The Audit Findings for Accrington & Rossendale College

Year ended 31 July 2017

21 December 2017

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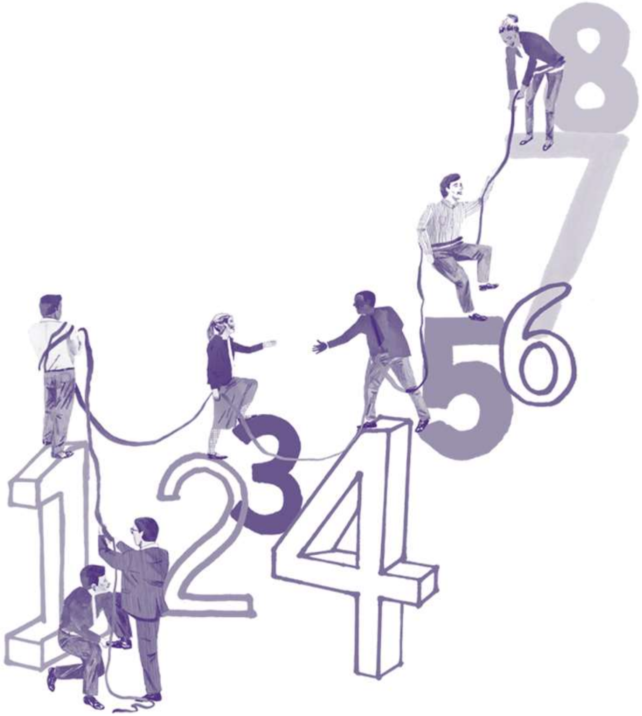

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21 December 2017

Dear Sirs

Audit Findings for Accrington & Rossendale College for the year ended 31 July 2017

This Audit Findings presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK and Ireland) 260. Its contents have been discussed with management.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK and Ireland), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

We would like to take this opportunity to record our appreciation for the kind assistance provided by the finance team and other staff during our audit.

Yours faithfully

Michael Frankish

Michael Frankish

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1. Review of performance and financial position

Statement of Comprehensive Income	2017 £'000	2016 £'000
Income:		
Funding body grants	9,694	9,698
Tuition fees and education contracts	2,176	2,929
Other grants and contracts	68	173
Other income	451	402
Endowment and investment income	-	5
Total income	**12,389**	**13,207**
Expenditure:		
Staff costs	8,346	9,483
Restructuring costs	296	298
Other operating expenses	3,205	3,472
Merger costs	198	52
Depreciation	1,066	1,088
Interest payable and other finance costs	643	688
Total expenditure	**13,754**	**15,081**
Deficit before other gains and losses	**(1,365)**	**(1,874)**
Loss on disposals of assets	(2)	(15)
Deficit before tax	**(1,367)**	**(1,889)**
Taxation	**(1)**	**(1)**
Deficit for the year	**(1,368)**	**(1,890)**
Actuarial loss in respect of pension scheme	**1,049**	**(2,584)**
Total comprehensive income for the year	**(319)**	**(4,474)**

The College has reported a deficit before tax of £1,367k for the year ended 31 July 2017 compared to £1,889k for the year ended 31 July 2016. This is stated after a charge of £294k (2016: £338k) in respect of applying Section 28 of FRS 102 – Retirement Benefits. The operating deficit represents 11.0% of total income (2015/16: 14.3%). The reasons for the movement year on year are discussed below.

Overall college income has decreased by 6.2% compared to 2015/16, largely due to a reduction in tuition fee and education contracts of 25.7% year on year. £599k of this decrease is the result of a fall in core FE / HE loans for supported courses.

Overall costs have decreased by 8.8% year on year. Staff costs have decreased by £1,137k and now represent 67.4% of total income, compared to 71.8% in the prior year. Other operating expenses have fallen by 7.7% year on year, from £3,472k to £3,205k. Restructuring costs continue to be incurred which mainly relate to the cost of redundancies, these were £296k in the current year and £298k in the prior year. In addition the College has incurred costs in connection with its proposed merger with Burnley College, these costs relate to legal and professional support and amounted to £198k in the current year and £52k in the prior year.

1. Review of performance and financial position (continued)

Balance sheet	2017 £'000	2016 £'000
Tangible assets	20,662	21,569
Fixed assets	**20,662**	**21,569**
Stock	21	24
Debtors	517	459
Cash at bank and in hand	898	-
Current assets	**1,436**	**483**
Creditors: amounts falling due within one year	(10,517)	(9,226)
Net current assets	**(9,081)**	**(8,743)**
Creditors: amounts falling due in more than one year	(8,985)	(9,299)
Provisions	(84)	(90)
Pension liability	(11,594)	(12,198)
Net liabilities	**(9,082)**	**(8,761)**
Income and expenditure reserve	(10,096)	(9,811)
Revaluation reserve	1,014	1,050
Total funds	**(9,082)**	**(8,761)**

The College's net liabilities have increased from £8,761k to £9,082k year on year.
Tangible assets have decreased mainly as a result of the depreciation charged during the year of £1,066k, additions for the year totalled £164k.
The College's cash balance has increased significantly from an overdrawn balance of £42k last year end to a credit balance of £898k at current year end.
Debtors have remained fairly stable in comparison to the prior year, the main movement being an increase in prepayments and accrued income.

The College has continued to repay its loans although it is in breach of the financial covenants in relation to the Barclays and Lloyds loans at the year end. As a result of this, the long term debt continues to be recognised in full as a current liability at year end (£6,309k). Creditors due within one year have also increased due to the exceptional financial support received from the ESFA which now totals £2,247k at the current year end compared to £326k last year end. Deferred capital grants have decreased year on year due to grants released to the Statement of Comprehensive Income during 2016/17. These grants relate to the College's on-going capital programme.

The College's pension liability relating to the Local Government Pension Scheme (LGPS). Which is recognised in accordance with Section 28 of Financial Reporting Standard (FRS) 102, has decreased year on year. The reasons for this movement and the accounting treatment are considered in further detail on page 6 below.

1. Review of performance and financial position (continued)

The College is involved in two pension schemes:

- The Lancashire County Pension Fund ("LCPF") (part of the LGPS)
- Teachers' Pension Scheme ("TPS")

The requirements under FRS 102 only impact on the LCPF. In respect of the TPS, it is not possible to identify the College's share of the underlying assets and liabilities. As such, the College has taken advantage of the exemption under FRS 102 to account for its contributions to this scheme as if it was a defined contribution scheme.

The LCPF

The major reason for the decrease in the pension scheme liability year on year is the actuarial gain of £1,049k (2016: an actuarial loss of £2,584k).

The actuarial valuation on which the FRS 102 pension deficit has been calculated has been provided by Mercer. As part of our audit procedures we have reviewed their actuarial report, including the assumptions on which the calculations have been based. The tables opposite show the key assumptions that have been used by the actuary. The actuarial assumptions made by Mercer were reviewed by the audit team and compared to sector data prepared by the Grant Thornton Financial Services Advisory team. This review concluded that the assumptions made by Mercer were within the expected parameters, and could therefore be considered reasonable. In respect of the assumptions, we continue to recommend that the Audit Committee keeps them under review for future periods in order to ensure that they remain appropriate for the College's circumstances.

Actuarial assumptions	2017	2016
Pension increases	2.2%	1.7%
Salary increases	3.7%	3.2%
Inflation	2.2%	1.7%
Discount rate	2.5%	2.5%

Mortality (based on future life expectancies at the age of 65)	2017	2016
Current pensioners - male	22.6	23.0
Current pensioners - female	25.2	25.6
Future pensioners – male	24.9	25.2
Future pensioners - female	27.9	27.9

Scheme deficit	2017 £'000	2016 £'000
Opening liability	12,198	9,247
Current service cost	800	718
Curtailment loss	56	12
Administration expenses	14	12
Actuarial losses/(gains)	(1,049)	2,584
Expected return on assets	294	338
Contributions by the employer	(719)	(713)
Closing liability	**11,594**	**12,198**

2. Status of the audit and audit opinion

Our work is complete.

Our audit report is unqualified but does include an Emphasis of Matter paragraph in relation to the basis of preparation.

Changes to Audit Plan

- We have not had to alter or change our Audit Plan as previously communicated to you.

3. Audit findings – Significant risks

	Risks identified in our Audit Plan	Commentary
1.	**The revenue cycles include fraudulent transactions** • Under ISA 240 (UK and Ireland) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue	**Auditor commentary** – Updated our understanding of controls in place around revenue recognition. – Reviewed recognition policies for appropriateness and consistency with the prior year, FRS102, the SORP and Accounts Direction. – Reviewed the College's significant income streams and considered whether the approach taken to revenue recognition is appropriate. – Reviewed performance against funding targets to assess whether any provision for clawback of funding is required in the financial statements. – Reviewed other material grant income recognised in the financial statements, and considered the extent to which terms and conditions attaching to such funding were met. – Tested a sample of tuition fee revenue transactions, and determined whether revenue has been recognised appropriately. – We will agree income to funding confirmations received directly from the ESFA. **Conclusion** No instances of improper revenue recognition were identified from our audit procedures. Revenue recognition policies appear appropriate. Please refer to page 12 for further detail of testing performed on the College's revenue streams.

3. Audit findings – Significant risks (continued)

	Risks identified in our Audit Plan	Commentary
2.	**Management override of controls** • Under ISA 240 there is a presumed risk that the risk of management over-ride of controls is present in all entities	• We undertook the following audit procedures in this area: – review of accounting estimates, judgements and decisions made by management – testing of a sample of journal entries (validity and authorisation) – review of unusual significant transactions. **Conclusion** Our testing did not identify any instances of management over-ride of internal controls. We have however, raised a control recommendation around the journals process. Refer to section 7 page 20 for further details.

3. Audit findings – Significant risks (continued)

	Risks identified in our Audit Plan	Commentary
3.	**The preparation of the financial statements on the going concern basis** • The Corporation and executive management are required to assess the suitability of the going concern assumption in their preparation of the financial statements and include suitable disclosures therein. • The College has made a deficit in both 2016/17 and 2015/16 financial years and over recent years. There is also limited headroom on the current banking facilities and the College is in breach of its financial covenants. • The College received exceptional financial support in the year from the ESFA of £1,921k. The total exceptional financial support received to date amounts to £2,247k. This amount remains repayable to the ESFA in the event of a merger and is currently included within creditors due under one year. • Discussions are in progress around a potential merger with a number of Lancashire Colleges, which would result in the dissolution of the College Corporation.	• The members of the Corporation needed to determine the basis on which the financial statements should be prepared; ie. whether this should be on a going concern or other basis of preparation. • If the going concern basis of preparation was adopted, the corporation would need to satisfy itself this was appropriate and we would also need to gain such assurance by undertaking the following procedures: - A detailed review of budgets and cash flow forecasts prepared by management for a period of at least 12 months from the date of approval of the financial statements and consider the availability of funding over this period. - We will review and challenge the key assumptions management have made in preparing their forecasts. - We will review the disclosures made by management in the financial statements and ensure that all uncertainties and assumptions made by management and the Corporation are adequately disclosed. **Conclusion** • The members of the Corporation opted to prepare the accounts on a cessation basis as it is intended that the College will merge with another college and the Corporation will be dissolved within 12 months from the date of signing. • An Emphasis of Matter paragraph for the basis of preparation has been included within our audit report to draw the users attention to this basis of preparation. **Management response** *Agreed.*

3. Audit findings – Reasonably possible risks

	Risks identified in our Audit Plan	Commentary
1.	**Revenue** The College's income is principally derived in the form of grants from the Skills Funding Agency ('ESFA') and the Education Funding Agency ('EFA'), and is driven by student numbers and achievement rates. The College has a limited number of other income streams, including grant income, which will normally have conditions attached and should only be recognised to the extent that such conditions have been met. The College's income from tuition fees charged directly to students is also increasing steadily due to changes in HE and 24+ funding.	**Approach** • We have conducted a detailed analytical review of the College's income streams, comparing income in 2016/17 to amounts recognised in previous periods. In respect of grant funding received, from the principal funding body, the ESFA, we have reviewed correspondence between the College and this body during the year as well as reviewing data returns submitted during the period. In order to complete our work, we are awaiting final confirmation from the ESFA of funding allocations made and the value of provision delivered for the year. • Funding in respect of ESFA adults is subject to clawback if the College doesn't meet its contract value for the year. The preliminary funding reconciliation issued by the ESFA for the 2016/17 financial year indicates that the College's allocation exceeded its outturn by £221k, and that clawback will be applied to the College's Adult Skills funding as a result. The probable clawback has already been accrued for in the financial statements of the College, and it is therefore not anticipated that any adjustment will be required to the College's financial statements for the year ended 31 July 2017 when the final confirmation is issued by the ESFA. However, we await receipt of the final ESFA reconciliation to conclude on this point. • The College has recognised £229k of core grant funding from HEFCE (2016: £333k). • We have tested a randomly selected sample of tuition fee income. As part of this testing, we have tested cash receipts, confirmed that students have been charged the correct fee, and agreed the students' details to enrolment data. We have also agreed receipt of the HEFCE core grant to remittances. • We have performed substantive testing on other material revenue streams, as necessary. **Conclusion** No issues were identified during the course of our testing.

3. Audit findings – Reasonably possible risks (continued)

	Risks identified in our Audit Plan	Commentary
2.	**Creditors and operating expenses** • Due to the nature of the College's activities, creditors and accruals are significant and there is therefore a risk that liabilities relating to the year may not be recorded, giving rise to a material impact on the reported results.	**Approach** • We have conducted an analytical review of expenditure, and have also performed a review of payments made and invoices received in the period from the year end to the date of our work, to ensure an accurate cut-off has been applied. We have also tested a randomly selected sample of operating expenditure, confirming that the amounts recognised agree to supporting documentation and that expenditure has been recognised in the correct period. **Conclusion** As part of our testing we noted that an invoice dated August 2017 totalling £18k which related to licence costs in 2017/18 had been included in trade creditors and prepaid in full. An adjustment has been proposed for this amount and is included on page 18, there is no impact to the profit and loss account for the year as a result of this adjustment.

3. Audit findings – Reasonably possible risks (continued)

	Risks identified in our Audit Plan	Commentary
3.	**Compliance with loan covenants** • Under the terms of the College's loan facility, it is required to comply with certain financial covenants. Under FRS102 – Financial instruments, a failure to comply with loan covenant requirements can result in a reclassification of debt within current liabilities, with significant implications for the presentation of the financial statements, and the assessment of going concern.	**Approach** • We have reviewed and re-computed covenant calculations with reference to the definitions contained in the loan agreement. • It was noted that the College has breached the financial covenants in relation to the loans with Barclays and Lloyds for the financial year and as such there is a requirement for the long term debt to be reclassified as short term debt. We have further considered this within the going concern review section on page 11. Furthermore Barclays has requested that the College's freehold property is pledged as security against the outstanding loan balance, a valuation in relation to this is currently being undertaken. **Conclusion** No issues were identified during the course of our testing.

3. Audit findings – Reasonably possible risks (continued)

	Risks identified in our Audit Plan	Commentary
4.	**Defined Benefit Pensions** • A number of the College's employees are included in the Local Government Pension Scheme, a defined benefit scheme accounted for under FRS 102. Under this standard the College is required to carry out a full valuation of the assets and liabilities of the scheme on an annual basis and the net deficit in the scheme is included in the year end financial statements.	**Approach** • We have reviewed the accuracy of the journals processed into the financial statements and ensured that the disclosures made are consistent with the provisions of Section 28 of FRS 102. • We have also reviewed the reasonableness of the assumptions adopted by the actuary. **Conclusion** We are satisfied that the assumptions are within the parameters of those that we would expect to be applied at 31 July 2017. Further information regarding the assumptions can be found in section 1 on page 6.

3. Audit findings – Reasonably possible risks (continued)

	Risks identified in our Audit Plan	Commentary
5.	**Employee remuneration** • Due to the number of staff and material size of this expense it has been deemed to be a risk area.	**Approach** • We have updated our understanding of the control processes in place and performed walk through testing to gain assurance that in year controls were operating in accordance with our documented understanding. • We have reviewed payroll expenses in comparison in prior years and budgets and investigated any significant or unexpected variances. • We have completed detailed testing of individual payslips to gain assurance that employees have been remunerated at the correct rates. • We have reviewed a sample of reconciliations between the payroll system and the finance system prepared by management to ensure that these have bee completed and reviewed on a timely basis. **Conclusion** No issues were identified during the course of our testing.

4. Other communication requirements

	Issue	Commentary
1.	**Matters in relation to fraud**	• We have previously discussed the risk of fraud with the Board and management and been made aware of an allegation of fraud during the year. We note that the amount involved is not material in the context of our audit and we understand that control procedures highlighted the incident to management. • We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit procedures.
2.	**Matters in relation to related parties**	• We are not aware of any related parties or related party transactions which have not been disclosed.
3.	**Matters in relation to laws and regulations**	• We are not aware of any significant incidences of non-compliance.
4.	**Written representations**	• Standard representations have been obtained from management. An additional representation has been included in relation to the basis of preparation.
5.	**Disclosures**	• We are in the process of performing a detailed review of the draft financial statements against the new requirements set out in the 2016/17 FEHE SORP.

5. Misstatements

Adjusted misstatements

The below misstatements have been adjusted in the accounts.

		£'000				
		Profit and loss account		Balance sheet		
Journal reference	Detail	Debit	Credit	Debit	Credit	Profit effect
	Profit/(Loss) per draft accounts					**1,367**
1	Trade Creditors			18		
	Prepayments				18	-
	Being the reversal of August 2017 licence invoice					
2	Grant Income	5				(5)
	Amount ow ed to funding bodies				5	
	Being the adjustment of funding body income to actual					
	Profit/(Loss) per final accounts					**1,362**

Unadjusted misstatements

No unadjusted misstatements were identified.

6. Regularity findings

This section provides commentary on issues and risks identified during the course of the regularity audit.

Summary

The Corporation is responsible under the Further and Higher Education Act 1992, subsequent legislation and related regulations, for ensuring that expenditure (disbursed) and income (received) is applied for the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. The role of the Corporation is to set objectives for the College, to determine the limits on the Principal's discretion to act, to monitor the performance of the College, the Principal and themselves and to be accountable to the College's stakeholders.

The role of the Principal is to manage the College towards the objectives set by the Corporation and within the limits they have prescribed. As Accounting Officer the Principal is responsible for the College's application of public funds.

The Skills Funding Agency funds colleges through a financial memorandum that requires colleges to make audit arrangements in accordance with the Joint Audit Code of Practice (the Code). Under the Code, funding bodies require all colleges to appoint their financial statements auditor to give an opinion to the Chief Executive of Skills Funding and to the College on the regularity of colleges' expenditure.

Colleges are required to obtain a regularity opinion in respect of the period 1 August 2016 to 31 July 2017.This report must form an opinion over the regularity and propriety of all college spending, irrespective of its source.

A regularity framework has been developed by the funding bodies. This framework is not mandatory but sets out the expectations of colleges and their financial statements auditor, acting as regularity auditors, in giving these regularity audit opinions.

Approach

Our work has been informed by this regularity framework and is based on review of the College's self-assessment questionnaire and those controls assessed as key to ensuring the regularity of the College's transactions.

This work has included (amongst other things) a review of a small sample of expenditure on key grant streams, governors' expenses, redundancy payments and declarations of governors' interests.

Conclusion

We have not identified any findings from our work, and as a result we are proposing to issue a limited assurance regularity opinion within the financial statements.

7. Internal controls

- The purpose of an audit is to express an opinion on the financial statements.
- Our audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control
- The matters being reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with ISA 265
- If we had performed more extensive procedures on internal control, we might have identified more deficiencies to be reported

	Assessment	Issue and risk	Recommendations
1.	●	**Journals process** • During our review of journal entries it was noted that there were 2 journal lines where which were part of a larger journal posting that contained no transaction description, furthermore there was 1 journal entry posted in the year which contained no transaction description at all. • There is a risk that sufficient evidence will not be retained in respect of adjustments processed.	• We recommend that a process be implemented so that a journal cannot be posted to the ledger without the description field being completed. **Management response** Our system does not allow us to add mandatory controls to this field. All finance staff have been reminded of the importance of completing the field. We consider the error rate to be insignificant.

"The auditor shall include in the written communication of significant deficiencies in internal control:

a. A description of the deficiencies and an explanation of their potential effects; and
b. Sufficient information to enable those charged with governance and management to understand the context of the communication. In particular, the auditor shall explain that:
   i. The purpose of the audit was for the auditor to express an opinion on the financial statements;
   ii. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and
   iii. The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance." (ISA UK and Ireland 265)

Assessment
- ● Significant deficiency – risk of significant misstatement
- ● Deficiency – risk of inconsequential misstatement

8. Fees and independence

	Fees	Threat Y/N	Safeguard
Audit – Financial statements and regularity audit	18,450	• N	
TPA Return	450	• N	
TOTAL Audit Fees	**18,900**		
SFA submission advice	30,320	• Y	Separate engagement team and terms of engagement
Tax compliance services	1,550	• Y	Separate engagement team and terms of engagement

- The above non-audit services are consistent with the college's policy on the allotment of non-audit work to your auditor.

Independence and ethics:

- Ethical Standards and ISA (UK and Ireland) 260 require us to give you timely disclosure of matters relating to our independence. In this context, we disclose the following to you:

- We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and confirm that we are independent and are able to express an objective opinion on the financial statements

- We confirm that we have implemented policies and procedures to meet the requirement of the Auditing Practices Board's Ethical Standards

9. Communication of audit matters with those charged with governance

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit, form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the group's accounting and financial reporting practices, significant matters and issue arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	✓	✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements		✓
Non-compliance with laws and regulations		✓
Expected modifications to the auditor's report, or emphasis of matter		✓
Unadjusted misstatements and material disclosure omissions		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern	✓	✓
Matters in relation to the group audit, including: Scope of work on components, involvement of group auditors in component audits, concerns over quality of component auditors' work, limitations of scope on the group audit, fraud or suspected fraud	✓	✓

International Standard on Auditing (ISA) (UK and Ireland) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table here.

This document, the Audit Findings, outlines those key issues and other matters arising from the audit, which we consider should be communicated in writing rather than orally, together with an explanation as to how these have been resolved.

Distribution of this Audit Findings report

Whilst we seek to ensure our Audit Findings are distributed to those individuals charged with governance, as a minimum a requirement exists for our findings to be distributed to all the company directors and those members of senior management with significant operational and strategic responsibilities. We are grateful for your specific consideration and onward distribution of our report to those charged with governance

Respective responsibilities

As auditor we are responsible for performing the audit in accordance with ISAs (UK and Ireland), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance.

The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

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