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INFRASTRUCTURE, GOVERNMENT & HEALTHCARE

Langside College

Annual audit report to the Board of Management of Langside College and the Auditor General for Scotland

Audit: Year ended 31 July 2007
20 December 2007

AUDIT

AUDIT ▪ TAX ▪ ADVISORY

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Complaints
If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact David Watt, who is the engagement leader for our services to the College, telephone 0141 300 5695, email david.watt@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Lorraine Bennett, our Head of Audit in Scotland, either by writing to her at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 222 2000 or email to lorraine.bennett@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Director of Audit Strategy, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.

Executive summary

This report summarises our work for the 2006-07 year and our findings in relation to our audit of the financial statements, financial reporting and corporate governance arrangements.

Financial statements

On 20 December 2007 we issued an audit report expressing a qualified opinion on the financial statements of the College for the year ended 31 July 2007.

The Board of Management has accounted for the College's participation in the Strathclyde Pension Fund on a defined contribution basis under FRS 17. It is understood that the Board of Management believes that the College cannot identify its share of assets and liabilities in the Fund on a reasonable and consistent basis. In our view, taking into account the work of our actuarial staff and specific discussions with the scheme actuaries, the exemptions under FRS 17 are not available to the College and its participation should therefore be accounted for as a defined benefit scheme. This conclusion has been reached by drawing on the work of our actuarial staff and has involved specific discussions with the scheme actuaries and the facts presented by them.

If the surplus in the College's share of the Fund at 31 July 2007 of £635,000 were able to be recognised in full as a pension asset (31 July 2006: pension liability of £545,000), we estimate that accounting for the College's participation in the Fund as a defined benefit pension scheme would increase the College's net assets at 31 July 2007 by approximately £765,000 (2006: £425,000 decrease), increase its surplus for the year by approximately £90,000 (2006: increase the surplus by £35,000) and increase its total recognised gains and losses for the year by approximately £1,070,000 (2006: £770,000).

Our audit opinion is qualified in respect of the adjustments and disclosures that would be required to comply with FRS 17. In all other respects our opinion is unqualified. Our opinion on the regularity of transactions is also unqualified.

Financial position

The College made a surplus on operating activities of £868,000, with £788,000 of the surplus designated within its economic development reserve for reinvestment in College initiatives in future years. The College's financial forecast return to the Scottish Funding Council in June 2006 forecast an outturn surplus of £80,000. The main reasons behind the significantly improved position was a reduction in staff costs of £293,000 principally due to the reduced restructuring costs, an increase in other income of £312,000 which includes increased recovering of staff costs from external sources, and an increase in tuition fee income of £197,000 due to the increased level of College activity during the year.

Governance and strategy

There are no significant weaknesses disclosed in the statement on internal control, and no significant control weaknesses were identified through our work on the control systems within the College. Based on our work, we have made five recommendations to improve the overall control environment.

The approved internal audit programme fro 2006-07 has been completed and the internal auditors have concluded that the College has in place "*an adequate framework of control over the systems they examined*".

We are not required to provide an opinion on the College's system of internal control. We have reviewed the corporate governance statement and consider it consistent with our understanding of the process followed by the College during the year. The corporate governance statement highlights the Board of Management's commitment to best practice in corporate governance.

Introduction

Audit framework

2006-07 was the first year of our five-year appointment as external auditors of Langside College ("the College"). This report to the College and the Auditor General for Scotland summarises our opinion and conclusions and highlights significant issues arising from our work.

In accordance with Audit Scotland's *Code of Audit Practice*, the scope of the audit was to:

- provide an opinion on the College's financial statements and, as required by relevant authorities, the regularity of transactions;
- review and report on (as required by relevant legislation, the Code and any guidance issued by Audit Scotland):
  - the College's corporate governance arrangements as they relate to: its review of systems of internal control; the prevention and detection of fraud and irregularity; standards of conduct, and prevention and detection of corruption; and its financial position
  - the College's arrangements to achieve Best Value
  - other aspects of the College's arrangements to manage its performance, as they relate to economy, efficiency and effectiveness in the use of resources.

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.

Basis of information

External auditors do not act as a substitute for the Board of Management's own responsibilities for putting in place proper arrangements to account for its stewardship of resources made available to it and its financial performance in the use of those resources, to ensure the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the effectiveness of those arrangements and, through accountable officers, to make arrangements to secure Best Value.

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 co-operation and assistance extended to us by staff during the first year of our work in the discharge of our responsibilities.

Financial commentary

This section of our report summarises the main features of the financial statements and key movements from the prior financial year.

Income and expenditure account

The surplus for the year of £868,000 is 6.0% of total income (2005-06 £80,000 surplus and 0.6%). Based on 2005-06 financial statements, the sector average is around 2%. The College has designated £788,000 of its surplus for the year within its economic development reserve for reinvestment in College initiatives and activities in future years. The result for the year has been affected by the following factors.

Income

Total income increased by £572,000 (4.1%). The most significant movements were:

- £425,000 increase in the Scottish Funding Council recurrent grant and a £130,000 increase in fee waiver grant, offset by a reduction in specific grant income of £282,000; and
- £209,000 increase in tuition fee income due to increased activity levels; and
- £70,000 increase in investment income due to positive cashflow during the year.

The following table identifies the sources of income in 2005-06 and 2006-07.

	2006-07 £'000	***2005-06 £'000***	**2006-07 %**	***2005-06 %***
Scottish Funding Council grants	10,566	*10,278*	73	*74*
Tuition fees	2,030	*1,821*	14	*13*
Other operating income	1,879	*1,804*	13	*13*
Total income	**14,475**	***13,903***	**100%**	***100%***

The majority of income is received from the Scottish Funding Council, with the proportion of income received from the various sources consistent year on year. In 2006-07 the College recovered £916,000 of salary costs from external sources, an increase of £119,000 over the previous year.

Expenditure

Overall, total expenditure has decreased by £216,000 (1.6%). The most significant movements were:

- staff costs increased by £218,000 as a result of general pay increases, but the impact on the College was limited by the additional recovery of staff costs from external sources; and
- restructuring costs reduced by £343,000, principally as a result of a reduction of £54,000 in 2006-07 in the actuarial valuation of the pension provision required for early retirements, compared to the charge of £260,000 required to increase the provision in 2005-06.

The following table identifies the key elements of expenditure in 2005-06 and 2006-07.

	2006-07 £'000	*2005-06 £'000*	2006-07 %	*2005-06 %*
Staff costs	10,106	*9,888*	74	*72*
Restructuring costs	(32)	*311*	-	*2*
Other operating expenditure	2,940	*2,969*	22	*21*
Depreciation	593	*655*	4	*5*
Total expenditure	**13,607**	***13,823***	**100%**	***100%***

The majority of expenditure is incurred on staff costs. Apart from the change in restructuring costs, the proportion of the expenditure on the various elements is consistent year on year.

Balance sheet

The College has reported an increase in net assets of £2,263,000 during the year. The balance sheets at 31 July 2006 and 2007 are as follows:

	2006-07 £'000	*2005-06 £'000*
Fixed assets		
Tangible assets	14,566	*13,335*
Current assets		
Debtors	1,227	*900*
Investments	1,258	*670*
Cash at bank and in hand	3,702	*2,441*
Creditors due within one year	2,892	*1,673*
Net current assets	**3,295**	***2,338***
Creditors due after one year	61	*nil*
Provisions for liabilities and charges	1,446	*1,582*
Net assets	**16,354**	***14,091***
Deferred capital grants	7,757	*6,362*
Revaluation reserve	5,724	*5,854*
Economic development reserve	1,300	*512*
Income and expenditure reserve	1,573	*1,363*
Total	**16,354**	***14,091***

Significant movements during the year include:

- an increase in the fixed asset base of £1,231,000 due to fixed asset additions of £1,824,000, offset by the depreciation charge for the year of £593,000;
- the increase in fixed assets is matched by an increase in deferred capital grants provided during the year by the Scottish Funding Council for works relating to the College campus redevelopment; and

- an increase in working capital balances of £957,000 with an increase in debtors of £327,000, increase in cash and investments held of £1,849,000, offset by an increase in creditors at the year end of £1,219,000. Within the year end creditors balance is deferred income totalling £859,000 of monies received during the year but not yet applied by the College.

Financial forecasting

The financial forecast return submitted to the Scottish Funding Council in June 2006 forecast a surplus of £80,000 to 31 July 2007. The actual outturn was a surplus of £868,000 before transfers to designated reserves. The following table summarises the movements during the year.

	£'000
2006-07 forecast outturn per the financial plan	**80**
Reduction in specific Scottish Funding Council grants received	(69)
Increase in tuition fee income	197
Additional other income, including staff costs recovered from external sources	312
Additional investment income receivable	92
Staff costs, principally relating to a reduction in pension provision costs in year	293
Other movements	(37)
2006-07 actual outturn at 31 July 2007	**868**

Source: Langside College (November 2007).

2007-08 financial forecasts

The following table summaries the forecast income, expenditure and cash balances for the College for 2007-08.

	£'000
Income	14,689
Expenditure	14,639
Forecast surplus for the year ending 31 July 2008	**50**
Cash & Investments balance at 31 July 2007	4,960
Forecast cash balance at 31 July 2008	4,649
Forecast movement in cash during 2007-08	**(311)**

As the College is currently forecasting a smaller surplus for 2007-08, it will be important for management to monitor costs closely during the year, consider whether savings and efficiency savings targets are attainable and revise the forecasts for 2007-08 as appropriate. Subsequent to the year end, the College was granted significant support from the Scottish Funding Council towards the building of a new college building on the Langside campus; the above cash and investments forecasts do not take into account any of the costs or funding associated with this project.

Governance and risk management

Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all bodies.

Through the principal, the Board of Management is responsible for establishing arrangements for ensuring the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The *Code* requires auditors to review and report on the College's corporate governance arrangements as they relate to:

- the College's reviews of its systems of internal control, including its reporting arrangements;
- the prevention and detection of fraud and irregularity;
- standards of conduct and arrangements for the prevention and detection of corruption; and
- its financial position.

Management is responsible for establishing arrangements for the conduct of its affairs, including compliance with applicable guidance, ensuring legality of activities and transactions and monitoring the adequacy and effectiveness of these arrangements in practice.

Governance arrangements

The Board of Management has 15 full members and four co-opted members, who were invited to join the board based on their individual skills. There are a number of standing committees, including property & estates, staffing, finance, audit and development, each of which is formally constituted and has its own terms of reference. This comprehensive governance structure – which includes non-executive, student and academic representation – is demonstrative of best practice and exceeds the minimum requirements of the Scottish Funding Council. The committee structure provides the Board of Management with the mechanisms to ensure appropriate oversight and monitoring of financial and academic activities.

The College's nine shared corporate values and aspirations are contained within the 2006-09 corporate strategy and state that the College will be:

- an organisation which is ethical and well governed;
- an inclusive community resource;
- a stepping stone to work;
- a bridge to higher learning;
- a beacon of sound educational principles;
- an organisation known for fairness, respect and equality of opportunity;
- a sustainable organisation which is confident and enthusiastic about its future;

- an organisation where high performance is valued and students and staff are encouraged to maximise their full potential; and
- fully committed to Lord Nolan's seven principles of good governance.

Risk management

The College maintains a risk register that is the responsibility of the Board. The risk register is subject to annual review by College managers and then by the Board. The College also has in place a business continuity plan that is reviewed periodically.

The strategic management team receives reports setting out key performance and risk indicators and considers possible control issues. Risk awareness training has been provided to staff of the College to embed risk management within operational units. The Board of Management's agenda includes a regular item for consideration of risk and control and receives reports thereon from the strategic management team and the audit committee.

Systems of internal control

Corporate governance statement

Management have established an internal controls assessment framework, complementing the risk management and internal audit arrangements. The assessment of internal control is informed by the strategic management team who have responsibility for the development and maintenance of the internal control framework, the work of internal audit, and comments made in reports by external audit. The audit committee is also responsible for providing assurance to the board of management relating to corporate governance.

The corporate governance statement for 2006-07 provides details of the internal control environment and risk and control framework. Management highlight that the College is committed to exhibiting best practice in all aspects of corporate governance.

The College has made a fully compliant corporate governance statement. We are required to review this to assess whether the description of the process adopted by the College in reviewing the effectiveness of the system of internal control is consistent with our understanding of the process and report any inconsistencies in our opinion. We are not required to provide an opinion on the College's system of internal control.

While no significant weaknesses are included in the corporate governance statement, the College does report that it does not comply with the Charities and Trustee Investment (Scotland) Act 2005 as its constitution permits Scottish Ministerial direction or control of its activities. This is narrated in detail below.

We have reviewed the corporate governance statement and consider it consistent with our understanding of the process followed by the College during the year.

Internal audit

The approved internal audit programme for 2006-07 has been completed and the internal auditors have concluded that the College has in place "*an adequate framework of control over the systems they examined*".

Internal audit monitor the systems of internal control, risk management controls and governance processes in accordance with an agreed plan of input, and report their findings to management and the audit committee. Management is responsible for the implementation of agreed audit recommendations and internal audit undertake periodic follow up reviews to ensure that such recommendations have been implemented.

The College maintains an audit action plan documenting any high grade recommendations that are identified by internal audit. Items are only removed from the plan when the audit committee is satisfied that corrective action has occurred. This is in line with best practice and ensures that the committee has the opportunity to challenge and assess management action in response to recommendations raised. As at November 2007 the College audit action plan contains seven high grade recommendations. Management has taken action in response to all of these, which will be subject to follow up by internal audit during 2007-08.

Internal controls

Drawing on the work of internal audit, in accordance with our plan we undertook detailed testing in relation to both entity-level and key financial controls. We have identified some areas for enhancement. Recommendations are included in the action plan in appendix one and have been accepted by management. None of these recommendations are significant.

Testing of the design and operation of controls over significant risk points in terms of major financial systems confirms that, subject to the minor weaknesses reported, controls are designed appropriately and operating effectively.

Charities and Trustee Investment (Scotland) Act 2005

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 Act 2005 and charities will have to show that they provide public benefit.

OSCR recently reported the results of its pilot review and that six of the eight organisations satisfied the 'public benefit' test. John Wheatley College was identified as one of the two organisations that do not meet the requirements. The report concluded that "*John Wheatley College has exclusively charitable purposes and provides public benefit. However, the Charity Test was not met as its constitution expressly permits Scottish Ministers or a Minister of the Crown to direct or otherwise control its activities.*" OSCR's report clearly states that the results of the review cannot necessarily be applied to similar organisations but there is an expectation within the sector that the charitable status of further education colleges is at risk because the ministerial control identified by OSCR exists in the Further and Higher Education (Scotland) Act 1992 (as amended by the Further and Higher Education (Scotland) Act 2002.

The College has reported its non-compliance with the Act within its corporate governance statement due to the allowance within its own constitution for Scottish Ministers to direct or take control of its activities.

We recognise that the Scottish Government has made a public commitment to amending the legislation as required to preserve the charitable status of further education colleges.

Prevention and detection of fraud and irregularity

The College's financial regulations detail measures put in place to prevent instances of fraud. The College has a whistle blowing policy in place to encourage staff to bring suspected frauds to notice and to ensure that prompt and effective action is taken.

The College has an over-arching anti-fraud policy in addition to policies and procedures in individual financial and operational areas. However, staff were unable to find a copy during our audit fieldwork and the document has not been updated for a number of years. Management should ensure that the anti-fraud policy is readily available to all staff and that it is included in the system of regular review of other College policies.

Significant frauds would be reported to the appropriate board committee. Management has not reported any material instances of fraud or irregularity in 2006-07.

Standards of conduct

The College has comprehensive human resources policies and procedures which are readily accessible to staff. There is also a formal register of interests for recording members of the board of management and senior managers' interests. This is regarded as best practice and assists in demonstrating consideration of independence in decision-making and the awarding of contracts.

Best Value

The 2006-07 planning guidance for further education colleges issued by Audit Scotland indicated that there was no requirement for auditors to undertake performance audit or other Best Value studies during the year.

Financial statements audit

Audit opinion

On 20 December 2007 we issued an audit report expressing a qualified opinion on the financial statements of the College for the year ended 31 July 2007.

Financial reporting standard 17 'retirement benefits' ("FRS 17") paragraph nine states that '*Where more than one employer participates in a defined benefit scheme the employer should account for the scheme as a defined benefit scheme*'. This indicates that there is a presumption that a defined benefit scheme will be accounted for on a defined benefit basis unless one of the two possible exemption criteria is met, which are:

- employers contributions are set in relation to the current service period, i.e. not impacted by any past surplus or deficit of the fund; or
- the employer is unable to identify its share of the underlying assets and liabilities in the fund on a consistent basis.

The Board of Management has accounted for the College's participation in the Strathclyde Pension Fund ("the Fund") on a defined contribution basis under FRS 17. It is understood that the Board of Management believes that the College cannot identify its share of assets and liabilities in the Fund on a reasonable and consistent basis and that the College is therefore entitled to use the multi-employer exemption permitted by FRS 17, which allows a defined benefit scheme to be accounted for as it was a defined contribution scheme when a body cannot identify its share of the assets and liabilities in the pension scheme.

Consequently, the financial statements have been prepared on the basis of the accounting policy of charging pension costs to the income and expenditure account on the basis of contributions payable during the financial year.

In our view, taking into account the work of our actuarial staff and specific discussions with the scheme actuaries, the exemptions under FRS 17 are not available to the College and its participation should therefore be accounted for as a defined benefit scheme. The conclusion is based on consideration of the facts presented by the Fund's actuaries against the two specific exemptions outlined above:

- the common contribution rate takes into account any surplus or deficit in the Fund and differing contribution rates are calculated with regard to the circumstances of employers (or homogenous groups of employers) and allows for any surplus or deficit attributable to them;
- allocation of assets to individual employers can be performed on the basis that assets can be derived based on movements in the liabilities, which can be explicitly measured and allocated to individual employers, in addition to measurement of gains and losses on assets and liabilities, both of which are based on the experience of the individual employer during the year.

As a result, in our opinion, pension costs should be charged to the income and expenditure account on the basis of reflecting the cost of benefits earned in the period and its share of assets and liabilities in the Fund should be included within the balance sheet of the College.

If the surplus in the College's share of the Fund at 31 July 2007 of £635,000 were able to be recognised in full as a pension asset (31 July 2006: pension liability of £545,000), we estimate that accounting for the College's participation in the Fund as a defined benefit pension scheme would increase the

College's net assets at 31 July 2007 by approximately £765,000 (2006: £425,000 decrease), increase its surplus for the year by approximately £90,000 (2006: increase the surplus by £35,000) and increase its total recognised gains and losses for the year by approximately £1,070,000 (2006: £770,000).

Our audit opinion is qualified in respect of the adjustments and disclosures that would be required to comply with FRS 17. In all other respects our opinion is unqualified. Our opinion on the regularity of transactions is also unqualified.

Fixed assets

The College received confirmation from the Scottish Funding Council in October 2007 that funding would be made available to support the construction of a new building on the Langside campus.

We discussed with management implication of this announcement in the context of FRS 21 *Events after the balance sheet date*. In line with this standard, the announcement of the Scottish Funding Council in October 2007 to provide funding for the development project is a non-adjusting event and thus no adjustment was required to the carrying value of the land and buildings at 31 July 2007. The College has, however, made appropriate disclosure within its financial statements.

We have agreed with management that this will become a key area for audit emphasis in 2007-08 and it is expected that significant accelerated depreciation will require to be charged.

Regularity

There are no issues arising from the regularity audit. We have reviewed the minutes of the College's key committees, including the board of management and audit committee meetings. From these minutes, we have established that the College has procedures in place to ensure discussion of key guidance from the Scottish Funding Council, as well as other relevant laws and regulations.

Management representations obtained from the principal included our standard representation that during 2006-07 the College had complied with all necessary laws and regulations.

Report to those charged with governance

At the audit committee meeting on 6 December 2007 we discussed our "report to those charged with governance" which is required under International Auditing Standard 260. This dealt with relevant aspects of the College's financial statements production process, amendments to draft financial statements during the audit process, the treatment of uncorrected audit differences and the content of the representation letter from the principal to us.

Appendix – action plan

Priority rating for performance improvement observations raised		
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.	**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.	**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.

No.	Issue and performance improvement observation	Management response	Officer and due date
1	The College has an over-arching anti-fraud policy in addition to policies and procedures in individual financial and operational areas. However, staff were unable to find a copy during our audit fieldwork and the document has not been updated for a number of years. Management should ensure that the anti-fraud policy is readily available to all staff and that it is included in the system of regular review of other College policies. *Grade two*	Agreed.	Assistant Principal: Resources 31 December 2007
2	The College's financial regulations have not been updated since 1995. There is a risk that up to date financial procedures and controls are not adhered to. The financial regulations should be reviewed, updated and circulated to all relevant staff *Grade two*	Agreed.	Assistant Principal: Resources 31 July 2008

3	Reconciliations were not regularly performed for certain bank accounts during the year. Discrepancies between the bank statement and the ledger may not be identified and investigated in a timely manner. It is recommended that bank reconciliations should be performed and reviewed shortly after the period end to which they relate *Grade two*	Agreed. There was a contributory problem on the part of the bank but this has now been solved.	Assistant Principal: Resources Achieved
4	The College maintains an induction log for new Board and committee members, however, we understand it is currently reviewing the induction process for members. It is recommended that this is progressed in order to enhance the College's established governance arrangements. *Grade three*	Agreed.	Secretary to the Board of Management 31 July 2008
5	The Principal does not currently seek positive assurances from budget holders on an annual basis that to their knowledge there have been no control weaknesses or instances of maladministration falling under their remit. While we have reported no issues arising from our regularity audit, the system of internal control would be enhanced through positive assurances being sought from budget holders on an annual basis that to their knowledge there have been no control weaknesses or instances of maladministration falling under their remit *Grade three*	Not agreed. The Principal expects this type of information to be reported to him as a matter of course and/or that it would be discussed during regular budget meetings. However, it is agreed that we will implement an annual signed statement of assurance from budget holders.	Assistant Principal: Resources By 31 July 2008

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