

INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

Jewel & Esk Valley College

Annual audit report for 2005-06 to the Board of Management
and the Auditor General for Scotland

20 November 2006

AUDIT

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Notice: About this report

This report has been prepared in accordance with the responsibilities set out within Audit Scotland's *Code of Audit Practice* ('the Code') and *Statement of Responsibilities of Auditors and Audited Bodies*.

This report is for the benefit of only Jewel and Esk Valley 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 requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes 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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Executive summary

Financial position

The financial statements reflect a consolidated surplus for the year of £96,000, after loss on disposal of £7,000, and an income and expenditure account balance of £1,305,000 at 31 July 2006 (excluding net pension liabilities).

Full implementation of FRS 17 'retirement benefits' required a prior year adjustment to the 2004-05 comparatives, resulting in a reduction of £2,483,000 to opening reserves at 1 August 2005. During the year, the College's share of the liabilities of the Lothian local government pension scheme decreased from £3.2 million to £3.0 million at 31 July 2006.

The College received various ring-fenced funds during 2005-06, of which £890,000 was awarded to assist the College in funding the cost of the campus redevelopment programme.

Corporate governance

During the 2005-06 financial statements audit our work has identified no significant weaknesses in the operation of financial controls and procedures.

In the year the College's internal auditor produced audit reports on corporate decision making processes, travel and subsistence systems and procedures, and the operation of the College's residences. For some 'key control objectives' it was reported that there were 'no major weaknesses in control but scope for improvement'.

The 2005-06 corporate governance statement on the systems of internal control prepared by the College does not disclose any major weaknesses.

We have not identified any significant control weaknesses in relation to fraud and irregularity, standards of conduct or prevention of corruption.

Financial statements

On 10 November 2006 we issued an audit report expressing an unqualified opinion on the financial statements of the College for the year ended 31 July 2006 and on the regularity of the financial transactions reflected in those financial statements.

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Introduction

Audit framework

2005-06 was the final year of our five-year appointment as external auditors of Jewel & Esk Valley College ("the College"). This report summarises our opinion and conclusions and highlights significant issues arising from our work. While a requirement of Audit Scotland's *Code of Audit Practice*, this report, having been discussed in draft with the audit committee, also discharges our obligations under International Auditing Standard 260: *Communication of audit matters to those charged with governance*.

The framework under which we operate under appointment by Audit Scotland was outlined in the audit plan for the year discussed with the College's audit committee on 23 May 2006.

The scope of the audit was to:

- provide an opinion on, to the extent required by the relevant authorities, the financial statements and the regularity of transactions in accordance with the standards and guidance issued by the Auditing Practices Board;
- review and report on the College's corporate governance arrangements in relation to systems of internal control, the prevention and detection of fraud and irregularity, standards of conduct, and prevention and detection of corruption; and the College's financial position; and
- review and report on the College's arrangements to manage its performance, as they relate to the economy, efficiency and effectiveness in the use of resources.

Our audit planning process identified a number of other areas for specific attention:

- full implementation of FRS 17;
- FRS 21: events after the balance sheet date, in relation to gift aid receipts from the trading subsidiary; and

- accounting for fixed assets in respect of the College's estates redevelopment plans, specifically the implications in relation to FRS 11.

Basis of information

External auditors do not act as a substitute for the College's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

To a certain extent the content of this report comprises general information that has been provided by, or is based on discussions with, management and staff of the College. Except to the extent necessary for the purposes of the audit, this information has not been independently verified. The contents of this report should not be taken as reflecting the views of KPMG LLP except where explicitly stated as being so.

Acknowledgement

Our audit has continued to bring us into contact with a range of College staff. We wish to place on record our appreciation of the continued co-operation and assistance extended to us by staff in the discharge of our responsibilities. In preparing for the audit visit in September the finance team prepared high quality supporting files which were available from the first day of our visit.

Since this is the final year of our audit appointment it is our intention to minimise the disruption to the College from a change in auditor through briefing and liaison on unresolved issues with the incoming auditor's staff.

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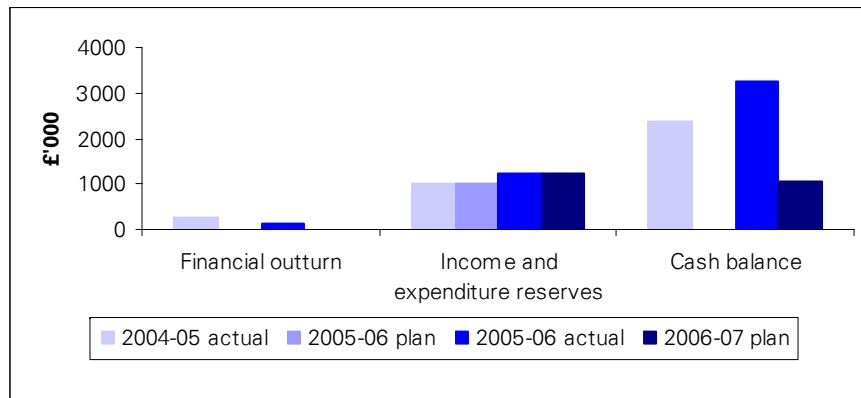
Financial position

Financial position

Funding Council circular FE/54/02, issued on 20 December 2002, defines a college that is financially secure as one that "on a continuing basis, is able to generate operating surpluses reliably and as planned, and through that accumulate a reasonable level of financial reserve. The college must also generate sufficient cash to finance its operations and meet its liabilities; regular operating surpluses would ensure this."

Figure 1 provides a summary of the College's planned and actual financial results, based on the formal returns submitted by the College to the Funding Council.

Figure 1: comparison of planned and actual results



The College has reported a surplus in 2005-06 of £96,000 after accelerated depreciation of assets at valuation and transfer from reserves. This has resulted in an accumulated income and expenditure balance of £1,305,000 (excluding pension reserves) and cash balances of £3,232,000, including investments, as at 31 July 2006.

The College surpassed its budgeted outturn for the year, primarily due to savings achieved by moving cleaning and janitorial services in-house in 2005-06. The College budgets for a breakeven outturn each year.

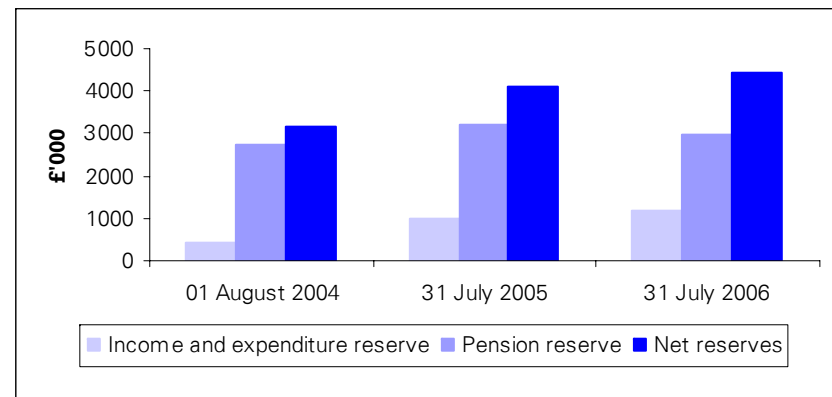
While cash in hand and at bank balances have decreased significantly in the year, the College now has investments of £2.8 million, up from £1.2 million in 2004-05. There is therefore a net increase in cash balances that is primarily due to the College building cash balances for use in the estates redevelopment programme.

FRS 17 'retirement benefits' ("FRS 17")

The College fully implemented FRS 17 during the year ended 31 July 2006, resulting in inclusion of the College's share of Lothian local government pension scheme in the balance sheet for the first time.

Full implementation of FRS 17 'retirement benefits' is a change of accounting policy and required a prior year adjustment in compliance with FRS 3 'reporting financial performance'. The 2004-05 comparatives have been restated, resulting in a reduction of £2,483,000 previously reported reserves as at 1 August 2005. Implementation of FRS 17 resulted in the recognition of a net pension liability on the balance sheet of £2.9 million as at 31 July 2006 (2005, £3.2 million). Figure 2 highlights the impact of the College's share of the pension deficit on its income and expenditure reserves.

Figure 2: impact of FRS 17 pension deficit



Financial position (continued)

Ring-fenced funding

The Scottish Funding Council allocated £890,000 of ring-fenced funding to the College during 2005-06, primarily for the estates redevelopment and the funding of teachers superannuation. The College's financial monitoring procedures include consideration of the use of this funding to ensure it is used for the purposes identified.

Capital income and expenditure

The College has incurred capital expenditure with a value of £1.24 million in the year, primarily relating to the new estates development programme, a CCTV and security system and various items of ICT equipment. These have been funded mainly from Scottish Funding Council grants, which have been capitalised in accordance with the College's accounting policies. There have also been fixed asset disposals in the year with a net book value of £7,000. Nominal proceeds were received, resulting in a loss on disposal of £7,000.

Provisions

The College's enhanced pension provision is £576,000, based on an actuarial valuation as at 31 July 2006, which has been updated using discount tables issued by the Scottish Funding Council. Full implementation of FRS 17 resulted in reversal of the previously unfunded element of the provision of £238,000 relating to members of the Lothian local government pension scheme, which is now included in the pension liabilities disclosed on the face of the balance sheet.

2005-06 SUMS outturn

The College's outturn against its 2004-05 and 2005-06 SUMS targets are shown in Figure 3.

Figure 3: SUMS outturn

	2004-05	2005-06
SUMS target	63,864	62,670
SUMS actual	64,822	62,095
Impact on recurring grant	Nil	Nil

2006-07 budget

The College has budgeted for a balanced position for the year ended 31 July 2007 which is consistent with the overall breakeven targets in prior years. The 2006-07 outturn will be significantly affected by the campus redevelopment programme and associated decampment costs as well as other changes such as continued increases in energy costs and the known 12.5% increase, to 13.5% in employer contributions to the Scottish Teachers' Superannuation Scheme from April 2007.

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Corporate governance

Introduction

Corporate governance is concerned with structures and processes for decision-making, control and behaviour at the upper levels of the College in accordance with the fundamental principles of openness, integrity and accountability. Management is responsible for establishing arrangements for the conduct of its affairs, including compliance with applicable guidance, ensure the legality of activities and transactions and to monitor the adequacy and effectiveness of these arrangements in practice. The *Code* requires auditors to review aspects of the corporate governance arrangements as they relate to:

- the Board's review of its systems of internal control;
- the prevention and detection of fraud and irregularity; and
- standards of conduct, and the prevention and detection of corruption.

Control environment

During the 2005-06 audit process our work has identified some minor areas for improvement in the operation of financial controls and procedures, which have been included in the action plan in appendix one. There are no priority one recommendations.

Overall our audit testing of the College's controls and procedures over cash income and banking, ordering and purchase invoice processing and sales invoice processing revealed no material weaknesses. The increasing demands of the College's finance function as a result of the ongoing campus redevelopment programme mean that continued strict financial controls and procedures is critical to the College's success.

As part of our planning process we tested whether the College has an appropriate system of high level College wide financial and corporate governance controls. It was found that the College has in place such a system which includes: a code of conduct per the constitution and articles of governance; a Board of Management register of interests; a scheme of delegation; and, a risk register. It was noted that in the year to 31 July 2006 all of these documents were updated in 2005-06

to take into consideration changes to the senior management team, and to increase preparedness for the campus development programme

Internal audit

During 2005-06, Scott-Moncreiff continued to provide internal audit services to the College. We have reviewed the scope and extent of work performed by internal audit during 2005-06 and considered the impact of their findings and conclusions on our work, where appropriate.

In the year the College's internal auditor produced audit reports on: corporate decision making processes; travel and subsistence systems and procedures; and, the operation of the College's residencies. For some 'key control objectives' it was reported that there were 'no major weaknesses in control but scope for improvement'.

Corporate governance statement

As part of the development of corporate governance, public sector bodies are required to make a statement of how they have applied the principles of corporate governance. We are required to review this to assess whether the description of the process adopted in reviewing the effectiveness of the system of internal control appropriately reflects the process. We are not required to provide an opinion on the College's systems of internal controls.

The 2005-06 corporate governance statement on the systems of internal control prepared by the College does not disclose any major weaknesses.

Fraud and irregularity, standards of conduct, and prevention and detection of corruption

Work in these areas has been addressed over the duration of our appointment. In relation to fraud, we have had regard to relevant auditing standards when completing our work. We also had regard to Statement of Auditing Standards 110: *Fraud and Error* and International Standards on Auditing 240: *The Auditor's Responsibility to Consider Fraud in the Audit of Financial Statements*.

Corporate governance (continued)

Performance audit

The terms of appointment from Audit Scotland include a requirement for a proportion of our audit time to be spent on performance audit work. Performance audit work covers a variety of areas, both financial and non-financial, including both Audit Scotland centrally directed studies and locally determined studies based on agreement between each organisation and their auditors.

No performance audit studies were identified by Audit Scotland for the College during 2005-06.

Reviews and inspections

The College was subject to a review by HM Inspectorate of Education during 2005-06 which was published on 14 April 2006. It was concluded that the HMIE was confident that:

- the College has in place effective learning and teaching processes;
- learners are progressing well and achieving appropriate outcomes, however the College needs to address weaknesses in retention and attainment in a range of programmes; and
- the College is managing well and improving the quality of its services for learners, however the College needs to address weaknesses in aspects of operational planning, learner self-evaluation and monitoring of progress.

The Charities and Trustee Investment (Scotland) Act 2005 ("the Act") came into force in April 2006, introducing new duties and responsibilities for the Office of the Scottish Charity Regulator ("OSCR"). Over time OSCR intends to undertake a rolling review of charities entered in the Scottish charity register to assess whether they meet, and continue to meet, the charity test: purposes will have to be charitable in the context of the charity test set out in Section 7 of the Charities and Trustee Investment (Scotland) Act 2005 and charities will have to show that they provide public benefit.

OSCR has recently proposed that the first phase of the rolling review should focus on those charities where uncertainty may exist regarding their ability to meet the new test, for example whether stated purposes are charitable, or where 'unduly restrictive conditions', such as fees, may exist. We understand that OSCR has written to parent organisations and umbrella bodies of such charities to inform them of the proposals and to invite comments.

There have been no other external inspections in the year.

Audit committee

Oversight of the College's internal control and reporting arrangements is provided through its audit committee.

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Audit opinion

On 10 November 2006 we issued an audit report expressing an unqualified opinion on the financial statements of the College and of its group for the year ended 31 July 2006 and on the regularity of the financial transactions reflected in those financial statements.

Audit completion

An important measure of proper financial control and accountability is the timely closure and publication of audited financial statements. Figure 4 summarises the key elements of the audit process with which we require management to engage.

Figure 4: key elements of the audit process

Completeness of draft financial statements
Although a set of draft financial statements were received at the start of the final audit visit on 4 September 2006, a number of presentational changes were required.
Quality of supporting working papers
In accordance with our normal practice, we issued a 'prepared by client' request that set out a number of documents required for our audit of the financial statements. Documentation provided was to a high standard and the College was at a good standard of readiness for the start of the final audit visit on 4 September 2006.
Response to audit queries
Our routine audit queries were dealt with in a timely manner.

Financial adjustments and confirmations

In Figure 5 we draw attention to adjustments to the financial statements made by management as a result of the audit process. None of the adjustments had a net effect on the financial position; two of them are for disclosure only.

Figure 5: financial statement adjustments

	Income and expenditure account £'000	Balance sheet £'000
Correction of categorisation of European debtors and accrued income.	-	14
	-	(14)
Benefits and allowances were omitted from the senior post holder's disclosure in note 7.	Disclosure only, per SORP	
Note 27: operating lease commitments changed to show payments due in next year analysed per expiry date rather than all future payments.	Disclosure only, per SORP / SSAP 21	
Net adjustment	-	-

Confirmations and representations

We confirm that as of 10 November 2006, in our professional judgement, KPMG LLP was independent within the meaning of regulatory and professional requirements and the objectivity of audit staff is not impaired. This has been confirmed separately in writing to the audit committee.

In accordance with auditing standards, we obtained representations from the Board's directors on material issues prior to signing our opinion. Management have adjusted all audit differences.

Financial statements (continued)

Significant accounting issues

FRS 17: Retirement benefits

In 2005-06 the College was required to make full disclosures in its financial statements including amending comparatives and bringing in the effect of a prior year adjustment. This required information from the actuaries of the College's pension fund.

In September 2006 the College's actuaries reported, in accordance with FRS 17, the College's year end position for the College's participation in the local government pension scheme. After a revised, corrected version of the actuarial report was received, the College produced proposed journal entries that we then audited. The agreed entries were made to the ledger and the financial statements were adjusted as necessary.

FRS 21: Events after the balance sheet date

In May 2004 the ASB issued FRS 21 'events after the balance sheet date'. The standard is applicable for accounting periods beginning on or after 1 January 2005. The new standard supersedes SSAP 17 'accounting for post balance sheet events'. The most significant impact for the College of this new standard is in relation to gift aid receipts from its trading subsidiary.

Gift aid payments declared after the balance sheet date will not be recognised unless there is evidence to demonstrate a specific commitment made prior to 31 July. As a result, the College agreed the gift aid payment at the subsidiary's annual general meeting, June 2006, and transferred the balance before 31 July 2006.

The project management costs relating to the College's campus redevelopment project have been disclosed as capital commitments as at 31 July 2006.

FRS 11: Impairment of fixed assets

During earlier years the board of management progressed its estates re-development plans and in 2005-06 brought these to a conclusion.

Reflecting the intention at the time, in 2004-05 the building at the Eskbank campus was subject to accelerated depreciation reflecting the anticipated demolition of the building. During 2005-06 the financial implications of the re-development plans have been re-considered in terms of each campus, in particular the implications of FRS 11. During 2005-06 the decision was made to dispose of the existing Eskbank campus and to use the proceeds to contribute to the financing of a new campus. As the anticipated site disposal proceeds are greater than the carrying value, no accelerated depreciation was provided in 2005-06 against the building. However, reflecting the re-development proposals for the Milton Road campus, accelerated depreciation was provided on certain assets at that location.

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Appendix I – action plan

This appendix summarises the performance improvement observations we have identified during the financial statements audit. Each of our observations has been allocated a risk rating, which is explained below.

	<p>Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the College or systems under consideration. The weakness may therefore give rise to loss or error.</p>		<p>Grade two (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.</p>		<p>Grade three (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the controls to meet their objectives in any significant way. These are less significant observations than grades one and two, but we still consider they merit attention.</p>
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Issue, risk and priority	Recommendation and benefit	Management response	Responsible officer and implementation timetable
<p>1</p> <p>In July 2006 capital expenditure was capitalised in relation to a security and CCTV system.</p> <p>The £72,000 system was capitalised in line with the College's stated depreciation policy, i.e. 10 years, however an element of the total in relation to installation and set-up costs which are therefore not transferable to the College's new campus.</p> <p>From 2006-07 the college will therefore under-depreciate the installation cost and there will be a loss on disposal when the College moves to the site and relocates the system hardware to the new campus.</p>	<p>It is recommended that the College identifies a proportion of the cost relating to installation and set-up of the security and CCTV system and reduces the expected asset life according to the expected campus completion date.</p> <p>This will ensure that a potentially significant loss on disposal of fixed assets is avoided.</p>	<p>Consideration will be given to this recommendation for the 2006-07 final accounts.</p>	<p>Director of finance July 2007</p>

Appendix II – follow-up of prior years' recommendations

In this section we provide a brief overview of the action taken to date against recommendations made in previous accounting periods. The following table contains a summary, by report, of the status of recommendations made in previous years.

Figure 6: follow-up of prior years' recommendations

	Fully implemented	Ongoing	Not implemented	Not yet due
Annual audit report for 2004-05 to the Board of Management and the Auditor General for Scotland	3	-	-	-
Total	3	-	-	-
% of total due	100%			

Management should ensure that recommendations are monitored to ensure full implementation.