Scott-Moncrieff

Cardonald College

Annual External Audit Report to the Board of Management and the Auditor General for Scotland 2011/12

February 2013

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Executive Summary

Finance

Our audit of Cardonald College ("the College") is complete. We audit the financial statements of the College under the Further and Higher Education (Scotland) Act 1992.

College financial year end

During the audit, Audit Scotland queried whether, in 1999/2000, the required changes were made to the 1992 Act to amend the financial year end of all colleges in Scotland from March to July. In response to this query, the Scottish Government has been unable to provide a copy of the formal order that effected this change to the Act. However, in January 2013 further evidence came to light and all auditors in the sector have agreed, in conjunction with Audit Scotland, that this evidence is sufficient to indicate that such an order was in fact made. The evidence includes the minute of a Lifelong Learning Committee meeting in October 1999 and legal representation from the Scottish Government.

We therefore now conclude that the financial statements have been prepared in accordance with the requirements of the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.

Financial position

The College has achieved a surplus of £0.844 million in 2011/12. The College's 2011/12 Financial Forecast Return (FFR) submitted to the Scottish Funding Council (SFC) projected a surplus of £0.309 million in 2011/12, and so the reported outturn surplus is significantly higher than initial estimate (which was anticipated during the year in higher forecast outturns to the Board of Management). This predominantly reflects the Colleges prudent approach to setting initial budget forecasts with overall grants and other income exceeding initial forecasts by £0.292 million. In addition actual payroll costs were £0.163 million below forecasts through teaching and other staffing costs being lower than forecasts reflecting the impact of efficiencies, restructuring and changes in teaching portfolio.

The College's 2012 FFR projects a surplus of £0.294 million in 2012/13.

Financial Reporting Standard 15: *Fixed Assets* and the Statement of Recommended Practice (SORP) for the Further and Higher Education sectors require colleges to undertake a full revaluation of assets held at valuation every five years with an interim revaluation undertaken every three years. The previous full revaluation was undertaken by the College in July 2008 and subsequently an interim revaluation should have been conducted in July 2011 and reflected in the Colleges 2010/11 financial statements however no interim revaluation was undertaken in 2010/11.

The College has subsequently undertaken a formal revaluation of land and buildings during 2011/12. This has resulted in a reduction in the opening carrying value of assets of £2.110 million and has been reflected as a prior year adjustment within the financial statements.

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 2011/12. 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.

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 2011/12 audit of Cardonald 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 Principal. 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
February 2013

Introduction

1. This report gives a summary of the findings from our external audit of Cardonald College ("the College") in 2011/12. The scope of our audit was set out in our External Audit Strategy and Plan which was presented to the Audit Committee on 31 May 2012. 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 2011/12 audit:

    - Financial Position and the effect that the reduction in core SFC grant and fee waiver income has had on the College's ability to meet their outflows
    - Strategic Partnerships and the proposed merger with Anniesland and Langside Colleges
    - Voluntary severance scheme
    - Pension fund liabilities.

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

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 as at 31 July 2012. 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.

Financial year end

7. We audit the financial statements of the College under the Further and Higher Education (Scotland) Act 1992. We are required to give an opinion as to whether the financial statements have been prepared in accordance with the requirements of the 1992 Act and directions made thereunder by the Scottish Funding Council.

8. Schedule 1 of the 1992 Act originally stated that a Scottish college's financial year runs from 1 April to 31 March. In December 1999, the Scottish Further Education Funding Council (SFEFC) issued a direction to Scottish colleges changing the college sector's financial year end from 31 March to 31 July. For colleges' 1999/2000 financial statements this resulted in 16 month accounts to facilitate this transition.

9. Any amendments to the Act require Ministerial approval. In October 2012 Audit Scotland identified that the direction issued by SFEFC in December 1999 did not, by itself, have the requisite statutory authority to amend the Act and queried whether the required Ministerial approval had been obtained.

10. In response to Audit Scotland's query, the Scottish Government has been unable to provide a copy of the formal order, signed by a Scottish Minister, that effected the change to the Act in respect of college year ends. However, in January 2013, the Scottish Government provided other evidence indicating that such an order had in fact been made. This evidence includes the minute of a Lifelong Learning Committee meeting in October 1999 and legal representation from the Scottish Government. All auditors in the sector have agreed, in conjunction with Audit Scotland, that this evidence is sufficient to indicate that the required order was made.

11. We therefore conclude that the financial statements have been prepared in accordance with the requirements of the Further and Higher Education (Scotland) Act 1992 and directions made

12. Resolving this national issue has caused a delay to the normal deadline of 31 December for submitting signed annual accounts to the Scottish Funding Council. In December 2012 the Scottish Funding Council formally extended this deadline for the 2011/12 accounts, through an amendment to the Accounts Direction, to allow time for the issue to be resolved.

13. The signed financial statements will now be submitted to the Scottish Funding Council and 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 £0.844 million for the year to 31 July 2012 despite a 10% fall in income

14. In line with the rest of the college sector, the College suffered a reduction of 10% in core teaching and fee waiver income from the Scottish Funding Council between 2010/11 and 2011/12. In addition the College has had a further reduction of 9.8% between 2011/12 and 2012/13 and has had to make savings to meet these funding reductions. The College identified savings primarily through a reduction in teaching staff costs. Overall staff costs expenditure has been reduced by £1.174 million between 2010/11 and 2011/12 with a reduction in the average number of full time equivalent employees of 45 staff between the two years.

15. Income has reduced by £2.240 million (10%) in 2011/12 compared to 2010/11. This is primarily due to a reduction in SFC recurrent grant allocations of £1.410 million, a reduction in the SFC Economic Downturn grant of £0.411 million and a reduction in European Social Fund income of £0.486 million.

16. Expenditure has also reduced in the year by approximately £1.178 million. This reduction is mainly due to the reduction in staff costs as a result of reductions through the College's voluntary severance scheme in 2010/11 as well as increased efficiencies.

Balance sheet

The College has a healthy net asset position, holding significant cash balance and reserves

17. The College has reserves of £7.814 million at 31 July 2012 (£9.042 million as at 31 July 2011) and holds £23.869 million of deferred capital grants (£24.247 million at 31 July 2011). The reserves position has weakened as at July 2012 as indicated above due to the increase in the Strathclyde Pension Fund liability of £1.966 million, reflecting an increase in the actuarial valuation of the College's share of the pension scheme liabilities. The College maintains a healthy cash balance throughout the year and held a cash and bank balance of £3.667 million at year end plus a short term investment balance of £3.667 million.

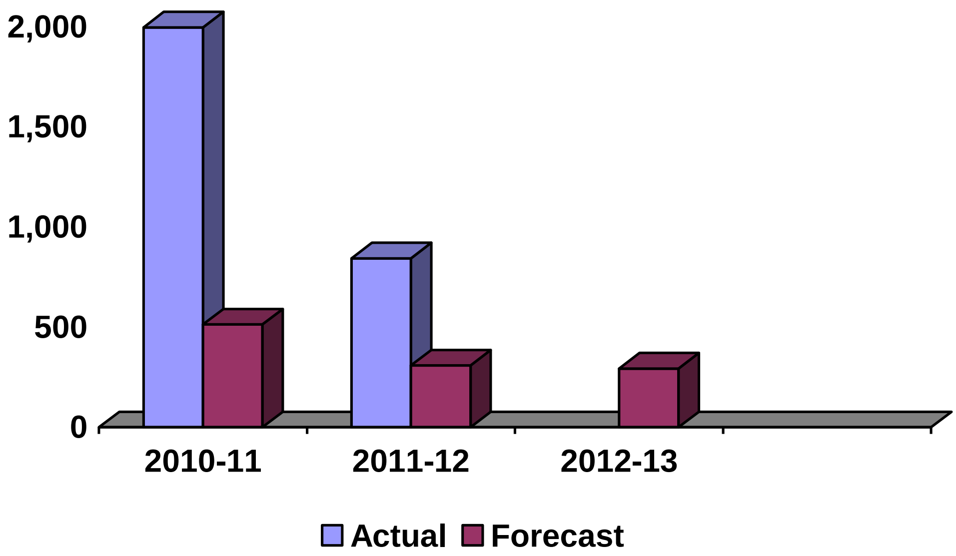
Financial forecasts

SFC funding has been confirmed for 2012/13 and a surplus has been forecast

18. The College has returned the 2012 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. Diagram 1 below compares the actual results for the College with FFR forecasts and sets out projections for 2012/13.

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



Source: Financial Forecast Returns

19. The diagram shows that the College has continued to perform well in recent years, achieving a surplus ahead of forecast for 2011/12 despite the pressures of funding reductions. A further surplus is expected in 2012/13 despite continued reductions in funding. The forecast surplus as per the FFR of £0.294 million (1.5 % of turnover) is forecast despite the further reduction of some £1.2 million of SFC grant in aid and fee waiver income. This is due to the savings 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.

20. With the ongoing regionalisation developments across the FE sector and changes to funding methodology, there is some uncertainty over future levels of funding for the College or subsequent merged institution. The College fully participates in discussions at a Glasgow regional level and is proactively planning its curriculum for the future alongside partner Colleges to meet the challenges of the ongoing reductions in funding levels.

21. We reviewed the College's budgets and Financial Forecast Return (FFR) for 2012/13 and are satisfied that the College has taken sufficient steps to ensure that the reduction in SFC income will not impact on the going concern status of the College.

Financial planning and monitoring arrangements

The financial management arrangements at the College are strong

22. 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.

23. The Board has an established Finance and Resources Committee which met regularly throughout the year. Budgets are prepared and approved at the start of the year and forecasts are updated during the year to take account of new information. Budget Monitoring Reports showing forecast year end positions against budget are presented to each Finance and Resources Committee.

24. In our opinion the College continues to have strong financial management arrangements in place.

Financial statements preparation

25. We are grateful to the Principal, the Vice Principal – Finance and Resources, the Director of Finance and the finance staff for their assistance and support during the course of the audit.

26. In addition, we found that the College continues to have adequate resources available in the Finance Department to meet the College's financial management and reporting needs.

Audit adjustments

27. In addition to a number of disclosure adjustments required to the draft financial statements, we identified four adjustments that impact on the surplus for the year or income and expenditure reserve that have been adjusted for by management. The effect of these journals are detailed below:

	Balance sheet		Income and Expenditure	
	DR	CR	DR	CR
	£	£	£	£
Dr Revaluation reserve (prior year)	2,110,000			
Cr Fixed assets (prior year)		2,110,000		
Being adjustment to reflect impact of revaluation of fixed assets				
Dr Income and Expenditure Reserve	106,000			
Cr Accruals		106,000		

Being reclassification of balances held in reserve				
Dr Accruals	17,030			
Cr Expenditure – Teaching support				17,030
Being correction of overstated accruals				
Dr Bad debt provision	15,000			
Cr Bad debt				15,000
Being reduction of bad debt provision				
Dr Income – Other SFC Grants			56,932	
Cr Accruals		56,932		
Being overstatement of grant income				
	Surplus per draft financial statements			869,000
	Impact of adjustments			**(24,902)**
	Surplus per the final financial statements			**844,098**

Revaluations

28. Financial Reporting Standard 15: Fixed Assets and the Statement of Recommended Practice (SORP) for the Further and Higher Education sectors require colleges to undertake a full revaluation of assets held at valuation every five years with an interim revaluation undertaken every three years. The previous full revaluation was undertaken by the College in July 2008 and subsequently an interim revaluation should have been conducted in July 2011 and reflected in the Colleges 2010/11 financial statements. No interim revaluation was undertaken in 2010/11.

29. Management engaged with a professionally qualified valuer to conduct an interim valuation of land and buildings. As the valuation should have been reflected in the 2010/11 financial statements and have resulted in a material reduction in carrying value of assets held, the revaluation has been reflected as a prior year adjustment in the accounts. The impact of this adjustment has reduced the opening carrying value of assets by £2.110 million and is included in the list of adjustments above.

Potential adjustments

30. During the audit we also identified three potential adjustments. We do not consider the effect of these to be material to the financial statements. The effect of these journals are detailed below:

	Balance sheet		Income and Expenditure	
	DR	CR	DR	CR
	£	£	£	£
Dr Fixed Assets - Depreciation	74,814			
Cr Depreciation charge for year				74,814
Being correction of overstatement of depreciation				
Dr Lennartz payable within one year	13,736			
Cr Lennartz payable over one year		13,736		
Being reclassification of Lennartz payable balances				
Dr Deferred Capital Grants	80,088			
Cr Income – Deferred capital grant release				80,088
Being correction of in-year deferred capital grant release				
	Potential increase in surplus from adjustments			**154,902**

Review of accounting systems

31. During our audit work we have considered the College's accounting systems and internal controls. We identified no reportable control issues during our audit of the accounting systems. In general, the College's systems of internal financial control appear to be adequate, well designed and operating effectively.

Other issues of significance in the 2011/12 audit

Voluntary severance scheme

32. To deliver a balanced budget for 2011/12 and 2012/13 following significant funding reductions from SFC the College has identified the need to reduce activity levels and further increase efficiencies. The College commenced a voluntary severance scheme during 2011/12 (further to a previous scheme which had already been offered in 2010/11).

33. *Guidance on severance arrangements to senior staff in Scottish further education colleges* produced by the Scottish Funding Council provides guidance to colleges on managing severance schemes. As

part of our audit we reviewed severance settlements for senior staff to confirm that severance arrangements conformed to the guidance.

34. We are satisfied, from the audit work performed as detailed above, that the voluntary severance scheme has conformed to guidance and has been accounted for and disclosed correctly in the 2011/12 financial statements.

Pension Fund Liabilities

35. The College's employees belong to two principal defined benefit pension schemes; the Scottish Teachers' Superannuation Scheme (STSS) for teaching staff and the Strathclyde Pension Fund (SPF) for non-teaching staff.

36. 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.

37. 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 on its balance sheet. The College reported a liability of £2.464 million as at 31 July 2012, an increase on the £1.966 million equivalent position as at 31 July 2011.

38. We reviewed the College's accounting for the pension liability to confirm that it complies with the requirements of FRS 17 and that the disclosure is consistent with the actuaries' valuation as at 31 July 2012. We also confirmed that the actuarial assumptions underpinning the valuation are reasonable and reflective of the College's circumstances.

39. We are satisfied, from the audit work performed as detailed above, that the pension fund liabilities have been accounted for and disclosed correctly in the 2011/12 financial statements.

Governance

40. 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.

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

Corporate Governance

The College's has robust governance arrangements

42. Colleges are required to include in their annual accounts 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.

43. The College's Corporate Governance Statement for 2011/12 states that the College was fully compliant with the UK Corporate Governance Code throughout the period.

44. 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.

45. 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.

Risk management

Good risk management system is in place

46. 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.

47. 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 has an oversight role with the full risk register and any changes to mitigating actions being reported in an annual report to the Board of Management and the Audit Committee.

Internal audit

48. The internal audit service is a key component of the College's internal control framework. As part of our corporate governance responsibilities, we have considered 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

49. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the College's total audit resource. For 2011/12 the internal audit service has been provided by Wylie and Bisset LLP. We have considered internal audit findings as part of our audit and have sought to minimise duplication of effort, to ensure the total audit resource to the College is used efficiently and effectively.

50. Wylie and Bisset LLP have concluded in their annual report that Cardonald College has adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives. We are grateful to Wylie and Bisset for their assistance during the course of our audit work.

Prevention and detection of fraud and irregularity

51. 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.

52. The College has a fraud response plan and a whistle blowing policy in place. There were no frauds identified during the year.

53. All SFC and other guidance and circulars are received by the Principal's Personal Assistant. All relevant regulatory information is distributed to the appropriate members of staff with deadlines as per the relevant circular for any necessary points to be actioned.

54. 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

55. 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.

56. 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, procurement and disposal of assets.

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

Looking Forward

Financial position

58. 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 2011/12 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.

International financial reporting standards

59. 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.

60. 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.

61. 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.

Financial position

62. In September 2011, the Scottish Government released '*Putting Learners at the Centre: Delivering Our Ambitions for Post-16 Education* '. This paper proposes the regionalisation of the college sector within Scotland. In response, the College is currently exploring options to align working relationships with other colleges within Glasgow. This includes a proposed merger with Anniesland and Langside Colleges.

63. The College formally agreed on 30 July 2012 to move towards a possible merger with Anniesland and Langside Ccolleges.

64. We discussed with management the progress being made by the College in response to the Scottish Government's regionalisation proposals. In particular, we considered the impact that this has on the College's operational plans and governance framework established to support successful implementation. In addition, we considered the impact that any proposed changes may have on the College's 2011-12 financial statements.

65. We are satisfied, from the audit work performed as detailed above, that the proposed merger has been disclosed appropriately in the 2011/12 financial statements.

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. There are four external audit recommendations arising in 2011/12.

The action plan details the officers responsible for implementing the recommendations and implementation dates. The College should assess the recommendation 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.

Issues arising from our 2011/12 audit

No	Title	Issue identified and recommendation	Management response
1	**Trade creditors and debtors**	The balance per the purchase and sales ledgers did not agree to the relevant control accounts in the trial balance. While the variances were not significant to balances held, there is a risk that the ledger does not reflect outstanding amounts due to or from the College. We recommend that the purchase and sales ledgers are reconciled to the control account every month, with any variances investigated and action taken to correct any difference. ***Grade 2***	Noted, and agreed **To be actioned by:** Financial Accountant **No later than:** 31 Jan 2013
2	**Fixed asset opening balance**	We noted that the plant and equipment cost and aggregate depreciation per the fixed asset register did not agree to the 2011 financial statements by £9,000. Although insignificant in amount, there is a risk of misstatement where such variances are not corrected. We recommend that the fixed asset register is reconciled to the trial balance and accounts annually, with any variances investigated and action taken to correct any difference. ***Grade 2***	Agreed **To be actioned by:** Director of Finance / Financial Accountant **No later than:** On system transfer of Opening Balances, planned for Jan 2013

No	Title	Issue identified and recommendation	Management response
3	**Fixed asset depreciation**	We noted that for some assets depreciation was not charged at the stated accounting policy. The accounting system automatically calculates depreciation and it was noted that for the land and buildings additions depreciation was charged at 10% by the system rather than 3% per the accounting policy. Although insignificant in amount, there is a risk of misstatement where such variances are not corrected. We recommend that at the year-end a sample of depreciation charges are tested to ensure that the system has used the correct rate. ***Grade 3***	Agreed **To be actioned by:** Director of Finance to review samples/workings as stated **No later than:** For 2012/13 year end work; process and working papers to be examined in advance

No	Title	Issue identified and recommendation	Management response
4	**Deferred capital grant release**	We noted that the release for the deferred capital grant was not released in line with the expected useful economic life of assets held. Deferred capital grants should be recognised through income to reflect the use of the assets. Subsequently there is a risk that the current approach adopted by the College does not enable this. We recommend that the College ensures that deferred capital grant release reflects the useful economic life of the asset. ***Grade 3***	Noted and agreed. In addition to internal review of working papers, the college is currently working with our Financial systems supplier to simplify and improve the process for generating annual deferred grant releases. **To be actioned by:** Director of Finance/Financial Accountant **No later than:** 31 Mar 2013

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