cutting through complexity™

Edinburgh College

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

Year ended 31 July 2013

13 December 2013

Contents

The contacts at KPMG in connection with this report are:

David Watt
Director, KPMG LLP

Tel: 0141 300 5695
Fax: 0141 204 1584
david.watt@kpmg.co.uk

Andy Shaw
Director, KPMG LLP

Tel: 0131 527 6673
Fax: 0131 527 6666
andrew.shaw@kpmg.co.uk

Rob Jones
Assistant Manager, KPMG LLP

Tel: 0141 300 5631
Fax: 0141 204 1584
robert.jones3@kpmg.co.uk

About this report

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 only the Board of Management of Edinburgh College and is made available to Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

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

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

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.

Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact David Watt, who is the engagement leader for our services to Edinburgh College, telephone 0141 300 5695 email david.watt@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 222 2000 or email to alex.sanderson@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.

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 out 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	On 1 October 2012 the Colleges of Edinburgh's Telford, Stevenson and Jewel & Esk merged to become Edinburgh College. This process included the transfer of all the activities and assets of the latter colleges to Edinburgh's Telford College which adopted the name Edinburgh College. Following the merger, there a number of synergies being realised and management approved 80 voluntary severance applications, supported and mostly funded by £2.4 million Scottish Funding Council merger support grants. Over the period following the merger functions have been combined, including the finance department	Page 7
Financial position	The College generated an overall surplus of £622,000 (2011-12: £218,000 deficit), against a budgeted £1.3 million deficit. A significant proportion of the excess over budget relates to the £603,000 partial release of a residence occupancy guarantee provision established in the prior year. Income and expenditure reduced on the prior year, the income primarily as a result of a reduction in Scottish Funding Council grant income and the expenditure mainly from the rationalisation of staff. The balance sheet reflects an increase in net assets of £1 million, corresponding to the surplus for the year and the actuarial gain on the defined benefit pension scheme.	Pages 7 and 8
Financial planning	The Board of Management has approved a budget for 2013-14 showing a £1.7 million deficit. This is primarily due to further reductions in Scottish Funding Council grant funding. There will also be additional staff costs in 2013-14 arising from a pay award made to all staff. Management have included assumed further efficiency savings to be realised from the merger, and anticipate staff costs reducing in future years as the College's new staff workforce model is implemented.	Page 8
Financial statements and accounting		
Accounting policies	The financial statements have been as set out in the Statement of Recommended Practice: *Accounting for Further and Higher Education* (2007) ("the SORP"). There have been no substantive changes to this financial reporting framework compared to previous year. Management reviewed accounting policies across the three pre-merger colleges to ensure they were consistent with those to of the host entity. In line with FRS 6 *Acquisitions and mergers,* management adjusted opening balances to ensure alignment of accounting policies between all entities. The key difference was in relation to land and buildings, as Stevenson College applied a policy of revaluations whereas the policy of Edinburgh College is to hold assets at historical cost. The financial statements have been prepared on a going concern basis.	Page 10

Headlines (continued)

Financial statements and accounting (continued)		
Audit conclusions	We have issued an unqualified audit opinion on the financial statements.	
Year end process	The unaudited financial statements were made available on a timely basis, in advance of the audit fieldwork. The finalisation of the financial statements was an iterative process over the period of the audit, as a result of the complexities in preparing the first set of merged primary financial statements and supporting notes.	Page 12
Financial accounting framework	Management are aware of the 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, the ability to carry forward and utilise surpluses and the accounting framework. A new SORP, that draws on the principles of FRS 102, will be applied for respect of the year ending 31 March 2016 and the College will need to draw up a transitional balance sheet as at 1 April 2014. There remains uncertainty over the interaction of the SORP and the IFRS-based Government Financial Reporting Manual, specifically which takes precedence and this may have implications for the College's accounting policies.	Page 12
Key judgement areas	We have considered management's approach to preparing merger financial statements in line with FRS 6: *Acquisitions and mergers,* including processes to align accounting policies and opening balances, and consider them to be appropriate. A significant amount of work was required from the consequence of aligning the accounting policies of the College in respect of property, plant and equipment due to the requirement to 'unwind' the revaluations at the Sighthill campus. We concur with management's judgement in respect of actuarial assumptions used to provide the valuation of the College's net pension liabilities. We agree with management's treatment and revision of the onerous lease provision for the residences, following further experience of occupancy.	Page 13

Headlines (continued)

Financial statements and accounting (continued)		
Performance management arrangements		
Performance management	The College produces 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 and ongoing as part of the merger business case. Performance against sector indicators is measured by the College.	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. 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 19
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 Edinburgh 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 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* requires us to communicate at least once a year regarding all relationships between KPMG LLP and the College that may be reasonably thought to have bearing on our independence.

KPMG LLP 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 1 October 2012 the Colleges of Edinburgh's Telford, Stevenson and Jewel and Esk merged to become Edinburgh College.

This process included the transfer of all the activities and assets of Jewel & Esk and Stevenson Colleges to Edinburgh's Telford College as at 1 October 2012.

Management approved 80 voluntary severance applications, supported and mostly funded by Scottish Funding Council merger support grants.

Sector organisational and structure changes

During 2011-12 the process of regionalisation of colleges began, with the goal of creating 13 college regions across Scotland, to be completed in 2013-14. As part of this change, Edinburgh College was created, being the merger of Edinburgh's Telford, Stevenson and Jewel & Esk Colleges, with Edinburgh's Telford being the host entity.

The establishment of Edinburgh College was effected by the transfer of all the activities and assets of Jewel & Esk and Stevenson Colleges to Edinburgh's Telford College as at 1 October 2012 which then adopted its new name.

The Board expects that the new regional arrangement will help address the significant funding challenges faced by the college sector in light of reduced levels of Scottish Funding Council recurrent and specific grant funding.

Management are continuing to rationalise the operations of the College. Further voluntary severance is planned in 2013-14, funded by Scottish Funding Council grant income and core funds. As the new operational and workforce structures of the merged college are embedded, further adjustments will be made.

Accounting framework

The Statement of Recommended Practice: *Accounting for further and higher education* (2007) requires that institutions must assess, in accordance with Financial Reporting Standard 6: *Acquisitions and mergers,* whether a combination of an institution with another institution is an acquisition or merger. Management has considered it appropriate to adopt merging accounting policies in the preparation of these financial statements.

Voluntary severance

A voluntary severance scheme across the campuses was ongoing in 2012-13 and a further programme is planned for 2013-14, funded by Scottish Funding Council merger support grants.

Management approved 80 voluntary severance applications with a total cost of £3.1 million in 2012-13, which are expected to deliver annual savings of £2.8 million. The voluntary severance was supported by a £2.5 million grant from Scottish Funding Council. The remaining SFC funding available for future schemes is £700,000, with any remaining costs to be met by the College directly.

Outcome agreement

The Edinburgh and Lothians region outcome agreement with the Scottish Ministers has been agreed for 2013-14 and includes the target of achieving a 5% increase in wSUMS delivered to 16 to 19 year-olds from 2012-13 to 2013-14.

The key outcomes agreed are:

- efficient regional structure following the merger;
- right learning in the right place for all students;
- higher quality and efficient learning for students to progress into positive destinations of future learning or employment;
- development of workforce to assist regional economic growth; and
- financially sustainable institutions.

Financial position

The College generated an overall surplus of £622,000 (2011-12: £218,000 deficit).

Income reduced on the prior year, primarily as a result of lower Scottish Funding Council grant income.

The lower expenditure is mainly in respect of staff costs, in relation to reductions in staff numbers and voluntary severance paid in the year.

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	52,209	60,496
Tuition fees and education grants	10,977	12,572
Research grants and contracts	1,949	1,741
Other operating income	3,326	4,384
Endowment and investment income	205	671
Total income	**68,666**	**79,864**
Expenditure		
Staff costs	(39,717)	(45,008)
Exceptional staff costs	(3,076)	(6,216)
Other operating expenses	(18,838)	(20,181)
Exceptional operating income/(expenditure)	603	(1,725)
Depreciation	(5,612)	(5,683)
Interest and other finance costs	(791)	(816)
Exceptional items – merger expenditure	(561)	(452)
Total expenditure	**(67,992)**	**(80,081)**
Surplus/(deficit) before the disposal of assets	**674**	**(217)**
Disposal of fixed assets	(52)	(1)
Surplus/(deficit) after the disposal of assets	**622**	**(218)**

Source: 2012-13 financial statements

Result for the year

The College generated a surplus of £622,000 (2011-12 deficit: £232,000). This reflects an improvement of £1.9 million against an initial budget of £1.2 million deficit.

Total income decreased by £11.2 million when compared to 2011-12:

- Scottish Funding Council grants reduced by £8.3 million, primarily as a result of a reduction in recurrent grant income for the year and £410,000 clawback arising from lower than expected student numbers.
- Tuition fee and education grants decreased by £1.6 million, mainly resulting from a significant reduction in overseas student income, after the UK Borders Agency suspended the College's highly trusted sponsor status for 2012-13.
- Other operating income reduced by £1.1 million, resulting from a number of individually minor reductions in income.

Expenditure decreased by £12.1 million when compared to 2011-12:

- Staff costs reduced by £5.2 million as a result of significantly reduced staff numbers, due to voluntary severance programmes in 2011-12 and 2012-13 (down 178 full time equivalent's from 2011-12). Exceptional staff costs decreased by £3.1 million due primarily to £2.6 million less voluntary severance payments in 2012-13.
- Other operating expenses decreased by £1.4 million. This is primarily due to efficiencies achieved in 2012-13 resulting from synergies from the merged College's activities, as well as a concerted effort to reduce costs to meet a forecast budget deficit.
- Exceptional operating income relates to the College's residences provision: the £603,000 release in 2012-13 reflects management's view that occupancy will be higher than originally assumed, as evidenced by the realised increase for the 2013-14 academic year.

Financial position (continued)

The balance sheet shows an increase in net assets of £1 million, arising from the reduction in the net pensions liability and the operating surplus in the year.

The 2013-14 budget, as approved by the board of management, forecasts a deficit of £1.7 million.

Balance sheet as at 31 July		
£000	**2013**	**2012**
Fixed assets		
Tangible assets	141,750	141,866
Current assets		
Stocks	73	38
Debtors: Amounts falling due within 1 year	2,156	3,816
Cash at bank and in hand	16,192	29,800
Creditors: Amounts falling due within 1 year	(12,392)	(18,013)
Net current assets	**6,029**	**15,641**
Creditors: Amounts falling due after 1 year	(15,260)	(23,051)
Provisions for liabilities and charges	(5,952)	(6,955)
Net pensions liability	(8,722)	(10,707)
Net assets including pension liability	**117,845**	**116,794**
Deferred capital grants	63,590	64,967
Reserves		
Income and expenditure reserve (including pension reserve)	47,452	44,711
Revaluation reserve	6,803	7,116
Total funds	**117,845**	**116,794**

Source: 2012-13 financial statements

£'000	**2013**	**2012**
Surplus for the year	1,563	3,822
Net restructuring costs	(1,144)	(2,315)
Clawback of SFC income	(400)	-
Provision release/(provision)	603	(1,725)
Adjusted operating surplus for the year	**622**	**(218)**
Adjusted operating surplus as a % of total income	**1.0%**	**0.3%**

Balance sheet

The balance sheet shows an increase in net assets of £1 million.

- Fixed asset additions of £5.5 million were offset by the annual depreciation charge of £5.6 million. Additions include £3.6 million in respect of assets in the course of construction, primarily in respect of the additional facilities at the Sighthill campus.
- Cash at bank and in hand decreased by £13.6 million. This is primarily the result of a repayment of bank loans of £7.7 million, capital investment and a net payment of creditors of £5.6 million.
- Debtors reduced by £1.6 million due a number of individually minor movements in debtor balances in the year, while creditors have decreased by £5.6 million, primarily arising from a reduction in voluntary severance accruals of £2.7 million, as well as a number of minor reductions.
- Provisions decreased by £1 million; both the early retirement provision and residences provision have been partially released. The early retirement provision for expenditure incurred in the year and the residences provision arose from a reassessment of occupancy rates, which are underwritten by the College.

Budget 2013-14

The Board of Management approved a budget for 2013-14 with a £1.7 million deficit for the year. The forecast deficit is primarily due to further reductions in Scottish Funding Council grant funding. There will also be additional staff costs in 2013-14 from a pay award made to all staff.

Management have included assumed further efficiency savings to be realised from the merger, and anticipate staff costs reducing in future years as the College's new staff workforce model is implemented.

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").

Accounting policies have been aligned across the predecessor colleges, to ensure consistent accounting at the post merger College.

Accounting policies have now 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. ■ 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. ■ Prior to the merger at 1 October 2012, Edinburgh's Telford, Stevenson and Jewel & Esk Colleges applied separate accounting policies. Management reviewed accounting policies across the colleges to ensure they were consistent with those of the host entity, Edinburgh's Telford College. A number of variations were identified and, in line with FRS 6: *Acquisitions and mergers*, management adjusted opening balances at the beginning of the comparative period to ensure alignment of accounting policies. ■ We are satisfied that material accounting policies were appropriately aligned or were already consistent across all colleges. The policies adopted remain appropriate to the business, and have been applied consistently in 2012-13. ■ Currently, all elements of the individual College buildings are depreciated over the same period. In order to comply with the requirements of component accounting for fixed assets, it is important that management ensure adequate information is available in respect of the constituent elements of large items, such as buildings. Individual items within an asset should be depreciated over their useful economic lives, for example windows within a building. The split on a component by component basis could be identified by engaging a chartered surveyor. **Recommendation three**
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	■ 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. At 31 July 2013, the College had £16 million cash and £6 million net current assets. We note that the impact of the reclassification of Further Education institutions will impact on the College's ability to utilise surplus reserves reflected in cash balances and this should be factored into future financial forecasting.

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 on the principles of FRS 102, will be applied in respect of the year ending 31 March 2016. Edinburgh College will need to prepare a transitional balance sheet as at 1 April 2014.

Financial statements preparation

- High quality working papers and draft financial statements were provided on 16 September 2013 in line with the agreed timetable. The operating and financial review and statement of corporate governance and internal control were provided separately during the onsite audit.
- Arising from the complexities of preparing primary statements and supporting notes for the newly merged college, there were a number of iterations of the financial statements. 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 are no non-trifling unadjusted audit differences, and there was one adjusted audit difference warranting disclosure. There were a number of amendments during the audit, as management worked through the accounting and related disclosure consequences arising from the merger.
- 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 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. The College will need to prepare a transitional balance sheet as at 1 April 2014.
- There are key differences to the existing SORP, particularly in respect of grant accounting, recognition of obligations arising from funding past deficits of multi-employer pension schemes, service concession arrangements and in respect of financial statement disclosures.

Year end process; future accounting framework (continued)

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.

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 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, Scottish Funding Council is reviewing the likely impact of this reclassification. Management is aware of the potential implications of the changes to classification and is considering the College's response, to be put in place prior to 1 April 2014.
- There remains uncertainty over the interaction of the SORP and the IFRS-based Government Financial Reporting Manual, in respect of which takes precedence in the event of a variation in treatment.

Key accounting judgements

Key accounting judgments and other accounting and audit matters	
Area	**KPMG comment**
Merger accounting	Following the combination of the three colleges through transfer to Edinburgh's Telford College, management considered the accounting treatment for the formation of the combined entity. Management have concluded that the terms of the agreement and structure of the College's governance arrangements result in merger accounting being applicable. The key feature of merger accounting is that neither party is viewed as the acquiring entity and the combined results and balances are presented as if the merged entity existed in the comparative periods. Merger accounting is applicable for the formation of a new reporting entity which is a substantially equal partnership where no party is dominant. Audit committee approval was received for the adoption of this accounting treatment, following consideration of the five criteria of FRS 6: *Acquisitions and mergers*: ■ the way the roles of each party are portrayed; ■ the involvement of each party to the combination in the selection of management of the combined entity; ■ the relative sizes of the parties to the combination; ■ whether shareholders receive any consideration; and ■ whether shareholders of the combined entities retain an interest in the performance of only part of the combined entity. At an early stage, we reviewed management's paper which sets out the assessment against each of the three principal criteria of FRS 6 and consider the appropriateness of merger accounting. In our view, the proposed treatment was appropriate and met the definitions of a merger in line with FRS 6: *Acquisitions and mergers*. We reviewed management's calculations and assumptions in determining the combined financial statements, including the impact on comparative amounts following the alignment of accounting policies across the three predecessor colleges. There were three significant consideration required to the opening balances of the College that were required as a result of aligning accounting policies: ■ Stevenson College had previously accounted for its land and buildings on a valuation basis rather than the Edinburgh College policy of historical cost less depreciation. In aligning the treatment of the Sighthill campus (previously within Stevenson College) the previous revaluations and related movements in reserves were unwound and retrospective depreciation charges were applied for the assets. This resulted in a £9 million reduction in the tangible fixed assets as at 1 August 2011, with a £1.7 million lower revaluation reserve. A revaluation reserve remains in respect of each predecessor college, reflecting the valuation of land in 1993, prior to the adoption of FRS 15: *Tangible fixed assets*.

Key accounting judgements (continued)

Key accounting judgments and other accounting and audit matters	
Area	**KPMG comment**
Merger accounting	■ The depreciation rates for property and computer equipment varied across the three predecessor colleges. In aligning accounting policies, management considered appropriate rates and engaged an external surveyor in respect of the properties. Management concluded that the existing property depreciation rates remain appropriate, the variations reflecting the different construction of the various buildings, and consequently made no adjustment to useful economic lives. New computer equipment additions are depreciated over a consistent period across the campuses, although management have elected not to revise the opening accumulated depreciation, on grounds that the varied depreciation rates do not result in a significant difference in net book values. ■ As at 31 July 2012 Jewel & Esk College accounted for its membership in the Lothian Pension Fund, a defined benefit pension scheme, under actuarial assumptions provided by the scheme actuaries that differed from those used by the other pre-merger colleges. To ensure the pension liability as at 31 July 2012 was consistently valued in the financial statements, a revised FRS 17 report was prepared as at that date under consistent assumptions. This resulted in a reduced pension liability in the 31 July 2012 comparative. The pension assumptions were consistent as at 31 July 2011 and no similar adjustment was therefore required to opening reserves. We consider that management have been thorough in their consideration of the accounting impact of the merger. We concur with the accounting adjustments in respect of the alignment of the valuation basis for land and buildings and also the amendment to the pension scheme liability in respect of the former Jewel & Esk College. On grounds of materiality, we concur with management's approach of retaining the existing net book values for computer equipment, despite a difference in the useful economic lives applied. We note that management has applied consistent depreciation rates for all new additions. We did not identify any further alignment adjustments following our review of the accounting policies for the merged college or through the course of our audit work in the year.

Key accounting judgements (continued)

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 Lothian 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. 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. Contribution estimates for the year included the accrued costs of voluntary severance payments made in the year. For the Lothian Pension Fund, 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. Using our actuarial specialists, we 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 2013-15 is 1% followed by 1% RPI + 1.5% from 2015 onwards. The increases assumed in the period 2014-15 to 2015-16 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. Total pension cost for the year, including Scottish Teachers' Superannuation Scheme contributions and the net interest cost, was £4,496,000 compared to £4,806,000 in 2011-12. The net FRS 17 pension liability has decreased by £2.0 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 scheme's assets.

Key accounting judgements (continued)

Key accounting judgments and other accounting and audit matters	
Area	**KPMG comment**
Residences provision	A provision of £1.7 million is recognised as at 31 July 2012 in respect of a residence occupancy underwriting arrangement. In 2009-10 Edinburgh's Telford College entered into a contract with Alumno Miller for the placement of students in residential accommodation, placing an obligation on the College to underwrite occupation below 100%. Management considered that the contract was onerous under FRS 12: *Provisions and contingencies* and a provision of £1.7 million was recognised in the financial statements as at 31 July 2012. This represented management's best estimate of the likely payments required under the underwriting clause, over the 15 year initial period of the contract. As at 31 July 2013 management reviewed the provision and concluded it was appropriate to reduce the provision by £603,000 (in addition to normal utilisation of the provision over 2012-13), resulting in exceptional operating disclosed in the financial statements. The adjustment is the result of increased occupancy for the 2013-14 academic year, following greater marketing and a transfer of students from other residences. The occupancy rate for 2012-13 was 62% and for 2013-14 it is 92%. As a relatively new arrangement, management do not consider that the occupancy rate for 2013-14 is the sole measurement basis for the carrying value, hence the provision has been only partially released. The occupancy rate for 2015-16 will be considered when the provision is re-assessed during the year to 31 March 2015. We reviewed the revised calculations, the occupancy rate and underlying assumptions. In our view it is reasonable to only partially reduce the provision, as one year of occupancy information should not form the basis of a multi-year provision. We concur with management's assumptions.
Subsidiaries	The College has a number of subsidiary undertakings, some of which are no longer trading. The ongoing activities of the subsidiaries are, in our opinion, not material to the College. Management have elected not to prepare consolidated financial statements, on grounds of materiality, and we concur with this treatment.

Key accounting judgements (continued)

Key accounting judgments and other accounting and audit matters	
Area	**KPMG comment**
Eskbank development litigation	We noted in our audit strategy document that the College had commenced litigation in respect of the development of the Eskbank campus, in relation to sale proceeds that the College was expecting to receive following conclusion of sale missives in October 2007. The College's legal advisers considered that there was a case that the College was inadequately advised in respect of the sale in 2007, and the legal proceedings were commenced on that basis. The College was not successful in the case and the matter is now concluded. There is no impact on the financial statements other than the recognition of the related legal expenses.
Corporation tax	Where colleges undertake non-primary purpose ("NPP") activities, they may be liable for corporation tax. Colleges are exempt from corporation tax on these activities (such activities might include conferences, non-student residences, consultancy) provided they do not exceed the threshold of £50,000, as a small trading exemption. In the case of a recently merged college, as all the various strands of NPP activity for the previously individual colleges will be consolidated, there is an increased risk of breaching the £50,000 small trading exemption threshold. It is therefore important management consider these activities in more detail to determine whether the limit is breached and if so whether an overall profit or loss arises from these activities. If profitable, the College would have a corporation tax liability, however it is more likely there will be an overall loss once an allocation of overheads has been taken into account. Calculations should be retained as evidence that no corporation tax return requires to be submitted. Tax specialist assistance may be required to assist consideration of NPP activities and have a process going forward for identifying NPP activities and calculate whether a profit arises on those activities. **Recommendation one**

Performance management

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

Performance management

The College produces monthly 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 have been achieved and ongoing savings are planned as part of the merger.

Performance against sector indicators 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. 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.

The College produces monthly management accounts which compare actual expenditure to budget and analyses variances. The College procurement strategy seeks to use the most advantageous supplier that is available. Efficiency savings are planned and are ongoing as part of the merger business case. We considered the process for authorisation of personal expenses for both employees and the Board of Management as part of our audit work and did not identify control weaknesses.

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	Actual 2012-13	Actual 2011-12
Performance against WSUMs target	(9,235)	-
Prompt payment to suppliers	23 days	20 days
Non-SFC income a % of income	24.0%	24.1%
Gearing	0.4%	0.6%
Current assets : current liabilities	1.5:1	1.8:1
Days' cash	96	141

The activity target set by Scottish Funding Council for 2012-13 was 249,017 wSUMs. The College delivered around 245,102 wSUMs in 2012-13, resulting in clawback of income of approximately £400,000 in the year. The reduction in current assets and cash KPI's are primarily due to the repayment of long term bank loans in the year.

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. 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. For the first two months of the year, the pre-merger colleges operated under their pre-existing corporate governance arrangements. Subsequent to 1 October 2012, merged College arrangements were developed and combined, with a single Board of Management, set of committees and underlying governance policies and principles. 2012-13 has been a year of considerable change for the College, arising from the merger of the predecessor colleges, the rationalisation of functions, the challenging operating environment and the changes in the governing body. In light of these significant changes, we consider that management has delivered a creditable performance, in respect of financial outturn, stability in control environment and continued development of the campuses. We note that the considerable staffing changes bring a risk of loss in 'corporate memory' and management accept that the loss of some key individuals has impacted on the full achievement of potential. Management has a strategy for the further development of the governance and internal control arrangements, not least in the implementation of a new finance system from 1 August 2013.
Senior post-holders' emoluments	The Accounts Direction, issued by Scottish Funding Council, sets out certain disclosures required in respect of senior post-holders' emoluments. We tested these disclosures to ensure that they were prepared in accordance with the requirements of the Accounts Direction. No issues were identified with the accuracy of the disclosures. There has been significant movement in senior-post holders' emoluments resulting from the merger of the three predecessor colleges to form Edinburgh College. This includes a significant reduction in contracted higher paid staff as the College consolidates into one management group, offset in the year by a number of higher paid staff due to receipt of voluntary severance payments made as part of the exceptional costs relating to the merger. We tested a sample of voluntary severance payments in the year to ensure they were calculated, approved by remuneration committee and paid correctly. We did not identify any instances where payments were not appropriately approved or where payments were incorrectly calculated. A number of employees, including one former senior member of a Board of Management, were paid in lieu of notice in addition to their severance payment.

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.

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. Management is finalising the process of consolidating all policies and procedures for Edinburgh College. Where policies and procedures are not currently in place for Edinburgh College management have communicated to staff to use either the pre-existing policies and procedures for the pre-merger Colleges, or where there are variances in existing policies the host entity, Edinburgh's Telford College, policies are being used. We have not identified any instances in the year where policies were being inconsistently used or staff were unaware of which policy to follow.
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. As with other policies these are in the process of review and updating for Edinburgh College policies, with previous policies currently in use as required.
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 over the following financial processes: ▪ operating income and expenditure ▪ staff costs ▪ cash and bank ▪ financial reporting; and ▪ fixed assets. We have identified a control improvement opportunity in respect of journals as outlined on the following page. During 2012-13 the College continued utilising the existing control environments across each campus for the pre-merger colleges, including three separate financial ledgers. Our audit required a testing of each of the three control environments and identified that, while controls were generally operating effectively across the campuses, there were variations in how controls were applied. The majority of finance staff are now permanently based at the Sighthill campus and operating one financial ledger from 1 August 2013. We would expect financial processes and controls to begin to align across all campuses in 2013-14 as a consistent approach to each financial process is adopted across the College. Management implemented a new finance system from 1 August 2013, Agresso, and we understand that the implementation was successful, albeit with challenges in respect of fully delivering on its capabilities.

Corporate governance arrangements (continued)

Internal audit	As set out in our audit plan and strategy, we have evaluated the work of internal audit in the year, both to enhance our understanding of the key risks and issues facing the College and to rely on the work of internal audit where possible to avoid duplication. The content of the internal audit plan is in line with our expectations. We did not directly rely on internal audit work in the year, as we determined that our testing of the pre and post merger control environment was fundamental to our audit opinion. Internal audit work was, however, utilised for an enhanced understanding of the new control environment. In particular, we considered internal audit's work in relation to: ■ financial controls; ■ payroll; ■ corporate governance; and ■ SUMs audit. Internal audit reported that "Edinburgh College did have adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives at the time of our audit work. In our opinion, the College has proper arrangements to promote and secure value for money."
Regularity	As part of our audit of the College's financial statements, we are required by the Public Finance and Accountability (Scotland) Act 2000 to give an opinion on the regularity of expenditure and receipts shown in the financial statements. The executive team considers all incoming correspondence relevant to its strategic management role from the Scottish Funding Council and other regulatory or advisory bodies, such as Audit Scotland to ensure it is appropriately aware of sector issues and developments and that it complies with the terms and conditions of funding. Our review of expenditure throughout the course of our audit did not identify weaknesses in the control environment over regularity of expenditure and receipts, or instances of non-compliance with Scottish Funding Council terms and conditions.

Observations arising from our audit

#	Risk	Issue, impact and recommendation	Management response/ responsible officer/due date
1	Moderate	Where Colleges undertake non-primary purpose ("NPP") activities, they may be liable for corporation tax. Colleges are exempt from corporation tax on these activities. In the case of a recently merged college there is an increased risk of breaching the £50,000 small trading exemption threshold. It is important management consider these activities in more detail to determine whether the limit is breached and if so whether an overall profit or loss arises from these activities. Calculations should be retained as evidence that no corporation tax return requires to be submitted. Tax specialist assistance may be required to assist consideration of NPP activities and have a process going forward for identifying NPP activities and calculate whether a profit arises on those activities.	A review with the assistance of tax specialists will be undertaken and procedures put in place to monitor NPP activities. **Responsible post holder:** Head of Finance and MIS **Date of implementation:** 30 November 2013
2	Low	We consider that journal controls are designed, implemented and operating effectively across both the Sighthill and Milton Road campuses. However, there is no authorisation of manual journals posted at the Telford campus. This is consistent with our findings from the audit of Edinburgh's Telford College in 2011-12. There is a risk that without appropriate management review and authorisation of manual journals inaccurate or inappropriate journals may be posted without management knowledge. Management should ensure all manual journals, across all campuses, are reviewed and approved by management as appropriate. This can be approach with a risk based methodology, with individual approval or significant or material journals, and monthly review of all other manual journals.	Procedures will be adopted for monthly review of manual journals by the Head of Finance. **Responsible post holder:** Head of Finance and MIS **Date of implementation:** 31 October 2013

Observations arising from our audit

#	Risk	Issue, impact and recommendation	Management response/ responsible officer/due date
3	Low	In order to comply with the requirements of component accounting for fixed assets, it is important that management ensure adequate information is available in respect of the constituent elements of large items, such as buildings. Individual items within an asset should be depreciated over their useful economic lives, for example windows within a building. The split on a component by component basis could be identified by engaging a chartered surveyor. Currently all elements of the individual College buildings are depreciated over the same period.	An appropriate level of componentisation will be agreed with KPMG and assets split accordingly based on chartered surveyor review **Responsible post holder:** Head of Finance and MIS **Date of implementation:** 31 January 2014

Key:

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

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 Adjustments made as a result of our audit	There was one audit adjustment required to the unaudited financial statements which impacted on the net assets or the surplus and deficit for the year. During the audit there were a number of iterations of the financial statements, including amendments following our enquires and testing. These iterations reflect the complexities of preparing the first set of financial statements for the merged entity.	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 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 specific representations required for our audit for this year to draw to your attention.	-

Summary of audit differences

There was one audit difference identified. These had the net affect of nil on the income and expenditure for the year ended 31 July 2013.

There were no unadjusted audit differences identified.

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.

£	**Income and expenditure account**		**Balance sheet**	
Narrative	**Dr**	**Cr**	**Dr**	**Cr**
Income and Expenditure reserve	-	-	395,000	-
Revaluation reserve	-	-	-	395,000
Overall impact	**-**	**-**	**-**	**-**

Presentational adjustments

We identified a number of presentational issues during our audit and these have all been amended by management. In particular, during the course of our work we identified a number of instances where categories of income, expenditure, debtors and creditors were allocated inconsistently by campus for both 2012-13 balances and prior year comparatives. This is due to differing approaches by the pre-merger colleges in how some items of income and expenditure were disclosed in the notes to the financial statements.

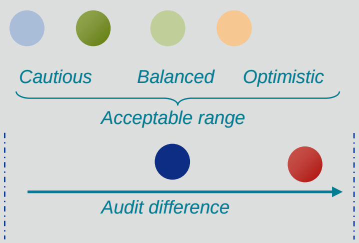
Uncorrected differences

There are 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

Level of prudence compared to KPMG central assumptions



Presented below is a comparison of the assumptions used by Hymans Robertson who advise the College in respect of the Lothian Pension 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 stronger than our central assumptions but are within our expected range.
Discount rate	4.60%	4.40%		■ The proposed discount rate is slightly stronger (higher liability) than our central rate but is within the range that we would normally consider acceptable.
RPI inflation	3.60%	3.50%		■ The proposed RPI inflation rate of 3.6% is stronger (higher 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 top of the range.
CPI inflation / Pension increases	2.80% RPI less 0.8%	2.50% RPI less 1.0%		■ The assumptions are slightly stronger (higher liability) than our central rate and but is acceptable for FRS 17 purposes.
Net discount rate (Discount rate – CPI)	1.80%	1.9%		■ 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	1% until 31 March 2015 RPI+1.5% 2015 onwards	Directors' best estimate, typically 1-2% 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)	 20.4 years 22.6 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.

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 in our letter included opposite.

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 13 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.

KPMG

cutting through complexity™