Scott-Moncrieff

The Adam Smith College

Annual Report to the Board of Governors and the Auditor General for Scotland 2010/11

December 2011

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Executive Summary

Finance

Our audit of Adam Smith College is complete and our audit opinions on the truth and fairness of the financial statements and the regularity of transactions are unqualified.

The College has achieved a surplus of £1.039m in 2010/11.

The College has restated its 2009/10 surplus to £2.422m within the 2010/11 accounts (previously reported as £0.889m), due to the prior year adjustment to reflect the CPI/RPI pensions change in the Income and Expenditure Account. This is as a result of the updated accounting guidance issued since the 2009/10 accounts were signed.

The College's 2010 Financial Forecast Return (FFR) submitted to the Scottish Funding Council (SFC) projected a surplus of £0.997m in 2010/11, and so the reported outturn is generally in line with projection.

The College's 2011 FFR projects a further surplus of £0.558m in 2011/12.

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 2010/11. 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 2010/11 audit of Adam Smith 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 Vice 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
14 December 2011

Introduction

1. This report gives a summary of the findings from our audit of Adam Smith College ("the College") in 2010/11. The scope of our audit was set out in our External Audit Strategy and Plan which was presented to the Audit Committee on 7 June 2011. Our audit has focused on the financial statements and governance arrangements at the College.

2. Our plan summarised three key issues in relation to the 2010/11 audit:

   - Estate developments, primarily relating to the Future Skills Centre at Stenton and the building at Mitchelston Industrial estate
   - Fife Council Pension Scheme and the accounting for the 2009/10 actuarial adjustment in relation to the move from RPI to CPI
   - Early retirement liabilities.

3. This report includes our findings in relation to these key issues and also includes a follow-up of issues identified in our previous annual reports.

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 at 31 July 2011. 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.

Auditors' opinion

7. 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 2011 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).

8. Our audit is now complete and we have issued unqualified audit opinions on the truth and fairness of the accounts and on the regularity of transactions.

9. 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.

Financial position

The College has reported a surplus of £1.039m for the year to 31 July 2011 despite a 5% fall in income

10. The College's consolidated performance includes the small surplus generated by the Adam Smith Enterprise and Education Foundation (ASEEF). The in-year performance is outlined in the table below, and is consistent with the forecast surplus of £0.997m for the year.

Table 1 – Consolidated surplus position

	Year ended 31 July 2011 £'000	Year ended 31 July 2010 (restated) £'000
College surplus	1,036	2,441
ASEEF surplus/(deficit)	3	(19)
Consolidated surplus	**1,039**	**2,422**

Source: Financial Statements for the year ended 31 July 2011

11. The College has restated its 2009/10 surplus to £2.422m within the 2010/11 accounts (previously disclosed as £0.889m), due to the prior year adjustment to reflect the CPI/RPI pensions change in the Income and Expenditure Account. This is as a result of the updated accounting guidance issued since the 2009/10 accounts were signed. This is discussed further in paragraphs 28-30.

12. Income has reduced by £1.726m (5%) compared to 2009/10. This is primarily due to a reduction in SFC allocations of £0.936m and a reduction in European grant income of £0.670m (the latter due to five projects finishing during the year).

Balance sheet

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

13. The College has reserves of £28.007m at 31 July 2011 (£26.196m as at 31 July 2010) and holds £18.999m of deferred capital grants (£19.153m at 31 July 2010). The reserves position has strengthened due to the surplus which has been made in the year and a reduction in the pension liability of £0.775m. There was also a healthy cash balance totalling £9.809m at year end.

The College entered into a new long term loan in 2010/11

14. A £7.5m long term loan was taken out in the period. This loan replaced the working capital facility needed to fund the construction of the Future Skills Centre upon its completion in August 2010. This has led to a shift in the year from current to non-current liabilities. The loan will be paid over 22 years and has led to an increase of £148,000 in interest costs charged to the Income and Expenditure account in the year. The College now holds two long term loans with Santander and is subject to a covenant on these. Table 3 shows the College's performance against this covenant in the year, and the forecast for 2011/12.

Table 2 – Performance against Bank Covenant

	Covenant	2010/11	2011/12
Debt servicing costs: Earnings before interest, tax and depreciation	1 : 1.15	1 : 11.6	1 : 6.8
Net Assets	£33m	£47m	£47m

Source: College FFR commentary report, June 2011

Future Skills Centre at the Stenton Campus – fully operational from August 2010

15. The Future Skills Centre at Stenton has been transferred from assets under construction to disclosure in land and buildings within fixed assets during 2010/11. This reflects the completion of the project during the year. The balance transferred from assets under construction was

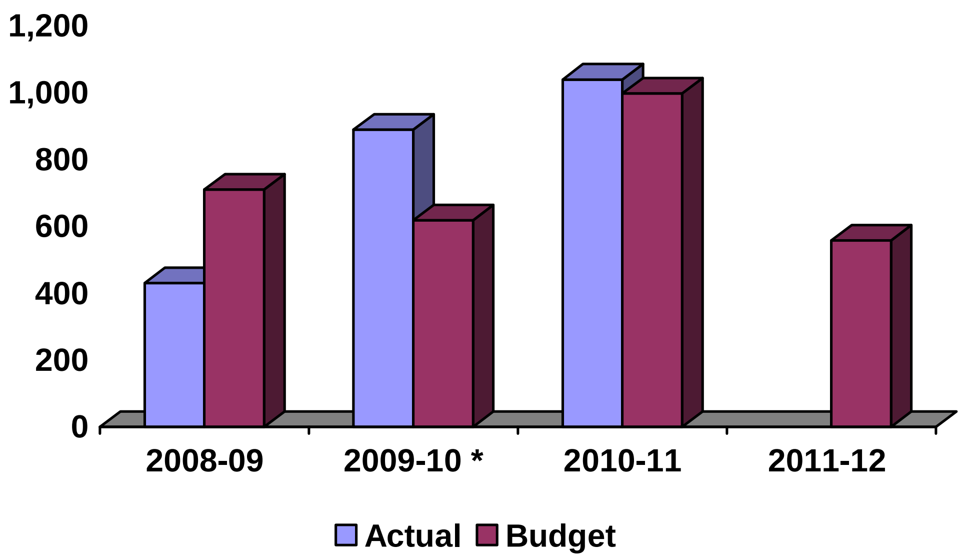
£15.319m, of which £0.989m relates to additions in 2010/11. We have reviewed the College's accounting treatment for the Future Skills Centre transactions and confirmed it has been accounted for appropriately.

Financial forecasts

SFC funding has been confirmed for 2011/12 and a surplus has been forecast

16. The College has returned the 2011 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. SFC has confirmed funding for 2011/12, but, unlike previous years, the College has not been asked to provide three year projections given uncertainty over the financial position of the sector as a whole. The result has been that the College has not been able to budget in the same level of detail as before beyond 2011/12. Instead, scenario planning has been undertaken to model the impacts of various funding settlements. Given the College's recent financial performance and strong balance sheet this is not expected to pose a major risk in the short term, however the College should seek to formalise its medium term plans as soon as it receives clarity on funding from SFC. Diagram 1 below compares the actual results with FFR forecasts and sets out projections for 2011/12.

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



Source: Financial Forecast Return

**adjusted to remove the exceptional gain relating to FRS 17 CPI/RPI restatement, to provide "like-for-like" comparison*

17. The diagram shows that the College has continued to perform well in recent years, achieving a surplus in excess of forecasts for 2009/10 and 2010/11. A further surplus is expected in 2011/12 despite having to work under significant funding pressures. The budgeted surplus of £0.557m (1.7% of turnover) is forecast despite the loss of some £2.5m of grant in aid and fee waiver. 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.

Financial planning and monitoring arrangements

The financial management arrangements at the College are strong

18. 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.

19. The Board has established a Finance Committee which met regularly throughout the year. Budgets are devised and approved at the start of the year and are updated during the year to take account of new information. Management accounts showing forecast year end positions against budget are presented to each Finance Committee.

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

Financial statements preparation

21. We are grateful to the Vice Principal, the Finance Managers and the finance staff for their assistance and support during the course of the audit. As in previous years, we found the draft accounts and supporting working papers to be of a very high standard.

22. In addition, we found that the College continues to have adequate resource available in the Finance Department to meet the College's financial management and reporting needs. Adam Smith College compares favourably when considered against the resources, organisation and quality of supporting papers of other Colleges across the sector.

Audit adjustments

23. During the course of our audit a small number of audit adjustments to the financial statements were identified and agreed. The table below outlines the impact on the surplus of the adjustments made during the course of the audit. The majority of the changes made were of a presentational and disclosure nature with no unadjusted misstatements.

Table 3 – Audit adjustments raised in 2010/11

	£'000
Surplus per accounts presented for audit	**1,247**
Adjustments identified during the audit:	
Increase in accrued costs re Mitchelston	(233)
Removal of provision (no clear legal/constructive obligation)	49
Adjustment to deferred capital grant release	(24)
Actual surplus per audited accounts	**1,039**

24. We also agreed a small number of adjustments to the Balance Sheet which did not impact directly on the surplus for the year. These were to adjust European Debtors and Creditors balances and to reclassify the pension accrual.

Fife Council Pension Fund

25. The College's employees belong to two principal defined benefit pension schemes, the Scottish Teachers' Superannuation Scheme (STSS) for the teaching staff and the Fife Council Pension Fund for the non-teaching staff.

26. 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* (FRS17) , 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.

27. The Fife Council Pension Fund 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 in the balance sheet. The College has consistently reported significant FRS 17 liabilities over the past few years. The Fife Council Pension Fund's actuaries provide the College with an updated valuation on an annual basis which is reflected in the pensions liability disclosed on the balance sheet. We have reviewed the College's accounting for these pension schemes and found that it complies with the requirements of FRS 17.

28. In 2009/10, there was also a one-off pension adjustment of £1.533m in favour of the College, which was reflected in the Statement of Recognised Gains and Losses (STRGL). This transaction was required because on 22 June 2010 the Chancellor of the Exchequer's Budget Statement confirmed that future pension increases were to be linked to the Consumer Prices Index (CPI) rather than Retail Prices Index (RPI).

29. The College's 2009/10 treatment - to take the adjustment through the STRGL - was based on the Draft Urgent Issue Task Force Note 48 (UITF 48) which was issued to inform the accounting for this change. It was only after the accounts were signed that the Final UITF 48 was updated and issued. The Final UITF 48 was changed in such a way as to indicate that accounting for the adjustment through the STRGL was not the most appropriate treatment in the College's circumstances.

30. As a result, the College has processed a prior year adjustment to account for the RPI/CPI move through the College's income and expenditure account. This is why the 31 July 2010 column on the Income and Expenditure Account and certain of the notes are labelled as "restated". This has been treated as a prior period adjustment arising from a change in accounting policy. We have confirmed that the College has made the appropriate accounting entries and disclosure in the financial statements. It is this matter which has led to the College restating its 2009/10 surplus to £2.422m (previously disclosed as £0.889m) within the comparative column of the 2010/11 accounts.

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 2010/11 audit

Early retirement provision

32. The College has previously offered early retirement to staff as part of the management restructuring programme. The College makes monthly payments to the pension fund to cover any shortfall arising from the decision to grant early access to retirement benefits. In line with *Financial Reporting Standard 12 - Provisions, Contingent Liabilities and Contingents Assets* (FRS 12), the College creates a provision for the future payments in relation to these early retirements. The provision for early retirement was £3.022m at 31 July 2011 (£3.045m at 31 July 2010).

33. We reviewed the College's accounting treatment of its liabilities arising from early retirements and confirmed that this was consistent with the calculated liability as provided by Hymans Robertson LLP.

Group financial statements

34. The College has a 100% controlling interest in the Adam Smith Enterprise and Education Foundation ('ASEEF'). ASEEF is consolidated within the College's financial statements.

Governance

35. 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.

36. We reported on the corporate governance arrangements in relation to its financial position 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 governance arrangements remain strong

37. Colleges are required to include in their annual accounts a statement covering the responsibilities of their Board of Management in relation 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.

38. The College's Corporate Governance Statement for 2010/11 states that the College was fully compliant with the UK Corporate Governance Code throughout the period.

39. 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.

40. 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.

The UK Corporate Governance Code has come in to effect for Colleges in 2010/11

41. A new Corporate Governance Code was published in June 2010 and has come in to effect for financial years beginning on or after 29 June 2010. The UK Corporate Governance Code, formerly known as the Combined Code, sets out standards of governance for listed companies. The Code is also applicable to publicly funded bodies that are required to prepare an annual statement on internal control or corporate governance for inclusion in their annual accounts. The "comply or explain" provision is retained in this new version of the code.

42. In March 2011 the Board formally considered the implications of the new code, in line with our recommendation in our 2009/10 annual report. This review found that not all of the provisions within the Code were relevant to the College. Key areas which were relevant were:

    - Risk Management: That the College's business model should be explained and the Board should be responsible for determining the nature and extent of the significant risks it is willing to take.
    - To further promote proper debate at Board meetings.
    - To encourage the Board to be well balanced.
    - To enhance the Board's performance by holding regular development reviews with Board members and to regularly review its effectiveness.

43. The Board found that the new code did not add materially to the existing corporate governance and risk management procedures already in place. This analysis appears reasonable, and is in keeping with our cumulated understanding of the Board's governance arrangements.

Risk management

Good risk management system is in place

44. 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.

45. 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 action plans being reported to the Board via the Audit Committee.

Internal audit

46. 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

47. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the College's total audit resource. For 2010/11 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.

48. Wylie and Bisset LLP have concluded in their annual report that Adam Smith 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

49. 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.

50. The College has a fraud prevention policy (including fraud response plan) and whistle blowing policy in place. The College has identified a fraud liaison officer and a whistle-blowing officer. There were no frauds identified during the year.

51. All SFC and other guidance and circulars are received by the Principal's Secretary. All relevant regulatory information is distributed to the appropriate members of staff. A database is held of all SFC circulars and responsible officers dealing with the relevant circular.

52. 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

53. 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.

54. 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.

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

Looking Forward

Financial position

56. 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 2010/11 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.

57. SFC has confirmed funding for 2011/12, but, unlike previous years, the College has not been asked to provide three year FFR projections given uncertainty over the financial position of the FE and public sector as a whole. This puts pressure on the College's ability to plan its medium term financial future. It is undoubtedly a significant variable which complicates strategic decision making. However, the history of strong financial performance has shown that the College operates on a firm financial footing and it is well placed to meet these future financial challenges when compared to many other FE bodies.

International financial reporting standards

58. 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.

59. 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.

60. 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.

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 no external audit recommendations arising in 2010/11, so this section follows up on prior year recommendations.

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

Follow-up of previous external audit recommendations

No	Title	Original recommendation and management response	Update at October 2011 by Scott Moncrieff
1	**Fixed Asset Verification**	**Original Recommendation** The College should conduct an annual verification exercise covering all material fixed assets on a cyclical basis, to confirm that assets recorded in the asset register and subsequently disclosed in the financial statements are physically held by the College and have not been impaired. ***Grade 2*** **Management response** Agreed	The College started to conduct a formal fixed asset verification exercise during the year, and has plans to continue this further in 2011/12. **Ongoing**

No	Title	Original recommendation and management response	Update at October 2011 by Scott Moncrieff
2	**Corporate Governance Code**	**Original Recommendation** To mitigate against the risk of non-compliance, we recommend that the College reviews its corporate governance arrangements against the new Code in preparation for making its Corporate Governance Statement in its 2010/11 annual accounts. ***Grade 3*** **Management response** Agreed	In March 2011 the Board formally considered the implications of the new code. The Board found that the new code did not add to the existing corporate governance and risk management procedures already in place at the College. We have found this analysis to be reasonable. **Satisfactory**

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