North East Scotland College

Annual Report on the 2013/14 audit

AUDIT SCOTLAND

Prepared for the Board of Management of North East Scotland College
and the Auditor General for Scotland
September 2014

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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Summary

Key messages from the 2013/14 Audit

1. With effect from 1 November 2013, Aberdeen College merged with Banff and Buchan College to form North East Scotland College. The reclassification of incorporated further education colleges took effect from 1 April 2014. This treats colleges as part of central government for financial budgeting and reporting purposes. The first stage of this regime was to move the financial year end and therefore the 2013/14 college year covers the 8 month period from 1 August 2013 to 31 March 2014.
2. We have given an unqualified opinion on the financial statements of North East Scotland College and its group for the period ended 31 March 2014 and on the regularity of the financial transactions reflected in those financial statements.
3. We recognise that work is ongoing to restructure and streamline processes and procedures across campuses since the merger but in general, we concluded that governance and internal controls were operating satisfactorily.
4. In 2013/14 the group reported a deficit of £12.190 million, after transferring £13.175 million to an arm's length trust.

Introduction

5. The purpose of this report is to summarise the auditor's opinions and conclusions, and to report any significant issues arising. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in the Annual Audit Plan presented to the Audit Committee in March 2014, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011.
6. The Board of Management is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. The auditor is responsible for auditing and expressing an opinion on the financial statements. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Status of the Audit

7. Our work on the financial statements is now complete. The issues arising from the audit were discussed with the Vice Principal - Finance throughout the audit process and our report to those charged with governance was considered by the Audit Committee in July 2014.

Financial statements audit opinion & representations

8. We have given an unqualified opinion on the financial statements of North East Scotland College and its group for the period ended 31 March 2014 and on the regularity of the financial transactions reflected in those financial statements. The auditor's report is attached at Appendix A.

9. Misstatements identified during the audit have been corrected in the revised accounts. In overall terms, the revised amounts had a net effect of decreasing income by £746,000 decreasing expenditure by £104,000 and increasing the deficit by £500,000. Net assets as recorded in the group balance sheet have decreased by £264,000.

10. The main adjustments were required to correct duplication errors in bringing together working papers for the former Banff and Buchan and Aberdeen Colleges to provide the figures for North East Scotland College. Accruals of £179,000 in respect of staff costs had been double counted and Scottish Funding Council transitional funding was overstated by £533,000.

11. In addition, the level of some deferred grant income released to the income and expenditure account during the year had not been adjusted to reflect the shorter accounting period of 8 months. As a result grant income was reduced by £237,000 with a corresponding increase in the deferred capital grants account in the balance sheet.

12. An adjustment of £17,000 in respect of depreciation charges has not been made. While more than clearly trivial, this error was immaterial to the accounts as a whole and therefore we agreed with finance not to adjust the accounts.

13. As part of the completion of our audit we seek written assurances from the Principal on aspects of the accounts and judgements and estimates made. A draft letter of representation under International Standard of Auditing (ISA) 580 has been provided to the Principal and this should be signed and returned prior to the independent auditor's opinion being certified.

Key Judgements

Acquisition accounting

14. From 1 November 2013, Aberdeen College merged with Banff and Buchan College to form North East Scotland College. Financial Reporting Standard (FRS) 6 covering acquisitions and mergers provides criteria to determine whether merger or acquisition accounting should be applied. The criteria includes the:

- role of the respective parties in the combination of the bodies
- dominance of management including the board and senior management structures
- the relative size of the parties combining.

15. Following management review of the criteria, acquisition accounting was considered appropriate for the combination of Banff and Buchan College with Aberdeen College. This meant that the assets, liabilities and rights and obligations of Banff and Buchan College transferred to North East Scotland College on 1 November 2013 and that only the results of

the former college for the 5 month period between 1 November 2013 and 31 March 2014 form part of North East Scotland College's accounts. Separate audited accounts were prepared for Banff and Buchan College covering the period from 1 August 2013 to 31 October 2013. In our view this approach was appropriate and met the requirements of FRS 6.

Recognition of income

16. In previous years, the accounting period matched the academic year and recurring grant income from the Scottish Funding Council (SFC) was received in respect of the academic year. As 2013/14 was an 8 month accounting period, it was necessary to give particular consideration to the approach to income recognition.

17. Traditionally, recurring grant income is allocated to colleges on a phased percentage basis with the profiling informed by the sector's cash flow requirements. For the academic year 2013/14, the college is due to receive £30.2 million of which £16.9 million has been recognised in the financial statements to 31 March 2014 based on the amount receivable.

18. The college receives recurring grant from the SFC to deliver the targets set out for the academic year within its Regional Outcome Agreement. One of the targets relates to student activity which is measured in weighted student units of measurement (WSUMs). At 31 March 2014, the college had achieved 84% of its WSUMs target. However, it would be difficult to assess the level of income which the college could recognise to reflect achievement of the overall outcome agreement at 31 March 2014.

19. The college's profile of expenditure shows that it accrues fairly evenly across the year. If a similar assumption were made for recognising income, on the basis that staff are involved in course preparation and other related activities throughout the year, then the relevant proportion for 8 months would be £18.3 million.

20. From 1 April 2014, following reclassification of colleges, the funding mechanism has changed in that colleges are now required to submit monthly cash flow forecasts setting out their funding needs. This method is more likely to match the college's income and expenditure patterns on an ongoing basis and may provide the opportunity for a more systematic basis for income recognition.

21. SFC Guidance for the completion of the 2013/14 financial statements acknowledged that no single methodology was seen as more correct, but that it is for individual colleges to demonstrate that they have applied an appropriate methodology to arrive at an acceptable estimate.

22. Having examined the different approaches set out above, the college's approach recognised a lower level of income than other alternatives. In overall terms, this has provided a consistency in the figures included in the Consolidated Income and Expenditure Account. This was a transitional period for the college with the merger taking place on 1 November 2013 and the impact of reclassification taking effect from 1 April 2014. Taking all these factors into account, we are satisfied that the approach adopted by the college for the period to 31 March 2014 has produced an acceptable estimate.

Revaluation Reserve

23. Financial Reporting Standard (FRS) 15 requires that any decrease in the valuation of an asset should be off-set first against any revaluation surplus for that asset. Any remaining balance should be taken to the Consolidated Income and Expenditure Account. In our 2012/13 report for Aberdeen College, we reported that management were unable to separate the revaluation reserve into its constituent elements and were therefore unable to fully demonstrate that an off-setting balance existed in relation to assets with downward revaluations. Further work was undertaken during the year which enabled the college to separate the constituent elements of the revaluation reserve and match them with specific assets. This exercise highlighted assets where, for example, capital expenditure on renovations exceeded upward revaluations in value for the assets since they were first valued. Therefore if the initial valuations had not been posted to the revaluation reserve, the downward revaluations would require to be accounted for through the Consolidated Income and Expenditure Account. Based on audited financial statements for the former Aberdeen College, we were able to confirm that when colleges were first required to value their assets, the full valuation was posted to the revaluation reserve. On this basis, we confirmed that the accounting treatment adopted in respect of the treatment of revaluations complied with the SORP.

Accounting for pension costs

24. In previous reports, we also drew attention to the college's accounting treatment for pension costs. The college accounted for pension contributions to the Local Government Pension Scheme as if it were a defined contribution scheme. This meant that the liability to pay for future pensions of current staff was not recognised on the balance sheet as required by FRS 17, accounting for retirement benefits. During the period to 31 March 2014, the college engaged the actuary to look at separating the college's assets and liabilities from other colleges with a view to implementing the pensions accounting requirements of FRS 17.

25. The effect on the balance sheet was to include an additional £9.6 million of provisions relating to Aberdeen-based pension scheme members at 31 July 2013. The merger brought in a further £3.7 million of liabilities from the former Banff and Buchan College. Together with actuarial movements during the eight month period, the impact of complying with FRS 17 was to increase the college's pension provision by some £13 million.

Governance and internal control systems

26. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their board members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.

27. Through its accountable officer or equivalent, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

28. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:

- corporate governance and systems of internal control
- the prevention and detection of fraud and irregularity.

Audit Committee

29. Scrutiny of the effectiveness of the internal control processes within North East Scotland College is undertaken by the Audit Committee. The terms of reference for the committee were in line with the UK Corporate Governance Code 2010 (the Code).

30. The Code and the Accounts Direction from the Scottish Funding Council require colleges to include a governance statement within their financial statements. The statement confirmed that in the opinion of the Board of Management, the college complied with the Code throughout the period ended 31 March 2014. We have reviewed the governance statement and have confirmed it is in line with the content required by the Accounts Direction and it reflects our understanding of North East Scotland College.

Internal control

31. The auditor evaluates significant financial systems and associated internal controls for the purpose of giving an opinion on the financial statements and as part of the review of the adequacy of governance arrangements. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.

32. Internal audit for the college is provided by Wylie & Bisset LLP. Generally, we seek to rely on the work of internal audit wherever possible and in respect of 2013/14, we concluded that reliance could be placed on their work. In their annual report for 2013/14, Wylie and Bisset LLP provided their opinion that based on the internal audit work undertaken during the year, the college had adequate and effective risk management, control and governance processes to manage its achievement of the college objectives.

33. Our testing identified the following areas where internal controls needed to be strengthened:

- procedures for checking and confirming changes to suppliers' bank details should be refreshed and implemented. Evidence supporting any changes and senior staff approval should be retained.
- following the transfer of staff records from Fraserburgh to Aberdeen and the departure of staff from the college as part of the merger process, there is a need to ensure that records are complete, up-to-date and reflect the revised establishment position.
- the finance team need to undertake work to merge the asset registers of the former Aberdeen and Banff and Buchan Colleges. In addition, componentisation of assets should be implemented, where appropriate, as part of the next asset revaluation exercise.

34. Internal audit identified some significant weaknesses around for example, business continuity and these have been reflected in the Governance Statement. Otherwise, we did not identify any material weaknesses in the accounting and internal control systems during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

Risk Management

35. The college's risk management strategy, processes and risk register were kept under regular review by the Board of Management to ensure that risks were adequately managed by the college.

Prevention and detection of fraud and irregularities

36. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. We noted for example, standing orders, a prevention of fraud policy, whistle blowing policy and codes of conduct for board members and staff. Combined these are the standard suite of policies and procedures we would expect to find in an organisation with satisfactory arrangements in place.

Arm's-length foundation

37. By bringing further education colleges within the central government framework, certain restrictions were put on aspects of existing financial management arrangements, including:

- the ability to generate and retain income and reserves
- use of existing reserves
- access to capital funding and commercial borrowing.

38. In order to protect existing reserves and minimise the impact of reclassification on colleges' finances, a solution was reached with SFC in the form of arm's-length foundations. Across the further education sector, colleges have either established their own foundation as arm's-length vehicles or have opted to join a national foundation, to which balances agreed by college boards were required to be transferred by 31 March 2014.

39. NES FE Foundation was constituted as a Scottish Charitable Incorporated Organisation which was approved by the Office of the Scottish Regulator (OSCR) in February 2014. The Foundation has 7 members, 4 of which are independent trustees including the chair. Having reviewed the Constitution, we were satisfied that the Foundation's funds would not be required to be consolidated with those of the college.

40. The college approved the transfer of funds to the Foundation and by 31 March 2014, a total amount of £13.175 million had been successfully transferred.

Financial position

41. North East Scotland College and its Group reported a deficit of £12.190 million at 31 March 2014, after transferring £13.175 million to its arm's-length foundation. More widely, the sector continues to face a variety of financial challenges in the year ahead as it embeds the requirements of reclassification of colleges as public bodies from April 2014 including the restriction on their ability to build up reserves.

Performance

Severance payments

42. At 31 March 2014, the financial statements showed that the college incurred £1.4 million in staff exit costs. In spring 2013, the Boards of Management of Aberdeen College and Banff and Buchan College, and the Aberdeen and Aberdeenshire Regional Partnership Board, approved the introduction of a voluntary severance scheme. The scheme opened in June 2013 for one year.

43. The scheme required senior staff applications to be considered by the Board of Management. In reality, for former Aberdeen College applications, this was delegated to the Remuneration Committee. One senior staff application was received and we confirmed that it had been approved by the committee and that it was supported by a detailed business case setting out the cost implications. Other staff applications were to be considered by the senior management team (SMT) and in respect of payments to former Aberdeen College staff, we were able confirm approval with SMT minutes in all cases.

44. The exit costs reported in the accounts also included some residual payments to former Banff and Buchan staff. Approval for these payments was the responsibility of the board of the former Banff and Buchan College which ceased to exist on 31 October 2013. We have reported separately on these severance payments within our report to those charged with governance for the accounts of Banff and Buchan College for the 3 month period ended 31 October 2013. Consequently, no further reference on the matter is made within this report.

Acknowledgements

45. We would like to express our thanks to the staff of North East Scotland College for their help and assistance during the 2013/14.

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APPENDIX A:

Independent Auditor's Report

Independent auditor's report to the members of the Board of Management of North East Scotland College, the Auditor General for Scotland and the Scottish Parliament

I have audited the financial statements of North East Scotland College for the year ended 31 March 2014 under the Further and Higher Education (Scotland) Act 1992 and section 44(1)(c) of the Charities and Trustee Investment (Scotland) Act 2005. The financial statements comprise the group Consolidated Income and Expenditure Account, Consolidated Statement of Historical Cost Surpluses and Deficits, Statement of Total Recognised Gains and Losses, the Balance Sheet, Consolidated Cash Flow Statement, college-only Balance Sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Auditor General for Scotland, I do not undertake to have responsibilities to board members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Board of Management and auditor

As explained more fully in the Statement of Responsibilities of the Board of Management, the Board of Management is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and is also responsible for ensuring the regularity of expenditure and income. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Auditor General for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors. I am also responsible for giving an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the body's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Board of Management; and the overall presentation of the financial statements. It also involves obtaining evidence about the regularity of expenditure and income. In addition, I read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements, irregularities or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council of the state of the affairs of the group and of North East Scotland College as at 31 March 2013 and of the surplus of the group and the college for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- 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, the Charities and Trustee Investment (Scotland) Act 2005, and regulation 14 of The Charities Accounts (Scotland) Regulations 2006.

Opinion on regularity

In my opinion in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

Opinion on other prescribed matters

In my opinion the information given in the Operating and Financial Review for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I am required to report by exception

I am required to report to you if, in my opinion:

- proper accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Statement of Corporate Governance and Internal Control does not comply with Scottish Funding Council requirements.

I have nothing to report in respect of these matters.

Anne MacDonald CA
Senior Audit Manager
Audit Scotland
Business Hub 11, 2nd Floor West
Marischal College
Broad Street
Aberdeen
AB10 1AB

16 September 2014

Anne MacDonald is eligible to act as an auditor in terms of section 21 of the Public Finance and Accountability (Scotland) Act 2000