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Cardonald College

Annual audit report to the Board of Management of Cardonald College and the Auditor General for Scotland

Year ended 31 July 2011

20 December 2011

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

This report is for the benefit of the Board of Management of Cardonald College and is made available to Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

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Headlines

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the *Code*"). This specifies a number of objectives for our audit.

This report summarises our work for the year ended 31 July 2011, the final year of our five-year appointment as the College's auditors. It also provides information required by ISA (UK and Ireland) 260: *Communication with those charged with governance*.

We wish to record our appreciation of the continued co-operation and assistance extended to us by Cardonald College staff during the course of our work.

Financial statements and accounting	Page
Draft financial statements and supporting documents were provided in line with the agreed timetable. Some work papers were incomplete resulting in delays in the audit process.	6 to 7
We have issued unqualified audit opinions on the 2010-11 financial statements and the regularity of transactions reflected in them.	-
A number of audit adjustments were made to the draft financial statements and there are no unadjusted audit differences.	5
Accounting policies are appropriate for the underlying operations.	4 to 5
Use of resources	
The College has reported a surplus of £2.0 million, well in excess of its budgeted surplus of £514,000. This is mainly due to income being higher than anticipated and a decrease in expected staffing costs.	4
The College forecast for 2011-12 is to achieve a surplus of £411,000.	8
Governance	
The statement of the responsibilities of the board of management and corporate governance statement continue to confirm the existence of a comprehensive framework of internal control.	9
Arrangements to protect and detect fraud are embedded in internal controls.	9
Internal audit did not report any significant weaknesses and concluded positively on the internal control framework.	9
The operating and financial review provides a very comprehensive account of the College's activities and exceeds reporting requirements.	-

Service overview

- **Student numbers / Weight Student Units of Measurement (“WSUMs”)**
  Despite a reduction in Scottish Funding Council funding in 2010-11, the College has delivered only a slight decrease of 326 in WSUMs, compared to 2009-10. The activity target set by the Scottish Funding Council for 2010-11 was 76,043 WSUMs. The combined target includes 2,583 WSUMs for the ongoing SFC administered European Structural Fund (ESF) project. This target was achieved. The College delivered 77,892 WSUMs in 2010-11; 2.4% greater than the Scottish Funding Council set target activity level.

- **Course provision**
  The College has a key part to play in supporting economic and social regeneration in the south and west of Glasgow and beyond.

  Due to changing economic needs, the College continually reviews the portfolio of courses to ensure it meets market, legislative and employer demands. While taking into consideration skills, economic and social needs, the College undertakes an annual exercise to ensure the overall financial viability of the portfolio removing programmes which have failed to recruit sufficient student numbers, meet retention targets etc. The proposed government cuts in further education funding in the future mean that some areas of the College’s portfolio and future delivery of courses will have to be significantly reviewed.

  The College will continue to increase the efficiency of teaching delivery whilst maintaining the strategic aims of responding to economic and skills needs, supporting access and progression and building capacity.

- **Campus development**
  The College’s estates strategy takes a long-term view of priorities and will continue to shape the development of capital spending in future years. During summer 2010, significant improvements were made to the science laboratories, health care practice rooms and supported learning teaching kitchen areas within the main tower block. In summer 2011, work was undertaken to create a new renewables facility, to upgrade areas of the skills centre, and refurbishment of the library and larger lecture theatre.

- **Future funding issues**
  In September 2011, the Scottish Government released a pre-legislative paper; ‘Putting Learners at the Centre: Delivering Our Ambitions for Post-16 Education’. This paper considers the regionalisation of the college sector and reforming of funding within Scotland, with an emphasis on the Scottish Government not being able to afford a system of individual institutions serving overlapping areas. The College is considering this paper along with the Scottish Government’s Scottish Spending Review 2011 and Draft Budget 2012-13. This sets out fiscal plans for the next three years, stating that the further education sector overall will receive a 7% reduction in funding in 2012-13.

  The paper has been considered by the board of management and a response will be sent to the consultation as required by 23 December 2011. The College has communicated with staff as a result of this legislation, through extensive consultation and weekly updates through the principal’s blog. The College had a Board planning event planned for mid-November 2011, where the College’s response in relation to the potential implications of these developments was to be discussed.

Accounting policies, financial statements preparation and audit process

There have been no changes to the College's accounting policies.

The audit plan anticipated significant risks around accounting for financial performance, economic climate, corporate governance, pension liabilities, compliance with tax authorities and valuation of buildings.

No audit adjustments were required and the audit was concluded in a timely manner.

Accounting policies			
There have been no changes in accounting policies from 2009-10 to 2010-11.			

Areas of HIGH audit risk

Area	Value (£'000) 2011	Value (£'000) 2010	KPMG comment
Financial performance	-	-	The College has exceeded the management accounts budgeted surplus (excluding costs such as depreciation) for 2010-11; the forecast management account surplus increased to £514,000 from £435,000 in early June 2011. The actual surplus in the financial statements amounted to £1,997,000 for 31 July 2011, mainly due to a decrease in recurring staff costs, due to the action by the College to reduce its staff base and a higher level of some income areas than previously anticipated. The College has budgeted effectively to match their income and expenditure to result in a surplus in 2010-11. The College exceeded its target performance in relation to WSUMs in 2010-11 and will continue to review its activity annually in line with SFC target levels.
Economic climate	-	-	The budget for 2011-12 has had to incorporate SFC funding cuts of 10.4% and the College is forecasting a £411,000 surplus. The budget has been set against a backdrop of continuing uncertainty around the level of main grant funding available to the College in future years. The College has a commercial income stream which is in part exposed to some commercial and international business risk, due to the current economic climate. The College incurred staff restructuring costs of £580,000 in 2010-11.
Corporate governance	-	-	We have considered the Accounts Direction in relation to the UK Corporate Governance Code, and the corporate governance statement provided by the board of management. The pilot of the sector specific CIPFA code of corporate governance has not been actioned any further, due to a decision by Scotland's Colleges not to use the issued draft. Our controls testing found no weaknesses in the system of internal controls and our review of the risk register confirmed our understanding of the risk management process at the College. We reviewed governance processes around the re-election of the chair of the board. The process was designed and operated effectively.

Accounting policies, financial statements preparation and audit process (continued)

Areas of HIGH audit risk			
	Value (£'000)		
Area	2011	2010	KPMG comment
Pension liabilities	498	646	Our actuarial team considered the underlying assumptions of the key drivers of the FRS17 valuations. We substantively tested the pension liability and all other pension disclosures in the financial statements.
Compliance with tax authorities	-	-	Consistent with our understanding of the College that there are no significant non-business activities undertaken by the College. We liaised with our tax compliance colleagues and have not identified any significant matters relevant to the audit which have not been appropriately reflected.
Staff restructuring	580	-	During the year, the College initiated a voluntary severance scheme which had two phases for applications. Forty-four members of staff were accepted to leave through the staff restructuring scheme. The total associated costs were £580,000. There were no unsettled liabilities as at 31 July 2011 as all staff who were accepted to leave had their employment terminated before the year end.

Preparation of financial information

- Draft financial statements and supporting documentation were provided on 7 October 2011, in line with the agreed timetable.
- Finance staff responded to our questions quickly and provided high quality information to support the financial statements, but the overall quality of the files prepared in advance of our visit was not as good as prior years and ,despite improvements in some areas, for some other captions, there were a number of duplicate working papers or incomplete working papers. The quality and range of information included in files improved during the course of the audit work
- Overall, management adopts an efficient approach to preparing the financial statements.

Audit conclusions

- A number of presentational and numerical audit differences were amended by management. There were no unadjusted differences arising from the audit.
- There are no matters to be brought to your attention regarding our independence or non-audit fees.
- We have issued unqualified opinions on the financial statements and the regularity of transactions reflected therein.

Financial position

Financial planning arrangements are robust. The surplus for the year was significantly better than forecast in management accounts.

The financial statements report a surplus for the year of £2.0 million, an increase of £34,000 on the position recorded in the previous year. As at 31 July 2011, there are general reserves of £7.4 million.

The College's income and expenditure account is summarised opposite.

Income for the year has decreased by £274,000 and expenditure for the year has decreased by £308,000 when compared to 2009-10. The key movements are:

- Grants received from the Scottish Funding Council have decreased by £354,000, (2%), compared with the prior year. This is partly due to lower fee waiver levels and reduction in specific grants, including knowledge transfer and MCMC.
- Other income has decreased by £372,000 due to lower volumes of trade, including fewer available full days open, mainly due to weather closure and reduction in income from trades work, including plumbing and construction.
- Tuition fees and education contract income has increased by £305,000 due to a significant increase in the number of higher education students, reflected in a proportionate recovery of fees from the Student Awards Agency for Scotland.
- European social fund income increased by £146,000 as a result of increased project activity in 2010-11 and investment income increased by £95,000 due to net return on pension asset, as a result of the FRS17 interest adjustment.
- Staff costs increased by £461,000 although there is an underlying decrease once the severance costs in 2010-11 are removed. In this comparison it should be noted that the 2009-10 staff costs were reduced as a result of a one-off past service gain associated with pension costs of £668,000. Therefore, the recurring College staff costs decreased significantly between 2009-10 and 2010-11.

	2010-11 £'000	2009-10 £'000
Income		
Scottish Funding Council grants	16,637	16,991
Tuition fees and education contracts	2,294	1,989
Other grant Income	942	894
Other operating income	2,859	3,231
Investment income	104	5
	22,836	**23,110**
Expenditure		
Staff costs	14,923	14,462
Other operating expenses	4,426	4,991
Impairment charges	25	118
Depreciation	1,465	1,449
Interest payable	-	127
	20,839	**21,147**
Surplus	1,997	1,963

- Decrease in other operating expenditure of £565,000 partly due to a decrease in other SFC grant expenses as a result of lower levels of grants received and a decrease in other income generating activities as a result of lower volumes of activity.

The outturn for the year is £1.1 million higher than the outturn projected in the management accounts in June 2011.

Financial position (continued)

Overall, net assets have increased by £1.95 million (6%) since the prior year. The key movements underlying this increase are as follows:

- Fixed assets have decreased £503,000. This is a result of additions in the year of £987,000, offset by a £1.46 million depreciation charge.
- Cash and short term investments have increased by £3.1 million which is partly a result of the College receiving a Lennartz payment of £1.1 million and the College's efforts to retain sufficient cash balances in order to allow future investment in learning resources and College assets.
- Creditors due within one year have increased by 135,000. This is due to a decrease in accruals following a change to the payroll processes to start paying all staff on a monthly basis rather than having some on a four weekly basis. There was also a decrease in capital accruals compared to prior year as a result of significant capital projects being completed during 2010-11 and related grant funding being transferred to deferred capital grants. This is offset by an increase in respect of balances held in respect of student support funds.
- Creditors due after more than one year increased by £625,000 which is a result of the Lennartz payment movements.

	2011 £'000	2010 £'000
Tangible fixed assets	32,274	32,777
Stocks	10	22
Debtors	982	1,296
Cash and short term investments	6,728	3,392
Creditors: Amounts falling due within one year.	(2,316)	(2,181)
Creditors: Amounts falling due after more than one year.	(760)	(125)
Provision for liabilities and charges	(1,021)	(982)
Pension liability	(498)	(646)
Net assets	**35,399**	**33,553**
Deferred capital grants	24,247	24,450
Revaluation reserve	4,239	4,240
General reserve	6,913	4,863
Total funds	**35,399**	**33,553**

Financial position (continued)

Corporate plan

The College has a corporate plan covering the period 2009-2012. This focuses on four key themes which are; portfolio, partnerships, people and performance. Each of the themes is underpinned by a number of related objectives. The College relies heavily on SFC funding, which was 73% of total funding in 2010-11 and the performance section of the plan has objectives for non-SFC funding areas.

The corporate plan for 2009-12 states that the College was aiming for a 2% surplus in 2010-11 rising to a 4% surplus in 2011-12. The surplus for 2010-11 is higher than forecast as a result of staffing adjustments made by the College and restructuring arrangements to prepare for the future funding position.

Post 2012, the senior management team has started to consider the detail in relation to this, but as there is uncertainty over the level of SFC grant income post April, management will incorporate the effects of future funding levels in the next plan update.

Financial forecasts

2011-12 financial forecast	£'000
Income	19,069
Expenditure	(18,658)
Forecast surplus	411

The forecast for 2011-12 is for the College to achieve a surplus of £411,000, which equates to 2.2% of income. This surplus is a significant reduction on the actual surplus in 2010-11. The College strategy includes an aim to expand non-SFC funding sources. However, in line with the rest of the sector, the College remains reliant on funding from SFC. The budget for 2011-12 reflects decreased SFC funding and the College undertook a significant financial realignment and staff restructuring process to meet the challenge of reduced SFC funding for 2011-12.

In respect of staff costs, the budget includes an estimate of the annual salary reduction of £1.1 million as a result of the voluntary severance scheme and staff restructuring process in 2010-11.

Future financial planning

An estates strategy covering the period 2009-19 was prepared and approved by the board of management in December 2009 with ongoing annual updates. This strategy was prepared following a review of the anticipated curriculum developments over the ten year period and an assessment of the current position of the estate. There are currently three key projects in the strategy at a total estimated cost of £13 million. Concerns over potential capital funding shortfalls have been raised, particularly as SFC capital funding allocations are expected to be reduced in future financial years.

SFC is keen that the constrained capital resources in 2011-12 are targeted at maintaining existing assets and annual grants must be used for estates build/maintenance and debt servicing associated with capital developments aligned to the estates plan. From the recent Scottish Government spending review, future capital funding allocations will be further reduced for the sector. The College will progress its estates strategy based on affordability and consideration may be given to loan support in addition to the option of utilising the College's available cash reserves.

Management have undertaken scenario planning exercises as part of the Framework for Institutional Sustainability which they have developed. This provided a number of potential actions that could be taken to address funding or resource cuts for 2011-12.

Corporate governance framework and supporting arrangements

Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.

Corporate governance framework	The board of management consists of 16 members and is supported in its role by the senior management team. The board has five standing committees covering audit, finance & resources, learning & teaching, organisational development and remuneration. Each committee is formally constituted and has its own formal terms of reference. This comprehensive governance structure, which includes non-executive, student and academic representation, is demonstrative of best practice and meets the minimum requirements of the Scottish Funding Council. The committee structure provides the board of management with the mechanisms to ensure appropriate oversight and monitoring of financial and academic activities. In the year there were a number of changes to the membership of the board and the standing committees.
Statement on internal control	The statement of internal control provides details of the internal financial control environment and risk management and control framework. Management highlights that the system of internal financial control is based on a framework of guidance and regular management information, financial regulations, administrative and authorisation procedures, management supervision and a system of delegation and accountability. The statement is informed by officers, the audit committee, and the work of internal and external audit. The content of the statement is consistent with our understanding of the College.
Internal controls	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively. However, we note that weaknesses exist over reconciliations and matching the formal fixed asset register with other departmental records.
Regularity	The board of management considers all incoming correspondence relevant to its strategic management role from SFC and other regulatory or advisory bodies, including organisations such as Scotland's Colleges and Audit Scotland. Relevant communication is also considered by the audit committee. This allows management to demonstrate the College's approach to considering incoming guidance and taking action where appropriate. Whilst the process for disseminating circulars to the relevant personnel is reasonable and the secretariat chases up any action required on a timely basis it may be beneficial to consider a more formalised approach to the recording of circulars received and noting the action required with a deadline date and reminder dates.

Corporate governance framework and supporting arrangements (continued)

Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.

Internal audit	Internal audit's annual report, submitted to the audit and standards committee on October 2011 states that, *"reasonable assurance can be placed upon the adequacy and effectiveness of the College's internal control systems in the year to 31 July 2011".*
Fraud and irregularity	The College has a fraud response plan in place to define authority levels, responsibilities for action and reporting lines in the event of a suspected fraud or irregularity. The fraud response plan has been placed on the intranet for employees to obtain. It will be subject to annual review and any changes requested will be required to be reported to the audit committee for approval. When management is made aware of a suspected fraud, a fraud investigation group would be convened to co-ordinate an investigation. Management has not reported any material instances of fraud or irregularity in 2010-11. There is also an unethical behaviour and whistle blowing policy available on the intranet as required by The Public Interest Disclosure Act 1998.

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