Banff and Buchan College of Further Education

Annual Report for the Year Ended 31 July 2010
To the Board of Management and the Auditor General for Scotland

RSM Tenon

5 Kings Place
Perth
PH2 8AA

Issued: November 2010

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

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

1 EXECUTIVE SUMMARY

1.1 Financial Review

- The college showed a deficit of £4,235,000 (previous year surplus - £2,000), although this was significantly impacted by the depreciation of the building which was demolished in line with the College 2012 Project prior to the year-end. This resulted in an additional unbudgeted cost of £4,699,000 being included within the income and expenditure account and a transfer of £4,187,000 from the revaluation reserve to the income and expenditure reserve.

- The college continues to maintain a healthy balance sheet with net assets (before the deduction of Deferred Capital Grants) of £7,703,000 (previous year - £9,422,000).

- The budget for 2010 - 11 predicts a surplus of £46,840, prior to any allowance for a pay increase.

1.2 Financial statements

- We have issued an unqualified audit opinion on the accounts of Banff and Buchan College for the year ended 31 July 2010.

- There were no significant adjustments to the draft accounts arising from our audit.

- In line with prior years, the college are unable to obtain the information required to fully comply with the accounting and disclosure requirements of FRS17.

1.3 Corporate Governance

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

1.4 Action Plan

Our recommendations relate to achieving:

- Accrual of all bank interest receivable

2 INTRODUCTION

***This is the fourth year of our five-year audit appointment. The purpose of this report is to give a summary of our audit activity. It includes details of the more significant matters arising from the audit, sets out the respective responsibilities of management and external audit, and reports what action has been taken or is necessary by members or executive management*.**

2.1 ***Our audit of Banff and Buchan College for the year ended 31 July 2010 has been carried out in accordance with statutory requirements and follows the practices prescribed by the Code of Audit Practice and guidance issued by the Auditing Practices Board (APB). The Code of Audit Practice sets out fully the responsibilities of the College and its officers in relation to financial probity, control, preparation of accounts and the achievement of value for money in the provision of services. We are required under the Code to give an independent assessment of how the College has discharged its stewardship of public funds. A summary of our responsibilities is contained in Appendix 2.***

2.2 ***We have summarised the Key Issues arising from our audit in Section One. In providing the summary, it can be difficult to strike a balance between recognising good performance when achieved and highlighting scope for improvement. The items referred to represent Key Issues for management attention and should not be taken out of the context of the remainder of this report, or the detailed reports covering individual reviews.***

2.3 **We invite Banff and Buchan College to receive this report and consider the recommendations we have made.**

2.4 **We would be grateful to receive the College's response to the issues we have raised.**

3 FINANCIAL REVIEW

3.1 Introduction

The purpose of the financial review is to consider the general financial standing of Banff and Buchan College by looking back at financial performance in 2009/10 and to look ahead to the future financial position. Our review is aimed at helping College members understand the financial position of Banff and Buchan College at a particular point in time. It should not be regarded as definitive or comprehensive and the College should not seek to rely on this summary in isolation.

3.2 Financial Performance 2009-10

The financial statements reflect a deficit for the year of £4,235,000 (previous year surplus - £2,000). This is a significant deviation to the budget of £2,000 surplus. This mostly due to the College 2012 project which resulted in the demolished areas of the main campus being fully depreciated in the year, while the related deferred capital grants were released to income. The main movements are summarised below:

	Budget **£000**	**Actual** **£000**	**Variance** **£000**	
SFC Grants	9,724	10,081	357	This is mainly a result of the increase in formula funding of £330k.
Tuition fees and education contracts	1,972	1,815	(157)	
Other Income	281	380	99	
Staff costs	8,759	8,884	125	
Other operating expenses	3,157	2,469	(688)	Included within the budget were balances related to the upkeep of the main campus. After approval of redevelopment, this expenditure was found to be unnecessary.
Depreciation	611	5,265	4,654	This is a result of the demolition of the main campus building contributing £4,699k of costs.

The college continues to maintain a healthy balance sheet position, with net assets of £7,703,000 including cash of £5,631,000.

3.3 Reserves

The college has maintained its general reserves at £2,041,000 (previous year - £2,089,000), including designated reserves of £1,219,000 (previous year - £1,236,000). This is part of the longer term strategic plan, including the strategic maintenance and upgrade of the college estate.

3.4 Financial Plan 2010 - 11

The forecast for 2010/11 predicts a surplus of £46,840, prior to any allowance for a pay increase.

3.5 Capital expenditure plans

The College 2012 project is fully underway at the year end 31 July 2010. This is a £23,978,000 project to redevelop the main campus in Fraserburgh. At the y/e, £4,370,000 of costs had been incurred and therefore £19,608,000 of capital costs remain to be incurred in the years ended 31 July 2011 and 2012. This will be funded using £2,478,000 of the college funds, £16,630,000 of SFC funding and the remainder will be funded by other grants and the sale of the portacabins.

3.6 Accounting for existing College buildings

As part of the College 2012 project, much of the existing College building at Fraserburgh has been demolished. As the accounting for this component of the project has had a significant effect on the year ended 31 July 2010 financial statements, we have taken the opportunity to summarise the entries made and provide our assessment of these.

The College fixed asset register for freehold property started in 1995 after the colleges became independent in 1993. The Colleges were instructed to commission a valuation of their estate and reflect the valuation within the accounts on the basis of recognising an asset for freehold property whilst making an equal and opposite credit to revaluation reserve. Over the years, depreciation of these 'valued' assets has been matched by a release from the revaluation reserve. Similarly, amounts which are removed from fixed assets are matched by a reduction in the revaluation reserve and do not affect the Income and Expenditure account balance within the College balance sheet.

The building which has been demolished and is being replaced is, broadly, the total of what existed at 1995. The main campus assets being retained are largely the valued land and subsequent additions to the core building which are separately identified on the fixed asset register as such. The only exception to this is the hair & beauty and restaurant facilities. However, whilst the structural integrity of these areas is being retained, it is understood that the interior (including plumbing and electrics) is being replaced, the outside walls are being re-clad and the insulation and windows are being improved.
On that basis, the accounts reflect a decision to write off the entire balance relating to the old College building on the basis that anything which is included within that balance and is being retained would be immaterial.

We concur with this view.

3.7 Recurrent grant allocation

The SFC has confirmed recurrent Grant income of £7,263,000 and Fee waiver initial grant of £1,027,000 for the year to 31 July 2011. This is comparable to the previously confirmed recurrent Grant income of £7.3m and Fee waiver initial grant of £1.0m for the year to 31 July 2010.

4 FINANCIAL STATEMENTS

4.1 The respective responsibilities of the College and RSM Tenon Audit are summarised in Appendix 2. The purpose of this section of our report is to highlight and explain our formal opinion on the financial statements, and to comment on the main issues arising from our audit of the financial statements.

4.2 Audit opinion

We have issued an unqualified audit opinion on the accounts of Banff and Buchan College for the year ended 31 July 2010. A copy of our audit opinion is attached to this report as Appendix 1.

4.3 Independence

In accordance with auditing standards, we can confirm that any relationships that may bear on the firm's independence and the objectivity of the audit engagement director and audit staff have been identified and assessed at the planning stage of our audit.

- No independence issues have been identified that Governors need to be aware of.

4.4 Timetable and procedures

The College is required to submit audited accounts to the Scottish Funding Council by (SFC) by 31 December following the year end.

In order to achieve this deadline the accounts preparation procedures require good planning, commitment, and resources.

We discussed plans for the preparation and audit of the accounts with the Finance Manager and the Audit Committee, commencing in May 2010.

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

4.5 Audit approach and materiality

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

In our planning, we have reviewed the work of the internal auditors. From our review, there were no areas on which the internal auditors focussed their attention which would allow us to take reliance on their work.

- The level of materiality for making adjustments to the financial statements, as set out in the detailed planning memorandum, was calculated based on total income and the value of general reserves, and was assessed at £111,000.

We are required to notify you of any potential adjustments identified during the course of our audit work unless they are clearly trifling.

- For the purposes of this report we have taken clearly trifling as being less than £2,000.

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

4.6 Accounting policies and practices

In preparing the financial statements of the College, Governors are required under FRS18 to review the College's accounting policies on an annual basis to ensure they remain appropriate to the College's circumstances and are being properly applied.

- We have reviewed the accounting policies and practices selected by the College and are satisfied that the College operates acceptable accounting policies and practices for the purpose of determining whether the financial statements show a true and fair view.

Section 2 of this report summarises the main accounting issues that we have discussed with management and records the adjustments that have been made to the draft accounts as a result of matters arising during the course of the audit. This section also summarises the errors identified during the course of the audit which remain unadjusted.

We draw the Members' attention to the following matters in particular:

- **Pensions**

Financial Reporting Standard 17 sets out requirements for accounting and disclosure in respect of pension schemes. Pensions schemes can generally be categorised into:-

- Defined contribution schemes – whereby the employer's obligation at any point in time is restricted to the amount of contributions payable.

- Defined benefit schemes – where the employee’s entitlement to a pension is dependent upon factors, such as final salary and length of service. The employer’s obligation is therefore dependent on these factors, which cannot be readily determined.

All colleges in Scotland are members of the Scottish Teachers Superannuation Scheme (STSS) and the Local Government Pension Scheme (LGPS), which are both multi-employer defined benefit schemes. However, FRS17 allows employers who are members of multi-employer schemes, to account for these as defined contribution schemes (with additional disclosures) if "the employer is unable to identify its share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis."

There is general agreement that the STSS cannot separately identify each employer member’s share of net assets and liabilities. With regard to the LGPS, Banff and Buchan College obtained an actuarial report in 2003 which did identify the college’s share of assets and liabilities. However, on further enquiry with Aberdeen City Council, who operates the scheme, it emerged that the share of the assets was calculated on a pro-rata basis to the liabilities. The college took the view, therefore, that this did not provide a “reasonable” basis and accounted for the scheme on a defined contribution basis. We have reviewed the evidence and, in the prior year, made further enquiries of Aberdeen City Council and the schemes actuaries and concluded that the adopted accounting treatment is appropriate.

We understand that discussions have taken place and the scheme is considering moving to individual contribution rates for each member employer within the scheme and this may result in a change of view expressed by the actuary. However, we accept that such a change would have implications for each contributing employer and that the Trustees, acting on behalf of all scheme members and employers would require to instruct the actuary accordingly.

The Board should be aware that even if a decision were to be made to amend the scheme such that the assets and liabilities of the scheme were tracked on an individual employer basis, our experience is that the costs of performing retrospective calculations significantly outweigh the benefits. It is likely, therefore, to be some years before a stage is reached where it could be argued that the scheme has obtained enough of a track record in order for the 'consistent and reasonable' test to be met.

The defined contribution basis is therefore likely to remain appropriate for the foreseeable future.

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

Conversely, the College will benefit from the change in the benefit structure of LGPS whereby future pension increases will be based on the Consumer Price Index rather than the Retail Price Index. Further details of this change are set out in Appendix 3.

- **Bad debt provision**

During our audit, it was identified that the recoverability of £29,340 of trade debts was not certain. A provision has been made by Jim Kirkwood in the financial statements to 31 July 2010.

- **Prepaid expenditure**

During our audit, we identified £10,770 of licenses which related to post year-end but had not been included in prepayments. Jim Kirkwood made an adjustment to the financial statements to include this.

- **Bank interest not accrued at the year end**

Bank interest of £13,917 to be received on the term accounts and relating to the year-end 31 July 2010 was not accrued within the accounts. As there was £7,918 of interest not accrued at the prior y/e, this has an overall effect on the income and expenditure account of a £5,999 overstatement of the deficit which is immaterial. It was agreed that this would remain as an unadjusted error.

- **International Financial Reporting Standards**

We would draw to your attention the information in Appendix 4 regarding potential conversion to the use of International Financial Reporting Standards. It is estimated that this will first impact the sector in the 2014/15 financial year.

Each of the following issues was identified as a risk in our original audit plan. This plan was revisited on receipt of the draft accounts, and one further significant risk was identified. The other risk areas identified in our plan were satisfactorily dealt with as follows:

Issue	Audit risks	Planned audit approach	Outcome
Recognition of Income			
The audit of 2009/10 student activity data by Henderson Loggie may result in adjustments to the SUMS which may take the College below 97% threshold and leave them subject to clawback of these funds.	Recurrent grant income may be overstated in the accounts.	Reconciliation to year end remittance advice from SFC and review the outcome of the student activity data audit.	Satisfactory
Estates strategy			
It is anticipated that the College will begin a major capital project in Spring 2010 to redevelop the Fraserburgh campus.	Incorrect capital treatment could lead to material under or overstatement of fixed assets.	We will conduct detailed reviews of fixed asset additions and disposals during the year.	Satisfactory
Going Concern			
With the current hot political topic being public spending cuts, there is an expectation that colleges might have to operate with a 15-20% cut in funding. This may have significant impact on going concern if the college does not react effectively	The college may have inadequate funding to meet its costs in the 12 months from balance sheet date.	Review of latest news in relation to public spending cuts, review budgets/forecasts, and discuss potential college reaction to the cuts.	Satisfactory

Issue	Audit risks	Planned audit approach	Outcome
FRS 17 Accounting for Pensions			

2009/10 is the fifth year in which FRS17 has applied for the pension assets and liabilities related to the defined benefit schemes.
In 2005/06 the College (in common with many other colleges) did not include a pension fund liability in its accounts as it was not at that time able to identify its own share of the assets and liabilities in the Local Government Superannuation Scheme. It therefore treated the scheme as being defined contribution scheme (in the same way as the Scottish Teachers' Superannuation Scheme).
This was also consistent with guidance issued by the SFC which suggested the treatment for the Aberdeen City local government pension fund scheme should be as a defined contribution scheme.
Audit Scotland's note for guidance issued on further education financial statements for 2005/06 provided guidance on auditors' responsibilities in these cases.
	Disclosures and the accounting for pension costs and liabilities may not comply with FRS17 and the SORP *Accounting in Further and Higher Education Institutions*.	• We will
		• discuss with the College any change in the ability of the local government pension fund to disaggregate its assets and liabilities together with any updates to existing guidance issued by the SFC and Audit Scotland; and
		• as appropriate
		  • *either,* review the College's grounds for concluding that the local government scheme continues to be a defined contribution scheme;
		  • *or,* review the disclosure and accounting for pensions liabilities as a defined benefit scheme.
			Satisfactory

ADJUSTED AND UNADJUSTED ERRORS

4.7 Actual Audit Adjustments

The following adjustments were processed during the course of our audit.

	£'000
Surplus / (Deficit) per accounts presented for audit	(4,217)
Adjustments:	
Recognition of license prepayment	11
Provision for potential bad debts	(29)
Surplus / (Deficit) per final accounts	(4,235)

4.8 Potential Audit Adjustments

There were the following potential adjustments noted during the course of our audit that have not been actioned:

Potential adjustments:	*£'000*
Interest not accrued – impact of difference between 2009 and 2010 non-accrual	6
Net impact of potential adjustments on surplus	6

All unadjusted errors below materiality are noted in this report unless they are clearly trifling. We have defined 'clearly trifling' as below £2,000.

4.9 Accounting and financial control systems

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

We found that all aspects of the College's financial systems that were reviewed to be well controlled, providing a good basis for the preparation of accounts.

- There were no matters of weakness identified during the audit that we wish to draw to your attention.

4.10 Regularity audit

- We have issued an unqualified regularity opinion and there are no significant issues that we wish to draw to the Board's attention.

5 CORPORATE GOVERNANCE

5.1 Corporate Governance is concerned with structures and processes for decision making, accountability, control and behaviour at the upper levels of the organisation. The respective responsibilities of Banff and Buchan College and |RSM Tenon Audit are summarised in Appendix 2. This section of our report comments on the main aspects of our work, and highlights particular issues which arose.

5.2 Statement on Corporate Governance

The College have included in their financial statements, a statement on Corporate Governance. The statement clearly sets out the College's arrangements under each aspect of the code, and is a valuable enhancement of public accountability.

Although we are not required to form an opinion on the adequacy and effectiveness of the College's Code of Corporate Governance, we are required to report where a statement does not comply with the requirements of SORP or other guidance, or if it is misleading or inconsistent with other information of which we are aware.

In our opinion the statement is not misleading or inconsistent with other information which we are aware of from our other audit work.

5.3 Risk Management

Although the term "Risk Management" has become relatively common recently, the underlying principles – of identifying and assessing risks and taking action to minimise their occurrence and impact, are well established. The College's Committee structure, Financial Regulations, and Internal Audit functions are all examples of policies and procedures which address potential risks. However, it is now generally recognised that this process needs to become explicitly established as part of a management culture, and requires the implementation of consistent best practice through formal policies and procedures. The College have in place a Risk Management policy, and maintain a risk Register.

5.4 Internal Audit

We adopt a managed approach in planning our audit work at your College. We do not however place any reliance on the work of your Internal Auditors.

Our relationship with Internal Audit is governed by the International Auditing Standard ISA610 "Considering the work of Internal Audit".

It is the responsibility of management to determine the extent of the internal control system required. Internal Audit is an important element of the internal control system. Henderson. Loggie C.A. provide the College's internal audit function.

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

5.5 Systems of Internal Control

The respective responsibilities of the College and ourselves as auditors are set out in Appendix 2.

Through the results of our own testing, we have concluded that the fundamental key financial systems of the College are operating satisfactorily.

5.6 Other Governance responsibilities

Prevention and Detection of Fraud and Irregularities

The respective responsibilities of the College and ourselves as auditors are set out in Appendix 2. During the year, we have reviewed the overall arrangements through our review of systems.

The College also has in place a Fraud Irregularity Policy and Procedure, and a complaints procedure.

In overall terms, we are satisfied that these arrangements are adequate.

Legality/Propriety

Again, the respective responsibilities of the College and ourselves as auditors are set out in the Appendix.

Our review of the College's transactions and arrangements has revealed no areas of concern.

Standards of Conduct, Integrity and Openness

We have reviewed the College's arrangements which include:-

- A Register of Members' Interests
- Information regarding their appointment to outside bodies and organisations is disclosed in the financial statements.
- Code of conduct (Included in the Governance Manual)
- Freedom of Information Publication scheme

6 ACTION PLAN

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

	Subject	Grade
1	We recommend that the term deposit accounts are considered at the year end to ensure that all interest for the year is included within the financial statements.	**3**

We have used the following grading system to indicate the significance of the matters we have raised and the priority that we believe should be given to our recommendations:

Grade 1: We believe these observations are particularly significant and that management should take prompt action.

Grade 2: These observations are significant but of a less urgent nature than Grade 1 observations. We believe that action needs to be taken within the agreed timescale.

Grade 3: Observations that merit attention but are less significant than Grade 1 and 2 observations.

Issues noted

1	*Bank interest not accrued*		**Grade 3**
Issue Not all bank interest for the year was recognised within the accounts.			
Recommendation Where term deposit account interest is not received until post year-end but relates to pre year-end, this should be accrued at the financial year-end.		*Management response* The College is of the opinion that we should apply accruals on a consistent basis, thus having 12 months of costs/income in each year. As is detailed in 4.6 the College did not accrue for investment income in either 2008/9 or 2009/10 thus ensuring 12 months figures in each year. Any net change would be immaterial, so the College will continue with its current practise of not accruing for investment income.	*Action by whom* *N/A* *Deadline* N/A

Banff and Buchan College of Further Education

Annual Report for the Year Ended 31 July 2010

Appendices for Management Information

RSM Tenon

APPENDIX 1

Independent auditor's report to the members of the Board of Management of Banff and Buchan College of Further Education, the Auditor General for Scotland and the Scottish Parliament

We have audited the financial statements of Banff and Buchan College for the year ended 31 July 2010 under the Further and Higher Education (Scotland) Act 1992. These comprise the Income and Expenditure Account, the Balance Sheet, the Cash Flow Statement and Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out within them.

This report is made solely to Banff & Buchan College and to the Auditor General for Scotland in accordance with sections 21 and 22 of the Public Finance and Accountability (Scotland) Act 2000. Our work has been undertaken so that we might state to those two parties those matters we are required to state to them in and auditor's report and for no other purpose. In accordance with the Code of Audit Practice approved by the Auditor General for Scotland, this report is also made available to the Scottish Parliament, as a body. To the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than Banff & Buchan College.

Respective responsibilities of the Board of Management, Chief Executive and auditor

The Board of Management and Chief Executive are responsible for preparing the Annual Report and the financial statements in accordance with the Further and Higher Education (Scotland) Act 1992 and the Accounts Direction issued thereunder by the Scottish Funding Council which requires compliance with the Statement of Recommended Practice: Accounting for Further and Higher Education (2007). They are also responsible for ensuring the regularity of expenditure and income. These responsibilities are set out in the Statement of the Board of Management's Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and with International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Auditor General for Scotland.

We report our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and the Accounts Direction. We also report if, in our opinion, the Report of the Board of Management is not consistent with the financial statements, if the body has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit. We also report whether in all material respects:

- the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers;
- funds provided by the Scottish Funding Council have been applied in accordance with the Financial Memorandum dated 1 January 2006 and any other terms and conditions attached to them for the year ended 31 July 2010; and
- funds from whatever source administered by the college for specific purposes have been properly applied for the intended purposes.

We review whether the Corporate Governance Statement reflects the college's compliance with the requirements of the Scottish Funding Council. We report if, in our opinion, it does not comply with these requirements or if it is misleading or inconsistent with other information we are aware of from our audit of the financial statements. We are not required to consider, nor have we considered, whether the statement covers all risks and controls. Neither are we required to form an opinion on the effectiveness of the college's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Report of the Board of Management and Statement of the Board of Management's Responsibilities for the Accounts. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with the Public Finance and Accountability (Scotland) Act 2000 and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board as required by the Code of Audit Practice approved by the Auditor General for Scotland. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of expenditure and income included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Board of Management and Accountable Officer in the preparation of the financial statements, and of whether the accounting policies are appropriate to the college's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error, and that in all material respects the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

Financial statements

In our opinion

- the financial statements give a true and fair view, in accordance with the Further and Higher Education (Scotland) Act 1992 and the Accounts Direction, of the state of affairs of the college as at 31 July 2010 and of its surplus, total recognised gains and losses and cash flows for the year then ended; and

- the financial statements have been properly prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and the Accounts Direction made thereunder.

Regularity

In our opinion in all material respects:

- the expenditure and income shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers
- funds provided by the Scottish Funding Council have been applied in accordance with the Financial Memorandum dated 1 January 2006 and any other terms and conditions attached to them for the year ended 31 July 2010; and
- funds from whatever source administered by the college for specific purposes have been properly applied for the intended purposes.

RSM Tenon Audit Limited
Registered Auditor

5 Kings Place
Perth
PH2 8AA

Date

APPENDIX 2

Our respective responsibilities

Financial Statements
It is the responsibility of the College to:-

- *Ensure the regularity of transactions by putting in place systems of internal control.*
- *Maintain proper accounting records.*
- *Prepare financial statements which present a true and fair view of the financial position of the* College *and its expenditure and income in accordance with the SORP.*

We are required to give an opinion on:-

- *Whether the accounts present a true and fair view of the financial position of the College and its expenditure and income for the period.*
- *Whether the accounts have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.*

In carrying out this responsibility we provide reasonable assurance that, subject to the concept of materiality, the financial statements:-

- *Are free from material misstatements.*
- *Comply with the statutory and other requirements applicable.*
- *Comply with relevant requirements for accounting presentation and disclosure.*

Corporate Governance
Corporate Governance is concerned with structures and processes for decision making, accountability, control and behaviour at the upper levels of the organisation. Three fundamental principles apply:-

- *Openness*
- *Integrity*
- *Accountability*

We have a responsibility to review and, where appropriate, report findings on the College's corporate governance arrangements as they relate to:-

- *The College's review of its systems of internal control including its reporting arrangements.*
- *The prevention and detection of fraud and irregularity.*
- *Standards of conduct and arrangements in relation to the prevention and detection of corruption.*
- *The financial position of the College.*

Our work has focused upon our review of the College's Risk Management arrangements, systems of internal control, Internal Audit, consideration of the controls to prevent and detect fraud and corruption, and the audit of the final accounts.

In giving an opinion on the accounts our audit strategy requires us to ensure that the fundamental financial systems are adequately covered each year. We have not placed reliance on Internal Audit work. However, our work cannot cover every financial activity and accounting procedure. We plan and perform our audit to give reasonable assurance that the financial statements are free from material misstatement and that they comply with statutory and other requirements.

Risk Management
The College's Responsibility
It is the responsibility of the College to identify and address its operational and financial risks and to develop and implement proper arrangements to manage them, including adequate and effective systems of Internal Control.

The Role of RSM Tenon Audit Limited
In planning our audit, we consider and assess your risk management arrangements as part of our assessment of audit risk. This helps us to tailor our audit plans so that they are both appropriate to your circumstances and directed to the areas of greatest risk.

Systems of Internal Control
The College's Responsibility

The College has a responsibility to develop and implement systems of internal control, including risk management, and systems of financial, operational and compliance controls.
Three components of a system of risk management are:-

- *Timely identification of key business risks.*
- *Consideration of the likelihood of the risks crystallising and the significance of the consequential financial or other impact.*
- *Establishment of priorities for the allocation of resources to control risk and the setting and communicating of key objectives.*

The monitoring of controls provides assurance that managers are assessing the existence of risk and the effectiveness of controls over the risks. The internal audit arrangements form an important part of management's monitoring and review of internal control arrangements, and in ensuring that appropriate monitoring of risks and controls takes place.

The role of RSM Tenon Audit Limited
In broad terms the external auditor is expected to assess the internal controls in the College's main financial systems and report on any significant control weaknesses identified. This does not absolve management from its responsibility for the maintenance of an adequate internal control system.

Prevention and Detection of Fraud and Irregularities
The College's Responsibility
It is the responsibility of the College to establish arrangements to prevent and detect fraud and other irregularity. It therefore needs to put in place proper arrangements for:-

- *Developing, promoting and monitoring compliance with standing orders and financial instructions.*
- *Developing and implementing strategies to prevent and detect fraud and other irregularity.*
- *Receiving and investigating allegations of breaches of proper standards of financial conduct or of fraud and irregularity.*

The Role of RSM Tenon Audit Limited
External audit is required to review the adequacy of the measures taken by the College, to test compliance, and to draw the attention of management to any weaknesses or omissions.

Legality
The responsibility for ensuring the legality of all activities and transactions rests with the College.

The responsibility of the external auditor is to review the legality of the College's transactions and to be aware of the requirements of statutory provisions.

Standards of Conduct, Integrity and Openness
Propriety is concerned with the way in which public business should be conducted. It is concerned with fairness and integrity. It must be recognised that the public view of propriety is as much about perception as reality.

The College's Responsibility
It is the responsibility of the College to ensure that its affairs are managed in accordance with proper standards of conduct. It needs therefore to put in place proper arrangements for:-

- *Implementing and monitoring compliance with appropriate guidance on standards of conduct.*
- *Expressing and promoting appropriate values and standards across the organisation.*
- *Developing, promoting and monitoring compliance with Codes of Conduct that advise Members, Officers or Managers of their personal responsibilities and expected standards of behaviour.*
- *Developing, promoting and monitoring compliance with standing orders and financial instructions.*

The Role of RSM Tenon Audit Limited
It is our role to consider whether the College has put in place adequate arrangements to maintain and promote proper standards of financial conduct and to prevent and detect corruption. We discharge this duty by reviewing and where appropriate examining evidence that is relevant to these arrangements.

Financial Position
The College's Responsibility

It is the responsibility of the College to conduct its affairs and put in place proper arrangements to ensure that the financial position is soundly based having regard to:-

- *Financial monitoring and reporting arrangements.*
- *Compliance with statutory financial requirements and achievement of financial targets.*
- *Levels of balances and reserves.*
- *The impact of planned future policies and known or foreseeable future developments.*

The Role of Tenon Audit Limited
It is our role to consider whether the College has established adequate arrangements. We are also required to have regard to going concern as part of the audit of the financial statements. In carrying out this responsibility we consider:-

- *Financial performance in the year.*
- *Compliance with statutory financial requirements and financial targets.*
- *Ability to meet known statutory and other financial obligations actual or contingent.*
- *Responses to known developments which may have an impact on the College's financial position.*

Appendix 3

Accounting for pension liabilities – FRS 17

The Chancellor announced in his emergency budget on 22 June 2010 that, from April 2011, increases in public sector pensions will be linked to the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) which is currently used. The first pension increase based CPI will be effective at April 2011. Government has indicated that future pension increases will apply to both pensions earned to date and future accruals.

It is anticipated that CPI will be significantly lower than RPI and this will reduce the value of the pension liabilities and the provisions included within the financial statements.

Consumer Prices Index: The CPI is the main measure of consumer price inflation and is the basis for the government's inflation target that the Bank of England's Monetary Policy Committee is required to achieve. It is calculated according to European Regulations.

Retail Prices Index: The RPI is the most long standing measure of inflation in the UK and statistics are available from 1947. It is still used for a variety of purposes by both government and external users, including the indexation of various incomes and prices, index-linked gilts and, until this budget, indexing pensions and benefits.

Differences between indices: The main differences are as follows.

- RPI includes elements of housing costs which make up to 25% of its constituents, including mortgage interest payments. The RPI can therefore be heavily influenced by the housing market, which dominated the periods when RPI fell below CPI in the early 90s and in 2009/10.
- There is also a more persistent effect from a different method of calculation which biases RPI above CPI by around 0.5% pa. Historically RPI has been higher, mainly reflecting the importance of the formula effect. In the past 20 years RPI has exceeded CPI by 0.7% pa on average.

Accounting periods ending on or after 22 June 2010

For employers with an accounting period ending on or after 22 June 2010 (the date of the emergency budget) pension increases are assumed to be in line with CPI. The change, which represents a gain in the net pension reserve, is accounted for as a negative past service cost.

The rationale for treating the change as a negative past service cost is that this is a change to benefits – that is, pension scheme members will expect a lower benefit following the change than before the change.

However, the proposed accounting treatment has come under scrutiny from public sector organisations and auditors alike since there is no consensus over whether the change should be accounted through the Income and Expenditure Account (I&E) or through the Statement of Recognised Gains and Losses (STRGL). As a result the matter was referred to the Urgent Issues Task Force (UITF) to provide guidance.

UITF Draft Abstract Information Sheet 90 was issued on the 13 October and is available through the web link http://www.frc.org.uk/asb/uitf/pub2392.html. Responses are requested by 10 November. The Final Abstract is envisaged to be published before the end of 2010 and will be the final determinant as to the accounting treatment required it is hoped.

The draft Abstract proposes that where there is a change in the obligation to the member, there is a benefit change which is accounted for as a past service cost. Where the obligation to the member is not changed, any change in the Scheme liabilities arises from a change in assumptions applied to measure those liabilities. The key to the accounting is whether there is a change in the members' obligation.

The UITF are proposing an approach that reflects the following:

- If the pension scheme rules/trust deed explicitly link pension increases to RPI and the scheme rules then change this to CPI, this should be treated as a change of benefit and any past service credit arising posted to I&E. *This change should be recognised in the accounting period when necessary consultations have been concluded. Consultations are concluded when the change has been agreed and announced, likely to be 2011*;

- If the scheme rules are silent on specifying an index but where there is a general presumption of an annual cost of living increase any change in measurement of inflation such as the change from RPI to CPI should be treated as a change of assumption with the credit taken through the STRGL;

- If the scheme rules are silent on specifying the index but where there is a constructive obligation to pay pension increases linked to RPI then the change to CPI should be treated as a change of benefit and any past service credit arising booked to I&E.

The key judgmental area therefore, if the Abstract is finalised as drafted, will be whether there is a '**constructive obligation**' for the college to pay RPI for pension increases. The key clauses within the appendix to the draft Abstract that cover this are:

> *A9. The UITF noted that the distinction between changes in benefits arising when a trust deed is specifically linked to RPI, compared to changes in benefits with an unspecified measure of inflation, should be considered in terms of whether the obligation to the member is being changed.*
>
> *A10. The UITF noted that a constructive obligation to the member for pensions linked to RPI could exist where the RPI is not embedded into the trust deed but where associated literature made reference to the RPI or where the general understanding of scheme members was that increases would be calculated using the RPI. The nature of any constructive obligation to members could vary and would depend on a number of factors, including the nature and content of the communications with members.*
>
> *Consideration would need to be given to whether any associated literature made reference to the RPI or whether the general understanding of scheme members was that increases would be calculated using the RPI.* ***However, a feature of a constructive obligation would be that the agreement of scheme trustees and/or members would generally be needed before any change could be made.*** *This change should be recognised in the accounting period in which the agreement of the scheme trustees and/or members was obtained, which for many colleges is unlikely to be year ended 31 July 2010.*

Most if not all FE Colleges have their LGPS as the main scheme for providing non academic retirement benefits. These schemes in turn have the same legislative origin and share the same rules to all intents and purposes. These clearly do not have an explicit link to RPI but instead refer to the Pensions (Increase) Acts of 1971 and 1974 which ultimately lead to the annual Pensions Increase (Review) Orders issued by Statutory Instrument (SI) around the end of the year. It is these SIs that use the RPI at 30 September each year and are intended to use CPI hereafter.

The same cannot be said for the pension scheme literature that accompanies the LGPS in each area and which may form a key source of evidence for determining whether a constructive obligation has been created.

The criteria for a 'constructive obligation' are set out in Paragraph 20 of FRS17 which states:

"Defined benefit scheme liabilities should be measured on an actuarial basis using the projected unit method. The scheme liabilities comprise:

> (a) Any benefits promised under the formal terms of the scheme;
> and
> (b) Any constructive obligations for further benefits where a public statement or past practice by the employer has created a valid expectation in the employees that such benefits will be granted."

Based on a sample of LGPS literature reviewed to date there is clear reference made to RPI and therefore in accordance with FRS 17 a constructive obligation established that would in normal circumstances see the credit adjusted through the I&E.

However, based on the clarifying definition contained within the UITF Abstract (highlighted in bold above) the change does not meet these refined terms and therefore the adjustment would be expected to be made through the STRGL.

Each college will have to examine its own circumstances and draw a conclusion as to whether there is a constructive obligation or not and present that case to their auditors. What will be paramount is that whichever treatment is adopted, then the rationale for that treatment should be explicitly summarised in the accounts of the College.

At the date of these financial statements, the Urgent Issues Task Force (UITF) is in the process of consulting widely on the accounting treatment for this change and is expected to issue a final Abstract towards the end of 2010. Should the Abstract call for a different accounting treatment it may be necessary to reflect any change as a prior period adjustment in the financial statements for the following year.

Appendix 4

International Financial Reporting Standards (IFRS) in Further and Higher Education

The Statement of Recommended Practice (SORP) for Further and Higher education institutions is based on UK General Accepted Accounting Practice (GAAP). At the moment the SORP has assumed that the education convergence to IFRS will follow that of UK GAAP, although it should be noted that under international standards there is no equivalent sector specific guidance such as SORPs and therefore more emphasis may be placed on a governing body such as the SFC to provide sector interpretation.

Whilst the Government sector has moved towards full implementation of international standards, there is currently no indication as to the date from which they will apply to the FE sector. The latest indications suggest an implementation in 2014/15.

The possible timeline for IFRS in Further and Higher Education

Year to 31 July 2014	Year to 31 July 2015
Comparative IFRS year end	**First IFRS year end**
2013/14 comparatives will need to be calculated	2014/15 Annual report (+ 2013/14 comparatives)

What does moving to IFRS mean for Further and Higher Education?

Significant differences	Some differences	No significant differences
Fixed assets	Related party disclosures	Stocks
Leases	Impairment	Post balance sheet events
PFI	Intangible assets	Accounting for government grants
Group accounts	Investment properties	Provisions
Format of accounts	Disclosure generally	
Employee benefits		
Financial instruments		