HENDERSON LOGGIE

Edinburgh's Telford College

Annual Audit report for 2006/07 to the Board of Management and the Auditor General for Scotland

External Audit Report No: 2007/03

Draft Issued: 12 November 2007

Final Issued: 11 December 2007

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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 Edinburgh's Telford College and is made available to Audit Scotland (together with the beneficiaries), and has been released to the beneficiaries on the basis that it shall not be copied, referred to or disclosed, in whole or in part, without prior written consent.

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 the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against Henderson Loggie CA (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law Henderson Loggie CA does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

Executive Summary

1.1 Corporate Governance

- The College has shown a deficit for the year of £0.032 million against a budgeted surplus of £0.871 million. The income and expenditure account balance at 31 July 2007 was a surplus of £32.705 million.

- The College's internal auditors carried out a limited programme of work during the year. New internal auditors were appointed on an interim basis to complete the annual internal audit plan.

- The out going internal auditors in their annual report have concluded that *"Substantial Assurance"* can be taken that the College's internal controls and governance frameworks are sufficient to ensure the efficient and effective operation of the organisation and that the strategic and operational risks to which the organisation is exposed are being managed.

- The internal auditors in their annual report have concluded that *"In our opinion Edinburgh's Telford College has a framework of controls in place, in the areas which we have reviewed, that provides reasonable assurance regarding the effective and efficient achievement of the College's objectives and management of key risks"*.

- The College's Corporate Governance Statement confirms that the College has been fully compliant with the principles of the Combined Code on Corporate Governance during 2006/07.

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

- The College has an on-going process for identifying, evaluating and managing its significant risks.

1.2 Performance

- The College's Strategic Plan 2006-2009 sets out the key strategic aims and objectives. World Class Key Performance Indicators (KPIs) have been set linked to the agreed objectives.

- Risk management arrangements include the linking of the KPIs to the specific risks in the risk register. Risks are assigned to specific individuals for monitoring and ensuring appropriate controls are in place for the identified risks.

- The College's strategic objectives are in effect incorporated into the risk register.

- Regular performance reports including benchmarking information are submitted to the Board and Committees during the year.

- The College's Efficient Government Initiative submission identified potential savings of £0.975 million over three years to 2008.

1.3 Financial Statements

- It is planned that on 18 December 2007 we will issue an audit report expressing an unqualified opinion on the financial settlements of the College for the year ended 31 July 2007 and on the regularity of the financial transactions reflected in those financial statements.

- The annual accounts of the College comply with the Accounts Direction issued by SFC and the Statement of Recommended Practice on Accounting for Further and Higher Education.

- A number of material and significant audit adjustments were made to the unaudited accounts. The accounting treatment for the recovery of VAT on the new campus and the subsequent liability to repay the VAT over instalments was considered further by the College. Acting on specialist VAT advice the College applied accounting adjustments to properly treat the Lennartz VAT liability. This required a prior year adjustment and current year adjustments. Its impact on the 2006/07 accounts has been the removal of a charge of £0.679 million from the Income and Expenditure Account and the reduction in the VAT Creditor balance and an increase in fixed assets by £0.165 million.

- A material adjustment was applied to comply with the Accounts Direction for the treatment of Restricted Reserves. Following the reinvestment of proceeds from the old campus the Restricted Reserve portion relating to this was released into the General Reserve with a £31.740 million prior year adjustment.

- The net effect of the audit adjustments has been the reduction in the deficit for the year from £1.606 million to £0.032 million.

- The College failed to meet its WSUMS offer for 2006/07 by 4,658 WSUMs (3.95%, (2005/06 – 1,043 WSUMs, 0.93%). College management has undertaken a review into the reasons for failing to achieve the target and an action plan has been agreed to address the identified issues.

Introduction

2.1 Background

2.1.1 2006/07 was the first year of our five year appointment as external auditors of Edinburgh's Telford College ('the College'). This report summarises our opinion and conclusions and highlights significant issues arising from our work.

2.1.2 The framework under which we operate under appointment by Audit Scotland is as outlined in our strategic planning memorandum and 2006/07 Audit Plan issued on 13 March 2007. 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.

2.1.3 Our audit approach focused on the identification of the significant risk areas facing the College and the significant classes of transactions, estimates, other account balances and disclosures impacting upon the financial statements. These include:

- compliance with legislation and financial regulations;
- estates capital expenditure and the appropriateness of the accounting entries;
- achievement of SUMs and commercial income targets;
- FRS 17 provision for pension liabilities; and
- recognition of funding provided for specific purposes and the regularity of corresponding expenditure.

2.2 Basis of Information

2.2.1 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.

2.2 Basis of Information (Cont'd)

2.2.2 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 Henderson Loggie CA except where explicitly stated as being so.

2.3 Acknowledgement

2.3.1 Our audit has brought us in contact with a range of College staff. We wish to place on record our appreciation of the co-operation and assistance extended to us by staff in the discharge of our responsibilities.

3.1 Financial Position

3.1.1 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 meets its liabilities; regular operating surpluses would ensure this.'*

3.1.2 Table 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.

Table 1: Comparison of planned and actual financial results

	2005/06 Actual £000	2006/07 Planned £000	2006/07 Actual £000	2007/08 Planned £000
Financial outturn Surplus/(Deficit)	1,093	871	(32)	1,037
Income and expenditure reserves	(1,877)	(430)	32,705	1,299
Cash balances	1,926	1,953	2,091	2,393

Source: Audited accounts and 2007 FFR

3.1.3 Based on the results for the year to 31 July 2007 the College meets the requirements of the Funding Council to be classed as financially secure.

3.1.4 Overall, the College income in 2006/07 has increased by £4.670 million (18.3%) over 2005/06. The main reason is due to a significant increase of £3.232 million (16.6%) in SFC grant income. This included an increase in recurrent grant of £1.691 million (9.3%), an increase of £0.109 million (21.8%) in financial security funding and the inclusion of £1.182 million of capital formula funding. Overall there was a £0.175 million (3.6%) increase in tuition fees and educational contracts. Other income sources contributed additional income of £0.090 million (19.3%).

3.1.5 Expenditure in 2006/07 increased by £5.830 million (23.9%) over 2005/06 primarily due to an increase in staff costs of £0.941 million (5.5%), an increase in other operating costs of £2.744 million (44.1%), and an increase in depreciation of £1.976 million due to a full year of depreciation on the new campus. The rise on other operating costs is due to an increase in premises costs of £1.881 million (114.1%), an increase in administration and academic services costs of £0.449 million (17.0%) and an increase in teaching department costs of £0.456 million (31.1%).

3.1.6 The outturn for the year is £0.903 million less than planned (as submitted to the Funding Council). The difference is largely due to additional depreciation on the new campus (£1.025 million) and an amendment in the treatment of VAT on fixed assets (£0.187 million), with other movements largely offsetting each other.

3.1 Financial Position (Cont'd)

3.1.7 The College's cash balance at 31 July 2007 was £2.091 million, an increase of £0.165 million (8.6%) on the previous year. The overdraft position improved through net cash inflows of £4.947 million, reducing the overdraft at 31 July 2007 to £8.190 million largely as the result of the receipt of proceeds from the sale of the old campus during the year.

2006/07 SUMS outturn

3.1.8 The College's outturn against its 2006/07 SUMS offer is shown in table 2.

Table 2: 2006/07 SUMS outturn

	2005/06	2006/07
SUMS offer	112,497	117,784
SUMS actual	111,454	113,126
Shortfall	1,043	4,658

Source: Audited SUMs returns.

3.1.9 College management has undertaken a review into the reasons for failing to achieve the offer and an action plan has been agreed to address the identified issues.

3.1.10 The College's internal auditor carried out the audit of the SUMs return for 2006/07. They concluded that controls over the collection of data and the preparation of the SUMs return require improvement before they can be said to be adequate.

3.1.11 The internal auditors through audit testing were able to certify that the WSUMs return was not materially misstated.

FRS 17

3.1.12 The College accounted for its participation in the local government pension scheme as a defined benefit scheme and accordingly this has resulted in the College's share of the net pension liabilities within the Lothian Pension Fund (LPF) being provided for in the balance sheet. This is consistent with the accounting treatment adopted in 2005/06.

3.1.13 Note 26 to the accounts highlights the deficit within the College's share of the LPF. A £0.603 million total pension liability has been reported in 2006/07, a reduction of £3.151 million from the position in 2005/06 as a result of an increase in the discount rate on liabilities and increased forecast investment returns. The Note provides the necessary FRS 17 disclosure.

3.1.14 With the exception of liabilities arising from early retirement provision costs, the College is unable to separately identify its share of assets and liabilities in the Scottish Teachers' Superannuation Scheme as the scheme is notionally funded. The College has applied the concession allowed by FRS 17 and has accounted for the scheme as a defined contribution scheme.

3.1 Financial Position (Cont'd)

Capital Income and Expenditure

3.1.15 The College's new campus was completed in May 2006 with the College moving its operations to it in July 2006. The official opening of the new campus was held on 15 September 2006. Further capital expenditure totalling £1.667 million in completing the campus car park and on further equipment and furnishings was incurred during the year. A significant number of construction snagging issues affecting the new campus have been identified and negotiations with the contractor on these issues are on-going. The College has monies held on retention as part of creditors at 31 July 2007 in the sum of £0.828 million.

Provisions

3.1.16 The College has a provision of £2.179 million at 31 July 2007 for early retirement pension costs. The provision relates to unfunded liabilities as a result of early retirements approved by management in previous years. The provision has been revalued using the actuarial tables supplied by SFC using a net interest rate of 3%.

3.2 Corporate Governance Arrangements

3.2.1 The College has established corporate governance arrangements, with committees operating within a culture of risk management. Regular meetings of the Board of Management and College committees are held during the year at which strategic and operational matters are addressed. The College corporate governance arrangements are described in its Corporate Governance Statement contained with the financial statements.

3.2.2 Internal audit carried out a governance review following the resignation of a Board member. They concluded that information provided to the Board of Management and its committees was comprehensive, transparent and accurate. Information on the roles, responsibilities and decisions of the Board is available to staff and students. The appointment of staff and student representatives to fill vacant posts would strengthen the governance arrangements and improve greater awareness of staff and student issues at Board of Management level.

3.3 Systems of Internal Control

Control environment

3.3.1 Our work undertaken in relation to the 2006/07 financial statements audit has not identified any control weaknesses in the operation of financial controls and procedures.

Internal Audit

3.3.2 By mutual consent Chiene and Tait ceased to be the College's internal auditor during the year having carried out a limited programme of work. Scott Moncrieff was appointed as the College's internal auditors on an interim basis to complete the agreed programme of work.

3.3.3 In regard to the work carried out by Chiene and Tait, their annual internal audit report stated that *"Substantial Assurance"* can be taken that the College's internal controls and governance frameworks are sufficient to ensure the efficient and effective operation of the organisation and that the strategic and operational risks to which the organisation is exposed are being managed.

3.3 Systems of Internal Control (Cont'd)

3.3.4 In their annual internal audit report Scott Moncrieff have concluded that *"In our opinion Edinburgh's Telford College has a framework of controls in place, in the areas which we have reviewed, that provides reasonable assurance regarding the effective and efficient achievement of the College's objectives and management of key risks."*

3.4 Corporate Governance Statement

3.4.1 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. In 2005/06 the College adopted the revised Combined Code on Corporate Governance issued in 2003 one year earlier than required.

3.4.2 We are required to review the statement 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 control.

3.4.3 The College's corporate governance statement for 2006/07 states that the College was fully compliant with the 2003 Code throughout the year.

3.4.4 Our audit opinion on the statement is covered by our auditors' report and is unqualified in this respect.

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

3.5.1 During 2006/07 we 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*.

3.5.2 While the College does not have a specific fraud policy in place it has Standing Orders, Financial Regulations, a Procurement Policy and a Whistleblowing Policy. These together with internal controls and internal audit help ensure that the College has adequate arrangements in place for the prevention and detection of fraud and corruption. Greater use of the College's intranet to make its policies accessible to staff will improve greater awareness to this area.

3.5.3 There are no outstanding recommendations from previous reports in relation to prevention and detection of fraud and irregularity, standards of conduct and prevention and detection of corruption.

Performance

Introduction

4.1.1 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.

4.1.2 No performance audit studies were identified by Audit Scotland for the College during 2006/07.

Strategic Plan

4.1.3 The College has a three year Strategic Plan covering the period from 2006 to 2009. In setting out its mission, vision and values the Plan goes on to identify its curriculum, strategic priorities and main partners. World Class key performance indicators covering 2006/07 to 2008/09 have been established.

4.1.4 The Plan is updated each year with input from the College's planning team.

Risk Management

4.1.5 The College has a Risk Management Policy which sets out the College's underlying approach to risk management and the roles and responsibilities of the Board of Management, College Principal, the College's Risk Management Team and other key parties. The main reporting procedures are also identified.

4.1.6 The system of internal control is designed to incorporate risk management, which together with other elements, facilitates the efficient and effective operation of the College and enables it to react to a variety of operational, financial and commercial risks.

4.1.7 The College's risk register is mapped to the World Class KPIs (Key Performance Indicators) and each risk is assigned to an individual for monitoring and ensuring that appropriate controls are in place. The corporate strategic aims are monitored for progress but are not formally linked into the risk register. However on review it is noted that the identified risks do cover the strategic aims.

Performance management

4.1.8 In developing its three-year Plan each school/unit has agreed KPIs. Templates have been created by the planning team for each school/unit to use in reporting progress. These templates include completed actions and milestones along with individual performance goals which are linked to team goals and KPIs.

4.1.9 The Board receives regular reports and feedback from the planning team on the College's performance in implementing its strategic aims and objectives.

4.1.10 Finance KPIs are reported to the Senior Management Team on a period by period basis, quarterly to the Finance and Property Committee and twice a year to the Board of Management.

Financial management

4.1.11 Monthly management accounts are prepared and reviewed by the finance team with quarterly reporting to the College's Finance and Property Committee. The College's arrangements in regard to its key financial risks include the regular review of the risk register and performance against agreed KPIs. Seven key financial risks are considered and linked to the KPIs. Reporting and tracking of the SUMs position is carried out fortnightly.

4.1.12 The deficit outturn against an FFR budgeted surplus for the year and the failure to meet its SUMs offer for the second year in a row are seen as key concerns for the College. The College recognises through its Strategic Plan the need to develop its financial security through ensuring the delivery of targeted operating surpluses at 5% of total income, an on-going growth in the level of non-SFC income and the achievement of efficiency gains resulting in a lowering of staff costs as a percentage of total income.

Efficient Government Initiative (EGI)

4.1.13 The College submitted its EGI information schedule to the SFC as required of them. Twelve areas mainly covering processes relating to the student journey and involving the improvement of processes around pre-enrolment, induction and enrolment, on course and attendance and achievement. A mix of time releasing and cash releasing savings have been quantified totalling £0.975 million over the period 2005/06 to 2007/08.

Value for Money

4.1.14 While there is no formal Value for Money Policy in place, the Strategic and operational plans together with the establishment and monitoring of KPIs ensures that the College has a culture of seeking improvement in its activities and operations that lead to the achievement of value for money.

4.1.15 The College carries out annual benchmarking using information provided by the SFC. The benchmarking information is considered by the Finance and Property Committee along side the College's own KPIs.

4.1.16 The College is currently undertaking a review of its procurement arrangements building upon the outcome of the McLelland report. The review is focussing on the need to reduce paperwork through the use of IT and purchasing consortia.

4.1.17 Internal audit undertook a Post Occupancy Benefit study following the College's relocation to its new campus. They concluded that *"…the relocation of the College to a single site has been largely successful thus far, as evidenced by the achievement of a number of anticipated benefits."* They identified specific instances of benefit including the removal of backlog maintenance, receipt of capital grants and property disposal; proceeds and improved IT. A number of areas of concern were noted for action including teaching space and access to the campus.

Financial Statements

5.1 Audit Opinion

5.1.1 On 18 December 2007, we plan to issue an audit report expressing an unqualified opinion on the financial statements of the College for the year ended 31 July 2007 and on the regularity of the financial transactions reflected in those financial statements.

5.2 Audit Completion

5.2.1 An important measure of proper financial control and accountability is the timely closure and publication of audited financial statements. We have summarised in table 3 the three key elements of the audit process that we require the College to engage with.

Table 3: Key elements of the audit process

Completeness of draft financial statements
A set of draft financial statements was received at the start of the final audit visit however some disclosures had not been finalised. These were of a high standard and required minimal presentational changes as part of the audit process.

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. An incomplete set of supporting working papers were provided in line with this list at the outset of the audit with the remaining working papers provided during the fieldwork. These were of a suitably high standard.

Response to audit queries
We are pleased to note that all audit queries were dealt with in a timely manner.

5.3 Audit Adjustments and Confirmation

5.3.1 A number of potential adjustments were identified during the audit. These were discussed with the Head of Finance and College Secretary on 11 October 2007 and it was agreed not to adjust the accounts on the grounds of materiality. Further items were agreed to be adjusted by management and in table 4 we draw your attention to these agree audit and accounting adjustments.

Table 4: Audit adjustments

Description	I&E DR £'000	I&E CR £'000	B/Sheet DR £'000	B/Sheet CR £'000
Fixed Assets 1		35	50	15
Fixed Assets 2			1,294	1,294
Deferred Income	500	610	955	845
Restatement of opening TB			116	116
Other income	269	269		
Consumables	71	71		
SFC Grant in aid	340	340		
Other income		8	8	
SFC Claw back		150	150	
Restricted Reserve			31,752	31,752
Lennartz adjustments		678	843	165
Deferred capital grants transfer			828	828
Release of prepaid income		781	781	
Extra depreciation – Lennartz	187			187
Pension reclassification			2,179	2,179
	______	______	______	______
	1,367	2,942	38,956	37,381
	=====	=====	=====	=====

5.3 Audit Adjustments and Confirmation (Cont'd)

5.3.2 A number of disclosure and clarification adjustments were made to the accounts to ensure SORP compliance and improve the overall presentation of the accounts.

5.3.3 Our ISA 260 Report: *Report to those charged with governance,* setting out key matters relating to the audit of the financial statements, including audit adjustments and uncorrected misstatements, was presented to the College's Audit Committee on 20 November 2007.

Confirmations and Representations

5.3.4 We confirm that as at 11 December 2007, in our professional judgement, Henderson Loggie CA was independent within the meaning of regulatory and professional requirements and the objectivity of audit staff was not impaired. Appendix I provides a copy of the letter issued to the Audit Committee.

5.3.5 In accordance with auditing standards, we obtained representations from the College on material issues.

Appendix I - Confirmation of Independence

To: Edinburgh's Telford College and the Auditor General for Scotland

Professional ethical standards require us to communicate to you in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on Henderson Loggie's independence and the objectivity of the audit team. This statement is intended to comply with this obligation.

We have considered the fees paid to us by Audit Scotland and the College for professional services provided by us during the reporting period.

We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

Henderson Loggie is committed to being and being seen to be independent. As part of our ethics and independence policies, all Henderson Loggie staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings or interests. Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through:

- instilling professional values;
- communications;
- internal accountability;
- risk management; and
- independent reviews.

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the College / audit committee.

Confirmation of Audit Independence

We confirm that as at 11 December 2007, in our professional judgement, Henderson Loggie is independent within the meaning of regulatory and professional requirements and the objectivity of the audit director and audit staff is not impaired.

This report is intended solely for the information of the College and audit committee of Edinburgh's Telford College and should not be used for any other purposes.

Yours faithfully

Henderson Loggie