

Scottish Funding Council

Report on the 2006/07 Audit



30 July 2007



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Executive Summary

Introduction

In 2006/07 we looked at the key strategic and financial risks being faced by the Scottish Funding Council. We audited the financial statements and we also reviewed aspects of performance management and governance. This report sets out our key findings.

Financial Position

The FReM requirement to account for grant-in-aid and certain grants as a credit to reserve has resulted in expenditure less other operating income for the year of £1.780 billion. The grant-in-aid credited to reserves for 2006/07 was £1.776 billion. As the Scottish Funding Council is funded on a financial year basis but distributes funds to institutions on an academic year basis, the expenditure in any financial year can be higher or lower than the level of funding provided for that year. Where expenditure exceeds the funds provided, the excess is funded from the reserves held for distribution at the end of the previous financial year. During 2006/07 the excess expenditure of £4million was met from the reserves held at the start of the financial year.

Financial Statements

We have concluded that the financial statements of the Scottish Funding Council give a true and fair view of the state of affairs of the Scottish Funding Council as at 31 March 2007.

We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

We have also reviewed the other issues which we are required to consider as part of our audit opinion, such as the management commentary, the remuneration report and the statement on internal control. We can confirm that there are no further matters that we need to bring to the attention of the Scottish Funding Council.

Performance Management

Audit Scotland report

A study is currently being carried out by Audit Scotland, on behalf of the Auditor General, to follow up concerns about a significant backlog of maintenance in the Higher Education Estate, highlighted in the 2004 Scottish Executive report 'Competiveness of Higher Education in Scotland'.



The overall aim of the study is to examine how Higher Education Institutions (HEIs) and the Scottish Funding Council use public sector funds to manage their estate to make best use of their property assets. A report setting out the key findings from the study will be published in September 2007

Performance

The Scottish Funding Council published its first corporate plan for the period 2006 – 2009. This included an outline Performance Measurement Framework against which the effectiveness of the corporate plan could be evaluated over time. It undertook to develop further the individual performance measures in the framework and set targets where appropriate by Spring 2007. A more detailed Performance Measurement Framework was approved by the Scottish Funding Council in March 2007. In our separate Corporate Governance Overview report, we noted that the Scottish Funding Council has developed appropriate processes to monitor its performance in relation to the corporate plan objectives and priority actions using the detailed measures specified in this Performance Measurement Framework. We said that, in our opinion, positive assurance can be taken from the satisfactory corporate governance arrangements at SFC.

Efficient Government

As part of its commitment to the Efficient Government Initiative, Scottish Funding Council agreed efficiency savings targets for 2006/07 with the Scottish Executive.

Scottish Funding Council has reported achievement of efficiency savings of £55.7 million in 2006/07. This compares with efficiency saving targets of £50 million agreed with the Scottish Executive.

Plans are under development to achieve further efficiencies as part of the Initiative in 2007/08. Planned efficiencies of £95 million are anticipated to be generated. It will be challenging for the Scottish Funding Council to deliver on savings, with existing financial constraints and national strategic change underway.

Governance

The establishment and operation of an efficient and effective internal audit function forms a key element of effective governance and stewardship. The Scottish Funding Council's internal audit service is provided by KPMG. We reviewed internal audit and concluded that they continue to comply with Government Internal Audit Standards and we were able to place reliance on their work.

We examined the key financial systems which underpin the organisation's control environment. We concluded that financial systems and procedures operated sufficiently well to enable us to place reliance on them and to mitigate the risks of material misstatement of the accounts, error or fraud.

Audit Scotland

30 July 2007



Introduction

1. This report summarises the findings from our 2006/07 audit of the Scottish Further and Higher Education Funding Council (SFC). The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 26 March 2007. The plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. In the Audit Risk and Analysis Plan, we identified twenty one main audit risks which informed our audit procedures. From our audit work we can conclude that these risks are being satisfactorily managed by SFC. A separate document was provided to SFC that summarised the outcome of the audit on the management assurances provided to reduce these risks. Appendix A of this report sets out an additional risk highlighted by our 2006-07 audit and the action planned by management to address it.
3. This is the first year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of the Scottish Funding Council during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, www.audit-scotland.gov.uk .
4. The principles of independence, the wider scope of the audit and the ability to report in public are central to public sector audit. All Audit Scotland staff are bound by its Staff Code of Conduct which incorporates the Seven Principles of Public Life identified by the Nolan Committee on Standards in Public Life and conforms to International Standards on Auditing. All staff also confirm annually that they comply with the Code's ethical values and principles. Staff are also subject to the relevant ethical standards and guidance of the professional bodies of which they are members.



Financial Statements

5. In this section we summarise key outcomes from our audit of the Scottish Funding Council's financial statements for 2006/07, and comment on the key financial management and accounting issues faced.

Our responsibilities

6. We audit the financial statements and give an opinion on:
 - whether they give a true and fair view of the financial position of the Scottish Funding Council and its expenditure and income for the period in question;
 - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements, and
 - the regularity of the expenditure and receipts.
7. We also review the statement on internal control by:
 - considering the adequacy of the process put in place by the Chief Executive as accountable officer to obtain assurances on systems of internal control, and
 - assessing whether disclosures in the statement are consistent with our knowledge of the Scottish Funding Council.

Overall conclusion

8. We have given an unqualified opinion on the financial statements of the Scottish Funding Council for 2006/07.

Financial Position

2006/07 outturn

9. The new FReM requirement to account for grant-in-aid as a credit to reserves has resulted in expenditure less other operating income for the year of £1.780 billion in 2006/07 (2005/06 result restated to reflect change in accounting policy: £1.428 billion excess expenditure). The grant-in-aid credited to reserves for the year was £1.776 billion (2005/06 grant-in-aid: £1.434 billion. The Scottish Funding Council's Net Asset Position decreased to £13.5 million (2005/06: £17.4 million).



10. The Scottish Funding Council is funded on a financial year basis but distributes funds to institutions on an academic year basis. Academic years run from August to July each year. The level of funds distributed in any financial year therefore depends on the expenditure profiles of the relevant two overlapping academic years. Expenditure in any financial year can therefore be higher or lower than the level of funding provided for that year. Where expenditure exceeds the funds provided, the excess is funded from the reserves held for distribution at the end of the previous financial year.
11. The total grant-in-aid received in 2006/07 comprised £1.767 billion for distribution to Higher Education Institutions and Colleges (2005/06: £1.425 billion) and £8.2 million for the Scottish Funding Council's running costs (2005/06: £8.4 million). The increase in funding in 2006/07 has been spent in four main areas : for HEIs and colleges main teaching (£93 million); research through the main quality research grant but also through project based grants (£45 million); nursing and midwifery pre-registration education (£32 million) and capital within HEIs and colleges (£74.5 million). In addition, £79.5 million was paid in February and March instead of June and July as a result of Scottish Executive re-profiling at the year end.
12. The Scottish Funding Council's net expenditure on running costs was £8.3 million. The grant-in-aid received for running costs was £8.2 million resulting in a deficit of £0.1 million. The Scottish Funding Council operated within the cash limited allocations of funds for distribution and running costs provided by the Scottish Executive.
13. During 2006/07, £28 million was paid to West Lothian College to fund the buyout of a PFI agreement. £5.5 million of this amount was a refundable grant to enable the College to fund its share of the costs.

Issues arising from the audit

14. As required by auditing standard ISA260 we report to the audit committee the main issues arising from our audit of the financial statements. A number of matters were discussed at a meeting on 29 June 2007 with Ingrid Hawkins, Head of Finance and Facilities. Subsequent comments were made on a further draft. Most matters were resolved satisfactorily and we are drawing to your attention matters which we think are worthy of note.
15. **Financial Reporting Manual (FReM) changes in the reporting of income:** The new FReM requirement to account for grant-in-aid and certain grants as a credit to reserves has resulted in a changed format for the Income and Expenditure Account now called the Operating Cost Statement (OCS). An additional section showing the effect on the reserves was subsequently added following discussions.
16. "Other grants" in 2006/07 and 2005/06 were understated by £195,000 and £300,000 respectively due to misinterpretation of the FReM change. The OCS was modified after discussions with the Chair of



the Audit Committee, Scottish Executive and Audit Scotland. Adjustments were also made for the other grants figures for 2006/07 and 2005/06.

17. **Deferred Government Grant Account:** Due to FReM changes, SFC is no longer required to release amounts to the operating cost statement to offset depreciation charges. Similarly gains or losses on disposal are now taken to the OCS. As the Deferred Government Grant Account is no longer required £280,000 has been transferred to the Income and Expenditure Account Reserve and an adjustment of £153,000 has been made to prior year figures.
18. **Education Maintenance Allowances:** To comply with the offer of Education Maintenance Allowance grant from the Scottish Executive, the Scottish Funding Council was required to submit a certified year end statement to the external auditor by 30th April 2007. This letter was only received by Audit Scotland on 20th July 2007 and therefore the conditions of grant had been breached. In future the Scottish Funding Council should ensure that year end certificates are submitted by the required deadlines in order to comply with the conditions of grant

Refer Action Plan No. 1

Statement on Internal Control

19. The Statement on Internal Control provided by the Scottish Funding Council's Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and set out the Scottish Funding Council's approach to this.

Regularity Assertion

20. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts was incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Accountable Officer as to his view on adherence to enactments and guidance. No significant issues were identified for disclosure.



Performance Management

21. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.
22. Accountable officers also have a duty to ensure the resources of their organisation are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.

Performance management

23. The Scottish Funding Council published its first corporate plan for the period 2006 – 2009. This included an outline Performance Measurement Framework against which the effectiveness of the corporate plan could be evaluated over time. It undertook to develop further the individual performance measures in the framework and set targets where appropriate by Spring 2007. A more detailed Performance Measurement Framework was approved by the Scottish Funding Council in March 2007 and published in June 2007. In our separate Corporate Governance Overview report, we noted that the Scottish Funding Council had developed appropriate processes to monitor its performance in relation to the corporate plan objectives and priority actions using the detailed measures specified in the Performance Measurement Framework. It will be reporting on progress in the Annual Review which is due to be published in November 2007. We said that, in our opinion, positive assurance can be taken from the satisfactory corporate governance arrangements at SFC.
24. A study is currently being carried out by Audit Scotland, on behalf of the Auditor General, to follow up concerns about a significant backlog of maintenance in the Higher Education Estate, highlighted in the 2004 Scottish Executive report 'Competiveness of Higher Education in Scotland'. The overall aim of the study is to examine how Higher Education Institutions (HEIs) and the Scottish Funding Council use public sector funds to manage their estate to make best use of their property assets. Specific objectives to be addressed in the study are:
 - do HEIs have good estate management strategies?
 - to what extent do higher education institutes meet the priorities for good estate management?
 - how do HEIs ensure their buildings are fit for purpose?

A report setting out the key findings from the study will be published in September 2007.



25. Since the end of the 2006/07 financial year Audit Scotland has worked with the Scottish Funding Council to develop a Memorandum of Understanding between the two organisations, which sets out the respective powers and responsibilities of each in the context of the external scrutiny of the performance and financial management of colleges of Further Education in Scotland. This document, which is currently being discussed by Audit Scotland and SFC, is expected to be agreed in Autumn 2007. Audit Scotland organised a Further Education sector meeting on 3rd July 2007 which involved Further Education college auditors, the Director of SFC's GMAP and members of Audit Scotland's Audit Services and Public Reporting Group.



Governance

26. This section sets out our main findings arising from our review of the Scottish Funding Council's governance arrangements. This year we reviewed:

- key systems of internal control;
- internal audit; and
- aspects of information and communications technology (ICT).

27. We also discharged our responsibilities as they relate to prevention and detection of fraud and irregularity; standards of conduct; and the organisation's financial position (see paragraphs 9 to 13).

Systems of internal control

28. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In his annual report for 2006/07 the Head of Internal Audit provided his opinion that, based on the internal audit work undertaken during the year, there was reasonable assurance on the adequacy and effectiveness on the systems of internal control.

29. As part of our audit we reviewed the high level controls in a number of the Scottish Funding Council's systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively.

Internal Audit

30. The establishment and operation of an effective Internal Audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of Internal Audit wherever possible and as part of our risk assessment and planning process for the 2006/07 audit we assessed whether we could place reliance on the Scottish Funding Council's Internal Audit function. We concluded that the Internal Audit service operates in accordance with the Government Internal Audit Manual and therefore placed reliance on a number of Internal Audit reviews including funding to institutions; corporate governance arrangements and the review of GMAP.



Information and Communication Technology

Computer Service Review

31. As part of our risk based assessment, we identified Information and Communication Technology (ICT) as a priority area for review in 2006/07. Management were asked to complete a Computer Service Review Client Questionnaire (CSR-CQ) and we reported our detailed findings from this exercise separately in our report issued in April 2007. The seven key areas covered by the review were:

- ICT Strategy
- Organisational Structure
- Installation Management
- Service Delivery
- Asset Protection and Security
- Business Continuity/ Contingency
- Data Networking

32. Our overall assessment was that the Scottish Funding Council has made improvements in its provision of ICT arrangements, and we identified some examples of good practice. We also identified some areas where improvements can be made.

Electronic Record and Document Management (eRDM)

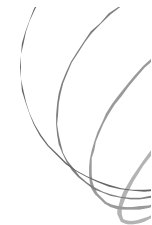
33. As part of our 2006/07 audit plan, we identified the implementation of the Electronic Record and Document Management (eRDM) system currently underway as a risk area and planned to address this risk by reviewing the Scottish Funding Council's implementation process.

34. Preliminary meetings with relevant staff were held in June 2007 to assess the level of risk involved in the implementation process. It was agreed that a more detailed review will be undertaken around October/ November 2007, when implementation of eRDM has progressed more, in order to extend the scope of the review to include the scanning pilot exercise.



Looking Forward

35. The Scottish Funding Council faces a number of challenges in 2007/08, which include:
- **Financial Strategy** - There may be a financial impact arising from changes in strategic direction in line with adjustments to national priorities and the Spending Review.
 - **Relocation Review** - Under the previous administration of the Scottish Parliament, the Scottish Funding Council was selected as the subject of a relocation review. With the lease on one of its properties due to run out in 2009, Ministers are due to announce their decision on the location of the Scottish Funding Council in 2007/08.
 - **Shared services** - The Scottish Executive has issued a consultation on a National Strategy for Shared Services. The Scottish Funding Council carried out a survey on current support service arrangements across the further education sector in November 2006. Taking forward this agenda and encouraging the development of shared services is a significant challenge for the public sector.
 - **Procurement** - The Review of Public Procurement in Scotland report by John McClelland issued in March 2006 contained a significant number of findings and recommendations in respect of procurement in the public sector. In December 2006, the Scottish Funding Council announced the successful outcome of its bid to the Efficient Reform Fund (ERF) (previously known as the Efficient Government Fund) to take forward the advanced procurement project for colleges and universities. The Scottish Funding Council will need to ensure that the project's objectives are delivered successfully.
 - **Best Value** - As part of the 2007/08 audit we will be reviewing the progress that the Scottish Funding Council has made in strengthening their arrangements for securing Best Value since our baseline review work in 2005/06. Over the next year we will also be developing and refining our approach to the audit of public bodies' arrangements to secure economy, efficiency and effectiveness in the use of resources, as this is one of our key objectives as auditors, set out within the new Code of Audit Practice approved by the Auditor General. This will inform our ongoing work to develop an approach to the audit of Best Value across the Scottish public sector. We intend to consult with both clients and stakeholders at key stages of these initiatives.
 - **Efficient Government** - The achievement of future Efficient Government targets represents a challenge for the organisation and its partner organisations.
 - **Overview Report** – The Auditor General for Scotland is due to publish an overview report on the Further Education sector in February 2008. The Scottish Funding Council may wish to respond to the findings of this report in due course.



Appendix A: Action Plan

Key Issues and Planned Management Action

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
1	<p>Education Maintenance Allowances:</p> <p>To comply with the offer of Education Maintenance Allowance grant from the Scottish Executive, the Scottish Funding Council was required to submit a certified year end statement to the external auditor by 30th April 2007.</p> <p>This letter was only received by Audit Scotland on 20th July 2007 and therefore the conditions of grant had been breached.</p> <p><i>We recommend that in future the Scottish Funding Council should ensure that year end certificates are submitted by the required deadlines in order to comply with the conditions of grant.</i></p> <p><i>(paragraph 18)</i></p>	<p>The branch operational plan will be extended further beyond the financial year dates to ensure that early year targets are identified and met</p>	Morag Campbell	For 2007-08 and future branch plans

