the future financial and other resources available to the College, management have undertaken a number of activities including:

- meeting with other College principals to discuss potential funding cuts the sector might face;
- meeting with every faculty and groups of support staff to explain to them the potential impact of funding cuts;
- budgeting for the last three months of 2010-11 based on existing funding levels;
- holding a scenario planning day with staff to assume various levels of cut and assess potential methods of implementing cuts across the College; and
- formation of a commercial unit responsible for delivering higher levels of commercial income.

Governance and risk management

Introduction

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

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

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

Framework

The board of management consists of 13 members, including those with relevant skills and expertise in accountancy, marketing and management consultancy to oversee the colleges' strategic plans. The board has four standing committees covering audit, finance, HR and facilities and learning & teaching. Each committee is formally constituted and has its own formal terms of reference. The comprehensive governance structure includes non-executive, professional and academic representation. The committee structure provides the board of management with the mechanisms to ensure appropriate oversight and monitoring of financial and academic activities.

Risk management

A formal risk management policy has been approved by the board of management. A risk register has been established, which is reviewed and updated on a regular basis, and the College also provides staff with risk awareness training. The risk assessment information is presented for consideration by the board of management, which includes details of the identified risk, its potential impact, the control and/or action implemented to mitigate the risk and the person or committee responsible for managing the risk.

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

Regularity

The board of management considers all incoming correspondence relevant to its strategic management role from the 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. The College therefore considers all incoming guidance received from these bodies, and can demonstrate that they take appropriate action when required.

Governance and risk management (continued)

Prevention and detection of fraud and irregularity

The College has a fraud policy and procedure which define responsibilities for action and reporting lines in the event of a suspected fraud or irregularity. The fraud policy was updated in December 2009 and is due to be reviewed in 2011. The policy is available to all employees on the intranet. Any suspicion of fraud should be reported to a member of senior management and/or the chairman of the board of management as appropriate.

There is also an unethical behaviour and whistle blowing policy in place, which is available on the intranet as required by The Public Interest Disclosure Act 1998.

Internal controls

The testing performed by internal audit on the financial controls did not identify any high priority recommendations.

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

Internal audit

During 2009-10, Wylie & Bisset LLP took over from BDO Stoy Hayward as internal auditors of the College.

The approved internal audit programme for 2009-10 has been completed. A review of the internal auditor's reports indicated a substantial control environment and made minimal recommendations. Management has continued to report action taken in response to internal audit recommendations to the audit committee.

An internal audit review covering corporate governance and risk management was performed by Wylie & Bisset LLP in the year, the results of which found no major control weaknesses. The internal audit review concluded that the College "has substantial systems and procedures appropriate to its operations in the area of corporate governance'.

The annual internal audit report for 2009-10 concludes that the College had *"adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives"*.

Best Value / value for money

There have been no value for money audits performed during the year however there is an internal audit review in this area scheduled for 2010-11. In addition, one of the College's financial objectives is to promote value for money to all staff.

Appendix one – 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	Supplier statement reconciliations are not performed on a regular basis. This results in the risk that liabilities are under or over stated in the accounts. It is recommended that supplier statement reconciliations are performed monthly by a member of the finance department and are subsequently reviewed by the finance manager or the Director of finance. *(grade three)*	Agreed.	Raymond O'Connell