



*cutting through complexity*

# Scottish Qualifications Authority

Annual audit report to the Board of Management of Scottish  
Qualifications Authority and the Auditor General for Scotland

Audit: year ended 31 March 2015

23 October 2015

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in connection with this  
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**About this report**

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

This report is for the benefit of the Scottish Qualifications Authority ("SQA") 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.



## Executive summary

# Headlines

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the Code"). This specifies a number of objectives for the audit.

In accordance with ISA (UK and Ireland) 260: *Communication with those charged with governance*, this report summarises our work in relation to the financial statements for the year ended 31 March 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
<b>Strategic overview</b>		
Key issues and update	SQA continued to work towards the successful delivery of the Curriculum for Excellence ("CfE") programme during 2014-15, with this being the first full financial year of the National 1-5 courses. 2014-15 also saw the introduction of new Higher qualifications. The Scottish Government has begun conversations with SQA, COSLA and the association of directors of education in Scotland to discuss possible alternative pricing models to be applied post August 2016.	Page 6
Financial position	SQA reported net expenditure of £24.4 million in 2014-15, with £21.4 million grant funding income, resulting in a current year deficit of £3 million. After adjusting for IAS 19 pension service costs in excess of cash contributions, the current year deficit was £0.7 million (2013-14: surplus of £6.0 million). The actuarial loss in respect of the pension scheme was £10.5 million, giving rise to a total deficit of £13.5 million for the year.	Page 7
<b>Financial statements and accounting</b>		
Audit conclusions	We have issued an unqualified audit opinion on the 2014-15 financial statements, following their approval by the Board on 23 October 2015.  The financial statements and remuneration report were received by the start of audit fieldwork and were supported by high quality working papers.	Page 12
Going concern	The financial statements have been prepared on a going concern basis, as management considers that support will continue to be provided by the Scottish Government. The 2015-16 budget includes an additional funding need of £4.9 million, and the Scottish Government has indicated that additional funding would be provided if required.  The financial statements show net liabilities of £7.4 million, incorporating the £28.3 million retirement benefit obligation. As this obligation does not fall due within one year it is not considered to impact on the going concern assumption.	Page 15
Accounting policies	There have been no changes to the accounting policies applied by SQA in 2014-15.  No newly effective accounting standards are expected to have a material impact on the 2015-16 financial statements.	Page 15

Area	Summary observations	Analysis
<b>Financial statements and accounting</b> (continued)		
<b>Significant risks and audit focus areas</b>	<p>The areas highlighted below are the specific audit focus areas identified within our audit strategy:</p> <ul style="list-style-type: none"> <li>■ fraud risk from management override of controls;</li> <li>■ fraud risk from income recognition;</li> <li>■ accounting for Curriculum for Excellence entry charges;</li> <li>■ completeness of appointee expenditure; and</li> <li>■ retirement benefit obligations.</li> </ul> <p>Audit work was 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.</p>	Page 13
<b>Governance and narrative reporting</b>		
<b>Governance</b>	Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.	Page 18
<b>Internal controls</b>	Testing of the design and operation of financial controls over significant risk points was undertaken as part of our interim and final audit testing. Our work concluded that controls relating to financial systems and procedures are designed appropriately and operating effectively.	Page 19
<b>Performance management</b>		
<b>Performance management</b>	<p>Our work has identified that SQA's performance management arrangements are generally robust and appropriate to its business objectives.</p> <p>Internal audit reviews, conducted as part of the internal audit plan, provided assurance over Best Value considerations in the year to 31 March 2015 and did not indicate significant weaknesses.</p>	Page 22

### Purpose of this report

The Auditor General for Scotland (“the Auditor General”) has appointed KPMG LLP as auditor of the Scottish Qualifications Authority (“SQA”) 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 SQA and the Auditor General. The scope and nature of our audit were set out in the 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.

### Accountable officer responsibilities

Audit Scotland’s *Code of Audit Practice* (“the Code”) sets out SQA’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 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 SQA and our presentation to the audit committee, together with previous reports to the audit committee throughout the year, discharges the requirements of ISA 260.

# Strategic overview

Our perspective on key business issues and financial position

**The main focus for SQA in 2014-15 has been the continued delivery of the CfE programme.**

**SQA operates in a challenging financial environment, and is seeking agreement to develop a new pricing structure.**

**In 2015-16 the key challenges for SQA will be:**

- **continued delivery of CfE;**
- **agreement of a pricing structure post 2016; and**
- **implementation of the new ledger.**

SQA continues to work towards the successful delivery of the Curriculum for Excellence (“CfE”) programme. 2014-15 is the first full financial year of National 1-5 courses and saw the introduction of new Highers. 2015-16 will be a key year for SQA; non-delivery of the courses could affect candidates’ entry to further and higher education courses.

The financial environment continues to be challenging, with efficiencies in expenditure required to achieve a break even budget, alongside maximising income generation. The aspiration of self-sufficiency cannot be achieved without agreeing a pricing structure which better reflects the costs of delivery.

#### **Curriculum for Excellence**

Key milestones for the CfE programme continue to be met by SQA, despite challenges around resources which result in an internal programme status of amber. This delivery has been achieved despite additional stakeholder demands during 2014-15 to secure the successful delivery of the CfE programme. These demands included enhancing the quality assurance programme for the new qualifications; providing continual professional development for teachers; provision of additional specimen question papers; and additional work with schools on Understanding Standards.

The delivery of the CfE programme in 2014-15 included dual running of Higher qualifications alongside planning activities undertaken to update the delivery model for CfE beyond 2016.

#### **Pricing**

The Scottish Government has begun conversations with SQA, COSLA and the association of directors of education in Scotland to discuss possible alternative pricing models to be applied post August 2016. SQA aims to agree a pricing model for post-2016 that better reflects SQA’s costs.

A number of options for pricing post August 2016 have been proposed. These include a pricing structure similar to the current fixed price agreement with local authorities, recalibrated to better reflect SQA’s costs and a grant funding pricing structure. The discussions are ongoing and no decision on pricing structure has been agreed.

Management is preparing scenario analysis to consider the potential impact of funding and pricing options, based on assumed entry numbers.

#### **New ledger system**

During 2015-16 SQA will introduce a new ledger system provided by Agresso. The system will also incorporate e-recruitment, HR, payroll and expenses modules. All 2015-16 transactions posted up until this date in the current ledger system will be transferred to Agresso. The e-recruitment phase is planned for implementation on 17 July 2015, with the HR, payroll and expenses phase due to be implemented on 1 April 2016.

The new system is expected to bring benefits to SQA in relation to better quality financial reporting, which should result in improved understanding of the cost to SQA of providing courses.

Total net expenditure increased by £5.2 million, while total income decreased by £4.9 million.

A deficit of £3.0 million is reported in 2014-15 compared to a surplus of £4.7 million in 2013-14. Adjusting for non-cash IAS 19 costs, the deficit was £0.7 million.

The prior year surplus was largely a result of the income recognition for the first year of Curriculum for Excellence.

### Financial position

Total expenditure was £24.4 million in 2014-15, with £21.4 million total grant funding income, which resulted in a deficit of £3 million before the actuarial loss.

The 2014-15 deficit of £3.0 million compares to a £4.7 million surplus in the year to 31 March 2014. £2.3 million (2013-14: £1.3 million) of the deficit relates to IAS 19 pension costs in excess of the cash contributions.

### Statement of comprehensive net expenditure

The key movements in income and expenditure compared to 2013-14:

- Staff costs increased by £3.7 million from an increase in staff numbers and greater IAS 19 costs as shown opposite. The full time equivalent total employees rose from 842 to 894 during 2014-15 in order to ensure the successful delivery of the CfE programme and to deliver other contract activity. In addition, and in line with Scottish Government pay policy, a pay award of 2.58% was paid during 2014-15.
- Other expenditure includes appointee related expenditure and other operating expenditure. Appointee related expenditure decreased by £1.4 million in 2014-15, as some of the increased verification activities required in the first stages of CfE implementation were not repeated in 2014-15. This was set off by various small increases in other expenditure types. The largest increase was due to a provision being created for VAT on seconded employee invoices.
- The £4.0 million entry charges income decrease was expected; 2013-14 included income recognised in respect of both the old qualifications and "new CfE". The income from entry charges is now more stable year-on-year.

- Other income increased by £1.7 million as a result of SQA's strategy to grow commercial income streams, in order to reduce the year end deficit during 2014-15. The largest movements were generated in commercial testing services.
- Grant funding decreased by £2.5 million, specifically in respect of the 2014-15 grant in aid of £6.7 million. 2013-14 grant in aid included a £2.4 million additional grant which was received to mitigate the cash impact of the change in timing of appointee income tax expenditure.

Consolidated statement of comprehensive income	2014-15 £'000	2013-14 £'000	Variance £'000
Staff costs	(34,205)	(30,514)	(3,691)
Depreciation and impairment	(2,149)	(2,473)	324
Other expenditure	(37,876)	(38,578)	702
<b>Total expenditure</b>	<b>(74,230)</b>	<b>(71,565)</b>	<b>(2,665)</b>
Entry charges	41,577	45,574	(3,997)
Other income	8,991	7,341	1,650
<b>Total income</b>	<b>50,568</b>	<b>52,915</b>	<b>(2,347)</b>
<b>Net expenditure</b>	<b>(23,662)</b>	<b>(18,650)</b>	<b>(5,012)</b>
Interest payable	(721)	(554)	(167)
<b>Total net expenditure</b>	<b>(24,383)</b>	<b>(19,204)</b>	<b>(5,179)</b>
Grant funding received	21,395	23,933	(2,538)
<b>(Deficit)/surplus</b>	<b>(2,988)</b>	<b>4,729</b>	<b>(7,717)</b>
<i>Split as:</i>			
Operating (deficit)/surplus	(689)	6,024	(6,713)
IAS 19 costs in excess of cash contributions	(2,299)	(1,295)	(1,004)

Source: KPMG analysis of SQA financial statements 2014-15



SQA had net liabilities of £7.4 million as at 31 March 2015, compared to £6.2 million net assets in the year to 31 March 2014.

The movement reflects the increase in the retirement benefit obligation of £12.8 million, driven by changes in assumptions.

#### 2014-15 budget

The adjusted 2014-15 operating deficit of £0.7 million compares to the budgeted deficit of £1.6 million. Additional grant in aid of £0.9 million was received to recognise timing differences in cashflows. Entry charges were £0.6 million less than budgeted and expenditure was £0.5 million lower, as a result of efficiencies which management achieved during 2014-15.

#### Statement of financial position

SQA had net liabilities of £7.4 million as at 31 March 2015 compared to net assets of £6.2 million in the prior year. The key elements of the movement are set out below.

#### Assets

The decrease in non-current assets is a result of the depreciation charge for the year of £2.1 million and disposals of £0.3 million, offset by additions of around £0.5 million.

Trade and other receivables increased by £2.1 million. The balance includes a CfE entry charges income accrual required to recognise income in line with diet completion rather than on a fixed cash basis. £14.1 million was accrued in 2014-15 compared to £12.6 million in 2013-14.

Other accrued income balances decreased by £0.4 million compared to 2013-14. The decrease in accrued income was offset by a decrease in prepayments of around £0.5 million.

Overseas trade receivables increased by £1.4 million in comparison to 2013-14 in relation to an increased outstanding balance for international consultancy activities. The majority of this balance was recovered post year end.

SQA achieved a flat cash position for the year, with opening and closing cash broadly at £2.8 million. This was achieved through controls over individual budget categories and monitoring of balances on a routine basis. Intra-month movements in cash can be significant and require close attention.

#### Liabilities

The increase in net liabilities from the prior year is primarily due to the higher retirement benefit obligation. Consideration of the pension assumptions and key movements is provided on pages 27 and 28.

Consolidated statement of financial position	2015 £'000	2014 £'000	Variance £'000
Non current assets	5,324	7,306	(1,982)
Trade and other receivables	23,846	21,770	2,076
Cash and cash equivalents	2,856	2,824	32
<b>Total assets</b>	<b>32,026</b>	<b>31,900</b>	<b>126</b>
Retirement benefit obligations	(28,331)	(15,487)	(12,844)
Trade and other payables	(10,220)	(9,423)	(797)
Other current liabilities	(842)	(817)	(25)
<b>Total liabilities</b>	<b>(39,393)</b>	<b>(25,727)</b>	<b>(13,666)</b>
<b>Net (liabilities) / assets</b>	<b>(7,367)</b>	<b>6,173</b>	<b>(13,540)</b>

Source: KPMG analysis of SQAs financial statements 2014-15

The 2015-16 budget incorporates a deficit of £4.9 million. This includes indicative funding of £1.8 million grant in aid, £2.6 million property funding and £13.7 million in programme grant funding.

The Scottish Government has expressed its intention to work with SQA to meet the deficit.

### Financial plans 2015-16

For 2015-16 the board of management has approved a budgeted deficit of £4.9 million, after core grant in aid of £1.8 million.

Budget savings of £1.5 million are included, following consultation with individual budget holders.

The 2015-16 budget has been prepared in line with the objectives set out in the 2015-18 corporate plan to maintain levels of service, efficiency and quality while continuing to focus on delivering the CfE programme.

Entry charges are forecast to be consistent with 2014-15, reflecting the more stable nature of the mix of entries and the fixed price arrangement with COSLA.

In line with the strategy for growth 2011 - 2020, other income is budgeted to increase by £1.9 million compared to the 2014-15 budget, and £1.7 million compared to the actual outturn.

Staff costs and appointee costs are budgeted to increase by £2.1 million and £1.3 million respectively as a result of wage inflation and pressures to support the continued delivery of the CfE programme, with national 5 qualifications requiring external assessment.

As in previous years, SQA requires additional funding from the Scottish Government to support the safe delivery of CfE. The Scottish Government has expressed its intention to work with SQA to meet the 2015-16 budgeted deficit although the £4.9 million deficit represents a present funding need.

The next page summarises the changes from the 2014-15 outturn to the 2015-16 budget.

Budget income and expenditure	2015-16 £'000	2014-15 £'000
<b>Core income:</b>		
Entry charges	42,100	42,200
Other income	10,700	8,800
Grant in aid	1,800	1,800
Scottish Government – property	2,600	2,600
Capital grant release	600	1,100
<b>Total income</b>	<b>57,800</b>	<b>56,500</b>
<b>Core expenditure:</b>		
Staff costs	27,300	25,200
Appointee costs	16,100	14,800
Operational costs	15,500	13,100
Property rental	2,600	2,600
Depreciation	1,200	2,400
<b>Total expenditure</b>	<b>62,700</b>	<b>58,100</b>
<b>Core deficit</b>	<b>(4,900)</b>	<b>(1,600)</b>
<b>Grant funding:</b>		
Income	13,700	15,000
Expenditure	(13,700)	(15,000)
<b>Grant deficit</b>	<b>-</b>	<b>-</b>
<b>Total deficit</b>	<b>(4,900)</b>	<b>(1,600)</b>

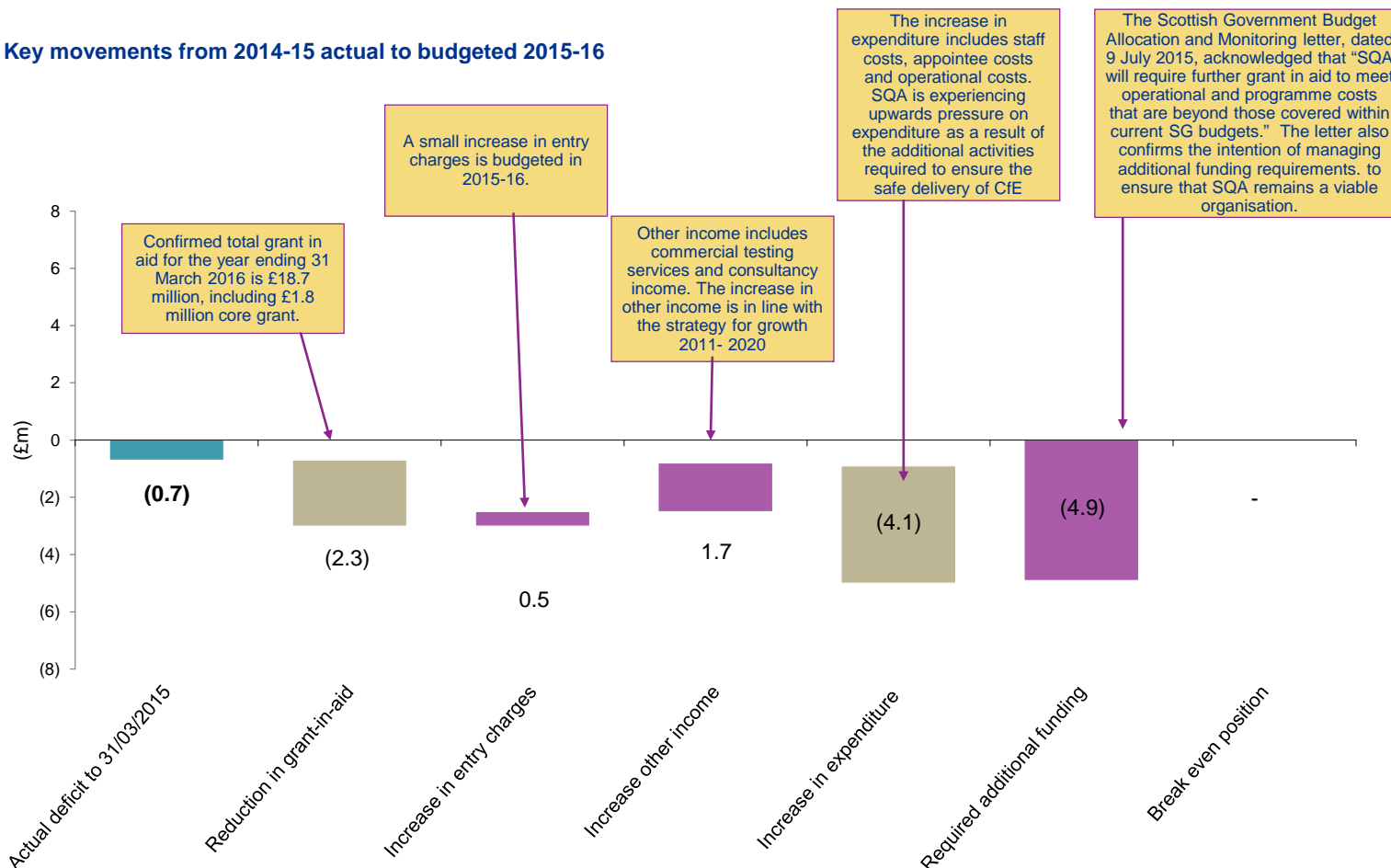
Source: SQA approved budget 2015-16.

The 2015-16 budgeted deficit of £4.9 million compares to the pension-adjusted deficit of £0.7 million.

Management anticipates that further funding will be forthcoming in the Autumn and Spring Budget Reviews.

The Budget Allocation and Monitoring letter from July 2015 acknowledges the Scottish Government's intention to make additional funding available to SQA should it be required.

Key movements from 2014-15 actual to budgeted 2015-16



# Financial statements and accounting

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

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

**The core financial statements, including the remuneration report, were made available on a timely basis and 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 SQA's affairs as at 31 March 2015, and of SQA's net operating costs for the year then ended. We have also issued an unqualified opinion on the regularity of transactions within the year. There are no matters identified on which we are required to report by exception.

In gathering the evidence for our opinion we have:

- performed controls testing and substantive procedures to ensure that key risks to the financial statements have been covered;
- communicated with internal audit and reviewed its reports as issued to audit 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 review of internal audit reports to gain a better understanding of the work performed in relation to prevention and detection of fraud; and
- attended the audit committee to communicate our findings to those charged with governance, and to update our understanding of the key governance processes.

### Financial statements preparation

- High quality working papers and draft financial statements were provided at the start of the audit fieldwork on 11 May 2015. This included the remuneration report. The front part of the financial statements, including the management commentary and strategic report, was received after the onsite audit.
- 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 SQA, the standard of documentation was very good and there was evidence of accountability and ownership of working papers across the finance department.
- Throughout the course of the year we have had regular communication and discussion with SQA's finance team to ensure that disclosure within the financial statements was consistent with the requirements of the FReM. We provided feedback to management on the content of the financial statements, annual report and governance statement 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.

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

- **management override of controls fraud risk;**
- **revenue recognition fraud risk; and**
- **accounting for CfE entry charges.**

**and other focus areas of:**

- **appointee expenditure; and**
- **retirement benefit obligations.**

We summarise below the risks of material misstatement as reported within the audit strategy document, no further matters of this nature were identified during the audit. We set out the key audit procedures to address those risks and our findings from those procedures, in order that the audit and committee may 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 fraudulent revenue recognition. We do not have findings to bring to your attention in relation to these matters; no control overrides were identified.

Significant risks	Our response	Audit findings
<p><b>Accounting for CfE entry charges</b></p> <p>Prices for entry charges are agreed and approved annually by Scottish Government. Although this minimises the level of judgement required in revenue recognition by management, there remains a key judgement area around the timing of income recognition in the context of the fixed price agreement for 2013-16. Therefore, we consider the risk from income recognition in relation to entry charges income to be significant.</p>	<p>We performed the following testing in order to conclude on this significant risk area:</p> <ul style="list-style-type: none"> <li>■ testing the reconciliation of APS to monthly invoices raised by the sales ledger team;</li> <li>■ discussion of entry number projections and the impact of these of the CfE income accrual for 2014-15;and</li> <li>■ consideration of the application of the income recognition policy in arriving at the entry charges income accrual, by reviewing and challenging the calculations.</li> </ul>	<p>We found that the reconciliation of APS to the monthly invoices raised by the sales ledger team was designed, implemented and operating effectively.</p> <p>Our discussions with management and our recalculation of the CfE entry charges income accrual enabled us to conclude that the income accrual is appropriate given the entry numbers in 2014-15.</p> <p>Our consideration of the application of the income recognition policy in our testing of the entry charges income recognition calculation found that this was being applied appropriately.</p> <p>From the procedures noted, we are satisfied that income from CfE entry charges presented as at 31 March 2015 is correctly stated in the financial statements.</p>

Significant risks	Our response	Audit findings
<p><b>Appointee expenditure</b></p> <p>Appointee expenditure is considered to be an other focus area due to the quantum of transactions and varying numbers of appointees, which is a factor in the account balance.</p>	<p>To address this other focus area we performed the following audit work:</p> <ul style="list-style-type: none"> <li>■ testing controls over the authorisation of appointee payroll and manual appointee claim forms; and</li> <li>■ performing predictive analytical procedures over the appointee expenditure balances included in the 2014-15 financial statements.</li> </ul>	<p>We found that appointee expenditure controls were designed, implemented and operating effectively.</p> <p>No exceptions were noted from the analytical procedures performed, with movements in line with our expectations.</p> <p>In respect of the expenditure items noted, we are satisfied that expenditure reported in the financial statements is appropriate.</p>
<p><b>Retirement benefit obligations</b></p> <p>SQA accounts for its participation in the Strathclyde Pension Fund in accordance with IAS 19 <i>Retirement benefits</i>, using a valuation report prepared by actuarial consultants. SQA's actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases.</p> <p>IAS 19 requires the discount rate to be set by reference to yields on high quality (i.e. AA) corporate bonds of equivalent term to the liabilities. The determination of the retirement benefit obligation is inherently judgemental and there is a financial statement risk as a result.</p>	<p>Our audit work consisted of:</p> <ul style="list-style-type: none"> <li>■ KPMG specialists reviewing the financial assumptions underlying actuarial calculations and comparison to our central benchmarks, the result of which are on page 28;</li> <li>■ testing the scheme assets and rolled-forward liabilities;</li> <li>■ testing the level of contributions used by the actuary to those actually paid during the year;</li> <li>■ testing the membership data used by the actuary to data from SQA; and</li> <li>■ agreeing actuarial reports to financial statement disclosures.</li> </ul>	<p>We are satisfied that the retirement benefit obligation:</p> <ul style="list-style-type: none"> <li>■ is correctly stated in the balance sheet as at 31 March 2015;</li> <li>■ has been accounted for and disclosed correctly in line with IAS19 <i>Retirement benefits</i>; and</li> <li>■ assumptions used in calculating this estimate and management's judgements are appropriate and within the acceptable KPMG range.</li> </ul> <p>We set out further information in respect of the defined benefit obligation on pages 28 and 29. The defined benefit obligation increased by £12.8 million compared to 31 March 2014, driven by a lower discount rate and increased mortality assumption.</p>

The financial statements have been appropriately prepared on a going concern basis, having due consideration of the requirement for further support in the form of grant in aid.

Accounting framework and application of accounting policies		
Area	Our response	Audit findings
<b>Accounting policies</b>	<ul style="list-style-type: none"> <li>There have been no changes to adopted accounting policies in the year.</li> <li>Critical accounting judgements continue to relate to the present value of defined benefit obligations under IAS 19 (as calculated by SQA's actuary, Hymans Robertson) using agreed financial assumptions. We considered the appropriateness of these assumptions and the accounting for pensions on page 14.</li> </ul>	We are satisfied that accounting policies and critical estimates adopted in the preparation of the financial statements remain appropriate. We have not identified indications of management bias.
<b>Going concern</b>	<ul style="list-style-type: none"> <li>SQA had net liabilities of £7.4 million as at 31 March 2015 (2013-14: net assets £6.2 million). The net liability position is due to the significant increase in the defined benefit obligation.</li> <li>The financial statements have been prepared under the assumption that the organisation is a going concern. Given the nature of SQA and its critical role in the implementation of CfE which is supported by the Scottish Government, as well as management's actions to increase other income and manage expenditure, this is a reasonable assumption. SQA expects to receive additional support from the Scottish Government in order to continue funding the CfE programme. Whilst there is technically some risk in the £4.9 million deficit budget for 2015-16, the July 2015 Budget Allocation and Monitoring letter indicates that the further support will be forthcoming. These circumstances have been disclosed within the financial statements.</li> <li>In respect of the defined benefit obligation: based on the 2014 triennial valuation of the Strathclyde Pension Fund, the full obligation of £28.4 million does not fall due within one year and therefore does not impact on the going concern assumption.</li> </ul>	<p>We concur with management's view that the going concern assumption remains appropriate for the reasons noted.</p> <p>We are satisfied that the going concern disclosure remains appropriate. This incorporates the support from Scottish Government and the fact that the pension deficit does not become due in the next 12 months.</p>
<b>Financial reporting framework</b>	<ul style="list-style-type: none"> <li>SQA prepares financial statements in accordance with the Government's Financial Reporting Manual ("FRoM").</li> <li>There have been no changes to the financial reporting framework in the year, other than minor changes to the disclosure of compensation payments within the remuneration report, however these have had no impact for SQA.</li> </ul>	We are satisfied that the accounting policies adopted remain appropriate to SQA, and have been correctly applied.



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	Our response	Audit findings
<b>Annual report, including the strategic and directors' reports</b>	<p>The financial statements form part of the annual report of SQA for the year ended 31 March 2015. We have reviewed the contents of the strategic and directors' 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 / or where additional information disclosures should be made.</p>	<p>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.</p>
<b>Remuneration report</b>	<p>The remuneration report was included within the draft financial statements and supported by good quality information and working papers. Our testing confirmed that the remuneration report has been prepared in accordance with the requirements of the FReM.</p>	<p>We are satisfied that the information contained within the remuneration report is consistent with the underlying records and the financial statements.</p>

# Governance and narrative reporting

Our overall perspective on the narrative reporting, including the annual governance statement

Update on controls findings from our audit

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

Our testing of the design and operation of financial controls over significant risk points undertaken as part of our interim work identified no exceptions.

Area	Our response	Audit findings
<p><b>Annual governance statement and governance arrangements</b></p>	<p>The statement for 2014-15 outlines the corporate governance and risk management arrangements in operation in the financial year. It provides detail on SQA's governance framework, operated internal controls, the work of internal audit, internal financial controls and risk management arrangements and analyses the efficiency and effectiveness of these elements of the framework.</p> <p>SQA is overseen by a Board of management and its work is supported by the executive management team and the audit committee which meet regularly. Reports from each are presented to the Board for consideration.</p> <p>SQA operates a risk management framework which is compliant with guidance issued by Scottish Ministers. Following improvement observations identified by internal audit, the risk management framework was reviewed by the audit committee in February 2015 and a risk appetite statement agreed. The framework is based on the Office of Government Commerce's Management of Risk (MoR) approach, which is regarded as best practice for the UK public sector.</p> <p>Risk registers are operated for the organisation as a whole and for individual directorates and are also regularly reviewed. Actions within registers are assigned 'actions directors' to ensure the accountability of actions to reduce and mitigate risk. The risk register for the organisation as a whole is considered and updated monthly by the executive management team and is also reviewed quarterly by the board of management and the audit committee to ensure it is up to date.</p> <p>Internal audit provides assurance over the effective management of the internal control framework. Internal audit completed 13 reviews in the year to 31 March 2015, none of which identified 'high' or 'very high' risk exposure actions.</p>	<p>We have updated our understanding of the governance framework and documented this through our overall assessment of SQA's risk and control environment. We consider the governance framework and annual governance statement to be appropriate for SQA and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.</p>

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

Our testing of the design and operation of financial controls over significant risk points undertaken as part of our interim work identified no exceptions.

Area	Our response	Audit findings
<p><b>Internal controls</b></p>	<p>SQA management is responsible for designing and implementing appropriate internal control systems to ensure a true and fair view of operations within the financial statements. 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.</p> <p>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. KPMG's identification of weaknesses, where applicable, does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.</p> <p>Within our interim audit report we raised a recommendation in relation to authorisation of journal entries. Management accepted the finding, with an implementation date of 31 May 2015. We will consider the implementation of recommendations as part of the 2015-16 audit.</p> <p>We have included at appendix four details of a control improvement observation in relation to our general IT controls testing over the SAP system.</p>	<p>Our work concluded that the controls relating to financial systems and procedures are designed appropriately and operating effectively. Since the conclusion of our interim work there have been no changes to the operation of the operation of the controls subject to review.</p>
<p><b>Prevention and detection of fraud</b></p>	<p>No material fraud or other irregularities were identified during the year and we consider that SQA has appropriate arrangements to prevent and detect fraud.</p> <p>The arrangements include policies and codes of conduct for staff, appointees and board members of SQA, supported by an anti-fraud policy and fraud response plan.</p>	<p>We consider that SQA has appropriate arrangements to prevent and detect fraud.</p>
<p><b>Arrangements for maintaining standards of conduct and the prevention and detection of corruption</b></p>	<p>SQA has arrangements including policies and codes of conduct for staff, appointees 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 SQA.</p>	<p>We consider that SQA has appropriate arrangements to prevent and detect inappropriate conduct and corruption.</p>

Area	Our response	Audit findings
<b>Internal audit</b>	<p>Internal audit is provided by Scott Moncrieff and 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.</p> <p>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.</p> <p>From this assessment, and considering the requirements of International Standard on Auditing 610 (<i>Considering the Work of Internal Audit</i>), we can apply Scott Moncrieff'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.</p> <p>The Internal Audit Annual Report for 2014-15 concludes that "In our opinion SQA has a framework of controls in place that provides reasonable assurance regarding the effective and efficient achievement of the organisation's objectives and the management of key risks".</p>	<p>We have concluded that the internal audit service operates in accordance with Public Sector Internal Audit Standards.</p>
<b>National Fraud Initiative ("NFI")</b>	<p>The National Fraud Initiative ("NFI") is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use for uploading data and monitoring matches. Our review of SQA's NFI participation resulted in a green grading and our findings have been separately reported to Audit Scotland, in accordance with issued guidance.</p>	<p>We consider that SQA has participated appropriately in the NFI process following up all higher risk actions in a timely manner.</p>

# Performance management

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

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

Area	Our response	Audit findings
<p><b>Performance management and best value</b></p>	<p>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.</p> <p>SQA's performance management arrangements remain unchanged from the prior year, focussed around detailed monitoring information on progress against key corporate milestones. Regular reporting to the audit committee and board of management includes details of recently completed or achieved milestones, those due to be achieved in the next period and a summary of potential risks which could arise.</p> <p>The quarterly performance pack includes consideration of each of SQA's eight strategic goals. Each goal has specific key performance indicators allocated to help determine progress towards meeting the goal. Each goal is also linked to relevant risks included in the corporate risk register with an update on the risk. Reporting on each strategic goal incorporates a number of reporting formats: graphs, charts and narrative and includes aspects of good practice such as noting actions required in respect of specific performance areas. This ensures appropriate governance over performance and facilitates the identification of mitigating actions in a timely manner for underperforming areas.</p> <p>To consider the controls and processes to support Best Value aims, the annual internal audit plan contains specific reviews that focus on assessing whether current processes provide best value. Each internal audit report also includes an assessment of value for money.</p> <p>Our consideration of the work of internal audit, as part of our extended control work, did not indicate high risk findings within these areas.</p>	<p>We consider that SQA has appropriate arrangements to effectively manage performance.</p>

Area	Our response	Audit findings
<p><b>Local response to national studies</b></p>	<p>Audit Scotland periodically undertakes national studies on topics relevant to the performance of central government bodies. To ensure that added value is secured through the role of Audit Scotland and its appointed auditors, auditors must verify that audited bodies respond appropriately to reports from Audit Scotland's programme of national performance audits.</p> <p>Notification of reports issued by Audit Scotland are received by the quality systems manager and shared with the relevant team for consideration. The audit committee receives an update of all reports received along with which team considered the report and whether any action was taken.</p>	<p>We consider that SQA has appropriate arrangements to effectively respond to national studies.</p>
<p><b>Financial capacity in public bodies</b></p>	<p>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.</p> <p>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.</p> <p>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.</p>	<p>We consider that SQA has appropriate financial capacity to effectively manage the organisation.</p>



# Appendices

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

Area	Key content	Reference
<b>Adjusted audit differences</b> Adjustments made as a result of our audit	There were no audit adjustments required to the draft financial statements.  A small number of minor presentational adjustments were required to some of the financial statement notes.	-
<b>Unadjusted audit differences</b> Audit differences identified that we do not consider material to our audit opinion	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you.  There are no unadjusted audit differences.	-
<b>Confirmation of Independence</b> 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 Director and audit staff.	Appendix two
<b>Schedule of Fees</b> Fees charged by KPMG for audit and non-audit services	Audit fees payable to Audit Scotland are in accordance with the range specified by Audit Scotland and as reported to the audit committee. Non audit fees of £24,000 in 2014-15 related to assistance with overseas taxation.	Appendix two
<b>Draft management representation letter</b> Proposed draft of letter to be issued by SQA to KPMG	There are no changes to the standard representations required for our audit from last year.	-
<b>Materiality</b> The materiality applied to audit testing.	We assessed materiality based on our knowledge and understanding of SQA's risk profile and financial statements balances. Materiality was determined at £1.4 million; approximately 2% of total forecast expenditure in 2014-15, which 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. £1.0 million.  We report identified errors greater than £70,000 to the audit committee.	

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

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

### **Auditor independence**

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

We have considered the fees paid to us by [client] 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 23 October 2015, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

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

Yours faithfully

KPMG LLP

In respect of employee benefits, each of the assumptions used to value SQA's net pension deficit are within an acceptable range of KPMG's expectations.

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

Defined benefit pension liability																													
2015 £'000	2014 £'000	KPMG comment																											
(28,331)	(15,487)	<p>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.</p> <p>Details of key actuarial assumptions are included in the table, along with our commentary.</p> <table border="1"> <thead> <tr> <th>Assumption</th> <th>SQA 2013-14</th> <th>SQA 2014-15</th> <th>KPMG central</th> <th>Comment</th> </tr> </thead> <tbody> <tr> <td>Discount rate (duration dependent)</td> <td>4.3%</td> <td>3.2%</td> <td>3.21 %– 3.36%</td> <td>Acceptable. The proposed discount rates are within an acceptable range of KPMG's central rates as at 31 March 2015.</td> </tr> <tr> <td>CPI inflation</td> <td>RPI - 0.8%</td> <td>RPI – 0.9%</td> <td>RPI – 1.0%</td> <td>Acceptable. KPMG's view is that the differential between RPI and CPI should be higher and closer to 1%. SQA's assumptions could therefore be considered prudent (higher liability).</td> </tr> <tr> <td>Net discount rate (discount rate – CPI)</td> <td>1.5%</td> <td>0.8%</td> <td>1.02% – 1.05%</td> <td>Acceptable. The proposed assumptions are within the acceptable range of +/- 0.3%.</td> </tr> <tr> <td>Salary growth</td> <td>RPI + 1.5%</td> <td>RPI + 1.0%</td> <td>Typically 1.0 –1.5% above RPI</td> <td>Acceptable. The proposed assumptions are within the acceptable range.</td> </tr> </tbody> </table>			Assumption	SQA 2013-14	SQA 2014-15	KPMG central	Comment	Discount rate (duration dependent)	4.3%	3.2%	3.21 %– 3.36%	Acceptable. The proposed discount rates are within an acceptable range of KPMG's central rates as at 31 March 2015.	CPI inflation	RPI - 0.8%	RPI – 0.9%	RPI – 1.0%	Acceptable. KPMG's view is that the differential between RPI and CPI should be higher and closer to 1%. SQA's assumptions could therefore be considered prudent (higher liability).	Net discount rate (discount rate – CPI)	1.5%	0.8%	1.02% – 1.05%	Acceptable. The proposed assumptions are within the acceptable range of +/- 0.3%.	Salary growth	RPI + 1.5%	RPI + 1.0%	Typically 1.0 –1.5% above RPI	Acceptable. The proposed assumptions are within the acceptable range.
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<p>The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of between 17 and 23 years. The closing deficit increased by £12.8 million compared to 2013-14, primarily due to changes in financial assumptions, driven by the decrease in the discount rate and changes to demographic assumptions, the latter having been driven by the latest triennial valuation as at 31 March 2014. SQA assumptions are towards the prudent end of KPMG's acceptable range.</p> <p>A reconciliation from opening to closing deficit is included on the next page.</p>																													

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 by changes to financial assumptions, primarily as a result of a decrease to the discount rate and demographic assumptions.

Our pension specialists have confirmed that the movements within I&E and OCI are reasonable for the size and duration of SQA's pension scheme.

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

Cash – cash-flow impact

OCI – charged through other comprehensive income

	£'000	Deficit / loss	Surplus / gain	Impact	Commentary
	Opening pension scheme deficit			(15,487)	The opening IAS 19 deficit for the Scheme at 31 March 2014 was £15.5 million (consisting of assets of £97.3 million and defined benefit obligation of £112.8 million).
I & E	Service cost			(5,559)	The scheme is open to accrual. The service cost represents the value of new benefits built up over the year.
	Net interest			(699)	This is the difference between the expected return on assets of £4.2 million and the interest on the defined benefit obligation of £4.9 million.
	Other experience			399	Other experience re-measurements resulted in a gain of around £0.4 million.
Cash	Contributions			3,975	SQA made cash contributions of around £4.0 million, including contributions in respect of unfunded benefits.
OCI	Actuarial gain/(loss) – demographic assumptions			(4,145)	There was an actuarial loss on the demographic assumptions of around £4.1 million as a result of the mortality rates increasing by 1.1 to 22.1 for males and 0.2 for females.
	Actuarial loss – financial assumptions			(15,838)	There was an actuarial loss on the financial assumptions of around £15.9 million. This is primarily due to a 1.1% decrease in the discount rate assumption as a result of falls in corporate bond yields.
	Return on assets			9,023	The return on plan assets, excluding interest on assets of £4.2 million, was £9.0 million.
	Closing pension scheme deficit			(28,331)	The closing IAS19 deficit for the scheme at 31 March 2015 is £28.3 million (consisting of assets of £113.4 million and defined benefit obligation of £141.7 million).

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

Priority rating for recommendations		
<p><b>Grade one</b> (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.</p>	<p><b>Grade two</b> (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.</p>	<p><b>Grade three</b> (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.</p>
Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
<p><b>1 GITC – audit trail logs</b></p> <p>Our testing of general IT controls in relation to the SAP system found that program change request forms were not available for six of our sample testing items.</p> <p>There is a risk that unauthorised or inappropriate program changes could be made if there is no requirement to have a change request form.</p> <p>We noted that a mitigating control is in place, as only approved members of staff have access on SAP to be able to make program changes.</p>	<p>A manager or appropriate IT staff member should review on a periodic basis the audit trail logs of activities performed by user accounts (excluding their own) with administration level access that resulted in changes or updates to the SAP system.</p> <p>This would strengthen the current process.</p>	<p><b>Grade three</b></p> <p>Enhancements to the program change request process have been made post year end which address this recommendation.</p> <p><b>Responsible officer:</b> IT Security Manager / Service Delivery Manager</p> <p><b>Implementation date:</b> n/a</p>



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