HENDERSON LOGGIE

Stevenson College Edinburgh

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: 14 November 2007

Final Issued: 16 November 2007

Contents

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 £0.779 million and an income and expenditure account balance of £7.670 million at 31 July 2007.

- 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 2006/07 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 2003 Combined Code on Corporate Governance, in so far as they apply to the further education sector, for the year to 31 July 2007.

- 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 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. Following their review internal audit concluded that the College's risk management arrangements were generally satisfactory.

- Regular performance reports including benchmarking information are submitted to the Board of Management and its Committees during the year. The Board of Management has requested that the College Senior Management Team develop relevant performance measures on its behalf, taking account of best practice models.

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

- The College Efficient Government Initiative submission identified potential savings of £0.464 million over three years to 2008.

1.3 Financial Statements

- On 14 December 2007 we plan to 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.

- While not having a material impact on our audit opinion a number of accounting adjustments identified by the finance team have been made to the unaudited accounts. A number of minor disclosure adjustments were also made to the accounts.

- The College completed the construction of the Music Box building and Phase 2 of the reconfiguration and refurbishment project during the year. Phase 3 of the project was underway at 31 July 2007.

- The College has made a contingent asset note in its accounts in regard to its application to HMRC to have the Lennartz mechanism apply to the construction costs of the Music Box building. If successful a refund of VAT will be due and a liability created to pay back the VAT over an agreed period of time.

- The College has exceeded its WSUMS target for 2006/07 by 980 WSUMs (1.1%); (2005/06 494 WSUMs – 0.6%).

Introduction

2.1 Background

2.1.1 2006/07 was the first 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 2006/07 Audit Plan issued on 23 February 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 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 completion of the Music and Performing Arts Centre, an asset under construction at 31 July 2006, and further phased work on the reconfiguration and refurbishment project, and compliance with relevant financial reporting standards;
- 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.

Introduction

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. The planned reserves figures for 2006/07 and 2007/08 have been restated to reflect the change in accounting treatment for early retiral pension liabilities (refer paragraph 3.1.17 below).

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	689	458	779	237
Income and expenditure reserves (excl. pension asset / liability)	6,799	7,567	7,670	8,114
Cash balances	7,174	3,710	5,854	3,895

Source: Audited accounts and 2007 FFR (restated)

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 £2.573 million (12.6%) over 2005/06. The main reason for this increase of £2.005 million (13.0%) is a significant increase in SFC grant income, largely made up of an increased core grant of £1.415 million and a release of estates infrastructure and revenue grants to match non-capitalised refurbishment costs. While income from educational contracts showed only a marginal increase, tuition fee income rose by £0.278 million (15.5%) due to an increase in SAAS funded students and part time provision.

3.1.5 Expenditure in 2006/07 rose by £2.483 million (12.6%) over 2005/06 primarily due to staff costs increasing by £1.312 million (9.2%), an increase in other operating costs of £0.783 million (17.4%) and an increase in depreciation charges of £0.439 million (50.2%).

3.1.6 The increase in staff costs is partly due to an award of a 4% salary increase in August 2006. There was an increase in temporary teaching staff hours in order to deliver additional commercial activity and meet the requirements of external funding awards.

3.1 Financial Position (Cont'd)

3.1.7 The main components of the increase in other operating costs were a £0.258 million (23.4%) increase in teaching activity costs, a £0.225 million (11.1%) increase in administration and central services costs, and a £0.294 million (32.3%) increase in premises costs. Significant factors impacting on these costs include the charging to revenue of expenditure on the refurbishment of property, costs incurred in upgrading teaching and learning equipment, and the fit out and equipment costs associated with the College's new hairdressing and beauty salon.

3.1.8 The College's cash balance at 31 July 2007 was £5.854 million, a decrease of £1.320 million (-18.4%) on the previous year. The main reason is the level of capital expenditure and financial investment net of deferred capital grants in the year, up from £0.485 million to £3.457 million. This was partly offset from an increase in cash flow from operating activities, including improved working capital movements.

2006/07 WSUMS outturn

3.1.9 The College's outturn against its 2006/07 WSUMS target is shown in table 2.

Table 2: 2006/07 WSUMS outturn

	2005/06	2006/07
WSUMS target	84,689	88,670
WSUMS actual	85,183	89,650
Excess	494	980

Source: Audited WSUMs returns.

3.1.10 The College's internal auditor carried out the audit of the WSUMs return for 2006/07. 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

3.1.11 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 shown on the balance sheet. This is consistent with the accounting treatment adopted in 2005/06.

3.1 Financial Position (Cont'd)

3.1.12 Note 23 to the accounts highlights the College's net pension asset position of £0.038 million within the LPF. This has moved significantly in the year from a net pension liability of £2.357 million at 31 July 2006. The main reasons for the improved financial position is due to a sustained growth in equity markets across the world together with a revision in the underlying assumptions used by the actuaries.

3.1.13 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.

Capital Income and Expenditure

3.1.14 The implementation of the College's estate strategy has progressed further in 2006/07 with the completion of Phase 2 of the Reconfiguration Project in August 2006 and the Arts, Music and Performing Arts Centre in May 2007. Phase 3 works began during the year and are still under construction at the year end. Completion of the works was achieved in September 2007.

3.1.15 In total capital expenditure of £7.215 million was added to fixed assets during the year. Deferred capital grants totalling £3.726 million were received during the year as part of the agreed funding package with the SFC and the Scottish Arts Council. Further capital works in line with the estate strategy is planned for 2007/08 and subsequent years.

3.1.16 Fixed asset disposals in the year represents the write out of fully depreciated ICT equipment. A transfer of £2.975 million from assets under construction to heritable land and buildings was made following the completion in 2006/07 of works commenced in 2005/06.

Provisions

3.1.17 The College has a provision in its balance sheet for £1.129 million relating to pension costs from early retirements awarded to former employees. A prior year adjustment was made to reflect a change in accounting treatment for early retiral pension liabilities. This resulted in a transfer of the liability to provisions from net pension liability.

3.1.18 In last year's annual report the external auditor recommended that an actuarial valuation be obtained for the early retiral pension liability. Following consideration management continued to apply the actuarial tables provided by SFC to calculate the liability.

Contingent asset

3.1.19 The College has included a contingent asset note describing the possibility of a VAT refund under the Lennartz mechanism for capital expenditure on its Music Box building. If successful there will be a liability for output VAT on the non-business use of the asset over a period of time. The accounting treatment for any refund and liability will require further discussion should the Lennartz mechanism apply.

3.2 Corporate Governance Arrangements

3.2.1 The College has developed its corporate governance arrangements over recent years. The arrangements were reviewed by the College's internal auditors during the year who concluded *"The College's Corporate Governance and Risk Management arrangements are generally satisfactory…"* A number of recommendations were made to strengthen the arrangements.

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 BDO Stoy Hayward LLP provided internal audit services to the College in 2006/07. 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 2006/07 proper arrangements to promote and secure value for money."*

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. The College applied the revised Combined Code on Corporate Governance issued in 2003 for the 2006/07 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 2003 Combined Code on Corporate Governance, in so far as they apply to the further education sector, for the year to 31 July 2007.

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 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 update 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 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 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 Internal audit reviewed the College's risk management arrangements and concluded that the risk management arrangements are generally satisfactory

Performance management

4.1.6 The Board of Management and its committees regularly consider the College's performance in implementing its Strategic Objectives. A review of progress against the Strategic Plan 2003-06 objectives has been carried out when developing the Strategic Plan 2006-09. This review highlighted specific achievements made during the planning period. On-going priorities were also noted and taken forward into the updated Plan.

4.1.7 In June 2007 the Board of Management sought a paper suggesting 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. A Board of Management / Senior Management Team away-day is planned to further discuss performance measures and current progress against these indicators and frameworks.

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 matched against the sector.

4.1 Performance (Cont'd)

Financial management

4.1.9 Monthly management accounts are prepared and reviewed by the finance team and the Vice Principal, Finance and Resources. Quarterly Financial Monitoring Statements are presented to the College's Finance, Property and General Purposes Committee for consideration. Our review confirms that appropriate and timely financial reporting is made at operational and strategic levels.

4.1.10 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)

4.1.11 The College submitted its EGI information schedule to the SFC as required of them. Eight main areas were identified providing the potential for savings of £0.464 million over a three year period to 2007/08. The largest area for savings, £0.345 million, comes from the implementation of new business processes for registration of students going forward to examination. Centralised printing savings of £0.050 million and MIS system development savings of £0.035 million make up the majority of the balance. Five smaller projects involving better use of technology have been identified.

Value for Money

4.1.12 The College has a Value for Money Strategy which sets out the scope, responsibilities, concept and means of measuring the achievement of VFM. The Strategy is dated May 2002 however management have confirmed to internal audit that the strategy has been subsequently reviewed by the Senior Management Team.

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

4.1.14 Although aspects of value for money are considered by internal audit in all of their reviews, no specific value for money projects were undertaken for 2006/07. The 2007/08 internal audit plan includes a value for money review of the Faculty of Languages & Tourism Business Development.

Financial Statements

5.1 Audit Opinion

5.1.1 On 14 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. 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. A full set of supporting working papers were provided in line with this list from the outset of the audit and 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 and Accounting Adjustments and Confirmation

5.3.1 There were no material adjustments identified during the audit. A number of minor accounting adjustments were identified by the finance team since the production of the unaudited accounts. These together with observations from the audit were discussed with Vice Principal Finance and Resources at a meeting on 18 October 2007. While not having a material impact on the audit opinion the College decided to amend the accounts for the identified adjustments. 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.

Confirmations and Representations

5.3.3 We confirm that as at 16 November 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.

5.3.4 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 16 November 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 Stevenson College Edinburgh and should not be used for any other purposes.

Yours faithfully

Henderson Loggie