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# Ayr College

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

Year ended 31 July 2013

# Contents

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This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*"). This report is for the benefit of the Board of Management of Ayr College and is made available to Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

We also draw your attention to the following:

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

# Headlines

**This annual audit report summarises our work for the year ended 31 July 2013. Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the Code") and guidance issued by Audit Scotland.**

**This report also sets our those matters specified by ISA (UK and Ireland) 260: *Communication with those charged with governance* in relation to the financial statements for the year ended 31 July 2013.**

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

| Area | Summary observations | Analysis |
|---|---|---|
| **Strategic overview and use of resources** | | |
| Key issues | During the 2012-13 financial year, the boards of management of Ayr, Kilmarnock and James Watt Colleges gave support to the creation of a merged college for the Ayrshire region. This new college is known as Ayrshire College and comprises Ayr College, Kilmarnock College and the James Watt College North Ayrshire campuses at Kilwinning, Largs and Nethermains.<br>The establishment of Ayrshire College was effected by the transfer of the activities and assets of all the other colleges to Ayr College as at 1 August 2013.<br>Management approved seven voluntary severance applications during the year which were supported by Scottish Funding Council transformation funding. | Page 6 |
| Financial position | The College made an overall surplus of £86,000 (2011-12: £224,000 surplus).<br>Income and expenditure increased in comparison to the previous year, primarily as a result of costs associated with voluntary severance offset by transformation funding received from the Scottish Funding Council.<br>The balance sheet reflects an increase in net assets of £8.9 million, primarily associated with the revaluation of freehold land and buildings. The increase in fixed assets as a result of the revaluation was £8.2 million. | Pages 7-8 |
| Financial planning | The Ayrshire region will receive £32 million core funding from the Scottish Funding Council for the academic year 2013-14. A financial budget was prepared as part of the merger business case and will be used, in conjunction with the regional outcome agreement with the Scottish Ministers, to monitor the merged college performance. | Page 8 |
| **Financial statements and accounting** | | |
| Accounting policies | There have been no substantive changes to the financial reporting framework as set out in the Statement of Recommended Practice: Accounting for Further and Higher Education (2007) ("the SORP").<br>There have been no changes to accounting policies in 2012-13. All accounting policies have been applied consistently.<br>The financial statements have been prepared on a going concern basis. | Page 10 |
| Audit conclusions | [We have issued] an unqualified audit opinion on the financial statements. | Page 11 |

# Headlines (continued)

| Financial statements and accounting (continued) | | |
|---|---|---|
| Year end process | The unaudited financial statements were made available on a timely basis in advance of audit field work. | Page 12 |
| Key judgment areas | We are in agreement with judgements made by management in respect of actuarial assumptions used to provide a valuation of the College's net pension liabilities. | Page 12 |
| Financial accounting framework | A new SORP, consistent with FRS102, will be applied in respect of the year ending 31 March 2016. Ayrshire College will need to prepare a transitional balance sheet as at 1 April 2014.<br><br>Management will also need to take account of changes to the classification of further education colleges with effect from 1 April 2014. This will affect the accounting reference date, budgeting arrangements, ability to carry forward surpluses and the accounting framework.<br><br>There remains some uncertainty over the interaction of the SORP and the IFRS-based Government Financial Reporting Manual. | Page 13 |
| **Performance management arrangements** | | |
| Performance management | The College produces quarterly management accounts which compare actual expenditure to budget and has a procurement strategy which seeks to use the most advantageous supplier that is available. Efficiency savings are planned as part of the merger business case.<br><br>Performance against sector indicators and other colleges is measured by the College during the year and reported regularly to management. | Page 15 |
| **Governance and narrative reporting** | | |
| Governance arrangements | The statement of corporate governance and internal control identifies no major weaknesses in governance or internal control arrangements.<br><br>We have reviewed the statement of corporate governance and consider it consistent with our understanding of the process followed by the College during the year.<br><br>Management has identified no significant fraud or irregularities. | Page 17 |
| Systems of internal control | Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively subject to recommendations made to enhance those controls. | Page 18 |

# Scope and responsibilities

## Background

The purpose of this report is to set out certain matters which came to our attention during the course of our audit of the financial statements of Ayr College (“the College”) for the year ended 31 July 2013.

## The purpose of our audit

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

- give a true and fair view of the state of the affairs of the College as at 31 July 2013 and of the College’s income and expenditure, recognised gains and losses and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice;
- have been prepared in accordance with the Statement of Recommended Practice: Accounting for Further and Higher Education; and
- the expenditure disbursed and income received during the year ended 31 July 2013 have been applied to purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

## The purpose of this report

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

## Independence

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

KPMG conforms to the highest governance standards at all times and we will ensure that any additional services are approved by the audit committee to ensure transparency. No additional services have been provided in respect of the year ended 31 July 2013.

# Strategic overview and use of resources

Our perspective on the College's approach to key issues affecting the further education sector, and its use of resources

# Key issues

**On 19 February 2013 the boards of management of Ayr, Kilmarnock and James Watt Colleges gave support to the creation of a merged college for the Ayrshire region.**

**The establishment of Ayrshire College, was effected by the transfer of all the activities and assets of Kilmarnock and the North Ayrshire Campuses of James Watt College to Ayr College as at 1 August 2013.**

**Management approved seven voluntary severance applications, supported by Scottish Funding Council transformation funding.**

## Sector organisational and structure changes

The process of regionalisation began in 2011-12 with the goal of creating 13 college regions across Scotland, to be completed by 2013-14.

On 19 February 2013 the boards of management of Ayr, Kilmarnock and James Watt Colleges gave support to the creation of a merged college for the Ayrshire region. All considered that the size and scale of the new college will allow it to operate more effectively within the regional structure for colleges across Scotland and ensure it meets the future education and skills development needs of the region. The boards also expect the new regional arrangement will help address the significant funding challenges faced by the college sector.

The establishment of Ayrshire College was effected by the transfer of all the activities and assets of Kilmarnock College and the North Ayrshire campuses of James Watt College to Ayr College as at 1 August 2013.

During the year a board of management for Ayrshire was established, comprising a chair, principal and additional representation from Ayr, Kilmarnock and James Watt Colleges, including college staff and student representation.

At a special board meeting convened in August 2012 to consider the results of financial and legal due diligence exercises conducted by third parties, the regionalisation was recommended, and subsequently accepted, with Ayr being the host college for the merger.

Going forward, the Statement of Recommended Practice: *Accounting for further and higher education* (2007) requires that institutions must assess, in accordance with Finance Reporting Standard 6: *Acquisitions and Mergers,* whether a combination of an institution with another institution is an acquisition or merger. It is important that management's proposed accounting treatment is agreed on a timely basis.

## Voluntary severance

A voluntary severance scheme was introduced during 2012-13, supported by transformation funding from the Scottish Funding Council. Management approved seven voluntary severance applications with a total cost of £749,000. £704,000 of this cost will be met by transformation funding, with the balance met by the College.

## Outcome agreement

The Ayrshire region outcome agreement with the Scottish Ministers was developed in consultation with Ayr College during 2012-13 and signed by representatives of all three colleges in June 2013.

The priority impacts to be achieved by the merged college include:

- achieving a 10.5% increase in wSUMS to 183,269 for 2013-14;
- implementing a fully merged regional college which will deliver effective, efficient, and sustainable curriculum and services;
- providing a streamlined regional curriculum which will shorten learner journeys, meet employer, learner, and community demands, and provide clear pathways to articulation and progression; and
- ensuring the sustainability of the regional college through sound financial management of the public funds available, and to direct the maximum level of resource towards learners.

# Financial position

**The College made an overall surplus of £86,000 (2011-12: £224,000).**

**Income and expenditure increased, primarily as a result of costs associated with voluntary severance offset by transformation funding receivable from the Scottish Funding Council.**

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

| Income and expenditure account | | |
|---|---|---|
| **£000** | **2013** | **2012** |
| **Income** | | |
| Funding Council grants | 11,766 | 11,220 |
| Tuition fees and education grants | 2,131 | 1,898 |
| Other grant income | 130 | 259 |
| Other operating income | 862 | 832 |
| Investment income | 45 | 121 |
| **Total income** | **14,934** | **14,330** |
| **Expenditure** | | |
| Staff costs | (10,891) | (10,041) |
| Other operating expenses | (2,813) | (2,858) |
| Depreciation | (1,121) | (1,205) |
| Interest payable | (23) | (2) |
| **Total expenditure** | **(14,848)** | **(14,106)** |
| **Surplus on continuing operations** | **86** | **224** |

*Source: 2012-13 draft financial statements*

## Result for the year

The College made a surplus of £86,000 (2011-12: £224,000). Total income increased by £423,000 when compared to 2011-12:

- Funding Council grants have increased by £365,000 as included within this is transformation funding of £1,153,000 (2011-12: £62,000) which was costs relating to the regionalisation. £704,000 of this was in respect of severance. This increase is partially offset by the £466,000 decrease in recurrent grant income due to the 10% reduction in income nationwide by Scottish Funding Council in 2012-13.
- Within the transformation expenditure there is £704,000 relating to severance and strain on funds, £137,000 for workshops to help staff transition, £107,000 of due diligence costs and £84,000 annual costs for a project manager who was hired to facilitate the regionalisation.
- Tuition fee and education grants have increased, primarily due to the New College Learning programme introduced by Skills Development Scotland in 2012-13. Ayr College received £320,000 of funding in respect of this.

Expenditure has increased by £561,000 when compared to 2011-12:

- Staff costs include £749,000 in respect of restructuring costs associated with the voluntary severance scheme as a direct result of the regionalisation of the Colleges in Ayrshire.
- Other operating expenses have decreased by £164,000. This is primarily due to European Social Fund project expenditure being £132,000 less than in the prior year as the programme was completed during 2012-13.

# Financial position (continued)

**The balance sheet reflects an increase in net assets of £8.9 million, primarily associated with the revaluation of freehold land and buildings by external experts. The increase in fixed assets, as a result of the revaluation, was £8.2 million.**

**The Ayrshire region, will receive £32 million core funding from the Scottish Funding Council in respect of the academic year 2013-14.**

**A financial budget was prepared as part of the merger business case and will be used, in conjunction with the regional outcome agreement with the Scottish Ministers, to monitor the merged college's future performance.**

## Balance sheet

| Balance sheet as at 31 July | | |
|---|---|---|
| **£000** | **2013** | **2012** |
| **Fixed assets** | | |
| Tangible assets | 25,745 | 17,524 |
| **Current assets** | | |
| Stocks | 4 | 5 |
| Debtors: Amounts falling due within one year | 561 | 485 |
| Cash at bank and in hand | 1,936 | 1,982 |
| Creditors: Amounts falling due within one year | (1,383) | (1,718) |
| **Net current assets** | **1,118** | **754** |
| Provisions for liabilities and charges | (907) | (951) |
| Net pensions liability | (1,239) | (1,498) |
| **Net assets** | **24,717** | **15,829** |
| Deferred capital grants | 7,590 | 7,890 |
| **Reserves** | | |
| Income and expenditure reserve (including pension reserve) | 3,691 | 3,148 |
| Revaluation reserve | 13,436 | 4,791 |
| **Total funds** | **24,717** | **15,829** |

*Source: 2012-13 draft financial statements*

- Fixed assets have increased £8.2 million as a result of the revaluation of the freehold land and buildings conducted at the year end by District Valuer Services. The valuation basis used was a mixture of market value for the cleared site at Newtonhead, depreciated replacement cost for the three main buildings, and existing use value for residential properties and the Cumnock site.
- Cash at bank and in hand remains in a healthy position in line with prior year.
- The decrease in creditors is due to a change in business practice by the College to pay as many of their creditors prior to year end. This change was instructed by senior management to bring their practices into line with that of Kilmarnock College prior to the merger on 1 August 2013. This has resulted in a £200,000 decrease in trade creditors in 2013 to £290,000 and also a £200,000 decrease in other creditors to just £60,000 at 31 July 2013.

### Budget 2013-14

Following the merger on 1 August 2013, Ayrshire will receive £32 million core funding from the Scottish Funding Council in respect of the academic year 2013-14. This reflects a projected 10.5% increase in combined sums activity of the Colleges to 183,269 in 2013-14. Other financial assumptions include a 1% pay increase to cover incremental drift and pension increases and fixed asset capital expenditure of £2.2m. This capital expenditure is required for the College to continue to meet its educational commitments and modernise the curriculum and delivery processes. This expenditure will be funded by the Scottish Funding Council

A financial budget was prepared as part of the merger business case and will be used, in conjunction with the regional outcome agreement with the Scottish Ministers to monitor the merged college's future performance.

# Financial statements and accounting

Our perspective on the preparation of the financial statements and key accounting judgements made by management

# Accounting policies

**There have been no substantive changes to the financial reporting framework as set out in the *Statement of Recommended Practice: Accounting for Further and Higher Education (2007)* ("the SORP").**

**There have been no changes to accounting policies in 2012-13. All accounting policies have been applied consistently.**

**The financial statements have been prepared on a going concern basis.**

| Accounting framework and application of accounting policies | |
|---|---|
| **Area** | **KPMG comment** |
| **Statement of Recommended Practice: Accounting for Further and Higher Education (2007) ("the SORP").** | ■ The 2012-13 financial statements have been prepared in accordance with the SORP.<br>■ During the year there have been no substantive changes in financial reporting requirements, and consequently there are no material changes to the College's accounting policies.<br>■ We are satisfied that the accounting policies adopted remain appropriate to the business, and have been applied consistently. |
| **Impact of revised accounting standards** | ■ There are no newly effective accounting standards which are considered to have a material impact on the College's financial statements. |
| **Going concern** | ■ The College merged with Kilmarnock College and acquired the North Ayrshire campuses of James Watt College on 1 August 2013. This is a transfer of functions within the public sector and accordingly the financial statement have been prepared on a going concern basis. No amendments have been made to established accounting policies to reflect the merger. Appropriate disclosures have been included within the financial statements in this respect.<br>■ Management has considered the funding available to the merged college in 2013-14 and consider it appropriate to adopt a going concern basis for the preparation of these financial statements.<br>■ We are satisfied that the going concern basis of preparation of the financial statements is appropriate. |

# Audit conclusions

**[We have issued] an unqualified audit opinion on the financial statements.**

## Audit conclusions

[We have issued] an unqualified opinion on the truth and fairness of the state of the affairs of the College as at 31 July 2013 and of the College's income and expenditure, recognised gains and losses and cash flows for the year then ended. The financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice and the SORP.

In gathering the evidence for our opinion we have:

- performed a mixture of substantive and controls testing to ensure an efficient approach that covers all the key risks;
- reviewed internal audit reports to ensure all key risk areas having a potential financial statements impact have been considered;
- reviewed assumptions and judgements made by management and considered these for appropriateness;
- considered if the financial statements may be affected by fraud through discussions with senior management and internal audit to gain a better understanding of their work in relation to the prevention and detection of fraud with the potential to impact on the financial statements;
- held discussions with senior management; and
- attended a meeting with those charged with governance to communicate our findings, but also to update our understanding of the key governance processes and obtain key stakeholder insights.

# Year end process; future accounting framework

**The unaudited financial statements were made available on a timely basis.**

**A new SORP, that draws out the principles of FRS102, will be applied in respect of the year ending 31 March 2016. Ayrshire College will need to prepare a transitional balance sheet as at 1 April 2014.**

**Management will need to take account of changes to the classification of further education colleges with effect from 1 April 2014. This will affect the accounting reference date, budgeting arrangements, ability to carry forward surpluses and the accounting framework.**

**There remains uncertainty over the interaction of the SORP and the IFRS-based Government Financial Reporting Manual.**

## Financial statements preparation

- High quality working papers and complete unaudited financial statements were provided on 7 October 2013 in line with the agreed timetable. This included the operating and financial review and statement of corporate governance and internal control.
- We provided feedback to management on the content of the financial statements, operating and financial review and statement of corporate governance and internal control, which were subsequently adjusted in the financial statements. We are satisfied that these are materially prepared in accordance with relevant regulations and guidance as appropriate.
- There were two adjusted audit differences. One was for the recognition of severance costs of £181,000 and the other to reallocate the severance costs from other expenditure to staff costs. There were no unadjusted audit differences. There are no significant matters in respect of (i) auditor independence and non-audit fees and (ii) management representation letter content, as reported in appendix one.

## Changes to Statement of Recommended Practice: Accounting for Further and Higher Education

- In March 2013, the Financial Report Council (“FRC”) issued FRS 102, the Financial Reporting Standard applicable in the UK and Republic of Ireland. This is the main part of the new UK GAAP regime and follows the issue in November 2012 of FRS 100 (overview of the framework) and FRS 101 (reduced disclosure framework).
- FRS 102, is applicable for accounting periods beginning on or after 1 January 2015. In response, the Further and Higher Education SORP Board has recently completed the development of a new SORP, which is currently subject to a process of consultation. Ayrshire College will need to prepare a transitional balance sheet as at 1 April 2014.

## Changes to the classification of further education institutions

- Following the creation of sixth form college Corporations on 1 April 2010 (which are classified as local government entities) the Office of National Statistics (“ONS”) decided to review the classification of all further education colleges in the UK. The key factors examined by ONS are the ‘public sector powers’ held by government Ministers, and their public agencies, such as the Scottish Funding Council, over further education colleges. As a result of their evaluation, the ONS concluded that all further education colleges should be classed as public sector bodies. This decision does not require legislative change.
- This has wide implications for colleges who will need to change their budgeting, reporting and accounting practices to align with those that applicable for central government organisations. Colleges currently budget and account on an academic year basis but will need to switch to the same financial year basis used across the public sector (April to March). For the purposes of HM Treasury budgeting, incorporated colleges will be classified as ‘Arms-Length Bodies’ (“ALBs”) analogous to non-departmental public bodies. This will restrict colleges’ abilities to use carried forward surpluses and require that all revenue and capital expenditure is within the Scottish Government’s annual expenditure limits.
- In consultation with the college sector, the Scottish Funding Council is reviewing this reclassification and giving consideration to the impact.

# Key accounting judgements

**We are in agreement with judgements made by management in respect of actuarial assumptions used to provide a valuation of the College's net pension liabilities.**

**Key accounting judgments and other accounting and audit matters**

| Area | KPMG comment |
|---|---|
| **Retirement benefits** | The College accounts for its participation in the Strathclyde Pension Fund in accordance with FRS 17 *Retirement benefits*, using a valuation report prepared by actuarial consultants. Our audit of the accounting for retirement benefits includes consideration of the data underlying the actuarial report. This includes the level of contributions made during the year, the financial assumptions and membership data provided to the actuary and the College's share of the pension fund assets.<br><br>No such requirement exists for Scottish Teachers' Superannuation Scheme obligations as this is a multi-employer scheme where the individual assets and liabilities cannot be separately identified for each employer and therefore accounted for as a defined contribution scheme under the provisions of FRS 17.<br><br>The level of contributions made by the College in the year is estimated based on data prior to the year end. It is important that this number is accurate as it is used to inform the calculation of the liabilities at the year end. Our testing included review of actual data against that used in the actuarial calculations. No issues were identified.<br><br>The actuaries use a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases. Our actuarial colleagues have reviewed the assumptions and concluded that those used fall within the range that we would normally consider acceptable for the purpose of FRS 17 for a typical employer. A breakdown of the assumptions against our expectations is included in Appendix three.<br><br>The rate of salary increases is set taking into account the College's expected long-term rate of salary increases, including incremental drift. Following discussion with management, the rate assumed in 2013-14 is 3.5% followed by 1% in each of 2014-15 and 2015-16 reverting thereafter to RPI + 1.4%. The increases assumed in the period 2014-15 to 2015-16 are 1% less than those included in the merger budget, but represent management's estimation of the most likely increases taking into account a variety of factors including harmonisation and headcount changes. Management should ensure that in setting this assumption it reflects the College's long-term plans and strategy.<br><br>Total pension cost for the year, including Strathclyde Pension Funds contributions and the service cost, was £1.2 million compared to £1.1 million in 2012-13. The net FRS 17 pension liability has decreased by £300,000 at 31 July 2013 compared to 2012. The movement in the pension deficit over 2012-13 is largely due to an increase in the value of the scheme's assets. |

# Performance management

Our perspective on the performance management arrangements, including follow up work on Audit Scotland reports

# Performance management

**The College produces quarterly management accounts which compare actual expenditure to budget and has a procurement strategy which seeks to use the most advantageous supplier that is available. Efficiency savings are planned as part of the merger business case.**

**Performance against sector indicators and other colleges is measured by the College.**

## Performance indicators

**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 and are summarised below. Performance against these is monitored during the year and reported regularly to management.

| KPI | Purpose | Actual 2012-13 | Actual 2011-12 |
|---|---|---|---|
| WSUMs | Number of WSUMS per year | 54,613 | 54,447 |
| Operating surplus / (deficit) as a % of income | Measures the surplus on continuing operations as a % of total income | 0.6% | 1.6% |
| Non SFC income as a % of income | Measures non SFC income as a % of total income | 21.5% | 21.8% |
| Current assets : current liabilities | Measures the colleges ability to pay its current liabilities | 1.8 | 1.4 |
| Days cash | Cash divided by total expenditure less depreciation expressed in days | 48 | 52 |
| Performance against wSUMs activity target | Measures performance against wSUMs activity target | 101.84% | 100.26% |
| wSUMs/FTE | Measures efficiency in teaching deployment | 423 | 425 |
| Student – early retention | Measures student retention before cut-off date | 95% | 94% |
| Student outcomes | Measures overall student success | 87% | 79% |

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

The activity target set by the Scottish Funding Council for 2012-13 was 53,627 wSUMs. The College delivered 54,613 wSUMs in 2012-13; 1.8% greater than the Scottish Funding Council set target activity level.

# Governance and narrative reporting

Update on your governance arrangements

Our overall perspective on your narrative reporting.

# Corporate governance arrangements

**The statement of corporate governance and internal control identifies no major weaknesses in governance or internal control arrangements.**

**We have reviewed the statement of corporate governance and consider it consistent with our understanding of the process followed by the College during the year.**

**Management has identified no significant fraud or irregularities.**

| | |
|---|---|
| **Corporate governance and internal control arrangements** | The College has made a compliant corporate governance and internal control 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. We are not required to provide an opinion on the College's system of internal control.<br><br>The statement of corporate governance and internal control provides detail on the governance framework, the system of internal control, internal audit, internal financial controls and risk management arrangements, and analyses the effectiveness of these elements of the framework. It describes a number of sources of assurance for the accountable officer.<br><br>We have reviewed the statement of corporate governance and internal control and consider it consistent with our understanding of the process followed by the College during the year.<br><br>The governance structure in the College has undergone changes since the year end 31 July 2013 which will result in the Board of Management of Ayrshire College considering the 2012-13 financial statement of the College. The Ayrshire College Board of Management had no assumed members from any of the former Colleges; each board member had to apply for membership to the board. Per discussions with senior management, arrangements are in place for the Ayrshire College board to approve the accounts of Ayr College for 12-13 under the new name of the Board of Management of Ayrshire College. |
| **Senior post-holders' emoluments** | The Accounts Direction, issued by the Scottish Funding Council, sets out certain disclosures required in respect of senior post-holders' emoluments.<br><br>We tested a sample of disclosures to ensure that they were prepared in accordance with the requirements of the Accounts Direction. |
| **Prevention and detection of fraud** | A key mechanism in the allocation of authority, accountability and responsibility and the prevention and detection of fraud is the existence and maintenance of strategic and financial documentation. The College has established appropriate processes for the prevention and detection of fraud. During 2012-13, management identified no significant fraud or irregularities.<br><br>The College has a fraud response plan to define authority levels, responsibilities for action and reporting lines in the event of a suspected fraud or irregularity. The fraud response plan is included within the financial regulations which are on the intranet for employees to obtain. When management is made aware of a suspected fraud the director of human resources shall immediately invoke the disciplinary procedures relating to fraud. Management has not reported any material instances of fraud or irregularity in 2012-13. There is also a whistle blowing policy available on the intranet as required by the Public Interest Disclosure Act 1998. |
| **Maintaining standards of conduct and the prevention and detection of corruption** | The College has appropriate policies and codes of conduct for staff and members, including the use of a register of members' interests. |

# Corporate governance arrangements (continued)

**Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively subject to recommendations made to enhance those controls.**

| | |
|---|---|
| **Systems of internal control** | Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively subject to recommendations made to enhance those controls. Our controls testing included testing of bank reconciliations, payroll variance reports and payments, and BACs payments. |
| **Internal audit** | As set out in our audit plan and strategy, we reviewed the work of internal audit in 2012-13. The content of the internal<br><br>audit plan is, in our view, appropriate for the size and nature of the College. Due to the areas of focus of internal audit in the year, we did not place specific reliance on any the reports issued in the year, but they assisted our understanding of the College's operations and overall systems of internal control.<br><br>Internal audit completed their planned audit work for the year and concluded that "*In our opinion Ayr College has a strong framework of controls in place that provides substantial assurance regarding the effective and efficient achievement of objectives and the management of key risks. Proper arrangements are in place, in the areas we have reviewed, to promote value for money, deliver best value and secure regularity and propriety in the administration and operation of the organisation.*" |

# Appendices

# Mandatory communications

**There were no changes to the core financial statements, no adjusted audit differences and no unadjusted audit difference.**

| Area | Key content | Reference |
|---|---|---|
| **Adjusted audit differences**<br>Adjustments made as a result of our audit | There were two audit adjustments required to the unaudited financial statements. These adjustments had no impact on the net assets or the surplus for the year. | Appendix 2 |
| **Unadjusted audit differences** | We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you. There are no unadjusted audit differences. | Appendix 2 |
| **Confirmation of Independence**<br>Letter issued by KPMG LLP to the audit committee | We have considered and confirmed our independence as auditor and our quality procedures, together with the objectivity of our Audit Director and audit staff. There were no non-audit fees payable in the year. | Appendix 4 |
| **Draft management representation letter**<br>Proposed draft of letter to be issued by the College to KPMG prior to audit sign-off | There are no changes to the representations required for our audit from last year. | - |

# Summary of audit differences

**There were no audit differences identified. There was no effect on the income and expenditure account.**

**We identified a number of presentational matters during our audit and these have all been amended by management.**

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 2013.

## Misstatements that management have corrected

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

| College | | | | |
|---|---|---|---|---|
| **£000** | **Income and expenditure account** | | **Balance sheet** | |
| ***Reallocation of severance costs claimed under transformation fund from other expenditure to staff costs*** | **Dr** | **Cr** | **Dr** | **Cr** |
| Staff costs | 523 | - | - | - |
| Other expenditure | - | (523) | - | - |
| ***Recognition of severance of Finance Director against transformation grant*** | | | | |
| Income – Funding Council grants | 181 | | | |
| Staff costs | | (181) | | |
| Accruals and deferred income | | | | (181) |
| Amounts owed to Scottish Funding Council (transformation grant) | | | 181 | |
| **Overall impact** | **-** | **-** | **-** | **-** |

## Presentational adjustments

We identified a small number of presentational issues during our audit and these have all been amended by management.

## Uncorrected

There were no differences identified during the course of the audit of the College's financial statements for which the statements have not been adjusted.

# Pensions assumptions

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

| Assumptions | Employer | KPMG central | Assessment | KPMG comments |
|---|---|---|---|---|
| **Overall** | | | Acceptable | ■ The net discount rate (discount rate – CPI inflation) proposed for the Local Government Pension Scheme (LGPS) falls within the acceptable range for the purpose of FRS17 / IAS19 for a typical LGPS employer (with a liability duration of around 17 years) |
| **Discount rate** | 4.6% | 4.4% | See comments | ■ The proposed discount rate of 4.6% is weaker (lower liability) than KPMG's central rate but is within the range that we would normally consider acceptable for the purposes of FRS 17 / IAS 19 |
| **RPI inflation** | 3.6% | 3.5% | Acceptable | ■ The proposed RPI inflation rate of 3.7% is slightly stronger (higher liabilities) than KPMG's central rate for a scheme with an average duration of 17 years but is within a range we consider to be acceptable for the purposes of FRS17 / IAS 19 |
| **CPI inflation / Pension increases** | 2.8% RPI less 0.8% | 2.5% RPI less 1.0% | See comments | ■ This assumption is more prudent (higher liabilities) than KPMG's central rate and is at the upper limit of what we consider to be acceptable for the purposes of FRS17 / IAS 19 |
| **Net discount rate (Discount rate – CPI)** | 1.8% | 1.9% | Acceptable | ■ The range that we would consider acceptable for this gap under FRS 17 / IAS 19 is 1.9% +/- 0.3%, hence the proposed assumption is within this range |
| **Salary growth** | 1% pa until 31 March 2015, 5.1%/4.6% from 31 March 2015 (RPI plus 1.5%/1.0%) | Directors' best estimate (typically 1-2% above RPI inflation) | Acceptable | ■ The proposed assumption is acceptable under FRS 17 / IAS 19 |
| Expected return on equities | Not stated<br>(gilt yields plus an ERP of 3.1%) | ERP 2-4.5% above gilts | See comments | ■ We have not been provided with the proposed assumption as at 31 July 2013. However the assumption based on market conditions as at 31 May 2013 gave a return (or 'equity risk premium' / 'ERP') of around 3.1% above long term gilts. Based on the same method, we would expect the proposed assumption to be around 6.5% at 31 July 2013. This is reasonable for the purposes of FRS 17 / IAS 19 |
| **Mortality** | Based on the latest formal funding valuation | - | Acceptable | ■ The mortality assumptions proposed are those used for the most recent signed off formal actuarial valuation, which is a reasonable approach and consistent with last year |

# Auditor independence and non-audit fees

**Auditing standards require us to consider and confirm formally our independence and related matters in our dealings with the College.**

**We have appropriate procedures and safeguards in place to enable us to make the formal confirmation.**

## Auditor independence

Professional ethical standards require us to provide to you at the conclusion of an audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed. This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence.

We have considered the fees paid to us by the College and its related entities for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

## General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Regular communications
- Internal accountability
- Risk management
- Independent reviews

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the board of governors.

## Confirmation of audit independence

We confirm that as of 18 October 2013, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of audit committee and should not be used for any other purpose.

Yours faithfully

KPMG LLP

# 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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