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Ayr College

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

Year ended 31 July 2012

19 February 2012

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 Ayr 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 Ayr 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 Managment of Ayr College from its responsibility to address the issues raised and to maintain an adequate system of control.

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*.

We wish to record our appreciation of the co-operation and assistance extended to us by College staff during the course of our work.

Issue	Summary	Page
Audit status	Our audit is now complete and have issued unqualified audit opinions for the year ended 31 July 2012, following the approval of the financial statements by the Board of Management.	6
Financial position	The surplus for the year was £224,000, representing 1.6% of total income (2010-11 £46,000 deficit). The increase is mainly due to a decrease in staff costs as a result of annual cost savings made through the voluntary severance scheme. These reductions in expenditure are a response to a reduction in Scottish Funding Council grant income.	7
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. Two audit adjustments were identified as a result of our audit in respect of the pension liabilities and grant income received for specific purposes. 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 of1.9% compared to our central assumption of 2.5%. Management proposed revised assumptions which reduced the pension liability and associated reserve by £750,000 / 6.8%.	6, 16
Performance improvement observations	We have identified two performance improvement observations which we are required to bring to your attention. 'Low' rated observations and recommendations have been raised in regard tuition fee reconciliations, treasury management policy and risk management policy.	12

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 Ayr 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 . We are satisfied that appropriate safeguards have been established in relation to these services such that our audit independence is not impaired.

We are not aware of any relationships which represent matters that have occurred during the financial year on which we are to report.

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).

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).
Accounting policies	There have been no changes to accounting policies in 2011-12. In our view, the accounting policies for the College remain appropriate.
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. The College has indicated that it supports the regionalisation reforms and is committed to forming an Ayrshire region through a merger with Kilmarnock College and the North Ayrshire campuses of James Watt College. We have reviewed the College's planned approach to the proposed merger and it is important that the College focuses on the continued effectiveness of internal controls, governance arrangements and ultimately the financial statements in the context of the proposed merger. In order to monitor this, the College has employed a project manager to oversee the merger process.
Compliance with tax authorities	Consistent with our understanding of the College there are no significant non-business activities undertaken by the College. 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: ■ opening balances contain misstatements that materially affect the current period's financial statements; and ■ 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. We have undertaken a number of specific procedures to allow us to confirm a selection of opening balances per ISA 510.

Accounting policies; accounting matters (continued)

An adjustment was processed in respect of the College's pension liabilities. This resulted in a reduction in the net liabilities as at 31 July 2012 of £750,000 / 6.8%.

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	8,811	Employer contributions	463
Liabilities	(10,309)	Income & expenditure account charge	(463)
Net (liabilities)	(1,498)	Contributions in respect of unfunded benefits	3
		Past service (costs)/gains	-
		Net return on pension asset	55
		Actuarial loss	(468)

The total pension cost for the year, including Scottish Teachers' Superannuation Scheme contributions and the net interest cost, was £1.1 million, compared to £1.25 million in 2010-11. The net FRS 17 pension liability has increased by £793,000

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 schemes' funded liabilities.

During the course of the audit we have reviewed the actuarial assumptions used. Overall, the assumptions adopted by the College in the draft financial statements, were outwith an 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, resulting in a higher pension liability. Following discussions, management proposed revised assumptions which resulted in a reduction in the gross pension liabilities of approximately 6.8%. Our detailed comments in this respect are set out in appendix three.

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.

Area	Comments
Financial statements preparation process	■ Draft financial statements and supporting documentation were provided on 19 October 2012, in line with the agreed timetable. ■ Finance staff responded to our questions quickly and provided high quality information to support the financial statements. Audit efficiency could be improved through provision of a complete set of electronic working papers, where available, on commencement of the audit. ■ Overall, management adopts an efficient approach to preparing the financial statements.
Corporate governance statement and Board of Management's report	The corporate governance statement was provided on 6 November 2012 with the operating and financial review ("OFR"). A number of amendments were required to the statement of corporate governance and internal control to ensure it was in line with relevant guidance.
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. There was no net impact on the College's result arising from either adjustment. There are no unadjusted audit differences.	

Financial position

The College achieved a surplus of £224,000 for the year. Reductions in funding over prior years required close control of in-year costs.

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

£000	2012	2011
Income		
Funding Council grants	11,220	12,069
Tuition fees and education grants	1,898	2,103
Research grants and contracts	259	688
Other income	832	1,118
Interest receivable	121	79
Total income	**14,330**	**16,057**
Expenditure		
Staff costs	10,041	11,753
Other operating expenses	2,858	3,207
Depreciation	1,205	1,143
Interest payable	2	-
Total expenditure	**14,106**	**16,103**
Surplus/(deficit) for the year	**224**	**(46)**

Source: Draft financial statements

Adjusted result for the year

	2012 £000	2011 £000
Surplus / (deficit) for the year	224	(46)
Restructuring costs	-	701
FRS 17 pension costs	(58)	(10)
Operating surplus for the year	**166**	**645**
Adjusted operating surplus as a % of total income	**1.16%**	**4.02%**

Result for the year

The overall surplus for the year was £224,000 (1.6% of total income), higher than in 2010-11 (deficit £46,000).

Total income decreased by £1.8 million (11.1%). This decrease was predominantly due to a reduction in Scottish Funding Council grants which have decreased by £910,000 (7.5%), compared with the prior year. The decrease is largely due to the target wSUMs being 3,136 lower than prior year following reductions in Government funding.

Expenditure has decreased by £2 million (12.8%) when compared to 2010-11:

- Staff costs have decreased by £1.7 million as a result of annual savings arising as a result of the voluntary severance exercise carried out in 2010-11.
- Other operating expenses decreased by £411,000 mainly due to a decrease in premises costs of £261,000 as a result of additional maintenance costs in 2010-11.

The overall result is for the year is a surplus of £224,000.

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 on the left, which shows the adjusted operating surplus after removing them.

In line with other institutions, the College does not budget for FRS 17 charges as it is not possible to predict these in advance.

Financial position (continued)

Balance sheet as at 31 July		
£000	**2012**	**2011**
Fixed assets		
Tangible assets	17,524	16,824
Current assets		
Stocks	5	5
Debtors: amounts falling due within 1 year	485	864
Cash at bank and in hand	1,982	2,757
Creditors: amounts falling due within 1 year	(1,718)	(2,852)
Net current assets	**754**	**774**
Total assets less current liabilities	**18,278**	**17,598**
Provision for liabilities and charges	(951)	(857)
Net pensions liability	(1,498)	(705)
Net assets including pension liability	**15,829**	**16,036**
Deferred capital grants	7,890	7,470
Reserves		
Revaluation reserve	4,791	4,896
Capital reserve	-	180
Income and expenditure reserve (including pension reserve)	3,148	3,490
Total funds	**15,829**	**16,036**

Source: Draft financial statements 2011-12

The balance sheet shows an increase in net assets of £680,000. Net current assets have remained consistent with prior year:

- Fixed assets have increased by £700,000. This was due to additions of £1.9 million, mainly relating to the new aeronautical building which opened in December 2011, offset by the depreciation charge for the year of £1.2 million.
- Debtors due within one year decreased by £380,000. This is mainly due to a decrease in the European funding debtor as a number of the European projects concluded in 2011-12.
- Cash and short term investments have decreased by £775,000 primarily due to capital expenditure. All balances have been agreed to bank statements and third party confirmation and demonstrate the College's current, liquid position. The College continues to maintain a positive cash balance of £1,982,000.
- Creditors due within one year have decreased by £1.1 million, mainly due to a decrease in accruals and deferred income of £733,000. There was also a decrease in other creditors of £875,000 compared to prior year as a result of a reduction in payroll creditors for voluntary severance payments in the prior year and a decrease in the student support fund creditor. This is offset, to an extent, by an increase in respect of balances owed to the Scottish Funding Council in respect of the transformation fund.

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 actual and forecast income and expenditure for the College for 2011-12 to 2012-13:

Forecast (at June 2012)		
£000	**2011-12 (actual) £'000**	**2012-13 (budget) £'000**
Income	14,330	13,930
Expenditure	(14,106)	(13,893)
Historic cost surplus for the year	**224**	**37**
Net current assets	**754**	**-**
Cash at bank and in hand	**1,982**	**-**

While the College is forecasting a small surplus in respect of the year ending 31 July 2013, there remains uncertainty over future Scottish Funding Council grant allocations, which form the most significant element of the College's income.

In addition, the College will receive grant support from the Scottish Funding Council in respect of the costs associated with the merger. The exact amount of funding and costs are not yet known.

Performance against targets

The financial statements include a number of key performance indicators. Performance against most is in line with the prior year.

Performance indicators

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

KPI	Purpose	Actual 2011-12	Actual 2010-11
WSUMs	Number of WSUMS per year	54,447	57,352
Operating surplus / (deficit) as a % of income	Measures the surplus on continuing operations as a % of total income	1.6%	(0.2%)
Non SFC income a % of income	Measures non SFC income as a % of total income	21.8%	24.8%
Current assets : current liabilities	Measures the colleges ability to pay its current liabilities	1.4	1.3
Days cash	Cash divided by total expenditure less depreciation expressed in days	53	63
Performance against wSUMs activity target	Measures performance against wSUMs activity target	100.26%	100.03%
wSUMs/FTE	Measures efficiency in teaching deployment	415	385
Student – early retention	Measures student retention before cut-off date	94%	95%
Student outcomes	Measures overall student success	79%	80%

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

The activity target set by the Scottish Funding Council for 2011-12 was 54.308 wSUMs. The combined target includes 1.576 wSUMs for the ongoing SFC administered European Structural Fund (ESF) project. This target was achieved. The College delivered 54,447 wSUMs in 2011-12; 0.26% greater than the Scottish Funding Council set target activity level.

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 **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. The College has established appropriate processes for the prevention and detection of corruption.
Statement of corporate governance and internal control	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. We reviewed the governance statement and informed management of a number of amendments to ensure 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. Internal audit completed their planned audit work for the year and concluded that "*In our opinion Ayr College has a strong framework of controls in place, in the areas which we have reviewed, that provides substantial assurance regarding the effective and efficient achievement of the College's objectives and the management of key risks. Arrangements are in place, in the areas we have reviewed, to promote and secure value for money.*" 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. 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. The College has a fraud response plan to define authority levels, responsibilities for action and reporting lines in the event of a suspected fraud or irregularity. The fraud response plan is included within the financial regulations which are on the intranet for employees to obtain. When management is made aware of a suspected fraud the Director of Human Resources shall immediately invoke the Disciplinary Procedures relating to Fraud. Management has not reported any material instances of fraud or irregularity in 2011-12. There is also a whistle blowing policy available on the intranet as required by the Public Interest Disclosure Act 1998.

Observations arising from our audit

#	Risk	Issue, impact and recommendation	Management response/ responsible officer/due date
1	Low	Tuition fee reconciliations were performed and retained on file. There was evidence of review but they were not physically signed and dated. There was no clear audit trail as to when the reconciliations were carried out therefore we were unable to test the timeliness of preparation of the reconciliations. We recommend that reconciliations are signed and dated by the preparer and reviewer.	Agreed. **Responsible officer:** Finance Manager **Implementation date:** March 13
2	Low	The College has a risk register which is reviewed quarterly by the Senior Management Team and then considered and further reviewed by the Audit Committee four times a year, but there is no written risk management policy.	A risk management policy will be drafted by February 2013 for consideration by the Audit Committee . **Responsible officer:** Director of Finance **Implementation date:** June 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;

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 expenditure by senior management. Significant expenditure requires three quotations. The College participates in the annual procurement capability assessment
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. The audit committee also considers any applicable correspondence.

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.

Summary of audit differences

There were three audit differences. There was no net effect on the income and expenditure account.

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**
Recognition of invest to save expenditure and associated grant income	62	62	-	-
Reduction in the net pension liability as a result of pessimistic assumptions.	-	-	750	750
Transfer from designated capital reserve to Income and expenditure reserve	-	-	180	180
Overall I&E impact	**-**	**-**	**-**	**-**

Presentational issues

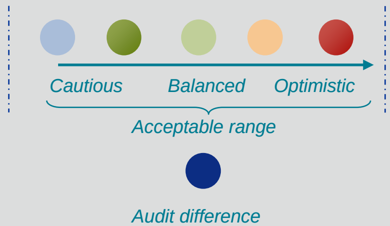
In addition to the above, we identified a small number of presentational issues during our audit and these have all been amended by management.

Pensions considerations

Presented below is a comparison of the assumptions used by Hymans Robertson who advise the Colleges 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 were stronger than we normally consider acceptable. Management revised the gross liabilities in line with the impact of increasing the net discount rate by 0.3% to the bottom of our acceptable range (2.20%). The net impact was a reduction in liabilities of £750,000.
Discount rate	4.1%	4.4%		The proposed discount rate is within a range we would normally consider acceptable.
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	2.50% RPI less 0.8%	1.90% RPI less 1.0%		The assumptions is stronger (higher liability) than our central rate and is outside the range we would normally consider reasonable.
Net discount rate (Discount rate – CPI)	**1.90%**	**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 of 22 years duration. The net discount rate is stronger (higher liability) than we our central rate, but within our acceptable range.
Salary growth	4.50% 1.5% above RPI	1-2% above RPI inflation		
Life expectancy Current male pensioner (age 65) Future male pensioner (age 45)	21.0 years 23.4 years	22.1 years 23.4 years		
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



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. 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: ■ the treatment and disclosures for restricted income, donations and endowments; ■ 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; ■ financial statement proformas; and ■ revenue recognition. 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.

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 consolation 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.

Sector update (continued)

Area	Issues
Pensions	**Pensions auto-enrolment** Organisations with around 4,000 to 6,000 employees will be required to be fully compliant by 1 May 2013. This means that most HE establishments will have to be compliant before the end of the 31 July 2013 year-end. 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. 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. ***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)** As you will be aware HMRC have proposed that all employers with more than 50 employees will implement RTI from 6 April 2013. 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. ***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.***

Sector update (continued)

Area	Issues
Corporation tax, VAT & PAYE updates	**Rate of corporation tax** 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. The small profits rate remains at 20%.
	Overseas agents 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. There are challenges that are being made, and alternative structures that are being implemented to reduce this additional cost.
	Cost Sharing Exemption 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. 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. Consideration is being given as to how this exemption can best be used to meet further education colleges' strategic needs.

Sector update (continued)

Area	Issues
Corporation tax, VAT & PAYE updates (cont.)	**Employment Status** 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. 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 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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