Oatridge College

Annual Audit report for 2006/07 to the Board of Management and the Auditor General for Scotland

External Audit Report No: 2007/03

Draft Issued: **13 December 2007**

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Contents

Notice: About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ('the Code') and *Statement of Responsibilities of Auditors and Audited Bodies*.

This report is for the benefit of only Oatridge College and is made available to Audit Scotland (together with the beneficiaries), and has been released to the beneficiaries on the basis that it shall not be copied, referred to or disclosed, in whole or in part, without prior written consent.

Nothing in this report constitutes a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than the limited circumstances set out in the scope and objectives section of this report.

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Executive Summary

1.1 Corporate Governance

- The College has shown a surplus for the year of £0.145 million and an income and expenditure account balance of £2.581 million at 31 July 2007.

- The College's internal auditors have concluded that "*Substantial Assurance*" can be taken and *"…that the internal controls and governance frameworks which it operates are sufficient to ensure the efficient and effective operation of the organisation and that the strategic and operational risks to which the organisation is exposed are being managed."*

- The College's Corporate Governance Statement confirms that the College has complied with the requirements of the 2003 Combined Code on Corporate Governance, in so far as they apply to the further education sector, for the year to 31 July 2007.

- Our work undertaken in relation to the 2006/07 financial statements audit identified some control weaknesses in the operation of financial controls and procedures. The College operates with a small finance team with limited resources resulting in a lack of segregation of duties for some members of staff. Also, the accounting system for the subsidiary was not fully segregated from the College's accounting systems leading to difficulties in financial reporting.

- The College has an on-going process for identifying, evaluating and managing its significant risks.

1.2 Performance

- The College's Strategic Development Plan 2007/08 – 2009/10 sets out six key aims together with a number of objectives to be pursued to enable each of the aims to be realised. The Board of Management and its committees consider the College's performance in implementing its strategic objectives.

- Detailed Operational Plans for 2007/08 have been drawn up for each Academic Department and Support Service within the context of the Strategic Development Plan. Achievement against the Operational Plans is monitored at the end of each block.

- Risk workshops were held in 2006/07 involving members of the College Board of Management and senior management, with assistance from the Internal Auditors, and a new Risk Register drawn up linked to the strategic objectives. The College does not have a formal approved Risk Management Policy document and this should be drawn up.

- Oatridge College is an active member of the Rural Colleges and Scotland's Countryside Colleges groups providing benchmarking information for performance management purposes.

- Financial management arrangements ensure timely financial reporting at strategic and operational levels.

1.3 Financial Statements

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

- The annual financial statements of the College comply with the Accounts Direction issued by SFC and the Statement of Recommended Practice on Accounting for Further and Higher Education.

- A number of audit adjustments have been made to the unaudited financial statements. These have been agreed with the College's Finance Manager. A number of disclosure adjustments were also made to the financial statements to ensure compliance with the Accounts Direction and SORP.

- The College completed the construction of the Teaching Block, the Scottish National Equestrian Centre and the new farriery and engineering facility during the year. Total capital expenditure in the year amounted to £4.061 million.

- The College has exceeded its WSUMs target for 2006/07 by 669 WSUMs (4.9%); (2005/06: 736 WSUMs – 5.7%).

Introduction

2.1 Background

2.1.1 2006/07 was the first year of our five year appointment as external auditors of Oatridge College ('the College'). This report summarises our opinion and conclusions and highlights significant issues arising from our work.

2.1.2 The framework under which we operate under appointment by Audit Scotland is as outlined in our *Strategic Planning Memorandum and 2006/07 Annual Audit Plan* issued on 26 March 2007. The scope of the audit was to:

- provide an opinion on, to the extent required by the relevant authorities, the financial statements and the regularity of transactions in accordance with the standards and guidance issued by the Auditing Practices Board;
- review and report on the College's corporate governance arrangements in relation to systems of internal control, the prevention and detection of fraud and irregularity, standards of conduct, and prevention and detection of corruption; and the College's financial position; and
- review and report on the College's arrangements to manage its performance, as they relate to the economy, efficiency and effectiveness in the use of resources.

2.1.3 Our audit approach focused on the identification of the significant risks areas facing the College and the significant classes of transactions, estimates, other account balances and disclosures impacting upon the financial statements. These include;

- compliance with legislation and financial regulations;
- fixed assets transactions, including the completion of the Teaching Block, the Scottish National Equestrian Centre and the new farriery and engineering facility during the year, and compliance with relevant financial reporting standards;
- accounting for provisions;
- VAT treatment in regard to the major capital expenditure;
- treatment of reserves following reinvestment of proceeds from previous asset disposals;
- recognition of funding provided for specific purposes and the regularity of corresponding expenditure.

2.2 Basis of Information

2.2.1 External auditors do not act as a substitute for the College's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

2.2.2 To a certain extent the content of this report comprises general information that has been provided by, or is based on discussions with, management and staff of the College. Except to the extent necessary for the purposes of the audit, this information has not been independently verified. The contents of this report should not be taken as reflecting the views of Henderson Loggie CA except where explicitly stated as being so.

2.3 Acknowledgement

2.3.1 Our audit has brought us in 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 in the discharge of our responsibilities.

3.1 Financial Position

3.1.1 Funding Council circular FE/54/02, issued on 20 December 2002 defines a college that is financially secure as one that '*on a continuing basis, is able to generate operating surpluses reliably and as planned, and through that accumulate a reasonable level of financial reserve. The college must also generate sufficient cash to finance its operations and meets its liabilities; regular operating surpluses would ensure this.*'

3.1.2 Table 1 provides a summary of the College's planned and actual financial results, based on the formal returns submitted, by the College, to the Funding Council.

Table 1: Comparison of planned and actual financial results

	2005/06 Actual £000	2006/07 Planned £000	2006/07 Actual £000	2007/08 Planned £000
Financial outturn Surplus/(Deficit)	67	(52)	145	(87)
Income and expenditure reserves (excluding pension liability)	2,064	2,511	2,656	2,559
Cash balances	1,938	575	593	949

Source: Audited accounts and 2007 FFR

3.1.3 Based on the results for the year to 31 July 2007 the College meets the requirements of the Funding Council to be classed as financially secure however the FFR is forecasting deficits for the financial years 2007/08 to 2009/10. The main reasons for this are an estimated 45% reduction in European income going forward and uncertainty over training contract income. The College is currently through to the second stage with three bids for ESF funding and this position should continue to be monitored by the Board of Management. In addition, the College is forecasting an annual contribution of £0.050 million from Equestrian Facilities Scotland Ltd for 2007/08 to 2009/10. The company has been operational since February 2007 and the financial statements show a deficit of £0.049 million for 2006/07. Again, the Board of Management should continue to monitor the position and ensure that appropriate action is taken if it is likely that the forecast contribution will not be achieved. It is also recognised that there is an ongoing dialogue with SFC in relation to a review of the funding methodology for rural colleges.

3.1.4 Overall, the College income in 2006/07 has increased by £0.154 million (2.7%) over 2005/06. The main reason for this increase is an increase of £0.193 million (13.7%) in 'other' income largely made up of an increase in residences and catering income and income generated from the operation of the Scottish National Equestrian Centre. Other significant movements in income relate to an increase of £0.211 million (8.7%) in SFC recurrent grant (largely off-set by a reduction in other SFC grants treated as revenue) and a reduction of £0.089 million (17.4%) in management income for LEC programmes.

3.1 Financial Position (Cont'd)

3.1.5 Expenditure in 2006/07 rose by only £0.088 million (1.6%) over 2005/06. Increases in other operating expenses (£0.237 million – 12.1%) and depreciation (£0.101 million – 33.2%) have been off-set by a decrease of £0.274 million (8.4%) in staff costs.

3.1.6 Although there was a 3% salary increase from August 2006, the decrease in staff costs can be partly explained by the fact that redundancy costs of £0.120 million were included in the figures for 2005/06 and an audit adjustment to the redundancy provision at 31 July 2007 has resulted in an overall credit of £0.041 million to the Income and Expenditure Account for redundancy in 2006/07. There has also been a reduction of £0.156 million from 2005/06 in Skillseekers salary, travel and subsistence payments due to new payment arrangements.

3.1.7 The main component of the increase in other operating costs was a £0.264 million (40.8%) increase in other income generating expenses largely relating to the operation of the Scottish National Equestrian Centre.

3.1.8 The College's cash balance at 31 July 2007 was £0.593 million, a decrease of £1.345 million (69.4%) on the previous year. The main reason is the level of capital expenditure and financial investment net of deferred capital grants in the year, up from £0.605 million to £1.802 million. A new bank loan of £0.600 million was drawn during the year.

2006/07 SUMS outturn

3.1.9 The College's outturn against its 2006/07 WSUMS target is shown in table 2.

Table 2: 2006/07 WSUMS outturn

	2005/06	2006/07
WSUMs target	12,968	13,577
WSUMs actual	13,704	14,246
Excess	736	669

Source: Audited SUMs returns.

3.1.10 The College's Internal Auditor carried out the audit of the SUMs return for 2006/07. They concluded that the student data returns have been compiled in accordance with all relevant guidance, that adequate procedures are in place to ensure the accurate collection and recording of data; and, on the basis of testing, reasonable assurance can be taken that the FES return contained no material mis-statement.

FRS 17

3.1.11 The College accounted for its participation in the local government pension scheme as a defined benefit scheme and accordingly this has resulted in the College's share of the net pension liabilities within the Lothian Pension Fund (LPF) being shown on the balance sheet. This is consistent with the accounting treatment adopted in 2005/06.

3.1.12 Note 23 to the financial statements highlights the College's net pension liability position of £0.075 million within the LPF. This has moved significantly in the year from a net pension liability of £0.663 million at 31 July 2006. The main reason for the improved financial position is due to a sustained growth in equity markets across the world together with a revision in the underlying assumptions used by the actuaries.

3.1 Financial Position (Cont'd)

FRS 17 (Cont'd)

3.1.13 With the exception of liabilities arising from early retirals, the College is unable to separately identify its share of assets and liabilities in the Scottish Teachers' Superannuation Scheme as the scheme is notionally funded. The College has applied the concession allowed by FRS 17 and has accounted for the scheme as a defined contribution scheme.

Capital Income and Expenditure

3.1.14 The implementation of the College's estate strategy has progressed further in 2006/07 with the completion of a new teaching block, the Scottish National Equestrian Centre and the farriery and engineering block. Total capital expenditure in the year amounted to £4.061 million. Over the past two years the capital expenditure on these projects has amounted to £7.1 million, funded through capital grants of £3.5 million from SFC with the balance from grants received from Scottish Enterprise and Sport Scotland, proceeds from the sale of assets, own funds and borrowings.

3.1.15 *Estate strategy guidance* issued by SFC in July 2007 requests all colleges and universities to provide an up-to-date estates strategy by the end of 2007 and this is currently being progressed.

3.1.16 Although not stated in the College's accounting policies note, previous practice has been to depreciate fixed assets additions from the year following the year in which they were brought into use. This is not in line with normal accounting practice. An adjustment was made to depreciate capital expenditure on the equine, farriery and classroom developments from the date the assets were brought into use. This led to an additional depreciation charge for the year of £0.089 million, partly offset by the release of related deferred capital grant of £0.053 million.

3.1.17 There were no fixed asset disposals in the year although the financial statements show a gain on sale of £0.012 million in relation to plant traded-in during the year that was not recorded on the fixed asset register. The current fixed asset registers are updated annually on spreadsheet and are very basic. The maintenance of a more detailed fixed asset register should be considered.

Provisions

3.1.18 The College has a provision in its balance sheet for £0.101 million relating to pension costs from early retirements awarded to former employees. A prior year adjustment was made to reflect a change in accounting treatment for early retiral pension liabilities. This resulted in a transfer of the liability to Provisions from Creditors. The provision has not been updated at 31 July 2007 on the basis of either an actuarial valuation or the actuarial tables provided by SFC. This has been left as an uncorrected misstatement to the financial statements but should be addressed for the 2007/08 financial statements.

3.1.19 A redundancy provision of £0.140 million was included in accruals at 31 July 2007 (£0.090 million at 31 July 2006). FRS 12 states that a provision should only be recognised when an entity has a present obligation as a result of a past event, it is probable that a transfer of economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. These conditions were only met for redundancy payments totalling £0.020 million and the remaining balance of £0.120 million was reversed. On a similar basis, a £0.120 million VAT provision included in accruals at 31 July 2007 was reduced by £0.060 million.

3.2 Corporate Governance Arrangements

3.2.1 The College has developed its corporate governance arrangements over recent years. The arrangements were reviewed by the College's Internal Auditors in 2005/06 who concluded that *'in general the corporate governance arrangements in place in relation to the Board and committees structure, meetings and planning process are appropriate and in accordance with best practice.'* A number of recommendations were noted to strengthen the arrangements.

3.2.2 The Board of Management carried out a self-evaluation of corporate governance arrangements in June 2006 using good practice guidance published by the Association of Scotland's Colleges. A number of SMART actions were identified to address areas of weakness. Responsibility for implementation has been allocated and target completion dates set, against which progress has been made.

3.3 Systems of Internal Control

Control environment

3.3.1 Our work undertaken in relation to the 2006/07 financial statements audit identified some control weaknesses in the operation of financial controls and procedures. These related to segregation of duties and the separate accounting for transactions relating to the College and its trading subsidiary.

3.3.2 The College operates with a small finance team with limited resources resulting in a lack of segregation of duties for some members of staff. This reduces the overall effectiveness of the College's internal control environment.

3.3.3 The accounting system for the subsidiary was not fully segregated from the College's accounting systems leading to difficulties in financial reporting. In particular there was a lack of clarity in the accounts working papers for the College and the subsidiary leading to non-compliant financial statements for both the College and the subsidiary. Additional accounting and audit work was necessary to address this issue and ensure the delivery of financial statements for the College and the subsidiary that met respective reporting requirements.

Internal Audit

3.3.4 Chiene & Tait provided internal audit services to the College in 2006/07. We have reviewed the scope and extent of work performed by internal audit during the year and considered the impact of their findings and conclusions on our work, where appropriate.

3.3.5 The College's internal auditors have concluded that "*Substantial Assurance*" can be taken and *"...that the internal controls and governance frameworks which it operates are sufficient to ensure the efficient and effective operation of the organisation and that the strategic and operational risks to which the organisation is exposed are being managed."*

3.4 Corporate Governance Statement

3.4.1 Colleges are required to include a statement on their corporate governance arrangements within their annual financial statements. The statement describes the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management. The College applied the revised Combined Code on Corporate Governance issued in 2003 for the 2006/07 financial statements.

3.4.2 We are required to review the statement to assess whether the description of the process adopted in reviewing the effectiveness of the system of internal control appropriately reflects the process. We are not required to provide an opinion on the College's systems of internal controls.

3.4.3 The College's Corporate Governance Statement confirms that the College has complied with the requirements of the 2003 Combined Code on Corporate Governance, in so far as they apply to the further education sector, for the year to 31 July 2007.

3.4.4 Our audit opinion on the statement is covered by our auditors' report and is unqualified in this respect.

3.5 Fraud and irregularity, standards and conduct, and prevention and detection of corruption

3.5.1 During 2006/07 we had regard to Statement of Auditing Standards 110: *Fraud and Error* and International Standards on Auditing 240: *The Auditor's Responsibility to Consider Fraud in the Audit of Financial Statements*.

3.5.2 The College has appropriate arrangements in place, including current versions off its Financial Regulations, Whistleblowing Policy and Procedure, Fraud Policy and Treasury Management Policy. These documents are reviewed and updated periodically.

3.5.3 There are no outstanding recommendations from previous reports in relation to prevention and detection of fraud and irregularity, standards of conduct and prevention and detection of corruption.

4.1 Performance

Introduction

4.1.1 The terms of appointment from Audit Scotland include a requirement for a proportion of our audit time to be spent on performance audit work. Performance audit work covers a variety of areas, both financial and non-financial, including both Audit Scotland centrally directed studies and locally determined studies based on agreement between each organisation and their auditors.

4.1.2 No performance audit studies were identified by Audit Scotland for the College during 2006/07.

Strategic Plan

4.1.3 The College has a three year Strategic Development Plan covering the period from 2007/08 to 2009/10. The Plan sets out six key aims together with a number of objectives to be pursued to enable each of the aims to be realised. The Strategic Development Plan is supported by the following College strategies: Estate; Human Resources; ICT; International; Knowledge Transfer and Employer Engagement; Learning and Teaching; Marketing; and Quality Enhancement.

Operational Plans

4.1.4 Detailed Operational Plans for 2007/08 have been drawn up for each Academic Department and Support Service within the context of the Strategic Development Plan. These list specific actions to be undertaken together with target dates, persons responsible and performance measures.

Risk Management

4.1.5 The College's Internal Auditor reported in 2005/06 that risk management was not fully embedded within the College. Risk workshops were held in 2006/07 involving members of the College Board of Management and senior management, with assistance from the Internal Auditors, and a new Risk Register drawn up linked to the strategic objectives. The Audit Committee examines the key risks on a rotational basis to identify any changes to the raw risk score or present risk rating and also identify any further action that should be taken. The 'action owner' is noted on the Risk Register. The College does not have a formal approved Risk Management Policy document and this should be drawn up to provide further assurance that the risk management framework is fully embedded.

4.1.6 The College's Internal Auditor also highlighted in 2005/06 that the absence of a formal Business Continuity Plan (BCP) represented a material risk. Following further consideration of this issue by the Board of Management at its meeting on 11 November 2006 the College concluded that a formal BCP was not appropriate at this time. This position should be kept under review particularly now that significant estate development work has been completed.

4.1 Performance (Cont'd)

Performance Management

4.1.7 The Board of Management and its committees consider the College's performance in implementing its strategic objectives. A presentation is given by the Principal at the Board of Management Planning Day on progress against targets. A formal review of progress against the Strategic Development Plan 2006/07 – 2008/09 objectives has been carried out when developing the Strategic Development Plan 2007/08 – 2009/10. This review highlighted specific achievements made during the planning period. On-going priorities were also noted and taken forward into the updated Plan.

4.1.8 Achievement against the detailed Operational Plans is monitored at the end of each block. Teams are required to provide senior management with a written update on achievement against each of the targets set.

4.1.9 In 2003 the SFC established a benchmarking approach founded upon an analysis of colleges' audited financial statements. The data produced provides benchmarking information on college performance which colleges can use. In addition, Oatridge College is an active member of the Rural Colleges and Scotland's Countryside Colleges groups providing more specific benchmarking information for performance management purposes.

Financial Management

4.1.10 Monthly management accounts are prepared and reviewed by the finance team and senior management. Financial monitoring reports are also presented to the College's Finance and Resources Committee for consideration. Our review confirms that timely financial reporting is made at operational and strategic levels.

Value for Money

4.1.11 The College has a Value for Money Policy which sets out objectives, and responsibilities in relation to the achievement of VFM. The Policy is dated December 2004 and is due for review at December 2007.

4.1.12 The College's benchmarking activities help identify possible areas for improvement action. Benchmarking of costs carried out has included salaries and utilities. The College also makes use of available purchasing consortium arrangements.

Financial Statements

5.1 Audit Opinion

5.1.1 On 17 December 2007 we plan to issue 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 the financial transactions reflected in those financial statements.

5.2 Audit Completion

5.2.1 An important measure of proper financial control and accountability is the timely closure and publication of audited financial statements. We have summarised in table 3 the three key elements of the audit process that we require the College to engage with.

Table 3: Key elements of the audit process

Completeness of draft financial statements
A set of draft financial statements was not received at the start of the final audit visit and a significant number of adjustments were made during the audit process.

Quality of supporting working papers
In accordance with our normal practice, we issued a *'prepared by client'* request that set out a number of documents required for our audit of the financial statements. Although year-end working papers were received in electronic format a full set of supporting working papers was not provided in line with this list from the outset of the audit. This would help improve the efficiency of the audit process going forward.

Response to audit queries
We are pleased to note that all audit queries were dealt with in a timely manner.

5.3 Audit Adjustments and Confirmation

5.3.1 In table 4 we draw attention to the agreed audit adjustments to the financial statements made by management following the audit process, followed by confirmation of our independence.

5.3 Audit Adjustments and Confirmation (Cont'd)

Table 4: Audit adjustments

	I & E Account £	Balance Sheet £
Depreciation on fixed asset additions	-89,324	-89,324
Release of deferred capital grant against the above	+52,577	+52,577
Correction re over-depreciation of plant and equipment	+1,167	+1,167
Reclassification of plant and equipment additions included in land and buildings	NIL	NIL
Correction of error on stock sheets	+1,650	+1,650
Increase in bad debt provision	-25,000	-25,000
Reclassification of credit balances on debtors ledger and debit balance on creditors ledger	NIL	NIL
Adjustment identified from supplier statement reconciliation	+2,063	+2,063
Reallocation of Equestrian Facilities Scotland Ltd irrecoverable VAT account to balance sheet	+17,193	+17,193
Reduction in redundancy provision	+120,000	+120,000
Reduction in VAT provision	+60,000	+60,000
Reallocation of SFC additional one-off grant to deferred income and deferred capital grants	-53,703	-53,703
Late invoice accruals	-9,782	-9,782
Reclassify early retirement pension provision.	NIL	NIL
FRS 17 pension adjustments	+45,000	NIL
Corrections to hardship and bursary disclosure note	NIL	NIL
Correction to education contracts and tuition fee disclosure note	NIL	NIL
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Total	+121,841	+76,841
	======	======

5.3.2 In addition, a number of disclosure and clarification adjustments were made to the financial statements to ensure SORP and Accounts Direction compliance and improve the overall presentation.

Confirmations and Representations

5.3.3 We confirm that as at 17 December 2007, in our professional judgement, Henderson Loggie CA was independent within the meaning of regulatory and professional requirements and the objectivity of audit staff was not impaired. Appendix I provides a copy of the letter issued to the Audit Committee.

5.3.4 In accordance with auditing standards, we obtained representations from the College on material issues.

Appendix I - Confirmation of Independence

To: Oatridge College and the Auditor General for Scotland

Professional ethical standards require us to communicate to you in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on Henderson Loggie's independence and the objectivity of the audit team. This statement is intended to comply with this obligation.

We have considered the fees paid to us by Audit Scotland and the College for professional services provided by us during the reporting period.

We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

Henderson Loggie is committed to being and being seen to be independent. As part of our ethics and independence policies, all Henderson Loggie staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings or interests. Our Ethics and independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through:

- instilling professional values;
- communications;
- internal accountability;
- risk management; and
- independent reviews.

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the College / Audit Committee.

Confirmation of Audit Independence

We confirm that as at 17 December 2007, in our professional judgement, Henderson Loggie is independent within the meaning of regulatory and professional requirements and the objectivity of the audit partner and audit staff is not impaired.

This report is intended solely for the information of the College and Audit Committee of Oatridge College and should not be used for any other purposes.

Yours faithfully

Henderson Loggie