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Clydebank College

Annual audit report to the Board of Governors of Clydebank College
and the Auditor General for Scotland

Year ended 31 July 2012

8 February 2013



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



Executive summary

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 Governors' 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	<p>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 Governors.</p> <p>The following matters are currently outstanding:</p> <ul style="list-style-type: none"> ■ Receipt of the management representation letter; and ■ Post balance sheet events review. 	7
Financial position	<p>The surplus for the year was £95,000 representing 0.6% of total income, 2010-11 £204,000 deficit.</p> <p>The increase is mainly due to a decrease in staff costs as a result of annual cost savings made through the voluntary severance scheme and other operating expenses, reflecting budget savings and normalisation of capital formula funding. These reductions in expenditure are a response to a reduction in Scottish Funding Council grant income.</p>	8
Audit Issues identified	<p>Under the requirements of ISA (UK and Ireland) 260: <i>Communications with those charged with governance</i>, we are required to report any material adjusted audit differences arising from our work.</p> <p>Two audit adjustments were identified as a result of our audit in respect of the pension liabilities and grant income received for specific purposes.</p> <p>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%. Management proposed revised assumptions which reduced the pension liability and associated reserve by £779,000 / 4.75%.</p>	7, 19
Performance improvement observations	<p>We have identified three performance improvement observations which we are required to bring to your attention. 'Low' rated observations and recommendations have been raised in regard to the whistle blowing policy, journal authorisation and payroll reconciliations.</p>	15

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 Clydebank 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 Governors 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

In addition to the audit of the financial statements, KPMG has also undertaken other work as follows:

- merger due diligence; and
- audit of the College’s student support funds.

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 have made enquiries of all KPMG teams providing services to the College and are not aware of any other relationships which represent matters that have occurred during the financial year on which we are to report.



Financial statements

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)*.

There has been one change to accounting estimation in the College in 2011-12 relating to the adoption of FRS17 as the basis of accounting for the unfunded pension scheme liabilities

Accounting Policies	There have been no changes to accounting policies in 2011-12. 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: <i>Accounting for Further and Higher Education (2007)</i> .
Unfunded pension liability	<p>There has been one change to the College's basis for calculating pension liabilities, relating to the adoption of FRS 17 in respect of the College's unfunded pension scheme liabilities. Until 2011-12, the College provided for unfunded pension liabilities by applying FRS 12 <i>Provisions for Liabilities and Charges</i>.</p> <p>In preparing their actuarial report for the year ended 31 July 2012, the College's actuaries included an annual valuation of unfunded liabilities in respect of members of the Local Government Pension Scheme ("LGPS"). The financial statements for the year ended 31 July 2012 have been amended to remove the unfunded pension provision, calculated in accordance with FRS 12, and account for these liabilities under FRS 17. The Board of Governors consider that this provides a more accurate representation of the result and of the financial position of the College and ensures that the basis of estimating the liability is consistent with the other colleges with whom the College intends to merge.</p>

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 £779,000 / 4.75%.

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	10,476	Employer contributions	471
Liabilities	(15,613)	Income & expenditure account charge	(496)
Net (liabilities)	(5,137)	Contributions in respect of unfunded benefits	166
		Past service (costs)/gains	-
		Net cost on pension asset	(112)
		Actuarial loss	(841)

The total pension cost for the year, including Scottish Teachers' Superannuation Scheme contributions and the net interest cost, was £1.1 million, compared to £1.3 million in 2010-11. The net FRS 17 pension liability has increased by £0.8 million 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. 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. This results in a higher pension liability. Following discussion management proposed revised assumptions which resulted in a reduction in the gross pension liabilities of approximately 4.75%. Our detailed comments in this respect are set out in appendix three.

Severance arrangements and accounting

During the year, the College initiated a voluntary severance scheme which had two phases for applications. 36 members of staff were accepted to leave through the staff restructuring scheme. The total associated costs were £648,000.

There were no unsettled liabilities as at 31 July 2012 as all staff who were accepted to leave had their employment terminated before the year end.

<p>Sector, organisational and structural changes</p>	<p>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.</p> <p>The College has indicated that it supports the regionalisation reforms and is committed to forming a West of Scotland region through a merger with James Watt and Reid Kerr colleges. 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 as a result of the proposed merger. In order to monitor this, the College has employed a project manager to oversee the merger process.</p>
<p>Compliance with tax authorities</p>	<p>Consistent with our understanding of the College that there are no significant non-business activities undertaken by the College.</p> <p>We liaised with our tax compliance colleagues and have not identified any significant matters relevant to the audit which have not been appropriately reflected.</p>
<p>Opening balances</p>	<p>International Standard on Auditing (UK and Ireland) 510: <i>Initial audit engagements – opening balances ("ISA 510")</i> requires us as auditors to obtain sufficient appropriate audit evidence about whether:</p> <ul style="list-style-type: none"> ■ 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. <p>We have undertaken a number of specific procedures to allow us to confirm a selection of opening balances per ISA 510.</p>



Financial statements

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	<ul style="list-style-type: none">■ Draft financial statements and supporting documentation were provided on 17 September 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 (reflecting the high quality hard copy versions we were provided with).■ Overall, management adopts an efficient approach to preparing the financial statements.
Corporate governance statement and Board of Governors' Report	The corporate governance statement was provided on 17 September 2012 with the operating and financial review ("OFR"). No issues or changes were required to be made to the corporate governance statement. A revised OFR was provided on 26 September 2012 which incorporated additional performance information. 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: <i>Communication with those charged with governance</i> , 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.	

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	12,928	14,486
Tuition fees and education grants	2,569	2,622
Research grants and contracts	151	150
Other income	799	680
Interest receivable	47	41
Pension scheme net expected return on assets	(112)	(11)
Total income	16,382	17,968
Expenditure		
Staff costs	10,545	11,803
Other staffing costs	673	842
Other operating expenses	3,899	4,293
Depreciation	1,170	1,170
Total expenditure	16,287	18,172
Surplus for the year	95	(204)

Source: Draft financial statements

Result for the year

The overall surplus for the year was £95,000 (0.6% of total income), higher than in 2010-11 (deficit £204,000).

Total income decreased by £1.59 million (8.8%). This decrease was predominantly due to a reduction in Funding Council grants which have decreased by £1.56 million, (10.8%), 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.

- Other income has increased by £119,000 following a one-off recovery of water costs (£70,000) and release of a provision (£47,000).

Expenditure has decreased by £1.89 million (10.4%) when compared to 2010-11:

- Staff costs have decreased by £1.26 million as a result of annual savings arising as a result of the voluntary severance exercises carried out in 2009-10 and 2010-11.
- Other staff costs have decreased by £145,000 as a result of a decrease in one-off voluntary severance costs. Fewer staff left in 2011-12 compared to the prior year.
- Other operating expenses increased in 2010-11 as a result of capital formula funding expensed (£0.5 million), but has decreased in 2011-12 by £543,000 reflecting budget savings and normalisation of capital formula funding.

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	95	(204)
Restructuring costs	618	821
FRS 17 pension costs	55	188
Operating surplus for the year	768	805
Adjusted operating surplus as a % of total income	4.7%	4.5%

The College has generated a strong adjusted surplus as illustrated above. The adjusted position for 2011-12 is in line with the reported position for 2010-11 and overall the results indicate a stable and consistent financial performance year-on-year.

Balance sheet

Balance sheet as at 31 July		
£000	2012	2011
Fixed assets		
Tangible assets	27,922	29,092
Current assets		
Stocks	4	5
Debtors: Amounts falling due within 1 year	789	887
Cash at Bank and in hand	3,458	3,941
Creditors: Amounts falling due within 1 year	(2,674)	(3,270)
Net current assets	1,577	1,563
Total assets less current liabilities	29,499	30,655
Creditors: Amounts falling due after more than 1 year	(931)	(1,118)
Net pensions liability	(5,137)	(4,735)
Net assets including pension liability	23,431	24,802
Deferred capital grants	24,447	25,482
Reserves		
Income and expenditure reserve (including pension reserve)	(1,016)	(680)
Total funds	23,431	24,802

Source: Draft financial statements 2011-12

The balance sheet shows a slight fall in net assets of £2.15 million. Net current assets have remained consistent with prior year.

The key changes in the balance sheet were as follows:

- Fixed assets have decreased by £1.17 million in line with the depreciation charge for the year. There were no tangible fixed asset additions in 2011-12.
- Cash and short term investments have decreased by £483,000, partly a result of the repayment of £212,000 in Lennartz funding to HM Revenue and Customs and payment of voluntary severance to staff of £648,000, this was offset by improved operating position for the year which resulted in a net cash outflow from operating activities of £271,000. The College continues to maintain a positive cash balance and once the amount owed to the HM Revenue and Customs is netted off, the remaining balance is £2,309,000.
- Creditors due within one year have decreased by £596,000. This is mainly due to a decrease in payments in advance of £481,000. There was also a decrease in other creditors of £299,000 compared to prior year as a result of a reduction in capital creditors. This is offset by an increase in respect of balances owed to the Scottish Funding Council in respect of student support funds.
- Creditors due after more than one year decreased by £187,000 which is a result of the Lennartz payment movements.

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	2012-13
Income	16,319	14,712
Expenditure	(16,224)	(14,609)
Historic cost surplus for the year	95	103
Net current assets	1,577	1,246
Cash at bank and in hand	3,458	2,222

While the college is forecasting a similar surplus in respect of the year ending 31 July 2013, there remains uncertainty over future 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 Funding Council in respect of the costs associated with the merger. The exact amount of funding and costs are not yet known.

Performance indicators

In accordance with Scottish Funding Council requirements, the College is required to publish and report progress against targets for national priorities. These indicators monitor the implementation of the Colleges' financial objectives. The College has met or exceeded all of its performance targets for 2011-12 except student enrolment targets.

KPI	Purpose	Actual 2010-11	Target 2011-12	Actual 2011-12	Target 2012-13
WSUMs	Number of WSUMS per year	60,785	57,913	58,316	53,185
Student numbers	Students enrolled after census date	9,195	8,800	7,467	7,000
Overall early retention	Measures student retention before cut-off date	95%	90%	94%	90%
Overall retention	Measures student retention	88%	85%	88%	85%
Operating surplus / (deficit) as a % of income	Measures the surplus on continuing operations as a % of total income	(0.6%)	0.8%	0.6%	0.3%
Non SFC income a % of income	Measures non SFC income as a % of total income	19%	21%	21%	22%
Staffing costs as a % of total income	Measures staff costs excluding exceptional staff costs as a % of total income	65%	67%	65%	68%
Current assets : current liabilities	Measures the colleges ability to pay its current liabilities	1.48	1.43	1.59	1.74
Days cash	Cash divided by total expenditure less depreciation expressed in days	85	75	84	60

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

The activity target set by the Scottish Funding Council for 2011-12 was 57,912 wSUMs. The combined target includes 2,090 wSUMs for the ongoing SFC administered European Structural Fund (ESF) project. This target was achieved. The College delivered 58,789 wSUMs in 2011-12; 0.7% greater than the Scottish Funding Council set target activity level.



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

<p>Corporate governance and internal control arrangements</p> <p>Standards of conduct and prevention and detection of corruption</p>	<p>The College has made a fully 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.</p> <p>We have reviewed the corporate governance statement and consider it consistent with our understanding of the process followed by the College during the year.</p> <p>The College has established appropriate processes for the prevention and detection of corruption.</p>
<p>Governance statement</p>	<p>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.</p> <p>We have reviewed the governance statement and have confirmed that it is in line with new guidance and reflects our understanding of the College.</p>
<p>Internal audit</p>	<p>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.</p> <p>Internal audit completed their planned audit work for the year and concluded that <i>"On the basis of work undertaken for the year ended 31 July 2012 as set out in the annual audit plan approved by the Audit Committee, we consider that Clydebank College generally has an adequate framework of controls over the systems examined"</i>.</p> <p>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.</p>

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 has been placed on the intranet for employees to obtain. It will be subject to annual review and any changes requested will be required to be reported to the audit committee for approval.

When management is made aware of a suspected fraud, a fraud investigation group would be convened to co-ordinate an investigation. Management has not reported any material instances of fraud or irregularity in 2011-12.

There is a public interest disclosure policy available on the intranet as required by the Public Interest Disclosure Act 1998. However, there is not a link on the homepage of the staff intranet site and when we asked staff if there was a whistle blowing policy they were unable to direct us to it on the intranet. Management should prepare a whistle blowing policy with a link available on the homepage of the staff intranet site so it is easily identifiable by all staff.

Recommendation one

#	Risk	Issue, impact and recommendation	Management response/ responsible officer/due date
1	● Low	<p>There is a public interest disclosure policy available on the intranet as required by the Public Interest Disclosure Act 1998. However, there is not a link on the homepage of the staff intranet site and when we asked staff if there was a whistle blowing policy they were unable to direct us to it on the intranet.</p> <p>We recommend that management prepare a whistle blowing policy with a link available on the homepage of the staff intranet site so it is easily identifiable by all staff.</p>	<p>Noted and the recommendation will be fully implemented.</p> <p>Director of Human Resources December 2012</p>
2	● Low	<p>The college has a process for the authorisation of journals. An excel spreadsheet is prepared which details the name of the preparer, the authoriser and the staff member who inputted the journal to Symmetry. We noted that this sheet is often marked as authorised after the journal has been posted.</p> <p>We recommend that all journals are authorised before posted onto the ledger system to reduce the chance of error or mis-posting.</p>	<p>Noted and the recommendation will be fully implemented.</p> <p>Director of Finance and Estates November 2012</p>
3	● Low	<p>Payroll reconciliations were performed on a monthly basis and retained on file. The name of the preparer and reviewer was documented on the reconciliation 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.</p> <p>We recommend that reconciliations are signed and dated by the preparer and reviewer or electronic entry made of the date of review.</p>	<p>Noted and the recommendation will be fully implemented.</p> <p>Director of Finance and Estates November 2012</p>

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;



Other audit areas Best Value

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

Audit area	Overview	Findings
Best Value	<p>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.</p>	<p>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 over £5,000 by senior management.</p> <p>There is no overarching formal best value plan and management should consider formally implementing best value principals, particularly as part of the merger process.</p> <p>The annual summer works capital programme is subject to a tender process, similar to the College's other significant expenditures.</p> <p>The College's participates in the annual procurement capability assessment and has increased its score year on year.</p>
Regularity	<p>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.</p>	<p>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. A summary of issued circulars is provided at each Board of Management meeting.</p>

Appendices

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.

There were two 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	63,	63	-	-
Reduction in the net pension liability as a result of pessimistic assumptions. The net discount rate was revised by management from 1.9% to 2.15%			779	779
Overall I&E impact	0		0	

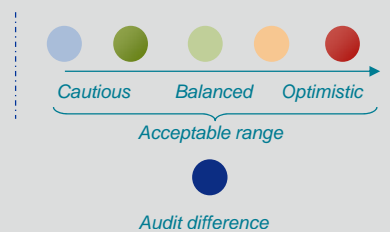
Presentational issues

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

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				<ul style="list-style-type: none"> 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 0.25% to the bottom of our acceptable range (2.15%). The net impact was a reduction in liabilities of £779,000.
Discount rate	4.35%	4.35%		<ul style="list-style-type: none"> The proposed discount rate is within a range we would normally consider acceptable.
RPI inflation	3.00%	2.90%		<ul style="list-style-type: none"> 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% RPI less 0.8%	1.90% RPI less 1.0%		<ul style="list-style-type: none"> 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)	2.15%	2.45%		<ul style="list-style-type: none"> The range we would normally consider reasonable for the purposes of FRS17 as at 31 July 2012 is 2.45% +/-0.3% for a scheme with liabilities of 18 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)	21.0 years	22.1 years		
Future male pensioner (age 45)	23.4 years	23.4 years		
Expected return on equities	Estimated ERP 5.5%	ERP 2-4.5%		<ul style="list-style-type: none"> 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



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

Area	Issues
<p>International Financial Reporting Standards (IFRS)</p>	<p>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.</p> <p>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:</p> <ul style="list-style-type: none"> ■ 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. <p>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.</p> <p>Please contact us for further information.</p>

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 consultation 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.

Area	Issues
Pensions	<p>Pensions auto-enrolment</p> <p>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.</p> <p>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.</p> <p>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.</p> <p><i>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.</i></p>
Employment Taxes and Pensions compliance	<p>Real Time Information (RTI)</p> <p>As you will be aware HMRC have proposed that all employers with more than 50 employees will implement RTI from 6 April 2013.</p> <p>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.</p> <p><i>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.</i></p>

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

Area	Issues
Corporation tax, VAT & PAYE updates (cont.)	<p>Employment Status</p> <p>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.</p> <p>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.</p>
	<p>Terminations</p> <p>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.</p>



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