

# **The 2011/12 Audit of Adam Smith College**

## **Governance and Financial Stewardship**



Prepared for Public Audit Committee by the Auditor General for Scotland  
Made under Section 22 of the Public Finance and Accountability (Scotland) Act 2000  
September 2013

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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# Governance and Financial Stewardship

## Introduction

1. I have received the audited accounts and the auditor's report for Adam Smith College for the year ended 31 July 2012. The purpose of this report is to draw Parliament's attention to the late laying of the accounts and weaknesses in corporate governance and financial management at the college.
2. I am submitting the accounts and the auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

## Late laying of accounts

3. Section 21(1) of the Public Finance and Accountability (Scotland) Act 2000 requires that any account sent to the Auditor General for auditing should be sent not later than six months after the end of the financial year to which the account relates. Section 22 of the Act requires that:
  - Under subsection 22(4) the Auditor General must send to the Scottish Ministers the account, the auditor's report on the account and any report prepared by the Auditor General in sufficient time to enable the Scottish Ministers to comply with subsection (5).
  - Under subsection 22(5) the Scottish Ministers must lay before Parliament a copy of every account and report sent to them under subsection (4) no later than nine months after the end of the financial year to which the account relates.
4. I did not receive the audited accounts until 28 May 2013. Scottish Ministers were therefore unable to lay the accounts in Parliament by the statutory deadline of 30 April 2013.

## The auditor's opinion

5. The auditor has given an unqualified audit opinion on the college's accounts but draws attention to an external review which found significant failures relating to its corporate governance and financial stewardship arrangements. These relate primarily to the administration of grants from the European Union (EU) which the college had to repay. The accounts identify £5.5 million grants which have now been repaid, and provide for a further repayment of up to £1.2 million for grants administered by another body using information supplied by the college that it cannot substantiate (Exhibit 1).

## Exhibit 1

### Extract from the independent auditor's report on the 2011/12 accounts of Adam Smith College

#### Emphasis of Matter

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosures made in Note 30 to the financial statements, which describes the college's requirement to repay European Social Funds (ESF) income totalling £5.5 million. The college has also made a £1.2 million provision for further European income for an externally led project which may become repayable. The college has been required to repay this income following an external review which found significant failures in governance and financial stewardship arrangements for ESF funded projects over a number of years.

*Source: The financial statement of Adam Smith College 2011/12*

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## Outcome of investigations

6. Investigations have identified significant failures in the College's corporate governance and financial stewardship arrangements.
7. The college is an independent legal body with charitable status as defined by the Further and Higher Education (Scotland) Act 1992. It is governed by a Board of Governors. The Board is responsible for determining the overall strategy of the college and its educational character, the proper use of public funds, the quality of provision, and appointing the Principal and other senior staff. On 1st August 2013, Adam Smith College merged with Carnegie College and parts of SRUC Elmwood Campus to form a new Fife College.
8. In accordance with the Further and Higher Education (Scotland) Act 1992 and Financial Memorandum, the Board is responsible for the administration and management of the college's affairs, including ensuring an effective system of internal control, and is required to present audited financial statements for each financial year.
9. During 2011-12 the college received correspondence under whistleblowing legislation<sup>1</sup> alleging bullying and mismanagement at the college. The allegations were investigated by the college's Designated Officer for Public Interest Disclosures and then, at the request of Adam Smith College Board of Governors, by consultants commissioned by the Scottish Funding Council (SFC).
10. The investigations identified a number of shortcomings in college management including the potential misuse of college funds.
11. The college subsequently appointed KPMG to consider the allegations of financial misconduct in more detail. The first review (referred to as Phase one) looked at financial areas such as severance payments and tendering. A second review (referred to as Phase two) investigated EU funded projects. KPMG found a lack of compliance with college policies and procedures

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<sup>1</sup> Public interest Disclosure Act 1998

during the first review and the second review identified significant weaknesses in the financial management of EU funded projects (Exhibit 2).

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## **Exhibit 2 Summary of KPMG findings**

### Phase 1- Review of allegations of financial misconduct

- 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 - Investigation of allegations related to funded projects

- KMPG 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.

*Source: Adam Smith College, Annual Report to the Board of Governors and the Auditor General for Scotland 2011-12, May 2013*

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12. Following KPMG's findings the Board of Governors invited the Scottish Government's internal audit team to review its management of EU funds. The auditors found significant irregularities including claims for staff costs claimed that were much higher than those actually incurred by the college, and other costs that were not eligible. The Scottish Government subsequently required the college to repay the full value of EU grants received.

## **The College is taking action to address weaknesses in corporate governance and financial management**

13. The college developed a number of action plans to address the issues arising from the investigations into its various aspects of its management. The Board of Governors put in place a revised committee structure to provide oversight of the implementation of the plans.
14. The college updated its risk register to take account of the findings of both internal and external audit work (Exhibit 3).

**Exhibit 3****Principal Risks and Uncertainties**

The principal financial risks relate to the uncertainty of future grant income due to the anticipated reductions in public sector funding and the recovery of a significant sum of the college's European project funding. The planned merger of the college with Carnegie College under the Regionalisation agenda, and the resultant merger costs, also increase the financial risks as well as potentially affecting the continuity and quality of learning and teaching of the college. The various reviews and investigations into the culture and European funding issues at the college threaten its financial security and stability, potentially harm its employee relations, and damage the reputation of the college. The Board and Senior Management of the college are aware of these risks and have in place controls and plans to mitigate these risks.

*Source: The financial statement of Adam Smith College 2011/12*

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15. The investigations led to significant changes to the college's board and to its senior management during 2012/13:
  - In January 2012, two board members resigned as did the Secretary to the Board
  - In February 2012, the Chair of the Board resigned and a new Chair was appointed
  - In March 2012 the college Principal resigned. Three senior managers were also on paid leave pending investigations, since then two senior managers have left the college and one remains in employment.
  - In September 2012, the Acting Principal was suspended
  - In October 2012, a new Interim Principal was appointed as was a new interim Director of Finance
  - In January 2013, three members of staff were suspended whilst internal investigations into the management and administration of EU funding were undertaken.
16. The college's financial statements for the year ended 31 July 2012 show that the decision to repay EU grants could cost the college up to £6.7 million. £5.5 million of this relates to European Social Funds claims administered directly by the college which had been identified for repayment and has been reflected in its accounts through an adjustment to income and expenditure reserve account. This amount has now been repaid. The accounts also provide for up to £1.2 million relating to claims administered by Fife Council based on information supplied by the college which cannot be fully substantiated.
17. The college remained a going concern with sufficient funds in place to support its operations up to the point of its merger with Carnegie College in August 2013. However, its financial position deteriorated as a result of the reduction in income associated with European projects and the forecast was for a deficit position of £380k, rather than the £430k surplus that the college budgeted for.

## Conclusions

18. The Board and management of Fife College must continue to address the weaknesses identified. It must ensure that all the issues identified in the reviews are addressed and where residual work is required this is followed up and implemented. Appointed auditors will continue to monitor progress closely and report as appropriate.