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# South Lanarkshire College

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

Year ended 31 July 2012

30 January 2013

# Contents

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This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").
This report is for the benefit of the Board of Management of South Lanarkshire College and is made available to Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.
Nothing in this report constitutes an opinion on 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 in 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 KPMG LLP (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, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.
We also draw your attention to the following:

- management of South Lanarkshire College is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems;
- weaknesses or risks identified by us are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist; and
- communication by us of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve the Board of Management of South Lanarkshire College from its responsibility to address the issues raised and to maintain an adequate system of control.

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# Audit status and key audit issues

**Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the *Code*"). This specifies a number of objectives for the audit; our audit strategy set out our responsibilities in respect of the audit. The Board of Management's responsibilities are set out in appendix one.**

**This report summarises our work for the year ended 31 July 2012. It also provides information required by International Statements on Auditing (UK and Ireland) 260: *Communication with those charged with governance.***

| Issue | Summary | Page |
|---|---|---|
| Audit status | Our audit is now complete and we have issued unqualified audit opinions for the year ended 31 July 2012, following the approval of the financial statements by the Board of Management. | 7 |
| Financial position | The surplus for the year was £172,000 (2010-11, £28,000), representing 1.56% of total income.<br><br>The increase is mainly due to a decrease in grant income offset by lower staff costs as a result of voluntary severance schemes in prior years. | 8 |
| Audit issues identified | Under the requirements of ISA (UK and Ireland) 260: *Communications with those charged with governance*, we are required to report any material adjusted audit differences arising from our work.<br><br>One audit adjustment was identified as a result of our audit in respect of deferred grant income that had not been released in 2011-12.<br><br>Pension assumptions adopted by management in the draft financial statements were outside our generally acceptable range as at 31 July 2012, particularly in respect of the net discount rate of 1.9% compared to our central assumption of 2.5%. Following consideration by the Board of Management, via the Finance and Audit committees, revised assumptions were adopted by the College which resulted in a net discount rate of 2.2%. Pension liabilities were reduced by £435,000, compared with the liability initially calculated and included in the draft financial statements as a result. | 4, 5, 19 |
| Performance improvement observations | We have identified one performance improvement observations which we are required to bring to your attention. We have raised a recommendation in respect of the College's reliance on the head of finance in respect of preparation of the financial statements and day to day processes, which limits segregation of duties and leads to a business continuity risk.<br><br>We discussed other, more minor performance improvement observations with the audit committee. | 14 |

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# Introduction

## Background

The purpose of this report is to set out certain matters which came to our attention during the course of our audit of the financial statements of South Lanarkshire College ("the College") for the year ended 31 July 2012.

## The purpose of our audit

The main purpose of our audit which is carried out in accordance with International Statements on Auditing (ISAs) (UK and Ireland) issued by the Auditing Practices Board, is to report to the Board of Management and Auditor General for Scotland on whether in our opinion the financial statements:

- give a true and fair view of the state of the affairs of the College as at 31 July 2012 and of the College's income and expenditure, recognised gains and losses and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice;
- have been prepared in accordance with the Statement of Recommended Practice: Accounting for Further and Higher Education; and
- the expenditure disbursed and income received during the year ended 31 July 2012 have been applied to purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

## Management letter

Our objective is to use our knowledge of the College gained during our routine audit work to make useful comments and suggestions for you to consider. However, you will appreciate that our routine audit work is designed to enable us to form the above audit opinions on the annual financial statements of the College and should not be relied upon to disclose errors or irregularities which are not material in relation to those financial statements. All issues raised in the report have been discussed with management and we have included responses where appropriate in the action plan. In order to provide an indication of the level of importance of the recommendations made, we have prioritised our recommendations on the basis shown in the action plan.

## Independence

ISA (UK and Ireland) 260:*Communication with those charged with governance'* requires us to communicate at least once a year regarding all relationships between KPMG and the College that may be reasonably thought to have bearing on our independence.

KPMG conforms to the highest governance standards at all times and we will ensure that any additional services are approved by the audit committee ensure transparency . No additional services have been provided in respect of the year ended 31 July 2012.

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# Accounting policies; accounting matters

**The financial reporting framework, as required by the Scottish Funding Council's Accounts Direction, remains the Statement of Recommended Practice: *Accounting for Further and Higher Education* (2007).**

**The accounting policy in respect of fixed assets was enhanced to note that individual assets falling below the £10,000 *de minimus* level will be capitalised when forming part of a project or spend on a group of assets where total expenditure exceeds the threshold.**

**An audit adjustment was required in respect of deferred income.**

| | |
|---|---|
| **Accounting policies** | The accounting policy relating to fixed assets was updated during 2011-12 in respect of the capitalisation threshold. In previous years, individual items costing more than £10,000 have been capitalised. The policy was enhanced such that assets costing less than £10,000 individually will be capitalised where similar assets have also been purchased, for example, as part of a larger project, and the total expenditure exceeds £10,000.<br><br>All other accounting policies remain unchanged.<br><br>In our view, the accounting policies for the College remain appropriate. |
| **Financial reporting framework** | The College prepares financial statements in accordance with the Accounts Direction issued by the Scottish Funding Council. In turn, this requires application of the Statement of Recommended Practice: *Accounting for Further and Higher Education* (2007). |
| **Deferred income** | Deferred income as at 31 July 2012 is £1.80 million (2010-11: £1.59 million).<br><br>Included within deferred income is significant capital funding of £850,000, together with grants, received in earlier years which have yet to be fully utilised, including: £157,000 for financial security; £36,000 for knowledge transfer and £25,000 for the ecohome. Grants from South Lanarkshire Council have also been deferred, including: £75,000 from the '*renewable energy pilot*' grant, £66,000 from the '*rebuilding*' grant and £49,000 from the '*future jobs*' grant. Deferred tuition fees comprise the remaining balance, £189,000 for students who began courses in 2011-12 that will be completed in 2012-13 and a further £336,000 where international students paid fees in 2011-12 for courses beginning in 2012-13.<br><br>The College's deferred income balance is significant and, while the largest components can be objectively considered, the smaller deferred amounts in respect of one-off Funding Council and local authority grants, by their nature, are subject to a greater degree of management judgement to determine when the income is recognised.<br><br>We reviewed the controls and processes in respect of significant sources of grant income, including inspecting original award documentation, review of the expenditure incurred and reported to the awarding bodies and we discussed the recognition of income with management. As a result of the above procedures, two balances were identified in which income had been deferred in the draft financial statements although the related project expenditure had been incurred. An audit adjustment was processed by management which decreased deferred income and increased income by £47,000 (appendix two).<br><br>There is a process in for recording income and expenditure against each grant, including the use of specific ledger codes to ensure expenditure is recorded against relevant grant income. In one instance, we identified that expenditure was not recorded against grant income in line with the above process, where we would have expected it to be, such as in respect of the '*renewable energy pilot'.* |

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# Accounting policies; accounting matters (continued)

**An adjustment was required in respect of the College's pension liabilities. This resulted in a reduction in the net liabilities as at 31 July 2012 of £435,000.**

**Retirement benefits**

The College accounts for its participation in the Local Government Pension Scheme in accordance with the recognised provisions of FRS 17 and has therefore again recognised the actuarial valuation of the pension liabilities in respect of its share of the Strathclyde Pension Fund. No such requirement exists for Scottish Teachers' Superannuation Scheme obligations as this is a multi-employer scheme where the individual assets and liabilities cannot be separately identified for each employer and therefore accounted for as a defined contribution scheme under the provisions of FRS 17.

A summary of the key balance sheet and income and expenditure entries is set out below:

| Balance sheet (£'000) | 2012 | Movement in deficit (£'000) | 2012 |
|---|---|---|---|
| Assets | 5,920 | Employer contributions | 249 |
| Liabilities | (6,821) | Income & expenditure account charge | (259) |
| Net (liabilities) | (901) | Contributions in respect of unfunded benefits | 1 |
| | | Past service (costs)/gains | 0 |
| | | Net interest return on pension asset | 37 |
| | | Actuarial loss | (434) |

The total pension cost for the year, including Scottish Teachers' Superannuation Scheme contributions and the net interest cost, was £791,000, compared to £859,000 in 2010-11. The net FRS 17 pension liability has increased by £406,000 at 31 July 2012 compared to 2011. The movement in the pension deficit over 2011-12 is largely due to an increase in the present value of the scheme's funded liabilities.

During the course of the audit we have reviewed the actuarial assumptions. Overall, the assumptions adopted by the College in the draft financial statements, were outwith our acceptable range. In particular, the net discount rate (comprising the difference between the discount rate and consumer price index) was lower than we would expect. Following consideration by the Board of Management, via the Finance and Audit committees, the College adopted a revised net discount rate which resulted in a reduction in the pension liabilities, compared to that initially calculated and included in the draft financial statements, of £435,000 (6%).

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# Accounting policies; accounting matters (continued)

**The College has indicated that it supports the regionalisation reforms and is committed to forming a federation of colleges in Lanarkshire, aimed at achieving economies of scale.**

| | |
|---|---|
| **Sector, organisational and structural changes** | Building on its pre-legislative paper, 'putting learners at the centre', the Scottish Government initiated a joint consultation process together with the Scottish Funding Council in November 2011 which outlined a vision for regional groupings of colleges, focussed on achieving set outcomes.<br>The College has indicated that it supports the regionalisation reforms and is committed to forming a federation of colleges comprising the College, together with Coatbridge, Cumbernauld and Motherwell Colleges. This will involve all four colleges working together to achieve the savings required by the Scottish Government, but have a limited effect, initially, on the staffing structure and operations of the individual colleges compared with a merger model as followed in some other regions.<br>It is intended that there will be a central board for the federation, whilst each individual college will retain its own board of management and management team. Economies of scale are expected to be achieved, which will allow all four colleges to make savings.<br>The federation board will require fundable status, and will take the place of a regional board (as in a merger model) receiving funding to be redistributed to all four colleges. |
| **Compliance with tax authorities** | Consistent with our understanding of the College that there are no significant non-business activities undertaken by the College.<br>We liaised with our tax compliance colleagues and have not identified any significant matters relevant to the audit which have not been appropriately reflected. |
| **Opening balances** | International Standard on Auditing (UK and Ireland) 510: *Initial audit engagements – opening balances* ("ISA 510") requires us as auditors to obtain sufficient appropriate audit evidence about whether:<br>■ opening balances contain misstatements that materially affect the current period's financial statements; and<br>■ appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes are appropriately accounted for, presented and disclosed in accordance with the applicable financial reporting framework.<br>We have undertaken a number of specific procedures to allow us to confirm a selection of opening balances per ISA 510. |

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# Financial statements preparation and audit process

**Draft financial statements were provided on the agreed start date for on-site fieldwork. A comprehensive auditor's file was provided in support of the draft financial statements.**

**The College has a relatively small finance team and is heavily reliant on the knowledge and experience of the head of finance. Consideration should be given to business continuity and succession planning.**

| Area | Comments |
|---|---|
| Financial statements preparation process | ■ Draft financial statements and supporting documentation were provided on 1 October 2012, in line with the agreed timetable.<br>■ Finance staff responded to our questions quickly and provided high quality information to support the financial statements. However, there were some items that we had requested prior to, or on commencement of the audit, which took some time to be prepared. Audit efficiency could be enhanced in the future if such information was available on commencement of the audit and we will work with management to tailor the information request we issue in advance of audit fieldwork to contribute to future efficiency.<br>■ The College has a relatively small finance team and is heavily reliant on the knowledge and experience of the head of finance, particularly in respect of the preparation of the financial statements and day to day transactions. There is a risk that loss of a key member of staff could impact on the College's operations and consideration should be given to business continuity and succession planning. Based on our experience, the College's finance team is relatively small and delegation of tasks and responsibilities to more junior members of the team is limited as a result.<br>***Recommendation one***<br>■ Overall, management adopts an efficient approach to preparing the financial statements. |
| Corporate governance statement and operating and financial review | The corporate governance statement was provided on 30 October 2012 with the operating and financial review ("OFR") provided 2 October 2012. No issues or changes were required to be made to the corporate governance statement. A revised OFR was provided which incorporated additional information of the proposal to form a federation of colleges. We reviewed the report in line with the requirements of the SORP and the requirements of the Accounts Direction. |
| **Audit differences** | |
| Under the requirements of ISA (UK and Ireland) 260: *Communication with those charged with governance*, we are required to report any adjusted audit differences arising from our work. During the course of our audit we identified two audit differences summarised in appendix two. The net impact of these adjustments were to increase Scottish Funding Council grant income by £47,000 and to reduce deferred income by £47,000. | |

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# Financial position

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

## Income and expenditure account

| Income and expenditure account | | |
|---|---|---|
| **£000** | **2012** | **2011** |
| **Income** | | |
| Funding Council grants | 8,118 | 9,025 |
| Tuition fees and education grants | 2,500 | 1,868 |
| Other grant income | 111 | 645 |
| Other operating income | 156 | 151 |
| Interest receivable | 69 | 48 |
| Pension scheme net expected return on assets | 37 | 12 |
| **Total income** | **10,991** | **11,749** |
| **Expenditure** | | |
| Staff costs | 7,402 | 8,336 |
| Other operating expenses | 2,586 | 2,537 |
| Depreciation | 831 | 848 |
| **Total expenditure** | **10,819** | **11,721** |
| **Surplus for the year** | **172** | **28** |

*Source: financial statements*

## Result for the year

The College made an overall surplus of £172,000 (2010-11: £28,000), equating to 1.56% of total income (2010-11: 0.24%).

Total income decreased by £0.76 million.

- This decrease was predominantly due to a reduction in Scottish Funding Council grants which have decreased by £0.91 million compared with the prior year. This is in line with the reduced settlements for colleges from the Scottish Government budget settlement.
- Other grant income has also decreased by £0.53 million due to reductions in grants from the European Union. A number of these grants are no longer being awarded to individual colleges.
- The College has compensated for the reduction in grant income by increasing tuition fee income by £0.63 million, primarily achieved as a result of increased income from international students. The College was awarded ‘highly trusted sponsor’ status by the UK Borders Agency in June 2012 which removes the limit on overseas student recruitment.
- The College has increased the percentage of its income received from non Funding Council sources from 23% in 2010-11 to 26% in 2011-12.

Expenditure has decreased by £0.90 million when compared to 2010-11:

- Staff costs have decreased by £0.93 million as a result of annual savings arising from the voluntary severance exercises carried out in 2010-11.
- Other operating expenses have increased marginally by £49,000.

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# Financial position (continued)

### Adjusted result for the year

A number of significant items have had an impact on the surplus for both 2011-12 and 2010-11; these are analysed in the table below, which shows the adjusted operating surplus after removing them.

| £'000 | 2012 | 2011 |
|---|---|---|
| **Surplus for the year** | 172 | 28 |
| Restructuring costs | 25 | 456 |
| FRS 17 pension costs | (28) | (7) |
| **Operating surplus for the year** | **169** | **477** |
| **Adjusted operating surplus as a % of total income** | **1.7%** | **4.1%** |

The College has generated a strong adjusted surplus as illustrated above. The adjusted position for 2011-12 is behind the 2010-11 position, however total income was lower in 2011-12.

The revised budget set in May 2011 forecast a surplus of £19,000. Therefore, the College is ahead of its original budget. This is primarily due to income being ahead of budget for the year.

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# Financial position (continued)

### Balance sheet

| Balance sheet as at 31 July | | |
|---|---|---|
| **£000** | **2012** | **2011** |
| **Fixed assets** | | |
| Tangible assets | 28,920 | 29,617 |
| **Current assets** | | |
| Stocks | 8 | 8 |
| Debtors: Amounts falling due within 1 year | 731 | 894 |
| Cash at Bank and in hand | 437 | 1,440 |
| Funds on bank deposit | 2,000 | 1,000 |
| Creditors: Amounts falling due within 1 year | (2,669) | (2,859) |
| **Net current assets** | **507** | **483** |
| **Total assets less current liabilities** | **29,427** | **30,100** |
| Creditors: Amounts falling due after more than 1 year | (1,435) | (1,656) |
| Provisions for Liabilities | (644) | (605) |
| Net pensions liability | (901) | (495) |
| **Net assets including pension liability** | **26,447** | **27,344** |
| Deferred capital grants | 25,766 | 26,401 |
| **Reserves** | | |
| Income and expenditure reserve (including pension reserve) | 681 | 943 |
| **Total funds** | **26,447** | **27,344** |

*Source: financial statements*

The balance sheet shows a fall in net assets of £0.90 million, including £0.41 million reduction in the balance on the income and expenditure account as a result of movements on the net pension liability. Net current assets have remained consistent with the prior year.

The key changes in the balance sheet were as follows:

- Fixed assets have decreased by £0.70 million in line with the depreciation charge for the year, offset by additions of £134,000 in 2011-12.
- Cash at bank and in hand has decreased by £1 million, but there has been a corresponding increase in funds on deposit, indicating that the total cash balance is consistent with the prior year. More funds are held on deposit to generate higher investment returns.
- Creditors falling due after one year have decreased by £0.22 million, reflecting the annual repayment of the Lennartz creditor due to HM Revenue and Customs.
- The main change in the balance sheet relates to the pension liability, which has increased by £0.41 million. This is subject to adjustment following confirmation of the underlying actuarial assumptions.

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# Financial position (continued)

## Budget 2012-13

The financial statements have been drawn up on the basis that the College is a going concern and will continue as such for the foreseeable future.

The following table summarises the forecast income and expenditure for the College for 2012-13:

| | Forecast (at June 2012) |
|---|---|
| **£000** | **2012-13 (excluding FRS17 adjustments)** |
| Income | 10,290 |
| Expenditure | (10,270) |
| **Historic cost surplus for the year** | **20** |

The forecast surplus for 2012-13 is currently £20,000. As at May 2011, the forecast for 2011-12 was a surplus of £19,000. While the College is forecasting a similar budgeted surplus in respect of the year ending 31 July 2013, there remains uncertainty over future Funding Council grant allocations, which, despite improvement in the percentage of income from non Funding Council sources, form the most significant element of the College's income.

The budget is set conservatively, so only income that is largely certain is included. Therefore, the actual position for 2011-12 was ahead of budget.

Core funding has increased alongside activity levels for 2012-13. This will result in additional expenditure to match the increased activity levels.

The College will continue to focus on achieving efficiency and enhancing the surplus through income from overseas students who attend existing courses (i.e. where there is limited incremental increase in cost associated with the additional teaching provision).

While core Funding Council grant income is expected to reduce, additional funds are available to the College through Skills Development Scotland activity. The College has been relatively successful in two bids for funding in this area, one of which is in collaboration with Motherwell College.

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# Performance against targets

### Performance indicators

In accordance with Scottish Funding Council requirements, the College is required to publish and report progress for national priorities. These indicators monitor the implementation of the College's financial objectives.

| KPI | Purpose | Actual 2010-11 | Actual 2011-12 |
|---|---|---|---|
| WSUMs | Number of WSUMS per year | 42,891 | 39,476 |
| Prompt payment to suppliers | Measures the average time taken to pay supplier invoices | 38 days | 20 days |
| Non SFC income a % of income | Measures non SFC income as a % of total income | 23.24% | 26.14% |
| Gearing | Measures the reliance on debt finance | 6.86% | 6.37% |
| Current assets : current liabilities | Measures the College's ability to pay its current liabilities | 1.17:1 | 1.19:1 |

### Student numbers / Weight Student Units of Measurement ("wSUMs")

The activity target set by the Scottish Funding Council for 2011-12 was 39,399 wSUMs. The combined target includes 1,826 wSUMs for the ongoing SFC administered European Structural Fund (ESF) project. This target was achieved. The College delivered 39,476 wSUMs in 2011-12.

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# Corporate governance framework and supporting arrangements

**Over-arching and supporting corporate governance arrangements were subject to significant change and continue to provide a sound framework for organisational decision-making.**

| | |
|---|---|
| **Corporate governance and internal control arrangements**<br><br>**Standards of conduct and prevention and detection of corruption** | The College has made a compliant corporate governance statement. We are required to review this to assess whether the description of the process adopted by the College in reviewing the effectiveness of the system of internal control is consistent with our understanding of the process and report any inconsistencies in our opinion. We are not required to provide an opinion on the College's system of internal control.<br><br>We have reviewed the corporate governance statement and consider it consistent with our understanding of the process followed by the College during the year.<br><br>The College has established appropriate processes for the prevention and detection of corruption. |
| **Governance statement** | The governance statement provides detail on the governance framework, the system of internal control, internal audit, internal financial controls and risk management arrangements, and analyses the effectiveness of these elements of the framework. It describes a number of sources of assurance for the accountable officer.<br><br>We have reviewed the governance statement and have confirmed that it is in line with new guidance and reflects our understanding of the College. |
| **Internal audit** | As set out in our audit plan and strategy, we reviewed the work of internal audit in 2011-12. The content of the internal audit plan is, in our view, appropriate for the size and nature of the College.<br><br>Internal audit completed their planned audit work for the year and concluded that "*In our opinion South Lanarkshire College did have adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives at the time of our audit work".*<br><br>Due to the areas of focus of internal audit in the year, we did not place specific reliance on any the reports issued in the year, but they assisted our understanding of the College's operations and overall systems of internal control. |
| **Prevention and detection of fraud** | ■ Procedures and controls related to fraud are designed and implemented effectively. Expenditure is reviewed and authorised by appropriate finance personnel and senior management.<br><br>■ In 2011-12 no significant or other fraud or irregularity was identified by management, internal audit, or through the course of our external audit work.<br><br>■ Policies and procedures have been updated in response to the Bribery Act 2010. |

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# Observations arising from our audit

| # | Risk | Issue, impact and recommendation | Management response/ responsible officer/due date |
|---|---|---|---|
| 1 | Medium | The College has a relatively small finance team and is heavily reliant on the knowledge and experience of the head of finance, particularly in respect of the preparation of the financial statements and day to day transactions. There is a risk that loss of a key member of staff could impact on the College's operations or that the ability to maintain segregation of duties is limited. For example, journals prepared by the head of finance are not subject to review.<br><br>We recommend that consideration should be given to business continuity and succession planning, together with enhancing segregation of duties, where possible. For example, delegating additional activities to other members of the finance team, increasing the finance team's participation in the financial statements preparation process and ensuring key processes and procedures are documented.<br><br>We understand that the nature of the College's finance team limits the ability for the head of finance's journals to be reviewed, but recommend that the audit committee consider the associated risks and potential mitigating controls, such as periodic review by internal audit or other finance staff. | College Management will review the Finance function in the light of the observation, taking into account the points made therein and the size of the organisation. The report will be presented to the Finance Committee of the Board of Management.<br><br>**Responsible officer:** Principal<br><br>**Due date:** March 2013 |

*Key:*

- Low risk – matters that merit attention and would improve overall control.
- Medium risk – matters that are considered significant, that should be addressed within three to six months; and
- High risk – matters that are considered fundamental, against which management should take action as soon as possible;

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# Best Value

**We have considered arrangements to achieve Best Value and regularity of income and expenditure.**

| Audit area | Overview | Findings |
|---|---|---|
| **Best Value** | In April 2002 the Scottish Ministers introduced a non-statutory duty on accountable officers to ensure arrangements exist to secure Best Value. Audit Scotland has been committed to extending the Best Value audit regime across the whole public sector for some time now. Using the Scottish Executive's nine Best Value principles as a basis for audit activity, Audit Scotland previously selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). A series of toolkits covering financial, performance and governance processes are available for public sector organisations and auditor to use, but auditors were not required to complete specific toolkit(s) in 2011-12. | We reviewed some of the processes management has established to ensure Best Value is achieved throughout the organisation. This included a review and authorisation of all expenditure senior management.<br><br>Zero-based budgets are being used for general expenditure, whereby departments are not given a budget for other expenditure. This helps to achieve Best Value, as it encourages staff to only make necessary purchases, rather than spend to utilise their full budget.<br><br>There is no overarching formal Best Value plan and management should consider implementing Best Value principles, particularly as part of the formation of the federation of colleges. |
| **Regularity** | As part of our audit of the College's financial statements, we are required by the Public Finance and Accountability (Scotland) Act 2000 to give an opinion on the regularity of expenditure and receipts shown in the financial statements. | The senior management team considers all incoming correspondence relevant to its strategic management role from the Scottish Funding Council and other regulatory or advisory bodies, such as Audit Scotland. |
| | | |

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# Appendices

# Audit Scotland code of audit practice – responsibilities of the Board of Management

### Financial statements

Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources. Audited bodies are responsible for:

- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice);
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report; and
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.

### Systems of internal control

Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls. They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.

### Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions;
- developing and implementing strategies to prevent and detect fraud and other irregularity;
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity; and
- participating, when required, in data matching exercises carried out by Audit Scotland.

### Standards of conduct and arrangements for the prevention and detection of bribery and corruption

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers;
- promoting appropriate values and standards; and
- developing, promoting and monitoring compliance with standing orders and financial instructions.

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# Summary of audit differences

**There were two audit differences identified. These had the net affect of increasing income by £47,000 and to reduce deferred income by the same amount, and to reduce pension liabilities by £435,000, compared with the draft financial statements.**

We are required by ISA (UK and Ireland) 260: *Communication with charged with governance* to communicate all uncorrected misstatements, other than those that we believe are clearly trivial, to the audit committee. We are also required to report all material misstatements that management has corrected but that we believe should be communicated to the audit committee to assist it in fulfilling its governance responsibilities.

This appendix sets out the audit differences that we identified during the course of our audit for the year ended 31 July 2012.

## Misstatements that management have corrected

The following table shows differences identified during the course of the audit of the College's financial statements for which the statements have been adjusted.

| College | | | | |
|---|---|---|---|---|
| **£000** | **Income and expenditure account** | | **Balance sheet** | |
| **Issue** | **Dr** | **Cr** | **Dr** | **Cr** |
| Funding Council grant income | - | (47) | - | - |
| Deferred income | - | - | 47 | - |
| Adjustment to pension liabilities (change in assumptions) | - | - | 435 | - |
| **Overall impact** | **(47)** | **(47)** | **482** | **-** |

## Misstatements that management have not corrected

There are no unadjusted audit misstatements.

## Presentational issues

In addition to the above, we identified a small number of presentational issues during our audit, including the disclosure of operating leases, and these have all been amended by management.

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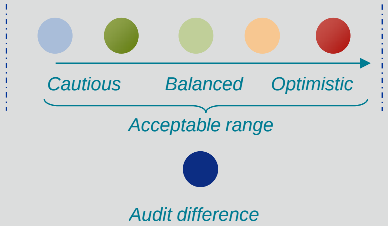
# Pensions considerations

Presented below is a comparison of the assumptions used by Hymans Robertson who advise the College in respect of the Strathclyde Pension Fund, alongside the typical assumptions we would anticipate in relation to each aspect:

| Assumptions | Employer | KPMG central | Assessment | KPMG comments |
|---|---|---|---|---|
| **Overall** | | | | The overall assumptions proposed are stronger than our central assumptions but in line with our generally accepted range. |
| **Discount rate** | 4.40% | 4.40% | | The proposed discount rate is in line with our central assumption. However, the assumption is not viewed in isolation but considered as part of the net discount rate. |
| **RPI inflation** | 3.00% | 2.90% | | The assumption is slightly stronger (higher liability) than our central rate but is within a range we would normally consider acceptable. |
| **CPI inflation / Pension increases** | 2.20%<br>RPI less 0.8% | 1.90%<br>RPI less 1.0% | | The assumptions is stronger (higher liability) than our central rate and is outside the range we would normally consider reasonable. However, the assumption is not viewed in isolation but considered as part of the net discount rate. |
| **Net discount rate (Discount rate – CPI)** | **2.20%** | **2.50%** | | The range we would normally consider reasonable for the purposes of FRS17 as at 31 July 2012 is 2.5% +/-0.3%, for a scheme with liabilities with a duration of 20 years. The net discount rate is therefore within that range. |
| **Salary growth** | 4.50%<br>1.5% above RPI | 1-2% above RPI inflation | | The assumptions is in line with the requirements of FRS17. |
| **Life expectancy**<br>Current male pensioner (age 65)<br>Future male pensioner (age 45) | 21.0 years<br>23.4 years | 22.1 years<br>23.4 years | | The mortality assumptions proposed are those used for the most recent signed off formal actuarial valuation, which is a reasonable approach. |
| **Expected return on equities** | Estimated ERP 5.5% | ERP 2-4.5% | | The proposed assumption gives a return (or 'equity risk premium' / 'ERP') of 2.7% above long term gilts, and is considered reasonable for the purposes of FRS17. |

**Level of prudence compared to KPMG central assumptions**

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# Sector update

**This section contains a brief update on topics which the College should be aware of.**

| Area | Issues |
|---|---|
| **International Financial Reporting Standards (IFRS)** | Draft Financial Reporting Standards (FRS) 100, 101 and 102 set out the future standards for UK GAAP. These standards are based upon International Financial Reporting Standards and anticipated to be effective for years commencing on or after 1 January 2015. For the further education sector this will require financial statements to be produced in line with the new standards for the year ending 31 July 2016 with restatement required to the comparative period.<br><br>KPMG are acting as consultants to BUFDG FRG in developing the new FE HE SORP in relation to these standards. Draft FRS102 contains many similarities to UK GAAP. The key areas being considered by the SORP working group include:<br><br>■ the treatment and disclosures for restricted income, donations and endowments;<br>■ the accounting for service concession arrangements and application to typical accommodation schemes, an area that is also being considered by the Financial Reporting Council in revisions to FRS 102;<br>■ financial statement proformas; and<br>■ revenue recognition.<br><br>During the development of the SORP there are a number of opportunities for further education colleges to be engaged in the process including commenting on the development of the SORP as topics are finalised, being part of the wider further education working group and attending seminars being arranged by BUFDG and KPMG to provide updates and training on the impact of the new standards and the SORP. |
| | Please contact us for further information. |

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# Sector update (continued)

**While these reforms apply to England, the College should be aware of the developments and trends which are likely to affect local government pension schemes.**

## Pensions Wider Considerations

### *Local Government Pension Scheme Reform*

Earlier in 2012 the proposals for changes to the LGPS were issued as a joint statement from the Local Government Association, GMB, Unison and Unite. The trade unions are consulting with their membership and the LGA is consulting with employers. The formal consaltation is expected to commence in the Autumn.

The main proposals for a new look scheme, “LGPS 2014”, are as follows:

- career average related earnings (CARE) scheme, with revaluation based on CPI;
- 1/49th accrual rate;
- each member’s Normal Pension Age will be equal to their State Pension Age;
- no change to average member contributions: the lowest paid to pay the same or less and the highest paid to pay more on a more progressive scale after tax relief;
- introduction of a 50/50 option - under some circumstances members can elect to pay half the contributions for half the pension;
- full protection of benefits for service prior to 1 April 2014 and full protection of all benefits for LGPS members who are over age 57 at 1 April 2014; and
- scheme members can stay in the scheme on first and subsequent transfers (if and when outsourced).

These proposals have now been approved by the membership of Unison and Unite.

### *Other Public Sector Pensions Reform*

Changes are being planned or made to all public sector pension schemes along the principles outlined in Lord Hutton’s report published in 2011 .

The principal ones in relation to the design of public sector pension benefits were:

- the scheme should move from a pension based on final salary to one based on the average salary of a member (after allowing for inflation);
- normal Pension Age should be linked to increasing life expectancy, through link to increasing State Pension Age;
- benefits already earned, including the link to final salary, should be unaffected;
- the benefits provided by public sector schemes should be the same across all income groups. However, to reflect higher life expectancy in higher income groups there should be higher member contributions for higher earners; and
- members should be given more choice at what age to take their benefits – pensions would be adjusted accordingly and flexible retirement should be encouraged.

With the increasing cost of final salary pension provision and the current pressures on government resources it is hard to see the status quo being maintained. A combination of lower benefits together with increased member contributions would seem to be the most likely outcome. This may be graduated across pay levels with the highest impact falling on the higher paid.

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# Sector update (continued)

| Area | Issues |
|---|---|
| **Pensions** | **Pensions auto-enrolment**<br>Organisations with around 4,000 to 6,000 employees will be required to be fully compliant by 1 May 2013. This means that most establishments will have to be compliant before the end of the 31 July 2013 year-end.<br><br>You may have seen recent media advertisements from the DWP which will be increasing general awareness of the new auto-enrolment requirements amongst your workforce. All of your workforce will need to be communicated to at your staging date.<br><br>Implementing automatic-enrolment strategy will involve balancing a complex range of financial, payroll, communications, IT and pensions considerations. There are a number of strategic decisions for you, as employer, to make which are likely to require input from the Board.<br><br>***As with Real Time Information, it is essential that a process is put in place to ensure that the necessary workforce profiling, systems changes, employee communication strategies and planning for ongoing monitoring are undertaken in good time for the relevant go live date.*** |
| **Employment taxes and pensions compliance** | **Real Time Information (RTI)**<br>As you will be aware HMRC have proposed that all employers with more than 50 employees will implement RTI from 6 April 2013.<br><br>RTI is a fundamental change in how PAYE and NIC operates and will provide information required to operate the new universal credit system. The level of increased information required is extensive and may not all be held centrally.<br><br>***It is essential that a process is put in place to ensure that the necessary data integration and cleansing is undertaken in good time in order to be ready for this radical change in reporting.*** |

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# Sector update (continued)

| Area | Issues |
|---|---|
| Corporation tax, VAT & PAYE updates | **Rate of corporation tax**<br>The standard rate of corporation tax decreased from 26% to 24% with effect from 1 April 2012, so that the effective rate of corporation tax for the year to 31 July 2012 is 25.33%. There will be subsequent annual reductions in the standard rate of 1 per cent per annum to 22% by 1 April 2014, but as these reductions are not yet substantively enacted, any deferred tax provision will need to use the current 24% rate.<br><br>The small profits rate remains at 20%. |
| | **Overseas agents**<br>HMRC are now of the opinion that overseas agents act as intermediaries and payments for their supplies to a further education college should now be subject to a VAT reverse charge which will significantly increase the cost of those supplies.<br><br>There are challenges that are being made, and alternative structures that are being implemented to reduce this additional cost. |
| | **Cost sharing exemption**<br>The VAT Cost Sharing Exemption is a provision in European law that allows businesses and organisations making VAT exempt and/or non-business supplies to form groups to achieve cost savings and economies of scale. Once formed the groups are relieved of a VAT charge on their supplies if all the conditions of the exemption are met.<br><br>The Government has issued more detailed guidance is expected to be released imminently. A key interpretation by HMRC is that any entity that has an overall VAT recovery rate of less than 15% would be eligible to join a Cost Sharing group.<br><br>Consideration is being given as to how this exemption can best be used to meet further education colleges' strategic needs. |

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# Sector update (continued)

| Area | Issues |
|---|---|
| Corporation tax, VAT & PAYE updates (cont.) | **Employment status**<br>HMRC have been maintaining a watching brief on employment status at education institutions for a number of years, gathering information through regular s.16 enquiries. Whilst the removal of the burdensome Categorisation of Earners (CoE) rule from April 2012 is welcome, we expect that HMRC will further focus their efforts on reviewing educational establishments' overall status compliance, not just the lecturers and academics previously subjected to (CoE). The recently announced Whitehall review of self employment status within the Public Sector is also likely to institute a new rush of Freedom of Information requests.<br><br>It is therefore important that colleges initially review the current arrangements in place to confirm that they are comfortable that they have no exposure. Colleges should also ensure that clear and robust procedures are implemented to ensure all future engagements are rigorously tested to avoid any potential exposure. |
| | **Terminations**<br>HMRC are aware that the education sector remains in a period of restructuring and downsizing. As a result HMRC continue to focus on the untaxed elements of termination payments including redundancy, severance, PILONS, restrictive covenants etc. Those enquiries often unearth other issues, such as the re-engagement of former employees as self employed workers and these are of particular interest to HMRC. It is essential that College HR, Finance and payroll teams work together when dealing with the impact of termination payments, consider both Employment Tax and Employment Law implications and take professional advice where there is any uncertainty. |

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