

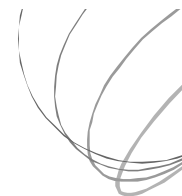
Elmwood College

Report on the 2005/06 Audit



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Key Messages

Introduction

In 2005/06 we audited the financial statements and looked at aspects of performance and governance. This report sets out our key findings, summarising key outcomes in 2005/06 and the outlook for the period ahead.

Key outcomes from 2005/06 audit

We have given an **unqualified** opinion on the financial statements of Elmwood College for 2005/06.

The income and expenditure account shows a surplus for the year of £370,000 on the year's operations. After transfer of £286,000 from the revaluation reserve, an in-year historical cost surplus of £656,000 was achieved, which when transferred to the general reserve, together with a transfer from the pension reserve of £25,000, resulted in an accumulated general reserve of £2,562,000 as at 31 July 2006. The college has no formal strategy for the use of its general reserve although we have been informed that the reserve will be used to maintain future financial security.

The corporate governance statement complies with accounting requirements and is not inconsistent with audit findings. The statement reflects the fact that adequate assurance can be placed on the college's corporate governance arrangements and internal control systems.

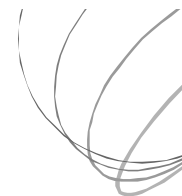
Outlook for future audits

The 2006 to 2009 college strategy was approved by the board of management in March 2006. Progress against the targets set in this strategy will be monitored by the board.

The colleges' estates strategy is currently under review. The outcome of this review is fundamental to the delivery of improved services to students in the coming years and will support the college's strategic direction.

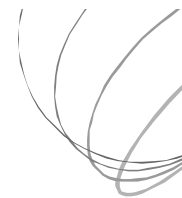
This is the final year of our appointment to the audit of Elmwood College. From 2006/07 the college's auditors will be Scott-Moncrieff.

**Audit Scotland
December 2006**



Introduction

1. This report summarises the findings from our 2005/06 audit of Elmwood College. The scope of the audit was set out in our 2005/06 audit planning memorandum, which was submitted to the college in February 2006. This described the audit work we planned to carry out in the year.
2. The financial statements of the college are the means by which it accounts for its stewardship of the resources made available to the college and its financial performance in the use of these resources. In accordance with the Further and Higher Education (Scotland) Act 1992 and the accounts direction issued by the Scottish Funding Council, it is the responsibility of the college to prepare financial statements which give a true and fair view of the college's financial position and the income and expenditure for the year.
3. The board of management are responsible for the management and governance of the organisation. As external auditors, we review and report on the arrangements in place and seek to gain assurance that:
 - the financial statements have been prepared in accordance with statutory requirements and that proper accounting practices have been observed;
 - the college's system of recording and processing transactions provides an adequate basis for the preparation of the financial statements and the effective management of assets and interests;
 - the college has adequate corporate governance arrangements which reflect the three fundamental principles of openness, integrity and accountability;
 - the systems of internal control provide an appropriate means of preventing or detecting material mis-statement, error, fraud or corruption; and
 - the college has proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
4. This is the final year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by the board of management, the Principal, the Director of Finance and their staff during the course of our audit work.



Performance

Introduction

5. In this section we summarise key aspects of the college's performance and provide an outlook on future performance.
6. It is the responsibility of the board of management to ensure that proper arrangements are in place to secure the economy, efficiency and effectiveness in the use of its resources. As part of the auditor's statutory responsibilities we are required to consider whether the college has made appropriate arrangements to fulfil its duty in this regard.

Overview of performance in 2005/06

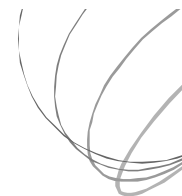
7. The college has in place a strategy document setting out the college's strategic aims and key targets for the period. The college strategy is reviewed and updated on an annual basis by the board of management. Progress against 2005/06 targets was presented to the board at a strategy away day in February 2006 and was incorporated into the 2006/07 to 2008/09 college strategy. The college strategy is discussed further at paragraph 10.
8. Over recent years the college has met its targets for student numbers. The college's contract with the Scottish Funding Council is 27,632 weighted SUMS. In 2005/06, the college achieved weighted SUMS of 28,682, a small increase in student numbers above the contracted amount.
9. The College's has also made good progress against the pilot governance and management self evaluation on which we first reported in 2004/05 and which addressed elements of performance management.

Performance outlook

10. In March 2006, the board of management approved the college strategy 2006-09. This identifies the college's vision *"to be a national and international centre of excellence for land-based and golf industry related specialisms whilst serving the lifelong learning needs of the local community"*.
11. To help achieve this vision, the college has identified the following strategic aims for 2006-09:
 - to encourage participation in lifelong learning, through a flexible, responsive and inclusive approach to the needs of business, the community and individuals and, in particular, to widen access to those who encounter barriers to education and training;



- to further enhance the College's reputation and standing as a world-class centre of excellence in the areas of golf, greenkeeping and other land-based specialisms and, in doing so, to make a significant contribution to both the local and rural economies;
 - to maximise student experience, fulfilment and progression in terms of personal, social and educational development, through continuous quality enhancement in all aspects of College provision and service;
 - to maximise full staff potential and to encourage innovation and enterprise through strong leadership; personal & professional development; team empowerment; and open and effective communication;
 - to continue to establish and further develop mutually beneficial collaboration and partnership; and
 - to continue to improve the College's financial health, accumulating increased reserves for future investment.
12. In providing the strategic direction to the achievement of these aims, the board of management has identified student experience, staffing and finance & governance as the college's key strategic priorities over 2006-07. Key targets are set to support the achievement of these priorities.
13. The college's strategic priorities are underpinned by key supporting strategies which have been approved by the board of management. The college's estate strategy is currently under review and the new strategy is seen as a key element of delivering improved services to students.
14. In 2004/05 we reported that the College had piloted a governance and management self evaluation for the Funding Council, which addressed performance management areas including strategic and operational planning, financial management, quality assurance and enhancement and estates and facilities management. The self evaluation identified a number of strengths, but also a number of points requiring action by the College.
15. We have undertaken an overview of the action taken by the College following the self evaluation and noted that good progress is being made on the actions contained in the self evaluation action plan. The College should continue to implement and monitor the agreed actions.



Financial Position

Introduction

16. In this section we summarise key aspects of the college's reported financial position and performance to 31 July 2006 and provide an outlook on potential future financial risks.

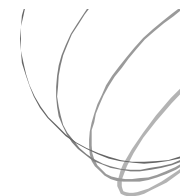
Revenue Account

Revenue performance 2005/06

17. The college's income and expenditure account shows a surplus for the year of £370,000 (deficit of £84,000 in 2004/05) on the year's operations compared to an expected surplus of £2,000 as per the 2005 financial forecast return (FFR). This variance was primarily due to additional money received at the year end from the European Social Fund. In 2005/06 the college also budgeted for £447,000 as the gain from the sale of property at Russell Mains. The sale of this property was not realised until 2006/07. The college's 2006 FFR records an anticipated surplus of £2,000 for 2006/07, before the gain from the sale.
18. After transferring £286,000 from the revaluation reserve to account for the difference between the actual depreciation charge for the year and depreciation based on historical cost, a historical cost surplus of £656,000 is shown (£202,000 in 2004/05).
19. The balance brought forward on the general reserve at 1 August 2005 was £1,881,000. After the transfer of the historical cost surplus of £656,000 and a transfer from the pension reserve of £25,000, the balance on the general reserve as at 31 July 2006 was £2,562,000. The college does not have a formal reserve strategy in place, although we understand that it plans to use these funds to maintain future financial security.

Pension Disclosures

20. Financial planning and accounting for the costs of pensions presents a difficult challenge. The amounts involved are large, the timescale is long, the estimation process is complex and involves many areas of uncertainty that are the subject of assumptions including projecting increased life expectancy. *Financial Reporting Standard 17: Retirement Benefits* (FRS 17) is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if the actual payment will be made years into the future. 2005/06 is the first year of full FRS 17 disclosure requirement for further education colleges. This means that for defined benefit schemes, the pension asset or liability attributable to the college has to be recognised in the balance

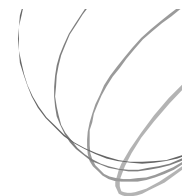


sheet and the full costs of benefit entitlements earned by employees, and not simply the cost of employer contributions to the fund, are to be reflected in the income and expenditure account.

21. The college employees belong to two principal pension schemes, the Scottish Teachers Superannuation Scheme (STSS) and the Fife Council Pension Fund (FCPF).
22. The STSS is a multi-employer scheme where the share of assets and liabilities of the college cannot be determined. The College has accounted for pension costs in relation to the STSS on a defined contribution basis as allowed under FRS 17, accounting for the scheme on a cash basis, with limited disclosures.
23. Note 26 to the Accounts highlights that the college's estimated pension liabilities at 31 July 2006 exceeded its share of assets in the FCPF by £1,132,000. The improvement from a liability of £1,857,000 at 31 July 2005 is largely due to an actuarial gain of £750,000 in 2005/06. On the recommendation of the college's actuaries, this overall net liability will be recouped through increased employers' contributions (the employer's contributions have risen from 265% in 2004/05 to 270% in the years 2005-08).
24. In accordance with FRS 17, £1,132,000 has been recognised as a liability in the accounts, with the creation of a matching pension reserve.

Financial position outlook

25. The College's forecast financial health over the next three years is rated as secure in its 2006 FFR. A healthy general reserve will be maintained for future use.



Governance

Introduction

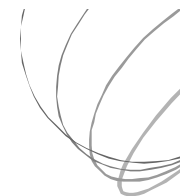
26. In this section we comment on key aspects of the college's governance arrangements during 2005/06.

Overview of arrangements in 2005/06

27. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviours at the upper levels of the organisation. The college has a responsibility to put in place arrangements for the conduct of its affairs, to ensure the legality of activities and transactions and to monitor the adequacy and effectiveness of these arrangements in practice. The auditor has a responsibility to report on the college's corporate governance arrangements.
28. The corporate governance statement included within the financial statements reflects the board of management's view that adequate assurance can be placed upon the adequacy and effectiveness of the college's corporate governance arrangements and internal financial control system.
29. In our opinion, the corporate governance statement included within the financial statements complies with the requirements of the accounts direction and is not inconsistent with the findings of our audit.

Systems of internal control

30. It is the responsibility of the college's management to maintain adequate financial systems and associated internal controls. The auditor evaluates these systems of internal control, both for the purpose of giving an opinion on the statement of accounts, and in order to report to the college on the adequacy of such systems and controls.
31. A review and assessment of the college's corporate governance arrangements was carried out. This assessment included a review of the college's committee minutes and completion of a number of standard Audit Scotland checklists.
32. The college's governance and management self evaluation also addresses governance issues which impact on the systems of internal control. We noted that good progress is being made on the actions contained in the self evaluation action plan.
33. In 2004/05 we recommended that the college undertake a fundamental review of its Financial Regulations in 2005/06. We understand that no review has yet taken place.



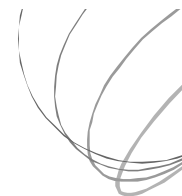
34. Our review of corporate governance confirmed that overall the college's arrangements appear to be well developed and operating effectively.
35. Overall, we conclude that the college's financial systems are adequate for the purpose of producing the financial statements.

Review of internal audit

36. Internal audit plays a key role in the college's governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system. To maximise the reliance that can be placed on internal audit and to avoid duplication of effort, the adequacy of internal audit is assessed each year.
37. Internal audit services are provided by Henderson Loggie. An assessment was made of the adequacy of the internal audit input and it was concluded that external audit can place formal reliance on the work of internal audit.
38. Overall, satisfactory progress has been made in implementing internal audit recommendations and progress towards any remaining actions will continue to be monitored by the audit committee.
39. On 13 November, Henderson Loggie issued an Internal Audit Report for the year ended 31 July 2006, which concluded that the *“College operates adequate and effective internal control systems as defined in the ANA (Audit Needs Assessment)”*.

Prevention and detection of fraud and irregularities

40. The college has appropriate arrangements in place to prevent and detect fraud. These arrangements include policies on the prevention of fraud and whistle-blowing.
41. The Director of Finance has confirmed that no frauds were identified in 2005/06.



Financial Statements

Introduction

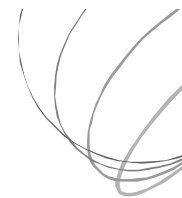
42. In this section we summarise key outcomes from our audit of the college's financial statements for 2005/06. We comment on the accounting issues faced and provide an outlook on future financial reporting issues.
43. We audit the financial statements and give an opinion on:
- whether they give a true and fair view of the financial position of the college and its expenditure and income for the period in question; and
 - whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.
44. We also review the corporate governance statement by:
- considering whether disclosures in the statement comply with the requirements of the Scottish Funding Council; and
 - assessing whether disclosures in the statement are consistent with our knowledge of the college.

Overall conclusion

45. We have given an **unqualified** opinion on the financial statements for 2005/06.
46. The college's unaudited financial statements were partly submitted for audit on 6 October 2006 (mainly due to the late submission of the actuarial report), in line with the agreed timetable. A full set of unaudited financial statements were subsequently provided on 24 October 2006. The Director of Finance has agreed that every attempt will be made to ensure that in future a complete set of financial statements is made available prior to the start of the audit. Key staff were readily available for consultation throughout the audit process however, and this enabled the audit to progress smoothly.

Accounting practice

47. The college's financial statements comply with the requirements of the statement of recommended practice: accounting for further and higher education (SORP) and the funding council's 2005/06 accounts direction. During the course of the audit a number of issues arose which were resolved in discussion with the Director of Finance. This practice is an established part of the audit process. A number of minor changes have been made to the accounts following completion of the audit.



Tangible fixed assets

48. *Financial Reporting Standard 15: Tangible Fixed Assets* (FRS 15) sets out the principles of accounting for the initial measurement, valuation and depreciation of tangible fixed assets. FRS 15 states that the requirements for the frequency of valuations will be met by a full valuation at least every five years and an interim valuation in year three.
49. The college does not have a formal policy for the frequency of revaluation of tangible fixed assets with the college's land and buildings last being valued as at 31st July 2003 and the golf course and clubhouse at 2001. The college should adopt a formal policy of revaluation in order to fully comply with the requirement of FRS 15 and revalue its tangible fixed assets in accordance with that policy.
50. The Statement of Principal Accounting Policies states that a review for impairment of a fixed asset is carried out if events or changes in circumstances indicate that the carrying amount of the fixed asset may not be recoverable. We understand that tangible fixed assets were not tested to determine whether any asset was subject to impairment.

Legality

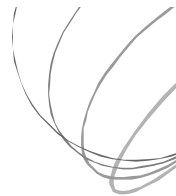
51. Each year we request written confirmation from the Principal that the college's financial transactions accord with relevant legislation and regulations. Significant legal requirements are also included in audit programmes and checklists. The Principal has confirmed that, to the best of her knowledge and belief and having made appropriate enquiries of the board of management, the financial transactions of the college were in accordance with the relevant legislation and regulations governing its activities.
52. There are no additional legality issues arising from our audit which require to be brought to the board's attention.

Financial reporting outlook

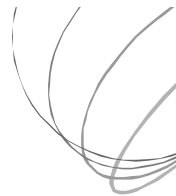
53. Overall the college is well placed to continue to prepare annual financial statements in accordance with accounting and statutory requirements. It has a record of responding positively to audit issues and developing accounting practice.

Change of external auditor

54. Regular rotation of auditors is required by auditing standards and is an important component in guarding against perceived or actual threats to auditors' objectivity and independence. Audit Scotland's policy is to rotate auditors at least once every five years.

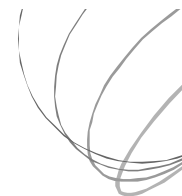


55. This is the final year of our current appointment to the audit of Elmwood College. From 2006/07 Scott-Moncrieff will become the college's appointed auditor. The change of auditor represents an opportunity to build on existing good practice to continuously improve accounts preparation processes in partnership with the incoming auditor.



Final Remarks

56. The members of the board of management are invited to note this report. We would be pleased to provide any additional information that may be required.
57. The co-operation and assistance given to us by the Principal, the Director of Finance and their staff over the five years of our audit appointment is gratefully acknowledged.



Appendix A: Action Plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No.	Risk Identified	Planned Action	Responsible Officer	Target Date
1	19	The college does not have a formal reserve strategy in place.	The college will introduce a formal reserve strategy, which will be approved by the board of management.	Director of Finance	30 April 2007
2	33	The college agreed to review its Financial Regulations in 2005/06. The review has not yet been carried out.	The college will review its Financial Regulations in 2006/07.	Director of Finance	30 April 2007
3	49	The college does not have a policy on the frequency of revaluation of tangible fixed assets.	The college will formally introduce a policy on the revaluation of tangible fixed assets. A full valuation of the golf course and clubhouse and an interim valuation of land and buildings will be undertaken in 2006/07.	Director of Finance	31 July 2007
4	50	We understand that tangible fixed assets were not tested to determine whether any asset was subject to impairment	Assets will be tested annually to determine if there is any requirement for impairment.	Director of Finance	31 July 2007