Inverness College

Report to Members on the 2005/2006 Audit

Contents

Executive summary

0. This report summarises the main issues arising from the 2005/2006 audit. Key aspects of the College's performance are highlighted in the table below, based on the audit work undertaken.

Financial statements
The financial statements present a true and fair view of the College's financial position. The Corporate Governance Statement complies with accounting requirements and is not inconsistent with audit findings. Final accounts preparation procedures and working papers were satisfactory, with some changes made as a result of the audit. Inverness College has treated the Local Government Pension Scheme as a defined benefits scheme for the purposes of disclosure made in the accounts.
Financial position
The College's deficit for the year was £667,000, in line with forecasts reported to the Board of Management throughout 2005/2006. The Financial Forecast Return (FFR), submitted to the Scottish Funding Council (SFC) in summer 2006, categorises the financial health of the college as "very weak" improving to "weak" next year and becoming "secure" from 2007/2008. The College's in-year severance scheme is expected to yield annual savings of £510,000 and this underpins the expected improvements in financial "health". If the expected sale of the Hedgefield site is achieved in 2006/2007, then this could relieve the College of its existing dependency on the bank overdraft facility and SFC advance funding.
Corporate governance
The College is taking actions to improve significant weaknesses in its risk management, governance and control processes, as identified in the Further Education Development Directorate (FEDD) report and by the Internal Auditor. The Audit Committee meets regularly to review issues of governance.

0. Key issues for the attention of members are outlined in the Action Plan included in this report.

Introduction

0. The Board of Management is responsible for the administration and management of the College's affairs, including ensuring an effective system of internal control, and is required to present audited financial statements for each financial year. As external auditors, we review and report on the arrangements in place and seek to gain assurance that:

   - the financial statements have been prepared in accordance with statutory requirements and that proper accounting practices have been observed;
   - the College's system of recording and processing transactions provides an adequate basis for the preparation of the financial statements and the effective management of the authority's assets and interests;
   - the College has adequate corporate governance arrangements which reflect the three fundamental principles of openness, integrity and accountability; and
   - the systems of internal control provide an appropriate means of preventing or detecting material mis-statement, error, fraud or corruption.

0. This report summarises the most significant issues arising from our work during 2005/2006.

Financial statements

Auditor’s report

5. The financial statements give a true and fair view of the College’s financial position at 31 July 2006 and income and expenditure during the year.

6. For the past two years the unqualified auditor’s report drew attention to the College’s going concern disclosures made in the Statement of Principal Accounting Policies. The reports identified the dependency on the continuing support of the College’s bankers and the Scottish Funding Council. This support is in the form of a significant overdraft facility and funding advances.

7. The College remains in a challenging financial position, although I note that the College has completed a severance process leading to a reduction in staff and expected operating cost reductions in subsequent years. I have considered the disclosures made in the Statement of Principal Accounting Policies in the financial statements and I consider that the issue of going concern should again be drawn to the attention of members and the Auditor General for Scotland.

Financial position and monitoring

8. The College achieved an in-year deficit of £667,000 (£236,000 historic cost deficit). This year’s expenditure included £670,000 of exceptional restructuring costs relating to a severance scheme. These costs were partly funded by a non-recurrent grant of £160,000 from the SFC (refer to exhibit 1).

Exhibit 1: The effect of severance costs on the College's deficit

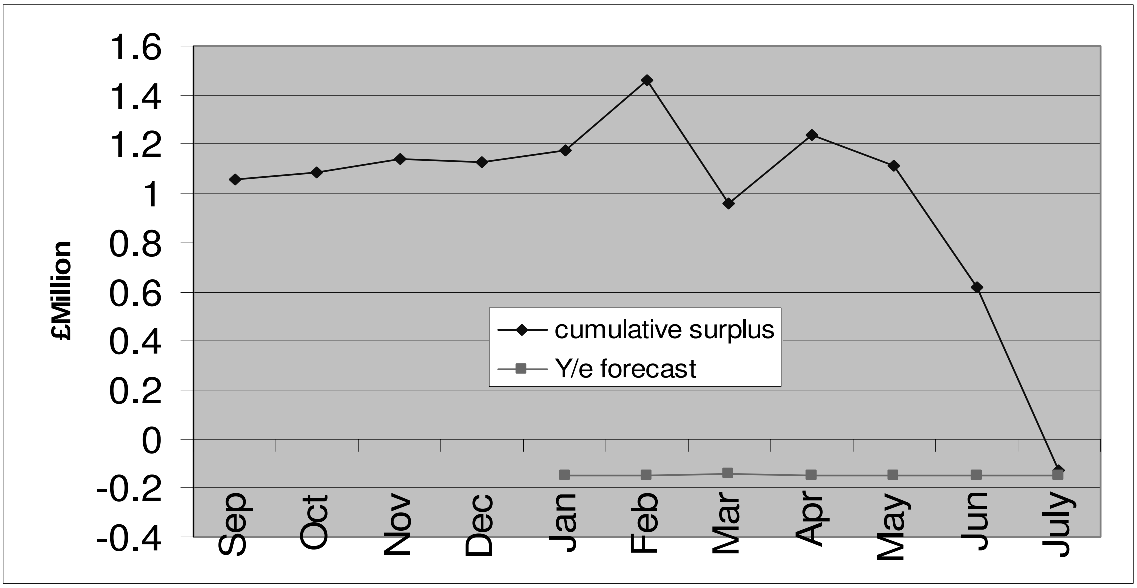
	£	£
Deficit per the financial statements		(667,000)
Exceptional restructuring costs	670,000	
SFC funding	(160,000)	
Exceptional restructuring costs (net of SFC funding)		510,000
Deficit net of severance costs		(157,000)

9. The severance process was completed towards the end of 2005/2006 and reduced teaching staff by 17 full time equivalent staff and helped to bring the College’s student to staff ratio more in line with the sector average.

10. Forecast out-turns were reported to the Board of Management throughout 2005/2006. The monthly management accounts demonstrate a year-end forecast deficit of £149,000 from January 2006. This is consistent with the actual out-turn (net of restructuring costs and related financing).

11. Within the monthly management accounts, the income budget phasing reflects the advances paid by the SFC. This effectively means that monthly income budgets are on a cash basis and actual income is not deferred to match with expenditure. This does not affect month by month monitoring, but does impact on the reported cumulative position (refer to exhibit 2). The basis used identifies an excess of income over expenditure of almost £1 million through the year. This represents income in advance from the SFC. Management reporting could be improved if monthly income was deferred in line with expenditure.

Exhibit 2: Reporting of surplus/deficit per College Management Accounts



12. In terms of the ongoing financial position of the College, the Financial Forecast Return (FFR) submitted to the Scottish Funding Council in July 2006, categorises the current financial health of the college as "very weak" improving to "weak" next year and becoming "secure" from 2007/2008. (The 2006/2007 projected total "health categorisation score" is 40 out of 100, up from an existing score of 19.). This poor "health" is also borne out by the ratios derived from the financial statements of the College:

- current liabilities represent more than twice the amount of current assets. Excluding the re-categorisation of the Hedgefield site, current liabilities would have been 5 times more than current assets;
- the cash flow from operating activities is a small but positive balance (inflow of £96,000). This is a significant improvement on the previous year (£489,000 outflow); and
- the debt ratio (total creditors vs total assets) has slightly improved to 18%, compared to 19% last year.

13. The College remains in a comparatively difficult financial position, however this should improve in future financial periods, as evidenced by the College's projections. The 2005/2006 severance scheme is expected to yield a sustainable reduction in costs of £510,000 per year. Existing forecasts and budgets indicate that an in-year operating surplus will be achieved next year (2006/2007) with a surplus of about £63,000 (before gains on sale of assets and before historic cost adjustments). It is also expected that the College will complete the sale of the Hedgefield site. The proceeds from this sale could potentially relieve the College of its dependency on existing overdraft and advance funding arrangements.

0. At 31 July 2006 the College had increased its accumulated general reserve deficit to £3.5 million (from £3.2 million (restated) at 31 July 2005).

Issues arising

0. The College's audited financial statements and my final report are to be submitted to the Auditor General by 31 December 2006. I am pleased to record that, following approval of the financial statements by the Board of Management on 18 December 2006 the audited financial statements will be submitted within this timetable.

0. In accordance with the agreed close-down timetable the unaudited financial statements were received on 4 October and our audit fieldwork commenced on 11 October 2006.

0. Some adjustments were made to the amounts and disclosures included in the unaudited accounts. In particular:

- corrections were made to the pensions transactions and disclosures, reducing the accumulated deficit by £51,000;
- the provision for the unfunded elements of the Scottish Teachers' Superannuation Scheme was revised to reflect a lower discount rate, as advised by the SFC. This resulted in an increased charge of £86,000 to the accounts;
- the release of deferred grant income was split between SFC and non-SFC grants and shown within Note 2 or Note 4 as appropriate;
- the provision for bad debts was adjusted to reflect working papers provided by the College and to include additional aged debtor amounts with local enterprise companies. The net effect of the adjustments was only £1,843;
- accrued income was increased by £14,000 reflecting invoices raised after the year end relating to 2005/2006;
- prepayments were reduced by £10,000 due to an error in working papers;

- some of the emolument disclosures for senior staff had been omitted and were added; and
- miscellaneous adjustments were made to disclosures in the notes including audit fees, capital commitments and cashflow.

18. Matters arising from the audit of the financial statements are summarised below.

Unfunded pension liabilities

19. The valuation of the unfunded pension liability has been reviewed and discounted at 2.5% (previously this was 3%) in accordance with 2005/2006 SFC guidance. The valuation relates to individuals within the Scottish Teachers' Superannuation Scheme where ongoing enhancements are paid. The total value of unfunded liabilities at 31 July 2006 is £1.6 million.

Pension disclosures

20. Inverness College is a member of the "Local Government Pension Scheme (LGPS) —The Highland Council Pension Fund" and makes contributions to the Scottish Teachers Superannuation Scheme (STSS). From 2005/2006, the College has fully implemented Financial Reporting Standard (FRS) 17. FRS17 sets out the accounting treatment for pension and other retirement benefits. On the basis of actuarial advice and SFC guidance the College has decided that it is able to identify its share of the underlying assets and liabilities in The Highland Council Pension Fund on a consistent and reasonable basis and has accounted for and disclosed the related transactions as a defined benefit scheme. The College is unable to separately identify its share of the underlying assets and liabilities for the STSS and has accounted for the contributions made as a defined contribution scheme, in accordance with FRS 17.

21. The financial statements include, for the first time, the net LGPS pension liability of £1.5 million. The comparative amount for the previous year is £2.3 million. The reduction in liability is attributable to the actuarial gain of £811,000. Note 21 demonstrates that this improvement is mainly due to increases in the value of investments in equities.

Fixed asset register

22. During 2005/2006, the College has begun to create a detailed fixed asset register. This exercise is not complete. A list of year-on-year capital additions dating back to 1998 has been prepared, but the College still does not have a detailed asset register. This issue was raised in last year's report.

Revaluation reserve

23. Each year, in the financial statements, the College makes a transfer from the revaluation reserve to the statement of historical cost surpluses and deficits. This transfer reflects the difference between

depreciation based on historical cost and depreciation based on current replacement cost (after incorporating revaluation). In the 2005/2006 accounts this transfer has been based on the current year's depreciation minus the deferred grant transfer to income & expenditure. I noted this same issue in 2004/2005. The College has not undertaken individual calculations for each asset based on historical cost from 1995 and subsequent revaluations. The transfer would appear to be reasonably stated in total, but I again recommend that the College undertakes an exercise to establish the amount of revaluation reserve attributable to each asset. This will ensure the accuracy of future transfers and that any future individual asset disposals or revaluations can be correctly reflected in revaluation reserve movements. This will be required, in particular, for the Hedgefield asset in order to account for its disposal correctly.

Tuition fee income

24. A number invoices for tuition income could not be agreed to the fees schedule approved by committee and there is a risk that incorrect or inconsistent fees may be charged. This was identified as an issue last year in connection with business development and the fee schedule was extended in 2005/2006 as a result. The College should further review the basis of raising fee charges and consider benchmarking with other colleges where this is considered appropriate.

Increase in bad debt provision

25. Following Internal Audit recommendation bad debt provisions were fundamentally reviewed in 2005/2006. This resulted in a significant increase in the provision for bad or doubtful debts. The provision now represents 42% of the total debtors listing (£0.5 million of £1.2 million). In 2004/2005 the provision was only 9% of debts. The College now recognises all debt over one year old within its provision, in line with the advice from the FEDD team and the practice at some other Colleges. The College has also reviewed and improved its debt collection processes and intends to consider debt write-off reports on a more regular basis. There has been only limited write-off of business or student bad debt in the past two years.

Bursary and other student support funds

26. Note 34 in the financial statements shows opening and closing balances together with in-year movements for various bursary and student support funds. The College accepts that individual fund balances do not agree to the opening and closing creditor balances in the ledger, although differences are not material. The College has recently introduced separate bank accounts for these funds and this is expected to afford improved control over individual fund reconciliations.

Legality

27. In reporting my opinion on the College's financial statements I am required to report "as to whether, in all material respects, funds from whatever source administered by the College for specific purposes have been properly applied for the intended purposes". The College is in receipt of a number of specific grants. Appropriate records are maintained within its accounting systems to match income and expenditure and I have not identified any material mis-application of funds.

28. With regard to the source and application of Higher Education (HE) funding, relative student activity provides a reasonable guide and basis for the allocation of costs and the activity achieved. Actual activity (960) is reasonably consistent (within 5%) of the target activity of 1,004 and I can conclude that, in all material respects, funding for the Further Education and Higher Education streams were applied for their intended purposes.

29. There are no additional legality issues arising from our audit which require to be brought to board members' attention.

Corporate governance statement

30. The College, in accordance with the Accounts Direction, has included in its financial statements a statement covering the responsibilities of the Board of Management in relation to corporate governance. The statement records that the Board complies with all of the provisions of the Combined Code on Corporate Governance 1998 and it has complied throughout the year ended 31 July 2006, subject to a number of areas identified as requiring further work to ensure that systems are operating effectively. The improvements are required to:

    - establish and monitor the achievement of the College's objectives;
    - identify, access and manage risks to achieving the College's objectives;
    - ensure economical and efficient use of resources;
    - ensure compliance with the College's policies, procedures, law and regulations;
    - safeguard the College's assets and interests from losses of all kind including those from fraud, irregularity and corruption; and
    - ensure the integrity and reliability of information, accounts and data, including internal and external reporting and accountability processes.

31. The internal auditor — Bentley Jennison Risk Management Ltd. — in the Annual Report for 2005/2006 states that, "Inverness College has inadequate and ineffective risk management, governance and control processes. However, we believe that the detailed action plan arising from the FEDD report and the response to Internal Audit recommendations should address these weaknesses. This being the case, the overall opinion should return to adequate and effective. The College has already reported considerable progress against the action plan." The Report identifies specific progress made by the College including:

- a revised planning process is now in place for 2007/2008, which begins in October 2006 with a strategic planning away-day;
- a revised budgetary process for 2006/2007 with identified key risks;
- a human resources manager is now in place;
- robust financial outturn figures are now produced on a monthly basis;
- the Board of Management is fully engaged with College staff;
- a management restructure is currently being progressed;
- clear links for improved controls between variable staffing and curriculum delivery are being set up;
- a finance officer role has been created, to co-ordinate purchasing, performance indicator information, benchmarking activities, etc; and
- a high level review has been completed, to improve integration of four main systems — Finance, HR, Payroll and Student Records.

32. This information is set out in the statement of corporate governance and our review of the statement concluded that it complies with guidance and is not inconsistent with other information we are aware of from our audit.

33. The College has not yet adopted the revised corporate governance combined code (2003) and is applying the 1998 Combined Code. Full compliance with the 2003 Code is required from next year (2006/2007) and I recommend that the College obtains and reviews the revised code at an early opportunity.

Bursary and other student support funds

34. Notes to the financial statements identify a number of funds which are not included in the College's Income & Expenditure Account and which are subject to separate audit certification. The Internal Auditor has not identified any fundamental or significant issues arising from the work undertaken and consequently I have formed the view that there are no material issues arising from the audit of these funds.

Corporate governance

Overview

0. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviours at the upper levels of the organisation.

0. A review and assessment of the College's corporate governance arrangements was carried out during the audit. This assessment included a review of the College's committee minutes and issues relating to systems of internal control, arrangements for the prevention and detection of fraud and corruption, standards of conduct, issues of legality and the College's financial position.

0. Specific issues are set out in the following paragraphs.

Corporate governance

0. Following the review of the College by the Further Education Development Directorate (FEDD), in March 2006, a report was presented to the College's Board of Management. The findings within this report were also discussed at a public meeting of the Scottish Parliamentary Audit Committee (SPAC) on 9 May 2006.

0. The report and SPAC were highly critical of many key areas within the College including leadership, strategic and operational planning, curriculum management, finance, human resources, marketing and management information systems.

0. This led to the Board of Management of the College developing an action plan to address the issues raised and this is being taken forward by the Board of Management in all of its sub-committees.

0. Recent feedback indicates that progress has been made within the College, with the continuing support of the FEDD team, in addressing the identified issues. Progress and outstanding actions are reported to each of the committees as a standing item on the agenda.

0. Our review of the revised financial regulations, standing orders and scheme of delegation found these documents to include the majority of instructions and explanations we expected. However, the financial memorandum mandatory requirements circular (SFC/14/2005) contains a number of items which were not clearly set out in the financial regulations. Having reviewed the requirements of this circular we considered that further disclosure is required in respect of:

- the criteria for obtaining and approving capital finance; and
- arrangements for disposal of exchequer funded assets and retention of proceeds.

Risk management

43. The strategic risk register was updated in December 2005, however it is recognised that a risk management culture does not exist across the whole College. The College now intends to integrate risk management with its planning and budgeting cycles and to embed risk management practices. The first stage in this process will be to assess the risk associated with the 2007/2010 strategic plan. This will be followed by training and active application of risk management practices at departmental level.

Anti-fraud and corruption arrangements

44. The College maintains an up-to-date register of members' interests and has a formal whistle blowing policy. A formal code of conduct has been adopted for members but this has not yet been extended to staff. No instances of fraud were reported or investigated during 2005/2006.

Systems of internal control

45. The College has an Audit Committee which meets regularly to review reports from the senior management team, internal auditors and Audit Scotland.

46. Reliance was placed on the work of internal audit in 2005/2006 to evaluate a number of key systems in place within the College. I have reviewed the reports of the internal auditor and the most significant findings taken from audit work in the period autumn 2005 to spring 2006 include:

- procedures and management in the Registry and SUMS area required improvement;
- outstanding debtors need to be reviewed and bad debts written off;
- payroll and HR systems were not integrated and periodic cross-checking was not possible;
- budget holders had become disengaged from the process and were not aware of their responsibilities;
- staff were not complying with ordering procedures; and
- there is no risk management mitigation plan or risk facilitator.

47. The overall assessment of the Internal Auditor is that risk management, governance and control processes are inadequate and ineffective, but that the College has taken action to address these issues and this has been noted in the Annual Report of the Internal Auditor for the year ended 31 July 2006.

Previous years follow up.

48. There were seven actions identified in the previous year’s action plan. Three of these actions are now complete. The outstanding actions relate to the creation of a detailed asset register, the identification of individual elements of the revaluation reserve, development of risk management and review of the business development fee rates. I have referred to these issues earlier in this report and included them in the action plan.

Action plan

No.	Issue, risk & recommendation	Responsible officer	Response & agreed action	Action date
1. (para 11)	Monthly Management Accounts: Deferral of Income Existing management reporting includes SFC income on a cash basis, including advances. This appears to indicate a cumulative surplus of about £1 million for most of the year. *Risk: The College reporting of the cumulative surplus is not clear and could lead false assumptions about the financial position.* *Recommendation: The College should defer income in line with expenditure within monthly management reports. This would demonstrate the accumulation of the year end position through the year.*	Director of Finance	Agreed. Changes will be made to next and future monitoring reports.	31 January 2007
2. (para 22)	Detailed Asset Register The College does not have a detailed fixed asset register, but the College has begun work to prepare a detailed register. *Risk: The College may not be able to identify and control its fixed assets, a detailed register of individual assets is necessary, particularly in respect of equipment assets, which are not subject to periodic revaluation exercises by independent valuers.* *Recommendation. The College should complete work to prepare a detailed asset register.*	Director of Finance	Agreed.	30 April 2007

No.	Issue, risk & recommendation	Responsible officer	Response & agreed action	Action date
3. (para 23)	Revaluation Reserve The balance on the revaluation reserve cannot currently be attributed to individual assets held by the College. *Risk: The annual transfer to the Historic Cost Surpluses and Deficits Statement may become materially inaccurate and the College may be unable to correctly account for reserve movements due to any reduction in value or disposal of individual assets. E.g. Hedgefield.* *Recommendation:* An exercise should be undertaken to attribute the total revaluation reserve to individual assets, based on historic information held by the College.	Director of Finance	Agreed.	30 April 2007
4. (para 24)	Invoiced Fee Rates We were unable to agree invoiced rates to the fee schedule. *Risk: The College cannot clearly demonstrate how invoice fees are determined and may not be charging appropriately or consistently for its services.* *Recommendation:* The College should review the basis of raising fee charges and consider benchmarking with other colleges where this is considered appropriate.	Director of Finance	Agreed. The annual fees report which goes to Finance & General Purposes Committee will be updated to reflect the true position of fees.	30 April 2007
5. (para 25)	Debt Write-off The College revised its bad debt provision in 2005/2006 and increased it significantly. There have been no significant write-off reports submitted to committee in the last two years. *Risk: The College debtors listing becomes unmanageable and contains a significant element of irrecoverable debt.* *Recommendation: Following specified debt collection processes, the college should periodically report irrecoverable debts to committee for authority to write-off.*	Director of Finance	Agreed. Regular reports will now be produced for Finance & General Purposes Committee.	31 March 2007

No.	Issue, risk & recommendation	Responsible officer	Response & agreed action	Action date
6. (para 26)	Bursary and Student Support Funds Minor differences exist between the balances on the bursary and student support funds recorded in the financial statements and recorded as creditors in the ledger. The College has introduced separate bank accounts which should improve controls over these funds. *Risk: The differences in the bank balances and creditor amounts lead to inaccuracies in the financial statements.* *Recommendation: Adjustments should be made to bring the creditor balances into line with the bursary/ fund bank account balances.*	Director of Finance	Agreed	31 May 2007
7. (para 33)	Revised Combined Code on Corporate Governance (2003) The College identifies in the financial statements that it has complied with the 1998 Code. Compliance with the Revised Code on Corporate Governance is required with effect from 2006/2007. *Risk: The College may not anticipate, or incorporate, changes in the Code on Corporate Governance.* *Recommendation:* The College should review the Combined Code on Corporate Governance 2003 and identify any actions that may be required.	Director of Finance	Agreed.	31 July 2007
8. (para 42)	Financial Regulations etc The College revised its financial regulations in 2005/2006. These do not describe the criteria for obtaining and approving capital finance and the arrangements for disposal of exchequer funded assets, as required by SFC/14/2005. *Risk: The College may not be aware of or comply with internal and external requirements in these areas.* *Recommendation:* Financial regulations should be revised to include criteria for obtaining and approving capital finance and arrangements for disposal of exchequer funded assets.	Director of Finance	Agreed.	31 January 2007

No.	Issue, risk & recommendation	Responsible officer	Response & agreed action	Action date
9. (para 43)	Risk Management Risk management with the College could be further developed by demonstrating a link with strategic objectives and planning and by embedding risk management as a normal part of general management practice. *Risk: Major risks relating to strategic objectives will not be identified or addressed and actual management practice may not reflect organisational risk management priorities.* *Recommendation:* Risk management should demonstrate a link with strategic objectives and planning and embed risk management as a normal part of general management practice.	Director of Finance	Agreed.	31 July 2007