Key Issues Memorandum

Elmwood College

For the 14 month period ended 30 September 2012

Gary Devlin
Engagement Leader
T 0131 659 8554
E gary.j.devlin@uk.gt.com

Jacqueline Marran
Manager
T 0141 223 0699
E jacqueline.a.marran@uk.gt.com

To the Audit Committee of SRUC and the Auditor General for Scotland

The purpose of this memorandum is to highlight the key issues affecting the results of Elmwood College (the College) and the preparation of the College's financial statements for the 14 month period ended 30 September 2012. It is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We take responsibility for this memorandum, which has been prepared on the basis of the limitations set out in 'The small print' (Section 11).

We would like to take this opportunity to record our appreciation for the kind assistance provided by the finance team and other staff during our audit.

Grant Thornton UK LLP
7 Exchange Crescent
Edinburgh EH3 8AN

T +44 (0)131 229 9181
F +44 (0)131 229 4560
DX ED428 Edinburgh
www.grant-thornton.co.uk

Grant Thornton UK LLP

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1 Executive Summary

Financial reporting issues	
Audit opinion	• The key issues impacting on the audit opinion this year have related to the merger of Elmwood College, Barony College and Oatridge College with the Scottish Agricultural College (SAC) to form SRUC. • We have issued an unqualified true and fair view opinion on the financial statements for the period ended 30 September 2012.

Governance issues	
	• The merger of Elmwood College with SAC to form SRUC has gone well. Our audit has not identified any material weakness in governance or internal control during the merger process. • We have identified low risk control matters from our testing which is detailed at Section 8 of this report.

Audit issues	
Key areas of audit risk	• Our audit has not identified any material performance issues at Elmwood College. • We note that Elmwood College was facing potentially significant financial challenges in relation to its long term financial sustainability in response to reductions in grant funding, however, these challenges are largely subsumed by the merger process.
Audit adjustments	• There were a number of adjustments found as a result of the audit procedures. The net effect on the Income and Expenditure account was a £12k reduction in the reported surplus.

2 Financial Results

2.1 Income and expenditure account

Table 1: Income and Expenditure account

	2011-12 £'000	2010-11 £'000
Income	11,485	10,622
Expenditure	11,227	10,079
Surplus for the year	**258**	**543**

Source: 2011-12 financial statements

Table 2: Income and Expenditure split by period

	2011-12 Period 1-12 £'000	2011-12 Period 13-14 £'000
Income	9,727	1,758
Expenditure	9,632	1,595
Surplus for the year	**95**	**163**

Source: 2011-12 general ledger

For the period ended 30 September 2012, the College reported a surplus of £258,000 (2011: £543,000). Table 1 above highlights the financial results for the year.

The College originally budgeted for a surplus of £12,171. However, against the back drop of funding cuts it should be recognised that achieving a surplus is a challenge and the current financial position reflects the monitoring processes in place within the College .

Income

Income has increased overall by £863k (8%), however it should be noted that the figures for 2011/12 cover a fourteen month period as opposed to twelve months covered by 2010/11. As part of our audit work we have split the income into the first 12 months and remaining 2 months (see table 2).

When only the first 12 months are used for comparative purposes this shows a net reduction in income of £895k. The key elements of this reduction are SFC grant income of £379k, decreased tuition fees of £72k and a decrease in other income of £435k.

The decrease in SFC funding reflects a 9% decrease in the main recurrent teaching grant as a result in a cut in funding by the Scottish Government.

Overall student numbers remained constant over HE and FE, however, the number of students domiciled outside the EU has reduced by 55%. The income raised per non EU student is significantly higher than domestic students and this accounts for the reduction.

Other grant income has decreased by 16% mainly due to a reduction in the amount received from Local Authorities in relation to places within supported accommodation. Another main contributor to the decrease is a reduction in grants not received from the Scottish Funding Council which totalled £260k in 2012 (2011: £550k)

Expenditure

When only the first 12 months are used for comparative purposes expenditure has decreased by £447k (4%), mainly due to a decrease in staff costs of £871k, a decrease in depreciation and impairment of £17k as offset by an increase in other operating expenses of £352k.

Overall average staff numbers have decreased by 25, with the number of teaching staff having decreased by 10. When staff costs for the first 12 months of 2011/12 (£5,901k) are compared to 2010/11 (£6,772k) there is a reduction of 13% which is consistent with the reduction in staff numbers.

2.2 Balance sheet

Table 3: Balance Sheet

	2011-12 £'000	2010-11 £'000
Fixed assets	12,686	12,961
Current assets	5,316	4,069
Current liabilities	(1,814)	(1,273)
Provisions	(911)	(902)
Pension Liability	(1,842)	(780)
Net Assets	**13,435**	**14,075**
Deferred capital grants	786	557
General Reserve	5,121	4,559
Pension Reserve	(1,842)	(780)
Revaluation Reserve	9,370	9,738
Total Funds	**13,435**	**14,075**

Source: 2011-12 financial statements

For the period ended 30 September 2012, the College held net funds of £13.4 million (2011: £14.1 million). Table 3 highlights the key balance sheet items for the year.

Fixed assets

The decrease in the value of fixed assets was mainly attributable to the depreciation charge of £572k. This was offset by a net investment in assets of £296k (£298k of additions and £2k of disposals).

Current Assets

Debtors have increased by £95k over the prior period due to the timing of payments. The main reason for this is the timing difference between the period end being moved from 31 July to 30 September. This resulted in a number of payments which usually take place after the year end and relate to balances apportioned over the period from August to July. This has resulted in an increased prepayments figure.

Cash balances have increased by £1,136k, similarly this is due to the change in period end. The SFC have awarded monies, which, have not been utilised at the period end date as it is still early in the academic year.

Current liabilities

Current liabilities have increased by £541k mainly due to the recognition of student fees which were paid in September for a full year course. The creditors balances recognise the liability the College has to deliver tuition to the students. This was not an issue in the prior period as it coincided with the end of the academic year.

Pension Liability

The pension deficit of £1,842k reflects the College's share of the assets and liabilities in the Local Government Pension Scheme (LGPS), which is accounted for as a defined benefit scheme under FRS 17. The movement of £1,062k mainly reflects an increase in current service cost as a result of the impact of the staff restructuring being in the prior year.

Deferred capital grants

The increase in deferred capital grants of £229k mainly relates to funding received for land and buildings of £233k in the period.

3 Key audit issues

In this section we present our findings in respect of matters and risks identified at the planning stage of the audit and we provide details of additional matters that arose during the course of our work.

3.1 Status of audit

Our audit is complete following discussions with management.

3.2 Matters identified at the planning stage

In the conduct of our audit, we have had to alter or change our audit plan, to reflect the change in the accounting period. This change was communicated to you in a revised Audit Approach Memorandum which was issued on 20 December 2012. The revised audit plan did not identify any additional risks. Our responses to the matters identified at the planning stage are detailed below.

3.3 Matters identified at the planning stage

	Issue	Auditor commentary
1	**Merger** The Griggs report on the Review of Further Education Governance in Scotland proposes a new governance structure for the further education sector. In response to this report, the College merged with Scottish Agricultural College, Oatridge College and Barony College to form SRUC, with effect from 1 October 2012. As a result the College have required the audit to now cover the 14 month period from 1 August 2011 to 30 September 2012. Furthermore, we have been informed that the Board of SRUC now represent those charged with governance of the College in relation to this final financial statements period ended 30 September 2012. Mergers of this type are, by their nature, complex and challenging undertakings impacting on all aspects of the College's operations, students and staff. Preparations for the merger will be a natural focus for the Board and senior management but does introduce a risk that operations of the College in the lead up to the merger may not be fully effective.	We have conducted the audit of the financial statements for the 14 month period to 30 September 2012. The disclosures in the accounts were evaluated against accounting standards, the requirements of the SFC accounts direction and guidance issued by Audit Scotland. Additional disclosures were required outlining the results of the merger and in particular in relation to the going concern principal. We have reviewed the disclosures in the accounts and discussed the appropriateness with the Finance Manager. **Management Commentary** Noted

2	**Property, plant and equipment** In advance of the merger the College should review its estate and considered if valuation was necessary. Assets should be identified which may become obsolete as a result of the merger and impairment reviews should have been carried out.	SRUC had a professional valuation undertaken on the land and buildings of the former Elmwood College on 1 October 2012. The results of this valuation have been provided to us and represent a material change in the value of the assets as reported in the college financial statements for the period ended 30 September 2012. However, it should be noted that the basis of the October 2012 valuation was Depreciated Replacement Cost. The previous professional interim valuation on 31 July 2011, carried out on behalf of the college had been undertaken on a Market Value basis. Given the differing valuation basis we have not recommended any uplift in the fixed assets as reported in the financial statements for the period ended 30 September 2012. Management have not identified impairment indicators following their review of assets, and our audit confirms this assessment. **Management Commentary** No adjustment is proposed to the carrying value of fixed assets at 30 September 2012 and we are not aware of any indicators of impairment.
3	**Financial planning and monitoring** The 2010-11 income and expenditure account showed an operating surplus of £258k. The surplus generated was recognised as an achievement against a backdrop of funding cuts. We have noted from minutes of meetings that historically the budget set at the beginning of a year has proved to be inaccurate and can be significantly different to the eventual outcome. To address these management are implementing monthly outturn forecasting reporting.	Monthly financial reporting has been implemented at the College and continues to be provided to the SRUC post- merger. The College reported a final surplus of £258k against a budgeted £12k. Remedial action was taken throughout the financial year to reduce operating costs where possible. **Management Commentary** Monthly results continue to be carefully monitored. Budgets for the year to 31 March 2014 are underway.

4	**Financial statements key risks** The two key areas of audit risk in relation to the financial statements are in income and employee remuneration.	There was increased testing on both the employee remuneration and income systems including performance of walkthroughs tests of the control systems in place. There was one low risk control weaknesses found within the systems, which we bring to your attention at section 8. There were no weaknesses which were so significant that the system could not be relied upon for our audit of the financial statements. We performed analytical review of both income and employee remuneration combined with detailed sample testing of the key balances with no significant issues noted. Based on the results of our testing we are satisfied that income and employee remuneration are not materially misstated. **Management Commentary** Noted
5	**European Structural Funds (ESF)** Errors in grant claims submitted by the College have been identified during an internal audit and as a result a clawback of approximately £200k has been made by the ESF. This has a financial impact on the Income and Expenditure account and will likely have to be accounted for as a prior year adjustment.	The College have reviewed the prior claims submitted for the ESF and created a schedule of the actual amount which should have been claimed. In addition the College have confirmed with Fife Council the maximum ESF amount they could claim on the basis of the revised figures. From the results of this exercise it was found that Elmwood was just under the maximum figure. No clawback of grant is therefore expected. However, in the prior year the College had accrued income for the ESF grants which they expected to receive in 2011/12. This accrual has been reversed in year to recognise this income will not be received. We have reviewed the reversal made in the current year and evaluated the calculation methodology. We have determined that the reversal has been appropriately charged to the financial statements. **Management Commentary** Noted

6	**Accounting for Charitable Donations** During 2011-12 the College refurbished a cottage used for supported accommodation. Donations from a Trust have been used to finance elements of the refurbishment programme.	The College had netted off the expenditure incurred for this project against the charitable income. This is not permitted by the SORP and therefore an adjustment has been included so that the gross figures for both income and expenditure are shown in the financial statements. **Management Commentary** We are satisfied that the accounts now correctly reflect the transactions.
7	**Early retirement scheme** The College has created efficiencies and savings via a management restructuring programme. As part of this a number of staff were offered early retirement. The College makes payments to the pension fund on a monthly basis to account for shortfalls arising from the early retirement. In the accounts the early retirements are accounted for as a provision in line with FRS 12. There may also be a need for additional provisions in connection with the merger.	We have conducted a review of the early retirement provision. There was no significant movement in the current financial year. The majority of those who accepted early retirement had departure dates after the year end. The provisions in year are therefore deemed to be appropriate and we expect the voluntary severance scheme to impact the 2012/13 provision. **Management Commentary** As no agreement had been confirmed at (or before) 30 September 2012 no provision was required for leavers post September 2012.

3.4 Matters identified during the course of the audit for Elmwood College

During the testing of the financial statements we identified a significant value of transactions, which related to estates purchases which had been written off to the Income and Expenditure account.

We considered whether the transactions met the definition of a fixed asset as outlined by the SORP and FRS 15. Further we evaluated each class of transaction against the criteria outlined in the standards and the capitalisation policies outlined by the College.

We noted a number of projects which we understand should have been capitalised in order to be in line with the standards and the College capitalisation policies.

We have discussed and agreed our adjustments with management and this has now been corrected within the financial statements for the period ended 30 September 2012.

4 Governance

4.1 Introduction

The Board are responsible for establishing arrangements for ensuring the proper conduct of its affairs, including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The Audit Committee has a role in monitoring these arrangements.

	Issue	Auditor commentary
1	**Merger** The college merger is by its nature, a complex and challenging undertaking which will impact on all aspects of the College's operations, students and staff. Preparations for the merger will be a natural focus for the Board and senior management, but does introduce a risk that the operations of the College in the lead up to the merger may not be fully effective. Following merger approval, we identified the following governance risks: • arrangements need to be in place to allow the new board to approve the 2011-12 accounts and receive the Annual Report • the impact on capacity, as senior staff time is required on the merger • key staff may leave the organisation during the transition • governance arrangements for 2011-12 may not be fully effective as a result • risk management arrangements may need to be reviewed to account for the merger transition.	We have undertaken a review of governance arrangements in place at the College as part of our audit work. Our audit found that good arrangements were in place to facilitate the merger process. There were some weaknesses in the entity level controls identified. Further detail on the identified issues are outlined at section 8. From our review of committee minutes it was evident that significant consideration had been given to the merger and the governance structures which would be in place following the merger. **Management Commentary** An internal audit review has been completed for the post-merger period and procedures were found to be satisfactory.

5 Performance

5.1 Introduction

All public bodies in Scotland have a duty to secure Best Value and continuous improvement. Elmwood College continues to work with the Scottish Government to identify further areas of efficiencies and savings.

	Issue	Auditor commentary
1	**Audit Scotland national reports** In August 2010, Audit Scotland published a national report on how public bodies are beginning to respond to the challenge of a significant reduction in budget. The report provides an overview of budgeting issues across the public sector and there is some key commentary on the reduction of the funding to the Further and Higher Education sector and the impact of the removal of the cap on tuition fees in England and Wales. In September 2010, Audit Scotland published a national report on the governance arrangements across the public sector. The report focused on three areas and provided recommendations on the following: • the role and accountability of boards • the skills and expertise of board members • how boards operate.	During 2011/12 there was no review of the Audit Scotland Reports by the College Board of Management. This is reasonable due to the uncertainty of the College's position going forward and the limited impact any action could have in the event of the merger. The merger has now taken place and there will be significant challenges concerning both budgeting and the governance arrangements. It is recommended that the Audit Scotland reports are considered by the Board of the SRUC to identify areas of good practice and evaluate the merged bodies performance against the findings of the national reports. **Management Commentary** Noted – these will be reviewed.

6 Financial reporting matters

6.1 Commentary on key judgements and estimates

Going concern

Elmwood College has ceased to be a separate entity following a merger with other Land Based Colleges and therefore increased disclosures have been required regarding going concern. The disclosures have been subject to review, and are deemed to reflect the circumstances of the College accurately.

6.2 Review of principal accounting policies

We have reviewed the financial statements and have noted no significant issues in relation to the key accounting policies, judgements and estimates.

6.3 Disclosure omissions

Our review found no material omissions in the financial statements.

7 Audit adjustments

7.1 Misstatements

We are required to communicate all uncorrected misstatements to you, other than those considered to be clearly trivial. We have requested that management correct these misstatements and have included (where applicable) the reasons given by them as to why the misstatements remain uncorrected.

7.2 Impact of misstatements

All unadjusted misstatements are set out in detail in section7.3 below. There is no impact on the audit report as a result of these unadjusted misstatements.

All adjusted misstatements are set out in detail in section 7.4 below. The net effect of the Income and Expenditure Account of these adjusted misstatements is a £12k reduction in the surplus for the period.

Misstatements in relation to the prior year

During the course of our audit we obtained audit evidence that the opening balances in relation to deferred accrued income contained misstatements. In the current year there was grant income received of £37k which related to the 2010/11 Economic Downturn grant from the SFC. This income should have been accrued in the prior year.

The impact of these misstatements on this year's income and expenditure account is £nil. There is no impact on our audit report as a consequence of these misstatements.

7.3 Unadjusted misstatements

Journal reference	Detail	Balance sheet		Profit and loss		Profit effect	Reason for not adjusting
		Dr	Cr	Dr	Cr		
1	Dr 2011-12 Grant Revenues			37,504		37,504	
	Cr 2011-12 Accrued Income	(37,504)					
	Dr 2010-11 Accrued Income	37,504					
	Cr 2010-11 Grant Revenues				(37,504)	(37,504)	
	Being the adjustment for grant incomes relating to 2010/11 not accrued in the prior year.						Immaterial
2	Dr Income			53,685		53,685	
	Dr Accrual	53,685					
	Cr Expenditure				(53,685)	(53,685)	
	Cr Deferred Income		(53,685)				
	Being adjustment for capital grant incorrectly recognised in year, carried forward to 2012/13						Immaterial net effect on financial statements
Impact on reported surplus						**0**	

7.4 Adjusted misstatements

Journal reference	Detail	Balance sheet		I & E		I & E effect
		Dr	Cr	Dr	Cr	
1	Dr Expenditure			29,288		29,288
	Cr Strategic Development Grant				(29,288)	(29,288)
	Being the reversal of expenditure directly recharged to the Strategic Development Grant Account and netted off against income.					
2	Dr SFC Bursary Income			8,655		
	Cr SFC Bursary Payments to Students				(8,655)	
	Being the adjustment for a transposition error where £43k was input instead of £34k.					
3	Dr Fixed Asset Additions	87,977				
	Cr Expenditure				(87,977)	(87,977)
	Dr Income			87,977		87,977
	Cr Deferred Grant Reserve		(87,977)			
	Being the move from writing off assets to I&E to capitalising the assets on balance sheet.					
4	Dr Expenditure			55,000		55,000
	Cr Other Income				(55,000)	(55,000)
	Being adjustment to gross up charitable donations income used to fund Cottage refurbishment costs.					
5	Dr Depreciation Expenditure			7,471		7,471
	Cr Fixed Asset Equipment Depreciation		(7,471)			
	Being the increase of depreciation per Fixed Asset Register but ommitted from ledger balances.					

Journal reference	Detail	Balance sheet		I & E		I & E effect
		Dr	Cr	Dr	Cr	
6	Dr Other Debtors	37,171				
	Dr Expenditure			4,472		4,472
	Cr Prepayments		(41,643)			
	Being adjustment for insurance refund					
7	Dr Revaluation Reserve	368,000				
	Cr General Reserve		(368,000)			
	Being adjustment for depreciation on revalued assets at period end					
Impact on reported surplus						**11,943**

8 Design effectiveness of internal controls

8.1 Accounting system and internal control

Our audit is not designed to identify all significant weaknesses in the College's internal controls but is designed primarily for the purpose of expressing our opinion on the financial statements of the College. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work did not encompass a detailed review of all aspects of the internal controls and cannot be relied upon necessarily to disclose all defalcations or other irregularities or to include all possible improvements in internal control.

See 'The small print' for further details of our approach in respect of internal controls.

8.2 Key findings

Key to assessment of internal control deficiencies

🔴	Material weakness - risk of material misstatement
🟡	Significant deficiency - risk of significant misstatement
🟢	Deficiency - risk of inconsequential misstatement

	Assessment	Issue and risk	Recommendation
1	🟡	**Payroll Reconciliations** There is no reconciliation conducted between the payroll system and the general ledger. We understand that payroll amounts are directly journalled into the ledger therefore there should be no differences. However, when conducting our audit testing we were unable to fully reconcile payroll to the period end trial balance. We have now been provided with a reconciliation between the payroll system and the general ledger. However, there is a risk that by not carrying out regular reconciliations payroll costs may be misstated.	We recommend monthly payroll reconciliations are prepared to agree payroll records to nominal ledger postings to identify any potential issues on a timely basis. **Management response:** This was completed for the 14 month period and we agree these should be performed monthly.

	Assessment	Issue and risk	Recommendation
2	●	**Audit Committee Attendance** There were a number of instances over 2011/12 where the Audit Committee was not quorate. The Audit Committee plays a fundamental role in monitoring the governance of the College and therefore it is vital that there is adequate presence at the committee to provide scrutiny to key decisions and reports.	We understand there will be new governance structures going forward as part of the merger with the SRUC. A key element of the new governance structures will be the terms of reference of the Audit Committee which should include procedures for ensuring the committee is quorate. **Management response:** There are such procedures.
3	●	**Register of Interests** All members of the Elmwood Board had completed a register of interests form. However, as part of our review we noted that some of the register of interests forms published on the Elmwood website had not been updated since 2007. This could result in related parties not being identified.	In order to comply with best practice, going forward, the SRUC should ensure all board members update their register of interests on an annual basis. **Management response:** A register is maintained which is updated annually.
4	●	**Authorisation of journal entries** All members of the finance team and payroll have the ability to post journals on the general ledger. As part of the controls in place all members of the team must have their journals authorised by a more senior member of the team. As the team is small the most senior member of the team also has the responsibility of posting journals. The journals posted by this individual are not subject to review or authorisation, therefore, increasing the risk of error. Poorly-controlled journal posting processes mean that errors or fraud can occur and go undetected. With the heightened risk of fraud caused by the current economic conditions, improving controls over journals should be an area of focus for the Board.	We understand there will be changes to the finance team going forward. Our recommendation is that as part of the revised team structure all journals are subject to review by a senior member of the team. We would recommend that the Director of Finance no longer be authorised to post journals entries but solely act as an authoriser of other individuals journal entries, to reduce the fraud risk by way of management override. **Management response:** Journals will be subject to review. No journals are posted by the finance director.

9 Financial reporting and legislative developments

UK GAAP

Improvements to FRSs

What is proposed?

As we have noted in previous years the Accounting Council is planning to replace all current UK financial reporting standards with a new framework, incorporating two new standards. The standards are "The FRS", a 300 page standard which will be applied by the majority of UK companies, and the Reduced Disclosure Framework, an option of IFRS with reduced disclosures available for subsidiaries and parent company individual accounts.

For more information on the proposals and their implications, visit our website, http://www.grant-thornton.co.uk/services/audit_and_assurance/the_future_of_uk_gaap.aspx.

What would this mean for SRUC?

Under the proposals, SRUC would be considered to be a public benefit entity, as its main purpose is not the generation of profit. The FRS includes supplementary paragraphs which address issues specific to public benefit entities, for example non-reciprocal transactions such as donations.

SRUC will be required to undergo transition to The FRS, as will any subsidiary companies. When undergoing transition to the new financial reporting regime, there are likely to be recognition and measurement differences on transition, for example the requirement to accrue for unused holiday balances. These differences are likely to impact on the reported profit and also on the balance sheet.

As a consequence, there may be an impact on:

- the amount payable under any employee bonus arrangements SRUC might put in place.

What other issues do I need to consider?

There are also operational issues which may need to be addressed in preparing for transition, such as:

- training requirements
- possible systems changes to ensure all information is captured
- education of stakeholders
- potential need for additional resources.

What about the not-for-profit SORPs?

The Accounting Council intends to retain the three not-for-profit SORPs, for Charities, Registered Social Landlords and Higher and Further Education Establishments. However as stated above these SORPs will need to be updated to reflect the requirements of The FRS.

How should I plan for the transition?

From our experience in helping other entities transition between frameworks we note that the key to managing the process successfully is thorough planning and ensuring the time and resource commitments are not underestimated.

Although the final standards will not be published until the end of 2012, and will not be effective until accounting periods beginning on or after 1 January 2015 at the earliest, it is not too soon to start considering how you will address the transition process.

For SRUC this will mean the first reporting period is likely to be the year ended 31 March 2016, which will mean comparative balance sheets will be required for 31 March 2015 and 31 March 2014.

Timely actions and the right support will ensure that the process goes as smoothly as possible.

We would be pleased to discuss this matter further and provide detailed guidance in regard to this transition.

Real Time Information (RTI)

The introduction of Real Time Information (RTI) will significantly change the way that employers report PAYE deductions from April 2013. Instead of notifying HM Revenue & Customs (HMRC) of pay and deductions made from employees' wages at the end of the tax year, employers will be required to do this each and every time that any payment is made to an employee, on or before the time the payment is made.

Employers with fewer than 5,000 employees must start filing RTI returns from 6 April 2013.

Non-compliance with the new rules could lead to payroll processing failures, reputational damage with HMRC and employees, and potential penalties by HMRC for late or incorrect submission of data. All employers will need to review their policies, processes and systems to make sure that they are robust enough, and contain the correct data, to enable them to file in real time.
We would be pleased to discuss this matter further and provide detailed guidance in regard to this transition.

Disguised remuneration

The new disguised remuneration legislation results in an upfront income tax charge and National Insurance contributions where a reward or sum of money is earmarked for or loaned to an employee by a third party as part of an arrangement in connection with employment.

The original draft of the legislation was very wide ranging and caught many commercial arrangements with no tax avoidance element. Although the latest changes to the legislation do address many of the anomalies, there are still key issues which need to be considered when a company is to introduce any reward, benefit or incentive arrangement which includes a party other than the employee and employer in the structure

10 Independence

Ethical standards require us to give you full and fair disclosure of matters relating to our independence.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

In accordance with best practice, we analyse our fees below:

	£
Audit of College	18,500
Total audit	**18,500**

11 The small print

Purpose of memorandum

This Key Issues Memorandum has been prepared for the benefit of discussions between Grant Thornton, the Audit Committee of SRUC and the Auditor General for Scotland.

The purpose of this memorandum is to highlight the key issues affecting the results and the preparation of the College's financial statements for the period 30 September 2012.

This document is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We would point out that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements of the College.

This memorandum is strictly confidential and although it has been made available to management to facilitate discussions, it may not be taken as altering our responsibilities to the College arising under our audit engagement letter.

The contents of this memorandum should not be disclosed to third parties without our prior written consent.

Responsibilities of the Board of Management and auditors

The Board of Management are responsible for the preparation of the financial statements and for making available to us all of the information and explanations we consider necessary. Therefore, it is essential that the Board of Management confirm that our understanding of all the matters in this memorandum is appropriate, having regard to their knowledge of the particular circumstances.

Clarification of roles and responsibilities with respect to internal controls

The College's management is responsible for the identification, assessment, management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance to the Audit Committee that it has done so.

The Audit Committee is required to review the College's internal financial controls. In addition, the Audit Committee are required to review all other internal controls and approve the statements included in the annual report in relation to internal control and the management of risk.

The Audit Committee should receive reports from management as to the effectiveness of the systems they have established as well as the conclusions of any testing conducted by internal audit or ourselves.

We have applied our audit approach to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We would be pleased to discuss any further work in this regard with the Audit Committee.

ISAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit work
- significant findings from the audit