Elmwood 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 Elmwood 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 achieved a surplus in of £0.543m in 2010/11. The College has restated its 2009/10 surplus to £0.694m within the 2010/11 accounts (previously disclosed as £0.099m), due to the prior year adjustment to reflect the CPI/RPI pensions change in the Income and Expenditure Account. This is as a result of the updated accounting guidance issued since the 2009/10 accounts were signed.

The College's 2010 Financial Forecast Return (FFR) submitted to the Scottish Funding Council (SFC) projected a surplus of £0.010m in 2010/11, and so the reported outturn represents better than expected financial performance. The College's 2011 FFR projects a further surplus of £0.012m in 2011/12, although as of October 2011 the College was forecasting a deficit of £0.161m.

Governance

The College's Corporate Governance Statement confirms that the College has been fully compliant with the key principles of the UK Corporate Governance Code during 2010/11. We have reviewed the College's statement and can confirm that this is in line with the SFC'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. However, we have noted that the Audit Committee was not quorate in March and June, which we have raised as an issue in this report.

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.

The College has announced plans to explore a merger with other land-based Colleges across Scotland. Senior management and board members will continue to lead these discussions in 2011/12.

Conclusion

This report concludes the 2010/11 audit of Elmwood 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 Director of Finance and 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
16 December 2011

Introduction

1. This report gives a summary of our findings from the audit of Elmwood College (“the College”) in 2010/11. The scope of our audit was set out in our External Audit Strategy and Plan which was presented to the Audit Committee on 14 September 2011. Our audit has focused on the financial statements and governance arrangements at the College.

2. Our plan summarised four key issues in relation to the 2010/11 audit:

   - Financial position and staff restructuring
   - Finance team changes
   - Fife Council Pension Scheme and the accounting for the 2009/10 actuarial adjustment in relation to the move from RPI to CPI
   - Early retirement liabilities.

3. This report includes our findings in relation to these key issues 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 will 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 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

The College has reported a surplus of £0.543m despite a 5% fall in income

10. The College reported an operating surplus for the year to 31 July 2011 of £0.543m. The College has restated its 2009/10 surplus to £0.694m within the 2010/11 accounts (previously disclosed as £0.099m), due to the prior year adjustment to reflect the CPI/RPI pensions change in the Income and Expenditure Account. This is as a result of the updated accounting guidance issued since the 2009/10 accounts were signed. This is discussed further in paragraphs 28-30.

11. Income has reduced by £0.604m (5%) compared to 2009/10. This is primarily due to a reduction in supported accommodation income of £0.513m. There has been a reduction in the use made of this service by local authorities, with both Fife Council and Perth and Kinross Council now offering tenancies for students that had previously used the College's service.

12. The College has made substantial savings in staffing costs compared to last year. When the impact of the prior year adjustment is discounted, the College has reduced these costs by £380,000 (which is in line with budget). There has also been a reduction in expenditure on supported accommodation, in line with the fall in income.

13. The College's operating surplus of £0.543m compares favourably to the budgeted surplus of £0.010m. The College has introduced more stringent financial controls during the year. The Finance Manager now meets with each key budget holder on a monthly basis to discuss expenditure in detail, and the budgets have also been analysed and set out in more detail. These meetings appear to have helped the College identify and deliver efficiencies.

Balance sheet

The College has a healthy net asset position

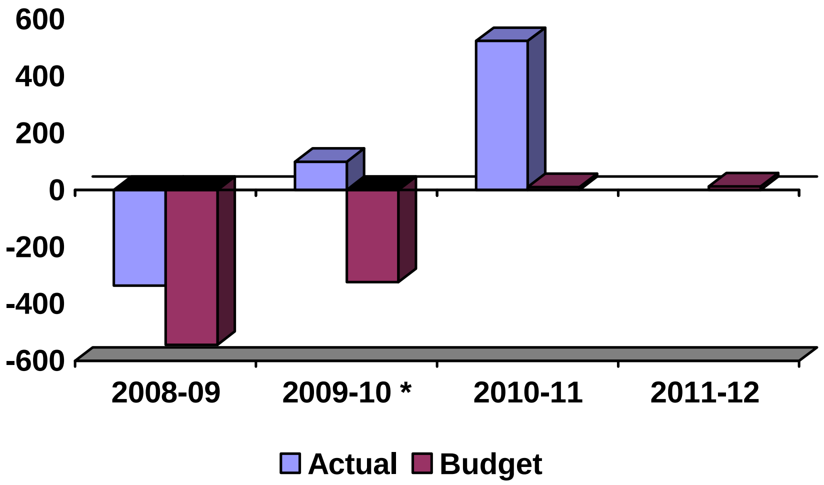
14. The College has reserves of £13.517m at 31 July 2011 (£12.508m as at 31 July 2010) and holds £0.557m of deferred capital grants (£0.517m at 31 July 2010). The reserves position has strengthened due to the surplus which has been made in the year and a reduction in the pension liability of £0.498m. There was also a healthy cash balance totalling £3.606m at year end.

Financial forecasts

SFC funding has been confirmed for 2011/12 and a surplus has been forecast

15. 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. The result has been that the College has not been able to budget beyond 2011/12 in the same level of detail as before, beyond 2012. The College should seek to formalise its medium term plans as soon as it receives clarity on funding from SFC. Diagram 1 below compares the actual results with FFR forecasts and sets out projections for 2011/12.

Diagram 1 - Actual performance and FFR Forecasts of surplus (£'000)



*Source: Financial Forecast Returns (*adjusted to remove the effect of FRS 17 CPI/RPI restatement to provide "like-for-like" comparison)*

16. The diagram shows that the College has performed well in the last two years, after a very difficult period. The budgeted surplus in 2011/12 of just £0.012m (0.1% of turnover) will make the coming year challenging for the College. This surplus has been forecast despite the loss of £0.756m (11%) of grant-in-aid and fee waiver income. This relates to the savings being made as part of the College's response to reduced public sector funding. It is likely that the College will face further reductions in SFC and related income in the coming years.

17. In October 2011 the College revised its outturn position and as at October 2011 was forecasting a deficit of £161,000 for 2011/12. The largest single factor in the projected deficit position is a staff pay award totalling £90,000. This will represent recurring expenditure to the College, and may make a break even position more difficult to attain in coming years. However, the financial impact has been considered by the College against the need to attract and retain staff to help deliver against the College's objectives.

Financial planning and monitoring arrangements

The financial management arrangements at the College are sound

18. 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.

19. The Board has a Finance Committee which met regularly throughout the year. Budgets are devised and approved at the start of the year and are updated during the year to take account of new information. Management accounts showing forecast year end positions against budget are presented to each Finance Committee.

20. In our opinion the College continues to have good financial management arrangements in place.

Financial statements preparation

21. We are grateful to the Director of Finance, the Finance Manager and the finance staff for their assistance and support during the course of the audit. As in previous years, we found the draft accounts and supporting working papers to be of a high standard.

Audit adjustments

22. During the course of our audit a small number of adjustments to the financial statements were identified and agreed. The table below outlines the impact of the adjustments made on the outturn position. The majority of the changes made were of a presentational and disclosure nature. There were no unadjusted misstatements.

Table 1 – Audit adjustments raised in 2010/11

	£'000
Surplus per accounts presented for audit	**250**
Adjustments identified during the audit:	
Reduction in accrued staff costs	100
Adjustments to other income and expenditure accruals	122
Reduction of the deferred capital grant release	(6)
Recognition of expenditure as Bursary costs	77
Actual surplus per audited accounts	**543**

Review of accounting systems

23. During our audit work we have considered the College's accounting systems and internal controls. We have found that they are reasonable and form an adequate basis for the preparation of the financial statements.

Other issues of significance in the 2010/11 audit

24. In order to assist College members' understanding of the financial statements and our audit, we have summarised the issues that we believe are of particular significance to the 2010/11 financial statements below and which have not been addressed elsewhere in this report.

Fife Council Pension Fund

25. The College's employees belong to two principal defined benefit pension schemes, the Scottish Teachers' Superannuation Scheme (STSS) for the teaching staff and the Fife Council Pension Fund for the non-teaching staff.

26. 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 FRS17, 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.

27. The Fife Council Pension Fund 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. The College has consistently reported significant FRS 17 liabilities over the past few years. The Fife Council Pension Fund's actuaries provide the College with an updated valuation on an annual basis which is reflected in the pensions liability disclosed on the Balance Sheet. We have

reviewed the College's accounting for these pension schemes and found that it complies with the requirements of FRS 17.

28. In 2009/10, there was also a one-off pension adjustment of £0.595m 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).

29. 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 specifically 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.

30. 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 of the 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 £0.694m (previously disclosed as £0.099m) within the comparative column of the 2010/11 accounts.

Early retirement provision

31. The College has previously offered early retirement to staff as part of the management restructuring programme. The College makes monthly payments to the pension fund to cover any shortfall arising from the decision to grant early access to retirement benefits. In line with *Financial Reporting Standard 12 - Provisions, Contingent Liabilities and Contingents Assets* (FRS 12), the College creates a provision for the future payments in relation to these early retirements. The provision for early retirement was £0.852m at 31 July 2011 (£0.870m at 31 July 2010).

32. We reviewed the College's accounting treatment of its liabilities arising from early retirements and confirmed that this was reasonable and appropriate.

Asset disposals

33. The College has written off a number of assets in the year. In total 17 entries from the fixed asset register have been written off which account for some 239 pieces of IT equipment and one vehicle. The College has been unable to provide evidence that these disposals were authorised before being written off.

Action plan point 1

Governance

34. 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

35. 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

Appropriate governance arrangements are in place within the College, but issues with Audit Committee attendance

36. Colleges are required to include in their annual accounts a statement covering the responsibilities of their Board of Management in relation 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.

37. The College's Corporate Governance Statement for 2010/11 explains that the College was fully compliant with the UK Corporate Governance Code throughout the period.

38. We reviewed the Corporate Governance Statement by:

- checking the statement against SFC and Audit Scotland 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

39. We are satisfied that the statement is consistent with SFC and Audit Scotland guidance and that the contents are not inconsistent with information gathered during the course of our normal audit work. However, we have noted that the Audit Committee met four times during the year and is made up of four external board members. There must be at least two external board members at

each meeting for it to be considered quorate. At the March and June meetings there was only one board member present, and so the Committee was not quorate for these meetings.

Action plan point 2

The UK Corporate Governance Code has come in to effect for Colleges in 2010/11

40. A new Corporate Governance Code was published in June 2010 and has come in to effect for financial years beginning on or after 29 June 2010. The UK Corporate Governance Code, formerly known as the Combined Code, sets out standards of governance for listed companies. The Code is also applicable to publicly funded bodies that are required to prepare an annual statement on internal control or corporate governance for inclusion in their annual accounts. The "comply or explain" provision is retained in this new version of the code.

41. In March 2011 the Board formally considered the implications of the new code, in line with our recommendation in our 2009/10 annual report. This review found that not all of the provisions within the Code were relevant to the College. Key areas which were relevant were:

    - Risk Management: That the College's business model should be explained and the Board should be responsible for determining the nature and extent of the significant risks it is willing to take.
    - To further promote proper debate at Board meetings.
    - To encourage the Board to be well balanced.
    - To enhance the Board's performance by holding regular development reviews with Board members and to regularly review its effectiveness.

42. The Board found that the new code did not add materially to the existing corporate governance and risk management procedures already in place. This analysis appears reasonable, and is in keeping with our cumulated understanding of the Board's governance arrangements.

Risk management

Good risk management systems are in place

43. Risk management is important to the establishment and regular review of systems of internal control. The College's financial statements outline the principal risks and uncertainties of the College and the College's response.

44. The College's approach to risk management has been formally approved by the Board, including clarifying respective roles and responsibilities within the College. Senior management, led by the Principal, regularly review and consider risks and associated systems of internal control and report any further risks identified. Management is also responsible for implementing policies of internal control to ensure risk is managed appropriately. The Audit Committee retains overall

responsibility for reviewing the risk register and any changes to action plans are reported to the Board via the Audit Committee.

45. The risk register is well-structured, setting out an impact/likelihood assessment of each risk, and identifies a risk ‘owner’. It also sets out the mitigating controls and further actions required to mitigate these risks, with a net/residual risk score after consideration of existing mitigating actions.

46. Overall, the College has good risk management systems in place to identify and monitor key strategic risks to the College.

Internal audit

47. The internal audit service is a key component of the College’s internal control framework. As part of our corporate governance responsibilities, we have reviewed the College’s arrangements to ensure that the work of internal audit is sufficient in quality and volume and complies with best practice. Our review was performed in accordance with the Code of Audit Practice and *International Standard on Auditing 610 - Considering the work of internal audit* (ISA 610).

Considering the work of internal audit

48. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the College’s total audit resource. For 2010/11 the internal audit service has been provided by Henderson Loggie. We have considered the findings of the work of internal audit within our audit process and have sought to minimise duplication of effort, to ensure the total audit resource to the College is used efficiently and effectively.

49. Henderson Loggie have concluded in their annual report that the College has adequate and effective risk management, control and governance processes to manage its achievement of the College’s objectives. We are grateful to Henderson Loggie for their assistance during the course of our audit work.

Prevention and detection of fraud and irregularity

50. 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.

51. The College has an anti-fraud and irregularity strategy (including a fraud response plan) and whistle blowing policy in place. The College has identified a fraud liaison officer and a whistle-blowing officer. There were no frauds identified during the year.

52. 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 dealing with the relevant circular.

53. 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

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

55. 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 arrangements in place for ordering and procurement and disposal of assets.

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

Looking Forward

Potential merger and financial position

57. The College has announced plans to explore a merger with other land-based Colleges across Scotland. Senior management and board members will continue to lead these discussions in 2011/12. This initiative offers a land-based response to the government's regionalisation agenda, and Elmwood, Oatridge and the Scottish Agricultural College will continue to explore options which offer the best possible outcome for learners and wider stakeholders.

58. This proposed merger is progressing at the same time as 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 is a trend which is expected to be reflected in funding settlements 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.

59. 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 and is a further variable in merger discussions and strategic decision making.

International financial reporting standards

60. 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.

61. 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.

62. 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.

Estates Strategy

63. A joint capital investment plan, developed in tandem with the "Going Further" merger project, has recently been approved by SFC for Scotland's land-based Colleges (Elmwood, Barony, Oatridge

and the Scottish Agricultural College). The development of the joint capital investment plan has led to delays in the Colleges capital plans in the current year, with significant levels of capital allocation being carried forward in to 2011/12.

Appendix 1 – Action Plan

Our annual report action plan details the control weaknesses and opportunities for improvement that we have identified during 2008/09. These are the issues that we believe need to be brought to the attention of the College.

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 Board 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.

External audit recommendations arising in 2010/11

No	Title	Issue identified	Risk and recommendation	Management comments
1	**Asset disposals (Para 33)**	The College has written off a number of assets in the year. In total 17 entries from the fixed asset register have been written off which account for some 239 pieces of IT equipment and one vehicle. The College has been unable to provide evidence that these disposals were authorised, such as asset disposal forms.	The risk of misappropriation of assets is increased if the fixed asset register is not maintained to a high standard, with all asset movements adequately authorised and tracked. The College should ensure adequate authorisation documents for asset disposals are retained. **Grade 2**	Agreed. The asset disposal procedure will be reinforced to all employees by Finance who will ensure relevant authorisation documents are completed and retained with immediate effect **Responsible officer:** Director of Finance **Implementation date:** Immediate
2	**Audit Committee attendance (Para 39)**	There must be at least two external board members at each Audit Committee meeting for it to be considered quorate. Only one board member present at the March and June Committees.	The scheme of delegation and committee decision making process may be adversely impacted by repeated low attendance. Members should be reminded of the need to ensure Committee meetings are quorate. The Board should monitor this area. **Grade 3**	Agreed. The importance of attendance will be raised with all committee members **Responsible officer:** Chair of the Audit Committee **Implementation date:** Immediate

Follow-up of previous external audit recommendations

No	Title	Original recommendation and management response	Update at October 2011 by Scott Moncrieff
1	**Register of interests**	**Original Recommendation** The College should ensure that declarations of interest are completed by each member of the Board of Management on an annual basis, with evidence retained of each update/review. ***Grade 3*** **Management response** Agreed	We have confirmed that declarations of interest have been completed by each member of the Board of Management, with evidence retained of each update/review. **Satisfactory**

No	Title	Original recommendation and management response	Update at October 2011 by Scott Moncrieff
2	**VAT Observations**	**Original Recommendation** 1) The College should review these capital projects to ensure that the capital goods adjustments are sufficient and appropriate. 2) HMRC has confirmed that grants could be excluded from the calculation, which could allow the College to increase its VAT recovery. ***Grade 2*** **Management response** Agreed	The College has taken VAT advice from its internal auditors during the year. **Satisfactory**

No	Title	Original recommendation and management response	Update at October 2011 by Scott Moncrieff
3	**Corporate Governance Code**	**Original Recommendation** 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 annual accounts. ***Grade 3*** **Management response** Agreed	In March 2011 the Board formally considered the implications of the new code. The Board found that the new code did not add to the existing corporate governance and risk management procedures already in place at the College. We have found this analysis to be reasonable. **Satisfactory**

No	Title	Original recommendation and management response	Update at October 2011 by Scott Moncrieff
4	**College Strategy and Financial Position**	**Original Recommendation** Previous financial difficulties are likely to be exacerbated by tight funding settlements related to the current economic environment. It is vital that the medium and longer term strategic direction of the College is established. This will give clarity of purpose and better inform the various underpinning documentation such as the financial strategy, workforce management considerations and the estates strategy. The overall aim should be to provide an overarching, comprehensive approach for the College to move towards financial and strategic sustainability. ***Grade 4*** **Management response** Agreed.	Although the College's financial performance has been much improved in 2010/11, the College still faces significant challenges in the coming years. This will be a significant part of the proposed merger discussions with other rural/land-based Colleges across Scotland. **Ongoing**

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