SCOTT-MONCRIEFF

EDINBURGH AND GLASGOW

Lauder College

Annual Report to the members of the Board of Management and the Auditor General for Scotland 2005/06

30 November 2006

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1 Summary and Conclusion

Financial statements ***Section 3***	•	Our audit opinion on the truth and fairness of the annual accounts and on the regularity of transactions is unqualified.
	•	The accounts comply with the Accounts Direction issued by the Scottish Funding Council (SFC) and the Statement of Recommended Practice on Accounting for Further and Higher Education. The deadline for submitting final accounts to SFC will be achieved.
	•	The College reported a surplus of £314,000 to 31 July 2006. This was achieved after crediting the gain on disposal of assets of £295,000.
	•	This is the first year in which the College has been required to disclose the local government pension scheme liability on its balance sheet. The pension liability as at 31 July 2006 was £2,522,000.
Corporate governance ***Section 4***	•	We identified no significant errors or weaknesses during our audit. In general, the College's systems of internal control appear to be adequate, well designed and operating effectively.
	•	The College's Corporate Governance Statement confirms that the College has been fully compliant with the key principles of the 1998 Combined Code on Corporate Governance during 2005/06.
	•	From 2006/07 the College will be required to comply with the revised Combined Code issued in 2003.
Action Plan ***Section 5***		We have identified two action points in section 5 of this report. None of these are considered to present a high risk to the College. The implementation of management's responses to the issues will address the risks identified.
Conclusion		This report concludes the 2005/06 audit of Lauder College, which we have performed in accordance with the Code of Audit Practice and Statement of Responsibilities issued by Audit Scotland. We would like to thank all members of College management and staff who have been involved in our work for their co-operation and assistance during our audit. ***Scott-Moncrieff*** ***30 November 2006***

2 Introduction

2.1 Audit framework

The Auditor General for Scotland is the Scottish Parliament's watchdog for ensuring propriety and value for money in the use of public funds. The Auditor General is therefore responsible for appointing auditors to Further Education colleges and for setting the terms of their appointment.

Audit Scotland is an independent statutory body that provides the Auditor General with the services required to carry out his statutory functions. Audit Scotland has prepared a Code of Audit Practice, which sets out the way in which auditors should carry out their functions, and a Statement of Responsibilities which explains where the responsibilities of the auditor begin and end.

The purpose of this report is to summarise the results of our audit work for 2005/06. The report describes the ways in which the requirements of the Statement of Responsibilities and the Code of Audit Practice have been met by both the College and us.

2.2 Responsibilities of the College

The College is accountable to the public for the conduct of public business and the stewardship of funds under its control. The College is therefore responsible for:

- establishing proper corporate governance arrangements;
- maintaining proper accounting records;
- preparing the financial statements;
- safeguarding assets;
- taking reasonable steps for the prevention and detection of fraud and other irregularities;
- managing its affairs to secure the economic, efficient and effective use of resources.

2.3 Responsibilities of auditors

Our responsibilities, which are significantly greater than those of auditors in the private sector, are derived from statute and from the Code of Audit Practice.

Our role is to carry out an independent and objective appraisal of the discharge by management of its stewardship responsibilities and in particular: -

- to provide an opinion on the financial statements and regularity of transactions;
- to review and report on the corporate governance arrangements relating to the prevention and detection of fraud and corruption;
- to review and report on the corporate governance arrangements relating to standards of conduct, accountability and openness;
- to review and report on the corporate governance arrangements relating to the organisation's financial position;
- to review and report on the corporate governance arrangements relating to the organisation's review of its systems of internal control;
- to review and report on the organisation's arrangements for managing its performance economically, efficiently and effectively.

3 Financial Statements

STATEMENT OF RESPONSIBILITIES

It is the responsibility of the audited body and its management to:

- act within the law and ensure the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority;
- maintain proper accounting records;
- prepare financial statements timeously which give a true and fair view of the financial position of the body and its expenditure and income.

The auditor is required to audit the financial statements in accordance with International Standards of Auditing and to give an opinion on:

- whether they give a true and fair view or present fairly the financial position of the audited body and its expenditure and income for the period;
- whether they have been prepared in accordance with relevant legislation and applicable accounting standards;
- on the regularity of the expenditure and receipts.

3.1 Accounts Direction

The College was required, in preparing its annual accounts, to comply with directions given by the Scottish Funding Council (SFC). We are pleased to confirm that the College's annual accounts for 2005/06 comply fully with the Accounts Direction issued by SFC.

3.2 Statement of Recommended Practice (SORP)

The purpose of the SORP on Accounting for Further and Higher Education is to ensure that the financial statements of institutions are prepared on a comparable and consistent basis. The SORP takes account of best accounting practice, the requirements of the Funding Councils, the accounting provisions of the Companies Act and other relevant legislation

We are pleased to report that the 2005/06 annual accounts of the College comply with the SORP in all material respects.

3.3 Annual accounts and audit timetable

The deadline for the submission to SFC of FE college audited annual accounts is 31 December. The accounts will be approved by the Board of Management on 13 December 2006 and will be submitted to SFC and the Auditor General prior to the 31 December deadline.

We were not presented with the draft financial statements on 2 October 2006 as agreed and did not receive draft financial statements until 10 October 2006. The delays in the accounts preparation process led to us spending additional time completing the audit.

With the exception of the delays described above, the audit process went well. Once prepared, the draft financial statements and working papers were of a high standard.

We are grateful to the Assistant Principal / Director of Finance, the Finance Manager and Finance Department staff for their assistance and support during the course of the audit.

3.4 Auditors' report – unqualified opinion

We are required to give an opinion as to whether the accounts present a true and fair view of the financial position of the College at 31 July 2006 and of its income and expenditure for the financial year.

We are also required to include a regularity assertion in our audit report stating that, in all material respects, expenditure and income were incurred or applied for their intended purposes and in accordance with guidance issued by the Scottish Ministers and the financial memorandum with SFC.

We plan to issue an unqualified audit opinion on the truth and fairness of the accounts and on the regularity of transactions.

3.5 Review of accounting systems

One of the objectives of our audit was to review the accounting systems and internal controls operating at the College to ensure they formed an adequate basis for the preparation of the financial statements.

We identified no control weaknesses during our audit of accounting systems. In general, the College's systems of internal control appear to be adequate, well designed and operating effectively.

3.6 Sustainable development centre

The College commissioned Muir Construction to construct a new building on its Halbeath campus. The new building will be used principally for gas engineering, construction and special needs education.

The total cost of the new build is expected to be £4.5 million. Work began during 2005/06 and the College had incurred costs of £3.3 million by 31 July 2006. This is included in the fixed asset additions line in note 11 to the financial statements.

The new build is expected to be completed and available for use in 2006/07.

3.7 FRS 17 – Retirement Benefits

Financial Reporting Standard 17 – Retirement Benefits (FRS 17) has been implemented in preparation of the financial statements for the year ended 31 July 2006. The implementation of this standard resulted in the College's share of the assets or liabilities in the local government pension scheme being shown on the balance sheet for the first time. This has resulted in a deficit on the general reserve of £1,336,000.

As noted in note 28, the retirement benefits to the College's employees are provided by either the Scottish Teachers Superannuation (STSS) or the Fife Council Local Government Pension Scheme (LGPS). Both schemes are defined benefit schemes.

Note 27 shows that the College's pension liability is made up of:

	£'000
LGPS – Net deficit	(2,096)
STSS – Unfunded liabilities	(426)
Total pension liability	**(2,522)**

The College's actuaries were able to separately identify the College's share of assets and liabilities in the Fife Council LGPS and this has been included in the College's accounts.

With the exception of liabilities arising from early retirements, the College has not been able to separately identify its share of assets and liabilities in the STSS scheme. The College has applied the concession allowed by FRS 17 and has accounted for the STSS scheme as a defined benefits scheme.

The College is able to identify its liabilities in the SPPA scheme arising from the College's previous decision to allow early retirement and early access to retirement benefits. These liabilities have been included in the College's pension liability.

Note 27 to the accounts illustrates the necessary disclosure required to comply with FRS 17.

The implementation of this standard resulted in a prior period adjustment to the 2005 figures to incorporate the pension liability and pension reserve. The effect of this is shown in note 33.

3.8 Amounts paid to the former Principal

The Annual Audit Report from the College's previous external auditors in 2004/05 raised a number of issues in relation to payments and early access to pension benefits made to the former Principal at the end of her service agreement.

We have reviewed these transactions and have not identified any issues of concern that require to be reported to either the Board of Management or the Auditor General for Scotland. Full disclosure of the transactions has been made in Note 6 to the financial statements.

3.9 Dunfermline Express Hotel Limited

During 2004/05, the College entered into an agreement with Chardon Hotels Limited to construct and operate a hotel on the Halbeath campus. In return for granting a lease over the land, the College received a 23% shareholding in Dunfermline Express Hotel Limited.

The College disposed of its interest in Dunfermline Express Hotel Limited to Chardon Hotels Limited during 2005/06. The total proceeds from the disposal are dependant on when Chardon Hotels makes the final payment.

The College recognised the gain on disposal in its 2005/06 financial statements. The gain was calculated as the difference between the minimum receipts from the sale and the cost of the investment.

3.10 eCom loan

The College made a loan to eCom Limited of £184,000 on 23 July 2001. The loan agreement did not require eCom to make repayments until certain criteria were met. During 2002/03 the College reviewed this loan and considered that it was unlikely that the company would meet the criteria and make repayments. Consequently the College created a provision against the debt and brought its net carrying value to nil.

During 2005/06 the College agreed with eCom that the loan plus accumulated interest would be converted into redeemable preference shares totalling £230,000. These will be redeemed over 30 years.

The College has not recognised the full face value of the redeemable preference shares due to uncertainty over the future redemptions. The College has recognised the preference shares at a value of £90,000. This is shown in note 12 to the financial statements.

4 Corporate Governance

STATEMENT OF RESPONSIBILITIES

The audited body has a responsibility to:

- Develop and implement systems of internal control and at least annually to conduct a review of the effectiveness of the internal control systems.
- Establish arrangements to prevent and detect fraud and irregularity.
- Ensure its affairs are managed in accordance with proper standards of conduct.
- Conduct its affairs and to put in place proper arrangements to ensure that its financial position is soundly based.

The auditor reviews and reports on the audited body's corporate governance arrangements.

4.1 Corporate governance framework

The Board of Management has formally established the following sub-committees, which contribute to the culture of risk management and internal control at the College: Resources & General Purposes Committee, Remuneration Committee, Chairman's Committee, Audit Committee, Curriculum and Student Affairs. The work of these committees is described in the Corporate Governance Statement.

4.2 Corporate governance statement

Requirement for a corporate governance statement

Colleges are required to include a statement on their corporate governance arrangements within their annual accounts. The statement describes the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management.

The College's corporate governance statement for 2005/06 – fully compliant statement

The College's corporate governance statement for 2005/06 illustrates that the College was fully compliant with the 1998 code throughout the period.

Combined Code 2003

A revised Combined Code on Corporate Governance was issued in July 2003, which supersedes the Code issued in 1998.

Following consultation with Further Education and Higher Education sector groups, colleges and universities, it was agreed that the 2003 Combined Code will be effective for the 2006/07 financial statements. We have recommended in our action plan that the College take steps in 2006/07 to ensure that it is compliant with the update code.

Unqualified audit opinion

We have reviewed the corporate governance statement included within the annual accounts. Our audit opinion on this statement is covered by our auditors' report and is unqualified in this respect.

4.3 Internal Audit

Internal audit is a key component of the College's corporate governance arrangements. The College's internal audit service is provided by Chiene and Tait.

As required by the Code of Audit Practice we undertook a review of the College's arrangements to ensure that the work of internal audit is sufficient in quality and volume and performed in accordance with the Code of Audit Practice. The review concluded that the internal audit service provided to the College was in compliance with the Code of Audit Practice.

Reliance on internal audit

To avoid duplication of effort and ensure an efficient audit process we planned our audit work to place reliance wherever possible on the work of internal audit.

We have made use of internal audit work in the following areas:

- Strategic & Operational Planning
- Commercial Development
- Budget Management & Controls
- Estates Management
- Network Security & Controls
- SUMS and fee waiver

We are grateful to Chiene and Tait for their assistance during the course of our audit work.

4.4 Fraud, irregularity and corruption

College's responsibilities

To ensure the integrity of public funds, the College is responsible for establishing arrangements to prevent and detect fraud and other irregularities.

Auditors' responsibilities

We consider the arrangements made by management in the following ways:

- Our systems based audit is planned so as to provide a reasonable expectation of detecting misstatements in the annual accounts resulting from fraud or irregularity.
- We focus on specific areas of high risk for potential fraud and irregularity and review the arrangements in place in these areas.
- We review the Technical Bulletins produced by Audit Scotland with regard to fraud reports and ensure that the College has arrangements in place to prevent similar frauds occurring.
- We review the extent and adequacy of the Internal Audit function within the College.
- We examine the financial instructions issued by the College to ensure that they deal adequately with fraud and corruption and provide a framework for exercising strong internal control.

Conclusion

Our audit identified no issues of concern in relation to regularity or fraud and corruption.

4.5 Standards of conduct, integrity and openness

Propriety requires that public business be conducted with fairness and integrity. This includes avoiding personal gain from public business, being even-handed in the appointment of staff, letting contracts based on open competition and avoiding waste and extravagance.

Our work in this area included a review of the arrangements for adopting and reviewing standing orders, financial instructions, registers' of interest and schemes of delegation and complying with national and local Codes of Conduct.

Conclusion

We are pleased to report that our audit identified no issues of concern in relation to standards of conduct, integrity and openness.

4.6 Financial standing

It is the responsibility of the College to conduct its financial affairs in a proper manner. As part of our audit, we are required to consider the College's financial standing, including the arrangements in place for financial planning, budgetary control and financial reporting. It is important that such arrangements are adequate in order to properly control the College's operations and use of resources.

4.6.1 Financial position

The College is reporting a surplus for the year of £314,000, including the gain on disposal of assets of £295,000. The College's operating surplus excluding these non-recurring items is £24,000.

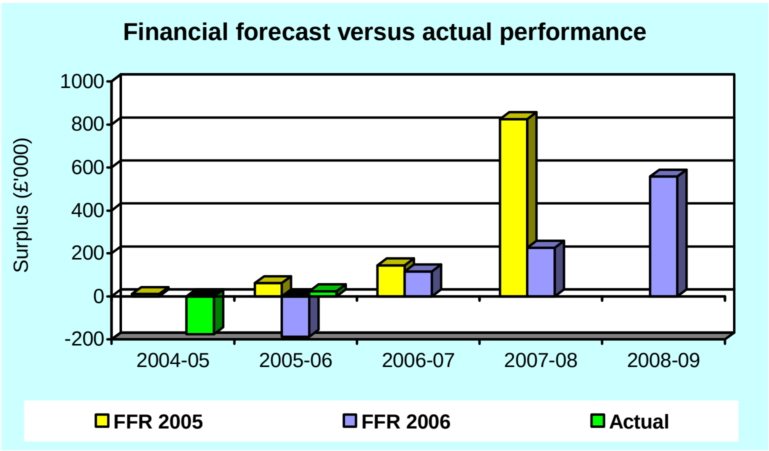
As noted in point 3.7, the financial statements for year ended 31 July 2005 required to be re-stated as a result of the implementation of FRS 17. This has resulted in the disclosure of a pension liability and pension reserve of £2,522,000 at 31 July 2006 (2005 - £3,035,000). The application of FRS 17 has resulted in the College having a negative general reserve of £1,336,000 (2005: £2,473,000)

In total, the College has reserves and deferred capital grants of £11,532,000. Of this £3,741,000 is held within the revaluation reserve created when the College was incorporated.

4.6.2 Financial planning, forecasting and control

The College submits annual financial forecast returns (FFRs) to SFC detailing the expected results for the current year and the next three years. SFC uses the FFRs to assess the financial performance of individual colleges and of the sector as a whole.

The graph below compares the actual results for 2005/06 with the FFR forecasts and shows the latest predictions within the 2006 FFR.



As shown above, the College is expecting to achieve surpluses over the next three years.

4.6.3 Conclusion

In our opinion the College has established robust and effective arrangements for financial planning, budgetary control and financial reporting.

5 Action Plan

5.1 Summary

Our action plan summarises all of the control weaknesses and opportunities for improvement that we have identified during our 2005/06 audit. These are the issues that we consider should be brought to the attention of the Board of Management and the Audit Committee.

We have made no priority one recommendations in 2005/06.

It should be noted that the weaknesses identified in this report are only those have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist.

5.2 Priority rating

The priority rating is intended to assist the College in assessing the significance of the issues raised and in prioritising the action required to address them. The rating structure is summarised as follows:

Priority 1	High risk, material observations requiring immediate action;
Priority 2	Medium risk, significant observations requiring reasonably urgent action;
Priority 3	Low risk, minor observations which require to be brought to the attention of management.

5.3 Issues from 2005/06 Final Audit

Title	Issues identified	Risk and recommendation	Management comments
5.3.1 **Combined code 2003** ***Priority 2***	A revised Combined Code on Corporate Governance was issued in July 2003, which supersedes the Code issued in 1998. Following consultation with Further Education and Higher Education sector groups, colleges and universities, it was agreed that the 2003 Combined Code will be effective for the 2006/07 financial statements.	The College should review its current corporate governance arrangements against the requirements of the 2003 Combined Code. The College should take action to address any areas of non-compliance to ensure that is compliant for its 2006/07 financial statements.	Agreed. This will reviewed during 2006/07. ***Responsible officer:*** *Assistant Principal / Director of Finance*
5.3.2 **Accounts preparation** ***Priority 2***	The College was not prepared for the audit. We did not receive draft accounts or working papers on 2 October as agreed. The delays in the accounts preparation process were due to a vacancy in the finance team. We had to spend additional time to complete the audit.	Future delays in the accounts preparation and audit process will result in additional fees and also jeopardises the College meeting its submission deadlines. We understand that the College has now filled its vacancy and are of the opinion that the accounts will be ready as agreed in future.	The vacancy has now been filled. We expect to adhere to the accounts preparation timetable in future. ***Responsible officer:*** *Assistant Principal / Director of Finance*

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