cutting through complexity

Scottish Qualifications Authority

Annual audit report

Audit: year ended 31 March 2013

19 September 2013

Contents

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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 the Scottish Qualifications Authority 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.

Headlines

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.

In accordance with ISA (UK and Ireland) 260: *Communication with those charged with governance,* this report summarises our work in relation to the financial statements for the year ended 31 March 2013.

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

Area	Summary observations	Analysis
Service overview		
Business issues and update	The financial and operating environment in which SQA operates continues to change, with developing priorities and supporting governance arrangements. There are increasing cost pressures and uncertainty arising from auto-enrolment, pay progression and introduction of the Curriculum for Excellence, together with challenges associated with planned reductions in government funding. A number of pricing models have been developed by management and are being discussed with partners and stakeholders. The pricing mechanism for Curriculum for Excellence, from August 2013, has not yet been agreed. A cost allocation, capacity planning and time recording project is due to be implemented by the end of 2013-14 which will enhance and consolidate information which supports decision making. SQA continues to focus on realising international and commercial activity growth.	Pages 5 to 7
Financial position	Total comprehensive expenditure was £20.8 million and grant funding received was £19.8 million. On a cash basis, outflows from operating and investing activities were £17.7 million which was £0.4 million less than the available Scottish Government funding of £18.1 million (excluding notional funding of £1.5 million). The 2013-14 budget includes a funding gap of £2.3 million, due to reduced grant-in-aid, wage and supplier inflation, auto-enrolment and increased investments in activities to support income generation.	Pages 8 to 9
Performance Management		
Performance management	Our work has identified that SQA's Best Value and performance management arrangements are generally robust. For the financial year 2012–13 SQA had a cash releasing efficiency savings target of £0.5 million; realising actual savings of £0.9 million. There are aspects of particular good practice in respect of the quarterly performance review pack and monitoring of efficiency savings. SQA enhanced its staff performance management system in 2012-13.	Pages 11 to 13
Governance and narrative reporting		
Governance	Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.	Page 15

Headlines (continued)

Area	Summary observations	Analysis
Control observations	Our testing of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively.	Page 16
Financial statements and accounting		
Accounting policies	There have been no changes to accounting policies in 2012-13. All accounting policies have been applied consistently. There have been no substantive changes to the financial reporting framework as set out in HM Treasury's Financial Reporting Manual ("FReM"). Disclosure has been included in respect of the impact of revisions to IAS 19 Employee Benefits. The financial statements have been appropriately prepared on a going concern basis. Future consideration will need to be given to the underlying estimation basis applied to the recognition of Curriculum for Excellence income.	Page 18
Audit conclusions	We have issued unqualified audit opinions on the 2012-13 financial statements, following their approval by the Board in August 2013.	Page 19
Year-end process	The financial statements, directors' report, governance statement and directors' remuneration report were received by the agreed date and were well supported by high quality working papers.	Page 19

Service overview

Our perspective on key business issues and the financial position of SQA

Key business issues

The financial and operating environment in which SQA operates continues to change, with developing priorities and supporting governance arrangements.

SQA faces a number of significant risks in delivering its strategic objectives. In our view, the nature, volume and interdependence of these risks leads to an increased likelihood that SQA will not fully meet its strategic objectives.

There are increasing cost pressures and challenges associated with planned reductions in government funding.

Overview

The Scottish Qualifications Authority ("SQA") is committed to providing and maintaining a comprehensive portfolio of products and services that support lifelong learning, the needs of learners, business, industry, the economy, and wider society in Scotland. Responding to increasing financial pressures, while also addressing the continued reduction in Scottish Government funding, remains a key challenge for SQA.

SQA has identified and planned for future challenges associated with reduced public sector funding. The corporate plan 2013-16 sets out SQA's strategic direction covering both accreditation and awarding functions and is informed by ministerial guidance on SQA's contribution to national objectives and is underpinned by the SQA Strategy for Growth, which is currently being updated. The Strategy for Growth is intended to enable SQA to proactively expand the market for its products and services.

The next three years include a high degree of uncertainty and change. SQA faces a number of significant risks in delivering its strategic objectives. Additionally, the nature, volume and interdependence of these risks leads to an increased likelihood that SQA will not fully achieve its strategic objectives. A number of risks are recognised in the corporate risk register and management are closely monitoring relevant activities. Management consider that to fully deliver the organisation's strategic objectives will require changes to the existing staff profile and additional investment in key skill sets.

The August 2013 quarterly performance review highlighted that a number of operational targets moved from 'green' to 'amber' "RAG" status; highlighting an increased risk that operational targets will not be achieved. Management estimate that there may be additional cost pressures required to ensure achievement of the agreed targets. A number of ongoing projects, related to operations, portfolio development and service delivery are dependent on IT systems and processes which have led to some delays in planned development.

Grant-in-aid funding

Grant-in-aid funding from the Scottish Government reduced from £5.4 million from 2011-12 to £5.1 million in 2012-13. The 2013-14 budget, presented to the board on 30 January 2013, identified a £2.3 million funding gap comprising a further £1.2 million reduction in Scottish Government grant funding together with increased cost pressures arising as a result of pensions auto-enrolment and pay progression.

The level of grant funding for 2014-15 is still to be confirmed, however the Scottish Government has set SQA the target to become self-financing by 2015-16. The self-financing target presents significant challenges to SQA and continues to be a key focus of the discussions with the Scottish Government. Management are continuing to develop new international markets and contracts, together with pricing discussions in respect of core charges for 2013-14.

Curriculum for Excellence

SQA is one of the partners in CfE, with the Scottish Government, Education Scotland, the Association of Directors of Education Scotland, schools and colleges. SQA leads in developing and implementing associated qualifications and is currently developing over 250 national courses and awards, and their associated assessments, to support CfE.

The CfE program introduces additional cost pressures through a growth in headcount and activity, which are, in part met through grant funding provided by the Scottish Government (£11.9 million). Associated with the move to CfE, there will be a number of changes in the respective levels of verification and examination costs incurred.

Key business issues (continued)

A number of pricing models have been developed by management and are being discussed with partners and stakeholders. The pricing mechanism for CfE from August 2013 has not yet been agreed.

A cost allocation, capacity planning and time recording project is due to be implemented by the end of 2013-14 which will enhance and consolidate information which supports decision making.

SQA continue to focus on international and commercial activity.

At May 2013, there were three corporate risks on the risk register related to CfE. These are in respect of delivery of the programme in accordance with set milestones. A baseline programme plan has been produced and is monitored monthly by senior officers and partners, with regular updates presented to the board. To date, all milestones have been achieved. Expenditure of £8.6 million has been incurred to the end of February 2013 in respect of CfE.

Pricing

SQA annually agrees the price increase application to National Qualifications in Scotland with the Scottish Government.

Current prices have not increased since 2010. SQA are in the process of reviewing its pricing and the Scottish Government has developed a number of pricing models to include assumptions in respect of the impact of CfE on SQA income and expenditure. The proposed pricing model will require agreement with the Scottish Government.

SQA recognises the need to ensure it has robust information in respect of individual course costs to inform pricing decisions, both in respect of CfE and in respect of commercial and international investment decisions. A cost allocation, capacity planning and time recording project is to be implemented by the end of 2013-14 which will enhance and consolidate the information currently available.

International activity

SQA continues to support the Scottish Government's international strategy and engagement plans through its work in a variety of countries. It works with other agencies, including Scottish Development International, the British Council and other stakeholders, to ensure that it meets the requirements and demands of international customers.

SQA's international brand continues to develop. In March 2013, the chief executive was invited to speak at the Global Mobility, Making it Happen qualification framework conference in Hong Kong and in April 2013, SQA hosted a study visit for Turkish delegates from the Ministry of National Education. SQA has taken action where international events offer opportunities for business growth.

The drive to increase international and commercial revenue streams is a key strategic imperative for SQA. These activities are overseen by a international and commercial committee.

As new products are developed and SQA operates in new international markets, there will continue to be a need for increased consideration of international legislation, such as tax requirements as well as cultural differences.

IT

SQA's internal auditor service highlighted weaknesses in the organisations' IT strategy, subsequently a consultant was appointed to conduct a review of the IT infrastructure, the fit of the IT strategy with the organisational strategy and to develop a technical improvement roadmap.

Initial feedback was provided by the consultant to the executive management team in August 2013 in respect of the IT department structure. The business systems development function is transferring responsibility for programme management to corporate services, which introduces a higher degree of segregation of duties and increases oversight.

Key business issues (continued)

The next stage of the review will consider the IT infrastructure and IT systems strategy. The IT strategy is also being revised, as part of the strategic plan 2013-16, to ensure it supports operations in a coordinated and joined-up way. A key element of development has been closing the gap between the articulation of business requirements and provision of IT services.

If IT infrastructure and systems are not appropriate to support operational objectives, such as the implementation of e-marking as part of CfE, there is a risk that the organisational strategy to become self-financing by 2015-16 will not be achieved.

Auto-enrolment

The UK Government introduced new legislation to place a compulsory duty on employers to automatically enrol all workers who meet certain age and earnings criteria into a pension scheme. The new pensions legislation came into effect at SQA on 1 March 2013. SQA postponed auto-enrolment for employees and appointees, in accordance with legislation, for three months to 1 June 2013 when full and part-time staff, auto-enrolment was completed. Appointees were not assessed until 1 July 2013 due to systems issues but SQA kept the Pensions Regulator informed of the position.

SQA originally budgeted £250,000 as the cost of new members of the pension scheme who would not opt-out following auto enrolment. The number of staff members opting out of the scheme to date is below expectations, creating additional cost pressures of up to approximately £250,000 in the 2013-14 budget.

Financial position

Total comprehensive expenditure was £20.8 million and grant funding received was £19.8 million.

On a cash basis, outflows from operating and investing activities were £17.7 million which was £0.4 million less than the available Scottish Government funding of £18.1 million (excluding notional funding of £1.5 million).

Financial targets

During 2012-13, SQA received £19.8 million grant-in-aid from the Scottish Government (including notional funding of £1.5 million, in respect of the annual rent of the Optima Building).

	2012-13 £'000	2011-12 £'000	Variance £'000
Staff costs	(27,606)	(27,417)	(189)
Depreciation and impairment	(2,479)	(1,646)	(833)
Other expenditures	(37,606)	(35,280)	(2,326)
Total expenditure	**(67,691)**	**(64,343)**	**(3,348)**
Entry charges	39,705	37,850	1,855
EU funding	125	786	(661)
Other income	6,645	8,276	(1,631)
Total income	**46,475**	**46,912**	**(437)**
Net expenditure	**(21,216)**	**(17,431)**	**(3,785)**
Interest (payable) / receivable	417	951	(534)
Total net expenditure	**(20,799)**	**(16,480)**	**(4,319)**
Actuarial gain/(loss)	(5,270)	(7,098)	1,828
Unfunded benefits paid	15	15	-
Release of revaluation reserve	-	22	(22)
Total recognised income and expenditure	**(26,054)**	**(23,541)**	**(2,513)**
Grant funding received	19,767	22,148	(2,381)
	(6,287)	(1,393)	(4,894)

Source: SQA management information

The increase in net expenditure compared to 2012-13 is shown in the following table:

Movement in the financial position 2011-12 to 2012-13	£'000
Total comprehensive expenditure 2011-12	**16,480**
Movement in pension liability recognised in net expenditure	(35)
Decrease in severance and compensation costs	(159)
Increase in other staff and related costs	383
Increase in depreciation charges	833
Increase in other expenditure	2,326
Decrease in interest receivable	534
Decrease in income received	437
Total comprehensive expenditure 2012-13	**20,799**

Source: SQA management information

Entries income in Scotland was higher than in 2011-12 and rest of UK and international income has continued to grow, however consultancy income and European Social Fund income has reduced.

Staff costs have increased as a result of the pay award and headcount growth associated with CfE, offsetting savings arising from the voluntary early release scheme in 2011-12. Other expenditure has also increased, primarily associated with CfE activities.

On a cash basis, outflows from operating and investing activities were £17.7 million which was £0.4 million less than the available Scottish Government funding of £18.1 million (excluding notional funding of £1.5 million). The financial performance report, presented to the audit committee noted a surplus of £0.3 million, the small difference related to the reporting format.

Financial position (continued)

The 2013-14 budget includes a funding gap of £2.3 million, due to reduced grant-in-aid, wage and supplier inflation, auto-enrolment and increased investments in activities to support income generation.

Financial plans 2013-14

2013-14 will continue to be challenging for SQA. The Scottish Government has set a target for SQA to achieve a self-financing status by 2015-16. This target is considered to present a major challenge to the organisation, and one which will require significant investment in capacity across SQA in order to be achieved.

The 2013-14 budget has been prepared in line with the objectives set out in the draft corporate plan 2012-15 to maintain levels of service, efficiency and quality while continuing to focus on the Strategy for Growth.

Associated with the target to become self-financing, grant-in-aid is continuing to reduce, from £5 million in 2012-13 to £3.8 million in 2013-14. Other financial constraints include:

- no price increases to customers (since August 2010);
- auto-enrolment to pension schemes;
- a need for investment to take advantage of commercial opportunities; and
- supporting development of the CfE through core resources.

The 2013-14 budget prepared by management forecasts a deficit £2.3 million. While the overall budget gap is significant, it has reduced compared with earlier draft budgets following senior management challenge on business targets and underlying assumptions.

However, without additional financial support from the Scottish Government, it is likely that the forecast deficit will increase if additional expenditure is required to ensure operational objectives are achieved – a number of which moved from green to amber status in SQA's August 2013 quarterly performance review.

The table opposite shows the proposed 2013-14 budget against the 2012-13 budget. Grant funded income and expenditure relates to specific programme funding, the majority of which (£11.9 million) relates to continued development and implementation of CfE.

	2013-14 budget £'000	2012-13 budget £'000
Core income		
Entry charges	40,100	39,100
Other income	6,700	6,800
Grant-in-aid	3,800	5,000
SG funding – property rental costs	2,600	2,600
Capital grant release	1,000	1,000
Core expenditure		
Staff costs	(23,200)	(21,900)
Appointee costs	(16,600)	(16,500)
Operational costs	(11,900)	(11,700)
Property rental costs	(2,600)	(2,600)
Depreciation	(2,200)	(2,400)
Core deficit	**(2,300)**	**(600)**
Grant funding		
Grant funded income	14,100	13,700
Grant funded expenditure	(14,100)	(13,700)
Grant deficit	**0.0**	**0.0**
Total deficit	**(2,300)**	**(600)**
Non-cash expenditure	**-**	**600**
Surplus / (deficit)	**(2.300)**	**0**

Source: *SQA management information*

Performance management

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

Performance management

Our work has identified that SQA's Best Value and performance management arrangements are generally robust.

For the financial year 2012–13 SQA had a cash releasing efficiency savings target of £0.5 million from the Scottish Government and realised actual savings of £0.9 million.

Best Value

In April 2002 the Scottish Ministers introduced a non-statutory duty on accountable officers to ensure there are arrangements designed to secure Best Value. Audit Scotland is committed to extending the Best Value audit regime across the whole public sector. 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).

For the financial year 2012–13 SQA had a cash releasing efficiency savings target of £0.5 million from the Scottish Government and realised actual savings of £0.9 million.

Efficiency savings to 31 March 2013	Actual Savings £'000	Original saving target £'000	Variance £'000
Staff costs	**574**	**285**	**289**
Appointee costs	**163**	**0**	**163**
Assessment materials	39	101	(62)
Postage and telephone	23	96	(73)
External venues	8	10	(2)
IT costs	25	34	(9)
Property	13	7	6
Other	15	16	(1)
Other operating costs	**353**	**260**	**93**
Total	***860***	***549***	***311***

Source: quarterly performance review May 2013

These savings included a focus on:

- staff cost reductions achieved as a result of the voluntary early release scheme in 2011-12 (£0.3 million);
- cost reductions created through the more effective use of technology;
- improving business processes and working practices; and
- embedding a culture of efficiency across the organisation while ensuring no reduction in outputs or quality of service.

Performance management (continued)

There are aspects of particular good practice in respect of the quarterly performance review pack and monitoring of efficiency savings.

SQA enhanced its staff performance management system in 2012-13.

Best Value (continued)	While the original savings target for 2012-13 was exceeded, this was primarily in respect of staff costs where savings of £0.6 million were achieved against a target of £0.3 million. In respect of other operating expenditure, with the exception of property costs, the savings target was not fully achieved. The budgeted funding gap in 2013-14 of £2.3 million will require further efficiency savings to be identified by SQA. Management are considering steps that can be taken to close the funding gap while taking care not to impact service delivery or the ability to achieve the target to be self-financing by 2015-16, as set by the Scottish Government.
Performance management	SQA enhanced its staff performance management system during 2012-13 to ensure the focus is on having high-quality and productive conversations. This has included the system being e-enabled, resulting in a live and active record of the individual's performance and development. A quarterly performance review pack is presented to the audit committee. It contains extensive information in respect of key corporate milestones, any recently completed or achieved and those due in the next period together with a summary of potential risks arising. The performance review pack incorporates a number of reporting formats, graphs, charts and narrative and includes aspects of good practice such as noting actions required in respect of specific performance areas. The quarterly review pack includes summary information in respect of: ▪ key corporate measures; ▪ finance; ▪ sales and income pipeline; ▪ portfolio management; ▪ key operations measures; and ▪ risk management. Internal audit completed a review of performance management arrangements in 2012-13, assessing the extent to which performance measures are linked to the delivery of corporate objectives and how these are linked to operational monitoring processes. While they reported that roles and responsibilities for performance management are well defined and that the performance management framework allows management to assess whether key financial objectives will be achieved, they identified some weaknesses and scope for improvement. The process does not allow management and non-executives to determine the extent to which SQA is meeting its other, non-financial, corporate objectives. Reliance on manually analysed data increases the risk of error and the quarterly performance review could be more effectively tailored to meet the needs of different audiences.

Performance management (continued)

During 2012-13 we have performed follow-up work in relation to the Audit Scotland national report: *Scotland's public finances: Addressing the challenges* as well as preparing returns on national studies.

Corporate expectations	SQA has assessed its position against the corporate expectations delivery areas and considers that good progress continues to be made in delivering continuous improvement. SQA has aligned corporate objectives with national outcomes and seeks to share services with other organisations where possible, for example in the provision of human resources expertise. During 2012-13, SQA recruited two modern apprenticeships and is currently investigating the opportunity to extend opportunities under the scheme. Opportunities to make efficiencies are being explored in the transformation of existing products and services and during procurement activities.
Scotland's public finances: addressing the challenges	We have considered SQA's response to Scotland's public finance's: responding to the challenge in our 2012-13 interim audit report and prepared a summary as part of our interim management report. The national report had not been formally considered and management had not performed a self-assessment of local arrangements against the recommendations it contained. However, in response to future challenges SQA has carried out long-term financial planning and identified savings which are tracked and reported to the board and audit committee. Management confirmed that they have taken steps to ensure that national reports are formally considered, as appropriate. This involves establishing a more reliable arrangement for identifying those Audit Scotland reports that should be drawn to the attention of relevant committees.
Local response to national studies	Audit Scotland periodically undertakes national studies on topics relevant to the performance of central government bodies. To ensure that added value is secured through the role of Audit Scotland and its appointed auditors, auditors will continue to ensure that audited bodies respond appropriately to reports from Audit Scotland's programme of national performance audits. Other than the national report Scotland's public finance's: responding to the challenge, no further national studies were noted.

Governance and narrative reporting

Our overall perspective on your narrative reporting, including the remuneration report and annual governance statement

Update on controls findings from our audit

Corporate governance arrangements

Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.

Annual governance statement and governance arrangements	The statement for 2012-13 outlines the corporate governance and risk management arrangements in operation in the financial year. It 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. The statement, which is made by the Accounting Officer, considers the effectiveness of the system of internal control based on information provided by senior management, the audit committee and internal audit. The statement identifies that the internal control system is operating effectively We have reviewed the governance statement and have confirmed that it is in line with guidance and reflects our understanding of SQA. SQA maintains an integrated governance framework to provide an appropriate structure for maintaining decision-making, accountability, control and behaviour. During the year, the board's composition changed; one board member's term of appointment ended and two new directors were appointed by the Scottish Ministers. The board is supported by six sub-committees; the accreditation committee, the advisory council, the qualifications committee, the international and commercial committee, the audit committee and the remuneration committee. We have updated our understanding of the governance framework and documented this through our overall assessment of SQA's risk and control environment. This work has formed part of our assessment of the annual governance statement.
Annual report, including the management commentary	The financial statements form part of the annual report of SQA for the year ended 31 March 2013. We are required to consider the annual report and provide our opinion on the consistency of it with the financial statements. We are satisfied that the information contained within the annual report is consistent with the financial statements. Changes to the UK Corporate Governance Code, which will be applicable for year ending 31 March 2014, will require that the \`front end' narrative reporting is \`fair, balanced and understandable.' Audit committees will be expected to consider this as part of their consideration of the annual report and financial statements. In our view, the annual report already complies well with this requirement, although we recommend early consideration of the requirements of the revised Code against SQA's reporting format. The annual report tends to summarise achievements in respect of SQA's strategic goals but could be enhanced to explain where achievement is ahead or behind schedule or any identified risks to continued achievement, to ensure a balanced message is given. Management are considering making revisions to the content and format of the annual report for 2013-14.
Remuneration report	The remuneration report was provided after the audit fieldwork was completed, and supported by good quality information in respect of the disclosures given.

Corporate governance arrangements (continued)

Our testing of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively.

Internal audit	As set out in our audit plan and strategy, we evaluated the work of internal audit and concluded that we can rely on their work, where relevant. The content of the internal audit plan is, in our view, comprehensive. We reviewed a number of reports, including those in respect of accounts payable and budgetary control. Internal audit has completed their agreed plan and their annual report concludes that "*SQA has a framework of controls in place that provides reasonable assurance regarding the effective and efficient achievement of the organisation's objectives and the management of key risks. Proper arrangements are in place, in the areas we have reviewed, to promote value for money, deliver best value and secure regularity and propriety in the administration and operation of the organisation".*
Internal controls	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively. In our interim management report, we made one `medium' grade recommendation in respect of operating expenditure and one 'low' grade recommendation in respect of journal entries. These recommendations were discussed with management and we understand action has been taken to address both matters.
Prevention and detection of fraud	Procedures and controls related to fraud are designed and implemented effectively. SQA has appropriate arrangements to prevent and detect fraud, inappropriate conduct and corruption, including policies and codes of conduct for staff and board members. These are supported by a fraud prevention policy and response plan. No significant fraud or irregularities were identified during the year.
National Fraud Initiative ("NFI")	The National Fraud Initiative ("NFI") is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use for uploading data and monitoring matches. The financial accounting manager submitted required data by 31 January 2013. 2012-13 is the first year SQA has participated in NFI. SQA received their matches and management are in the process of reviewing and closing these matches. We are required to complete an NFI questionnaire to Audit Scotland by 31 January 2014, assessing SQA's engagement with the 2012-13 NFI exercise. We will complete this in liaison with management.

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 changes to accounting policies in 2012-13. All accounting policies have been applied consistently.

There have been no substantive changes to the financial reporting framework as set out in HM Treasury's *Financial Reporting Manual* ("FReM").

Disclosure has been included in respect of the impact of revisions to IAS 19 *Employee Benefits.*

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

Future consideration will need to be given to the underlying estimation basis applied to the recognition of Curriculum for Excellence income.

Accounting framework and application of accounting policies

Area	KPMG comment
Financial reporting framework	▪ SQA prepares the financial statements in accordance with the principles of HM Treasury's Financial Reporting Manual 2012-13 ("FReM"). ▪ During the year there have been no substantive changes in financial reporting requirements, and consequently there are no material changes to SQA's accounting policies. ▪ We are satisfied that the accounting policies adopted remain appropriate to SQA.
Impact of revised accounting standards	▪ Disclosure has been included in the financial statements highlighting that revisions to IAS 19 `*Employee Benefits*' have not been applied for 2012-13. The amended version of IAS 19 comes into effect for financial years beginning on or after 1 January 2013. SQA will apply the amended IAS 19 from financial year 2013-14. ▪ No other newly effective accounting standards are considered to have a material impact on SQA's financial statements.
Going concern	▪ The financial statements have been prepared under the assumption that the organisation is a going concern. Given the nature of SQA, this is a reasonable assumption and a budget has been set, together with agreed funding for 2013-14, which indicates that the organisation will continue to operate.
Income recognition	▪ SQA income mainly arises from entry charges. The introduction of CfE and expansion in the rest of the UK and international markets will result in new products and services associated with different pricing and charging mechanisms compared with existing income sources, which leads to increased complexity in the application of income recognition accounting policies. ▪ During 2012-13, management reviewed the accounting policy in respect of income recognition and the requirements of IAS 18 *Revenue* and completed a detailed analysis of its main sources of income against those requirements. A particular consideration was the proposed approach in respect of CfE income which is a new income stream from 2013-14. ▪ Following consultation with management it was confirmed that the existing accounting policy remained appropriate, together with the underlying estimation basis which is applied to the various categories of income to allocate it across accounting periods in the financial statements. ▪ With respect to CfE income, consideration will need to be give to the period over which a service is delivered when applying the accounting policy.

Audit conclusions

We have issued an unqualified audit opinion on the financial statements and the regularity of transactions reflected in those financial statements.

The financial statements were made available on a timely basis and were accompanied by high quality working papers.

The draft governance statement was made available after the majority of fieldwork had been completed.

Audit conclusions

Our audit work is complete and following approval of the financial statements by the board, we have issued an unqualified opinion on the truth and fairness of the state of SQA's affairs as at 31 March 2013, and of SQA's net expenditure for the year then ended. We also issued an unqualified opinion on the regularity of transactions within the year. There are no matters identified on which we are required to report by exception.

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;
- liaised with internal audit and reviewed their 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 prevention and detection of fraud with the potential to impact on the financial statements; and
- attended the audit committee to communicate our findings to those charged with governance, but also to update our understanding of the key governance processes and obtain key stakeholder insights.

Financial statements preparation

Preparation of the financial statements

- High quality working papers and draft financial statements were provided at the start of the audit fieldwork on 7 May 2013. The directors' report, remuneration report and governance statement were provided on 14 June 2013.
- In advance of our audit fieldwork, we issued a 'prepared by client' request setting out a list of required analyses and supporting documentation. The standard of documentation was very good and there was evidence of accountability and ownership of working papers across the finance department.
- Throughout the course of the year we have had regular correspondence with SQA's finance team to ensure that disclosure within the financial statements was consistent with the requirements of the FReM. We provided feedback to management on the content of the financial statements, annual report and governance statement.

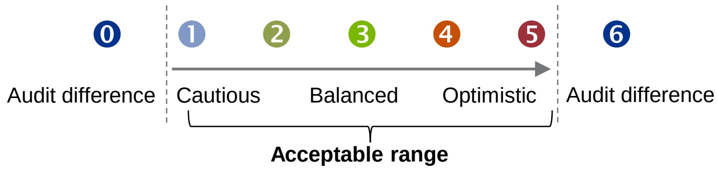
Overview assessment

Overall, in respect of the key judgements made in the preparation of the financial statements, we are satisfied that management's judgements are generally balanced, and do not represent either an overly optimistic, or overly cautious, position.

Assessment of subjective areas

Asset/liability class	Current year	Prior year	Balance (£m)	KPMG comment
Pensions IAS 19 pension deficit	3	3	(11.4)	We have reviewed the assumptions used by the actuary in calculating the pension deficit. The assumptions are within the acceptable range of the guideline assumptions that KPMG actuaries have calculated. Overall, the assumptions are considered to represent a balanced approach to valuation of the net pension deficit.

Level of prudence



Cautious means a smaller asset or bigger liability; Optimistic is the reverse

Employee benefits (continued)

Each of the assumptions used to value SQA's net pension deficit are within an acceptable range of KPMG's expectations.

We are of the view that this therefore represents a reasonable and balanced approach, in accordance with the requirements of IAS 19.

Defined benefit pension liability		
Value (£000s)		
2013	2012	KPMG comment
(11,370)	(6,641)	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the IAS19 pension scheme valuation. Details of key actuarial assumptions are included in the table, along with our commentary. The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of around 17 years. The closing deficit increased by £4.7 million from 2012-13, primarily due to the application of an updated discount rate. A reconciliation from opening to closing deficit is included on the next page.

Assumption	SQA	KPMG central	Comment
Discount rate	4.5%	4.25%	Acceptable - the SQA's rate is weaker (lower liability) than KPMG's central rate and is at the top end of the range we consider acceptable
RPI inflation	3.6%	3.6%	Acceptable
CPI inflation	2.8% RPI - 0.8%	2.6% RPI – 1%	Acceptable – SQA's assumption is more prudent (higher liability) than KPMG's central rate, and is within the acceptable range.
Salary growth (long term)	5.1% 1.5% above RPI	1-2% above RPI/CPI inflation	Acceptable – SQA's assumption reflects the extension of the public sector pay freeze to 2016, followed by a long term assumption of RPI plus 1.5%.

Employee benefits (continued)

The table opposite shows the reconciliation of the movement in the balance sheet.

The main elements of volatility are in respect of the discount rate, which drives the valuation of the liabilities.

	£000	Deficit / loss	Surplus / gain	Impact	Volatility	Commentary
	Opening surplus/(deficit)			**(6,641)**	-	The opening IAS 19 deficit for the Scheme at 31 March 2012 was £6.641 million, in line with the Hymans Robertson's IAS 19 actuarial valuation report.
I & E	Service cost			(3,196)	●	The scheme is open to accrual. The service cost represents the value of new benefits built up over the year.
	Net finance charge			439	●	This is the difference between the expected return on assets of £4.388 million and the interest on the defined benefit obligation of £3.949 million.
Cash	Contributions			3,283	●	SQA made cash contributions of £3.283 million.
OCI	Change in assumptions gain/(loss)			(5,270)	●	This represents an actuarial loss due to changes in assumptions, primarily due to the reduction in the discount rate.
	Contributions in respect of unfunded benefits			15	●	
	Closing surplus/(deficit)			**(11,370)**	-	

Key: ● Low ● Medium ● High

Source: KPMG analysis of scheme valuation movements. Volatility assessment based on KPMG's market experience.

I&E – impacts on surplus /(deficit) within statement of comprehensive net expenditure

Cash – cash-flow impact

OCI – charged through other comprehensive income

Appendices

Mandatory communications

There were no changes to the core financial statement and there are no unadjusted audit differences

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	There were no audit adjustments required to the draft financial statements which impacted on the net assets or net operating cost for the year. A small number of minor numerical and presentational adjustments were required to some of the financial statement notes.	-
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	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.	-
Confirmation of Independence Letter issued by KPMG to the Audit Committee	We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Director and audit staff.	Appendix two
Schedule of Fees Fees charged by KPMG for audit and non-audit services	There were no non-audit services in 2012-13.	Appendix two
Draft management representation letter Proposed draft of letter to be issued by SQA to KPMG prior to audit sign-off	There are no changes to the standard representations required for our audit from last year.	-

Auditor independence and non-audit fees

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

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 SQA 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 directors.

Confirmation of audit independence

We confirm that as of 10 September 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 the audit committee and should not be used for any other purpose.

Yours faithfully

KPMG LLP

cutting through complexity