Stevenson College Edinburgh and Edinburgh's Telford College

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

Year ended 31 July 2012

21 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 Management of Edinburgh 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.
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We also draw your attention to the following:

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

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Audit status and key audit issues

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the *Code*"). This specifies a number of objectives for the audit; our audit strategies set out our responsibilities in respect of each audit. Board of Management 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 Colleges staff during the course of our work.

Issue	Summary	Page
Audit status	Our audits are now complete and we have issued unqualified audit opinions for the year ended 31 July 2012, following the approval of the financial statements by the Board of Management.	6
Financial position	**Stevenson College Edinburgh** The surplus for the year was £253,000, representing 0.9% of total income (2010-11: £1.1 million surplus). The decrease is mainly due to an increase in staff costs as a result of the voluntary severance scheme undertaken as a result of reduced further education funding and ahead of the Edinburgh College merger, although significant elements of this were met from additional Scottish Funding Council grants.	7
	Edinburgh's Telford College The operating deficit for the year was £1.08 million representing (3.4)% of total income (2010-11 £1.19 million surplus, 3.4% of total income). Additional costs were incurred due to the implementation of a voluntary severance scheme to manage reduced funding and duplication of staff responsibilities following the announcement of the Edinburgh College merger, again with Scottish Funding Council grant support. A charge of £1.73 million was recognised in respect of the onerous contract with the College's residences accommodation provider.	19
Audit adjustments	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. Audit adjustments were identified in respect of the pension liabilities in both colleges and accrued expenditure in Stevenson College Edinburgh. 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%. Significant adjustments were made to both Colleges' financial statements in relation to this.	6, 17
Performance improvement	We have identified a number of performance improvement observations which we bring to your attention. These are included in the action plan forming part of this report.	13

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Introduction

Background

The purpose of this report is to set out certain matters which came to our attention during the course of our audits of the financial statements of Stevenson College Edinburgh ("Stevenson College") and Edinburgh's Telford College ("Telford College", together "the Colleges") for the year ended 31 July 2012.

The purpose of our audits

The main purpose of our audits, which were 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 Colleges as at 31 July 2012 and of the Colleges' 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 Colleges 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 Colleges 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 Colleges 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 . KPMG has undertaken no non-audit work in the year.

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

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Accounting policies; accounting matters

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

Financial reporting framework	The Colleges prepared 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 Colleges 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. In support of the regionalisation reforms, the Colleges formed part of an Edinburgh region college through a merger with Jewel and Esk College on 1 October 2012. We have reviewed the approach to the merger and believe it is important that management focuses on the continued effectiveness of existing internal controls, and updated governance arrangements in the context of the merged College.
Compliance with tax authorities	Consistent with our understanding of the Colleges, no significant non-business activities were undertaken during the year. 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.

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Accounting policies; accounting matters

In preparation for the merger process and reflecting the funding position in the sector, voluntary severance schemes were implemented during the year. This was required due to the merger of Telford College, Stevenson College and Jewel and Esk College in order to manage duplication of responsibilities. A grant totalling £3.7 million was provided to the three colleges from the Scottish Funding Council to provide financial assistance with the scheme. The terms of the voluntary severance scheme were the same across the three colleges, with 90 full-time equivalent ("FTE") voluntary severances required across all three colleges.

Severance arrangements and accounting

In preparation for the merger process and reflecting the funding position in the sector, voluntary severance schemes were implemented during the year. This was required due to the merger of Telford College, Stevenson College and Jewel and Esk College in order to manage duplication of responsibilities. A grant totalling £3.7 million was provided to the three colleges from the Scottish Funding Council to provide financial assistance with the scheme. The terms of the voluntary severance scheme were the same across the three colleges, with 90 full-time equivalent ("FTE") voluntary severances required across the three colleges.

Fifty-nine employees from Telford College agreed to take voluntary severance. Of these, 16 individuals (FTE: 13.7) left employment before the year end and 43 individuals (FTE: 36.4) were due to leave before 31 December 2012. At Stevenson College, 70 people agreed to take voluntary severance, including the principal (refer later for further information). Of these, 12 individuals had left by the year end, 52 left in August 2012 and the remainder had left by the end of October 2012.

We tested a sample of those who had been terminated or approved to leave through the schemes. The payments were agreed to the severance payments calculated by the College's human resources departments and, where the employee had already left a College under the scheme, we agreed the severance payments made to the transaction in the bank statement. Scottish Funding Council support was provided for voluntary severance costs up to 31 July 2012, with a reduced level of funding available after this date.

The total cost to Telford College was £2.0 million, of which £1.5 million was funded through the grant from Scottish Funding Council and the remainder from reserves. Due to most employees leaving after the year end, £1.98 million of these costs were accrued as at 31 July 2012. The total cost to Stevenson College was £3.1 million, of which £2.3 million was funded through Scottish Funding Council grant and the remainder from reserves. Only £86,000 was paid during the year; the remainder held as an accrual at year end.

The terms of the grant from Scottish Funding Council was considered; where this were applicable to employees leaving prior to 31 July 2012, the income had been correctly recognised in the period, as the College had a current liability to pay the severance at the 31 July 2012. The Colleges considered themselves committed to a termination under voluntary severance if:

- *"the location, function, and approximate number of employees whose services are to be terminated;*
- *the termination benefits for each job classification or function; and*
- *the time at which the plan will be implemented; implementation should begin as soon as possible and the period of time to complete implementation should be such that material changes to the plan are not likely."*

Source: Audit Scotland note for guidance 2011/1

As the Colleges had named individuals approved by the year end and had calculations of the severance payments due, along with proposed leaving dates, the Colleges were committed to the terminations and correctly accrued the full liability and recognised the associated income from Scottish Funding Council to match the costs to be funded through the grant.

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Accounting policies; accounting matters (continued)

Audit differences were identified in respect of the Colleges' participation in the Lothian Pension Fund arising from the actuarial assumptions used in the calculation.

Retirement benefits

The Colleges account for participation in the Local Government Pension Scheme in accordance with the recognised provisions of FRS 17 and have therefore recognised the actuarial valuation of the pension liabilities in respect of their shares of the Lothian Pension Fund ("LPF"). 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 is 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 in respect of the LPF is set out in the tables below.

The total pension costs for the year, including Scottish Teachers' Superannuation Scheme contributions and the net interest cost, were £1.99 million for Stevenson College and £1.69 million for Telford College; this compares to £2.24 million and £2.01 million, respectively, in 2010-11. The net FRS 17 pension liabilities at both Colleges reflected significant increases (£574,000 million at Stevenson College and £455,000 at Telford College). These movements in the pension deficits over 2011-12 are largely due to an increase in the present value of the schemes' funded liabilities which are calculated based on a number of actuarial assumptions.

We reviewed these assumptions as part of our audit and compared them against our expectations. Overall, the assumptions adopted by the Colleges 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, resulting in higher pension liabilities. Following discussion with management and the audit committee of Edinburgh College, updated calculations were requested from the actuaries and these have been reflected in the financial statements. This resulted in a decrease in the net liability of £1.4 million in Stevenson College and £1.8 million in Telford College. There was no impact on the income and expenditure account in this year. Further information is provided in appendix 3.

Stevenson College

Balance sheet (£'000)	2012	Movement in deficit (£'000)	2012
Assets	18,608	Employer contributions	874
Liabilities	(21,598)	Current service charge	(847)
Net (liabilities)	**(2,990)**	Contributions in respect of unfunded benefits	7
		Settlements and curtailments	(52)
		Net return on pension asset	91
		Actuarial loss	(647)

Telford College

Balance sheet (£'000)	2012	Movement in deficit (£'000)	2012
Assets	22,702	Employer contributions	938
Liabilities	(26,696)	Current service charge	(850)
Net (liabilities)	**(3,994)**	Contributions in respect of unfunded benefits	25
		Settlements and curtailments	(24)
		Net return on pension asset	104
		Actuarial loss	(648)

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Specific matters relating to Stevenson College

Financial statements preparation and audit process

Draft financial statements were provided on the agreed start date for on-site fieldwork. Documentation in support of the draft financial statements was provided on request.

Area	Comments
Financial statements preparation process	■ Draft financial statements were provided on 7 September 2012 in advance of our audit. Supporting documentation was provided on 8 October 2012 on commencement of our fieldwork, in line with the agreed timetable. ■ Finance staff attempted to respond to our questions and requests quickly and provided high quality information to support the financial statements. However, due to the impact of the Edinburgh College merger, finance staff occasionally had pressing commitments that led to a delay in the receipt of certain requested information. Audit efficiency could have been improved through provision of a complete set of electronic working papers, where available, on commencement of the audit and we will reflect this is planning for future work. ■ 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 7 September 2012 with the operating and financial review ("OFR") in the draft financial statements. We have considered this against guidance and consider that the statement is in line with this.

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 the adjustment posted. There was one unadjusted audit differences which, if adjusted, would have increased the surplus recognised in the year by £108,000. This is based on the extrapolation of an error identified so we consider it a 'soft' adjustment.

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Financial position

The College achieved a surplus of £253,000 for the year. This is lower than in 2010-11 due to exceptional costs of the voluntary severance scheme related to the Edinburgh College merger incurred in the year.

Income and expenditure account		
£000	**2012**	**2011**
Income		
Funding Council grants	21,057	19,794
Tuition fees and education grants	4,965	4,871
Other grant income	1,561	1,224
Other operating income	624	543
Interest receivable	244	153
Total income	**28,451**	**26,585**
Expenditure		
Staff costs	20,784	18,203
Other operating expenses	5,938	5,961
Depreciation	1.450	1,291
Interest payable	26	27
Total expenditure	**28,198**	**25,482**
Surplus/(deficit) for the year	**253**	**1,103**

Source: Draft financial statements

Adjusted result for the year		
	2012	**2011**
	£000	**£000**
Surplus for the year	253	1,103
SFC college collaboration income	(2,377)	(351)
Restructuring costs	3,130	440
FRS 17 pension income	(91)	(36)
Operating surplus for the year	**915**	**1,156**
Adjusted operating surplus as a % of total income	**3.22%**	**4.35%**

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

Result for the year

The overall results for the year was a surplus of £253,000 (0.9% of total income), lower than in 2010-11 (£1.1 million).

Total income increased by £1.9 million (7.0%). This increase was predominantly due to an additional Scottish Funding Council grant of £1.9 million towards the voluntary severance costs related to the Edinburgh College merger. A £1 million fall in the main SFC grant income was offset by a £434,000 increase in income from employability contracts and increased income from higher education tuition fees, secondments, and investment income.

Expenditure has increased by £2.7 million (10.7%) when compared to 2010-11; the main reasons were:

- increased staff costs have of £2.6 million as a result of the voluntary severance exercise carried out in the year (the net cost to the College was £753,000); and
- increased depreciation charges of £159,000 due to additional capital investment of £956,000 during the year.

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.

The most significant reason for the movement in the surplus for the prior year was the restructuring costs incurred in year; after funding from SFC, this resulted in a net cost to the College of £753,000.

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Financial position (continued)

Balance sheet as at 31 July		
£000	**2012**	**2011**
Fixed assets		
Tangible assets	32,085	32,579
Current assets		
Debtors: amounts falling due within 1 year	1,756	1,908
Cash at bank and in hand	11,267	8,656
Creditors: amounts falling due within 1 year	(6,254)	(4,231)
Net current assets	**6,769**	**6,333**
Total assets less current liabilities	**38,854**	**38,912**
Debtors: amounts falling due after more than 1 year	107	160
Creditors: amounts falling due after more than 1 year	(468)	(643)
Provision for liabilities and charges	(1,345)	(1,322)
Net pensions liability	(2,990)	(2,416)
Net assets including pension liability	**34,158**	**34,691**
Deferred capital grants	13,198	13,337
Reserves		
Revaluation reserve	12,358	12,618
General reserve (including pension reserve)	8,602	8,736
Total funds	**34,158**	**34,691**

Source: Draft financial statements 2011-12

The balance sheet shows a decrease in net assets of £1,966,000. Net current assets have increased by £436,000 on prior year. The following are the main movements underlying these:

- Fixed assets have decreased by £494,000. This was due to additions of £956,000, mainly relating to the Sighthill campus redevelopment, partly offset by the depreciation charge for the year of £1.45 million.
- Cash has increased by £2.6 million primarily due to timing differences between cash received for voluntary severance payments and these payments being made to staff. 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 £11,267,000 (2010-11: £8,656,000).
- Creditors due within one year have increased by £2 million, mainly due to the accrual for voluntary severance payments described above.

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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
Operating surplus / (deficit) as a % of income	Measures the surplus on continuing operations as a % of total income	0.9%	4.1%
Non SFC income a % of income	Measures non SFC income as a % of total income	26.0%	25.5%
Current assets : current liabilities	Measures the colleges ability to pay its current liabilities	2.1:1	2.5:1
Days cash	Cash divided by total expenditure less depreciation expressed in days	155	130
Performance against wSUMs activity target	Measures performance against wSUMs activity target	98.5%	100.5%
wSUMs/FTE	Measures efficiency in teaching deployment	416	413
Student – early retention	Measures student retention before cut-off date	90.4%	89.7%
Student outcomes	Measures overall student success	74.7%	72.5%

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

The activity target set by the Scottish Funding Council for 2011-12 was 88,538 wSUMs. The combined target includes 2,523 wSUMs for the ongoing SFC administered European Structural Fund (ESF) project; this target was. The College delivered 88,080 wSUMs in 2011-12; 0.5% less than the Scottish Funding Council set target activity level and well within the acceptable range.

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Corporate governance framework and supporting arrangements

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 confirmed that it is in line with new guidance and reflects our understanding of the College.
Internal audit	As set out in our audit plan and strategy, we reviewed the work of internal audit in 2011-12. The content of the internal audit plan was, 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 "*we are satisfied that sufficient internal audit work has been undertaken to allow us to draw a conclusion as to the adequacy and effectiveness of the College's risk management, control and governance processes. In our opinion Stevenson College Edinburgh did have adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives at the time of our audit work*". 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 assessment of the 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 policy and response plan which details responsibilities with regards to fraud, and processes for reporting, investigating and managing any resulting disciplinary or legal action. 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.

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Accounting policies; accounting matters (continued)

Voluntary severance arrangements	Included in the costs accrued by Stevenson College at the year end are costs in relation to the departure of the principal. Once the merger of the Edinburgh Colleges was confirmed, and prior to the year end, the principal of Stevenson College publically announced that he would not be standing for the position of principal in Edinburgh College and would therefore be taking voluntary severance from the College. It was agreed however, that he would continue in his position until the point of merger on 1 October 2012. While the fact of the principal's departure had been recognised, the terms had not been agreed by the year end. On 14 September 2012, the remuneration committee approved the details of the severance arrangements for the principal. This included a severance payment of 21 months' salary (relating to 21 years' service and in line with the arrangements offered to other staff) and a payment in lieu of notice. The payment in lieu of notice covered the period from 1 October to 14 March 2013 (relating to six months notice from 14 September 2012). Management considers that the College had a constructive obligation to pay these costs at the year end and has therefore accrued the total cost of the severance package into the 2011-12 financial statements. It is not clear from documentation provided as to why the notice period covered by the severance arrangements was not considered to commence earlier, such as when the principal confirmed he would not be standing for the position of principal of Edinburgh College. This would have reduced the noticed period covered by the severance payment and impact on the level of pay in lieu of notice.

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Observations arising from our audit

#	Risk	Issue, impact and recommendation	Management response/ responsible officer/due date
1	Low	For one item of accrued expenditure tested during the audit, the accrual was overstated due to the incorrect number of months being used in the calculation. This did not give rise to a material misstatement, but it did suggest controls over this balance needed to be tightened. We recommend an internal control be implemented to confirm the accuracy of accrued expenditure calculations.	We agree that we need a more robust review process for expenditure and income accruals and prepayments and will instigate this immediately. **Responsible officer:** Financial Accountant **Implementation date:** 30 November 2012
2	Medium	During the course of our audit, it arose that for certain complex journal entries there was a lack of segregation of duties, with the head of finance preparing and authorising them. We recommend that there is a segregation of duties for all journal entries so preparation and authorisation can not be performed by the same individual.	Agreed. The Finance Manager will countersign any journals entries produced by the Head of Finance. **Responsible officer:** Head of Finance **Implementation date:** 30 November 2012
3	Low	During testing, it was discovered that two journal entry top sheets, which contain the preparer's and authoriser's names as well as a summary of the journal entry, were missing. Whilst not a control deficiency, as someone had posted the journals and the top sheets were present on all other journals in the sample, there was a lack of evidence that these particular journals had been authorised, and which person had prepared the journals. We recommend that journal top sheets are completed and retained for all journal entries to improve the available audit trail.	We believe the top sheets went missing when we relocated from the ground floor to the 8th floor recently. We will ensure that all journal entries have the top sheet intact in future. **Responsible officer:** Finance Manager **Implementation date:** 30 November 2012

Key:

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

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Best Value

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

Audit area	Overview	Findings
Best Value	In April 2002 the Scottish Ministers introduced a non-statutory duty on accountable officers to ensure arrangements exist to secure Best Value. Audit Scotland has been committed to extending the Best Value audit regime across the whole public sector for some time now. Using the Scottish Executive's nine Best Value principles as a basis for audit activity, Audit Scotland previously selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). A series of toolkits covering financial, performance and governance processes are available for public sector organisations and auditor to use, but auditors were not required to complete specific toolkit(s) in 2011-12.	We reviewed some of the processes management has established to ensure Best Value is achieved throughout the organisation. This included review and authorisation of expenditure by senior management. This included consideration of participation in the annual procurement capability assessment; the College compared favourably to other further education institutions in this. There is no formal overarching Best Value plan in place; we believe management should consider formally implementing best value principles, particularly for the merged college.
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.

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Specific matters relating to Edinburgh’sTelford College

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 15 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. ■ 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 15 October 2012 with the operating and financial review ("OFR"). Changes were suggested to the corporate governance statement in respect of an enhanced disclosure of risk assessment and to the OFT in respect of greater details in forward-looking plans. A revised OFR was provided on 26 November 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: *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 one audit difference in respect of pensions, summarised in appendix two.

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Financial position

The College reported a deficit of £1.1 million for the year. This was primarily due to a £1.7 million charge for an onerous contract.

Income and expenditure account

Income and expenditure account		
£000	**2012**	**2011**
Income		
Funding council grants	24,291	26,086
Tuition fees and education grants	5,223	5,883
Research grants and contracts	180	943
Other income	1,886	1,651
Interest receivable	297	107
Total income	**31,877**	**34,670**
Expenditure		
Staff costs	19,457	20,822
Other operating expenses	10,895	9,677
Depreciation	2,549	2,702
Interest payable	54	284
Total expenditure	**32,955**	**33,485**
(Deficit)/surplus for the year	**(1,078)**	**1,185**

Source: Draft financial statements

Adjusted result for the year		
	2012	**2011**
	£000	**£000**
(Deficit)/surplus for the year	(1,078)	1,185
Onerous contract charge	1,725	240
SFC college collaboration income	(1,457)	-
Restructuring costs	2,035	873
FRS 17 pension costs	104	29
Operating surplus for the year	**1,329**	**2,327**
Adjusted operating surplus as a % of income	**4.2%**	**6.7%**

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

Result for the year

The overall deficit for the year was £1.08 million (2010-11: £1.19 million surplus), which equates to (3.4)% of total income (2010-11: 3.4%).

Total income decreased by £2.79 million from 2010-11, primarily due to:

- a reduction in Scottish Funding Council grants which decreased by £1.8 million compared with the prior year;
- a reduction in non-EU students resulted in income from these students reducing to £1.69 million, compared with £2.08 million in 2010-11;
- income from research grants and contracts was £0.76 million lower than the prior year, arising from the completion of a contract with JISC on 31 July 2011; there was no corresponding income from this in 2011-12; and
- Other income yielded a small rise of £0.20 million.

Expenditure (excluding the exception onerous contract charge of £1.73 million) decreased by £2.26 million when compared to 2010-11:

- Normal staff costs decreased by £2.80 million as a result of the average full-time equivalent employees dropping to 417 in 2011-12 compared to 551 in 2011-12. This is due to intentionally not filling vacancies following to the voluntary severance programme.
- Other staff costs of £2.52 million relate to costs incurred as part of the voluntary severance scheme and other pension costs.

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.

The most significant reason for the movement in the surplus from the prior year was the £1.73 million onerous contract charge. Restructuring costs were also incurred, resulting in a net cost to the College of £580,000.

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Financial position (continued)

Consolidated Balance sheet as at 31 July		
£000	**2012**	**2011**
Fixed assets		
Tangible assets	57,479	59,491
Current assets		
Stocks	31	32
Debtors: Amounts falling due within 1 year	1,464	1,055
Cash at bank and in hand	13,955	11,849
Creditors: Amounts falling due within 1 year	(6,658)	(6,653)
Net current assets	**8,792**	**7,268**
Total assets less current liabilities	**66,271**	**66,759**
Creditors: Amounts falling due after more than 1 year	(7,250)	(7,748)
Provisions for liabilities and charges	(4,910)	(3,195)
Net pensions liability	(3,994)	(3,539)
Net assets including pension liability	**50,117**	**52,277**
Deferred capital grants	(22,338)	(22,772)
Reserves		
Income and expenditure reserve (including pension reserve)	(27,779)	(29,505)
Total funds	**50,117**	**52,277**

Source: Draft financial statements 2011-12

The balance sheet shows a fall in net assets of £3.95 million. Net current assets have increased, but total assets less current liabilities have decreased.

- Fixed assets decreased by £2.01 million, primarily representing the depreciation charge for the year of £2.50 million. Additions of £560,000 were made during the year. These largely related to the purchase of fixtures, fittings and equipment, including solar panels.
- Cash at bank and in hand increased by £2.10 million, reflecting the core operating surplus and also the result of the receipt of £1.17 million cash from the Scottish Funding Council to fund the voluntary severance scheme. As the majority of staff under voluntary severance will not leave until 2012-13, the cash has not yet been spent.
- Creditors due after one year decreased by £498,000. No new loans have been taken out during the year. The reduction relates to repayments of the Lennartz creditor to HMRC and an annual repayment of the long-term loan to Lloyds TSB.
- Provisions for liabilities and charges include £1.73 million in respect of the onerous contract with Alumno Miller, as detailed on page 23.
- The pension liability increased by £455,000 million. This is a result of changes to assumptions used in calculating the liability, such as the discount rate.
- Deferred capital grants have decreased by £430,000, which is a result of a release to match depreciation of £840,000 and the receipt of an additional £410,000 of new capital grants.

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Financial position (continued)

Budget 2012-13

The financial statements have been drawn up on the basis that the College is a going concern and will continue as such for the foreseeable future. This is based on the transfer of assets and liabilities to Edinburgh College and the continuing of activities following merger.

The following table summarises the actual and forecast income and expenditure for the College for 2011-12 and the merged college for 2012-13:

Forecast (at June 2012)		
£000	**2011-12 (actual) £'000**	**2012-13 (budget) £'000**
Income	31,877	71,132
Expenditure	32,955	72,385
Historic deficit surplus for the year	**(1,078)**	**(1,253)**
Net current assets	**8,792**	**-**
Cash at bank and in hand	**13,955**	**-**

The above forecast is for the newly formed Edinburgh College, which consists of Stevenson, Edinburgh's Telford and Jewel & Esk Valley Colleges. The forecast deficit for 2012-13 is in line with the projected loss for the first three years of operations for the merged College and will be supported by adequate reserves and funding from the Scottish Funding Council.

The enlarged college is anticipated to generate significant efficiency and costs savings in future years in order to break even.

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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 targets for national priorities. These indicators monitor the implementation of the Colleges’ financial objectives. The College has met or exceeded of its performance targets for 2011-12, with the exception of student enrolment targets.

KPI	Purpose	Actual 2011-12	Actual 2010-11
WSUMs	Number of WSUMs per year	112,539	123,746
Operating surplus / (deficit) as a % of income	Measures the surplus on continuing operations as a % of total income	2.0%	3.4%
Total Non-SFC and non-Recurrent SFC income a % of income	Measures non SFC and non-recurrent SFC income as a % of total income	24%	24.7%
Staff costs as a % of income	Staff costs (excluding exceptional items and agency costs) as a % of total income	53%	56.9%
Payment days	Average level of creditors in terms of the month end creditors to the aggregated invoiced amounts during each month	15.8	10.9

Student numbers / Weight Student Units of Measurement (“wSUMs”)

The activity target set by the Scottish Funding Council for 2011-12 was 114,257 wSUMs. The College delivered 112,539 wSUMs in 2011-12; 1.5% less than the Scottish Funding Council set target activity level.

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Corporate governance framework and supporting arrangements

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

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Corporate governance and internal control arrangements **Standards of conduct and prevention and detection of corruption**	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. We have reviewed the corporate governance statement and consider it consistent with our understanding of the process followed by the College during the year. The College has established appropriate processes for the prevention and detection of corruption.
Governance statement	The governance statement provides detail on the governance framework, the system of internal control, internal audit, internal financial controls and risk management arrangements, and analyses the effectiveness of these elements of the framework. It describes a number of sources of assurance for the accountable officer. We have reviewed the governance statement and , subsequent to some suggested amendments, have confirmed that it is in line with new guidance and reflects our understanding of the College.
Internal audit	As set out in our audit plan and strategy, we reviewed the work of internal audit in 2011-12. The content of the internal audit plan is, in our view, appropriate for the size and nature of the College. Internal audit completed their planned audit work for the year and concluded that "*In our opinion Edinburgh's Telford College has a framework in place, in the areas which we have reviewed, that provides reasonable assurance regarding the effective and efficient achievement of the College's objectives and the management of key risks. Arrangements are in place to help support the achievement of 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, although they assisted our understanding of the College's operations and overall systems of internal control.

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Accounting policies; accounting matters (continued)

A provision of £1.7 million is recognised in the financial statements in relation to an obligation to underwrite occupancy in the residences.

This is in respect of a contract with Alumno Miller which has a break clause after 15 years.

Onerous contract provision – Telford College	**Background** In 2009-10 Telford College entered into a contract with Alumno Miller for the placement of students in residential accommodation, placing an obligation on the College to underwrite occupation below 100%. The first students occupied the residences in September 2010. As at 31 July 2011, Telford College was in dispute with Alumno Miller regarding the terms of the agreement; legal proceedings were initiated by Alumno Miller against the College in May 2011, resulting in a court case. As at the date of approval of the 2010-11 financial statements, the College was awaiting the outcome of the court case and had received legal advice that it had a case to challenge the contract. At this date there was limited information in respect of the likely occupancy of the residences, since they were only brought into use at the start of the 2010-11 academic year, and therefore limited information in respect of the guarantee obligation. While no payments were made against contract obligations prior to 31 July 2011, a provision of £240,000 was included in the financial statements as at that date for the estimated liability arising from the guarantee. Lord Glennie found in favour of Alumno Miller and the decision was delivered at the end of 2011. The Board of Management considered this and decided in 2012 not to appeal the decision. **2011-12** Following the ruling and with the availability of another academic year of occupancy rates, management considered the obligations under the contract and the level of occupation of the residences. Management consider that the contract is onerous under FRS 12 *Provisions and contingencies* and have recognised a provision of £1.73 million. This represents management's best estimate of the likely payments required under the underwriting clause, based on historical occupation levels and discounted at 8% over the 15 year initial period of the contract. A corresponding charge of £1.73 million has been recognised in the financial statements. We concur that a provision is appropriate, since there is a present obligation to transfer economic benefit as a result of a past event, being the signing of the contract. Management have based the provision on historical occupation rates and, given the limited other information available in respect of occupation, this is considered to be an appropriate basis. There is an argument that the £1.73 million obligation existed as at 31 July 2011, contrary to the treatment in the financial statements. Management consider that the uncertainty of the court case and the inherent limited availability of occupancy rates made it difficult to make a reliable estimate of the likely obligation in respect of the guarantee and £240,000 was considered to be appropriate at that date. We concur that further evidence of the likely obligation became available during 2011-12 and the £1.7 million charge is appropriately recognised.

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Corporate governance framework and supporting arrangements (continued)

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. Policies are in place which address fraud, including a whistle-blowing policy. There is adequate segregation of duties which reduces the risk of fraud. There is no authorisation of manual journals, giving rise to the risk of fraud as well as error. Management consider that the implementation of a journal review and authorisation process is unrealistically onerous, although we consider that a risk-based review of journals and supporting documentation is important in managing the risk of fraud and error inherent in manual journals. Management consider that a compensating control is in place by way of the preparation and review of monthly management accounts. *Recommendation one*

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Observations arising from our audit

#	Risk	Issue, impact and recommendation	Management response/ responsible officer/due date
1	● Medium	The College has no process in place for the authorisation of manual journals. These are created and posted by the same user, and there is no separate review by another member of staff. There is no requirement to keep a hardcopy of the support for the journal. Manual journals carry inherent risk of fraud and nature and without a separate review instances of fraud or error may not be prevented or detected. We recommend that journals are authorised prior to posting onto the ledger system, following review of the supporting documentation. Where the finance function is small and a full review is not possible, a risk-based review process should be implemented.	Journals are produced by senior staff within the department who have appropriate skills and knowledge. The introduction of a specific authorisation process would simply introduce another manual step which should be unnecessary. This may be looked at if a new finance system can automate workflow authorisation processes. **Responsible officer:** Financial controller **Implementation date:** To review when a new finance system is implemented.

Key:

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

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Best Value

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

Audit area	Overview	Findings
Best Value	In April 2002 the Scottish Ministers introduced a non-statutory duty on accountable officers to ensure arrangements exist to secure Best Value. Audit Scotland has been committed to extending the Best Value audit regime across the whole public sector for some time now. Using the Scottish Executive's nine Best Value principles as a basis for audit activity, Audit Scotland previously selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). A series of toolkits covering financial, performance and governance processes are available for public sector organisations and auditor to use, but auditors were not required to complete specific toolkit(s) in 2011-12.	We reviewed some of the processes management has established to ensure Best Value is achieved throughout the organisation. This included review and authorisation of expenditure by senior management. This included consideration of participation in the annual procurement capability assessment; the College compared favourably to other further education institutions in this. There is no formal overarching Best Value plan in place; we believe management should consider formally implementing best value principles, particularly for the merged college.
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. A summary of issued circulars is provided at each Board of Management meeting.

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Appendices

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

Financial statements

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

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

Systems of internal control

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

Prevention and detection of fraud and irregularities

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

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

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

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

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

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Summary of audit differences

There were [two] audit differences. 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 Colleges' financial statements for which the statements have been adjusted.

£000	Income and expenditure account		Balance sheet	
Issue	**Dr**	**Cr**	**Dr**	**Cr**
Stevenson College	-	-	1,433	1,433
Telford College			1,787	1,787
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%				
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.

Misstatements that management have not corrected

The following table shows differences identified during the course of the audit of Stevenson College's financial statements for which the statements have not been adjusted.

Stevenson College				
£000	**Income and expenditure account**		**Balance sheet**	
Issue	**Dr**	**Cr**	**Dr**	**Cr**
Adjustment from extrapolation for overstatement of accrued expenditure	-	108	108	-
Overall I&E impact	**-**	**108**	**108**	**-**

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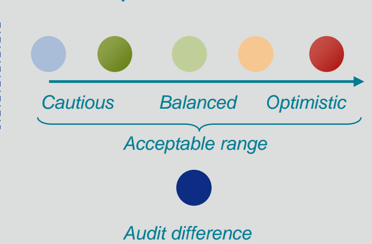
Pensions considerations

Presented below is a comparison of the assumptions used by Hymans Robertson who advise the Colleges in respect of the Lothian and Strathclyde Pension Funds, 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. This results in an audit difference in the balance sheet. There is no impact on the income and expenditure account.
Discount rate	4.1%	4.4%		The proposed discount rate is on the limits of the 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	2.20% RPI less 0.8%	1.90% RPI less 1.0%		The assumptions is stronger (higher liability) than our central rate and is on the limits of the range we would normally consider reasonable.
Net discount rate (Discount rate – CPI)	**1.9%**	**2.5%**		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 20 years duration. The net discount rate is stronger (higher liability) than our central rate. This combined result of the discount rate and inflation assumption is an audit difference.
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



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Sector update

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

Area	Issues
International Financial Reporting Standards (IFRS)	Draft Financial Reporting Standards (FRS) 100, 101 and 102 set out the future standards for UK GAAP. These standards are based upon International Financial Reporting Standards and anticipated to be effective for years commencing on or after 1 January 2015. For the further education sector this will require financial statements to be produced in line with the new standards for the year ending 31 July 2016 with restatement required to the comparative period. 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.

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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.

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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.***

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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.

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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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