Perth 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: 9 December 2010

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This report is part of a continuing dialogue between the College and ourselves and is therefore not intended to cover every matter discussed during the course of the audit. For this reason, the report is intended for the sole use of the College, and of Audit Scotland. We do not accept responsibility to any officer or member of the College acting in an individual capacity, and do not accept responsibility for any reliance that third parties may place on the report.

It should be noted that the primary objective of our audit is to express an opinion on the truth and fairness of the College accounts as a whole. An audit does not examine every operating activity and accounting procedure in the College, nor does it provide a substitute for management's responsibility to maintain adequate controls over the College's activities. Our work is not designed therefore to provide a comprehensive statement of all weaknesses or inefficiencies that may exist in the College's systems and working practices, or of all improvements that could be made.

1 EXECUTIVE SUMMARY

1.1 Financial Review

- The college achieved a surplus of £211,000 (previous year - £260,000)
- The college continues to maintain a healthy balance sheet with net assets of £21.3m (previous year - £21.2m)
- The budget for 2010-11 predicts a surplus of £252,000 and historical cost surplus of £578k.

1.2 Financial statements

- We have issued an unqualified audit opinion on the accounts of Perth College for the year ended 31 July 2010.
- There were no significant adjustments to the draft accounts arising from our audit.

1.3 Corporate Governance

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

1.4 Action Plan

Our recommendations relate to achieving:

- Increased accuracy over bank payment cut-off
- Full review of fixed asset registers

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 Perth 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 the appendices.

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 Perth 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 Perth 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 Perth 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 financial statements reflect a surplus for the year of £211,000 (previous year - £260,000). This is a significant improvement on the budget of £82,000 deficit. The main movements are summarised below:

	Budget £000	**Actual £000**	**Variance £000**
Funding Council Grants	*11218*	11,292	74
Tuition fees and education contracts	*4,311*	4,233	(78)
Other Income	*4268*	3,898	(370)
Staff costs and other operating expenses	*18,970*	18,269	(701)
Depreciation	*953*	961	8

The college continues to maintain a healthy balance sheet position, with net assets of £21.3m including cash of £4.4m.

3.3 Reserves

The college continues to build up its income & expenditure reserves to £4.0m, (previous year - £3.4m). The College also has a designated reserve of £0.5m and this is held as funds to contribute to the longer term strategic plan, including upgrade of the college estate, and provision of student accommodation.

3.4 Financial Plan 2010/11

The forecast for 2010/11 predicts a surplus of £252,000, including a contribution from the trading subsidiary, Air Service Training (Engineering) Limited (AST), of £150,000.

3.5 Capital expenditure plans

Perth College's Capital plan for 2010-11 predicts nominal expenditure of £378k in the year to 31 July 2011 relating to the student residences.

3.6 Recurrent grant allocation

The SFC has confirmed recurrent Grant income of £6.0m (2010: £6m) and Fee waiver initial grant of £1.0m (2010: £1m) for the year to 31 July 2011.

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 Perth College for the year ended 31 July 2010. A copy of our audit opinion is attached to this report as 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 by (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 the Finance Director and the Audit Committee, commencing in May 2010.

We are pleased to report that the audited accounts were submitted to the SFC and Audit Scotland by the due date of 31 December 2010. We are grateful to all of those in the Finance and other departments who helped to achieve this.

4.5 Audit approach and materiality

Our audit planning was carried out taking account of the issues highlighted through a planning meeting with you, together with our knowledge and understanding of the college from previous years.

In our planning, we have taken reliance from the work of the internal auditors in areas in which their work can give us comfort over certain of the amounts and disclosures included within the financial statements.

- 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 at year end 31 July 2010 and was assessed at £164,000.

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 £2,500.

The following significant matters were discussed with management during the course of the audit. This includes the audit outcome of the key risks identified within our audit planning memorandum.

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 summarise the main accounting issues that we have discussed with management and records the adjustments that have been made to the draft accounts as a result of matters arising during the course of the audit. Section 4.7 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:

Outstanding items on bank reconciliation

A cheque for £7k which was written post year end was posted through the system in the year end 31 July 2010 and thus appeared as an outstanding cheque at the year end. The supplier which this cheque was paying should have remained as a trade creditor at the year end rather than as a credit balance within bank and cash. This has no impact on the income and expenditure account.

Fixed asset register including assets which have been scrapped

Fixed assets on the fixed asset register were identified as no longer existing. These assets had a zero net book value at the year end and thus fixed assets were not overstated within the year end 31 July 2010 accounts. A full review of the fixed asset registers is thus required, to ensure that they only include assets which are in use by the college.

Contingent liability

It is disclosed within the accounts that the college have a contingent liability to cover the redundancy and cessation costs associated with Air Service Training (Engineering) Limited in the event that the company was discontinued. As the subsidiary of the college is an entirely separate limited company, this liability would not strictly exist under company law unless the College had given a formal guarantee to that effect. However, it is recognised that the college may wish to meet these liabilities from a reputational perspective.

Designated Reserves

Within note 23 of the financial statements, the College disclose a 'designated reserve' of £500k in respect of funds earmarked for future use in respect of long term estates management and student support. Whilst the inclusion of the designated reserve is not prohibited by any statute, SFC have indicated in their accounting guidance that they consider designated reserves to be an internal matter for a College and should not be included within the financial statements.

Tayside Superannuation Fund

Whilst the College does not apply the accounting provisions of FRS17, the Board should maintain an awareness of the deficit position on the Tayside LGPS. In particular, we would point out that despite the recent recovery in the market values of stocks and shares, many schemes have seen a substantial worsening in their actuarial position between 2009 and 2010 due to changes in inflation assumptions and projected bond yields.

Conversely, the College will benefit 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.

Bank Loan Agreement

In order to finance the Halls of Residence development, the College has entered into a Bank Term Loan agreement with Bank of Scotland. As part of our audit, we carried out a review of the terms of the bank loan in order to understand the matters which require to be disclosed in the financial statements and any other terms which we consider should be brought to the attention of the Audit Committee.

We would confirm that the loan agreement does not include any financial covenants in relation to either the annual surplus/ deficit or the balance sheet position of the College.

However, we would point out that under Schedule 3 of the agreement, the College requires prior written consent of Bank of Scotland fro a number of classes of potential transactions including:

- granting any security over College assets (3.1)
- entering into any other loan agreements (3.2)
- carry on any business (material to the College as a whole) which was not undertaken when the loan agreement was made (3.4)
- join any partnership or joint venture with any other person (3.6)
- in any financial year incur capital expenditure in excess of £25,000 (3.7)

The College is also required to send the Bank of Scotland copies of its annual financial statements within 9 months of the end of the financial year.

Each of the issues below was identified as risks in our original audit plan. This 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 risks	Planned audit approach	Outcome
Recognition of Funding Council Income			
The audit of 2009/10 student activity data by Henderson Loggie may result in adjustments to the SUMS which may take the College below 97% threshold and leave them subject to clawback of these funds.	Recurrent grant income may be overstated in the accounts.	Reconciliation to year end remittance advice from SFC and review the outcome of the student activity data audit.	Satisfactory
Halls of residence			
The halls are due to be completed by June 2010.	If completed, the capitalized fixed assets and related capital grants may be under/overstated, and therefore not disclosed accurately in the financial statements. If incomplete, capital commitments may not be appropriately disclosed within the financial statements.	The audit team will review the stage of completion of the new halls of residence. If incomplete, the team will assess the level of capital commitment, and the level of capital grant which should be deferred at the year end. If completed, the team will perform a detailed substantive testing on the fixed asset additions and related capital grants.	Satisfactory

Issue	Audit risks	Planned audit approach	Outcome
UHI income			
The College receives around £2.9m of UHI funding per year, and is one of the largest of 14 colleges that form the partnership.	The College has overstated income in the accounts in relation to UHI.	The audit team will do a full reconciliation of UHI income.	Satisfactory – the UHI income appears to be correctly stated in the financial statements.

Issue	Audit risks	Planned audit approach	Outcome
FRS 17 Accounting for Pensions			
On preparation of the financial statements for year ending 31st July 2009, it was decided that the Tayside Superannuation Fund be accounted for as a defined contribution scheme in accordance with information available at that time.	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 current technical assessments in relation to the accounting for pension schemes in public body financial statements. ▪ Assess whether the basis of the pension scheme and reasoning related to the disclosure as a defined contribution scheme remains valid at 31st July 2010.	Satisfactory

ADJUSTED AND UNADJUSTED ERRORS

4.7 Actual Audit Adjustments

No accounts adjustments were processed during the course of our audit.

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's*
Sales credit note provision	(10)
Zero NBV assets on register no longer owned by college (£20k cost)	0
Outstanding cheque not written until post year-end (£7k)	0
Net impact of potential adjustments	(10)

All unadjusted errors below materiality are noted in this report unless they are clearly trifling. We have defined 'clearly trifling' as below £2,500.

4.9 Accounting and financial control systems

The College produced high quality draft financial statements for our audit. This continues to reflect well on the professionalism of the finance staff and their commitment to maintaining robust financial systems.

We found that 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 significant matters of weakness identified during the audit that we wish to draw to your attention.

4.10 Regularity audit

- We have issued an unqualified regularity opinion and there are no significant 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 Perth 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 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. 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's Committee structure, Financial Regulations, and Internal Audit functions are all examples of policies and procedures which address potential risks. The College also has in place a Risk Management policy, and a risk Register.

5.4 Internal Audit

We adopt a managed approach in planning our audit work at your College. In our planning, we have reviewed the work of the internal auditors. From our review, there were no areas other than the WSUMS audit on which the internal auditors focussed their attention which would allow us to take reliance on their work.

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. provide the College's internal audit function.

- Despite no formal reliance being placed on the work of the internal auditors other than the WSUMS audit, the internal audit reports were reviewed as part of the audit fieldwork.

5.5 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, we have concluded that the fundamental key financial systems of the College are operating satisfactorily.

5.6 Other Governance responsibilities

Prevention and Detection of Fraud and Irregularities

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

The College also has in place a Fraud Prevention Policy and Response plan, a Gifts and Inducements policy and a Whistle Blowing policy.

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 appendices.

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:-

- Rules 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 procedure for the appointment of new board members
- A Freedom of Information policy

6 ACTION PLAN

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

	Subject	Grade
1	To ensure that trade creditors and bank are correct, cheques should only be posted through the system in the period in which they have been written.	**3**
2	To ensure that fixed assets are accurate, a full review of the fixed asset register should be performed and any asset which is no longer in existence should be disposed of.	**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 Outstanding item within bank reconciliation		**Grade 3**
Issue From a review of outstanding items on the bank reconciliation at the year end, it was identified that a cheque written in August 2010 was included as an outstanding cheque at the year end.		
Recommendation Ensure that cheques are only posted through the system in the period in which they have been written.	*Management response* 'One off' but comment is noted	*Outcome*
2 Fixed asset register		
Issue There are assets on the fixed asset register at the year end which the college no longer has. It should be noted that these assets have a zero net book value at the year end.		
Recommendation A full review of fixed assets should be conducted to ensure that only assets in existence are included within the fixed asset registers.	*Management response* Agreed and this review will be carried out during 2010-2011	*Action by whom* Iain Neilson

Perth 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 Perth College, the Auditor General for Scotland and the Scottish Parliament

We have audited the financial statements of Perth 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 Perth College and to the Auditor General for Scotland 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 Perth 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: Accounting for Further and Higher Education (2007). 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 are 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 judgements 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. We have not placed reliance on Internal Audit work. 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 are 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 2013/14 comparatives will need to be calculated	**First IFRS year end** 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**