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Dundee College

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

Year ended 31 July 2013

19 December 2013

Contents

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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 strategy set out our responsibilities in respect of the audit. The board of managements' responsibilities are set out in appendix one.

This report summarises our work for the year ended 31 July 2013. It also provides information required by International Statements on Auditing (UK and Ireland) 260: *Communication with those charged with governance*.

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

Area	Summary observations	Analysis
Strategic overview and use of resources		
Key issues	On 18 June 2012 the boards of management of Dundee and Angus colleges gave support to the creation of a merged college for the Tayside region. The establishment of Dundee and Angus College has been effected by the transfer of all the activities and assets of Angus College to Dundee College as at 1 November 2013. Management has accrued for the cost of 42 voluntary severance applications, supported by Scottish Funding Council transformation funding. The regional outcome agreement for Tayside region was developed in consultation with Dundee College during 2012-13.	Page 7
Financial position	The College reported an overall deficit of £825,000 (2011-12: £361,000 surplus). The reduction in recurrent grant funding of £1.9 million was offset by transformation funding of £1.3 million associated with voluntary severance costs. Expenditure increased by £729,000, primarily as a result of additional restructuring costs associated with the voluntary severance programme and depreciation, offset by a reduction in underlying staff costs. There is a loss on sale of £213,000 relating to the claw back of sale proceeds by the Scottish Funding Council following the disposal of fixed assets. The balance sheet reflects an increase in net assets of £2.8 million, primarily as a result of the reduction in pension liabilities (£5.3 million) offset by reductions in the value of fixed assets following depreciation. A number of significant items have had an impact on the surplus for both 2012-13 and 2011-12. On a consistent basis, the adjusted operating surplus for 2012-13 was £0.2 million compared with £1.4 million in 2011-12.	Page 8
Financial planning	The Tayside region will receive £33.5 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 College performance. Associated with the change in accounting period to 31 March, merger and staff changes, there is an increased risk over ineffective performance and budget management and accountability arrangements.	Page 9

Audit status and key audit issues (continued)

Area	Summary observations	Analysis
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"). There has been one change to accounting policies in respect of accounting for retirement benefits which are now accounted for on a defined benefit basis in respect of the College's participation in the Tayside Superannuation Scheme. The financial statements have been prepared on a going concern basis.	Page 12
Audit conclusions	We have issued an unqualified audit opinion on the financial statements. There were changes to the core financial statements including three adjusted audit differences and one unadjusted audit difference.	Page 13
Financial accounting framework	A new SORP, that is consistent with FRS102 will be applied in respect of the year ending 31 March 2016. Dundee and Angus 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.	Page 14
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. Land held for sale at Constitution Road was impaired by £340,000 to £160,000, reflecting the amount expected to be received, assuming the College does not incur remedial costs. Land held for sale at Melrose terrace continues to be held at a value of £500,000; there has been some recent interest in the site from a developer. The Scottish Funding Council provided clarification that they intend to claw back 25% from the sale proceeds of each site, excluding £400,000 of the proceeds from the Graham Street sale. Consequently, a £213,000 loss on that sale was recognised in the financial statements.	Page 15

Audit status and key audit issues (continued)

Area	Summary observations	Analysis
Performance management arrangements		
Performance management	During 2012-13 management accounts were produced which compared actual expenditure to budget. Efficiency savings are planned as part of the merger business case. Performance against sector indicators and other colleges is measured by the College.	Page 18
Governance and narrative reporting		
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.	Page 20
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 21

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 Dundee 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 its deficit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice and the Statement of Recommended Practice: Accounting for Further and Higher Education; and
- have been prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council, the Charities and Trustee Investment (Scotland) Act 2005 and regulation 14 of The Charities Accounts (Scotland) Regulations 2006 (as amended).

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.

Independence

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

KPMG conforms to the highest governance standards at all times and we will ensure that any additional services are approved by the audit committee 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 18 June 2012 the boards of management of Dundee and Angus colleges gave support to the creation of a merged college for the Tayside region.

The establishment of Dundee and Angus College has been effected by the transfer of all the activities and assets of Angus College to Dundee College as at 1 November 2013.

Management has accrued the cost of 42 voluntary severance applications, supported by Scottish Funding Council transformation funding.

The regional outcome agreement for Tayside region was developed in consultation with Dundee College during 2012-13.

Sector organisational and structure changes

During 2011-12 the process of regionalisation begun and on 19 September 2012 the board of management agreed that the preferred option in respect of regionalisation was to progress merger talks with Angus College.

On 18 June 2012 the boards of management of Dundee and Angus colleges gave support to the creation of a merged college for the Tayside region. Both boards 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 Dundee City and Angus regional area. The boards also considered that the new regional arrangement would help address the significant funding challenges faced by the college sector.

The boards of management established a Tayside partnership board, comprising the two college chairs, principals and additional representation from both colleges, including college staff and student representation. The partnership board, merger executive steering group and work stream representatives have met regularly during 2012-13 to consider merger progress with updates regularly provided to the respective college boards.

At a special board meeting convened in February 2013 to consider the results of financial and legal due diligence exercises conducted by third parties, Dundee College was recommended, and subsequently accepted, as the host college for the merger.

The establishment of Dundee and Angus College has been effected by the transfer of all the activities and assets of Angus College to Dundee College as at 1 November 2013.

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. Following the audit planning meeting in June 2013, we provided a draft scope of work to management. This was subsequently agreed in November 2013 and we have commenced consideration of the proposed treatment and anticipate reporting to management in January 2014.

Voluntary severance

A joint voluntary severance scheme with Angus College was introduced during 2012-13, supported by transformation funding by the Scottish Funding Council.

Management has accrued the cost of £1.7 million, representing 42 voluntary severance applications. £1.3 million of the costs will be met by transformation funding with the balance met by the College.

Outcome agreement

The Tayside region outcome agreement with the Scottish Ministers was developed in consultation with Angus College during 2012-13 and signed by representatives of both colleges in April 2013.

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

- achieving a 2% increase in wSUMS delivered to 16 to 19 year olds from 2012-13 to 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 reported an overall deficit of £825,000 (2011-12: £361,000 surplus).

The reduction in recurrent grant funding of £1.9 million was offset by transformation funding of £1.3 million associated with voluntary severance costs.

Expenditure increased by £729,000, primarily as a result of additional restructuring costs associated with the voluntary severance programme and depreciation, offset by a reduction in underlying staff costs.

There is a loss on sale of £213,000 relating to the claw back of sale proceeds by 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

Income and expenditure account		
£'000	**2013**	**2012**
Income		
Funding council grants	22,685	22,864
Tuition fees and education contracts	3,856	3,761
Other grants and contracts	827	865
Other income	1,259	1,194
Interest Income	113	106
Total income	**28,740**	**28,790**
Expenditure		
Staff costs	17,251	17,630
Restructuring costs	1,687	827
Other operating expenses	6,449	6,352
Depreciation	3,773	3,636
Interest and other finance costs	192	178
Total expenditure	**29,352**	**28,623**
Surplus/(deficit) after depreciation of tangible assets at valuation and before taxation and disposal of assets	**(612)**	**167**
Disposal of assets	(213)	194
Surplus/(deficit) on continuing operations after depreciation and disposal of assets at valuation and taxation	**(825)**	**361**

Source: 2012-13 draft financial statements

Result for the year

The College made an overall deficit of £825,000 (2011-12: £361,000 surplus).

Total income decreased by £50,000.

- Scottish Funding Council grants decreased by £179,000 in 2012-13 primarily as a result of £1.9 million reduction in recurrent grant funding, offset by addition accrued income of £1.3 million in respect of transformation funding associated with voluntary severance costs.
- Tuition fees and education contracts increased by £95,000 primarily due to an increase in education contract income (£390,000) which has offset decreases in non-EU tuition fees (£227,000).

Expenditure has increased by £729,000:

- Staff costs have decreased by £379,000, primarily as a result of annual savings arising from the voluntary severance exercise carried out in 2011-12.
- Restructuring costs have increased by £860,000 due to the increased number of voluntary applications and approvals in advance of the merger.
- Depreciation is £137,000 higher in the current year due to new assets being transferred from assets under construction to fixed assets and depreciated for the first time.

Following the sale of land at Graham Street in 2011-12 for £1.4 million, a gain on sale was recognised. Following receipt of further clarification from the Scottish Funding Council in November 2013, it was confirmed that 25% of the sale proceeds in excess of £400,000 would be clawed back, resulting in a loss on disposal recognised in 2012-13 of £213,000. Further detail is provided on page 15.

Financial position (continued)

A number of items have had an impact on the surplus for both 2012-13 and 2011-12.

On a consistent basis, the adjusted operating surplus for 2012-13 was £0.2 million compared with £1.4 million in 2011-12.

Associated with the change in accounting period to 31 March, merger and staff changes, there is an increased risk over ineffective performance and budget management and accountability arrangements.

Adjusted result for the year

A number of significant items have had an impact on the surplus for both 2012-13 and 2011-12; these are analysed in the table below, which shows the adjusted operating surplus after removing them, on a consistent, comparable basis.

£'000	2013	2012
Surplus/(Deficit) for the year	(825)	361
Restructuring costs	1,687	827
SFC transformation funding	(1,170)	-
(Gain)/loss on disposal of assets	213	(194)
Non-recurring Gardyne campus development costs	-	450
Net FRS 17 pension costs	257	(76)
Operating surplus for the year	**162**	**1,368**
Adjusted operating surplus as a % of total income	**0.6%**	**4.8%**

Budget 2012-13

Following the merger on 1 November 2013, Dundee and Angus College, as the College providing services to the Tayside region, will receive £33.5 million core funding from the Scottish Funding Council in respect of the academic year 2013-14, inclusive of £6.67 million student support funds, but excluding transformation funding.

A financial budget was prepared as part of the merger business case and is being used, in conjunction with the regional outcome agreement with the Scottish Ministers, to monitor the College's performance, based on eight months pro-rata to 31 March 2014, recognising the planned change in accounting period for the college sector.

Management recognise that a number of costs included in the merger business case may not be profiled evenly across the year and therefore the budget basis for the period to 31 March 2013 may be incorrect. In addition, there remains uncertainty in respect of some aspects of the new College structure and a number of academic budget holders have changed, increasing the risk of ineffective performance and budget management and accountability arrangements.

Management recognise this increased risk and are monitoring major budgets, high level statistics and cash balances on an ongoing basis with periodic informal reporting to the convenor of the finance and estates committee.

Financial position (continued)

The balance sheet reflects an increase in net assets of £2.8 million, primarily as a result of the reduction in pension liabilities (£5.3 million) offset by reductions in the value of fixed assets following depreciation.

Balance sheet

Balance sheet as at 31 July		
£000	**2013**	**2012**
Fixed assets		
Tangible assets	57,181	59,908
Current assets		
Assets held for disposal	660	1,000
Stocks	12	10
Debtors: Amounts falling due within 1 year	3,246	2,504
Cash at bank and in hand	5,634	2,289
Short term investments	2,115	4,052
Creditors: Amounts falling due within 1 year	5,551	3,376
Total assets less current liabilities	**63,297**	**66,387**
Creditors: Amounts falling due after more than 1 year	7,429	8,000
Pension liability	7,583	12,887
Net assets	**48,285**	**45,500**
Deferred capital grants	37,223	38,874
Endowments	90	50
Reserves		
Income and expenditure reserve	11,552	10,825
Pension reserve	(7,583)	(12,887)
Restricted reserve	1,264	1,288
Revaluation reserve	5,739	7,350
Total funds	**48,285**	**45,500**

Source: 2012-13 draft financial statements

The balance sheet reflects an increase in net assets of £2.8 million, primarily as a result of the reduction in pension liabilities (£5.3 million) offset by reductions in the value of fixed assets following depreciation.

The key changes in the balance sheet were as follows:

- Fixed asset additions of £1.3 million were offset by the annual depreciation charge of £3.8 million and a small number of disposals (£247,000).
- Assets held for disposal have decreased by £340,000 related to the impairment of Constitution Road to £160,000. This reflects the most recent offer less amounts expected to be incurred to secure the sale of the site in respect of remedial works required on the concrete structure. The remaining asset held for disposal, Melrose Terrace, continues to be held at £500,000.
- Debtors have increased by £0.7 million related to amounts due from the Scottish Funding Council in respect of transformation funding associated with voluntary severance costs.
- Creditors falling due within one year have increased by £2 million, primarily in relation to £1.4 million increase in accruals, mainly in respect of voluntary severance together with £0.9 million held on behalf of the sector, where the College acts as paying agent.
- The restricted reserve relates to the proceeds of sale that are retained from the sale of assets for future investment in the College estate.
- A loan of £50,000 was made by the College to Gardyne Theatre Limited during 2012-13. There is no associated loan agreement and management have confirmed that it is repayable on demand. There is a risk that the loan is not classed as charitable as it has been made to a trading subsidiary and should be repaid as soon as possible. Management agree with our assessment and it is important that the loan arrangements are formalised in the short term.

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 has been one change to accounting policies in respect of accounting for retirement benefits which are now accounted for on a defined benefit basis in respect of the College's participation in the Tayside Superannuation Scheme.

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

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. ■ 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 in that respect. ■ We are satisfied that the accounting policies adopted remain appropriate to the business, and have been applied consistently, with the exception of accounting for retirement benefits.
Revised accounting standards	■ There are no newly effective accounting standards which are considered to have a material impact on the College's financial statements.
Revised accounting policy in respect of retirement benefits	■ The accounting policy relating to pensions was updated during 2012-13. Financial reporting standard 17, *Retirement benefits* ("FRS 17") paragraph nine states that 'Where more than one employer participates in a defined benefit scheme the employer should account for the scheme as a defined benefit scheme'. Previously, the College's board of management accounted for its participation in the scheme on a defined contribution basis, as they believed they were unable to identify the College's share of the underlying assets and liabilities in the fund on a consistent and reasonable basis and could therefore apply the multi-employer exemption. This was inconsistent with our interpretation and resulted in a qualified audit opinion in respect of 2011-12. ■ Having reconsidered the actuary's analysis and in anticipation of the merger, management has confirmed that the exemption was not appropriate. A summary of the College's share of the scheme assets and liabilities was received which has been used to restate the balances in the financial statements in respect of 2011-12 and to account for the College's participation in the scheme on a defined benefit basis in 2012-13.
Going concern	■ The College merged with Angus College on 1 November 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. ■ 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. ■ 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 of the College and Gardyne Theatre Limited.

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.
We have issued an unqualified opinion on the truth and fairness of the state of the affairs of Gardyne Theatre Limited as at 31 July 2013 and of its loss for the year then ended. The financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice and the Companies Act 2006. There are no specific matters arising in respect of our audit of the College's subsidiary. In order to avoid future tax liabilities, it is important to ensure that Gardyne Theatre Limited has sufficient net assets and cash to make any gift aid payment, donated to the College in respect of its taxable profits.

Year end process; future accounting framework

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

A new SORP, that is consistent with FRS102, will be applied in respect of the year ending 31 March 2016. Dundee and Angus 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 in line with the agreed timetable.
- 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 is one unadjusted audit difference relating to voluntary severance, and two audit adjustments related to assets held for sale. 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 FRS102, 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, which is based on International Financial Reporting Standards (“IFRS”), 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. Dundee and Angus 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 Scottish further education colleges should be classed as public sector bodies. This decision does not require legislative change.
- This has wide implications for Scottish 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, 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 the likely impact of this reclassification.

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.

Area	KPMG comment
Key accounting judgments and other accounting and audit matters	
Retirement benefits	The College accounts for its participation in the Tayside Superannuation 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. 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. 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. 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. 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 0% 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. The net FRS 17 pension liability has decreased by £5.3 million 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 schemes' assets.

Key accounting judgements (continued)

Assets held for sale at Constitution Road were impaired by £340,000 to £160,000, reflecting the amount expected to be received assuming the College does not incur remedial costs.

Land held for sale at Melrose terrace continues to be held at a value of £500,000; there has been some recent interest in the site from a developer.

The Scottish Funding Council provided clarification that they intend to claw back 25% from the sale proceeds of each site, excluding £400,000 of the proceeds from the Graham Street sale. Consequently, a £213,000 loss on that sale was recognised in the financial statements.

Area	KPMG comment
Key accounting judgments and other accounting and audit matters	
Valuation of assets held for sale	The College holds two sites for sale as at 31 July 2013 at Constitution Road and Melrose Terrace. Assets held for sale at Constitution Road was impaired by £340,000 to £160,000, reflecting the amount expected to be received should the College assuming the College does not incur remedial costs in respect of concrete repairs (estimated at up to £100,000) to secure the full offer price of £260,000 which had been previously accepted. Land held for sale at Melrose Terrace continues to be held at a value of £500,000; there has been some recent interest in the site from a developer.
Scottish Funding Council claw back	In 2011-12, £194,000 gain on disposal of assets was recognised, of which the majority related to the sale of the Graham Street campus. The first tranche of payments of £0.68 million of £1.3 million in respect of the disposal of Graham Street were received in the previous year with the balance received during 2012-13. Initial indications from the Scottish Funding Council, in 2010-11, confirmed that up to £1.3 million of disposal proceeds from the sale of all three sites would be clawed back, with the remainder retained by the College for investment in the Kingsway campus. In line with the Scottish Funding Council's instructions in their letter of 2 August 2011, the College contacted them in October 2012 regarding the concluded disposal of the Graham Street asset to confirm any claw back of the proceeds of sale. Confirmation received from the Scottish Funding Council on 19 November 2012 was interpreted as permitting the College to retain all of the proceeds from the disposal of Graham Street for future investment in the College's estate and were accordingly transferred to a restricted reserve. We indicated that the College would need to seek similar permission in respect of the extent to which future sale proceeds could be retained. In November 2013, the Scottish Funding Council clarified that their letter of 19 November 2012 was intended to confirm that no claw back in cash terms would be made in respect of the Graham Street proceeds, but that an amount of 25% of those proceeds, in excess of £400,000, would be clawed back, by a reduction in 2013-14 capital grant income, following the sale of Melrose Terrace – at which time 25% of those sale proceeds would also be clawed back. The SORP states that the gain or loss on disposal presented in the financial statements should be shown after the effect of any amount to be repaid to the Scottish Funding Council. Consequently, a £213,000 loss on disposal is reflected in the financial statements for the year ended 31 March 2013 and a corresponding transfer has been made from restricted reserves. Until amounts are deducted from future grant payments, the College has recognised a creditor in respect of the amount repayable.

Performance management

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

Performance management

During 2012-13 management accounts were produced which compared actual expenditure to budget. Efficiency savings are planned as part of the merger business case.

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

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 2012-13.

During 2012-13 management accounts were produced which compared actual expenditure to budget. Efficiency savings are planned as part of the merger business case.

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 College's financial objectives.

KPI	Purpose	Actual 2012-13	Actual 2011-12
WSUMs	Performance against WSUMs activity target	103%	100%
Non SFC income a % of income	Measures non SFC income as a % of total income	21.1%	20.5%
Gearing	Measures the reliance on debt finance	73%	122%
Current assets : current liabilities	Measures the College's ability to pay its current liabilities	2:1	2:1
Days cash	Cash divided by total expenditure less depreciation expressed in days	111	93

The activity target set by the Scottish Funding Council for 2012-13 was 96,072 wSUMs. This target was achieved in 2012-13. The wSUM target for 2013-14 is 144,093.

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.

Management considers all incoming correspondence from the Scottish Funding Council and other regulatory or advisory bodies, such as Audit Scotland to ensure it is appropriately aware of sector issues and developments and that it complies with the terms and conditions of funding.

Governance and narrative reporting

Update on your governance arrangements

Our overall perspective on your narrative reporting

Corporate governance arrangements (continued)

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. 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. 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. Following our recommendation raised in the prior year, management has enhanced the statement of corporate governance and internal control to include details of members' attendance at individual board meetings.
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. We tested a sample of disclosures to ensure that they were prepared in accordance with the requirements of the Accounts Direction. A presentational adjustment was made to include disclosure of compensation payable to senior post-holders for loss of office together with the terms of compensation.
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.
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. These appear proportionate for the College's purposes.

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.
Internal audit	As set out in our audit plan and strategy, we have evaluated the work of internal audit. The content of the internal audit plan is in line with our expectations. Internal audit reported that "In our opinion the College operates adequate and effective internal control systems as defined in the Audit Needs Assessment. Proper arrangements are in place to promote and secure value for money." This opinion was arrived at taking into consideration the work performed during 2012-13 and in prior years.

Appendices

Mandatory communications

There were changes to the core financial statements including two adjusted audit differences and one unadjusted audit difference.

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	There are two audit adjustments related to assets held for sale.	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 is one unadjusted audit difference related to voluntary severance costs which is not material.	Appendix 2
Confirmation of Independence 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 Proposed draft of letter to be issued by the College to KPMG prior to audit sign-off	There are no significant changes to the representations required for our audit from last year.	-

Summary of audit differences

There were two adjusted audit differences identified. This had the net affect of reducing the College's surplus by £553,000.

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**	
Impairment of assets held for sale				
Assets held for sale	-	-	-	340
STRGL (income and expenditure reserve)	340	-	-	-
Scottish Funding Council claw back				
Gain / loss on sale	213	-	-	-
Creditors	-	-	-	213
Income and expenditure reserve	-	-	-	213
Restricted reserve	-	-	213	-
Overall impact	**553**	**-**	**-**	**553**

Presentational adjustments

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

Summary of audit differences (continued)

There is one unadjusted audit difference.

Misstatements that are uncorrected

There is one uncorrected misstatement in respect of voluntary severance costs. An amount was incorrectly included in creditors in respect of three members of staff who applied for severance after 31 July 2013, together with an associated accrual of transformation funding from the Scottish Funding Council. The net impact of the financial statements is £16,000 which is not considered material.

College				
£000	**Income and expenditure account**		**Balance sheet**	
Voluntary severance	**Dr**	**Cr**	**Dr**	**Cr**
Cost of severance	88	-	-	88
Transformation funding	-	72	72	-
Overall impact	**16**	**-**	**-**	**16**

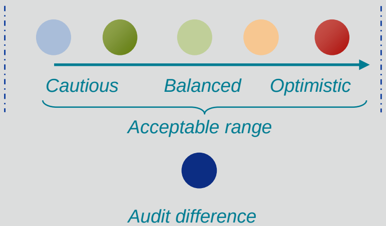
Appendix three

Pensions assumptions

Presented below is a comparison of the assumptions used by Barnett Waddingham who advise the College in respect of the Tayside Superannuation Scheme, 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 slightly weaker than we normally expect but within our generally accepted range.
Discount rate	4.70%	4.55%		■ The proposed discount rate is slightly weaker (lower liability) than our central rate but is within the range that we would normally consider acceptable.
RPI inflation	3.30%	3.57%		■ The proposed RPI inflation rate of 3.3% is weaker (lower liabilities) than KPMG's central rate for a scheme with an average duration of 22 years but is within a range we consider to be acceptable for the purposes of FRS17, albeit towards the bottom of the range.
CPI inflation / Pension increases	2.50% RPI less 0.8%	2.57% RPI less 1.0%		■ The assumptions is slightly weaker (lower liability) than our central rate and but is acceptable for FRS 17 purposes.
Net discount rate (Discount rate – CPI)	2.20%	2.0%		■ The range we would normally consider reasonable for the purposes of FRS17 as at 31 July 2012 is 2.0% +/-0.3%, for a scheme with liabilities with a duration of 22 years. The net discount rate is within our generally expected range.
Salary growth	0% 2013-14 1% 2014-16 RPI+1.4% 2016 onwards	0.5-1.5% above RPI inflation		■ The assumptions is in line with the requirements of FRS17.
Life expectancy Current male pensioner (age 65) Future male pensioner (age 45)	20.6 years 22.9 years	Dependent on assumption		■ The mortality assumptions proposed are those used for the most recent signed off formal actuarial valuation, which is a reasonable approach.

Level of prudence compared to KPMG central assumptions



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 management.

Confirmation of audit independence

We confirm that as of 19 December 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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