cutting through complexity

# Edinburgh College

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

Audit: period ended 31 July 2015

16 December 2015

# Contents

**The contacts at KPMG in connection with this report are:**

**Hugh Harvie**
*Partner, KPMG LLP*

Tel: 0131 527 6682
Fax: 0131 527 6666
hugh.harvie@kpmg.co.uk

**Matt Swann**
*Senior Manager, KPMG LLP*

Tel: 0131 527 6662
Fax: 0131 527 6666
matthew.swann@kpmg.co.uk

**Rachel Slaski**
*Assistant Manager, KPMG LLP*

Tel: 0131 527 6831
Fax: 0131 527 6666
rachel.slaski@kpmg.co.uk



**About this report**

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

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

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

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the 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 period-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 eight month period ended 31 March 2014.<br><br>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 2014-15 £4.0 million of Income and Expenditure Account excluding pension reserve has been utilised. In the period to 31 July 2015 the College ran two voluntary severance schemes, and incurred £1.9 million of costs in relation to awards made. | Page 7 |
| Financial position | The College reported a deficit of £5.1 million in the 16 month period to 31 July 2015. Net assets decreased by £10.6 million to £114.4 million, largely due to a £7.9 million increase to the College's LGPS pension liability.<br><br>To comply with the Government Financial Reporting Manual (FReM), the College has moved to the revaluation basis for accounting for land and buildings. This is a change in accounting policy which has required a prior period adjustment to the College's income and expenditure account and balance sheet.<br><br>Following the year end the College received notification that it had not achieved its annual target for Weighted Student Units of Measurement (WSUMs) in 2014-15, delivering a shortfall of 4,854 WSUMs. In addition for the 2015-16 financial year the College has reduced its credit targets from 200,258 to 188,258. The combination of these matters results in cash receipt being c.£3.3 million lower than forecast. This leaves the College with very limited headroom on projected available cash resources. The College has therefore sought and received confirmation from the Scottish Funding Council that it will provide such support as is required to enable the College to meet its liabilities as they fall due. | Page 8 |
| **Financial statements and accounting** | | |
| Audit conclusions | We intend to issue an unqualified audit opinion on the 2014-15 financial statements and on the regularity of financial transactions, following their approval by the Board of Management in December 2015.<br><br>The financial statements were received by the start of audit fieldwork and overall were supported by high quality working papers. The financial review, corporate governance statement, statement of responsibilities and remuneration report were received in a timely manner during the audit fieldwork. | Page 12 |

# Headlines (continued)

| Area | Summary observations | Analysis |
|---|---|---|
| **Financial statements and accounting** | | |
| Significant risks and audit focus areas | The areas highlighted below are the specific audit focus areas identified within our audit strategy document:<br>▪ fraud risk from management override of controls;<br>▪ fraud risk from recognition of Scottish Funding Council grant income;<br>▪ voluntary severance payments;<br>▪ residences provision; and<br>▪ retirement benefit obligations<br>We also considered management's approach to and treatment of the revaluation of fixed assets.<br>Audit work was completed to satisfy the requirements of ISA 330 *The auditor's responses to assessed risks*, including tests of key financial controls. | Pages 13-15 |
| Going concern | Management has considered the funding available to the College in 2015-16. Following a significant exercise to assess the basis for curriculum and resource planning the College has agreed with the Scottish Funding Council to reduce the credits target for the year by c.12,000 to 188,258. This has a financial impact by reducing projected income by c.£2.5 million. In addition following the 2014-15 year end the College was notified of a claw back of funds of some £0.8 million in relation to that year by the Scottish Funding Council.<br><br>Taken together this anticipated reduction in forecast cash resources of £3.3 million would leave the College with an unmanageably low level of funds in order to meet its liabilities as they fall due. In this regard the College has sought and received financial support of the Scottish Funding Council sufficient to enable the accounts of the College to be signed on a going concern basis. | Page 16 |

# Headlines (continued)

| Area | Summary observations | Analysis |
|---|---|---|
| **Financial statements and accounting (continued)** | | |
| 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").<br><br>Colleges must therefore make additional disclosures, including a Remuneration Report and additional information about their estates strategy and resource outturn within the financial review; and from April 2014 onwards colleges must revalue their land and buildings.<br><br>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 August 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 |
| **Governance and narrative reporting** | | |
| Governance | During 2014-15 the Code of Good Governance for Scottish Colleges has been adopted. This has coincided with the appointment of a new Principal and a number of other Board changes. Throughout these changes Edinburgh College has maintained a sound framework for organisational decision-making. | Page 19 |
| Internal controls | Testing of the design and operation of financial controls over significant risk points was undertaken as part of our period-end testing. Our work concluded that controls relating to financial systems and procedures are designed appropriately and operating effectively. We raised four control recommendations, detailed at appendix four, in respect of journal authorisation, calculation of FTE, access authorisation to the PECOS system and removal of access from the PECOS system when staff members leave the college. | 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<br><br>Performance against sector indicators is measured by the College. | Page 23 |

# Scope and responsibilities

## Purpose of this report

The Auditor General for Scotland ("the Auditor General") has appointed KPMG LLP as auditor of Edinburgh College under the Public Finance and Accountability (Scotland) Act 2000 ("the Act"). The period of appointment is 2011-12 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. The scope and nature of our audit were set out in our audit strategy document which was presented to the Audit and Risk Assurance Committee at the outset of our audit.

## Accountable officer responsibilities

Audit Scotland's *Code of Audit Practice* ("the Code") sets out Edinburgh 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.

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.

## 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 period, discharges the requirements of ISA 260.

# Strategic overview

Our perspective on key business issues and financial position

# Key business issues

**Edinburgh College has rebased its forecast delivery to better reflect expected demand. This has resulted in a significant reduction in projected funding and a forecast deficit for the 2015-16 year.**

**College management are preparing a transformation plan designed to address the deficit position. This will seek to address areas where perceived student demand is un-met, but also reduce capacity in areas where demand is considered to be over-provided for.**

**Management acknowledge that the College will require the support of the Scottish Funding Council in order to continue to meet its liabilities as they fall due during 2015-16 and beyond while the transformation plan takes effect.**

## Forecast financial position and sustainability

The Scottish further education sector has had to deal with a number of challenges in the recent past. This has included a reduction in real term funding while instroducing new policies to provide routes to work and higher education through further education. During this period Edinburgh College has faced the additional challenge of dealing with the merger of 3 institutions into one.

In light of this the College has faced severe budgetary pressure, with the 2014-15 budget initially being set at a deficit of £2 million reflecting the effect of the costs associated with pay harmonisation, merger activity and a drop in income which were realised in the prior year.

During 2014 work was carried out in order to create a Development Plan which was finalised in February 2015. The plan addressed areas such as configuration of leadership, repositioning of the college for growth, improving quality and curriculum, reshaping and rebasing the operations and culture change development. The Board and relevant committees have received updates on the progress against this plan.

By the end of 2014-15 the College had achieved a significant number of cost savings, and a budget for 2015-16 was set at a deficit level of £0.6 million, with an agreed approach to identify further reductions across departments to close this gap and realise a break even position.

However, at the end of 2014-15 it became apparent that the College had only met its education targets for that year through the route of additionality on top of core credits. Additionality is the provision of additional education to already enrolled students. This is no longer allowed within the current funding model, which seeks to provide opportunities to a greater number of students.

This was discussed with the Scottish Funding Council who confirmed that it had the financial impact of reducing core funding for the 2014-15 financial year by £0.8 million.

The investigation of this issue has highlighted that the College has struggled to recruit the number of students required in order to meet the activity target that has been set since the merger. It has therefore commenced an exercise in order to understand how many students the region the College operates within can bear, followed by actions to grow areas where there is existing unmet demand, but re-base operations in areas where demand is over-provided for or does not exist.

As part of the exercise the target activity levels for 2015-16 have been reconsidered and rebased down from 200,258 to 188,258. This will have a financial impact of c.£2.5 million in the financial year.

In order to address this management is producing a more radical transformation plan to address the scale of operations and curriculum of the College to better meet student demands. This will inevitably result in workforce reshaping.

As noted above, the College suffered claw back of funding, and has forecast a reduction in delivery. These matters will have a short term financial impact reducing available cash resources within the next 6 months. However, any savings which might be realised from changing the operating model to better service the forecast lower demand will take more time to realise.

As a result, in the short to medium term the College has agreed to work closely with the Scottish Funding Council in order to forecast when it will require additional resources in order to meet its liabilities as they fall due, either in the normal course of business, or in order to meet the costs of any transformation plan. The Scottish Funding Council have confirmed that this support will be available.

# 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 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 accounting measurements and disclosures continue to be required to comply with the HM Treasury Financial Reporting Manual; the College had to revalue its land and buildings as at 31 July 2015.
- 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. The full impact of these changes to the business will become apparent in 2015-16 once they are more fully embedded.

## Voluntary severances

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, and the College agreed applications from over 90 employees, incurring costs of £1.9 million.

We would not expect the benefits of a staff restructuring exercise to be realised immediately, especially as the most recent scheme only closed in June 2015. However, despite voluntary severances the average number of full time equivalent staff in the period increased by 105 compared to the period-ended 31 March 2014. We note this is partly related to the change in catering arrangements whereby catering is now delivered in-house (previously outsourced). We also understand that additional guest lecturers were employed by the College on a temporary basis, compared to the previous period.

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 £5.1 million for the 16 month period (2013-14 surplus of £2,000).**

**Like-for-like over the previous two academic years, ordinary staff costs have increased by £1.6 million, mainly due to a cumulative pay rise of 6.5% for teachers 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 £1.9 million have been awarded.**

**The revaluation of land and buildings under the FReM is a change in accounting policy and has resulted in a restatement of the 2013-14 financial statements.**

## Financial position reported at 31 July 2015

The College is reporting a deficit for the 16 month period to 31 July 2015 of £5.1 million. This compares to a surplus of £2,000 in the previous eight month period. The budget for the 12 month period (academic year) to 31 July 2015 was for a deficit of £2.0 million, before FRS 17 adjustments and gains/losses on revaluation of land and buildings.

Total income increased by £46.6 million when compared to 2013-14 but this is largely as a result of the change in accounting periods. Overall, on a like-for-like basis:

- Total income for the academic year 2014-15 increased by £1.3 million to £67.9 million, compared to the 2013-14 academic year. This was driven by small increases in each of the individual income streams.
- Total expenditure for the academic year 2014-15 increased by £2.4 million to £71.1 million, mainly due to an increase of £1.6 million in ordinary staff costs.

Full time equivalent staff numbers increased from 1,078 to 1,183 in the 16 month period which has contributed to an overall increase in staff costs of £33.9 million (124%). This is in spite of over 90 voluntary redundancies having been agreed in the period, at a total cost of £1.9 million. The Scottish Funding Council provided funding to contribute to the costs of severance incurred by Edinburgh College .

Land and buildings have been revalued in the period as required by the FReM. This has resulted in a gain of £0.6 million being recognised in the income and expenditure account in 2014-15.

**Income and Expenditure Account**

| | 2014-15 (16 months) £'000 | 2013-14 (8 months) as restated £'000 |
|---|---|---|
| Scottish Funding Council Grants | 68,349 | 33,163 |
| Tuition Fees and Education Contracts | 14,522 | 7,083 |
| Other Grant Income | 1,953 | 1,529 |
| Other Operating Income | 5,270 | 2,273 |
| Endowment and Investment Income | 909 | 357 |
| **Total income** | 91,003 | 44,405 |
| Staff Costs | 61,258 | 27,386 |
| Other Staff Costs: Voluntary Severance | 1,915 | - |
| Other Operating Expenses | 24,850 | 13,984 |
| Depreciation | 7,685 | 3,599 |
| Interest and Other Finance Costs | 1,010 | 528 |
| (Gain) on Revaluation of Assets | (576) | (1,094) |
| **Total expenditure** | 96,142 | 44,403 |
| **(Deficit) / Surplus on Continuing Operations after Depreciation of Assets at Valuation and before Transfers from Reserves** | (5,139) | 2 |

Source: [2014-15 financial statements].

# Financial position (continued)

**The College has net assets (including pension liability) at 31 July 2015 of £114.4 million (31 March 2014 (restated): net assets of £125.0 million).**

## Balance sheet

The College has net assets (including pension liability) at 31 July 2015 of £114.4 million (31 March 2014 (restated): net assets of £125.0 million). The key elements of the movement are set out below.

### *Assets*

As a result of moving to the revaluation model for land and buildings a gain of £14.0 million was recognised as a prior period adjustment to the opening balance sheet at 1 August 2013. Land and buildings will continue to be revalued on a regular basis, according to FReM requirements.

Debtors have decreased by £2.1 million is largely as a result of the change in accounting period-end, which has led to a reduction in amounts due from SFC.

Cash at bank and in hand has decreased by £1.8 million. This is the result of a loan capital repayment of £0.5 million; and a £1.3 million Lennartz VAT repayment to HMRC.

### *Liabilities*

Creditors have decreased by £1.8 million as a result of the repayments made as noted above.

Net pension liabilities in respect of participation in the Lothian Pension Fund increased by £7.9 million as a result of changes in demographic and financial assumptions.

### *Reserves*

The overall reserve position has worsened by £10.9 million in 2014-15. This is primarily a result of the deficit for the period of £4.3 million and an increase in the pension liability of £7.9 million.

**Balance sheet**

| | **2015 £'000** | **2014 as restated £'000** |
|---|---|---|
| **Fixed assets** | | |
| Tangible assets | 155,436 | 156,523 |
| **Current assets** | | |
| Stocks | 137 | 107 |
| Debtors: Amounts falling due within 1 year | 3,853 | 5,958 |
| Cash | 3,111 | 4,937 |
| Creditors: Amounts falling due within 1 year | (7,181) | (7,234) |
| **Net current (liabilities)/assets** | **(80)** | **3,768** |
| Creditors: Amounts falling due after 1 year | (12,681) | (14,443) |
| Provisions for liabilities and charges | (5,040) | (5,466) |
| Net pensions liability | (23,216) | (15,344) |
| **Net assets including pension liability** | **114,419** | **125,038** |
| Deferred capital grants | 63,837 | 62,742 |
| **Reserves** | | |
| Income and expenditure reserve | 21,818 | 33,665 |
| Revaluation reserve | 28,764 | 28,631 |
| **Total funds** | **114,419** | **125,038** |

*Source: KPMG analysis of Edinburgh College financial statements 2014-15*

# Financial statements and accounting

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

# Audit conclusions

**We intend to issue 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

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 period. 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 were provided. This included the financial review, corporate governance statement and remuneration report. Due to the need to obtain confirmation of funding from the Scottish Funding Council, the financial statements were updated by management in late December 2015.

Throughout the course of the period 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. We provided feedback to management on the content of the financial statements, finance review, corporate governance statement and remuneration report and we are pleased to report that these were consequently prepared appropriately.

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:**

- **voluntary severance payments;**
- **residences provision; and**
- **retirement benefit obligations**

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**<br><br>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.<br><br>The College's actuaries use membership data and 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. | We performed the following procedures to assess the College's liability in respect of retirement benefits:<br><br>■ KPMG specialists reviewed the financial assumptions underlying the actuary's calculations and compared these to our central benchmarks;<br><br>■ assessed the objectivity of the College's actuary as a third party expert;<br><br>■ tested the level of contributions used by the actuary to those actually paid during the period;<br><br>■ tested the membership data used by the actuary; and<br><br>■ agreed the financial statements disclosures to the actuarial report. | As at 31 July 2015 the College's liability in respect of retirement benefits has increased by £7.9 million to £23.2 million.<br><br>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.<br><br>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 (2.60%) fell slightly out with our expected range.<br><br>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 (continued)

| Focus Area | Our response | Audit findings |
|---|---|---|
| **Fixed asset revaluation**<br><br>In accordance with the FReM tangible fixed assets are required to be valued on the current value basis. Previously the tangible fixed assets were accounted for under the historical cost basis.<br><br>In order to assist with the valuation a firm of chartered surveyors were appointed. They provided the College with information in relation to the 2015 and 2014 financial year ends in order that the appropriate accounting adjustment could be made. | We considered the approach to appointment and instructions issued to the valuer.<br><br>We have obtained the valuation report and have considered the basis of valuation and assumptions inherent in the calculated values of the College's fixed assets.<br><br>We have considered the detailed adjustments made by management to reflect the revalued amounts in the financial statements, together with their revised useful economic lives.<br><br>Significant work was required by management in order to obtain and process adjustments in respect of the third party valuation of tangible fixed assets as at 31 July 2013, 31 March 2014 and 31 July 2015 in order to comply with the FReM requirements. | We are satisfied that the valuer was objective and that the resulting adjustments, including prior year adjustments have been appropriately disclosed in the financial statements. |

# Significant risks and audit focus areas (continued)

| Focus Area | Our response | Audit findings |
|---|---|---|
| **Onerous contract – residences provision**<br><br>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.<br><br>Management have reviewed the provision annually since then and, in light of improving occupancy rates, in 2013-14 the provision was reduced to £0.67 million. | For our 2014-15 audit we found that management had again reviewed the level of provision required as at 31 July 2015, and in light of a further years' knowledge about expected future occupancy rates the provision has been reduced to £0.07 million.<br><br>We reviewed and re-performed the calculations prepared by management to arrive at the required provision at the reporting date.<br><br>We sought corroboration from the residence management team to confirm the actual occupancy rates for 2014-15, and the level of applications for rooms in 2015-16. | Management have based their revised calculation on a reduction in anticipated unoccupied rooms from 13 in 2013-14 to just one in 2014-15, based on their understanding of the rental market conditions and an oversubscription for accommodation for 2015-16.<br><br>We found the underlying assumptions and revised calculations to be acceptable.<br><br>Management should continue to review this provision for any changes in the underlying assumptions. |

# Significant risks and audit focus areas (continued)

| Focus Area | Our response | Audit findings |
|---|---|---|
| **Voluntary severance payments**<br><br>Audit Scotland has previously identified weaknesses in how some colleges have managed and approved senior staff severance arrangements.<br><br>In 2014-15 the College has incurred £1.9 million costs in respect of voluntary severance payments, including a number of payments to senior staff members. Awards were made under two separate College-wide schemes run in the period, one in 2014 and the other in 2015. Awards made to senior staff members were to be made under the rules of these schemes. The payment to the former Principal was separate to the college wide schemes. | We agreed the amounts recognised in respect of awards to senior staff members to source documentation, and confirmed that they were in line with the scheme rules.<br><br>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.<br><br>In respect of the severance of the former Principal we have reviewed:<br><br>■ The original contract of employment<br><br>■ Approval of the process by the remuneration committee<br><br>■ Approval of the process by the Scottish Funding Council.<br><br>. | We found that payments made to senior staff members have been accurately recognised and awarded in line with scheme rules. The payment made to the former Principal was approved by the Chair of the Board of Management.<br><br>The 2014 scheme was approved by the full Board of Management in April 2014. The 2015 scheme was approved by the Policy and Resources Committee, with delegated authority from the Board.<br><br>The College also sought approval from the Scottish Funding Council for the schemes prior to their opening. We have not been able to corroborate the Funding Council's approval of the 2014 scheme due to current senior management not having access to the document trail.<br><br>We have concluded that despite the payment to the former Principal including a payment In lieu of notice that this was in line with the employee contract and payments were appropriately authorised. |

# 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").**

**New FReM reporting requirements, including the application of the revaluation model, have been applied appropriately. Accounting policies have otherwise been applied consistently with those introduced in the previous year.**

**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.**

**Accounting framework and application of accounting policies**

| Area | Summary observations | Audit findings |
|---|---|---|
| **Accounting policies and financial reporting framework** | 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").<br><br>This change impacted the College's accounting policies in a number of respects:<br><br>■ additional disclosures, including a Remuneration Report and details about the College's estates strategy and resource outturn, must be included in the Annual Report;<br><br>■ the revaluation model for fixed assets was adopted from 2014-15 onwards as a result of applying the FReM. This has required a restatement of the 2013-14 values in the accounts which has been appropriately processed by Edinburgh; and<br><br>■ it introduced a higher degree of judgement in the recognition of income for 2013-14, a shorter period, and the release of which impacted on the longer accounting period to 31 July 2015.<br><br>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).<br><br>FRS 102 is applicable for accounting periods beginning on or after 1 January 2015. In response, the Further and Higher Education SORP Board developed 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. | 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.<br><br>We are satisfied that the accounting policies remain appropriate to the College, and have been applied consistently. |

# Accounting policies (continued)

| Accounting framework and application of accounting policies | | |
|---|---|---|
| **Area** | **Summary observations** | **Audit findings** |
| **Going concern** | The College had net assets of £114.4 million (2013-14 £125.0 million) at the balance sheet date. The main reason for the decrease is the increase in net pension liabilities in respect of participation in the Lothian Pension Fund increased by £7.9 million as a result of changes in demographic and financial assumptions. The College has moved from net current asset position of £3.8 million to a net liability position of £0.08 million.<br><br>The College has a term loan facility with Lloyds Bank. Under the facility agreement they must meet certain financial covenants. The College met these covenants in 2014-15 and, based on forecasts for 2015-16, will continue to be compliant over the next 12 months.<br><br>Management has rebased the level of education, reducing it to 188,258, with a resultant reduction in forecast income of c.£2.5 million. Also, as noted, above management has commenced a transformation plan to address a number of issues faced by the College. The costs associated with the plan are not yet known.<br><br>Management have prepared cash flow forecasts which indicate that, taking account of the forecast reduction in income, it will have very limited cash resources towards the end of the financial year, giving it no capacity of unplanned expenditure or reduction in other income sources.<br><br>This, together with the need to fund any costs associated with the transformation plan, has been discussed with the Scottish Funding Council. It has been agreed that the College will work closely with the Scottish Funding Council as it formulates and works through this plan, and that the Scottish Funding Council will support it financially as it does so; providing funding to allow it to meet its liabilities as they fall due.<br><br>On the basis of this support the financial statements have been prepared on a going concern basis. | In assessing the College's ability to continue as a going concern we have reviewed the 2015-16 revised budget and cash flow forecast prepared by management following WSUM clawback and re-based delivery plan.<br><br>We concur with management's view that the going concern assumption remains appropriate for the reasons noted. |

# 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.**

| Area | Summary observations | Audit findings |
|---|---|---|
| **Annual report, including the financial review.** | The financial statements form part of the annual report of the College for the period 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 annual report, and provide our opinion on the consistency of it with the financial statements. We are satisfied that the information contained within the annual report is consistent with the financial statements. |
| **Remuneration report** | The Scottish Funding Council's accounts direction set out the requirements of the remuneration report, to be included in the financial statements for the first time in 2014-15. Management has prepared a report in accordance with the template which is supported by good quality information and working papers.<br><br>We provided management with some relatively minor suggestions relating to where additional disclosures should be made. | We are satisfied that the information contained within the remuneration report is consistent with the underlying records and the financial statements. |
| **Senior post-holders' emoluments** | The SFC'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. |

# Governance and narrative reporting

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

# 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.**

**Annual governance statement and governance arrangements**

- The governance framework of the College is considered to be appropriate.
- The corporate governance statement is in accordance with guidance and reflects our understanding of the organisation

**Internal controls**

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

**Over-arching and supporting governance arrangements provide a sound framework for organisational decision making**

**Prevention and detection of fraud;**

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

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

**Internal audit**

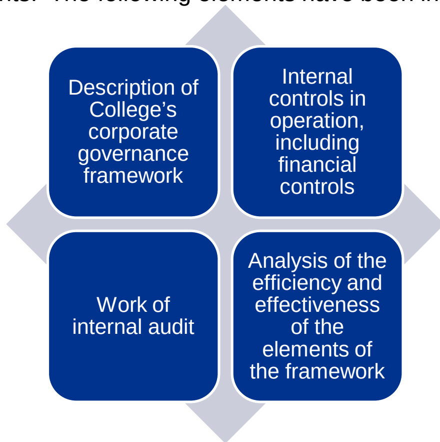
- Internal audit is compliant with the Public Sector Internal Audit Standards.

# Corporate governance arrangements (continued)

**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 Chief Executive as Accountable Officer, and the Board, the College is compliant with its requirements under the Code.

The college has faced a challenging task in maintaining appropriate governance throughout a change in Principal and other Board members. The transition was appropriately managed with appropriate interim arrangements put in place to manage the change.

*Risk management*

The Board has established a Risk Management Group which oversees the College's risk management processes, and management is continuing to review risk management arrangements to provide assurance to Board members and external stakeholders over the mitigation of identified risks. The risk management policy, which has been in place since June 2013, and supporting documentation demonstrate a commitment to good practice.

A top risk register is in place and is supported by an operational risk register. These are reviewed regularly by the Risk Management Group.

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 have raised four recommendations in this report. We welcome the progress in implementing the recommendations.**

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

## Internal controls

Edinburgh 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.

## Prevention and detection of fraud

No material fraud or other irregularities were identified during the period. The arrangements in place at the College include policies and codes of conduct for staff and board members, and maintenance of strategic and financial documentation.

## Arrangements for 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.

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.

**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 draft Annual Report states that Edinburgh 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 period.

**Summary of internal audit work**

- Agreed plan completed for the period. One review postponed to 2015-16.
- Seven reviews completed.
- Out of a total of 24 findings, one was categorised as a 'high' risk finding.
- 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 against sector indicators is measured by the College.**

## 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 actual expenditure to budget; and has a procurement strategy which seeks to use the most advantageous supplier that is available.

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.

We have commented above the issue in relation to the claw back of SUMs.

| KPI | Target 2014-15 | Actual 2014-15 | Actual 2013-14 |
|---|---|---|---|
| Weighted Student Units of Measurement (WSUMs) | 254,687* | 249,833 | 249,991 |
| Operating deficit before exceptional items as a % of income | n/a | (5.6%) | (2.5%) |
| Non SFC income as a % of income | 29%* | 24.9% | 25.3% |
| Staffing costs (excluding exceptional items) as a % of total income | 63.8%** | 67.3% | 61.6% |
| Current assets: current liabilities | 1.0* | 1.1 | 1.5 |
| Gearing | n/a | 0.4 | 0.4 |
| Days cash to expenditure*** | 41* | 13 | 43 |

*Agreed to 2014-17 Outcome Agreement
** Internal performance measure
*** Currently not reported in financial statements

The KPI targets for WSUMs, and current asset: current liability ratios have been achieved. However, Edinburgh College have become increasingly reliant upon SFC income in the period. The increase in staff costs as a proportion of expenditure is partially a result of severance incurred during the period.

# 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 and 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.

## 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 SFC 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 SFC 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 no changes to the core financial statement and there are no unadjusted audit differences**

| Area | Key content | Reference |
|---|---|---|
| **Adjusted audit differences**<br><br>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 period.<br><br>A small number of minor numerical and presentational adjustments were required to some of the financial statement notes. | - |
| **Unadjusted audit differences**<br><br>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.<br><br>There are no unadjusted audit differences. | - |
| **Confirmation of Independence**<br><br>Letter issued to the Audit and Risk Assurance 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, in our Audit Strategy document. | Appendix 2 |
| **Schedule of Fees**<br><br>Fees charged by KPMG for non-audit services | KPMG did not provide any non-audit services to the College in 2014-15 | - |
| **Draft management representation letter**<br><br>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 period. | - |
| **Materiality**<br><br>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 £1.9 million; approximately 2% of total expenditure, and is broadly consistent with the materiality identified in our audit strategy.<br><br>We designed our audit procedures to detect errors at a lower level of precision, i.e. £1.425 million.<br><br>We report identified errors greater than £95,000 to the audit and risk assurance committee. | - |

# Auditor independence

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

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

## Auditor independence

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

We have considered the fees paid to us by Edinburgh 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 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 23 November 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 the College's net pension deficit are within an acceptable range of KPMG's expectations, with the exception of pension increase rate which is considered to be overly prudent.**

**However, we are of the view that overall this represents a reasonable and balanced approach, in accordance with the requirements of FRS 17.**

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

<table>
<tr><th colspan="3">Defined benefit pension liability</th></tr>
<tr><th>2015<br>31 July<br>£'000</th><th>2014<br>31 March<br>£'000</th><th>KPMG comment</th></tr>
<tr><td>(23,216)</td><td>(15,344)</td><td>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 FRS 17 pension scheme valuation.<br><br>Details of key actuarial assumptions are included in the table, along with our commentary.
<table>
<tr><th>Assumption</th><th>Edinburgh College</th><th>KPMG central</th><th>Comment</th></tr>
<tr><td>Discount rate (duration dependent)</td><td>Less than 17 years:<br>3.50%<br>Between 17 and 23 years:<br>3.60%<br>More than 23 years:<br>3.70%</td><td>17 years :<br>3.60%<br>20 years:<br>3.65%<br>23 years:<br>3.70%</td><td>Acceptable. The proposed discount rates are within an acceptable range of KPMG's central rates as at 31 July 2015.</td></tr>
<tr><td>CPI inflation</td><td>RPI less 0.9%</td><td>RPI less 1.0%</td><td>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).</td></tr>
<tr><td>Net discount rate (discount rate – CPI)</td><td>1.00% - 1.10%</td><td>1.20%</td><td>Acceptable. The proposed assumptions are within the acceptable range of +/- 0.3% from the KPMG central range.</td></tr>
<tr><td>Salary growth</td><td>RPI + 1.0%</td><td>Typically 0% - 1.5% above inflation</td><td>Acceptable. The proposed assumption is consistent with the latest triennial valuation and is acceptable under FRS 17.</td></tr>
</table>
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 £7.9 million compared to 2013-14, primarily due to changes in assumptions, driven by the decrease in the discount rate and increase in mortality rates. A reconciliation from opening to closing deficit is included on the next page.</td></tr>
</table>

# 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 period have been driven by changes in financial and demographic assumptions.**

| | £'000 | Deficit / loss | Surplus / gain | Impact | Commentary |
|---|---|---|---|---|---|
| | Opening pension scheme deficit | | | **(15,344)** | The opening FRS 17 deficit for the Scheme at 1 April 2014 was £15.3 million, consisting of assets of £72.1 million and defined benefit obligation of £87.4 million. |
| I & E | Service cost | | | (5,233) | The employees' share of the cost of benefits accruing over the period is £5.2 million. |
| I & E | Past service cost | | | (48) | A past service cost of £48,000 is recognised, relating to early retirement over the period. |
| I & E | Net interest | | | 882 | This is the interest on the opening deficit of £15.3 million. This is made up of £6.1 million interest income on plan assets, and £5.2 million interest cost on obligations. |
| Cash | Contributions | | | 3,840 | The College made contributions of £3.8 million. This is proportionately in line with contributions made in the previous period. |
| STRGL | Actuarial losses – demographic assumptions | | | (7,313) | There was a actuarial losses of £7.3 million as a result of increasing mortality rates and a decrease of 0.7% to the discount rate. |
| | Closing pension scheme deficit | | | **(23,216)** | The closing FRS 17 deficit on the scheme at 31 July 2015 is £23.2 million (consisting of assets of £83.4 million and defined benefit obligation of £106.7 million). |

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

Cash – cash-flow impact

STRGL – charged through statement of total recognised gains and losses

# Action plan

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

| 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 Journal Authorisation** | | **Grade two** |
| We understand that manual journals posted by the management accounts team are not formally authorised on a journal-by-journal basis.<br><br>There is a risk that erroneous or fraudulent journals are posted, or that insufficient audit evidence is retained explaining the reason for the journal.<br><br>We noted one instance where a journal for £700,000 had been posted between two payroll expense codes, which was meant to be a budget journal but was posted in error to the nominal ledger. It was also not supported by any documentation. If such journals were appropriately authorised and documented it is less likely that such errors would arise. | We recommend that all manual journals posted by the management accounts team are authorised by the Head of Finance or the Finance Manager, and that a log is kept by each member of staff with appropriate supporting documentation for the journal. | In the interim, at month-end Management Accounts staff will prepare summary journals for each area which will be duly authorised by the Finance Manager or Head of Finance.<br><br>A finance system electronic solution is being explored and will be implemented as soon as possible.<br><br>**Responsible officer:**<br><br>Head of Finance<br><br>**Implementation date:**<br><br>Interim action already implemented. Electronic solution to be implemented as soon as possible. |

# Action plan (continued)

| Finding(s) and risk(s) | Recommendation(s) | Agreed management actions |
|---|---|---|
| **2 FTE calculation for financial statement disclosure** | | **Grade three** |
| The finance team receives FTE figures from HR for disclosure in the financial statements. It was identified during our testing that these figures were being manipulated by the finance team so that, although the FTE in total was correct, the split between job description was not. Since the equivalent staff costs by job description is also disclosed this was skewing average costs per FTE by job description. | FTE figures disclosed in the financial statements should be based on a staff members' contract. | A monthly staff return from HR in the format of the annual accounts will be received in order to ensure compliance at year-end<br><br>**Responsible officer:**<br><br>Head of Finance<br><br>**Implementation date:**<br><br>Already actioned |
| **3 PECOS Leavers** | | **Grade three** |
| Members of staff are granted access to PECOS – the College's purchasing system – on a needs basis. This is actioned by the procurement department who manage PECOS, and the member of staff will either be set up as a requisitioner or an approver, but not both. When the member of staff leaves the College the procurement team are supposed to be notified so that they can remove access. During our audit we identified 34 leavers who had access to PECOS and whose access had not been removed.<br><br>PECOS is a web-based system, and therefore any former staff member whose account is still active will be able to access the system, which could lead to inappropriate orders being raised or approved.<br><br>We understand that procurement have reviewed the activity of these leavers and have identified no such orders, and that all accounts have now been deactivated. | The College should develop a process for ensuring that the procurement department is notified when a PECOS user leaves. This should be included as part of a leaver's checklist completed by either HR or the specific department. | We have implemented an interim solution, whereby the payroll team email procurement each time they process a leaver. The automated email is being investigated, but has not yet been implemented.<br><br>**Responsible officer:**<br><br>Head of Finance<br><br>**Implementation date:**<br><br>30 November 2015 |

# Action plan (continued)

| Finding(s) and risk(s) | Recommendation(s) | Agreed management actions |
|---|---|---|
| **4 PECOS user request evidence** | | **Grade three** |
| If a member of staff is to be granted access to the purchasing system PECOS this must be requested by their line manager, who submits a user request form to the procurement department.<br><br>We tested a sample of PECOS starters in the period but the procurement department was unable to provide copies of the user request forms for any of our sample, because the procurement officer who processes the user requests was on annual leave during our audit, and no one else in the department was able to locate the forms.<br><br>There is a risk that processes will be disrupted if only one member of the team knows how to perform them. | All procurement staff who are PECOS administrators should know how to process and file user request forms so that the process is not disrupted during periods of annual leave.<br><br>The forms should be stored on procurement's shared drive so that anyone in the department can locate them. | This will be implemented and forms will be stored on the procurement shared drive.<br><br>**Responsible officer:**<br><br>Head of Finance<br><br>**Implementation date:**<br><br>30 November 2015 |

cutting through complexity