HENDERSON LOGGIE

Stevenson College Edinburgh

Annual Audit report for 2007/08 to the Board of Management and the Auditor General for Scotland

External Audit Report No: 2008/03

Draft Issued:	**12 November 2008**
2nd Draft Issued:	**14 November 2008**
Final Issued:	**19 November 2008**

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Notice: About this report

This report has been prepared in accordance with the responsibilities set out within the 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 Stevenson College Edinburgh 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 surplus for the year of £0.738 million, which includes a £0.230 million adjustment for movements arising from the Lothian Pension Fund (LPF) actuarial report as at 31 July 2008. The College surplus, excluding this pension adjustment, is therefore £0.508 million, against a forecast surplus of £0.460 million, which was submitted to the SFC in June 2008. The income and expenditure account balance at 31 July 2008 was £8.425 million.

- The College's internal auditors have concluded that '*Stevenson College Edinburgh has a framework of control which provides reasonable assurance regarding the effective and efficient achievement of the College's objectives' and 'Stevenson College Edinburgh has, based on the areas examined in 2007/08, proper arrangements to promote and secure value for money.'*

- The College's Corporate Governance Statement confirms that the College has complied with the requirements of the 2006 Combined Code on Corporate Governance, in so far as they apply to the further education sector, for the year to 31 July 2008.

- We identified no significant control weaknesses during our audit. In general, the College's key systems of internal control appear, from our review of them, 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 four themed strategic aims and objectives.

- Risk management arrangements include the on-going assessment of the College's Risk Register to reflect current strategic and operational risks.

- Regular performance reports including benchmarking information are submitted to the Board of Management and its committees during the year. A set of performance measures mapped against Her Majesty's Inspectorate of Education (HMIe) framework and European Foundation of Quality Management (EFQM) model has been proposed and approved by the Board of Management.

- Financial management arrangements ensure appropriate and timely financial reporting at strategic and operational levels.

- The College submitted its latest Efficient Government Initiative (EGI) information schedule to the SFC in November 2008. 13 areas were identified outlining actual savings of £0.560 million over the three-year period to 2007/08. This compares favourably with the forecast of £0.539 million reported to SFC in February 2008.

1.3 Financial Statements

- On 12 December 2008 we plan to issue an audit report expressing an unqualified opinion on the financial settlements of the College for the year ended 31 July 2008 and on the regularity of the financial transactions reflected in those financial statements.

- The annual financial statements of the College comply with the Accounts Direction issued by SFC and the new Statement of Recommended Practice (SORP) on Accounting for Further and Higher Education.

- Whilst not having a material impact on our audit opinion a small number of audit adjustments, together with accounting adjustments already identified by the Finance Team, were made to the unaudited financial statements. A number of minor disclosure adjustments were also made to the financial statements.

- The implementation of the College's estates strategy has progressed further in 2007/08 with the completion of Phase 3 of the refurbishment project early in the year.

- The College has made an application to HM Revenue & Customs (HMRC) to have the Lennartz mechanism applied to the VAT on construction costs of the Music Box building. If the College's application is successful, the College would be able to reclaim the input VAT incurred on the construction of the Music Box building and would then be liable for output VAT on the non-business use of the asset over a period agreed with HMRC. In the first instance the impact of this on the financial statements would be to recognise a debtor for the VAT recoverable and a creditor to the HMRC for the future output VAT payments.

- The College has exceeded its WSUMS target for 2007/08 by 1120 WSUMs (1.2%); (2006/07 980 WSUMs, exceeded by 1.1%).

Introduction

2.1 Background

2.1.1 2007/08 was the second year of our five year appointment as external auditors of Stevenson College Edinburgh (‘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 2007/08 Annual Audit Plan* issued on 10 April 2008 and considered and approved by the Audit Committee on 23 April 2008. 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 risks 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;
- ❑ fixed assets transactions, including the interim valuation of the College’s land and buildings; treatment of refurbishment works and the temporary sports facility; application of the £10,000 capitalisation threshold and compliance with relevant financial reporting standards;
- ❑ recoverability of debtors;
- ❑ achievement of SUMs and commercial income targets;
- ❑ FRS 17 provision for pension liabilities;
- ❑ recognition of funding provided for specific purposes and the regularity of corresponding expenditure. and
- ❑ compliance with the new SORP on Accounting for Further and Higher Education.

Introduction

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.

2.2.2 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.

2.2.3 As our audit is designed primarily to enable us to form an opinion on the financial statements taken as a whole, our report cannot be expected to include all the possible comments and recommendations that a more extensive special examination would bring to light.

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.

Corporate Governance

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 Financial Forecast Return (FFR) submitted by the College to the Funding Council.

Table 1: Comparison of planned and actual financial results

	2006/07 Actual £000	2007/08 Planned £000	2007/08 Actual £000	2008/09 Planned £000
Financial outturn:				
Surplus	779	460	738	320
Surplus (excl. net return on pension assets and liabilities)	634	460	508	320
Income and expenditure reserves (excl. pension reserve)	7,670	8,559	8,425	9,222
Income and expenditure reserves (incl. pension reserve)	7,708	8,559	7,495	9,222
Cash balances	5,854	4,966	5,119	5,073

Source: Audited accounts and 2008 FFR

3.1.3 Based on the results for the year to 31 July 2008 the College meets the requirements of the Funding Council to be classed as financially secure.

3.1.4 Overall, the College income in 2007/08 has increased by £1.278 million (5.5%) over 2006/07. The main reason for this is a significant increase of £0.805 million (4.6%) in SFC grant income largely made up of an increase in core grant of £0.525 million, one-off grants and a release of estates infrastructure and revenue grants to match non-capitalised refurbishment and equipment costs. There was a small increase in income from tuition and education contracts of £0.220 million and miscellaneous other movements.

3.1.5 Expenditure in 2007/08 rose by £1.271 million (5.7%) over 2006/07 primarily due to staff costs increasing by £1.297 million (8.3%), an increase in other operating costs of £0.083 million (1.6%) offset by a reduction in depreciation charges of £0.108 million (8.2%).

3.1.6 The increase in staff costs is partly due to an award of a 3% salary increase in August 2007. There was also an increase in the number of FTEs, particularly in relation to permanent support staff, and increased overtime required due to the ongoing refurbishment work and rental of the Music Box facilities.

3.1.7 The College's cash balance at 31 July 2008 was £5.119 million, a decrease of £0.735 million (12.6%) on the previous year. The main reason for this decrease is the level of capital expenditure during the year net of deferred capital grants (£1.443 million), which was partly offset by an increase in cash flow from operating activities and returns on investment.

3.1 Financial Position (Cont'd)

2007/08 WSUMS outturn

3.1.8 The College's outturn against its 2007/08 WSUMs target is shown in table 2.

Table 2: 2007/08 WSUMs outturn

	2005/06	2006/07	2007/08
WSUMs target	84,689	88,670	89,734
WSUMs actual	85,183	89,650	90,854
Excess	494	980	1,120

Source: Audited WSUMs returns.

3.1.9 The College's internal auditors carried out the audit of the WSUMs return for 2007/08. They concluded that the student data returns have been compiled in accordance with all relevant guidance, that adequate procedures are in place to ensure the accurate collection and recording of data; and, on the basis of testing, reasonable assurance can be taken that the FES return contained no material mis-statement.

FRS 17 Retirement Benefits

3.1.10 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 LPF being shown on the Balance Sheet. This is consistent with the accounting treatment adopted in 2006/07.

3.1.11 Note 22 to the financial statements highlights the College's net pension liability position of £0.930 million within the LPF. This has moved significantly in the year from a net pension asset of £0.038 million at 31 July 2007. This change in financial position results from both a fall in the fair value of employer assets as at 31 July 2008 and a change in the assumptions in relation to future salary costs and future pension payments, which affect the actuarially determined liability balance (refer table 3 below). The amount recognised in the income and expenditure account in relation to the LPF includes a net return on pension assets and liabilities of £0.230 million (2006/07 - £0.145 million), which is disclosed under 'interest receivable'.

Table 3: LPF financial assumptions

	31 Jul 08 % p.a.	31 Jul 07 % p.a.
Pension increase rate	3.8	3.3
Salary increase rate	5.3	4.8
Expected return on assets	7.3	7.4
Discount rate	6.7	5.8

Source: LPF actuarial valuation for FRS 17 purposes at 31 July 2008

3.1.12 With the exception of liabilities arising from early retirals, 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. This is consistent with the accounting treatment adopted in 2006/07.

3.1 Financial Position (Cont'd)

Capital Income and Expenditure

3.1.13 The implementation of the College's estates strategy has progressed further in 2007/08 with the completion of Phase 3 of the refurbishment project early in the year. Work on Phase 4 commenced subsequent to the year-end and the associated expenditure will fall within the 2008/09 financial year. Future capital plans include three major capital projects: a new sports facility; refurbishment and reconfiguration of the College engineering facilities; and development of the quadrangle area. In October 2008 the SFC requested that a full and final business case for the development of a joint sports facility with Napier University be completed for consideration by its Capital Investment Committee in April 2009.

3.1.14 In total, expenditure of £2.237 million was added to fixed assets during the year, mainly in relation to the above enhancement works. Deferred capital grants totalling £0.794 million were used to assist with funding fixed asset additions, with the remainder being funded from College resources.

3.1.15 At 31 July 2008 an interim valuation of the College's land and buildings was performed in line with the College's accounting policy and Financial Reporting Standard (FRS) 15 *Tangible Fixed Assets*. This gave rise to a valuation gain of £0.838 million, which has been credited to the revaluation reserve.

Provisions

3.1.16 The College has a provision in its Balance Sheet for £1.266 million relating to pension costs from early retirements awarded to former teaching staff. The College's approach to the valuation of the provision has been to apply SFC actuarial tables on a consistent basis. The net interest applied was 2.0% in line with SFC guidance.

Contingent Asset

3.1.17 The College has made an application to HMRC to have the Lennartz mechanism applied to the VAT on construction costs of the Music Box building. If the College's application is successful, the College would be able to reclaim the input VAT incurred on the construction of the Music Box building and would then be liable for output VAT on the non-business use of the asset over a period agreed with HMRC. The accounting treatment for any refund and liability will require further discussion if the Lennartz mechanism applies although, in the first instance, the impact of this on the financial statements would be to recognise a debtor for the VAT recoverable and a creditor to the HMRC for the future output VAT payments.

3.2 Corporate Governance Arrangements

3.2.1 The College has established corporate governance arrangements, with committees operating within a culture of risk management. The College corporate governance arrangements are described in its Corporate Governance Statement contained with the financial statements. The terms of reference of Board committees were reviewed during the year.

3.3 Systems of Internal Control

Control environment

3.3.1 Our work undertaken in relation to the 2007/08 financial statements audit has not identified any significant control weaknesses in the operation of financial controls and procedures. Minor weaknesses discussed with the Finance Team included:

- At our year-end audit visit we reviewed the bank reconciliations prepared throughout the year. We noted for some of the later months that although these had been completed and signed by the preparer there was no signature to evidence that an independent review had been carried out by line management. We recognise that the College's Finance Team has faced a challenging period during 2008 due to staff absences and vacancies in posts and this finding has been immediately addressed.

Internal Audit

3.3.2 BDO Stoy Hayward LLP provided internal audit services to the College in 2007/08. We have reviewed the scope and extent of work performed by internal audit during the year and considered the impact of their findings and conclusions on our work, where appropriate.

3.3.3 The College's internal auditors have concluded that '*Stevenson College Edinburgh has a framework of control which provides reasonable assurance regarding the effective and efficient achievement of the College's objectives'*. The internal auditors also concluded that *'Stevenson College Edinburgh has, based on the areas examined in 2007/08, proper arrangements to promote and secure value for money.'*

3.3.4 During the year the College re-tendered the internal audit services contract and subsequently appointed Wylie and Bisset to provide internal audit services for the five-year period from 2008/09.

3.4 Corporate Governance Statement

3.4.1 Colleges are required to include a statement on their corporate governance arrangements within their annual financial statements. The statement describes the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management. The College applied the revised Combined Code on Corporate Governance issued in June 2006 for the 2007/08 financial statements.

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 controls.

3.4.3 The College's Corporate Governance Statement confirms that the College has complied with the requirements of the 2006 Combined Code on Corporate Governance, in so far as they apply to the Further Education sector, for the year to 31 July 2008.

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 2007/08 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 The College has appropriate arrangements in place, including current versions of its Standing Orders, Financial Regulations, Purchasing Policy and Procedures manual, Whistleblowing Policy, Fraud Policy and Response Plan and Risk Policies. These documents are reviewed and updated periodically.

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.

4.1 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 2007/08.

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 four themed strategic objectives.

Risk Management

4.1.4 The College has an approved Risk Management Policy and Risk Register. The Risk Register is categorised by function and has subsequently been updated to reflect on-going assessment of the strategic and operational risks faced by the College. Risks, controls and control responsibility are assigned to appropriate officers.

4.1.5 There are separate risk registers produced for each of the capital projects and these are regularly updated. Both these risk registers, along with the finance risks are presented to the Finance, Property and General Purposes Committee for their review regularly.

Performance Management

4.1.6 The Board of Management and its committees regularly consider the College's performance in implementing its strategic objectives. The Principal presents a report to each Board meeting outlining activities and achievement against the College's four strategic objectives.

4.1.7 In December 2007 the Board of Management received a paper outlining key performance measures for assessing the College's progress in achieving its vision of being 'Scotland's Leading College'. In developing the paper reference was made to existing KPIs within the Strategic Plan, the SFC circular '*Performance Measurement Framework for the Council's Corporate Plan*', the EFQM model and the current HMIe review process and framework. This final framework will be developed with input from the College's new Principal in 2008/09.

4.1.8 Annually, accounting ratios and benchmarking data are brought to the attention of the Finance, Property and General Purposes Committee where the College's performance is benchmarked against the sector.

Financial Management

4.1.9 Monthly management accounts are prepared and reviewed by the Finance Team and the Vice Principal, Finance and Resources. Financial Monitoring Statements are presented at each meeting of the College's Finance, Property and General Purposes Committee for consideration. The Committee met on six occasions during 2007/08. Our review confirms that appropriate and timely financial reporting is made at operational and strategic levels.

4.1 Performance (Cont'd)

Financial Management (Cont'd)

4.1.10 The College's internal auditors reviewed the budgetary control and accounting processes during the year and concluded that the College has good procedures in place in this area *'with sufficient involvement by Senior Management and budget holders in the budget setting process. There also appears to be sufficient information available for the purpose of monitoring by the Board of Management, Senior Management and budget holders. The monthly management accounts appear to be prepared in a timely manner.'*

4.1.11 Financial risks included in the corporate Risk Register are reviewed periodically and reported to the Board of Management and its committees.

Efficient Government Initiative (EGI)

4.1.12 The College submitted its latest EGI information schedule to the SFC in November 2008. 13 areas were identified outlining actual savings of £0.560 million over the three-year period to 2007/08. This compares favourably with the forecast of £0.539 million reported to SFC in February 2008. The largest area for savings, £0.295 million, comes from the implementation of new business processes for registration of students going forward to examination. Other significant savings have been achieved through centralised printing (£0.077 million) and the implementation of a revised centralised bursary processing system (£0.086 million). 10 smaller projects involving better use of technology and resources gave rise to the balance of the savings.

Value for Money

4.1.13 The College has a Value for Money Strategy which sets out the scope, responsibilities, concept and means of measuring the achievement of VFM.

4.1.14 The College considers best value in the context of its wider planning and operational procedures and business processes.

4.1.15 Aspects of value for money are considered by internal audit in all of their reviews. A specific value for money audit was undertaken in relation to the Faculty of Languages and Tourism in 2007/08. The internal audit plan for 2008/09 includes time for a value for money review.

5.1 Audit Opinion

5.1.1 On 12 December 2008 we plan to issue an audit report expressing an unqualified opinion on the financial statements of the College for the year ended 31 July 2008 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 4 the three key elements of the audit process.

Table 4: Key elements of the audit process

Completeness of draft financial statements
As previously stated the College's Finance Team has faced a challenging period during 2008 due to staff absences and vacancies in posts. As a result of the absence of a key member of Finance staff we delayed our audit visit by two days at the request of the College and a set of draft financial statements was received two days after the start of the final audit visit. Although substantially complete some further notes and information was required and this was provided during the course of the audit fieldwork.

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. The supporting working papers provided at the commencement of the audit were of a suitably high standard although, for the reasons noted above, some further information was required and this was provided during the course of the audit fieldwork.

Table 4: Key elements of the audit process (Cont'd)

Response to audit queries
The assistance of the College Finance Team in dealing with audit queries in the absence of a key member of Finance staff was very much appreciated and helped to prevent slippage to the audit process and meet the required reporting deadlines.

5.3 Audit and Accounting Adjustments and Confirmation

5.3.1 A small number of audit adjustments were identified during the course of the audit of the financial statements. These were discussed with the Vice Principal Finance and Resources and Finance Team at a meeting on 20 October 2008 and, whilst not having a material impact on our audit opinion, the proposed audit adjustments, together with accounting adjustments already identified by the Finance Team, were agreed and the College chose to amend the financial statements for these. We commend the College for doing so.

5.3.2 In addition, a number of minor disclosure and clarification adjustments were made to the accounts.

5.3.3 Our ISA 260 Report: *Report to those charged with Governance on the Audit of Stevenson College Edinburgh,* setting out key matters relating to the audit of the financial statements was also presented to the College's Audit Committee on 3 December 2008.

5.3 Audit and Accounting Adjustments and Confirmation (Cont'd)

Confirmations and Representations

5.3.4 We confirm that as at 19 November 2008, 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: Stevenson College Edinburgh 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 19 November 2008, in our professional judgement, Henderson Loggie is independent within the meaning of regulatory and professional requirements and the objectivity of the audit partner and audit staff is not impaired.

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

Yours faithfully

Henderson Loggie