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INFRASTRUCTURE, GOVERNMENT & HEALTHCARE

Cardonald College

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

Audit: Year ended 31 July 2007
20 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 20 December 2007 we issued an audit report giving our unqualified opinions on the financial statements of the College for the year ended 31 July 2007.

In 2005-06, the College accounted for its participation in the Strathclyde Pension Fund under FRS 17 on a defined contribution basis. The Board of Management has reviewed this accounting policy during the course of the year end audit process. As a result, it decided to change its accounting policy to adopt defined benefit accounting for the Fund. The College has processed a prior year adjustment to its financial statements in order to restate the comparative figures.

The College's share of assets and liabilities in the Strathclyde Pension Fund has resulted in a net asset as at 31 July 2007 of £533,000 (31 July 2006: net liability of £969,000). The College has confirmed with the actuaries of the Fund that under the requirements of FRS 17, it is entitled to recognise this net asset in full on the balance sheet.

The College continued work on the transformation of its estate through the main campus redevelopment project which is expected to complete in 2007-08. During 2006-07, the phase one new build element was completed and this is reflected in the financial statements as a transfer from assets under construction of £10,196,000. The phase two tower block element will complete during 2007-08.

Financial position

The College made a surplus on continuing operations after depreciation of assets at valuation and disposal of assets of £939,000. The College had forecast a year end surplus of £173,000 in its financial forecast return to the Scottish Funding Council at the beginning of the year, although this was subsequently revised to a surplus of £403,000 as a result of an underspend in staff costs and additional funding received. The variance against the revised forecast was principally due to an underspend in teaching staff costs of £147,000, due to cautious forecasting which will be reviewed as far as suitable, plus a favourable position on commercial activity of around £220,000 due to increased activity combined with the costing methodology which used full costing methods. The College has forecast a surplus in 2007-08 of £124,000.

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. Based on our work, we have made a number of recommendations to improve the overall control environment.

The approved internal audit programme for 2006-07 has been completed and the internal auditors have concluded that the College "has a sound framework of control which provides assurance regarding the effective and efficient achievement of the College's objectives."

Introduction

Audit framework

2006-07 was the first year of our five-year appointment as external auditors of Cardonald 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.

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 £939,000 is 4.7% of total income (2005-06: £(565,000) and (3.1%)). Based on 2005-06 financial statements, the sector average was around 2%. The 2005-06 result was a consequence of accelerated depreciation of £754,000 arising from the campus redevelopment project. The College is classed as financially secure.

Total income increased by £1,691,000 (9.3%). The increase is due to an increase of £1,174,000 in funding from the Scottish Funding Council in 2006-07 and an increase in other operating income of £174,000. In addition, total investment income has increased by £192,000 due to significant levels of interest receivable in the year as a result of a positive cashflow position on the campus redevelopment project and FRS 17 adjustments. The following table identifies the sources of income in 2005-06 and 2006-07.

	2006-07 £'000	***2005-06 £'000***	**2006-07 %**	***2005-06 %***
Scottish Funding Council grants	14,667	*13,493*	74%	*74%*
Tuition fees and education contracts	1,738	*1,695*	9%	*9%*
Other grant income	616	*508*	3%	*3%*
Other operating income	2,494	*2,320*	12%	*13%*
Investment income	404	*212*	2%	*1%*
Total income	**19,919**	***18,228***	**100%**	***100%***

The majority of income is received from the Scottish Funding Council, with the proportion of income received from the various sources consistent year on year. At 74%, the proportion of income received from the Scottish Funding Council is slightly higher than other comparable colleges according to the Scottish Funding Council's performance indicators for 2005-06.

Overall, total expenditure has increased by £187,000 (1%), which is less than the equivalent movement in income. The increase is primarily due to an increase in staff costs with the most significant movements being:

- an increase of £335,000 in staff costs, relating to general pay increases;
- an increase of £357,000 in depreciation charges due to the transfer of £10,196,000 of assets under construction to land and buildings on completion of phase one of the campus development project, offset by a decrease of £674,000 in the accelerated depreciation charge necessary to impair fixed asset disposals during 2005-06; and
- an increase of £168,000 in other operating expenses.

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 £'000	*2005-06 £'000*	2006-07 %	*2005-06 %*
Staff costs	12,988	*12,653*	69%	*67%*
Other operating expenditure	4,689	*4,521*	25%	*24%*
Depreciation	1,201	*844*	6%	*5%*
Accelerated depreciation	80	*754*	0%	*4%*
Interest payable	22	*21*	0%	*0%*
Total expenditure	**18,980**	***18,793***	**100%**	***100%***

The proportion of expenditure on the various elements has remained consistent year on year with the exception of the accelerated depreciation charge.

Balance sheet

The College has reported an increase in net assets of £10,501,000 during the year. The balance sheets at 31 July 2006 and 2007 are summarised as follows:

	2006-07 £'000	*2005-06 £'000*
Fixed assets		
Tangible assets	31,436	*22,035*
Current assets		
Stock	14	*20*
Debtors	881	*2,087*
Cash at bank and in hand	3,855	*4,521*
Creditors due within one year	(4,531)	*(5,972)*
Net current assets	**219**	***656***
Creditors > 1 year: Bank loan	(275)	*(325)*
Provisions for liabilities and charges	(822)	*(807)*
Pension asset / (liability)	533	*(969)*
Net assets including pension asset / (liability)	**31,091**	***20,590***
Deferred capital grants	24,269	*16,110*
Income and expenditure account, including the pension reserve	3,213	*704*
Revaluation reserve	3,609	*3,776*
Total	**31,091**	***20,590***

Significant movements during the year include:

- an increase in the fixed asset base of £9,401,000, due to fixed asset additions of £10,682,000 offset by the depreciation charges for the year of £1,281,000;
- the increase in fixed assets matched by an increase in deferred capital grants of £8,159,000; and
- a decrease in working capital balances of £437,000, due primarily to movements related to the campus development project.

Financial forecasting

The original 2006-07 financial plan forecast a surplus of £173,000 as at 31 July 2007, reported to the Scottish Funding Council in June 2006. The forecast was revised in June 2007 to a surplus of £403,000 as a result of underspends in relation to staff costs and additional funding received from the Scottish Funding Council. The actual outturn as at 31 July 2007 was a surplus of £939,000. The following table summarises the significant movements during the year.

	£'000
2006-07 forecast outturn per the financial forecast return	**403**
Reduction in staff costs due to cautious forecasting	147
Increased commercial income due to increased activity	100
Reduced commercial costs due to costing on full cost basis	120
FRS 17 adjustments	99
Other movements	70
2006-07 actual outturn at 31 July 2007	**939**

Source: Cardonald College (October 2007)

The following table summaries the forecast income, expenditure and cash balances for the College for 2007-08.

	£'000
Income	19,495
Expenditure	19,371
Forecast surplus for the year ending 31 July 2008	**124**
Cash balance at 31 July 2007	3,855
Forecast cash balance at 31 July 2008	2,584
Forecast movement in cash during 2007-08	**(1,271)**

Source: Cardonald College (June 2007)

Taking into account the lower forecast surplus for 2007-08, and the cash outflow which will be expected with the completion of the campus redevelopment, it will be important for the College to monitor costs closely during 2007-08, consider whether savings and efficiency savings targets are attainable and revise the forecasts for 2007-08 as appropriate.

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 its principal, the Board of Management of the College 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.

Governance arrangements

The Board of Management has 16 full members and meets seven times a year to oversee the College's strategic plans. It is supported in this role by the strategic management group. The College operates a comparatively thin committee structure with four standing committees of the Board, covering finance, audit, salaries and conditions of service and the search and nomination committee, which meets as and when required. This governance structure, which includes non-executive, student and academic representation, follows best practice and meets the minimum requirements of the Scottish Funding Council. The committee structure provides the Board of Management with the framework to ensure appropriate oversight and monitoring of financial and academic activities.

The College has identified four strategic aims within its 2006-09 strategic development plan covering the following themes:

- provision of a range of learning opportunities that reflects current and future needs, while demonstrating a commitment to social and economic inclusion;
- provision of the widest possible access to, and progression through, learning, responding positively and flexibly to the diversity of clients and communities;
- promotion of achievement and the realisation of potential, by providing the highest possible standards of quality in learning and teaching, support services and College environment; and
- further development of the College's capacity as an effective, responsible and sustainable organisation.

Risk management

A formal risk management policy is in place, approved by the Board of Management. A risk log has been established and each identified risk has a member of the strategic management group identified as the risk owner. The risk management policy requires review of risks by the strategic management group during the year, which presents to the audit committee and Board of Management annually.

Risks are identified and prioritised; there is a process to manage and mitigate risks. Risks are assessed according to impact, probability and proximity and where there is no existing mitigating control in place an action plan is created to address the risk.

Systems of internal control

Corporate governance statement

Internal audit monitor the systems of internal control, risk management controls and governance processes in accordance with an agreed plan of input, and report their findings to management and the audit committee. Management is responsible for the implementation of agreed audit recommendations and internal audit undertake periodic follow up reviews to ensure that such recommendations have been implemented. The audit committee considers detailed reports together with recommendations for the improvement of the College's systems of internal control and management's responses and implementation plans.

Management has established an internal controls assessment framework, complementing the risk management and internal audit arrangements. The assessment of internal control is informed by the strategic management group who have responsibility for the development and maintenance of the internal control framework, the work of internal audit, and comments made in reports by external audit. The audit committee is also responsible for providing assurance to the Board of Management relating to corporate governance.

The corporate governance statement for 2006-07 provides details of the internal control environment and risk and control framework. The Board of Management highlights its commitment to exhibiting best practice in all aspects of corporate governance.

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 process 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 concluded that the College "has a sound framework of control which provides assurance regarding the effective and efficient achievement of the College's objectives." They have also reported that the College has "in their opinion, based on the areas examined in 2006-07 proper arrangements to promote and secure value for money."

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 identified a number of areas for enhancement, including implementation of a formal process in respect of the notification of leavers to the IT department and introduction of more robust controls over journal entries. Recommendations are included in the action plan in appendix one and have been accepted by management.

Testing of the design and operation of controls over significant risk points in terms of major financial systems confirms that, subject to the minor 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 2005 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. John Wheatley College was identified as one of the two organisations that do not meet the requirements. The report concluded that "*John Wheatley College has exclusively charitable purposes and provides public benefit. However, the Charity Test was not met as its constitution expressly permits Scottish Ministers or a Minister of the Crown to direct or otherwise control its activities.*" 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 should consider this risk appropriately within its risk management arrangements and keep itself informed of further developments.

Prevention and detection of fraud and irregularity

The College has a fraud response plan in place to encourage staff to bring suspected frauds to notice and to ensure that prompt and effective action is taken. Where management is made aware of a suspected fraud, the internal fraud project group is convened to co-ordinate an investigation. Significant frauds would be reported to the audit committee.

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 setting out the required minimal ethical and behavioural expectations. There are comprehensive human resources policies and procedures providing additional guidance to staff which are readily accessible to staff on the intranet. There is also a formal register of interests for recording members of the Board of Management and senior managers' interests. This is regarded as best practice and assists in demonstrating consideration of independence in decision-making and the awarding of contracts.

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.

Financial statements audit

Audit opinion

On 20 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.

Accounting for pensions

In 2005-06, the College accounted for its participation in the Strathclyde Pension Fund under FRS 17 on a defined contribution basis. The Board of Management has reviewed this accounting policy as part of the year end audit process. As a result, it has decided to change its accounting policy to adopt defined benefit accounting for the Fund. The College has processed a prior year adjustment to its financial statements in order to restate the comparative figures.

The College's share of assets and liabilities in the Strathclyde Pension Fund has resulted in a net asset as at 31 July 2007 of £533,000 (31 July 2006: net liability of £969,000). The College has confirmed with the actuaries of the Fund, that under the requirements of FRS 17, it is entitled to recognise this net asset in full on the balance sheet.

Regularity

There are no 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. There is also a formal procedure in place to record receipt and distribution of guidance and to provide evidence of action taken which is an example of good practice.

Management representations obtained from the principal included our standard representation that during 2006-07 the College had complied with all necessary laws and regulations.

Fixed assets

The College continued work on the transformation of its estate through the main campus redevelopment project which is expected to complete in 2007-08. During 2006-07, the phase one new build element was completed and this is reflected in the financial statements as a transfer from assets under construction of £10,196,000. A further £9,720,000 has been incurred on phase two of the development project, primarily in relation to the tower block element. This is now scheduled for completion during 2007-08.

Report to those charged with governance

At the audit committee meeting on 26 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 from the principal to us. We made one recommendation in regard to the efficiency of the year end financial statements production process within this report.

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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	Audit work performed over staff costs identified a number of control weaknesses:		
	• Payroll staff do not sign the new start form to provide evidence that payroll information has been input or checked.	A new line will be added to the new start form.	Personnel Officer
	• When holiday pay is due upon termination of employment this is calculated by payroll. However, there is no evidence that the calculation of holiday pay has been double checked.	Checking is done but not signed at the moment. Signing and dating will be completed in future.	Personnel Officer
	• Exception reports are run detailing variances between current and prior period's pay runs. These are not checked until after the pay run has been made. In several cases the exception report was not signed as reviewed by the senior personnel assistant.	The checking of these reports has to be done after the pay run, however the exception report will be signed in future in all cases.	Personnel Officer
	• In many cases the payroll checklist was not signed by the senior personnel assistant, personnel officer, personnel manager or the assistant principal as required by internal procedures.	Agreed that the payroll checklist should be signed off each time. This will be updated and kept up to date on an ongoing basis.	Personnel Manager
	Procedures should be implemented to ensure that all payroll information is subject to the required checks and that documents are signed by relevant personnel to ensure evidence of checks occurring.		All January 2008
	Grade 2		

2	Audit work performed identified some control weaknesses in respect of bank reconciliations: • bank reconciliations prepared by the assistant financial manager are not subject to independent review; and • bank reconciliations are not regularly signed as completed. There is a risk that incorrect or erroneous items may not be identified in a timely manner and that a clear audit trail is not maintained. Management should ensure that all bank reconciliations are subject to independent review and that reconciliations are signed as prepared and reviewed to provide evidence of sufficient segregation of duty. *Grade 2*	Bank reconciliations will be subject to independent review by the finance officer in future. Bank reconciliations will be signed as completed in future.	Finance Officer Assistant Finance Manager Both December 2007
3	Leavers are notified to the IT department by HR to allow their user account to be deleted from the IT systems. However, as this process is only undertaken on a monthly basis there is a risk that leavers may not be removed in a timely manner and that inappropriate personnel may have access to college systems and information It is recommended that all leavers are notified to IT immediately to allow them to be removed from the system. This is increasingly important as more use is made of remote access. *Grade 2*	Leavers will be notified to IT in future at point of termination or notice as well as in a monthly report from payroll.	Personnel Manager January 2008
4	The College has a disaster recovery plan in plan which includes an IT section. Although there is a plan in place the College does not have resources to conduct a dry run to confirm that all data could be restored in the event of a disaster. It was noted that the introduction of virtual servers would help to reduce this risk. As the College becomes increasingly dependant upon IT it is paramount that data could be restored should a disaster occur. *Grade 2*	The College is planning to introduce virtual servers from summer 2008 and perform dry run restoration during 2008-09.	Assistant Principal Information Systems October 08

5	Audit work performed over the financial statements found that there were a number of cut-off errors resulting in income and expenditure being posted to the incorrect period. Although these amounts were not significant to the year end results, management should ensure a more robust process is introduced regarding the posting of income and expenditure to the ledger around the year end. *Grade 2*	A review of the deadline for cut off will be undertaken and a manual review of at-risk supplier invoices will be carried out during year end.	Assistant Finance Manager August 2008
6	A number of control weaknesses were identified in respect of journals entries to the ledger: • Journal header sheets are not signed by the person who has input the journal. • Journal entries are not independently reviewed. • In many cases no back-up is attached to the journal header sheet to support the entry to the ledger. There is a risk that incorrect or erroneous entries are made to the ledger and that a clear audit trail is not maintained. Management should ensure that all journal entries are independently reviewed and that the journal header sheet is signed by the person who input the journal and the person who reviewed the entry to provide evidence of sufficient segregation of duty. Supporting documentation should be attached to all journal header sheets. *Grade 2*	Journals will be subjected to more rigorous review in future to ensure these checks/signoffs are in place in future for all journals.	Assistant Finance Manager / Finance Officer December 2007

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