

INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

South Lanarkshire College

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

13 December 2006

AUDIT

Contents

Executive summary	1
Introduction	3
Financial position	5
Corporate governance	8
Financial statements	11

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 South Lanarkshire 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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Contents

Executive summary	1
Introduction	3
Financial position	5
Corporate governance	8
Financial statements	11

Executive summary

Financial position

The financial statements reflect a surplus for the year of £294,000 (2004-05, £55,000) before net transfers to reserves of (£227,000) (2004-05, £4,000), giving a balance on the income and expenditure account of £811,000 (excluding pension reserve) as at 31 July 2006 (2005, £538,000).

Full implementation of FRS 17 'retirement benefits' required a prior year adjustment to previously reported information for 2004-05, resulting in a reduction of £523,000 to opening reserves as at 1 August 2005. During the year, the College's share of its net liabilities in the Strathclyde local government pension scheme decreased from £663,000 to £362,000 million at 31 July 2006.

Corporate governance

Our audit work for 2005-06 has identified no significant weaknesses in the operation of financial controls and procedures and has not identified any significant control weaknesses in relation to fraud and irregularity, standards of conduct or prevention of corruption.

During the year the College's internal auditor produced audit reports on income collection and credit control, treasury management, personnel and payroll, budgetary and financial controls, value for money selection criteria, collection of student activity data, together with a follow-up report on the status of previous recommendations. For these areas, it was reported that 'the College has adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives'. Some 'areas for potential improvement' were reported.

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

Financial statements

On 6 December 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.

Contents

Executive summary	1
Introduction	3
Financial position	5
Corporate governance	8
Financial statements	11

Introduction

Audit framework

2005-06 was the final year of our five-year appointment as external auditors of South Lanarkshire 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 15 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, to the extent required by relevant legislation and the requirements of the Code, 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, to the extent required by relevant legislation and the requirements of the Code, 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 areas for specific attention during the audit process:

- full implementation of FRS 17;

- the effect of the revised Scottish Funding Council financial memorandum; and
- accounting for fixed assets in respect of the College's estates redevelopment programme and, in particular, the implications of financial reporting standard 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. 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.

Contents

Executive summary	1
Introduction	3
Financial position	5
Corporate governance	8
Financial statements	11

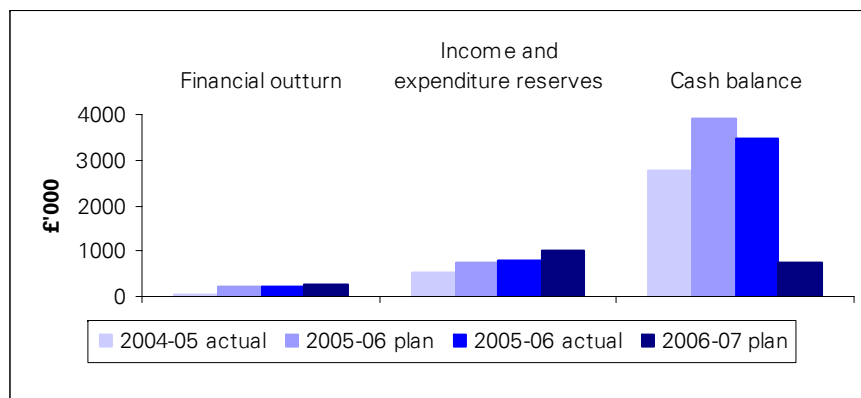
Financial position

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 £294,000 (2004-05: £55,000) after depreciation of fixed assets at valuation and before funds transfers. After a £3,000 transfer from restricted funds and a £230,000 transfer to designated funds, the resultant surplus is £67,000 (2004-05: £59,000). On an historical cost basis, the surplus for the year was £247,000 (2004-05, £238,000). This has resulted in an accumulated income and expenditure balance of £811,000 (excluding pension reserve) at the year end (2005: £538,000).

The College surpassed its budgeted outturn for the year, primarily due to savings achieved by reductions on expenditure in relation to replacement of non-capitalised assets and additional income from interest receivable from funds on short term deposits. The budget and actual surplus meets the Scottish Funding Council's definition of a financially secure college.

While cash in hand and at bank balances have decreased significantly in the year, the College now has short terms investments of £2,606,000 (2005: £1,606,000). There is therefore a net increase in the College's cash position as funds are built up to support the development of the new campus in East Kilbride.

College management has confirmed that the designated funds are to be used to support additional fit-out costs of the new campus building. The intention is that these costs will be capitalised when incurred, with the designated reserves released to match the depreciation charge.

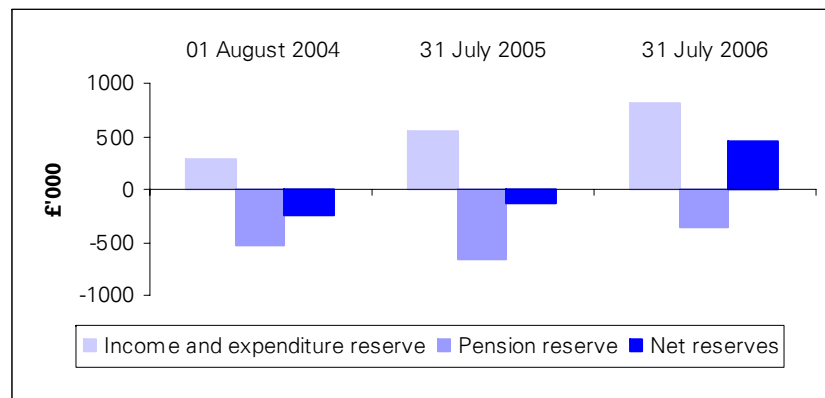
FRS 17 'retirement benefits' ("FRS 17")

The College fully implemented FRS 17 during the year ended 31 July 2006, resulting in inclusion of the College's share of its assets and liabilities in the Strathclyde 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 £523,000 to opening reserves as at 1 August 2004. Implementation of FRS 17 resulted in the recognition of net pension liabilities on the balance sheet of £362,000 at 31 July 2006 (2005, £663,000). Figure 2 highlights the impact of the College's share of the pension deficit on its income and expenditure reserves.

Financial position (continued)

Figure 2: impact of FRS 17 pension deficit



Ring-fenced funding

The Funding Council allocated £730,000 of ring fenced funding to the College during 2005-06, primarily for the estates redevelopment, financial security and the funding of the courses for pupils from schools in the area. 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 £2,231,000 in the year, all of which is related to the new campus. These have been funded from Scottish Funding Council and ERDF grants, which have been capitalised in accordance with the College's accounting policies.

Provisions

The College's enhanced pension provision is £485,000, based on a valuation as at 31 July 2006, which has been updated using discount tables issued by the Scottish Funding Council.

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	35,583	34,918
SUMS actual	37,299	36,080
Impact on recurring grant	£Nil	Nil

2006-07 budget

The College has budgeted for a £269,000 surplus in the year ending 31 July 2007, consistent with the overall budget for 2005-06. The 2006-07 outturn will be significantly affected by changes such as continued increases in energy costs, the annual pay award and the known increase, to 13.5%, in employer contributions to the Scottish Teachers' Superannuation Scheme from April 2007.

Contents

Executive summary	1
Introduction	3
Financial position	5
Corporate governance	8
Financial statements	11

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

The College has an appropriate system of high level financial and corporate governance controls which includes: a code of conduct; a register of interests for members of the board of management; a scheme of delegation and a risk management policy which includes a risk register. The new build project managers maintain a separate risk register over the project.

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. Our work did identify some minor areas for improvement in the operation of financial controls and procedures relating to approval of journal entries and approval of payroll amendments. An action plan to address these has been agreed with management.

There are increasing demands on the College's finance function as a result of the ongoing campus redevelopment programme which means that continued application of strict financial controls, monitoring and procedures is critical to the College's success.

Scottish Funding Council Circular FE/35/05 requested that its revised draft financial memorandum should be formally considered by each college's board of management during late 2005 to allow timely and efficient adoption from 1 January 2006. The Scottish Funding Council financial memorandum was approved by the board of management in December 2005.

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

Internal audit

During 2005-06, Wylie & Bisset 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 income collection and credit control, treasury management, personnel and payroll, budgetary and financial controls, value for money selection criteria, collection of student activity data and a follow-up report on previous reports. For the areas reviewed, it was reported that 'the College has adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives'.

In some areas it was reported that there are 'weaknesses or areas for potential improvement'. However, none of the reports deficiencies were graded as 'high risk' representing 'major weaknesses that we consider needs to be brought to the attention of the audit committee and addressed by senior management of the College as a matter of urgency'.

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.

Financial statements (continued)

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

The following table contains a summary, by report, of the status of recommendations made in previous years.

Figure 4: follow-up of prior years' recommendations

	Fully implemented	Ongoing	Not implemented	Not yet due
Annual audit report for 2004-05	2	1	1	-
Total	2	1	1	-
% of total due	50%	25%	25%	-

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

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*.

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 has not been subject to any external inspections in the year in respect of impacting on the financial or governance arrangements of the College.

The College is due for an inspection by the HM Inspectorate of Education in November and December 2006 which will be published in 2007. The areas of assessment are likely to include the College's learning and teaching processes, progression of learners and achievement of appropriate outcomes, including learner self-evaluation, the College's retention and recruitment of learners and the College's overall management, its operational planning and its progress towards improving the quality of its services for learners.

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.

Contents

Executive summary	1
Introduction	3
Financial position	5
Corporate governance	8
Financial statements	11

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Audit opinion

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Audit completion

An important measure of proper financial control and accountability is the timely closure and publication of audited financial statements. Figure 5 summarises the key elements of the audit process with which we require management to engage.

Figure 5: key elements of the audit process

Completeness of draft financial statements
A set of draft financial statements was received in the final audit visit, although some disclosure sections were incomplete and number of presentational adjustments 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 again to a good standard.
Response to audit queries
Our routine audit queries were dealt with in a timely manner.

Financial adjustments and confirmations

In Figure 6 we draw attention to adjustments to the financial statements made by management as a result of the audit process.

Figure 6: financial statement adjustments

	Income and expenditure account £'000	Balance sheet £'000
Adjustment for credit balances disclosed within debtors and vice versa		35 (35)
Invoices accounted as expenditure in 2005-06, when they related to 2006-07.	28	(28)
Sales invoices which related to 2005-06 not accrued in the draft financial statements.	(24)	24
Net adjustment	4	(4)

Confirmations and representations

We confirm that as of 22 November 2006, in our professional judgement, KPMG LLP is 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.

Significant accounting issues

FRS 17: Retirement Benefits

In 2005-06 the College was required to progress to full implementation of the FRS for the first time. During the previous transitional years of disclosure, the College has received a report from the actuaries of the Strathclyde Pension Fund, providing details of the College's share of assets and liabilities within the Fund. The College had used this information to include transitional disclosure as if accounting for its participation in the SPF on a defined benefit basis.

Financial statements (continued)

Our review of the FRS 17 report provided to the College by the scheme actuaries, in conjunction with other information relating to the SPF, has resulted in our opinion that the College's participation in the SPF should be accounted for on a defined benefit basis. Following discussion with College management through the audit clearance process, they agreed to account for their participation in the SPF on a defined benefit basis. The full adoption of the standard represents a change in accounting policy and the comparative figures have been restated accordingly. Details of the effect of adopting FRS 17 are given in notes 20 and 32 to the College's financial statements.

Campus new build

The College's sale of the current campuses was concluded in September 2005. However, as the College has retained title to its buildings until an estimated completion in 2008, with full payment not due until that date, the sale has not been recognised within the financial statements.

The College had full operational use of its existing properties throughout 2005-06, and will do for financial year 2006-07. Consequently, the College has charged its income and expenditure account in 2005-06 with depreciation relating to the consumption of economic benefits was accounted for correctly in accordance with financial reporting standard 15. In accordance with the College's accounting policies, the carrying value for the sites remained as depreciated replacement cost.