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INFRASTRUCTURE, GOVERNMENT & HEALTHCARE

Barony College

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

Audit: Year ended 31 July 2007
17 December 2007

AUDIT

AUDIT ▪ TAX ▪ ADVISORY

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If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact David Watt, who is the engagement leader for our services to the College, telephone 0141 300 5695, email david.watt@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Lorraine Bennett, our Head of Audit in Scotland, either by writing to her at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 222 2000 or email to lorraine.bennett@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Director of Audit Strategy, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.

Executive summary

This report summarises our work for the 2006-07 year and our findings in relation to our audit of the financial statements, financial reporting and corporate governance arrangements.

Financial statements

On 17 December 2007 we issued an audit report giving our unqualified opinions on the financial statements of Barony College for 2006-07.

There were three key issues relating to the financial statements. Fixed asset additions during the year relate mainly to the construction of the dairy technology centre, which was brought into use in August 2007. The College undertook a revaluation of all assets in the year 2002-03, and, under FRS 15, an interim valuation should have taken place in 2005-06. At our request, an interim valuation was performed in 2006-07. A full revaluation will be performed in 2007-08.

The draft financial statements included stock of £509,000, which was calculated on the basis of market value. As a result of the audit process this was changed to the lower of cost and net realisable value to ensure compliance with SORP 2003 and financial reporting standards.

Financial position

The College made a surplus on continuing operations after depreciation of assets at valuation and disposal of assets of £44,602. The College had forecast a year end surplus of £10,000 in its financial forecast return to the Scottish Funding Council at the beginning of the year. The variance against budget is due to £40,000 credit as a result of the FRS 17 pension adjustment and a loss on disposal of assets of £5,000. The results of the College's underlying operations have not varied significantly from the forecast outturn.

Governance and strategy

There are no significant weaknesses disclosed in the statement on internal control, and no significant control weaknesses were identified through our work on the control systems within the College.

During 2006-07 internal audit performed a detailed review of corporate governance arrangements. They concluded that adequate controls are in place and are operating effectively. Two recommendations were made to ensure that the register of members' interests is updated regularly and to implement a separate fraud policy. We have reviewed up to date returns from Board members, which have been used to update the register of interests, and the College's fraud policy, demonstrating that management has taken these recommendations on board.

Internal audit has concluded in their annual report that the College has adequate and effective risk management, control and governance processes to manage achievement of the College's objectives.

Due to the size of the finance team, there is little segregation of duties in respect of review and authorisation of the work of the finance manager and this has been discussed with senior management.

Corporate governance arrangements are discussed regularly by the Board of Management, with particular attention paid to the combined code, demonstrating members' involvement and interest in this area.

Introduction

Audit framework

2006-07 was the first year of our five-year appointment as external auditors of Barony College ("the College"). This report to the Board of Management of the College and the Auditor General for Scotland summarises our opinion and conclusions and highlights significant issues arising from our work.

In accordance with Audit Scotland's *Code of Audit Practice*, the scope of the audit was to:

- provide an opinion on the College's financial statements and, as required by relevant authorities, the regularity of transactions;
- review and report on (as required by relevant legislation, the Code and any guidance issued by Audit Scotland):
  - 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, and prevention and detection of corruption; and its financial position
  - the College's arrangements to achieve Best Value
  - other aspects of the College's arrangements to manage its performance, as they relate to economy, efficiency and effectiveness in the use of resources.

The framework under which we operate under appointment by Audit Scotland was outlined in the audit plan for the year discussed with the College's audit committee.

Basis of information

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 its 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 its principal, to make arrangements to secure Best Value.

Acknowledgement

Our audit has continued to bring us into contact with a range of College staff. We wish to place on record our appreciation of the co-operation and assistance extended to us by staff during the first year of our work in the discharge of our responsibilities. We also note the high quality of the College's preparation for the audit and the co-operation of the finance manager.

Financial commentary

This section of our report summarises the main features of the financial statements and key movements from the prior financial year.

Income and expenditure account

The surplus for the year of £45,000 is 1% of total income (2005-06: £221,000 and 5%). Based on 2005-06 financial statements the sector average is around 2%. The level of surplus in 2006-07 is below the sector average.

The majority of income is received from the Scottish Funding Council, but the College has also increased external other operating income. Total income increased by £155,000 (4%), primarily due to an increase in other operating income. The most significant movements in income were:

- £93,000 increase in Scottish Funding Council grants;
- decrease of £20,000 in tuition fees and education contracts;
- £85,000 decrease in other grant income; and
- an increase of £164,000 of other operating income, including £35,000 increase in residences and catering and £137,000 increase in income from farming activities.

The following table identifies the sources of income in 2005-06 and 2006-07.

	2006-07	***2005-06***	**2006-07**	***2005-06***
	£'000	***£'000***	**%**	***%***
Scottish Funding Council grants	2,414	*2,321*	55%	*55%*
Tuition fees and education contracts	436	*455*	10%	*11%*
Other grant income	336	*421*	8%	*10%*
Other operating income	1,149	*985*	26%	*23%*
Investment income	22	*20*	1%	*1%*
Total income	**4,357**	***4,202***	**100%**	***100%***

Income levels have remained in line with those in 2005-06; the slight increase in other operating income is due to the dairy technology centre becoming operational in 2006-07, and the increased milk sales due to the larger herd size.

Overall, total expenditure has increased by £154,000 (4%), which is consistent with the equivalent movement in income. The most significant movements were:

- £76,000 increase in staff costs;
- operating expenditure increased by £62,000; and
- interest payable increased by £14,000.

The majority of expenditure is incurred on staff costs. The following table identifies the key elements of expenditure in 2005-06 and 2006-07.

	2006-07	*2005-06*	2006-07	*2005-06*
	£'000	*£'000*	%	*%*
Staff costs	2,504	*2,428*	59%	*59%*
Other operating expenditure	1,578	*1,516*	36%	*36%*
Depreciation	180	*180*	4%	*4%*
Amortisation of intangible assets	13	*12*	0%	*0%*
Interest payable	32	*18*	1%	*1%*
Total expenditure	**4,307**	***4,154***	**100%**	***100%***

Balance sheet

The College has reported an increase in net assets of £619,000 during the year. The balance sheets at 31 July 2006 and 2007 are summarised as follows:

	2006-07	*2005-06*
	£'000	*£'000*
Fixed assets		
Tangible assets	5,016	*4,851*
Intangible assets	79	*82*
Investments	24	*16*
Current assets		
Stock	388	*378*
Debtors	486	*564*
Cash at bank and in hand	2	*1*
Creditors due within one year	(798)	*(1,072)*
Net current assets	**78**	***(129)***
Creditors due after one year	(452)	*(171)*
Pension liability	(8)	*(530)*
Net assets including pension liability	**4,737**	***4,119***
Deferred capital grants	1,862	*1,770*
Income and expenditure account, including the pension reserve	1,188	*606*
Revaluation reserve	1,687	*1,743*
	4,737	***4,119***

Significant movements during the year include:

- an increase of £85,000 in the overdraft;
- decrease in creditors due within one year due to the existence of a £415,000 creditor at 31 July 2006 for works on the dairy technology centre, for which there was no equivalent at 31 July 2007; and
- an increase in fixed asset net book value of £165,000 due to additions in relation to the dairy technology centre.

Financial forecasting

The original 2006-07 financial plan forecast a surplus of £10,000 to 31 July 2007. The actual outturn to 31 July 2007 was a surplus of £45,000. The following table summarises the significant movements during the year.

	£'000
2006-07 forecast outturn per the financial plan	**10**
Impact of accounting for pension costs under FRS 17	40
Loss on disposal of fixed assets	(5)
2006-07 actual outturn to 31 July 2007	**45**

Source: Barony College (October 2007)

The significant movement in the surplus occurred after the year end as a result of independent valuations prepared by the College's external actuaries on pension costs. The results of the College's underlying operations have not varied significantly from the forecast outturn.

The financial statements have been prepared on the basis that the College is a going concern and will continue as such for the foreseeable future. The following table summaries the forecast income, expenditure and cash balances for the College for 2007-08.

	£'000
Income	4,323
Expenditure	4,312
Forecast surplus for the year ending 31 July 2008	**11**
Cash balance at 31 July 2007	2
Forecast cash balance at 31 July 2008	38
Forecast movement in cash during 2007-08	**36**

Source: Barony College (June 2007)

The College is forecasting a small surplus, consistent with management's financial strategy and in line with prior years. The dairy technology centre will be fully operational during 2007-08 and management expect to realise additional revenue benefits from the capital investment, resulting in a forecast increase in other income generating activities. This is offset by an anticipated decrease in European Social Fund funding.

Management will be dependent on the use of overdraft facilities during 2007-08 to meet timing differences between income and expenditure. Management has obtained confirmation from its bankers that this facility is available until December 2008.

Governance and risk management

Introduction

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

Through the principal, the Board of Management is responsible for establishing arrangements for ensuring the proper conduct of its 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 the College's corporate governance arrangements as they relate to:

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

Management is responsible for establishing arrangements for the conduct of its affairs, including compliance with applicable guidance, ensuring legality of activities and transactions and monitoring the adequacy and effectiveness of these arrangements in practice.

Risk management

A formal risk management policy statement is in place. This was updated and approved by the Board of Management in April 2007. The College maintains a risk register on the staff intranet that can be updated by risk owners when required. A review of all risks on the register is undertaken each term by the senior management team and reported to the Board of Management for approval. The risk register is also considered by the audit committee during each meeting.

Systems of internal control

Corporate governance statement

The preparation of the corporate governance statement is the responsibility of principal. The principal obtains assurance from internal audit's annual report and the audit committee to inform the corporate governance statement. The audit committee is responsible for providing assurance to the Board of Management relating to corporate governance. The Board of Management are also active in considering corporate governance arrangements, with particular attention being paid to the combined code and ensuring the College's compliance with relevant guidance.

During the year internal audit performed a review of the College's risk management arrangements. No high priority recommendations were made.

The College has made a fully compliant corporate governance statement. We are required to review this to assess whether the description of the process adopted by the College in reviewing the effectiveness of the system of internal control is consistent with our understanding of the process and report any inconsistencies in our opinion. We are not required to provide an opinion on the College's system of internal control.

We have reviewed the corporate governance statement and consider it consistent with our understanding of the processes followed by the College during the year.

Internal audit

The approved internal audit programme for 2006-07 has been completed and the internal auditors have reported that the College's performance in areas reviewed is strong. Areas covered in the programme include purchasing and payments, personnel and payroll, corporate governance, risk management, catering conference and residence and student funding. Accordingly, based on the programme of work undertaken during the year, the internal auditors have concluded that "*[the] College did have adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives at the time of our audit work*".

Internal controls

Drawing on the work of internal audit, in accordance with our plan we undertook detailed testing in relation to both entity-level and key financial controls. We have identified two areas for enhancement. Recommendations are included in the action plan in appendix one. Neither of these recommendations is significant.

Testing of the design and operation of controls over significant risk points in terms of major financial systems confirms that, subject to the weaknesses reported, controls are designed appropriately and operating effectively.

Charities and Trustee Investment (Scotland) Act 2005

The Charities and Trustee Investment (Scotland) Act 2005 ("the Act") came into force in April 2006, introducing new duties and responsibilities for the Office of the Scottish Charity Regulator ("OSCR"). Over time OSCR intends to undertake a rolling review of charities entered in the Scottish charity register to assess whether they meet, and continue to meet, the charity test: purposes will have to be charitable in the context of the charity test set out in section 7 of the Act and charities will have to show that they provide public benefit.

OSCR recently reported the results of its pilot review and that six of the eight organisations satisfied the 'public benefit' test. OSCR's report clearly states that the results of the review cannot necessarily be applied to similar organisations, but there is an expectation within the sector that the charitable status of further education colleges is at risk because the ministerial control identified by OSCR exists in the Further and Higher Education (Scotland) Act 1992 (as amended by the Further and Higher Education (Scotland) Act 2002.

We recognise that the Scottish Government has made a public commitment to amending the legislation as required to preserve the charitable status of further education colleges.

The College has identified and recorded the risk of losing charitable status in the risk register. Management believe that the issue over ministerial control is the only issue that would prevent the College from retaining charitable status.

Prevention and detection of fraud and irregularity

The College has introduced a fraud policy, which was approved in September 2007, in response to a recommendation made by internal audit. The policy documents the procedures in place for the avoidance of fraud and corruption, providing guidance to staff on the action which should be taken when fraud, theft or corruption is suspected. Key elements of the College's strategy to combat fraud and corruption are: an open and honest culture; adequate preventative measures; systems for detection and investigation; understanding and awareness within the College; the adoption of a whistle blowing policy. The content of the policy meets the requirements and identifies responsibilities for the prevention and detection of fraud.

Management has not reported any material instances of fraud or irregularity in 2006-07.

Standards of conduct

Staff are required to operate in accordance with the College's internal code of conduct, which was established having regard to the principles established by the Committee on Standards in Public Life (formerly known as the Nolan Committee), which all members of staff are expected to observe. The College has comprehensive policies and procedures which provide guidance to staff; all documents are available to staff on the intranet and staff are made aware when updates are made.

There is also a formal register of interests for recording members of the Board of Management and senior managers' interests. As part of their work in the year internal audit found that the register of interests was out of date, and recommended that it be updated regularly. The register of interests was in the process of being updated at the time of our audit, with board members filling out updated forms in July 2007. It was confirmed at the audit committee on 20 November 2007 that the register has now been updated.

Best Value

The 2006-07 planning guidance for further education colleges issued by Audit Scotland indicated that there was no requirement for auditors to undertake performance audit or other Best Value studies during the year.

Her Majesty's Inspectorate of Education

The College was subject to a review by Her Majesty's Inspectorate of Education (HMIE) between October 2006 and January 2007. HMIE concluded that:

- the College has in place effective learning and teaching processes overall;
- learners are achieving appropriate outcomes overall; and
- the College is managing well and improving the quality of its services for learners.

The College obtained 'good' grades in the four subject areas reviewed. In addition, the College achieved five 'good' and two 'very good' grades for cross-college elements reviewed.

The report identified 13 main points for action; four in relation to educational provision; five in relation to learner services, resources and staff; and four regarding quality assurance, improvement and enhancement. However, the report also identified five areas where the College demonstrates sector-leading and innovative practice, including programme design of core skills development in national certificate agriculture and the veterinary surgery operating theatre suite. Three cross-college areas were also recognised: employer engagement on curriculum, resources and employability skills; and Board of Management involvement in the work of the College; partnership working with manufacturers and dealers.

HMIE concluded that the members of the Board of Management were actively and effectively involved in the educational work of the College. The *"overarching benefit to the College and its learners was that their Board fully understood the educational context of the College business and was particularly well informed to take account of them in any decision or investment."*

Financial statements audit

Audit opinion

On 17 December 2007 we issued an audit report expressing an unqualified opinion on the financial statements of the College for the year ended 31 July 2007 and on the regularity of transactions reflected in those financial statements.

Stock

Generally accepted accounting practice requires that stock is valued at the lower of cost and net realisable value. The College engaged an external valuer to provide an independent report on the quantity and value of all stock, including livestock and consumables, at 31 July 2007. The value for livestock crops reported by the external valuer was based on market value. We discussed the valuation basis with management, particularly in relation to whether the market value could be demonstrated to be lower than cost. Management subsequently re-assessed the basis of valuation and identified that, by reference to deemed costs, stock was overstated by £121,379. This adjustment was reflected in the financial statements, resulting in a decrease in the surplus. The accounting policy has been revised to state that the deemed cost of livestock, other than purchased livestock, is derived by applying specific reductions to open market at the year end on the basis of published guidance applicable to the farming sector. All consumables are correctly valued at cost.

Fixed assets

Valuation

The College accounts for its fixed assets on a valuation basis under financial reporting standard 15 ‘tangible fixed assets’, which requires that fixed assets are valued every five years, with an interim valuation in year three. The College’s estate was subject to a full revaluation at 31 July 2003, therefore the interim valuation was due at 31 July 2006. In response to our request, management obtained written confirmation from the College’s independent valuer that the carrying value of the College’s estate is not inappropriate.

The College’s estate is valued at market value, which was agreed as an appropriate basis with the independent valuer in 2003. SORP 2003 requires that fixed assets are valued on the basis of market value for existing use, but recognises that specialist buildings, such as further education colleges, may not have an ascertainable market value. The use of depreciated replacement costs is acceptable as a valuation basis in these circumstances. While there are no indications that market value is not an appropriate basis for the College, it is recommended that management consider this fully during 2007-08 prior to requesting a full revaluation at 31 July 2008. In particular, management should consider whether the value of the site as a whole is equal to the market value of the component parts, based on the likelihood that component parts would be considered valuable to an individual purchaser.

Dairy technology centre

The dairy technology centre has been one the College’s significant projects in 2005-06 and 2006-07 and an additional £278,690 was spent during the last year. The College has received positive coverage in local and specialised press in relation to this significant investment in modern technology. The centre was funded by a combination of loan funding and capital grants from the Scottish Funding Council and will be finished and fully operational in 2007-08. The centre adds value to the College, as it is a unique educational training centre within the United Kingdom. The latest animal welfare designs and management systems, such as robotic milking, mean that the College can offer specialised training in this area.

Regularity

There are no significant issues arising from the regularity audit. We have reviewed the minutes of the College's key committees, including the board of management and audit committee meetings. From these minutes, we have established that the College has procedures in place to ensure discussion of key guidance from the Scottish Funding Council, as well as other relevant laws and regulations. One person is responsible for noting the receipt of guidance and following up action taken by management. When this person is on annual leave this task is not taken on by anyone else. It is important that this process is completed on a continuous basis throughout the year to mitigate the risk that necessary action is not taken in a timely manner.

Report to those charged with governance

At the audit committee meeting on 20 November 2007 we discussed our "report to those charged with governance" which is required under International Auditing Standard 260. This dealt with relevant aspects of the College's financial statements production process, amendments to draft financial statements during the audit process, the treatment of uncorrected audit differences and the content of the representation letter to us.

Appendix – action plan

Priority rating for performance improvement observations raised		
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 performance improvement observation	Management response	Officer and due date
1	The College has a very small finance team and, as a result, there are areas where is there is a lack of segregation of duties, including: • bank and fixed asset reconciliations are not independently reviewed; and • journals raised by the finance manager are not independently reviewed. We appreciate that the College's operations do not require additional finance staff, but recommend that the current allocation of duties is reviewed. *Grade 2*	This has been considered several times at Board of Management level. The decision has been made that current staffing and work allocation is sufficient given the scale of the college.	-

No.	Issue and performance improvement observation	Management response	Officer and due date
2	One person is responsible for noting the receipt of guidance and following up action taken by management. When this person is on annual leave this task is not taken on by anyone else. It has been noted that guidance may be received electronically, in which case no mail log would be kept of the receipt of guidance. Nevertheless, it is important that the recording of action to be taken is completed on a continuous basis throughout the year to mitigate the risk that necessary action is not taken in a timely manner. *Grade 2*	The College has an excellent track record of meeting SFC response dates. The log kept by the Principal's secretary is a back up.	-

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