cutting through complexity

Ayrshire College

Annual audit report to the Board of Management of Ayrshire College

and the Auditor General for Scotland

16 month period ended 31 July 2015

Date: 18 December 2015

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 Ayrshire College and is made available to Audit Scotland and the Auditor General for Scotland/Controller of Audit (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 circumstances set out in the executive summary: scope and responsibilities.

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 period ended 31 July 2015.

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

Area	Summary observations	Analysis
Strategic overview		
Key issues and update	As a result of organisational change within the Further Education sector, the College has changed accounting period for the second time in two years, from a March 31 year-end - changed to in 2014 - back to 31 July in 2015. The College has therefore prepared its financial statements for the 16 month period ended 31 July 2015 with comparatives for the 8 month period ended 31 March 2014. The College continues to face increasing challenges in the management of its costs due to an overall 12 per cent real-terms reduction in revenue grant funding from the Scottish Government in the period 2011-12 to 2015-16. In the period to 31 July 2015 the College ran two voluntary severance schemes, and incurred £2.6 million of costs in relation to voluntary severance awards made. Due to late changes in the funding for all colleges during 2014-15, the College faced challenges in respect of student support funding during the period. A £0.46 million student support funding shortfall was met through college funds. The College will be required to report 2015-16 accounts under the new FRS 102 accounting requirements, with the application of the new statement of recommended practice: *accounting for further and higher education* ("the SORP").	Page 7
Financial position	The College reported a deficit of £2.4 million in the 16 month period to 31 July 2015, compared to a deficit of £11.5 million in 2013-14. The deficit in the year was a result of exceptional restructuring costs relating to voluntary severance, transformation expenditure and student support costs. The balance sheet reflects an decrease in net assets of £4.8 million, corresponding to the movements in debtor and creditor balances as the financial year realigns with the academic year and the increased pension liability.	Page 8
Financial statements and accounting		
Audit conclusions	We intend to issue an unqualified audit opinions on the 2014-15 financial statements and on the regularity of financial transactions, following their approval by the Board of Management in December 2015. We intend to issue a qualified opinion on the remuneration report. The financial statements were received by the start of audit fieldwork and overall were supported by high quality working papers.	Page 12

Headlines (continued)

Area	Summary observations	Analysis
Financial statements and accounting (cont)		
Audit focus areas	The areas highlighted below are the specific audit focus areas identified within our audit strategy and additional areas identified during the course of the audit: ■ student support funding; ■ voluntary severance payments; ■ retirement benefit obligation; ■ Change in accounting year end and income recognition; and ■ Treatment of net depreciation. The areas of audit focus were agreed with the management as part of our planning procedures and audit work has been completed to satisfy the requirements of ISA 330 'The auditor's procedures in response to assessed risks', including tests of key financial controls. In respect of each matter, we are content with management's judgements and accounting treatment.	Page 13
Going concern	Management has considered the funding available to the College in 2015-16 and consider it appropriate to adopt a going concern basis for the preparation of these financial statements. We have reviewed management's forecast for 2015-16, having due consideration of the agreement of Grant-in-Aid in respect of 2015-16, and are satisfied with management's assessment.	Page 16
Accounting policies	From April 2014 all Scottish Colleges were reclassified by the UK Office of National Statistics ("the ONS") as public bodies. This has led to greater accountability for the use of public money in the college sector through additional financial reporting, since Colleges must now comply with the requirements of the Government Financial Reporting Manual ("the FReM"), as well as the Statement of Recommended Practice: *Accounting for Further and Higher Education* (2007) ("the SORP"). Colleges must therefore make additional disclosures, including a remuneration report and additional information about their estates strategy and resource outturn within the financial review. A new SORP, that draws on the principles of FRS 102, will be applied in respect of the year ending 31 July 2016. The College will need to prepare a transitional balance sheet as at 1 April 2014 and a comparative balance sheet at 1 August 2015, together with restated comparative statement of comprehensive income for the period to 31 July 2015.	Page 16

Headlines (continued)

Area	Summary observations	Analysis
Governance and narrative reporting		
Governance	As public bodies, Scottish colleges have the new requirement for 2014-15 to take account of the Scottish public finance manual ("SPFM") in preparing their governance statement. In addition, colleges must demonstrate compliance with the code of good governance for Scottish colleges issued in December 2014 ("the code"). In the opinion of the principal and the Board, the College is compliant with its requirements under the code. Over-arching and supporting corporate governance arrangements remain primarily unchanged, in line with the core principles of the SPFM and the code and provide a sound framework for organisational decision-making.	Page 20
	Testing of the design and operation of financial controls over significant risk points was undertaken. Our work concluded that controls relating to financial systems and procedures are designed appropriately and operating effectively. We raise two minor control recommendations, detailed at appendix five, relating to improving the effectiveness of journal review and updating HR policies post merger.	Page 21
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 and supports the College's commitment to obtaining value for money. Efficiency savings are planned and ongoing as part of the merger business case. Performance against sector indicators is measured by the College.	Page 24
Regularity	We intend to issue an unqualified opinion in respect of regularity of expenditure and receipts shown in the 2014-15 financial statements, following their approval by the Board of Management in December 2015.	Page 25

Scope and responsibilities

Purpose of this report

The Auditor General for Scotland ("the Auditor General") has appointed KPMG LLP as auditor of Ayrshire College under the Public Finance and Accountability (Scotland) Act 2000 ("the Act"). The period of appointment is 2013-14 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 Ayrshire College and the Auditor General. 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.

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.

Board of Management responsibilities

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

- preparation of financial statements that show a true and fair view;
- 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.

Auditor responsibilities

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.

Scope

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 and risk assurance committee, together with previous reports to the audit and risk assurance committee throughout the year, discharges the requirements of ISA 260.

Strategic overview

Our perspective on key business issues and financial position

Key business issues

The Scottish further education sector continues to undergo significant structural reform. Scotland's colleges have been reclassified as public bodies, which has led to changes in accounting periods in each of the last two periods. This change restricts the scope for colleges to build up financial reserves.

Funding for the college sector has decreased in recent years and the College has faced increasing challenges in meeting its student support funding commitments and in monitoring costs.

Sector organisation and structural changes

In October 2010 the ONS reclassified incorporated further education colleges throughout the UK, so that from 1 April 2014 they would be treated as part of central government for financial budgeting and reporting processes. This also had the effect of requiring the College to prepare financial statements to 31 March 2014.

The Colleges of Further Education (Financial Year) (Scotland) Order 2015 came into force on 31 March 2015 with the effect of changing the College year end back to 31 July. The College has therefore prepared financial statements for a 16 month period, running from 1 April 2014 to 31 July 2015. The change has also impacted the College in a number of other respects:

- the College must continue to break-even, in resource terms, within each Scottish Government financial year (to 31 March), which results in reduced working capital balances and an increased focus on cash flow monitoring throughout the year, and in particular at 31 March 2015;
- additional disclosures continue to be required to comply with the HM Treasury Financial Reporting Manual;
- management had to consider accounting entries required in respect of income recognition, which were more complex in respect of the shortened period in 2013-14 and the release or adjustment of which impacted on the longer accounting period in 2014-15.

Overall we are satisfied with management's response to the accounting impacts of these; however, the full impact of these changes to the business will better be able to be assessed in 2015-16 once they are more fully embedded.

Voluntary severance

As part of the College's response to ongoing funding cuts in the sector it ran two College-wide voluntary severance schemes in the period. The schemes were approved by the Scottish Funding Council, with the College incurring costs of £2.6 million.

We would not expect the cost benefits of a staff restructuring exercise to be realised immediately, however, despite voluntary severances the average number of full time equivalent staff in the period increased by 39 compared to the period-ended 31 March 2014.

We have reviewed the budget for 2015-16 and note that staff costs are budgeted to increase, albeit only by a small margin. The full impact of the changes in achieving best value for money from the staff restructuring exercises to date, should be reviewed before any further restructuring plans are put in place.

Financial position

The College is reporting a deficit of £2.4 million for the 16 month period (2013-14 £11.5 million deficit).

Like-for-like over the previous two academic years, ordinary staff costs have increased by £3.5 million, mainly due to pay rises for most lecturers and service staff and an increase in FTE.

The increase in headcount across the 16 month period is in spite of two voluntary severance schemes, under which payments of £2.6 million have been awarded.

Financial position

The College is reporting a deficit for the 16 month period to 31 July 2015 of £2.4 million. This compares to a deficit of £11.5 million in the previous eight month period.

- Total income increased by £24.4 million when compared to 2013-14 but this is largely as a result of the change in accounting periods.
- Expenditure increased by £15.3 million when compared to 2013-14, but again this is largely as a result of the change in accounting period. The expenditure last year has been high due to the exceptional items (£8.8 million impairment of the current Kilmarnock campus building and a cash donation of £6.6 million to the Ayrshire College Foundation).

Overall if comparing like for like the revenue has slightly decreased in 2014/15 compared to previous year, however the expenditure has decreased by more than the revenue.

Total income increased by £9.13 million when compared to 2013-14 but this is largely as a result of the change in accounting periods.

Full time equivalent staff numbers increased from 697 to 736 in the 16 month period which has contributed to an overall increase in staff costs of £21.4 million. This is in spite of over 80 voluntary redundancies having been agreed in the period, at a total cost of £2.6 million.

Income and Expenditure Account

	2014-15 (16 months) £'000	2013-14 (8 months) £'000
Income		
Scottish Funding Council Grants	47,855	27,418
Tuition Fees and Education Contracts	5,501	3,158
Other Grant Income	123	134
Other Operating Income	4,200	2,738
Endowment and Investment Income	327	153
Total income	**58,006**	**33,601**
Expenditure		
Staff Costs	(39,179)	(17,827)
Exceptional restructuring costs	(2,586)	(1,867)
PFI Deferred Expenditure release to I&E	-	(429)
Impairment of Building/Asset write down	-	(8,765)
Donation to Ayrshire College Foundation	-	(6,611)
Other Operating expenses	(15,249)	(8,033)
Depreciation	(3,396)	(1,569)
Interest and Other Finance Costs	-	-
Total expenditure	**(60,410)**	**(45,101)**
Deficit on Continuing Operations after depreciation of fixed assets and before taxation	**(2,404)**	**(11,500)**

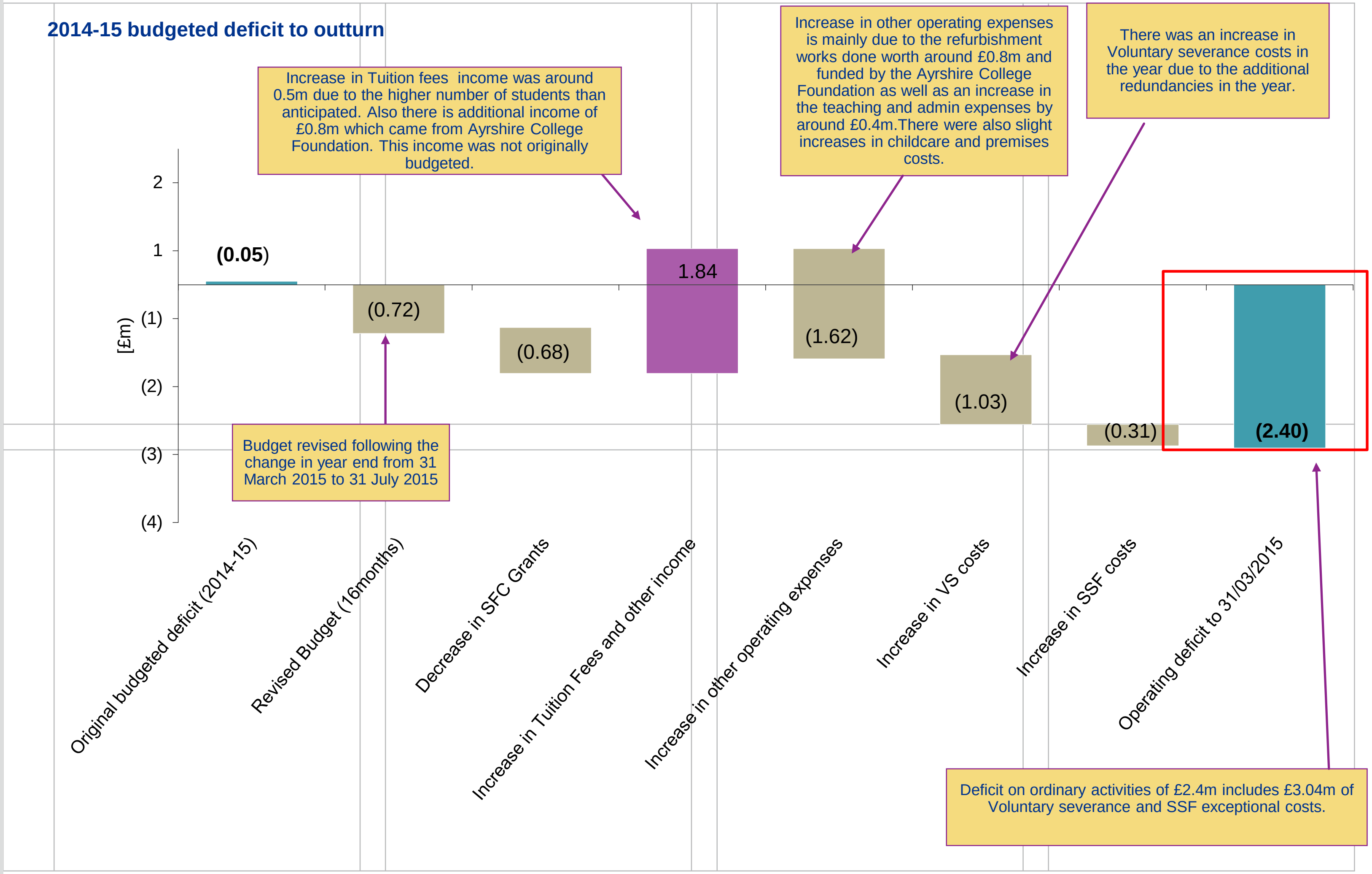
Source: [2014-15 financial statements].

Financial position (continued)

The original 2014-15 budgeted outturn was for a surplus of £0.05 million before additional voluntary severance costs.

We provide an analysis of the movements from original budget to outturn position in the graph.

2014-15 budgeted deficit to outturn



Financial position (continued)

The College has net assets (including pension liability) at 31 July 2015 of £27.4 million (31 March 2014: net assets of £32.2 million).

Balance sheet

The College has net assets at 31 July 2015 of £27.4 million (2013-14: net assets of £32.2 million). The key elements of the movement is set out below.

Assets

Tangible assets have decreased by £1.7 million. This is the result of depreciation in year of £3.4 million against existing assets exceeding capital additions of £2.0 million, as well as the adjustment of Kilwinning value and disposals in the year.

Debtors have decreased significantly by £2.9 million, primarily due to decreased amounts receivable from the SFC, with the realignment of the accounting year end with the academic year end.

Liabilities

Short term creditors have decreased significantly by £1.85 million, reflecting the re-alignment of the academic and financial year ends resulting in lower accruals and deferrals of income and expenditure.

Net pension liabilities in respect of participation in the Strathclyde Pension Fund increased by £2.97 million as a result of changes in demographic and financial assumptions in the actuarial valuation.

Deferred capital grants increased by £0.3 million primarily reflecting capital grants received in year for the development of the new teaching facility at Irvine.

Reserves

We agreed with management that the capital reserve of £6.057 million created when the College brought Kilwinning PFI building on balance sheet would be more appropriately shown as part of the revaluation reserve. This has resulted in a balance sheet reclassification from capital reserve to revaluation reserve.

Balance sheet

	31 July 2015 £'000	31 March 2014 £'000
Fixed assets		
Tangible assets	49,280	51,002
Current assets		
Stocks	21	13
Debtors: Amounts falling due within 1 year	1,080	4,024
Debtors: Amounts falling due after 1 year	-	-
Cash at bank and in hand	2,989	3,013
Creditors: Amounts falling due within 1 year	(4,723)	(6,573)
Net current assets	**(633)**	**477**
Creditors: Amounts falling due after 1 year	(9,182)	(10,253)
Provisions for liabilities and charges	(1,771)	(1,701)
Net pensions liability	(10,272)	(7,298)
Net assets including pension liability	**27,422**	**32,227**
Deferred capital grants	10,435	10,094
Reserves		
Income and expenditure reserve (including pension reserve)	(5,395)	(1,858)
Restricted Reserve	466	470
Capital reserve	-	6,057
Revaluation reserve	21,916	17,464
Total funds	**27,422**	**32,227**

Source: 2013-14 financial statements

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 on the regularity of transactions reflected in those financial statements.

The financial statements, including the financial review, corporate governance statement, and remuneration report, were accompanied by high quality working papers.

Audit conclusions

Our audit work is complete following receipt of management's representations and update of subsequent events. Following approval of the financial statements by the Board we have issued an unqualified opinion on the truth and fairness of the state of the College's affairs as at 31 July 2015, and of the College's deficit for the period then ended. We also have issued an unqualified opinion on the regularity of transactions within the year. We intend to issue a qualified audit opinion on the remuneration report. There are no matters identified on which we are required to report by exception.

In gathering the evidence for our opinion we have:

- performed controls testing and substantive procedures to ensure that key risks to the financial statements have been covered;
- communicated with internal audit and reviewed their reports as issued to the audit and risk assurance committee to ensure all key risk areas which may be viewed to have an impact on the financial statements have been considered;
- reviewed estimates and accounting judgements made by management and considered these for appropriateness;
- considered the potential effect of fraud on the financial statements through discussions with senior management and internal audit to gain a better understanding of the work performed in relation to prevention and detection of fraud; and
- attended audit and risk assurance committee to communicate our findings to those charged with governance, and to update our understanding of the key governance processes.

Financial statements preparation

Overall, good quality working papers and draft financial statements and remuneration report were provided at the start of the audit fieldwork on 29th September 2015 . The operating and financial review, governance statement, and statement of responsibilities were received on12 November 2015 and we suggested minor presentational adjustments to ensure they were in line with available guidance.

In advance of our audit fieldwork, we issued a 'prepared by client' request setting out a list of required analyses and supporting documentation. Reflective of the long standing working relationship with you the standard of documentation was 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 communication and discussion with the College's finance team to ensure that disclosure within the financial statements was consistent with the requirements of the SORP and the FReM.
- There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content, as reported in appendix one.
- We consider that management has maintained a robust control environment.

Significant risks and audit focus areas

The significant areas of risk identified in our audit strategy were in respect of:

- **management override of controls; and**
- **revenue recognition fraud risk;**

and other focus areas of:

- **retirement benefit obligation;**
- **student support funding;**
- **voluntary severance;**
- **change in accounting year end and income recognition; and**
- **treatment of net depreciation**

We summarise below the risks of material misstatement as reported within the audit strategy document. We set out the key audit procedures to address those risks and our findings from those procedures, in order that the audit and risk assurance committee may better understand the process by which we arrived at our audit opinion.

We have no changes to the risk or our approach to addressing the assumed ISA risks of fraud in management override of controls and risks of fraud in revenue recognition. We do not have findings to bring to your attention in relation to these matters. No control overrides were identified

Focus area	Our response	Audit findings
Retirement benefit obligations The College accounts for its participation in the Strathclyde 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 period, 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 performed the following procedures to assess the College's liability in respect of retirement benefits: ■ KPMG specialists reviewed the financial assumptions underlying the actuary's calculations and compared these to our central benchmarks; ■ assessed the objectivity of the College's actuary as a third party expert; ■ tested the level of contributions used by the actuary to those actually paid during the year; ■ tested the membership data used by the actuary; and ■ agreed the financial statements disclosures to the actuarial report.	We found that the actuarial consultant as a third party expert was objective and had the appropriate experience and expertise to provide the information for use by the College. Overall the assumptions used by the actuary were in line with our central benchmarks. The rate of increase to pension payments used by the actuary (RPI less 0.9%) fell slightly out with our expected range (RPI less 1%) We found that contributions and membership data used by the actuary were accurate, and that the financial statements disclosures agreed to the actuarial report.

Significant risks and audit focus areas

Significant risks	Our response	Audit findings
Student support funding There was uncertainty regarding the level of funding for student support for 2014-15 and future years. The amounts received from the SFC were reduced in 2014-15 and the SFC required the College to utilise funding originally allocated for net depreciation to cover any funding gap.	We held discussions with management and corroborated student support funding received in the period to underlying accounting records. We reviewed internal audit findings on student support funds for the 2014-15 academic year and reconciled audited figures to those presented in the 16 month accounts. We inspected correspondence with SFC confirming student support funds for 2014-15 and 2015-16 financial years.	Student support funding was managed during the period and has been appropriately accounted for. The College utilised £0.46 million to fund the shortfall in student bursary support costs. Management consider the 2015-16 funding for student support from SFC to be sufficient for the period.
Voluntary severance payments Audit Scotland has previously identified weaknesses in how some colleges have managed and approved senior staff severance arrangements. In 2014-15 the College has incurred £2.6 million costs in respect of voluntary severance payments. Awards were made under two separate College-wide schemes run in the period, one in 2014 and the other in 2015. There were no awards made to senior staff members.	We agreed the amounts recognised in respect of awards to staff members to source documentation, and confirmed that they were in line with the scheme rules. We reviewed governance around the approval of the schemes by the College and the Scottish Funding Council, and approval of the former Principal's severance payment.	We found that payments made to staff members have been accurately recognised and awarded in line with scheme rules.

Significant risks and audit focus areas

Significant risks	Our response	Audit findings
Change in accounting year end and income recognition Income recognition remains a focus area due to the change in accounting reference date from 31 March back to 31 July. The requirement for the College to break-even, in resource terms as at 31 March 2015 for Scottish Government accounting and budgeting purposes, increases the risk of accounting adjustments during the accounting period subject to audit. The College's ability to spend and accumulate reserves remains restricted. Applications are made to the Foundation during the period, primarily to support capital expenditure. These must be accounted for in accordance with SFC communication number 14.	We audited income adjustments and recognition as part of our year end fieldwork, particularly in respect of year end cut-off. We considered applications for, and funding received from the foundation and the associated presentation and recognition in the financial statements.	Student support funding was managed during the period and has been appropriately accounted for. The College utilised £0.46 million to fund the shortfall in student bursary support costs. Management consider the 2015-16 funding for student support from SFC to be sufficient for the period.
Treatment of net depreciation Following reclassification the College was given a cash budget to cover their costs, including depreciation (and a separate budget for fixed assets). An arrangement was agreed to allow this cash balance for depreciation in financial year 2014-15 to be spent by the College sector within certain parameters: either to bridge the student support funding gap; to address some specific regional pressures, or to pay down debt, where this represents value for money.	We considered the application of the depreciation budget cover as part of our year end audit procedures. We confirmed its use to fund the shortfall in student bursary support costs, to fund the voluntary severance and for the repayment of the capital element of the PFI liability, through corroboration to underlying records and bank statements. We reviewed the presentation of this repayment in the accounts.	The budget for net depreciation of £1.8 million was used to fund the shortfall in student support fund costs, to fund the voluntary severance and for the repayment of the capital element of the PFI liability, in line with SFC guidance. This is appropriately presented in the accounts, as a reduction in the liability. The funding received in respect of this is correctly included within income.

Accounting policies

The financial statements have been appropriately prepared on a going concern basis, having due consideration of the agreement of Grant-in-Aid in respect of 2015-16.

Accounting framework and application of accounting policies		
Area	**Summary observations**	**Audit findings**
Accounting policies	From April 2014 all Scottish Colleges were reclassified by the UK Office of National Statistics ("the ONS") as public bodies. This has led to greater accountability for the use of public money in the college sector through additional financial reporting, since Colleges must now comply with the requirements of the Government Financial Reporting Manual ("the FReM"), as well as the Statement of Recommended Practice: *Accounting for Further and Higher Education* (2007) ("the SORP"). This change impacted the College's accounting policies in a number of respects: ■ additional disclosures, including a Remuneration Report and details about the College's estates strategy and resource outturn, must be included in the Annual Report; ■ it introduced a higher degree of judgement in the recognition of income for 2013-14, a shorter period, the release of which impacted on the longer accounting period to 31 July 2015.	The College has prepared its accounts in line with the requirements of the SORP, the FReM, and the Scottish Funding Council's 2014-15 Accounts Direction for Scotland's colleges and universities. We are satisfied that the accounting policies remain appropriate to the College, and have been applied consistently.
Going concern	Management has considered the funding available to the College in 2015-16 and considers it appropriate to adopt a going concern basis for the preparation of these financial statements. Grant-in-Aid for 2015-16 is budgeted to be in line with the 2014-15 academic year, with small increases in SFC Childcare Grants and tuition fee income. The budgeted deficit for 2015-16 is £0.77m however this is due to depreciation and supported in principle by the SFC in line with the College's requirement to have a breakeven cash position. The College does not have any loan facilities at 31 July 2015 and does not plan to rely on any during 2015-16.	In assessing the College's ability to continue as a going concern we have reviewed the 2015-16 budget and 6 month cash flow forecast prepared by management. We concur with management's view that the going concern assumption remains appropriate for the reasons noted. Management should continue to monitor their cash position closely in the event of any unplanned expenditure.

Management reporting in financial statements

Our testing of the design and operation of financial controls over the production of the annual report and remuneration report are consistent with the financial statements.

We intend to issue a qualified opinion on the remuneration report.

Area	Summary observations	Audit findings
Annual report, including the strategic and directors' reports	The financial statements form part of the annual report of the College for the year ended 31 July 2015. We have reviewed the contents of the annual report against the disclosure requirements and are content with the proposed reports. We provided management with some relatively minor suggestions relating to how the reports could be enhanced and where additional information disclosures should be made.	We are required to consider the strategic and directors' reports, and provide our opinion on the consistency of it with the financial statements. We are satisfied that the information contained within the strategic and directors' report is consistent with the financial statements.
Remuneration report	The remuneration report was received during the audit fieldwork. The accounts direction requires the preparation of a remuneration report in accordance with the Government Financial Reporting Manual (FReM). The FReM requires pension disclosures for each senior official who has served during the year including: ▪ the real increase during 2014-15 in the pension and, if applicable related lump sum at age 60; ▪ the value at 31 July 2015 of the accrued pension and, if applicable, related lump sum at age 60; ▪ the value of the cash equivalent transfer value (CETV) at 1 April 2014 and 31 July 2015; and ▪ the real increase in the CETV funded by the employer during 2014-15. The College has not included these disclosures in the remuneration report, as senior management do not believe it to be beneficial to the College.	We are satisfied that the information contained within the remuneration report is consistent with the underlying records and the financial statements. We intend to issue a qualified audit opinion in respect of the remuneration report to reflect that pension disclosures required by the FReM were not made. Except for this matter, in our opinion, the part of the Remuneration Report to be audited has been properly prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made there under by the Scottish Ministers.

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

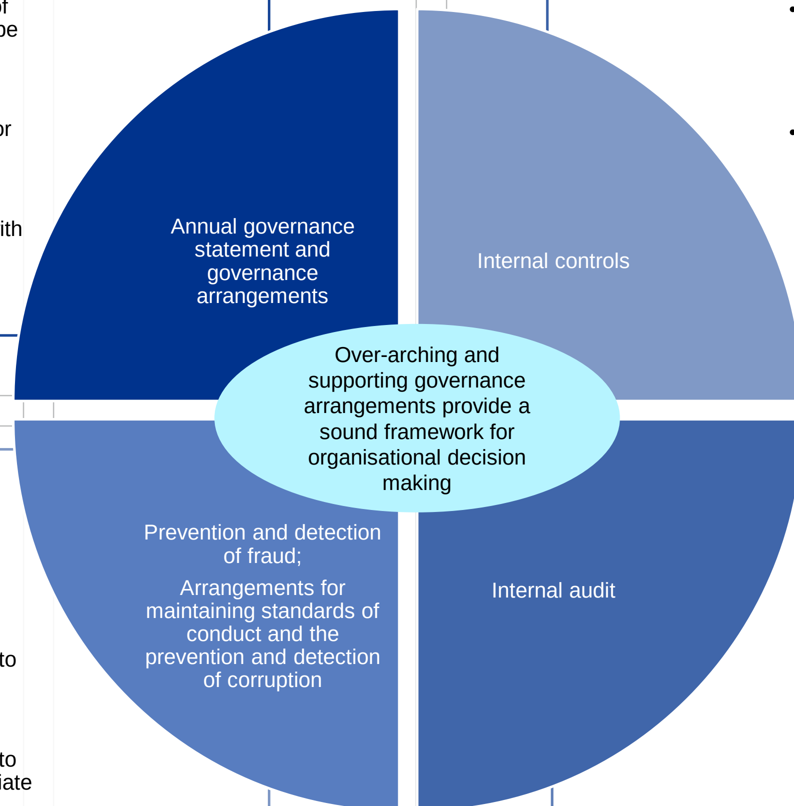
Corporate governance arrangements

We considered the College's corporate governance arrangements against a number of key areas which we consider to make up an effective governance framework.

Our audit findings against each key area are provided opposite.

- The governance framework of the College is considered to be appropriate.
- The College has adopted the Code of Good Governance for Scotland's Colleges.
- The corporate governance statement is in accordance with guidance and reflects our understanding of the organisation.

- Controls relating to financial systems and procedures are designed appropriately and operating effectively.
- We raised one minor control recommendations in this report. We do not consider these to impact the overall control framework.



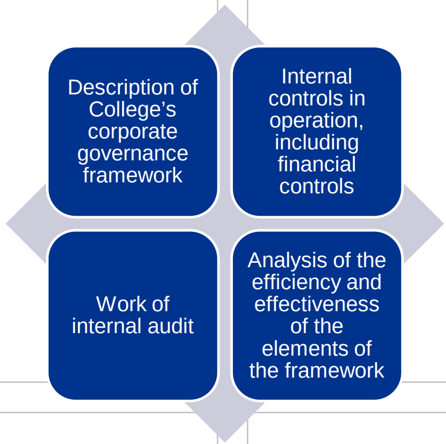
- The College's arrangements to prevent and detect fraud are appropriate.
- The College's arrangements to prevent and detect inappropriate conduct and corruption are appropriate

- Internal audit is compliant with the Public Sector Internal Audit Standards.

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

Corporate governance statement

The College includes an annual governance statement within its annual accounts. The following elements have been included.



Governance arrangements

The College has a Board of Management which is supported by seven committees, helping to ensure sound governance arrangements.

Compliance with the Code of Good Governance for Scotland's Colleges ("the Code")

The Code came into effect in December 2014, and since then the College's Board of Management has defined its overall responsibilities in accordance with the Code. In the opinion of the Principal and the Board, the College is compliant with its requirements under the Code.

Risk management

The Board has a risk management group which coordinates the College's risk management processes. Management is responsible for considering risks through the year at an operational level and escalating these to the risk management group as appropriate.

There is a main college risk register with risk scoring, controls and risk owners detailed. The risk management group is responsible for reviewing the top level risk register and ensuring effective links with departments.

Internal audit conducted a review of risk management in May 2015 and assessed the College's risk maturity as "risk managed", based on the Institute of Internal Audit's risk maturity scale, commenting that it is as well developed as any college they have reviewed and in the upper quartile of their clients across the public sector.

We have updated our understanding of the governance framework and documented this though our overall assessment of the College's risk and control environment. We consider the governance framework to be appropriate for the College and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.

Corporate governance arrangements (continued)

We raised two minor recommendation from our controls testing in respect of journals exception reporting.

The College has procedures in place for the prevention and detection of fraud and corruption.

Internal controls

The College management is responsible for designing and implementing appropriate internal control systems to ensure a true and fair view of operations within the annual accounts. 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.

The findings of our controls testing relate only to those matters identified during our normal audit work, in accordance with the Code, and there may still be weaknesses or risks within the control environment which have not been identified through this work.

We raised two minor recommendations from our controls testing, relating to the review of journals and updating HR policies post merger.

Recommendation one

Prevention and detection of fraud

No material fraud or other irregularities were identified during the year. The financial regulations detail responsibilities in relation to fraud, supported by anti-bribery and whistle-blowing policies.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

The College has arrangements including policies and codes of conduct for staff and board members, supported by a whistleblowing policy. Board members are responsible for setting the 'tone at the top' and for abiding by the code of conduct and disclosing interests which may be of importance – material or otherwise – to their work at the College. We consider these appropriate for the College's purposes to prevent and detect inappropriate conduct and corruption.

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.

We consider that the College has appropriate arrangements to prevent and detect fraud.

Corporate governance arrangements (continued)

The College's internal auditors support management in maintaining sound corporate governance arrangements and internal controls. We have found internal audit to be compliant with the Public Sector Internal Audit Standards.

Internal audit

Internal audit supports management in maintaining sound corporate governance and internal controls through the independent examination and evaluation of control systems and the reporting of any weaknesses to management for action.

Audit Scotland's Code of Audit Practice sets out the wider dimension of public sector audit. It requires external auditors to perform an annual assessment of the adequacy of the internal audit function. We considered the activities of internal audit against the requirements of Public Sector Internal Audit Standards ('PSIAS'), focusing our review on the public sector requirements of the attribute and performance standards contained within PSIAS. This included a review of the internal audit charter, reporting lines, independence, objectivity and proficiency and the range of work carried out by internal audit. We also considered the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*.

From this assessment, and considering the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*, we can apply internal audit's work to inform our procedures, where relevant. The review of internal audit reports and conclusions did not indicate additional risks and there is no impact on our planned substantive testing.

Internal audit has completed its agreed plan for the period ended 31 July 2015 and the Annual Report states that Ayrshire College has a framework of controls in place that provides reasonable assurance regarding the effective and efficient achievement of the College's objectives and the management of key risks. The graphic opposite provides a summary of internal audit's work during the year.

Summary of internal audit work

- Agreed plan completed for the year.
- Four reviews and follow up of prior year recommendations completed.
- Out of a total of 11 findings, there were no 'high' risk findings.
- Annual audit opinion provides reasonable assurance regarding the effective and efficient achievement of the College's objectives and the management of key risks.

We have concluded that the internal audit service operates in accordance with Public Sector Internal Audit Standards.

We can apply internal audit's work to inform our procedures, where relevant. The review of internal audit reports and conclusions did not indicate additional risks and there is no impact on our planned substantive testing.

Performance management

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

Performance management

Our work has identified that the College's best value and performance management arrangements are generally robust.

Performance management and best value

Scottish Government guidance for accountable officers on best value in public services requires a systematic approach to self-evaluation and continuous improvement. The guidance identifies the themes an organisation needs to focus on in order to deliver the duty of Best Value, but notes that implementation should be appropriate and proportionate to the priorities, operating environment, scale and nature of the body's business.

The College produces monthly management accounts which compare budgeted income and expenditure with latest actual month to date.

The College has a procurement strategy which supports its commitment to obtaining value for money.

In accordance with Scottish Funding Council requirements, the College is required to publish and report progress against national priorities. Within these are financial indicator as disclosed opposite.

Non-SFC income as a percentage of total income fell slightly to 18% (2013-14: 19.2%). This follows a slight reduction in tuition and other fees income, however does not indicate any significant increase in reliance on SFC funding. The College continues to seek additional non-SFC funding, as evident in their 2015-16 budget with increased tuition fee income.

Working capital cash balances fell to an average 17 days expenditure (2013-14: 28 days expenditure due to the management of cashflow following the donation of £6.6 million to the Foundation in 2014.)

KPI	Actual 2014-15	Actual 2013-14
Recurring operating surplus as a % total income	(2.1%)	2.4%
Non-SFC income as a % of income	18.0%	19.2%
Gearing	Nil	Nil
Current assets : current liabilities	0.9:1	1.1:1
Days' cash	17	28
WSUMS activity target set by SFC for year to July	183,269	183,269
Activity Target WSUMS per curriculum staff FTE	542	547

Source: Ayrshire College financial statements 2014-15

We have concluded that the College's best value and performance management arrangements are generally robust.

Performance management (continued)

We have prepared a return to Audit Scotland in 2014-15 in respect of our findings on financial capacity within the College.

We are required to provide an opinion on the regularity of expenditure and receipts shown in the financial statements.

Financial capacity in public bodies

Through the process of feedback through Annual Audit Reports, current issues reports and sector meetings, Audit Scotland has identified that overall reductions in staff numbers in public bodies may be affecting the capacity of back-office functions and specifically finance.

Audit Scotland has requested the collation of baseline data across the public sector to inform sector specific overview reports which may inform a follow-up to the joint report on the public sector workforce which was published in November 2013 or support the development of the future performance audit programme.

We have completed a return to Audit Scotland in respect of our findings. Our review in response to the request for data collection identified that there is appropriate financial capacity within the organisation to ensure effective management.

We note an improvement required in respect of the long term financial planning of the College. The College has a strategic plan for the period 2014-17, with financial plans prepared annually for the academic year ahead, however does not have a long term financial strategy.

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.

We consider that the College has appropriate financial capacity to effectively manage the organisation.

We intend to issue an unqualified opinion in respect of regularity of expenditure and receipts shown in the financial statements.

Appendices

Mandatory communications

There were two unadjusted audit differences identified.

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.	-
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 were two unadjusted audit differences and a small number of minor numerical and presentational adjustments were required to some of the financial statement notes. Please see Appendix two.	Appendix two
Confirmation of Independence Letter issued to the Audit Committee	We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Partner and audit staff.	Appendix three
Schedule of Fees Fees charged by KPMG for non-audit services	KPMG did not provide any non-audit services to the College in 2014-15	Appendix three
Draft management representation letter Proposed draft of letter to be issued by the College to KPMG	There are no changes to the standard representations required for our audit from last year.	-
Materiality The materiality applied to audit testing.	We assessed materiality based on our knowledge and understanding of the College's risk profile and financial statements balances. Materiality was determined at £825,000; approximately 1.5% of total expenditure, and is consistent with the materiality identified in our audit strategy. We designed our audit procedures to detect errors at a lower level of precision, i.e. £620,000. We report identified errors greater than £41,000 to the audit committee.	

Adjusted audit differences

We identified two unadjusted audit differences to the core financial statements, with £48,000 impact on net operating income for the year.

Adjusted and unadjusted audit differences

We are required by ISA (UK and Ireland) 260 to communicate all corrected and uncorrected misstatements, other than those which are trivial, to you. There were two unadjusted audit differences.

		Balance sheet £’000		Income and expenditure £’000	
Nature of adjustment	**Caption**	**DR**	**CR**	**DR**	**CR**
Disclosure of student support funding relating to HE and FE childcare within income and expenditure					
After FES audit./submission were finished off, this reduced WSUMs to the shortfall of 2,234 WSUMs instead of 2,500.	Income – Scottish Funding Council Grants - FE and HE childcare	-	-	-	48
An adjustment to this amount disclosed was identified by audit and suggested to the Ayrshire college. This is uncorrected by management.	Creditors - SFC Clawback Creditor	48	-	-	-
Net impact		**48**	**-**	**-**	**48**
Debit balances on purchase ledger					
An adjustment is uncorrected by management.	Trade Debtors	85		-	-
	Other creditors		85		
Net impact			**-**		**-**

Auditor independence

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

We have appropriate procedures and safeguards in place to enable us to make the formal confirmation in our letter included opposite.

Auditor independence

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

We have considered the fees paid to us by 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/Partners] 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 18 December 2015, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Partner and audit staff is not impaired.

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

Yours faithfully

KPMG LLP

Defined benefit obligations

In respect of employee benefits, each of the assumptions used to value Ayrshire College'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.

We set out below the assumptions in respect of employee benefits.

Defined benefit pension liability

2015 £'000	2014 £'000	KPMG comment
(10,.272)	(7,298)	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.

Assumption	Ayrshire College	KPMG central	Comment
Discount rate (duration dependent)	Less than 17 years: 3.50% Between 17 and 23 years: 3.60% More than 23 years: 3.70%	17 years : 3.60% 20 years: 3.65% 23 years: 3.70%	Acceptable. The proposed discount rates are within an acceptable range of KPMG's central rates as at 31 July 2015.
CPI inflation	RPI less 0.9%	RPI less 1.0%	KPMG's view is that the differential between RPI and CPI should be closer to 1%. The College's assumptions could therefore be considered prudent (higher liability).
Net discount rate (discount rate – CPI)	1.00% - 1.10%	1.20%	Acceptable. The proposed assumptions are within the acceptable range of +/- 0.3% from the KPMG central range.
Salary growth	RPI + 1.0%	Typically 0% - 1.5% above inflation	Acceptable. The proposed assumption is consistent with the latest triennial valuation and is acceptable under FRS 17.

The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of more than 23 years. The closing deficit increased by £2.97 million compared to 2013-14, primarily due to changes to actuarial assumptions, including a decrease in the real discount rate and increased life expectancies. A reconciliation from opening to closing deficit is included on the next page.

Defined benefit obligations

The table opposite shows the reconciliation of the movement in the statement of financial position.

Increases to the pension scheme deficit in the year have been driven primarily by increased service costs and altered actuarial assumptions, offset by increased contributions.

	£'000	Deficit / loss	Surplus / gain	Impact	Commentary
	Opening pension scheme deficit			**(7,298)**	The opening FRS 17 deficit for the Scheme at 1 April 2014 was £7.3 million, consisting of assets of £31 million and defined benefit obligation of £38.2 million.
I & E	**Service cost**			(2,945)	The employees' share of the cost of benefits accruing over the period is £2.9 million.
I & E	**Past service cost**			0	No past service cost relating to early retirement over the year is recognised.
I & E	**Net interest**			0	No interest recognised.
Cash	**Contributions**			2.077	The College made contributions of £2.1 million. This is proportionately higher than contributions made in the previous period due to increased active members in the scheme (403 compared to 256)
STRGL	**Actuarial losses – demographic and financial assumptions**			(2,392)	Actuarial losses of £2.4 million are as a result of changed actuarial assumptions, including increased life expectancy assumptions and a decrease of 0.5% to the real discount rate.
STRGL	**Return on assets**			286	Net return on pension scheme has increased slightly from 0.01 million in 2014 to 0.03 millions in 2015.
STRGL	**Closing pension scheme deficit**			**(10,272)**	The closing FRS 17 deficit on the scheme at 31 July 2015 is £10.3 million consisting of assets of £36.3 million and defined benefit obligation of £46.6 million.

Action plan

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

We raised two recommendations:

- **Journals exception reporting**
- **Updating HR policies**

Priority rating for recommendations

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 Journals exception reporting (page 21)		**Grade three**
Journals are subject to high level review by the Head of Finance. Journals posted by the Head of Finance are not subject to secondary review. To mitigate the risk of journal posting errors being undetected, review controls should be strengthened.	Exception reports should be run quarterly to identify journals with higher risk of fraud or error, for example those posted on weekends, to cash, or with rounded amounts. Unusual journals should be reviewed to confirm their accuracy and appropriateness.	**Responsible officer:** Head of Finance **Implementation date:** 2015/2016
2 HR policies		**Grade three**
It was noted during the course of the audit that individual HR policies for the predecessor colleges have not been aligned for Ayrshire College. There is a risk that the HR policies are no longer appropriate for the new staffing structure of Ayrshire College.	Management should ensure HR policies are updated for the new Ayrshire College structure	**Responsible officer:** Director of HR **Implementation date:** 2015/2016

cutting through complexity