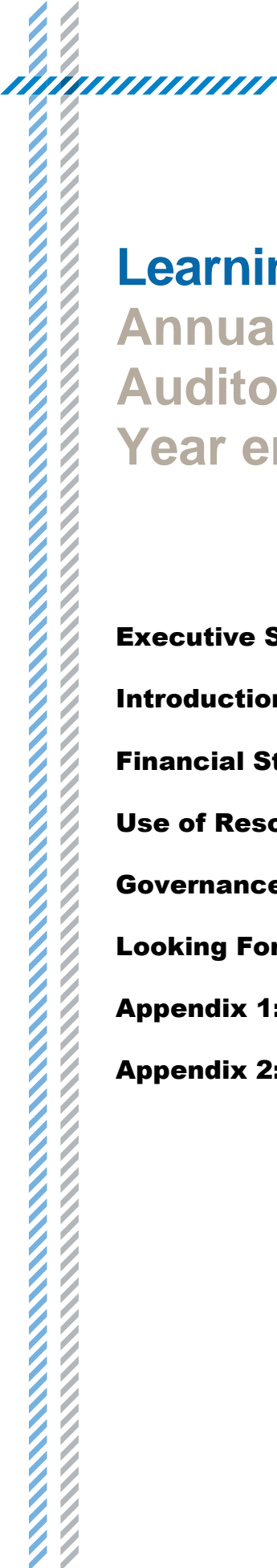


Learning and Teaching Scotland
Annual Report to the Board and the
Auditor General for Scotland
Year ended 31 March 2011

June 2011



Learning and Teaching Scotland

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Executive Summary

Financial Statements

Our audit of the 2010/11 financial statements is complete and our audit opinion is unqualified. Our auditors report includes an emphasis of matter paragraph as we believe it necessary to draw users' attention to the pension disclosure in the financial statements. On the transfer to the new executive agency, Learning and Teaching Scotland staff will be eligible to join the civil service pension scheme. They will not remain as contributing members of the Strathclyde Pension Fund. It is expected that Learning and Teaching Scotland's pension deficit will have to be recalculated at the transfer date on a cessation/transfer basis. This is not the basis used in calculating the pension liability as at 31 March 2011 and this change is likely to significantly change the value of the pension fund liability.

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.

Learning and Teaching Scotland launched a voluntary severance scheme during the year. 27 applications for voluntary severance were approved at a total cost of £1.026m. We have reviewed the accounting transactions with regard to this scheme and concluded they are in accordance with the applicable accounting standards and guidance.

During our audit we identified a number of VAT accounting issues which we consider are both applicable to Learning and Teaching Scotland and the new executive agency, Education Scotland. We have raised a number of recommendations to be considered and taken forward by Education Scotland.

Use of Resources

The financial statements for Learning and Teaching Scotland reported a net operating deficit, before Scottish Government funding, of £20.3m (2009/10: £23.1m). Learning and Teaching Scotland received £23.7m in Scottish Government funding during the year.

Scottish Government provides financial support to Learning and Teaching Scotland through grant-in-aid and programme funding. During the year, Learning and Teaching Scotland notified the Scottish Government that it intended to draw down £2.1m less than the approved grant in aid funding for the year (combined core and programme funding). This has been offset by additional funding received from the Scottish Government to support its voluntary severance scheme.

Governance

We are pleased to report that overall governance arrangements at Learning and Teaching Scotland are generally strong.

Learning and Teaching Scotland's internal auditors also commented in their annual report that they "*did not identify any critical control weaknesses that they consider to be pervasive in their effects on the organisation's overall system of internal control*".

Looking Forward

In October 2010, Scottish Ministers announced that Learning and Teaching Scotland and Her Majesty's Inspectorate of Education (HMIe) will be brought together into a new executive agency (Education Scotland). The agency is expected to be operational from 1 July 2011. Virtually all assets, liabilities and operations of Learning and Teaching Scotland will transfer to Education Scotland, with the exception of those associated with Learning and Teaching Scotland's contract with the Hanban (The Office of Chinese Language Council International) which will remain with Learning and Teaching Scotland for the time being. Since the announcement, Learning and Teaching Scotland has been preparing for the transition. Learning and Teaching Scotland has sought advice from its legal advisors and is in the process of developing a revised transfer agreement.

The Chief Executive and Director of Corporate Services are due to leave the organisation on 30 June 2011, through the voluntary severance scheme. It is essential that arrangements are put in place to ensure assurances are provided to the Accountable Officer at Education Scotland and Learning and Teaching Scotland over the internal control framework at Learning and Teaching Scotland for the period 1 April 2011 to 30 June 2011 and that adequate financial records are maintained to allow for the preparation of statutory financial statements.

Conclusion

This report concludes the 2010/11 audit of Learning and Teaching Scotland. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards.

This report has been discussed and agreed with the Director of Corporate Services and Finance Manager. We would like to thank all management and staff for their co-operation and assistance during our audit.

Scott-Moncrieff

June 2011

Introduction

1. The Auditor General for Scotland is the Scottish Parliament's watchdog for ensuring propriety and value for money in the spending of public monies. The Auditor General for Scotland is responsible for securing the audit of the Scottish Government and most public bodies, including central government bodies, in Scotland.
2. The Companies Act 2006 (Scottish public sector companies to be audited by the Auditor General for Scotland) Order 2008 provides that Learning and Teaching Scotland is to have its accounts audited by the Auditor General for Scotland. The Order came into force from 6 April 2008. The Auditor General for Scotland has appointed Scott-Moncrieff as external auditor of Learning Teaching Scotland for the three year period 2008/09 to 2010/11.
3. This report summarises the findings from our 2010/11 audit of Learning and Teaching Scotland. The scope of our audit was set out in our External Audit Annual Plan, which was presented to the Learning and Teaching Scotland Audit Committee on 24 March 2011.
4. The Code of Audit Practice prepared by Audit Scotland and approved by the Auditor General for Scotland, sets out the ways in which auditors should carry out their functions under the Public Finance and Accountability (Scotland) Act 2000. With reference to the Code of Audit Practice, the main elements of our audit work in 2010/11 have been:
 - Audit of the financial statements, including a review of the Statement on the System of Internal Control
 - Review of governance arrangements, internal controls and financial systems

The key issues from these outputs are summarised in this annual report.

5. In October 2010, Scottish Ministers announced that Learning and Teaching Scotland and Her Majesty's Inspectorate of Education (HMIe) will be brought together into a new executive agency. Work is ongoing at present to finalise the scope, functions, structure and leadership of new agency. The agency is expected to be operational from 1 July 2011. We comment on the progress made on the transition to the new executive agency in the 'Looking Forward' section of this report.
6. This report is addressed to the Board and the Auditor General for Scotland and will be published on Audit Scotland's website, www.audit-scotland.gov.uk

Financial Statements

Introduction

7. The financial statements are a key way for Learning and Teaching Scotland to demonstrate stewardship of the resources made available to them. In this section we set out our audit opinion and summarise the issues found as a result of our audit work on the financial statements.

Our responsibilities

8. We audit the financial statements and give an opinion on:
 - Whether they give a true and fair view of the body's affairs as at 31 March 2011, of its incoming resources and application of resources, including its income and expenditure for the year then ended
 - Whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements
 - Whether the information which comprises the Directors Report is consistent with the financial statements
 - Whether the part of the Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006 and directions made by the Scottish Ministers
 - The regularity of the expenditure and receipts
9. We also review the Statement on the System of 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
 - Assessing whether disclosures in the statement are consistent with our knowledge of Learning and Teaching Scotland and comply with Scottish Government guidance

Independence

10. International Standard on Auditing 260 – Communication of Audit Matters with those Charged with Governance – requires us to communicate on a timely basis all facts and matters that may have a bearing on our independence. In addition to the audit of the financial statements, Scott-Moncrieff provided Learning and Teaching Scotland with support in the development of a model to demonstrate how it plans and manages its funding, activities and resources. To ensure that this review complied with ethical standards and did not impact on the firm's objectivity and appearance of independence, the following safeguards were applied:
 - The review was undertaken by a partner who was not involved in the audit engagement in any way

- The review had no material effect on the preparation or presentation of the financial statements
- A member of the Learning and Teaching Scotland's senior management was designated as responsible for reviewing the results of the review and making any judgements or decisions that were needed

11. We can confirm that we have complied with the Auditing Practices Board Ethical Standard 1 – Integrity, Objectivity and Independence. In our professional judgement the audit process has been independent and our objectivity has not been compromised.

Overall conclusion

12. This annual report concludes the audit of Learning and Teaching Scotland for the year ended 31 March 2011. We are pleased to report that our independent auditors' report expresses an unqualified opinion on the financial statements for the year ended 31 March 2011 and on the regularity of transactions reflected in those financial statements.

13. Our auditors report will also include an emphasis of matter following our opinion on the financial statements. We believe it necessary to draw users' attention to part of the FRS 17 disclosure in the financial statements (the potential pension fund cessation deficit figure). This is of fundamental importance to users' understanding. This is discussed further at paragraphs 35-37.

Accounts Timetable

14. It is current practice for Learning and Teaching Scotland's financial statements to be presented to the Audit Committee and Board for approval. In previous years, the Board has approved the financial statements at its August meeting. With the move to the new executive agency on 1 July 2011, however, it was recognised that the full Board of Learning and Teaching Scotland would no longer be in operation in August 2011 and the timeline has therefore been brought forward.

15. The Chief Executive is the Accountable Officer at Learning and Teaching Scotland. As Accountable Officer, he has responsibility for maintaining a sound system of internal control. A statement on the system of internal control, as prepared by the Accountable Officer, is included in the financial statements. It was noted that the Chief Executive is due to leave the organisation, under its 2010/11 voluntary severance scheme, on 30 June 2011. Arrangements were therefore put in place to approve the financial statements before the end of June 2011. A Board meeting is arranged for 24 June 2011. As such, the annual accounts will be submitted to the Scottish Government and the Auditor General for Scotland prior to the 31 October 2011 deadline.

16. We received draft annual accounts and supporting papers in line with our agreed audit timetable. We are pleased to report that the audit process ran smoothly, and our thanks go to the finance team for their assistance with our work.

Accounts Direction

17. Learning and Teaching Scotland is required, in preparing its financial statements, to comply with directions given by the Scottish Ministers. The direction by the Scottish Ministers requires Learning and Teaching Scotland to comply with the accounting principles and disclosure requirements of the Government Financial Reporting Manual (FRoM).
18. The 2010/11 FRoM notes that non-departmental public bodies (NDPBs) that are incorporated as companies and have charitable status, should comply with, respectively, the Companies Act 2006, regulations issued under charities legislation and, where applicable, the Statement of Recommended Practice (SORP) *Accounting by Charities*. They should also follow the principles in the FRoM and provide the additional disclosures (for example, on salary and pension entitlements) where these go beyond the Companies Act 2006 or the SORP.
19. We are pleased to report that the 2010/11 financial statements of Learning and Teaching Scotland comply with the 2010/11 edition of the FRoM which was in force for the year when the statement of accounts were prepared and the Charities Statement of Recommended Practice (Charities SORP).

Audit Adjustments

20. We identified no major errors or weaknesses during our audit. Adjustments to the financial statements arising from the audit related mainly to changes in disclosure and presentation. We agreed all adjustments and potential adjustments with the Director of Corporate Services.
21. Appendix 2 outlines the audit adjustments made to Learning and Teaching Scotland's financial statements. The net effect on the financial statements is as follows:

	£
Net operating deficit (transferred to reserves) per 1 st draft accounts	23,499,830
Net effect of adjustments made during the audit	(3,246,821)
Revised operating deficit per final accounts	20,253,009
Adjustment made to financing items	(22,997)
Total effect of adjustments made during the audit	(3,269,818)

22. We have also identified potential adjustments which are not considered material to the financial statements, either individually or in aggregate.
23. These potential adjustments are shown as an appendix to the letter of representation and we ask the Board to confirm that they do not consider any unadjusted misstatement to be material.

Issues arising from the audit

24. We are required by international auditing standards to report to the Board the main issues arising from our audit of the financial statements. The most significant issues are noted below.

Going Concern

25. Directors are required, by company law, to prepare financial statements which give a true and fair view. In so doing, directors should make an assessment of the charitable company's ability to continue as a going concern for a period of at least twelve months from the date of approval of the financial statements. Where there are concerns about the going concern basis of accounting, the directors are responsible for ensuring adequate disclosure is made in the financial statements.
26. The financial statements have been prepared on the assumption that, under the conventions of Machinery of Government changes, Learning and Teaching Scotland's functions will continue in operational existence for the foreseeable future albeit through different delivery bodies, including the new executive agency. The directors therefore consider it appropriate for the financial statements to be prepared on a going concern basis.

Voluntary Severance Scheme

27. Learning and Teaching Scotland launched a voluntary severance scheme during the year. 27 applications for voluntary severance were approved at a total cost of £1.026m. The applications approved included two of the five individuals who comprise the corporate management team: the Chief Executive and Director of Corporate Services. Fifteen individuals left on 31 March 2011; the remainder are due to leave between 1 April 2011 and 30 June 2011. During our audit we confirmed that Learning and Teaching Scotland received approval from its sponsor Directorate for a voluntary severance scheme at a cost of up to £1.2m.
28. The funding for this scheme is being met primarily from grant-in-aid. Grant-in-aid is provided to match the recipients cash needs and is accounted for on a cash basis. Learning and Teaching Scotland has therefore reported in its financial statements £500,000 income to match the cost for those individuals who left the organisation at 31 March 2011.
29. In accordance with applicable accounting standards, however, Learning and Teaching Scotland has recognised the total cost of the voluntary severance scheme (£1.026m) in its 2010/11 financial statements. As a result, Learning and Teaching Scotland is reporting a deficit position on the voluntary severance scheme in its 2010/11 financial statements.
30. We have reviewed the accounting transactions with regard to this scheme and concluded they are in accordance with the applicable accounting standards and guidance.

FRS 17 Valuation

31. All members of staff of Learning and Teaching Scotland have the option of joining the Strathclyde Pension Fund (SPF) with existing employees who are members of the Scottish

Teachers Superannuation Scheme entitled to maintain their membership of that scheme. The SPF is a defined benefit scheme where the assets and liabilities can be separately identified each year by an actuary. Under Financial Reporting Standard 17 this scheme is therefore reflected within the financial statements.

32. At 31 March 2010, Learning and Teaching Scotland reported a net liability of £8.318m. At 31 March 2011 this had decreased to a net pension liability of £1.999m.
33. The Chancellor's decision to allow the valuation of public sector pensions to be based on the Consumer's Price Index (CPI) instead of the Retail Price Index (RPI) has had a significant impact on this year's valuation of the pension scheme. Learning and Teaching Scotland has reported a past service gain due to the change from RPI to CPI of £3.612m. This has significantly reduced the pension liability. The fair value of the employer assets has also improved during the year (by £1.870m). This also contributes to the reduction in the pension liability reported as at 31 March 2011.
34. As noted in paragraph 27, Learning and Teaching Scotland launched a voluntary severance scheme during 2010/11. As part of this scheme, nine individuals were eligible for early retirement; of which three participated in the Strathclyde Pension Fund and left in March 2011. The 'strain on the fund' costs associated with these early retrials were obtained from the Strathclyde Pension Fund and have been provided for in the financial statements. There is a risk that these costs are accounted for twice in the financial statements; through the voluntary severance provision and through the FRS 17 actuarial valuation. A late amendment was made to the FRS 17 actuarial valuation to reflect the costs associated with these early retrials. The financial statements however were not adjusted to reflect this amendment. The adjustment has been included in the letter of representation. The net impact on the deficit in the year was £766.
35. In preparation for the 2010/11 financial statements, Learning and Teaching Scotland requested two FRS 17 reports; a standard FRS 17 report and a FRS 17 report based on transfer/cessation values. On the move to the new executive agency, Learning and Teaching Scotland staff will be eligible to join the civil service pension scheme from 1 July 2011. They will not remain as contributing members of the Strathclyde Pension Fund.
36. The actuary has provided an indication of the potential cessation deficit that may arise following the transfer of staff. The actuary has however reported that the method used in the calculation is approximate and the actual cessation deficit may be materially different when a full cessation valuation is carried out. The potential cessation deficit provided by the actuary is £4.581m. This information has been disclosed as a note to the financial statements.
37. We have disclosed this matter in our independent auditors report as 'an emphasis of matter'. We consider it necessary to draw the users attention to the accuracy of the potential cessation deficit figure disclosed in the financial statements. The actuary has reported that the actual cessation deficit may be materially different when the full cessation valuation is carried out.

38. The Scottish Government has confirmed, that in the event of Learning and Teaching Scotland ceasing to exist it will meet any contingent liability for costs arising out of any discretion exercised under the Local Government Pension Scheme (Scotland) Regulations.

Remuneration Report

39. In accordance with the FReM, Learning and Teaching Scotland discloses a remuneration report in its Report and Financial Statements. The remuneration report should disclose, for each director who has served during the year:
- the real increase during the year in the pension and, if applicable, related lump sum at age 60 in bands of £2,500
 - the value at the end of the year of the accrued pension and, if applicable, related lump sum at age 60 in bands of £5,000
 - the value of the cash equivalent transfer value at the beginning of the year to the nearest £1,000
 - the real increase in the cash equivalent transfer value during the year to the nearest £1,000
 - the value of the cash equivalent transfer value at the end of the year to the nearest £1,000
40. There is a requirement in Scotland that the prior consent of individuals to disclose information in remuneration reports is obtained. There is however a presumption that information about named individuals will be given, except in circumstances as specified in the FReM, including national security or where an individual may be at risk if their name is disclosed. Where non-disclosure is agreed, the fact that certain disclosures have been omitted should be disclosed.
41. The directors at Learning and Teaching Scotland have stated in the remuneration report that they do not wish to disclose details regarding the real increase in their pension earned in the year or the value of their accrued pension as at 31 March 2011.

Non-consolidated Performance Bonus

42. In February 2011, the Scottish Government approved the Learning and Teaching Scotland Board's proposal to award the Chief Executive a bonus of £9,018 for his performance in 2009/10. At the time, the Scottish Government referred Learning and Teaching Scotland to Mr Swinney's letter (5 May 2010) in which Ministers made it clear that, in line with current policy on bonuses, the Chief Executive should be invited to waive this bonus.
43. We understand that the Chief Executive has now decided to accept this performance related bonus for 2009/10. In line with the Scottish Government's pay policy, no bonus payment will be made in respect of the Chief Executive's performance in 2010/11.

Grants to third parties - VAT

44. Learning and Teaching Scotland pays grant funding to third parties. Where a payment is a genuine grant and Learning and Teaching Scotland does not receive any specific or measureable benefit, the payment will be outside the scope of VAT.

45. We noted that Learning and Teaching Scotland awarded grants to third parties under the “Communities Programme”. Under the terms and conditions of this programme, the recipient is required to satisfy specific and measurable outcomes. As long as the recipient approaches Learning and Teaching Scotland for the funding and confirms the outcomes it will achieve, the Learning and Teaching Scotland payment should be outside the scope of VAT.
46. Conversely where Learning and Teaching Scotland engages a third party to provide a service to (or on behalf of) Learning and Teaching Scotland and makes a payment in return for this, the payment may be liable to VAT. As Learning and Teaching Scotland can only recover a small element of VAT incurred on expenditure it would be prudent to confirm (where possible) that the payments or funding is “inclusive of VAT”. This will ensure that it is not required to make an additional payment where any grant payment is held to be liable to standard-rate VAT.

Action Plan Point 1

Staff secondments

47. Learning and Teaching Scotland second staff from a number of local authorities. The secondment of staff between charities and not for profit organisations is outside the scope of VAT as long as the member of staff performs non-business duties for each organisation and only the member of staff's payroll costs are recharged (i.e. no mark-up or management charge is applied). Local authorities and public bodies are specifically excluded from this arrangement.
48. Although Learning and Teaching Scotland is a qualifying charity, local authorities are not. We would therefore expect all local authorities to charge VAT on their secondment of staff to Learning and Teaching Scotland. We understand that some local authorities have not charged VAT. Learning and Teaching Scotland has highlighted this to the local authorities in question. The position of Learning and Teaching Scotland is that it is not contractually liable to pay the VAT (as the contracts are silent on VAT and therefore the price is deemed to be VAT inclusive) but that it would pay a proportion of any VAT due on such secondments. Learning and Teaching Scotland has made a provision in its financial statements for the VAT that has not been charged by local authorities and may be charged at a later date.
49. It is anticipated, with the transition to the new executive agency, that this provision for VAT will be written down by 25% for the next four years, in line with HMRC's error correction time limits.
50. If the new agency continues to receive seconded staff from local authorities it will also have to consider this issue. Secondments of staff between local authorities (or similar organisations) are outside the scope of VAT as long as the local authority (or similar) is acting in its capacity as a public authority and is not creating a distortion of competition.
51. From the information available we would expect the secondment of staff (by local authorities) to the new executive agency to be liable to VAT as we do not believe that the staff are seconded under a special legal rule. We would suggest that once the new agency is established that this is categorically confirmed before any contracts are entered into.

Action Plan Point 2

Statement on Internal Control

52. As part of our audit we have considered the statement on the system of internal control, included with the Report and Financial Statements. We are satisfied that the statement is consistent with guidance issued by Scottish Ministers and that the contents are not inconsistent with information gathered during the course of our normal audit work.

Regularity

53. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors to certify that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have issued an unqualified opinion on the regularity of transactions in Learning and Teaching Scotland's accounts.
54. We have also concluded that the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with guidance issued by Scottish Ministers, and that information in the Directors Report which is included in the Report and Financial Statements is consistent with the financial statements.

Use of Resources

55. This section sets out our main findings from our review of how Learning and Teaching Scotland manages its key resources in terms of its financial position.

Financial Performance in 2010/11

56. Learning and Teaching Scotland has reported a net operating deficit of £20.3m in year. This deficit is offset through grant-in-aid income received from Scottish Government which is recognised through the general reserve rather than the income and expenditure account. The table below provides a summary of Learning and Teaching Scotland's financial results for the year.

	2010/11 £	2009/10 £
Income	2,248,883	2,300,999
	2,248,883	2,300,999
Cost of sales	(628,204)	(899,620)
Charitable activities	(22,003,985)	(24,260,242)
Governance costs	(71,392)	(27,581)
	(22,703,581)	(25,187,443)
Other income/(expenditure)	201,689	(194,274)
Net operating costs	(20,253,009)	(23,080,718)
Grant-in-aid	7,818,000	7,505,000
Funding toward voluntary severance scheme	500,000	0
Scottish Government Programme Funding	15,395,718	15,896,974

Source: Learning and Teaching Scotland's Report and Financial Statements 2010/11

57. Operating expenditure for the year includes a past service gain (£3.612m) due to the change in basis on valuation of public sector pensions from RPI to CPI (paragraph 33). Learning and Teaching Scotland applies its Scottish Government programme funding across five specific educational programmes:

Programme	2010/11 £	2009/10 £
Curriculum and Assessment, including Curriculum for Excellence	2,451,450	3,655,990
Targeted Support for Education	2,828,531	2,714,066
Technology for Learning*	6,460,438	7,931,851
Developing Global Citizens	1,734,053	1,318,256
Communities	1,913,902	0
Other activities funded by the Scottish Government	0	82,098
Total	15,388,374	15,702,261
Other government funding towards project funded assets	7,344	194,713
Total Scottish Government programme funding	15,395,718	15,896,974
Source: Learning and Teaching Scotland's financial statements 2010/11 and 2009/10 Previously classified as two programmes: Glow and Schools ICT		

58. In April 2010, the staff and functions of the Learning Connections Division of the Scottish Government were transferred to Learning and Teaching Scotland. The funding and expenditure associated with these functions are reported under the 'communities' programme.
59. The Scottish Government provides financial support to Learning and Teaching Scotland through grant-in-aid and programme funding. In July 2010, Learning and Teaching Scotland was awarded grant-in-aid funding of £8.423m for 2010/11 to meet expenditure on core operational costs (staffing and services). Learning and Teaching Scotland drawdown funds as and when required. During the year, Learning and Teaching Scotland notified the Scottish Government that it intended to claim £0.605m less than the agreed award. This was due to a number of efficiencies, including a number of unfilled vacancies. As a result, Learning and Teaching Scotland received £7.818m in grant-in-aid during 2010/11. In addition to this, Learning and Teaching Scotland, claimed £1.45m less than the agreed programme funding award for the year. These 'under-claims' have been offset by the additional funding received from the Scottish Government for the voluntary severance scheme.

Budgetary Control

60. Learning and Teaching Scotland reported an adverse variance of £127,000 for the year compared with its reforecast annual budget. In April 2010, Learning and Teaching Scotland set a balanced budget with expected costs of £26.559m. A high level annual budget is prepared alongside the annual business plan for the forthcoming year. The budget is approved by the Scottish Government. Comprehensive budgets are not carried out until formal notification of core and project funding is received from the Scottish Government. Adjustments to the budget figures through the year are common; however they are not formally approved by senior management.
61. Looking forward, the Cabinet Secretary has approved an allocation of up to £17.7m for Learning and Teaching Scotland activity in 2011/12. The allocation comprises cash funding of up to

£17.3m to meet recurring core operational costs (staffing and services) and the non-recurring costs of Learning and Teaching Scotland's programme of work to be agreed. This funding has reduced by approximately £5m in comparison to the funding received in 2010/11. This has been factored into Learning and Teaching Scotland's 2011/12 budget and annual plan. There is a reduction in staff numbers due to the non renewal of fixed term contracts and seconded staff agreements and the departure of staff under the voluntary severance scheme.

Governance

62. This section sets out the main findings arising from our review of Learning and Teaching Scotland's governance arrangements as they relate to:

- Overall governance arrangements
- Risk management
- Internal audit

Overall governance arrangements

63. Our work on corporate governance focussed on our review of Learning and Teaching Scotland's arrangements to ensure effective systems of internal control, prevention and detection of fraud and irregularity and standards of conduct and prevention and detection of corruption. We are pleased to report that overall governance arrangements at Learning and Teaching Scotland are generally strong.

Board of Learning and Teaching Scotland

64. Learning and Teaching Scotland's Board of Directors has corporate responsibility for ensuring that Learning and Teaching Scotland fulfils its aims and objectives. Board members are appointed by Scottish Ministers, normally for a period of three years. In June 2010, Scottish Ministers announced the appointment of two new members to the Board and the re-appointment of two members to the Board. Formal induction arrangements are in place for new board members.

65. The deputy chair of the Board has been acting as chair during the year (the former chair's term of office expired on 31 March 2010). Whilst the role of the chair has been remunerated in the past, we noted that the deputy chair has not received any remuneration for his role in 2010/11. With the exception of the Chief Executive, no other directors received remuneration in 2010/11.

66. The Board has delegated certain matters to sub-committees, including an audit committee, remuneration committee, chairs committee and an organisational development committee.

Risk Management

67. An important feature of a robust system of internal control is a developed and integrated approach to risk management. Effective risk management will deliver an appropriate balance between risk and control, more effective decision making, better use of limited resources and greater innovation.

68. During the year, internal audit carried out a review of Learning and Teaching Scotland's risk management arrangements. Internal audit commented that Learning and Teaching Scotland has 'well embedded risk management arrangements'. Two medium risk recommendations were

raised by internal audit in relation to the documented procedures and formalisation of staff responsibility for the risk management process. Learning and Teaching Scotland has accepted these recommendations.

Internal Audit

69. Internal Audit is a key component of Learning and Teaching Scotland's internal control framework. PricewaterhouseCoopers provide an internal audit service to Learning and Teaching Scotland.
70. In accordance with the Code of Audit Practice and International Standard on Auditing 610 – *Considering the work of internal audit, “the external auditor should perform an assessment of the internal audit function when internal auditing is relevant to the external auditor’s risk assessment”*. Overall we concluded that reliance could be placed on the work of internal audit. To avoid duplication of effort and to ensure an efficient audit process, we have made use of internal audit work where appropriate.
71. Internal audit made the following comments on Learning and Teaching Scotland in its annual report:
72. *“We have completed the programme of internal audit work for the period to June 2011 in accordance with the Government Internal Audit Standards and can report that our work did not identify any critical control weaknesses that we consider to be pervasive in their effects on the organisation’s overall system of internal control. Furthermore, we have not identified any weaknesses from our audit work during the year that we consider should be included as ‘Significant Internal Control Issues’ in your Statement on Internal Control.”*
73. These comments have been incorporated into Learning and Teaching Scotland's statement of internal control.

Fraud and Irregularity

74. Our audit has been planned to provide a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud and irregularity. As part of our governance work we reviewed the arrangements in place to prevent and detect fraud and irregularity.
75. We did not find any indication of fraud and irregularity and concluded that Learning and Teaching Scotland's internal controls and financial procedures were adequate to prevent and detect material fraud and irregularity.

Legality

76. We have planned and performed our audit recognising that non-compliance with statute or regulations may materially effect the financial statements. Our audit procedures included the following:

- Reviewing minutes of relevant meetings;
- Enquiring of senior management and the company's solicitors concerning litigation, claims and assessments;
- Performing a company search; and
- Performing detailed testing of transactions and balances.

77. We are pleased to report that we did not identify any instances of concern with regard to the legality of transactions or events.

National study reports

78. Audit Scotland has carried out national studies in a variety of areas. There is an expectation that central government bodies review the national study reports, published during 2010/11, that are relevant to them and action them accordingly. Audit Scotland requires external auditors to complete a pro forma template for each National Study which will address the following points:

- Was the national report discussed at any of the body's committees and on what dates?
- Did the body carry out a self assessment against the national report?
- Did the board produce an action plan? A copy of which is to be submitted to Audit Scotland.
- Are there plans to provide the committee(s) with feedback on the actions?

79. Due to the forthcoming move to the new executive agency, we have not completed pro forma templates for each national study. We did however note that Learning and Teaching Scotland's Board of Directors considered 'The Role of Boards' report in October 2010 and carried out a self assessment review against the key issues within this report. Overall the Board concluded that its corporate governance arrangements compare favourably against the issues identified in the national report.

Looking Forward

80. In October 2010, Scottish Ministers announced that Learning and Teaching Scotland and Her Majesty's Inspectorate of Education (HMIE) will be brought together into a new executive agency (the 'Scottish Education Quality and Improvement Agency'). Work is ongoing at present to finalise the scope, functions, structure and leadership of new agency. The agency is expected to be operational from 1 July 2011.
81. In February 2011, the Cabinet Secretary agreed the remit and purpose statement. Following the 2011 Scottish elections, the Cabinet Secretary confirmed that he envisages no significant changes to the scope of the functions of the new agency. An extract from the remit and purpose statement is shown in table below, highlighting the core purpose and strategic priorities for the new agency.

Extract from the remit and purpose statement (agreed by the Cabinet Secretary in February 2011)

The new agency is to be established by the Cabinet Secretary as a key national body supporting quality and improvement in Scottish education by:

- leading and supporting the implementation of Curriculum for Excellence
- increasing the capacity for self-evaluation and self-improvement amongst education providers and practitioners
- promoting high quality professional learning and leadership
- identifying and stimulating innovation, sharing successful approaches widely with others
- providing independent external evaluations of the quality of educational provision at individual provider, local authority and partners, and national levels
- supporting the development and implementation of policy at National Level

Source: <http://www.scotland.gov.uk/Topics/Education/Schools/Latest/SEQIAremit>

82. The Cabinet Secretary also recently agreed the name of the new agency; Education Scotland. Dr Bill Maxwell, currently Senior Chief Inspector of Her Majesty's Inspectorate of Education, has been appointed the transitional Chief Executive Officer of the new education agency. This appointment is effective from 2 May 2011 for one year. It is envisaged that Education Scotland will be a multi-site organisation, with senior management and corporate functions across Livingston, Glasgow and other locations.
83. Since the announcement in October 2011, Learning and Teaching Scotland has been preparing for the transition to the new education agency. The original intention was that the creation of Education Scotland would lead to the 'winding up' of Learning and Teaching Scotland and all assets, liabilities and operations would transfer to Education Scotland. Learning and Teaching Scotland, however, has recently received notification from the Scottish Government that virtually all assets, liabilities and operations will transfer to Education Scotland, with the exception of

those associated with Learning and Teaching Scotland's contract with the Hanban (The Office of Chinese Language Council International) which will remain with Learning and Teaching Scotland for the time being.

84. Learning and Teaching Scotland, in 2007, signed a Letter of Co-operation Intent with the Hanban and in 2010 entered into a 5 year agreement. A key aspect of this co-operation is to set up Confucius classrooms in Scotland (local hubs, based in Scottish Schools or colleges, which stimulate and support innovative teaching and learning of Chinese language and culture (source). In 2010/11, Learning and Teaching Scotland received £169,000 from the Hanban. As at 31 March 2011, Learning and Teaching Scotland reported deferred project income in relation to Hanban income of £264,000 in its financial statements. Learning and Teaching Scotland also acts as a Tier 4 sponsor, under the UK Border Agency, for six Chinese nationals now in Scotland. The intention has been to act as a Tier 4 sponsor for a further nine Chinese nationals in August 2011.
85. The Scotland Act 1998 lists those reserved matters for which the UK Parliament retains responsibility. This list includes with foreign affairs and as such these arrangements cannot be transferred to the new executive agency. Learning and Teaching Scotland is now progressing with a transfer agreement which excludes these matters.
86. Learning and Teaching Scotland will continue as an organisation until alternative arrangements are put in place. Options which are currently being considered include, for example, a transfer of the remaining functions to another Non Departmental Public Body (NDPB) or another public sector organisation.
87. Learning and Teaching Scotland has sought advice from its legal advisors, MacRoberts, on the 'winding up' of Learning and Teaching Scotland and the transition to Education Scotland. The paragraphs which follow highlight some of those areas considered during the transition process and the impact that the revised transfer agreement may have on those arrangements:
88. **Removal from registration at Companies House:** The original intention was that the creation of Education Scotland would lead to the 'winding up' of Learning and Teaching Scotland and all assets, liabilities and operations would transfer to Education Scotland. Learning and Teaching Scotland is a company with charitable status. In order to meet requirements under the Companies Act in relation to removing the remaining 'inactive' company from Companies House, a three month period during which the company has not actually carried on business should be observed and, at the end of this period, the Directors can then apply to have the company removed. The process of removing the company from the Register normally takes a further three months. A minimum number of Directors (the quorum is 3) are required to remain on the Board after 30 June 2011 to enable the dissolution process to take place.

89. The Board of Directors comprises eight directors (including the Chief Executive). For four of the directors their term of appointment expires in 2014. For the other three directors their term of appointment expires in 2011.
90. In planning for the transition to Education Scotland on 1 July 2011, it was expected that the company would be 'inactive' from this date and it would subsequently apply to be removed from the Register following a three month period. It was also anticipated that the three Board members whose term of appointment expires in July/August 2011 would continue until the end of their appointment. The remaining directors would resign at the point Learning and Teaching Scotland is removed from the Register. It has yet to be clarified what final arrangements will be in place now that Learning and Teaching Scotland is continuing for the foreseeable future but the current intention is that the three Board members noted above will now resign on 30 June 2011.
91. **Removal from the Scottish Charities Register:** Arrangements are also required to be put in place to apply to Office of the Scottish Charity Regulator (OSCR) to have Learning and Teaching Scotland removed from the Scottish Charities Register. This application process takes 42 days. Learning and Teaching Scotland intended to apply to OSCR in May 2011 to be removed from the Scottish charity register. It has however withheld its application to OSCR until such time that it is to be 'wound up'.
92. **Macrocom (968) Limited:** Learning and Teaching Scotland has a subsidiary company (Macrocom (968) Limited) which was incorporated in 2007 and has remained dormant since that date. The company has a £100 share capital, 100% held by Learning and Teaching Scotland and has a single Director, the Chief Executive of Learning and Teaching Scotland, with Learning and Teaching Scotland's Director of Corporate Services as its Company Secretary. The company has a 31 March year end and dormant company accounts have been filed with Companies House since 2007. An application has been made in April 2011 to have the company removed from the Register. It is the intention that, whilst the Chief Executive, as sole director, and the Director of Corporate Services, as company secretary, are to leave Learning and Teaching Scotland, under the voluntary severance scheme, on 30 June 2011, they will continue as director and company secretary until the company is removed from the Register.
93. **Financial Statements:** Based on the original transfer arrangement, three month statutory financial statements would require to be prepared for Learning and Teaching Scotland (1 April 2011 – 30 June 2011), reflecting the requirements of the charities statement of recommended practice (the SORP). As Learning and Teaching Scotland will now continue to exist for the foreseeable future this is no longer considered a requirement. A set of statutory financial statements will however be required, for the period from 1 April 2011 to the point at which Learning and Teaching Scotland is eventually 'wound up'. It is expected that these financial statements will include an annual report that comprises a Trustees Annual Report (in accordance with the requirements set out in the Charities SORP), a remuneration report and a statement on internal control. The accountable officer will be responsible for preparing the financial statements. The accountable officer, for the period from 30 June 2011, however, has

yet to be appointed. Arrangements will need to be put in place to ensure the appropriate records and resources are in place to prepare these financial statements.

Action Plan Point 3

94. Learning and Teaching Scotland is a charitable NDPB and as such has not adopted international financial reporting standards (IFRS). It is anticipated, on the other hand, that Education Scotland will not have charitable status and that its financial statements will be prepared in accordance with the IFRS based Government Financial Reporting Manual. Work will therefore be required to restate the Learning and Teaching Scotland's financial statements on an IFRS basis to enable the financial statements to be merged within Education Scotland's financial statements.
95. It is anticipated that merger accounting will be adopted and that one set of statutory financial statements will be prepared for the period 1 April 2011 to 31 March 2012. Additional reporting will be disclosed in the financial statements including a statement showing the assets and liabilities vested from Learning and Teaching Scotland and HMIE and segmental reporting information to reflect the reporting periods preceding and subsequent to the effective date (1 July 2011). The Chief Executive of Education Scotland, as accountable officer, will sign a statement of internal control which covers the period 1 April 2011 to 31 March 2012. This therefore covers the three month period where internal controls were in operation at Learning and Teaching Scotland. We would expect the Chief Executive of Learning and Teaching Scotland to provide an assurance statement to the Chief Executive of Education Scotland on the effectiveness of the internal control framework at Learning and Teaching Scotland for the three month period 1 April 2011 to 30 June 2012. The Chief Executive of Learning and Teaching Scotland should also provide an assurance statement to the accountable officer of Learning and Teaching Scotland for the same period.

Action Plan Point 4

Transition Costs

96. The costs of transition are to be initially borne by the individual entities (Learning and Teaching Scotland and HMIE). In 2010/11 Learning and Teaching Scotland has incurred £48,000 costs relating to legal fees.

Appendix 1: Action Plan

Our action plan details the key weaknesses and opportunities for improvement that we have identified during this review. To assist Learning and Teaching Scotland in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated. The rating structure is summarised as follows:

5	Very high risk exposure - Major concerns requiring immediate Board attention.
4	High risk exposure - Absence / failure of significant key controls.
3	Moderate risk exposure - Not all key control procedures are working effectively.
2	Limited risk exposure - Minor control procedures are not in place / not working effectively.
1	Efficiency / housekeeping point.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist.

No	Title	Risk and Recommendation	Management Comments
1	Financial Statements - Grants to third parties - VAT	As Learning and Teaching Scotland can only recover a small element of VAT incurred on expenditure it would be prudent to confirm (where possible) that the payments or funding is “inclusive of VAT”. This will ensure that it is not required to make an additional payment where any grant payment is held to be liable to standard-rate VAT. Priority 3	Agreed. To be taken forward by Education Scotland.
2	Financial Statements - Staff secondments	From the information available we would expect the secondment of staff (by local authorities) to Education Scotland to be liable to VAT as we do not believe that the staff are seconded under a special legal rule. We would suggest that once the new agency is established that this is confirmed before contracts are entered into Priority 4	Agreed. To be taken forward by Education Scotland.
3	Looking forward – financial statements	A set of financial statements will be required for the period 1 April 2011 to the point at which Learning and Teaching Scotland is eventually ‘wound up’. Arrangements will need to be put in place to ensure the appropriate records and resources are in place to prepare these financial statements. Priority 4	Agreed. To be taken forward by Education Scotland.
4	Looking forward- financial statements	The Chief Executive of Education Scotland, as accountable officer will sign a statement of internal control which covers the period 1 April 2011 to 31 March 2012. This therefore covers the three month period where internal controls were in operation at Learning and Teaching Scotland. We would expect the Chief Executive of Learning and Teaching Scotland to provide an assurance statement to the Chief Executive of Education Scotland on the effectiveness of the internal control framework at Learning and Teaching Scotland for the three month period 1 April 2011 to 30 June 2012. In addition, the Chief Executive of Learning and Teaching Scotland should provide an assurance statement to the Accountable Officer of Learning and Teaching Scotland. Priority 4	Agreed. To be taken forward by Education Scotland.

Appendix 2: Audit Adjustments

The following audit adjustments were made during the audit which impacted on the final position as follows:

	£	£	£	£
1 Scottish Government general activities grant			477,004	
Debtors	22,996			
Voluntary severance funding received				500,000
<i>Being recognition of Scottish Government funding received towards voluntary severance costs</i>				
2 Voluntary severance costs			553,682	
Provisions		553,862		
Staff Costs			5,496	
Creditors		5,316		
<i>Being recognition of voluntary severance costs in year</i>				
3 Conferences and seminars			171,305	
Promotional expenses				171,305
<i>Being reallocation of costs in year</i>				
4 Bank and Cash	192,407			
Creditors		192,407		
<i>Being correction to PAYE payment at year end</i>				
5 Pension Liability	6,319,000			
Staff costs				3,680,000
Other finance costs				126,000
Actuarial gain		2,513,000		
<i>Being recognition of FRS 17 entries</i>				
6 External auditors remuneration			27,295	
Board and internal audit costs				27,295
<i>Being reallocation of costs in year</i>				
Net impact on profit			<u><u>(3,269,818)</u></u>	



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