Edinburgh College

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

Period ended 31 March 2014

25 September 2014

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 Board of Management of Edinburgh College and is made available to Audit Scotland and the Auditor General for Scotland (together "the Beneficiaries"). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone.

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

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

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Headlines

This annual audit report summarises our work at Edinburgh College for the eight month period ended 31 March 2014. Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* and guidance issued by Audit Scotland.

This report also includes those matters specified by ISA (UK and Ireland) 260: *Communication with those charged with governance* in relation to the financial statements for the period ended 31 March 2014.

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

Area	Summary observations	Analysis
Strategic overview and use of resources		
Business issues	In its second period of operation, management have continued to develop a strategic vision for the College based on the principles in the business case for the establishment of the College. Continuing reductions in Scottish Government real-time funding continue to present challenges. Colleges in Scotland have been reclassified as public bodies from April 2014. One consequence has been the change in accounting reference date away from one which matched academic activity.	Page 6
Financial position	The budget for the 12 month period to 31 July 2014 was a deficit of £1.7 million. The deficit for the period to 31 March 2014 is £986,000 which compares to a surplus of £622,000 in the comparative 12 month period. Income has reduced primarily as a result of a reduction in grant income from the Scottish Funding Council and a decrease in commercial and international contracts. The outturn has also been impacted by higher than budgeted post merger pay harmonisation costs. The balance sheet reflects a decrease in net assets of £9 million, corresponding to the deficit for the year and the actuarial loss on the defined benefit pension scheme. The budget for the 12 months to 31 March 2015 is for a further deficit of £1.1 million.	Pages 7 - 8
Financial statements and accounting		
Audit conclusions	We have issued unqualified audit opinions on the financial statements and on the regularity of financial transactions.	Page 10
Significant risks	We have considered inherent significant risks that International Standards on Auditing require us to address covering risks in relation to revenue recognition and management override of controls and have satisfactorily concluded our work in these areas.	Pages 10 - 11
Audit focus areas	We have satisfactorily concluded work identified at the planning stage in relation to retirement benefits valuation, accounting for onerous contract obligations and proposals for the establishment of a charitable foundation.	Pages 11-12
Year end process	The unaudited financial statements were made available on a timely basis, in advance of the audit fieldwork. There were some changes to the statements due to the change in accounting reference date.	Page 14

Headlines (continued)

Financial statements and accounting (continued)		
Control observations	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 in the main designed appropriately and operating effectively. We have raised a number of recommendations over the operation of controls.	Page 14
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.	Pages 16 and 17
Performance management		
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 19

Scope and responsibilities

Purpose of this report

The Auditor General for Scotland ("the Auditor General") has appointed KPMG LLP as auditor of the Board of Management of Edinburgh College ("Edinburgh College") under the Public Finance and Accountability (Scotland) Act 2000 ("the Act"). The period of appointment is 2012-13 to 2015-16, inclusive.

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at Edinburgh College and the Auditor General for Scotland. The scope and nature of our audit were set out in our audit strategy document which was presented to the audit committee at the outset of our audit.

Responsibilities

Audit Scotland's *Code of Audit Practice* ("the Code") sets out Edinburgh College's responsibilities in respect of:

- preparation of financial statements;
- systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- financial position; and
- Best Value.

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code.

The Code sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements but also consideration of areas such as financial performance and corporate governance.

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Weaknesses or risks identified are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity.

This annual audit report to members and our presentation to the audit committee, together with previous reports to the audit committee throughout the year, discharges the requirements of ISA 260.

Service overview

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

Key business issues

The Scottish further education sector is undergoing significant structural reform. Edinburgh College was established in 2012 in anticipation of the Post-16 Education (Scotland) Act 2013 and the consequent creation of 13 new college regions.

Funding for the college sector has decreased in recent years and the Scottish Government expects continued efficiencies from the merger programme and wider reforms to allow further real-term reductions in funding.

Colleges have been re-classified as public bodies from April 2014, restricting the scope to build up financial reserves. The accounting reference date has been altered as a consequence.

Edinburgh College was formed on 1 October 2012 following the merger of Edinburgh's Telford, Jewel & Esk and Stevenson Colleges as part of the process of creating 13 new college regions. With around 26,000 student enrolments across four campuses in Edinburgh and the Lothians, the College is one of the largest colleges in the UK.

Through the merger, the College inherited a legacy of staff, infrastructure and a reputation, and continues to build on this to ensure that the communities of Edinburgh, the Lothians and beyond have access to top quality higher and vocational education in a style and setting that meets their needs. The College has developed several cross-campus projects involving green transport, renewable energies, academies for tourism and health, knowledge transfer and incubator hubs, and a community garden – all of which seeks to contribute factors to a more dynamic and socially responsible way of working and learning.

Based on the seven key principles presented in the merger proposal document, the College has working to establish a shared vision and goals for the whole college community. The strategic plan 2013-18 sets out five key messages and measures for the College.

The College seeks to meet its mission and progress towards the vision of the future through planning and achieving a balanced set of outcomes and results that meet both the short and long term needs of the College and its key stakeholders.

A 'balanced scorecard' is being developed which translates the College's strategy and the requirements of the Scottish Funding Council Outcome Agreement into a comprehensive set of objectives and related performance measures and indicators.

Messages	Measures
Achieving a positive destination for every student	100% of full time students achieving a positive destination
Shaping an innovative Edinburgh College culture	An operating surplus of at least 2% of turnover
Growing the college by 20% during the period of the plan	Increasing turnover to £75 million
Delivering an upward trend in student places	Rated in the Sunday Times top 75 employers (upper quartile)
Keeping things simple	Increased spend on staff as educators of the future

In its latest review of the college sector, Audit Scotland reported that, while the overall financial standing of the sector continued to be generally sound, the sector faces an overall 11 per cent real-terms reduction in revenue grant funding from the Scottish Government in the period to 2014-15. Some college regions will see larger reductions in grant funding than others – including Edinburgh – meaning that they face greater challenges in reducing costs. Reducing staff numbers is likely to be the main way in which savings will be delivered, but that presents risks in terms of retaining skills and experience required to maintain quality of learning.

Colleges in Scotland have been re-classified as public bodies from April 2014 and this will require them to operate within the same annual budget limits as other Scottish Government bodies. This will restrict the scope to build up financial reserves. A number of colleges – including Edinburgh – have established separate charitable foundations as a means of minimising some of the impact of this change. One consequence of the re-classification has been the change in accounting reference date to 31 March from 2014.

Financial position

The College generated an overall deficit of £986,000 in the eight month period (2012-13: £622,000 surplus).

Income reduced on the prior year mainly as a result of the year end change meaning the figures were only for an 8 month period this year. Income also reduced due to the fact that the voluntary severance scheme grant was not required in the current year to the same extent.

The movement in expenditure is due to the fact that the exceptional staff costs (redundancy costs) have decreased due to most of the activity taking place in the year of the merger (2012-13).

Release of a part of an utilised provision gave a benefit of £239,000.

The College is reporting a deficit for the eight month period to 31 March 2014 of £986,000. This compares to a surplus of £622,000 in the previous 12 month period. The budget for the 12 month period (academic year) to 31 July 2014 was for a deficit of £1.7 million; the actual outturn in the eight month period is in line with expectations.

Total income decreased by £24.3 million when compared to 2012-13 but this has been largely as a result of the change in accounting periods. Overall, on a like-for-like basis:

- Scottish Funding Council grants awarded for the academic year 2013-14 reduced by £1.2 million, primarily as a result of a reduction in recurrent grant income and a re-allocation of 2,500 WSUMS to West Lothian College with a monetary value of £414,200.
- Tuition fee and education grants have remained broadly consistent when considering the reduction in the accounting period from 12 to eight months.
- Other operating income reduced by £1.1 million, in absolute terms but has remained consistent when taking into consideration the reduction in the accounting periods.

Expenditure decreased by £22.6 million when compared to 2012-13. However, this has been largely as a result of the change in accounting period. On a consistent basis expenditure has increased as a result of higher than budgeted pay awards relating to post merger pay harmonisation as well additional requirements in the year.

Overall, on a like-for-like basis:

- Staff costs reduced by £12.3 million but have remained consistent when considering the shorter accounting period. Staff numbers have remained consistent year on year, only dropping slightly. In line with expectations, exceptional staff costs have fallen £3 million due to the voluntary severance programme in 2012-13 coming to an end.
- Other operating expenses decreased by £4.7 million. This is primarily due to the reduced months in the accounting period rather than significant savings achieved by the College.

	2014 £'000	2013 £'000
Income		
Funding council grants	33,163	52,209
Tuition fees and education grants	7,083	10,977
Research grants and contracts	1,529	1,949
Other operating income	2,273	3,326
Endowment and investment income	357	205
Total	**44,405**	**68,666**
Expenditure		
Staff costs	(27,346)	(39,717)
Exceptional staff costs	(40)	(3,076)
Other operating expenses	(14,108)	(18,836)
Exceptional operating income/(expenditure)	239	603
Depreciation	(3,493)	(5,612)
Interest and other finance costs	(528)	(791)
Exceptional items – merger expenditure	(115)	(561)
Total	**(45,391)**	**(67,992)**
Surplus/(deficit) before the disposal of assets	**(986)**	**674**
Disposal of fixed assets	-	(52)
Surplus/(deficit) after the disposal of assets	**(986)**	**622**

Source: 2013-14 financial statements

Financial position (continued)

The balance sheet shows a decrease in net assets of £9 million, arising from the increase in the net pensions liability and the operating deficit in the current year. Period end comparisons have been impacted by the change in accounting reference date.

The 2014-15 budget anticipates a deficit of £1.1 million.

The balance sheet shows a decrease in net assets of £9 million.

- There was a reclassification of £4.5 million of fixed assets from assets under construction to land and buildings, computer equipment and fixtures and fittings following completion of the North Campus re-development which came into use in the financial year 2013-14.
- Cash at bank and in hand decreased by £11.3 million. This is primarily the result of the repayment to the Scottish Funding Council of £3.6 million for unutilised capital funds, the transfer to the Development Trust and an increase in the prepayments and accrued income by £2.2 million at 31 March which was primarily due to the change in accounting period. There was also £1 million of capital development expenditure and £1 million of debt related payments in the current year.
- Debtors increased by £3.8 million due a £2.2 million increase in the prepayments and accrued income balances in the year, while creditors have decreased by £5.1 million, primarily arising from a change in the ONS regulations which mean that the College is no longer enable to show unapplied Scottish Funding Council grant as a creditor.
- Provisions decreased by £0.5 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.
- Net pension liabilities in respect of participation in the Lothian Pension Fund increased by £6.2 million as a result of market conditions and assumption changes.

31 March / 31 July	2014 £'000	2013 £'000
Fixed assets		
Tangible assets	140,754	141,750
Current assets		
Stocks	107	73
Debtors: Amounts falling due within 1 year	5,958	2,156
Cash at bank and in hand	4,937	16,192
Creditors: Amounts falling due within 1 year	(7,233)	(12,392)
Net current assets	**3,769**	**6,029**
Creditors: Amounts falling due after 1 year	(14,443)	(15,260)
Provisions for liabilities and charges	(5,466)	(5,952)
Net pensions liability	(15,344)	(8,722)
Net assets including pension liability	**109,270**	**117,845**
Deferred capital grants	62,742	63,590
Reserves		
Income and expenditure reserve (including pension reserve)	39,933	47,452
Revaluation reserve	6,595	6,803
Total funds	**109,270**	**117,845**

Source: 2013-14 financial statements

Budget 2014-15

The approved a budget for 2014-15 reflects a £1.1 million deficit for the year. This is primarily due to further reductions in Scottish Funding Council funding and timing differences on balancing cost profiles.

Financial statements and accounting

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

Audit conclusions

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

International Standards on Auditing require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk and that management override of controls is a significant risk.

We have satisfactorily carried out audit work to address these risks.

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 March 2014 and of the College's income and expenditure, recognised gains and losses and cash flows for the year then ended. We have also issued an unqualified opinion on the regularity of the transactions reflected in those financial statements. There are no matters identified on which we require 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;
- 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 meetings 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.

Significant risks

Revenue recognition	While fraud risk associated with grant income would ordinarily be rebutted, the change in accounting reference date to 31 March introduced a degree of judgement as to underlying activity measures and compliance with funding conditions. This included whether underlying activity was such that provision should be made for anticipated clawback of grant funding. We found that management had considered the different variables impacting recognition of grants and had arrived at an appropriate basis. Where there was room for some interpretation, we found management's judgement to have been balanced. We did not identify any errors requiring adjustment in the financial statements or evidence of bias in determining income to be recognised.

Audit conclusions (continued)

In addition to the significant risks which International Standards on Auditing require us to address, our audit planning also identified areas of audit focus around:

- **retirement benefits valuation;**
- **onerous contract (residences) provision; and**
- **establishment of a charitable foundation.**

Our work in each of these areas has been satisfactorily concluded.

Significant risks (continued)	
Management override of controls	To address this risk, we have performed testing of journal entries during the year and at the year end, undertaken a review of unusual transactions in the year, made enquiries with employees outside the finance department, incorporated audit tests of an unpredictable nature and undertaken testing of controls, including 'higher level' controls and reviewed management's accounting estimates for bias. Our work did not identify any matters that required adjustment in the financial statements or which require to be brought to your attention.
Audit focus areas	
Retirement benefits valuation	The College accounts for its participation in the Lothian Pension Fund in accordance with FRS 17: *Retirement benefits* on a defined benefits basis using valuation information prepared by actuarial consultants. Our audit of the accounting for retirement benefits includes evaluation of the actuarial consultants as a third party expert, consideration of the data underlying the actuarial report, including the level of contributions made during the year, the financial assumptions and membership data provided to the actuary by the College, and estimates of the College's share of the pension fund assets. We found that the actuarial consultants as a third party expert was objective and had the appropriate experience and expertise to provide the information for use by the College. The level of contributions made by the College in the period is estimated based on data prior to the period end. It is important that this number is accurate as it is used to inform the calculation of the liabilities at the period 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 period. For the Lothian Pension Fund, the actuaries use a number of assumptions in their calculations based on market conditions at the period end, including a discount rate to derive the anticipated future liabilities back to the period end date and assumptions on future salary increases. Using our own actuarial specialists, we have reviewed the assumptions and concluded that the overall assumptions proposed were slightly stronger than our central assumptions but are within our expected range. The rate of salary increases is set taking into account the College's expected long-term rate of salary increases, including incremental drift. Following discussion with management, the rate assumed in 2013-14 is 1% followed by 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.

Audit focus areas	
Onerous contract – residences provision	A contract for provision of student accommodation entered into by Edinburgh's Telford College in 2009-10 placed 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. For the year ended 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). The adjustment is the result of increased occupancy, following greater marketing and a transfer of students from other residences. For our 2013-14 audit, we found that management had again reviewed the level of provision required as at 31 March 2014 in the light of occupancy experience and had concluded it appropriate to reduce the provision again by a further £239,000. Management did not consider that the improving occupancy rates over two periods alone warranted any further adjustment beyond a partial release, although it is acknowledged that once information from 2014-15 is available, a further re-assessment will be required. We found the underlying assumptions and revised calculations to be acceptable.
Charitable foundation	As a result of the college reclassification, colleges' abilities to spend existing reserves, eg. by operating at a deficit in a given year, will be restricted due to the Scottish Government funding mechanisms. In order to protect existing reserves levels, Edinburgh College Development Trust has been established as a company limited by guarantee and registered with the Office of the Scottish Charity Regulator. We have considered the status of the Trust against the relevant accounting requirements which determine whether it should be consolidated in the College's financial statements. This requires consideration of whether: ■ there is direct ownership or control of the Trust; and ■ there is evidence of indirect control through established practices or other means. Following consideration of the Trust's constitution and associated documentation, we have agreed with management's intention that the Trust will not require to be consolidated at 31 March 2014. In so doing, we note, that there are a number of risks that should be considered by management where future actions may indicate that consolidation is required. £150,000 was gifted to the Trust during 2013-14.

Accounting framework; application of 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 applied consistently with those introduced in the previous year following the establishment of the College.

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

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

Statement of Recommended Practice: *Accounting for Further and Higher Education* (2007) ("the SORP")	■ The 2013-14 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 changes to the College's accounting policies. ■ We are satisfied that the accounting policies remain appropriate to the business, and have been applied consistently.
Impact of revised accounting standards	■ There are no newly effective accounting standards which are considered to have a material impact on the College's financial statements for 2013-14. ■ 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. Management will need to consider the accounting and reporting implications of the revised SORP and 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. Each of these will need careful consideration.
Going concern	■ Management has considered the funding available to the College in 2014-15 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 March 2014, the College had £5 million cash and £4 million net current assets.

Year end process; internal control; other matters

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

They were still operating on separate systems until the current year. During the 2013-14 year, the merged college moved away from systems reflecting the predecessor colleges onto a unified system.

Financial statements preparation	■ High quality working papers and draft financial statements were provided on 19 May 2014 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. ■ There are no non-trifling unadjusted audit differences, and there were no adjusted audit differences 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.
Systems of internal control	Management implemented a new finance system with effect from 1 August 2013. The implementation was mostly successful and management have noted that they plan to have an audit of the system performed soon so that they can identify areas where efficiencies can be made. We satisfactorily tested the transfer of data onto the new system. 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: ■ income and expenditure; ■ staff costs; and ■ cash and bank. We have identified a number of control improvement opportunities. These are set out in the action plan at Appendix two.
Other matters	Mandatory communications required by International Standards on Auditing are given in Appendix one. There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content.

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 period.
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 period, as we performed a interim audit over systems and controls due to the change in the systems during the current year. We also carried out an IT based audit to further our understanding of the control environment. 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.

Corporate governance arrangements (continued)

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. We consider that the College has established appropriate processes for the prevention and detection of fraud. During 2013-14, management identified no significant fraud or irregularities.
Maintaining standards of conduct and the prevention and detection of corruption	The College has appropriate policies and codes of conduct for staff and members, including the use of a register of members' interests. These appear proportionate for the College's purposes. As with other policies, these are in the process of review and updating for College policies, with previous policies currently in use as required.
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 continue to consider these activities in more detail to determine whether the limit is breached each year 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
Senior post-holders' emoluments	The Scottish Funding Council's Accounts Direction 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.

Performance management

Our perspective on the performance management arrangements

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 have not been required to complete specific toolkit(s) during the period.

Efficiency savings are planned and are ongoing as part of the merger business case. While the College produces monthly management accounts which compare actual expenditure to budget and analyses variances, to support the development of efficient and effective operation we suggest that consideration is given to the use of these toolkits.

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 2013-14	Actual 2012-13
Prompt payment to suppliers	15 days	23 days
Non-SFC income a % of income	25.3%	24.0%
Gearing	0.4%	0.4%
Current assets : current liabilities	1.5:1	1.5:1
Days' cash	43	96

The activity target set by Scottish Funding Council for 2013-14 was 254,760 wSUMs. As at 31 March 2014, the College delivered around 249,991 wSUMs in 2013-14, following a reduction of 2,500 wSUMs through the Scottish Funding Council's needs based activity alignment. The reduction in the cash KPI is primarily due to the repayment of long term bank loans in the year and a change in the accounting period.

Appendices

Mandatory communications

Mandatory communications regarding audit adjustments, auditor independence and representation letter content are given here.

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 the net expenditure for the year. A small number of numerical and presentational adjustments were required to some of the financial statements notes; these have been adjusted by management.	-
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 identified above our materiality thresholds agreed with the audit committee.	-
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.	Appendix 3
Schedule of Fees Fees charged by KPMG for audit and non-audit services	There were no non-audit services in 2013-14.	-
Draft management representation letter Proposed draft of letter to be issued by the College to KPMG prior to audit sign-off	There are no changes to the standard representations required for our audit from last year and there are no specific representations required for our audit for this year to draw to your attention.	-

Action plan

The action plan summarises specific recommendations arising from our audit work, together with related risks and management's responses.

Priority rating for recommendations

Grade one	Grade two	Grade three
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Year end accruals		**Grade three**
It was noted during the audit that it was College policy not to accrue for any purchase or sales items under £500. There is the risk that the cumulative impact of these balances could lead to a misstatement in the cut off of income and purchases within the financial statements.	KPMG have performed procedures in the current year to ensure that the net impact is not significant this year however, management should consider this going forward.	Head of Finance to review. **Responsible officer:** Head of Finance **Implementation date:** 2014
2 Capital programme monitoring		**Grade three**
It was noted during the course of the audit that the capital programme was not formally monitored at the executive team meetings or by the Board.	To ensure there is sufficient oversight where there is significant capital expenditure it is recommended that the capital spend information is summarised and discussed by the executive team on a regular basis.	This has already been picked up by management. To be discussed at the next committee meeting. **Responsible post holder:** Head of Finance **Date of implementation:** 2014

Action plan (continued)

The action plan summarises specific recommendations arising from our work, together with related risks and management's responses.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
3 Journal entries		**Grade three**
We consider that journal controls are generally designed, implemented and operating effectively within the College. However, an internal audit review at the start of the year identified that there was no authorisation required for manual journals posted. This is consistent with our findings from the audit of a predecessor college. There is a risk that without appropriate management review and authorisation of manual journals inaccurate or inappropriate journals may be posted without management knowledge. As a result of the internal audit findings, it College policy from February 2014 that all journals should be authorised by an appropriate individual. KPMG identified several journals that still had no authorisation post February 2014.	Management should ensure all manual journals are reviewed and approved by management as appropriate. This could be approached with a risk based methodology, with individual approval or significant or material journals, and monthly review of all other manual journals.	The College is in the process of putting an electronic procedure in place which means that journals have to by authorised on the system before the system will allow them to be posted. **Responsible officer:** Head of Finance **Implementation date:** 2014
4 Bank reconciliations		**Grade three**
Our testing indicated that cash controls are designed, implemented and operating effectively within the College, with bank reconciliations are prepared on a monthly basis. Reconciliations are prepared and then authorised by the Finance manager or the Financial Controller. While performing our work, we identified that the August 2013 reconciliations were not performed due to the system changeover taking place and, although we could see that the September 2014 reconciliation had been prepared, we were unable to locate the signed and authorised copy.	Management should ensure that all authorised bank reconciliations are retained, in line with policy.	This should not be an issue going forward as this was mainly a result of the activity surrounding the system changeover. **Responsible post holder:** Head of Finance **Date of implementation:** 2014

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.

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 [date] 2014, 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

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