The 2015/16 audit of Moray College

Prepared for the Public Audit and Post Legislative Scrutiny Committee by the Auditor General for Scotland

Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000

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Introduction

1. I have received the audited financial statements and the auditor's report for Moray College for 2015/16. I am submitting these financial statements and the independent 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.

2. The purpose of this report is to draw Parliament's attention to concerns about financial management and sustainability at Moray College.

The auditor's opinion

3. The auditor gave an unqualified opinion on Moray College's financial statements for 2015/16 but, in her audit report, highlighted concerns relating to the financial position. During the year, the college needed to urgently draw down an advance on its funding allocation for 2016/17 from the University of the Highlands and Islands (UHI) as it did not have enough money to meet its operational costs. The auditor concluded that the current financial position was not sustainable and that the college needs to take action to achieve financial balance. The college's recovery plan has been submitted to UHI and the Scottish Funding Council (SFC).

Background

4. Moray College is an independent legal body with charitable status as defined by the Further and Higher Education (Scotland) Act 1992 (the 1992 Act). It is governed by a Board which is responsible for determining the overall strategy of the college and the proper use of public funds, the quality of provision and appointing the Principal and other senior staff. In 2015-16, the college had 4,184 registered students and employed 249 FTE members of staff.

5. Colleges are organised into 13 college regions. Ten of the regions contain a single college, while three are multi-college regions (Glasgow, Highlands and Islands and Lanarkshire). In each multi-college region, there is a regional strategic body which is responsible for planning and funding delivery of learning across all of the colleges in the region. The regional body is also responsible for working with the Scottish Funding Council, to determine and agree the priorities for the region. Moray College is part of the Highlands and Islands Region, and the associated regional strategic body is the University of the Highlands and Islands. UHI took on its regional strategic body responsibilities from August 2014. Moray College received 72 per cent of its 2015/16 income from the Scottish Funding Council (SFC). These grants were allocated by UHI as the regional strategic body. The college also received income from course fees, research grants and contracts.

6. The college's total income in 2015/16 was £12.1 million. The college reported a deficit of £876,000 (seven per cent of income). After excluding items that do not reflect in-year financial payments but instead relate to longer-term considerations (that is, depreciation and pension accounting adjustments), the underlying deficit would be £158,000.

Financial management and reporting

7. In my report, *Scotland's colleges 2016*, I highlighted that the college had received a cash advance of £568,000 from UHI during 2014/15. This was required to meet immediate commitments, following a failure by the college to adjust its budget to reflect changes in higher education funding. The college repaid this in full by the end of October 2015. However, the college had to make another request for funding in 2015/16, requesting £697,000 of advance funding (six per cent of income) in June 2016.

8. In 2014/15 the auditor stated that Board and committee minutes did not evidence decisions or agreed actions to address the college's financial challenges and concluded that there needed to be clearer evidence of the decisions taken by the Board and its committees following their consideration of the financial position. While the college took steps to address concerns raised by the auditor in 2014/15, these were not sufficient.

9. The college was forecasting an end-year surplus of £145,000 in January 2016. By April 2016, this had changed to a forecast deficit of £499,000. The auditor found that the management accounts analysed the areas of overspend but did not provide explanations for variances between budgets and forecasts. Neither did they indicate why the issues were not identified earlier so alternative action could have been considered. In addition, there was a lack of audit trails to support some budget and forecast figures included in management accounts.

10. The cash advance of £697,000 included the following items:
    - repayment of the outstanding amount of £368,000 in respect of the 2014/15 cash advance
    - an invoice for £46,000 from HMRC following a failed bid for VAT relief during the construction of a major capital project and a remaining payment of £83,000 in connection with the same project
    - a funding claw back of £79,000 for a project review by European Regional Development Fund auditors
    - a backdated amount of £60,000 following implementation of a national pay award
    - delay in the release of European Structural and Investment Fund (ESIF) grant income to the college of £39,000.

11. The college's 2015/16 budget and cash flow were initially prepared in June 2015 but subsequent revisions were not fully updated to reflect the effect of unplanned amounts on cash flow, for example the backdated national pay award and the delay in ESIF grant income. Consequently, the cash flow position in 2015/16 was lower than the college had been planning for. In April 2016, the Board was advised that the college would be in a cash deficit position by July 2016 and would need a cash advance from UHI.

12. Between April 2015 and February 2016, the college was operating without a permanent Principal. The Director of Finance was on long-term absence from August 2015 until formally retiring on 31 July 2016. The Acting Principal took on the Director of Finance role during this time and day-to-day financial management was provided by the accounts team, led by an

Assistant Accountant. The auditor concluded that the team was competent but that more capacity was needed. The auditor previously flagged concerns about a lack of senior financial expertise in her audit report on the 2014/15 financial statements. Following the appointment of a new Principal in March 2016, an interim Director of Finance was appointed on a part-time basis in June 2016 to develop a financial forecast and plan for the next three years.

Financial sustainability

13. The auditor highlighted a number of contributing factors that are indicative of the difficulties the college faces:

- deficits reported on income and expenditure statements year-to-year
- the net current liability position is increasing each year
- the decision to delay property repairs as a short-term funding solution may lead to increased costs in the future, accelerated deterioration in the value of the assets and an adverse impact on students' learning experiences
- failure to achieve financial targets against resource limits.

14. The current financial position is not sustainable. The college's 2015/16 accounts forecast a deficit of £641,000 in respect of 2016/17 and the college has identified funding shortfalls until 2019. At February 2017, the college reported that its forecast deficit for 2016/17 is £472,000. There is a risk that the college will not secure the necessary efficiencies to meet the estimated shortfall in the longer term. The auditor's report highlights that the college is currently faced with a level of staff costs which appear unsustainable. Staff costs were £9.4 million in 2015/16, and accounted for 72 per cent of gross expenditure. This is higher than the average for Scotland's colleges overall (63 per cent of gross expenditure). In light of the college's restriction on non-pay expenditure in 2016/17, the auditor questioned 'whether more can be saved without impacting on the learning experience'. The auditor concluded that a fundamental change is required to reduce the cost base and deliver a sustainable, balanced budget.

Recovery plan

15. The Principal (appointed in March 2016) has reviewed the college's activities and its associated income and expenditure streams. The college began discussing a recovery plan with UHI in June 2016 and the plan was submitted to the SFC in February 2017. The college has already implemented a temporary freeze on the recruitment of support staff. It is also considering a severance scheme to reduce costs - this is likely to require additional funding from the SFC. The college also identified a need to appoint a senior staff member in the finance team. UHI has appointed a Director of Finance who will be seconded to Moray College for at least two years. Other actions proposed include:

- a review of activity targets, to determine whether a change in allocation is appropriate (this is part of a regional review with UHI)
- increasing income generation.

16. It is clear that the college will have to work closely with both UHI and the SFC in order to implement all of the actions needed to achieve recovery.

Timeline of events

17. A timeline of key events is included at Appendix 1.

Conclusion

18. Moray College had a significant underlying deficit in 2014/15, which I commented on in my report, *Scotland's colleges 2016*. The college has again experienced difficulties in managing its finances within budget in 2015/16. Moray College will continue to face financial difficulties without fundamental changes to its costs and financial management arrangements. The college is taking steps to address its financial difficulties but as yet has to agree its recovery plan with the SFC. The organisations need to agree actions as a matter of urgency. It is important that UHI as the regional body ensures that the college is able to deliver on its priorities within the resources available. The College Board will also have an important role to play in monitoring the college's progress with its agreed recovery plan. I have asked the auditor to keep the position under review.

Appendix 1

Timeline

Date	Event
August 2014	New Principal appointed
March 2015	Principal left by mutual agreement
March 2015 - February 2016	Acting Principal arrangements in place (the Assistant Principal was acting up as Principal)
June 2015	The college needed to draw down £568,000 cash in advance from UHI to meet immediate commitments
By 31 July 2015	£200,000 repaid leaving a balance of £368,000
June - August 2015	Detailed review of Moray College's financial position reported to UHI's Finance and General Purposes Committee
11 August 2015	UHI sent a letter to the Chair of Moray College highlighting serious concerns and requesting a number of urgent actions in return for the short-term funding.
October 2015	The college cleared the balance of £368,000
August 2015 - July 2016	Director of Finance on long-term absence
March 2016	New Principal appointed
31 July 2016	Director of Finance retired
June 2016 to present	Part-time Interim Director of Finance in post to assess the financial position within the college and develop a financial forecast and plan for the next three years
June 2016	The college requested an advance of £697,000 from UHI to meet immediate commitments.
At 31 July 2016	£658,000 of the cash advance still owed at the end of the month.

Date	Event
August 2016	Cash advance fully repaid.
August 2016	Ten non-executive members of the college board (from a total of 18) resigned. Nine new appointments were made. This was part of a national refresh of college boards of management. The refresh was due at the end of 2014/15 but was deferred following the departure of the Principal in March 2015 in order to provide continuity until a new Principal was appointed. Four members (including the Acting Chair) provided continuity during the period of transition between boards.
June 2016 - ongoing	UHI in discussion with Moray College about its recovery plan and possible solutions.
November 2016	Moray College provided an update and position statement on the Recovery Plan to UHI
December 2016	Moray College submitted a formal request to the SFC, through UHI, for approval and funding for a voluntary severance scheme
January 2017	Moray College incorporated UHI and SFC feedback into the final version of the Recovery Plan
2 February 2017	Moray College's board approved the Recovery Plan.
8 February 2017	UHI received Moray College's Recovery Plan without amendment
13 February 2017	UHI submitted the final Recovery Plan to the SFC.