Scott-Moncrieff

Cumbernauld College

Annual Report to the Board of Management and the Auditor General for Scotland 2010/11

December 2011

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Executive Summary

Finance

Our audit of Cumbernauld College is complete and our audit opinions on the truth and fairness of the financial statements and the regularity of transactions are unqualified.

The College has reported a surplus of £152,000 in 2010/11 (£528,000 in 2009/10 - restated). The budgeted surplus shown on the 2010 Financial Forecast Return submitted to the Scottish Funding Council was £25,000.

The 2011 Financial Forecast Return shows the College forecasting an operating surplus of £1,000 in 2011/12.

The College is financially secure and the balance sheet as at 31 July 2011 is showing net assets of £10.223m including a bank balance, net of overdraft, of £1.955m.

Governance

The College's Corporate Governance Statement confirms that the College has been compliant with the key principles of the UK Corporate Governance Code throughout the period, except for the fact that, the Chair of the Board of Management was also the Chair of the Remuneration Committee. This exception has been disclosed in the Corporate Governance Statement within the financial statements. We have reviewed the College's statement and can confirm that this is in line with the Scottish Funding Council's guidance and is not inconsistent with our understanding of the College's governance arrangements based on the information gathered as part of our normal audit work.

We did not identify any areas of concern from our review of the College's corporate governance arrangements in so far as they relate to prevention and detection of fraud and irregularity, or standards of conduct and prevention and detection of corruption.

Conclusion

This report concludes the 2010/11 audit of Cumbernauld College. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards.

This report has been discussed and agreed with the Finance Manager. We would like to thank all members of the College's management and staff who have been involved in our work for their co-operation and assistance during our audit.

Scott-Moncrieff
15 December 2011

Introduction

1. This report gives a summary of the findings from our 2010/11 audit of Cumbernauld College ("the College"). The scope of our audit was set out in our External Audit Strategy and Plan which was presented to the Audit Committee on 15 September 2011. Our audit has focused on the financial statements and governance arrangements at the College.

2. Our plan summarised the following key audit issue for 2010/11:

   - Strathclyde Pension Fund Liabilities.

3. This report sets out our findings in relation to this key issue and also includes a follow-up of issues identified in our previous annual reports.

4. The report is also addressed to the Auditor General for Scotland and will be published on Audit Scotland's website, www.audit-scotland.gov.uk.

Finance

5. This section of the report summarises our findings in relation to the College's financial performance for the year and its position at 31 July 2011. We also discuss any significant issues identified during our audit.

6. It is the responsibility of the College to conduct its financial affairs in a proper manner. It is our responsibility to audit the financial statements and to consider the College's governance arrangements in relation to the College's financial position.

Auditors' opinion

7. We are required to give an opinion as to whether the financial statements present a true and fair view of the financial position of the College as at 31 July 2011 and of its expenditure and income for the financial year. We are also required to include a regularity assertion in our independent auditors' report stating whether, in all material respects, expenditure and income were incurred or applied for their intended purposes and in accordance with guidance issued by the Scottish Ministers and the financial memorandum with the Scottish Funding Council (SFC).

8. Our audit is now complete and we have issued unqualified audit opinions on the truth and fairness of the accounts and on the regularity of transactions.

9. The signed financial statements will now be submitted to Audit Scotland, who will pass them to the Scottish Government for laying before the Scottish Parliament.

Financial position

10. The College reported an operating surplus for the year to 31 July 2011 of £152,000.

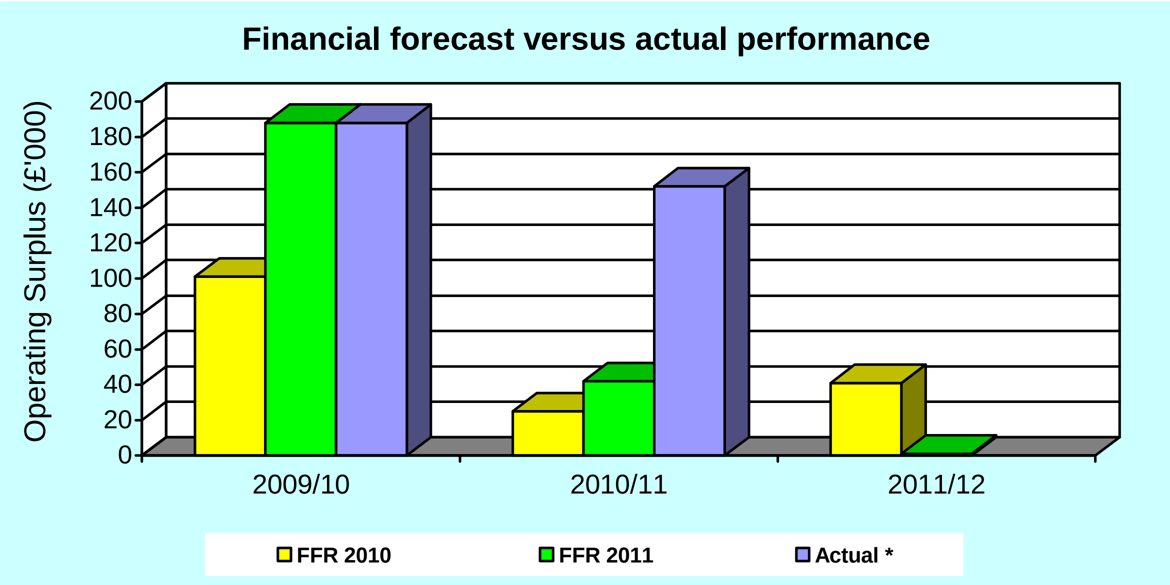
11. The College is financially secure and the balance sheet as at 31 July 2011 is showing net assets of £10.223m including a bank balance, net of overdraft, of £1.955m.

Financial forecasts

12. The College has returned the 2011 Financial Forecast Return (FFR) to the Scottish Funding Council (SFC). SFC uses the FFR to assess the financial position and performance of individual colleges and the sector as a whole. SFC has confirmed funding for 2011/12, but, unlike previous years, the College has not been asked to provide three year projections given uncertainty over the financial position of the sector as a whole.

13. The result has been that the College has not been able to budget in the same level of detail as before beyond 2011/12. The College should seek to formalise its medium term plans as soon as it receives clarity on funding from SFC - ***Action plan point 1***.

14. The following graph compares the actual results for 2010/11 with the FFR forecasts and sets out future projections as contained within the 2011 FFR.



**2009/10 actual figures have been adjusted to remove the exceptional gain relating to FRS 17 CPI/RPI restatement, to provide "like-for-like" comparison*

15. As shown above, the College is expecting to report a small surplus in 2011/12 of £1,000.

16. The College's original budget for 2010/11 per the 2010 FFR showed a surplus of £25,000.

17. A reconciliation between the forecast surplus and the actual surplus is set out below:

	£
Surplus per initial budget	**25,000**
FRS 17 adjustment **(paragraph 18)**	(45,000)
SFC grant income **(paragraph 19)**	(159,000)
Other grant income **(paragraph 19)**	60,000
Restructuring costs **(paragraph 20)**	(142,000)
Staff costs **(paragraph 20)**	89,000
Property costs, educational and admin supplies **(paragraph 21)**	205,000
Total of other insignificant expenditure variances **(paragraph 22)**	119,000
Actual surplus per financial statements	**152,000**
Variance to original budget	**127,000**
Variance as percentage of total income	**1.19%**

18. The Board of Management can not, with reasonable certainty, quantify the annual effect of FRS 17 on the figures in the financial statements, or on the FFR, and as such no impact was anticipated at the time the FFR was prepared.

19. A reduction in spanning activity and the repayment of 2009/10 and 2010/11 ESOL funding are attributable to the decrease in SFC grant income. Whilst the increase in other grant income is attributable mainly to a receipt of £15k from The Princes Trust and £33k of gains in respect of foreign currency transactions. In respect of both income streams, these variations were not reflected within the original expectations upon which the preparation of the 2010 FFR was based.

20. At the time when the FFR was prepared the cost associated with voluntary severance arrangements entered into in the year totalling £142k could not have been anticipated. Savings were achieved in respect of budgeted staff costs by not recruiting to fill vacant posts and through increased efficiencies achieved within the teaching faculty.

21. The College achieved savings in respect of budgeted property costs of £89k, through improved contract prices for energy usage and by a targeted reduction in maintenance costs. Similar cost efficiencies were achieved in relation to educational supplies (£66k) and admin supplies (£50k).

22. In all cases the College will take a prudent approach to budget setting, and following the economic downturn budget holders were encouraged to deliver efficiencies where possible.

Financial planning and monitoring arrangements

23. As part of our audit, we considered the College's financial standing, including the arrangements in place for financial planning, budgetary control and financial reporting. It is important that such arrangements are adequate in order to properly control the College's operations and use of resources.

24. Budgets are devised prior to the submission of the FFR which is approved by the Resources & General Purposes Committee. This committee meets four times a year. Management accounts showing actual against budget, as well as a projected forecast are presented to each Resources & General Purposes Committee.

25. In our opinion the College has effective financial management arrangements in place.

Financial reporting framework

26. The principal elements of the College's financial reporting framework are:
    - Accounts Direction issued by the Scottish Funding Council
    - Further Education / Higher Education Statement of Recommended Practice (FE/HE SORP) 2007

27. We are pleased to confirm that the College's 2010/11 financial statements comply fully with the Accounts Direction and FE/HE SORP 2007 in all material aspects.

Financial statements preparation

28. We are grateful to the Finance Manager and the finance staff for their assistance and support during the course of the audit. We found the draft financial statements and supporting working papers to be of a very high standard.

29. We found that the College has adequate resources available in the Finance Department to meet the College's financial management and reporting needs.

Audit adjustments

Actual adjustments

30. Subsequent to the presentation of the financial statements for audit, the following adjustments to the financial statements were identified:-

1	Dr Creditors > 1 year	£20,000	
	Cr Creditors < 1 year		£20,000
	Being adjustment to correct the disclosure split of the Lennartz creditor		
2	Dr Trade Creditors	£22,000	
	Cr Trade Debtors		£20,000
	Cr Miscellaneous Income		£2,000
	Being write-off of ROK debtor and creditor following Board of Management approval		

31. The table below outlines the impact of the above adjustments on the outturn position:-

	£'000
Surplus per accounts originally presented for audit	**150**
Adjustments identified during the audit:	
Write-off of ROK debtor and creditor	2
Actual surplus per audited accounts	**152**

32. All other adjustments related to presentational and disclosure issues.

Potential adjustments

33. There were no potential adjustments noted as a result of the audit work performed.

Review of accounting systems

34. During our audit work we have considered the College's accounting systems and internal controls. Please refer to the action plan for details of control improvements detected during audit fieldwork. In general, the College's systems of internal financial control appear to be adequate, well designed and operating effectively.

Other issues of particular significance for the 2010/11 audit

35. In order to assist College members' understanding of the financial statements and our audit, we have summarised issues below which we believe are of particular significance to the 2010/11 financial statements, which have not already been discussed fully in our report.

Pension Fund liabilities

36. The College's employees belong to two principal defined benefit pension schemes, the Scottish Teachers' Superannuation Scheme (STSS) and the Strathclyde Pension Fund (SPF).

37. The STSS is a multi-employer, notionally funded scheme and the College is unable to identify its share of the underlying assets and liabilities of the scheme. In line with Financial Reporting Standard 17 – *Retirement Benefits* (FRS 17), the College does not recognise any asset or liability relating to the STSS and the scheme is effectively accounted for as if it was a defined contribution scheme.

38. The SPF is also a multi-employer scheme but the College can identify its share of underlying assets and liabilities and has therefore recognised a net liability in its balance sheet. In 2010/11, the College reported a liability in respect of the SPF of £1.026m.

39. In 2009/10, there was also a one-off pension adjustment of £340,000 in favour of the College, which was reflected in the Statement of Recognised Gains and Losses (STRGL). This transaction was required because on 22 June 2010 the Chancellor of the Exchequer's Budget Statement confirmed that future pension increases were to be linked to the Consumer Prices Index (CPI) rather than Retail Prices Index (RPI).

40. The College's 2009/10 treatment - to take the adjustment through the STRGL - was based on the Draft Urgent Issue Task Force Note 48 (UITF 48) which was issued to inform the accounting for this change. It was only after the accounts were signed that the Final UITF 48 was updated and issued. The Final UITF 48 was changed in such a way as to indicate that accounting for the adjustment through the STRGL was not the most appropriate treatment in the College's circumstances.

41. As a result, the College has processed a prior year adjustment to account for the RPI/CPI move through the College's Income and Expenditure Account. This is why the 31 July 2010 column on the Income and Expenditure Account and certain notes are labelled as "restated". This has been treated as a prior period adjustment arising from a change in accounting policy. We have confirmed that the College has made the appropriate accounting entries and disclosure in the

financial statements. It is this matter which has led to the College restating its 2009/10 surplus to £528,000 (previously disclosed as £188,000) within the comparative column of the 2010/11 accounts.

Breach of bank covenants

42. During the 2010 audit of the financial statements, the Finance Manager brought it to the attention of audit staff that a breach of covenants had taken place in respect of the Clydesdale Bank loan, following the incorporation within the financial statements of the results of the interim valuation of land and buildings.

43. The covenants in place stipulate that the Income and Expenditure reserve (excluding pension reserve) plus the revaluation reserve should not fall below £2.15m. Based on the 2010/11 financial statements the reserves as defined within the agreement total £2,106,000, and hence are College remains in breach.

44. Negotiations have been on-going throughout the year between the College and the Clydesdale Bank PLC, and have now reached an advanced stage, with written confirmation of the proposals received from the bank on 14 December 2011 - ***Follow up of previous year action plan point 1.***

Governance

45. It is the College’s responsibility to ensure that it has adequate governance arrangements in place. It is our responsibility to review and report on these arrangements as they relate to:

- the College’s review of its systems of internal control, including reporting arrangements;
- the prevention and detection of fraud and other irregularities;
- standards of conduct and arrangements for the prevention and detection of corruption;
- the College’s financial position.

46. We reported on the corporate governance arrangements in relation to its financial position in the Finance section of this report. This section includes our comments on other aspects of the College’s arrangements.

Corporate Governance

Current governance arrangements

47. Colleges are required to include in their financial statements a statement covering the responsibilities of their Board of Management in relation to corporate governance arrangements. The statement should describe the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management, and report on the College’s compliance with the UK Corporate Governance Code.

48. The College’s Corporate Governance Statement for 2010/11 states that the College was compliant with all provisions of the UK Corporate Governance Code throughout the period, except for the fact that the Chair of the Board of Management was also the Chair of the Remuneration Committee. This exception is clearly disclosed within the Corporate Governance Statement in the financial statements. The College considers it appropriate to maintain this position as the Remuneration Committee does not determine remuneration for Board members but only for senior management. As a result the College considers that it remains compliant with the principles of the UK Corporate Governance Code.

49. We reviewed the Corporate Governance Statement by:

- checking the statement against Scottish Funding Council guidance;
- considering the adequacy of the process put in place by the Principal and Board of Management to obtain assurances on systems of internal control;
- assessing whether disclosures in the statement are consistent with our knowledge of the College.

50. We are satisfied that the statement is consistent with the Scottish Funding Council's guidance and that the contents are not inconsistent with information gathered during the course of our normal audit work.

Risk management

51. Risk management is important to the establishment and regular review of systems of internal control. The College's annual accounts outline the principal risks and uncertainties of the College and confirm that mitigating controls are in place in response to these risks.

52. The College has a Risk Management Policy and Risk Management Procedures in place. The College has a risk register, which is subject to regular review and update by the Risk Management Group. Procedures ensure that risk management is reported as a standing item at each meeting of the Audit Committee. An up to date, electronic, full risk register is made available to members prior to each Audit Committee meeting. The Board consider all high level risks on a bi-annual basis.

53. We have concluded that the College has robust risk management systems in place.

Internal audit

54. Internal audit is a key component of the College's corporate governance arrangements. The College's internal audit service is provided by Wylie & Bisset.

55. To avoid duplication of effort and ensure an efficient audit process, we have made use of internal audit work where appropriate.

Internal audit's annual opinion statement

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

57. We are grateful to Wylie & Bisset for their assistance during the course of our audit work.

Prevention and detection of fraud and irregularity

58. As part of our audit we consider how the College ensures compliance with all relevant guidance and regulations. This includes a consideration of the College's arrangements for the prevention and detection of fraud and irregularity.

59. The College has a fraud policy and a whistle blowing policy in place. These policies identify the appropriate persons to contact in the event of any fraud or irregularity. There were no frauds identified during the year.

60. All SFC and other guidance and circulars are received by the Principal's secretary. All relevant regulatory information is distributed to the appropriate members of staff. A database is held of all

SFC circulars and responsible officers. All relevant guidance is presented to the Board of Management meetings ensuring that all those concerned have access to adequate and relevant information.

61. We identified no issues of concern in relation to the arrangements for the prevention and detection of fraud, with regard to the legality of transactions or in relation to compliance with relevant guidance and regulations.

Standards of conduct

62. We are required to consider the arrangements made by management in relation to standards of conduct and prevention and detection of corruption.

63. Propriety requires that public business is conducted with fairness and integrity. This includes avoiding personal gain from public business, being even-handed in the appointment of staff, letting contracts based on open competition and avoiding waste and extravagance. Guidance on standards of conduct, accountability and openness has been issued by the Scottish Government.

64. Our work in this area included a review of the arrangements for adopting and reviewing standing orders, financial instructions, registers of interest and schemes of delegation and complying with national and local Codes of Conduct. We also considered controls over ordering, procurement and disposal of assets.

65. We are pleased to report that our audit identified no issues of concern in this area.

Looking Forward

Financial position

66. There is increasing uncertainty over the level of future funding that will be provided to the sector. Indications from the Scottish Government are that the reductions in funding experienced in 2010/11 may continue over the next few years. Coupled with increasing cost pressures this will result in significant financial challenges for the College and the sector as a whole.

67. SFC has confirmed funding for 2011/12, but, unlike previous years, the College has not been asked to provide three year FFR projections given uncertainty over the financial position of the FE and public sector as a whole. This puts pressure on the College's ability to plan its medium term financial future. It is undoubtedly a significant variable which complicates strategic decision making. However, the history of strong financial performance over recent years has shown that the College operates on a firm financial footing and it is well placed to meet these future financial challenges when compared to many other FE bodies.

International financial reporting standards

68. The College's financial statements are still prepared on the basis of UK accounting standards (UK GAAP) which the Statement of Recommended Practice: Accounting for Further and Higher Education (SORP) Board believes continues to be appropriate for colleges.

69. Colleges will continue to converge with international financial reporting standards (IFRS) as UK GAAP converges with IFRS. It appears likely that full implementation of IFRS will not take place before 2013/14.

70. As we have previously noted, the conversion process requires sufficient and appropriate information to be available to support the production of comparator balances. Effectively, this means work to produce full IFRS-compliant financial statements will begin at least one year before the actual implementation date. In some areas, such as in relation to fixed assets and component accounting, the earlier the work begins the more straightforward the conversion process may be and we endorse any moves the College may make to work towards IFRS transition in a structured and well-planned way.

Appendix 1 – Action Plan

Our annual report action plan details the financial control weaknesses and opportunities for improvement that we have identified during our audit visit in addition to any reportable matters arising from our review of performance and governance systems.

The action plan details the officers responsible for implementing the recommendations and implementation dates. The College should assess these recommendations for their wider implications before approving the action plan. Following submission of this report to the Audit Committee, we will send a copy to the Auditor General.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist.

Grading

To assist the College in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been graded. The grading structure is summarised as follows:

Grade 5	Very high risk exposure – Major concerns requiring Board attention.
Grade 4	High risk exposure – Material observations requiring management attention.
Grade 3	Moderate risk exposure – Significant observations requiring management attention.
Grade 2	Limited risk exposure – Minor observations requiring management attention.
Grade 1	Efficiency / housekeeping point.

Issues arising from our 2010/11 audit

Action point	Issue identified and recommendation	Management response
1 **Scenario planning post 2012**	Despite the current uncertainty over the level of future funding that will be provided to the College, the Board of Management, through its Chair, are required to sign the financial statements having given consideration to the fact that the College is a going concern for a period of at least 12 months from the date of approval of the accounts. As such, we would recommend that high level scenario planning is formally documented which outlines the impact on the College outturn of various incremental reductions to income. **Grade 4**	**Management response:** Agreed **Responsible officer:** Assistant Principal 1 **Implementation date:** February 2012
2 **VAT returns**	During the audit it was noted that there were underpayments made to HMRC, in January and April 2011, in respect of the repayment of the Lennartz creditor, following the change in the VAT rate to 20%. The Lennartz repayment should also be reflected within the VAT return, and fieldwork identified that this was not included within the January 2011 return. The payment was made on time, and the correction to disclose the remittance was reflected through the subsequent April 2011 return. There is a risk that interest and/or penalties may be levied by HMRC in respect of the incorrect submission of VAT returns. We recommend that procedures are updated to ensure that the Lennartz repayment schedule is reviewed each quarter to confirm that the correct amount is being included in the VAT return and hence remitted to HMRC. **Grade 3**	**Management response:** Agreed **Responsible officer:** Finance Manager **Implementation date:** December 2011

Follow-up of previous external audit recommendations

Action point	Issue identified and recommendation	Update at December 2011
1 **Breach of bank loan covenants** **2009/10**	The Finance Manager brought it to the attention of audit staff that a breach of covenant had occurred in relation to the Clydesdale Bank loan, following the incorporation within the financial statements of the results of the interim valuation of land and buildings. The bank covenant stipulates that the Income and Expenditure reserve (excluding pension reserve) plus the revaluation reserve should not fall below £2.15m. Based on the year-end financial statements the reserves as defined within the agreement total £1,909,000. The breach has been reported to Clydesdale Bank plc by the Finance Manager. We understand that negotiations are in progress on the potential re-wording of the covenant and that the initial meeting with the bank on 14 December 2010 to discuss this went well. On this basis we have graded this issue as moderate risk however we suggest that the Board monitor the issue closely to ensure that agreement is reached swiftly with the bank in order to mitigate the College's risk in relation to its loan facility. **Management response:** Agreed **Responsible officer:** Finance Manager **Implementation date:** Initial negotiations - December 2010	The position has been reconsidered during the 2010/11 audit, and the breach of covenant issue has not been resolved, but negotiations with the bank are now at an advanced stage. Based on the 2010/11 financial statements the reserves as defined within the agreement total £2.106m, thus below the £2.15m limit. **Management response:** Revised loan covenants have been agreed and will be formally signed off by the Board of Management **Responsible officer:** Finance Manager **Implementation date:** By end of December 2011

Action point	Issue identified and recommendation	Update at December 2011
2 **Redundancy policy** **2009/10**	We raised this issue following our 2006/07 audit, at which time the College felt it was inappropriate to implement such a policy. Given the current economic climate, the reductions in funding which face the sector as a whole, and the fact that such a policy is deemed good practice within the sector, we would recommend that a redundancy policy is implemented. This would provide clarification to all parties as to the redundancy process, if ever such a situation occurred. **Management response:** Agreed **Responsible officer:** Depute Principal **Implementation date:** Consultations to commence January 2011	A redundancy policy has been drafted and is currently subject to consultation with the unions. **Responsible officer:** Depute Principal **Implementation date:** Negotiations to commence January 2012
3 **Corporate Governance Code** **2009/10**	The UK Corporate Governance Code, formerly known as the Combined Code, sets out standards of governance, against which publicly funded bodies are required to prepare a corporate governance statement. This replaces the 2008 Combined Code. To mitigate against the risk of non-compliance, we recommend that the College reviews its corporate governance arrangements against the new Code in preparation for making its Corporate Governance Statement in its 2010/11 financial statements. We have undertaken an analysis of the key changes applicable to education bodies and will be sharing this guidance with College management to help inform this assessment. **Management response:** Agreed **Responsible officer:** College Secretary **Implementation date:** January 2011	Issue addressed. **Action taken as agreed**

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