



Adam Smith College

Annual Report to the Board of Governors and the
Auditor General for Scotland

2011-12

May 2013

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1. Executive Summary

Introduction

The Accounts Commission for Scotland appointed Grant Thornton UK LLP as auditors to Adam Smith College for the period 2011-12 to 2016-17. This is therefore the first year of our appointment. This document summarises our responsibilities as external auditors for the year ended 31 July 2012 and our approach to issues impacting the College during the year.

We carry out our audit in accordance with the International Standards on Auditing (UK and Ireland).

Our key findings

The College has faced a particularly challenging year, during which it has identified significant failures in both its governance and financial stewardship arrangements. These failures have led to a change in leadership at the College, and resulted in a requirement to repay over £5.5 million of EU grant income with a consequent impact on the financial position of the College. The College has also established a £1.2 million provision for further European grant funding where Fife Council acted as lead partner. The College has taken action to address these failings following separate investigations by the Scottish Funding Council, the Scottish Government and by independent auditors.

These events have occurred during a period of transition within the further education sector, which will

see reductions in funding across the sector and result in the creation of a new regional college for the Fife area from 1 August 2013. Many of the issues identified are now legacy issues and have not impacted to any significant degree of learning outcomes for students as evidenced by recent inspection reports.

Our audit of the financial statements is now complete, but has been delayed by the events outlined above, particularly in resolving the total amount of EU grants to be repaid. We are able to confirm that the financial statements present a true and fair view of the College's financial position at 31 July 2012. In light of the significant governance and financial stewardship issues identified in relation to the College's administration of EU grants, we have to draw attention to this significant issue in forming our opinion on the accounts. In addition, as a result of delays in finalising these accounts, they have not been laid before Parliament by Scottish Ministers within 9 months of the financial year end as required by the Public Finance and Accountability (Scotland) Act 2000. We have not been required to amend our opinion on the accounts as a result of this matter.

Acknowledgements

We would like to take this opportunity to record our appreciation for the kind assistance provided by the Finance Team and other staff during our audit

| Reporting Area | Our Summary |
|----------------------|---|
| Financial Position | <ul style="list-style-type: none"> As a result of the requirement to repay EU grants, the College reported a deficit for the year of £767k, representing 2.5% of income (2011 restated surplus: £387k). Total reserves have fallen by around £4.5 million during 2011-12, to £18.5 million. We are able to confirm that the College remains a going concern with sufficient funds in place to support its operations up to the point of merger with Carnegie College. |
| Financial Statements | <ul style="list-style-type: none"> The draft financial statements were of a good standard, but significant adjustments have been processed following the outcomes of a range of audit reports during the year. We intend to give an unqualified opinion on the truth and fairness of the financial statements |

of the College.

- We have also provided an emphasis of matter paragraph in our opinion in drawing the Board's attention to the significant governance failures during the year which resulted in the requirement to repay EU grant funding.
- We note that the College's accounts were not laid before the Scottish Parliament by Scottish Ministers within 9 months of the year end as required by the Public Finance and Accountability (Scotland) Act 2000. Whilst this technical breach of a statutory requirement has not required us to amend our opinion on the accounts, the College should avoid any recurrence.

Governance and Performance

- During the financial year, the College responded to a number of Public Interest Disclosures (PID) relating to the culture and governance of the organisation. Following an investigation supported by the Scottish Funding Council, the College agreed an action plan to address the weaknesses identified.
- In response to the allegations raised, the College changed its senior leadership team in October 2012, and has taken action to improve organisational culture, and financial control arrangements. Learning outcomes for students have been largely unaffected and the College continues to receive strong ratings from Education Scotland.
- The College is expected to merge with Carnegie College and the non-land based elements of Elmwood College on 1 August 2013. We have reviewed the Colleges' preparations for the merger, but in light of the adjustments to the College accounts, financial resilience will remain a key concern for the incoming Board, particularly in light of a potential inability to access future EU funding and an expected reduction in the availability of revenue grant support from the Scottish Government.

2. Introduction

This report has been prepared for the benefit of discussion between Grant Thornton UK LLP and Adam Smith College (the College). This has been our first year of auditing the College and this report gives a summary of the findings from our work. Our audit has focused on the financial statements and governance arrangements at the College.

Our Audit Approach Memorandum, issued in May 2012 identified two key issues in relation to the 2011-12 audit:

- the outcomes of a Scottish Funding Council (SFC) general governance oversight review of the College's response to public interest disclosures and related matters
- the regionalisation agenda and proposed merger of Fife Colleges.

During the audit year, the College has faced a number of significant challenges emerging from subsequent investigations into the public interest disclosures.

Sector developments

All Colleges in Scotland face a period of significant change, as structural reform is embedded, coupled with a challenging financial outlook as cost pressures rise while funding from the Scottish Government is expected to reduce by around 24% by 2014-15.

We use this report to consider the financial position of the College, and we hope to continue to support the College as it prepares for merger with Carnegie College.

Our responsibilities

It is a condition of our appointment that we meet the requirements of the Code of Audit Practice, which is approved by the Auditor General for Scotland. The most recent Code was published in May 2011 and applies to audits for financial years starting on or after 1 April 2011.

The Code of Audit Practice highlights the special accountabilities that are attached to the conduct of public business and the use of public money. This means that public sector audit must be planned and undertaken from a wider perspective than the private sector. We are therefore required to provide assurance, not only on the financial statements, but also on the College's governance arrangements and use of resources.

This report meets the mandatory requirements of International Standard on Auditing 260 (ISA 260) to report the outcome of the audit to 'those charged with governance', designated as the Audit Committee and the Board.

The Board is responsible for the preparation of financial statements which record its financial position as at 31 July 2012, and its income and expenditure for the year then ended. We are responsible for undertaking an audit and reporting whether, in our opinion, the Board's financial statements present a true and fair view of the financial position.

3. Governance arrangements

During 2011-12, the College responded to Public Interest Disclosures relating to the culture of the College, and the misuse of public funds. The College's leadership team has changed significantly as a result of the subsequent investigations. A temporary Principal and Interim Vice Principal were appointed in October 2012, to lead the College until the merger with Carnegie College.

Public Interest Disclosures

In 2011-12, a number of Public Interest Disclosures were made alleging various matters including bullying and mismanagement at the College. The College initially asked their internal auditors to investigate claims regarding the potential inappropriate use of College resources. In February 2012, the Education Secretary asked the Scottish Funding Council (SFC) to prepare a further report on the allegations relating to the culture of the College.

As a result of this review, the College and SFC jointly published an action plan to address the issues arising in April 2012. The action plan included further investigations into specific allegations around the misuse of College funds. The College subsequently appointed KPMG to independently investigate the allegations and report to the Chair of the Board. KPMG's work was completed in two phases:

- Phase 1 reviewed allegations of financial misconduct, including severance payments to members of staff and irregularities in tendering and the use of College resources
- Phase 2 investigated allegations regarding funded projects

KPMG made a number of findings which have significant implications for the College and our audit

(Table 1). As a result of the Phase 2 report, Scottish Government internal auditors were engaged to review the management of EU funds at the College. The auditors found significant irregularities, including the apparent systemic overclaiming of staff time. The Scottish Government has subsequently required the College to repay the full value of EU grants received (£5.5 million), and has de-committed the balance of grants not yet paid (amounting to a further £2.6 million).

Table 1: Summary of KPMG findings

Phase 1

- Voluntary severance payments made to two individuals were not in line with the College policy at the time.
- The College's Financial Regulations were not adhered to in the engagement of two companies to undertake a marketing strategy review.
- There was a lack of documentation around a number of decisions, including the personal use of College facilities and suppliers.

Phase 2

- KPMG found evidence that the College had submitted claims to grant funding bodies which are inaccurate, unsupported by evidence of input and overstated since at least 2007.
- There is no control or reconciliation over total expenditure on individual projects and the College used an inappropriate method for income recognition.

During the course of our audit we also identified a debtor relating to projects that were funded by European grants, but where Fife Council acted as the lead partner. As the College are currently unable to provide assurances about the eligibility of this funding, the College have made a provision for this amount. We consider the effect of the repayment of European funding and further provision on the College's financial position in Section 4 of this report.

Partner Organisations

The Scottish Government internal auditors reviewed the College's claims for a number of grants under European Structural Funds.

Under these projects, the College acted as lead partner for around 30 other organisations, including public sector and charitable bodies. Around £1.5 million of the funding for the projects was therefore distributed to other bodies.

The Board is accountable for the College's stewardship of public funds, and therefore has a duty to protect the public purse, and to ensure the probity and value for money of College resources. At its meeting on 20th March 2013, the College Board considered a potential clawback of funding that had been passed to partner organisations, and is now required to be repaid to the Scottish Government. At the meeting, the Board agreed not to pursue repayment of this funding, on the basis that the partner organisations had claimed funding in good faith, and had been subject to the College's own audit and confirmation processes.

Statement on Corporate Governance and Internal Control

The College prepares a Statement on Corporate Governance and Internal Control as part of their annual accounts. This Statement is prepared in line with the good practice guidance provided in the SFC's Accounts Direction and summarises the internal control framework, including arrangements for risk. The 2011-12 Statement also highlights the governance concerns

emerging from the Public Interest Disclosures (PID) and subsequent reviews.

The College initially set up a PID working group to investigate and respond to the disclosures. The role of the working group now falls to the Organisational Change Committee, which provides a direct reporting line to the Board. This Committee is also responsible for monitoring the progress against recommendations arising from each review.

Our testing of Internal Controls

As part of our audit work we reviewed the internal control environment in operation across the College finance systems. We completed walkthrough testing on three systems. We make a number of minor recommendations within **Appendix 1**, principally relating to segregation of control issues associated with the size of the Finance team.

Risk Management

The College has recently taken steps to improve its risk management processes. A Risk Management Group has been established with representation from across the college to provide a comprehensive and balanced assessment of risks facing the College.

The College's Audit Committee receive reports on the strategic risk register throughout the year. We understand that a separate risk management system is in place to consider the risks arising from the merger.

Review of Internal Audit

The Board's Internal Audit service is provided by Wylie & Bissett. For 2011-12, 40 days were planned, although only 39 days were used. Additional work was also undertaken in relation to public interest disclosures at the request of the College. Eight reviews were planned and completed, and the internal auditors also followed up prior year reports to ensure that actions had been taken as planned.

Due to the nature of the reviews carried out during 2011-12, we did not place formal reliance on the work of Internal Audit, but we reviewed their work to ensure

that our work was appropriately focused, and to highlight where there were control weaknesses.

Internal Audit concluded in their annual report to the Audit Committee that the College had 'adequate and effective risk management, control and governance processes'. The internal auditors have, however, excluded additional work performed in respect of the public interest disclosures from their opinion.

Looking forward

We are satisfied that the Board has responded appropriately to the findings emerging from the public interest disclosure reviews. During 2012-13, we will, however, continue to monitor the progress against

action plans and revised governance and internal control arrangements.

The College is also preparing for the merger Carnegie College, to form a new regional Fife College by 1 August 2013.

Preparations for the merger, following the 'Putting Learners at the Centre' principles, are critical if the College Board is to ensure that a smooth transition is achieved for students across Fife. We understand that a Shadow Partnership Board and Executive Steering Group are in place to lead the merger. We will therefore continue to monitor progress, although note that the recent publication of a Regional Curriculum and Course Directory, and launch of information events is a key achievement.

4. Financial Position

The College's financial position has been significantly affected by the requirement to repay European grants worth £5.5 million. The College has also set aside a provision for further European grants where Fife Council acted as the lead partner.

Financial position

In Section 3, we refer to the College's requirement to repay European grants worth £5.5 million. The College has subsequently investigated other European grants administered by Fife Council, and has subsequently provided for an additional £1.168 million which may have to be repaid. The resulting accrual has had a significant effect on the financial position of the College.

To reflect the timing of funding, and to aid comparability across years, the College has made a series of prior year adjustments, which have resulted in a restatement of balances in 2010-11 and 2009-10.

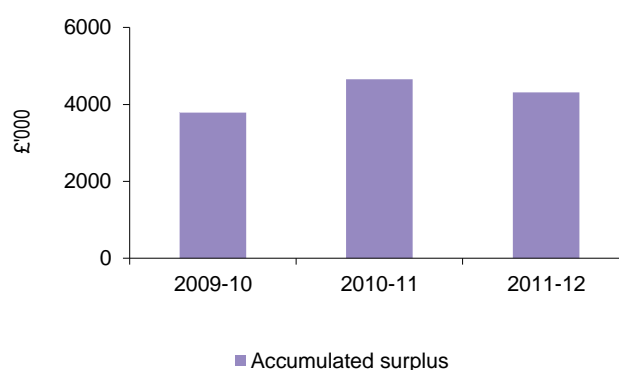
The College has reported a deficit of £0.767 million in 2011-12, representing 2.5% of the income for the year. This compares with the £0.56 million surplus that the College had budgeted for, and a restated £0.387 million surplus in 2010-11.

The College's annual surplus or deficit is transferred to its Income and Expenditure (I & E) reserve so that any surplus can be used to help finance future investments, and balance any future operating deficits. In prior years, Adam Smith was considered one of the most financially stable colleges in the sector in Scotland. However, Table 1, below, highlights the significant impact of the restatements on the I & E reserve position. These transactions have had a significant impact on the College's financial position.

Table 1: The Impact of adjustments on the Income & Expenditure Reserve

| | 2009-10 | 2010-11 | 2011-12 |
|--|--------------|--------------|--------------|
| | £'000 | £'000 | £'000 |
| Reported I & E Reserve carried forward | 8,190 | 9,706 | N/a |
| Restated I & E Reserve | 3,791 | 4,655 | 4,311 |
| Cumulative adjustments (Refer to Section 6) | 4,399 | 5,051 | 6,700 |

Figure 1: The College's accumulated income and expenditure reserves have fallen significantly compared to prior years, principally as a result of the accrual to repay European grants



Source: Adam Smith College Annual Accounts

Note: 2009-10 and 2010-11 figures have been restated to remove income received from European Grants to allow comparability across years.

The net pension liability means that the College's general reserves are now in a £3.1 million deficit position (2011: surplus of £0.847million).

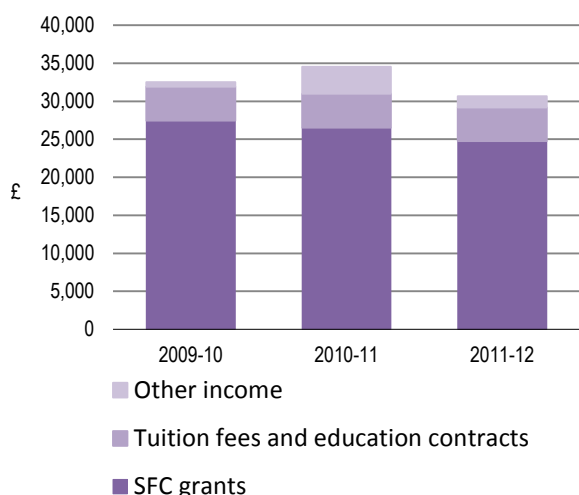
At the year end, the College had cash balances of £8.7 million. We do, however, note that £3.3 million of this balance relates to capital grants. The remaining balance is therefore fully committed to repaying European monies. We have therefore asked the College for their assessment of the going concern position within Section 6.

Income and expenditure

Public sector spending restraint means that all Colleges in Scotland face a more challenging financial position as income reduces and cost pressures increase. Figure 1 highlights that the overall income the College received from the Scottish Funding Council (SFC) fell by around 7% during the year (following a decrease of 5% in 2010-11), principally as a result of a £2.2 million fall in recurrent teaching grant, offset by additional further education childcare income and property and equipment grants. Income from commercial and overseas students also fell during the year.

The level of student activity that the College was funded for fell by 7.7% to reflect the reduction in income. The College enrolled over 13,800 students (2011:25,990) during the year, of which 4,951 (2011: 4,899) attended on a full time basis.

Figure 1: In line with the rest of the sector, the College's income fell in 2011-12 following a reduction in recurrent teaching grant from the SFC

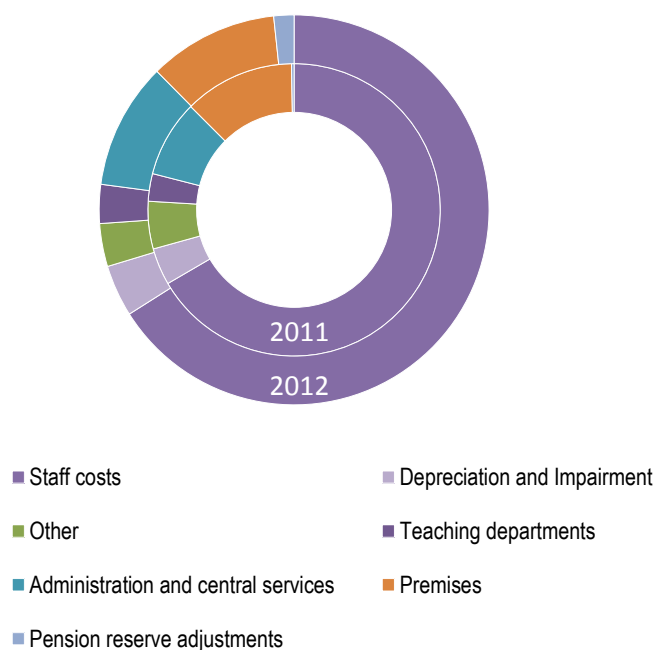


Source: Adam Smith College Annual Accounts

Note: 2009-10 and 2010-11 figures have been restated to remove income received from European Grants to allow comparability across years.

Expenditure decreased by £2.3 million (6.8%) during 2011-12, mainly due to a decrease in staff costs of £1.7 million, reflecting restructuring in prior years. Overall staff numbers have decreased from 606 in 2010-11 to 548 in 2011-12, which reflects the Board's plans to manage a reduced funding settlement.

Figure 2: Expenditure in 2012 was broadly in line with the prior year, with proportionally more spent administration and central services as a result of reviews into the public interest disclosures



Capital Expenditure

Capital expenditure in 2011-12 was £644k. The main transaction related to the purchase and immediate sale of the Mitchelston Campus in Kirkcaldy. The construction of the new Future Skills Centre, which became operational in August 2010, meant that this lease was no longer required.

Other capital spend related to ongoing improvement works at the Stenton campus, including air conditioning, and car-parking.

Budgetary control

The College has a Finance Committee in place to monitor and approve arrangements for financial control. Members of the Committee have been selected for their background in finance and management. The Senior Management Team and Finance Committee review the College's performance against budget on a regular basis, including explanations for significant variances.

The Finance Committee will continue to play a key role in preparing for the merger, including ensuring that limited resources are targeted in line with key priorities for Fife.

Current Projections for 2012-13

We have reviewed the College's projections for 2012-13 within the quarterly management accounts.

The financial position has deteriorated as a result of the reduction in income associated with European projects. The College is also forecasting a reduction in income from commercial activities, partly as a result of a change in the balance of work undertaken by partners in the SDS Energy Challenge Fund project.

The challenging income position is partly offset by a reduction in staff and other costs, but the forecast is now for a deficit position of £380k, rather than the £430k surplus that the College budgeted for. The College anticipate that cash balances will fall to £1.6 million before the merger.

5. Financial Statements

We intend to give an unqualified true and fair view audit opinion on the financial statements. However, we have drawn attention in our opinion to the significant governance failures during the year which resulted in the requirement to repay EU grant funding. We also note that the College's accounts were not laid before Parliament on time due to delays in finalising the accounts.

Introduction

We have audited the financial statements of Adam Smith College in accordance with our Audit Approach Memorandum, issued in May 2012.

Preparation of Accounts

The accounts and working papers were presented for audit on 9th July 2012, in accordance with our audit timetable. The standard of working papers was of a very high quality, and is reflected in the minor proposed adjustments that we identified during the audit.

Our audit was postponed to ensure that we were aware of the findings of other reviews relating to public interest disclosures before providing our opinion on the accounts. We were provided with the findings from the two key reviews by KPMG and the Scottish Government Internal Audit department in February 2013.

Opinion

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 2012 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).

Our audit is now complete and we have issued an unqualified audit opinion on the truth and fairness and regularity of the accounts. We have, however, included an emphasis of matter paragraph in our opinion to draw attention to the significant failures of governance and financial control identified during the year in relation to the administration and internal control arrangements for managing EU grant funded projects. These significant failures have resulted in a requirement to repay £5.5 million of EU grant funding claimed incorrectly over a number of years. The College has also made a provision for a further £1.2 million of European grants administered by Fife College on behalf of the Community Planning Partnership.

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.

Matters Identified at the Planning Stage

| | Matter Identified | Audit Commentary |
|---|--|---|
| 1 | <p>Proposed merger</p> <p>If a merger is approved, the 2011-12 financial statements will need to incorporate adequate disclosures in relation to the financial and operational aspects of the merger.</p> | <p>As part of our audit planning procedures we noted the College was in discussion with Carnegie and Elmwood Colleges to create a merged Regional College for Fife.</p> <p>We understand the date for this proposed regional College is now 1 August 2013, and as a result there are no further</p> |

| | Matter Identified | Audit Commentary |
|---|---|--|
| | | <p>disclosures required for the financial statements for the year ended 31 July 2012.</p> <p>A Fife Regional College Partnership Board has been established to consider all aspects of governance and management of the proposed new regional College.</p> |
| 2 | <p>Financial Statement Risks - Income There is a risk that income is not completely and accurately stated in the financial statements for the year ended 31 July 2012.</p> | <p>As income was identified as a reasonably possible risk during our audit planning, we performed our own testing to document the College's key income streams following review of fund provider documentation and discussions with key members of the Adam Smith finance team.</p> <p>We subsequently agreed the awards from the fund provider documentation to bank statements. We then performed analytical review of income to ensure material movements were reasonable and in line with expectations.</p> <p>We have also considered the results of reviews undertaken following public interest disclosures. As a result of the Scottish Government's internal audit work, the College has been required to repay the full value of all European Grants paid to date. The College has recognised a creditor for this balance within the 2011-12 financial statements. No further errors or irregularities were noted within our testing on income and we are therefore satisfied that income is not materially misstated within the financial statements for the year ended 31 July 2012.</p> |
| 3 | <p>Financial Statement Risks – Employee Remuneration There is a risk that employee remuneration expenses are not completely and accurately stated in the financial statements for the year ended 31 July 2012.</p> | <p>Our testing involved reconciling employee remuneration to monthly payroll reports produced by the payroll department. We also performed reasonableness on the year end employee remuneration accrual .</p> <p>Based on our testing performed, we are satisfied that employee remuneration is not materially misstated within the financial statements for the year ended 31 July 2012.</p> |

Matters Identified during the Audit

| | Matter Identified | Audit Commentary |
|---|---|--|
| 4 | <p>Debtors relating to European Grants As part of our review of the financial statements, we highlighted a debtor balance with Fife Council, which related to a number of European projects where the Council acted as lead partner. This EU grant scheme had not been covered by the Scottish</p> | <p>Following a review by the Interim Vice Principal, the College has been unable to conclude that the debtor with Fife Council is valid. The College has therefore set up a provision for the income received to date, to account for the event that this amount is required to be repaid in full.</p> |

| | |
|--|--|
| <p>Government audit or KPMG forensic audits.</p> <p>We therefore asked the College for assurance that its claim for funding under the scheme could be supported by underlying records.</p> | |
|--|--|

6. Financial Reporting Matters

Introduction

We use this section to comment on the key judgements, estimates and policies adopted by the Board that have an impact on the financial statements. We also describe the impact that changes identified during the audit process have had on the Annual Accounts.

Commentary on key judgements and estimates

Going Concern

We asked management to consider the going concern of the College, and to document this assertion in their letter of representation. The College held cash balances of £8.7 million at the year end, and are forecasting a surplus position in 2012-13. We therefore agree with the College's assessment that it is considered appropriate to adopt a going concern basis for the preparation of the financial statements.

Uncertainty and estimates

The Board uses independent actuarial experts to provide an estimate of the value of the pension liability each year. We have reviewed the qualifications and credibility of the actuary, and our actuarial team assumptions used by the actuary to underpin the financial liabilities. Our review did not highlight any concerns in relation to the valuation provided by the actuary.

Revenue recognition

The predominant source of revenue for the Board is from Grants from the SFC. Revenue for this category of receipts is recognised when the amounts become due. Revenue with regard to goods and services is recognised when it becomes probable that economic benefits will flow to the Board. The basis of revenue recognition was found to be appropriate and in line with prior years.

Review of principal accounting policies

We have reviewed the financial statements and confirmed that the accounting policies appear appropriate and in line with sector expectations.

Audit Adjustments

Misstatements

We are required to communicate all uncorrected misstatements to you, other than those considered to be clearly trivial. There were no uncorrected misstatements that we require to bring to your attention.

Impact of misstatements

All adjusted misstatements are set out in the table below.

The summarised impact of audit adjustments in 2011-12

| Balance Sheet | Increase/ (Decrease) in Net Assets |
|--|--|
| Processed adjustments | £'000 |
| Adjustment relating to European grant income received in 2011-12 which now requires to be repaid | (£449k) |
| Adjustment relating to a credit balance within European Structural Fund debtors | £387K |
| Releasing debtors related to Fife Council and the European Structural Fund | (£138k) |
| Adjustment to accruals to reflect partner costs | (£255k) |
| Creation of a provision in relation to CPP ERDF grants administered by Fife Council | (£1,168k) |
| Impact on net assets | £1,623k |

Prior year adjustments

| Balance Sheet | Increase/ (Decrease) in Net Assets |
|--|--|
| Processed adjustments | £'000 |
| 2009-10 opening balances | |
| Adjustment relating to income received prior to 31 July 2010 which now requires to be repaid | (£4,399) |
| 2010-11 | |
| Adjustment relating to income received in 2010-11 which now requires to be repaid | (£652k) |

Disclosures

We asked the Board to make additional disclosures within the Notes to the Accounts, and the Statement of Corporate Governance and Internal Control, to reflect the significant changes required as a result of the repayment of European grant funding.

7. The challenges ahead

This has been the first year of our appointment as auditors to the College and we know it has been a significantly challenging for the Board, as it faced significant changes in personnel, at both Board and Senior Management level. The Board has also found that internal controls were not operating as they expected, or had been told. We use this section to outline the key challenges for the next financial year to support the Board deliver their aims for the College, and for young people across Fife.

We look forward to working with the College in 2012-13, and hope to support you on the next stage of your journey.

1 Develop a financial strategy to protect further education services across Fife

The College now faces an acute financial position as a result of having to repay significant European grant funding. The repayment will significantly reduce the cash balances in advance of the merger. The Board has also considered the impact of pension strain costs on any future voluntary severance. The Scottish Public Pensions Authority (SPPA) scheme is oversubscribed, which means that some staff are too expensive to release under the scheme guidelines. The Board has recently agreed to pay for pension strain costs, but this will place additional pressure on the College finances. We understand that the College Board has plans to meet the Scottish Funding Council in the near future to seek support during the merger process.

2 Deliver a smooth merger process that enhances the culture and outcomes for staff and students

Work continues to progress towards a merger with Carnegie College and the non-land element of Elmwood College. The Shadow Board, and incoming Fife College Board must ensure that operational issues such as structures, systems and processes are established as quickly as possible to ensure that the merger delivers a positive change for staff and students.

3 Continuing focus on governance, internal control and risk management arrangements to ensure that the Board is not exposed again

Strong, effective governance is critical to provide challenge to management on College performance and the way finances and services are managed. We note that the College has taken steps to improve the risk management process. The Audit Committee has a key role to ensure that they receive the assurance they need on key areas of risk, by influencing and targeting audit activity, and ensuring that findings are robust and are acted upon.

Appendix A: "The Small Print"

Purpose of report

This report has been prepared for the benefit of discussions between Grant Thornton UK LLP, and the Audit Committee of Adam Smith College.

The purpose of this report is to highlight the key issues affecting the results of the Board and the preparation of the Board's financial statements for the year ended 31 July 2012.

This document is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We would point out that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements of the Board.

Responsibilities of the Board and auditors

The Board is responsible for the preparation of the financial statements and for making available to us all of the information and explanations we consider necessary. Therefore, it is essential that the Board confirm that our understanding of all the matters in this memorandum is appropriate, having regard to their knowledge of the particular circumstances.

Clarification of roles and responsibilities with respect to internal controls

The Board's management is responsible for the identification, assessment, management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance to Audit Committee that it has done so.

The Audit Committee is required to review the Board's internal financial controls. In addition, the Audit Committee is required to review all other internal controls and approve the statements included in the annual report in relation to internal control and the management of risk.

The Audit Committee should receive reports from management as to the effectiveness of the systems they have established as well as the conclusions of any testing conducted by

internal audit or ourselves.

We have applied our audit approach to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We would be pleased to discuss any further work in this regard with the Audit Committee.

Independence and robustness

Ethical standards require us to give you full and fair disclosure of matters relating to our independence.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

ISAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit work
- significant findings from the audit



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