The Skills Development Scotland Co. Limited

Annual audit report to the Board of Directors of Skills Development Scotland Co. Limited and the Auditor General for Scotland

Audit: year ended 31 March 2015

3 November 2015

Contents

The contacts at KPMG in connection with this report are:

Andy Shaw
Director, KPMG LLP

Tel: 0131 527 6673
Fax: 0131 527 6666
andrew.shaw@kpmg.co.uk

Sarah Burden
Manager, KPMG LLP

Tel: 0131 527 6611
Fax: 0131 527 6666
sarah.burden@kpmg.co.uk

Beth Grieve
Assistant manager, KPMG LLP

Tel: 0131 527 6729
Fax: 0131 527 6666
bethany.grieve@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 Skills Development Scotland Co. Limited ("SDS") 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 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
Strategic overview		
Key issues and update	2014-15 was the final year of the Skills Development Scotland Co. Limited's ("SDS") three year corporate strategy. Scottish Government policy aspirations were for an increase in the number of Modern Apprenticeship starts of 25,000 in the year to 31 March 2015. SDS achieved this target with 25,247 starts, of which 52% were in the 16-19 age category, a crucial demographic. A new corporate strategy to 2020 has been drafted by management and sets out SDS' key goals for the next five years. Five goals have been identified under an overarching vision which states that SDS will '*contribute significantly to a Scotland that values skills.'*	Page 6
Financial position	In 2014-15, the agreed financial objective was for a small deficit after pension costs and a reduced cash-holding. Despite the inherent challenges this presented, the financial targets were met by management, resulting in a deficit on ordinary activities of £5.7 million (2013-14: £10.0 million). Excluding IAS 19 pension costs of £5.1 million in excess of cash contributions, the underlying operating deficit for the year was £0.5 million (2013-14: £6.4 million). A balanced budget was set for 2015-16, although with some risk as only £183.5 million grant in aid was originally approved by the Scottish Parliament. On 30 October 2015 a further £21.6 million was approved in the Autumn Budget Review, with circa £2.9 million of further funding expected to be approved in the Spring Budget Review.	Page 8
Financial statements and accounting		
Audit conclusions	We have issued an unqualified audit opinion on the 2014-15 financial statements, following their approval by the Board. The financial statements, strategic report, directors' report, governance statement and remuneration report were received by the start of audit fieldwork and were supported by high quality working papers.	Page 14
Significant risks and audit focus areas	The areas highlighted below are the specific audit focus areas identified within our audit strategy: ■ working capital balances; ■ changes to accounting for, and control frameworks supporting, National Training Programme ('NTP") expenditure; and ■ SDS's participation in the Strathclyde Pension Fund and Highland Council pension fund. An additional risk regarding cut-off of expenditure was identified during final audit planning procedures. 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 the accounting treatment.	Pages 15 and 16

Headlines (continued)

Area	Summary observations	Analysis
Financial statements and accounting (continued)		
Going concern	The financial statements have been prepared on a going concern basis, as management considers that the confirmed grant in aid of £205.1 million and the available cash balance are sufficient to ensure that SDS is able to meet debts as they fall due. Whilst there is technically some risk in the unconfirmed grant in aid, required to deliver the 2015-16 and 2016-17 expenditure budgets, discussions with Scottish Government indicate that this will be forthcoming. The financial statements show net liabilities of £75.1 million incorporating the £94.1 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 18
Accounting policies	There have been no changes to accounting policy applied by SDS in 2014-15. No newly effective accounting standards are expected to have a material impact on the 2015-16 financial statements.	Page 18
Governance and narrative reporting		
Governance	Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making. During 2014-15 there have been changes in those charged with governance with a number of Board members appointed as well as one term ending in May 2014.	Page 23
Internal controls	Testing of the design and operation of financial controls over significant risk points was undertaken as part of interim and final audit testing. Our work concluded that that controls relating to financial systems and procedures are designed appropriately and operating effectively.	Pages 23 and 24
Performance management		
Performance management	Our review of SDS's performance management arrangements in the year to 31 March 2015 indicates that these continue to be appropriate. Internal audit reviews, conducted as part of the 2013-16 internal audit plan, provided assurance over Best Value considerations in the year to 31 March 2015 and did not indicate significant weaknesses.	Page 27

Scope and responsibilities

Purpose of this report

The Auditor General for Scotland (“the Auditor General”) has appointed KPMG LLP as auditor of SDS 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 SDS 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 and risk 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 SDS’s responsibilities in respect of:

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

Auditor responsibilities

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

Scope

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance.

Weaknesses or risks identified are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist.

Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

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

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

Strategic overview

Our perspective on key business issues and financial position

Key business issues

An exercise has recently been undertaken to draft a new corporate plan to 2020.

During the period of the strategic plan to 2015, SDS has met targets for Modern Apprenticeship starts, a key performance metric as communicated by Scottish Government.

Corporate plan to 2020

2015 is the final year of SDS's three year corporate strategy and a process has recently been undertaken by management to agree the next corporate plan. The draft corporate plan, subject to approval, sets out five goals aligned under a single vision; *'to contribute significantly to a Scotland that values skills, realising the potential of its people and businesses.'*

Four of the goals are aligned under SDS's two key ambitions: to support employers and individuals in developing Scotland's workforce. The fifth is internally focused and centres on ensuring that SDS is an employer of choice, internationally recognised for its excellence and innovation.

SDS's goals are aligned to Scotland's National Performance Framework, ensuring that outcomes are linked to overarching objectives of the Scottish Government.

The corporate plan will be supported by annual operating plans, the first of which has been drafted for 2015-16. The annual operating plan sets out SDS's commitments against each of its goals.

Service overview and national training programmes

SDS continued to work to an annual target set by Scottish Government of 25,000 Modern Apprenticeship starts and 17,150 Employability Fund starts. For the latter, a ring-fenced target of 2,650 College starts was also communicated for the 2014-15 year.

	2014-15 target	2014-15 actual
Modern Apprenticeship starts	25,000	25,247
Employability Fund starts	17,150	17,339

In April 2014 it was announced that the apprenticeship programme would be expanded annually through to 2020, eventually culminating in a revised target of 30,000 starts. In the first year, 2015-16, the annual Modern Apprenticeship targets of 25,500 is communicated in the annual operating plan. These starts are expected to focus on young people; a demographic which SDS has success in recruiting with 52% of starts in 2014-15 in the 16-19 age category.

Whilst the full funding is not currently confirmed, additional funding is expected to be made available to SDS and this will be used in part to fund foundation and graduate level apprenticeships across Scotland. The former scheme will offer senior pupils in secondary schools the chance to access structured vocational learning while the graduate apprenticeships will facilitate the combination of academic and work-based learning. It is expected that a minimum of 450 foundation apprenticeships will be delivered in 2015-16, with activity on graduate level apprenticeships focusing on developing pathfinder programmes for commencement of delivery in 2016-17.

In the year to 31 March 2015, £3 million was awarded to SDS from the Scottish Government to implement the recommendations of the Commission for Developing Scotland's Young Workforce. Monies have been awarded to support the extension of careers information, advice and guidance with partners as well as continued provision of apprenticeship and other employability schemes.

Key business issues (continued)

IT shared service transition

The proposed transition in 2014-15 from the existing IT tower arrangement held with Atos (and shared between SDS, Scottish Enterprise, Highlands and Islands Enterprise and the Scottish Criminal Cases Review Commission) to a multi-source model was delayed to 2015-16 as a result of project slippage with a key supplier failing to meet agreed timescales.

All IT service packages, with the exception of communications, were transitioned in July 2015. The communications service package with Atos was extended for six months to 31 December 2015. The transition is now expected to conclude by January 2016.

The delay to the transition has resulted in increased costs from extending the Atos arrangement. The project has a dedicated financial management resource to ensure that costs are appropriately managed. We performed testing over the expenditure on IT costs in the year to 31 March 2015, including prepayments due in relation to the extension of the existing tower contract.

Discussion with management as part of final audit procedures indicated that subsequent progress has been positive, with some applications already having transitioned to the new model. Downtime has arisen during transition of legacy applications at SDS and its partners, however support from the contractors and project manager minimised the business impact.

Financial position

Income increased compared to prior year while total expenditure remained broadly consistent. A deficit of £5.7 million was reported in 2014-15, in comparison to £10.0 million in 2013-14.

Income has predominantly increased as a result of greater grant in aid.

Financial position

The 2014-15 deficit of £5.7 million compares to a £10.0 million deficit in the year to 31 March 2014. The underlying deficit, after adjusting for IAS 19 charges, is £0.5 million (2013-14: £6.4 million). The reduction in deficit is the result of increased grant-in-aid receipts, with expenditure broadly consistent with the prior year.

As noted, the proposed 2014-15 spend on IT transition from the existing Atos tower arrangement to a service integration and management model has been impacted by project delays. As a result, the existing Atos arrangement was extended to cover the transition and this increased other income in respect of IT income recharges.

Consolidated statement of comprehensive income

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

- Increased grant-in-aid; additional ring-fenced funding awarded in the Spring and Autumn Budget Reviews amounted to £31.6 million, of which £6.0 million was new funding. This was awarded in relation to the Developing Scotland's Young Workforce programme (£3.0 million) and the implementation of the ICT Skills Investment Action Plan (£2.2 million) along with other smaller initiatives.
- National Training Programmes expenditure decreased due to a reduction in college engagement spend (£5.3 million) and Get Ready for Work and Training for Work residuals (total £9.5 million). The programmes are now part of the Employability Fund, the spend on which increased by £7.8 million in the year to 31 March 2015.
- Staff costs increased on the prior year in line with an increase in full time equivalents of employees ('FTEs'). The increase is partly due to the introduction of interns and Modern Apprentices which accounted for around 70 FTE. Pay progressions were also awarded in the year to 31 March 2015 alongside a £400 payment for all employees earning below £21,000 per annum.
- Increased other expenditure includes increases on core IT costs of £6.0 million and £1.6 million of Developing Scotland's Young Workforce grants disbursed in the year to 31 March 2015. This has been offset by a decrease in business enhancement expenditure due to non-recurring estates costs included in prior year balances.

Consolidated statement of comprehensive income	2014-15 £'000	2013-14 £'000	Variance £'000
Grant-in-aid	196,145	190,112	6,033
European income	-	1,393	(1,393)
Other income	12,501	9,864	2,637
Total income	**208,646**	**201,369**	**7,277**
National training programmes	(114,154)	(120,480)	6,326
Staff costs	(53,761)	(49,203)	(4,558)
Other expenditure	(44,936)	(40,585)	(4,351)
Total expenditure	**(212,851)**	**(210,268)**	**(2,583)**
Net expenditure	**(4,205)**	**(8,899)**	**4,694**
Finance cost	(1,561)	(1,162)	(399)
Finance income	122	137	(15)
Income tax	(20)	(27)	7
Deficit	**(5,664)**	**(9,951)**	**4,287**
Split as:			
Operating deficit	*(526)*	*(6,441)*	*5,915*
IAS 19 costs in excess of cash contributions	*(5,138)*	*(3,510)*	*(1,628)*

Source: KPMG analysis of SDS's financial statements 2014-15

The next page provides an analysis of the movement in the budgeted to actual result for 2014-15.

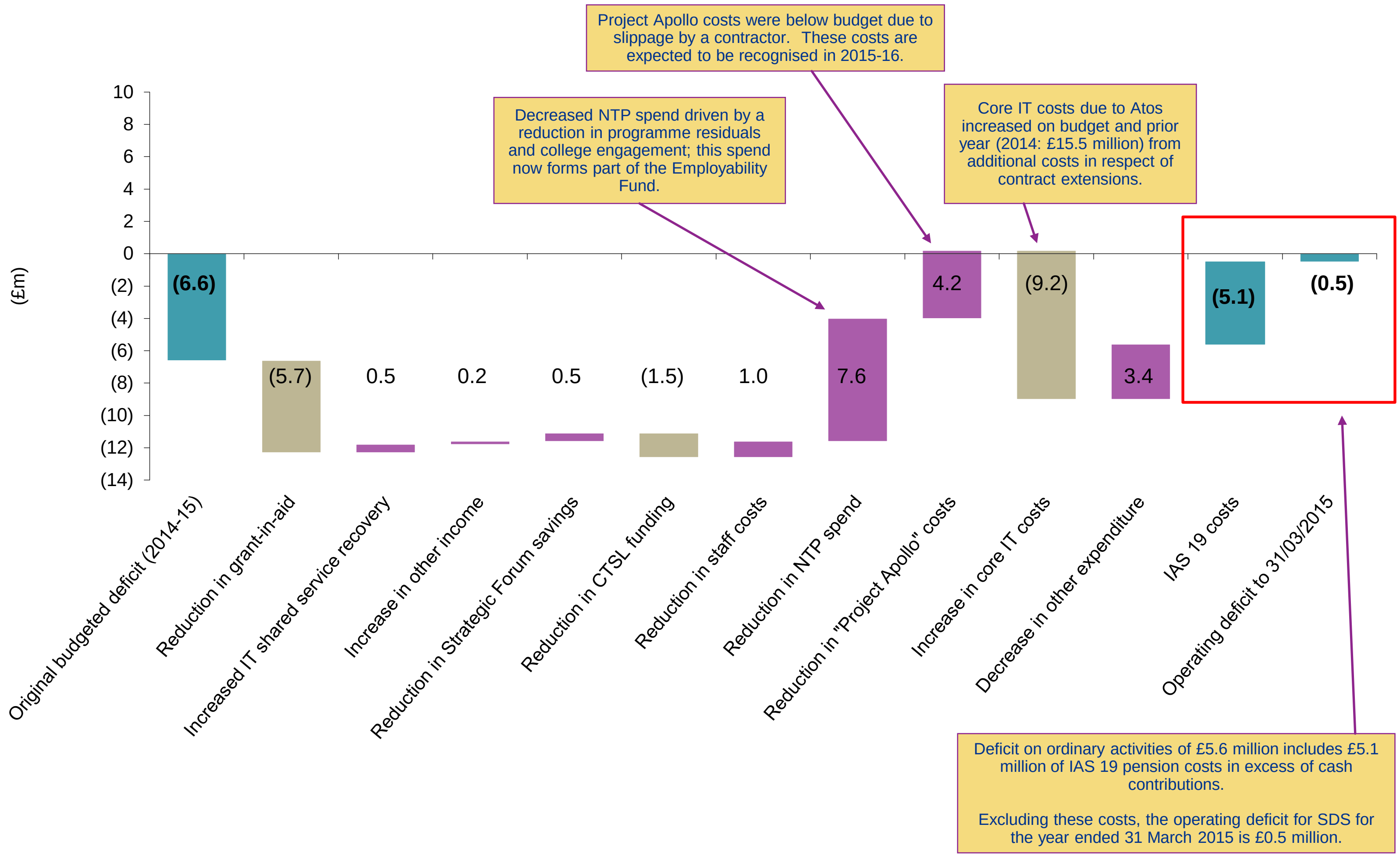
Financial position (continued)

The original 2014-15 budgeted outturn was for a deficit of £6.6 million before pension costs; in December 2014 this was revised to a budgeted breakeven position.

The breakeven was achieved by SDS through a number of agreed financial management actions, with a reported deficit on ordinary activities of £0.5 million, excluding pension costs.

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

2014-15 budgeted deficit to outturn



Financial position (continued)

The group has net liabilities of £75.1 million as at 31 March 2015 (2013-14: net liabilities of £15.0 million).

The movement reflects increases to the retirement benefit obligation of £59.6 million, with a small increase to liabilities due in less than one year of £0.8 million.

Consolidated statement of financial position

The group has net liabilities at 31 March 2015 date of £75.1 million, a movement of £60.1 million on the prior year. The key elements of the movement is set out below.

Assets

The increase in trade and other receivables of £5.4 million is due to greater prepayments as at 31 March 2015 from the extension of the Atos contract. Prepayments increased by £5.0 million, of which £6.8 million related to Atos core costs for quarter one of 2015-16 and the renewal of third party contracting costs to 31 March 2016; this represents an increase of £4.4 million on the prior year prepayment. Other debtors decreased in the year by £0.4 million partly due to non-recurrence of clawback funding from a training provider recognised in the prior year financial statements.

Cash and cash equivalents decreased in accordance with working capital changes agreed with the Scottish Government during the finalisation of the 2014-15 grant-in-aid allocations.

Liabilities

The increase in net liabilities from the prior year is primarily due to the greater retirement benefit obligation. Consideration of the pension assumptions and key movements is provided on pages 14 and 15.

Trade and other payables increased by £0.6 million from 2013-14. Accruals increased by £2.4 million, driven by amounts due to external bodies which increased by £2.1 million.

Trade creditors decreased by £1.8 million. In the prior year, £2.2 million was recognised in trade creditors in relation to shared service secondments for 2010 to 2014; this has not recurred as at 31 March 2015.

Consolidated statement of financial position	2015 £'000	2014 £'000	Variance £'000
Non current assets	428	444	(16)
Trade and other receivables	18,379	13,012	5,367
Cash and cash equivalents	11,501	16,627	(5,126)
Total assets	**30,308**	**30,083**	**225**
Retirement benefit obligations	(94,126)	(34,541)	(59,585)
Trade and other payables	(10,118)	(9,563)	(555)
Other current liabilities	(1,151)	(955)	(196)
Total liabilities	**(105,395)**	**(45,059)**	**(60,336)**
Net liabilities	**(75,087)**	**(14,976)**	**(60,111)**

Source: KPMG analysis of SDS's financial statements 2014-15

Financial position (continued)

The original 2015-16 budget shows a managed budget of £210 million. This included indicative funding of £24.5 million in additional grant-in-aid. £21.6 million of additional funding was confirmed as part of Autumn Budget Review in October 2015. The remaining additional funding may be subject to revision as part of Spring Budget Review.

Financial plans 2015-16

For 2015-16, a managed budget of £210 million was agreed by the Board. This is comprised of £183.5 million core grant-in-aid with a further £24.5 million additional grant-in-aid proposed to be awarded during the Autumn and Spring Budget Reviews. Confirmation of an award of £21.6 million from the Autumn Budget Review was received on 30 October 2015.

Management confirmed that the total additional awards primarily relate to: £6 million in respect of college engagement with the Employability Fund; £6.3 million in respect of Employability Fund allowances; £1.9 million for the ICT Skills Investment Plan; and £4.3 million for the development of Foundation, Advanced and Graduate Apprenticeships, the expansion of Modern Apprenticeship programmes and work to support equality of access following the recommendations of the Commission for Developing Scotland's Young Workforce.

European Social Fund ("ESF") of £2.5 million is also expected to be received from 2015-16.

We have provided further analysis of the movements to derive the 2015-16 budget in the diagram on page 12.

Financial plans 2016-17 onwards

Management has conducted a provisional eight year forecasting exercise to facilitate longer-term strategic planning. The forecasting exercise inherently incorporates a number of assumptions:

- Static grant-in-aid of £183.5 million;
- £12.4 million of enhanced grant-in-aid in respect of Employability Fund allowances;
- £7 million from 2016-17 onwards for initiatives, based on c. £1 million for each initiative;
- £10.9 million of Developing Scotland's Young Workforce funding;
- European Social Fund ("ESF") income of £50 million (total), to be received from 2016/17;
- Annual bank interest of £0.3 million;
- Recurring Strategic Forum savings of £2.4 million; and
- 3.5% uplift on pay costs annually.

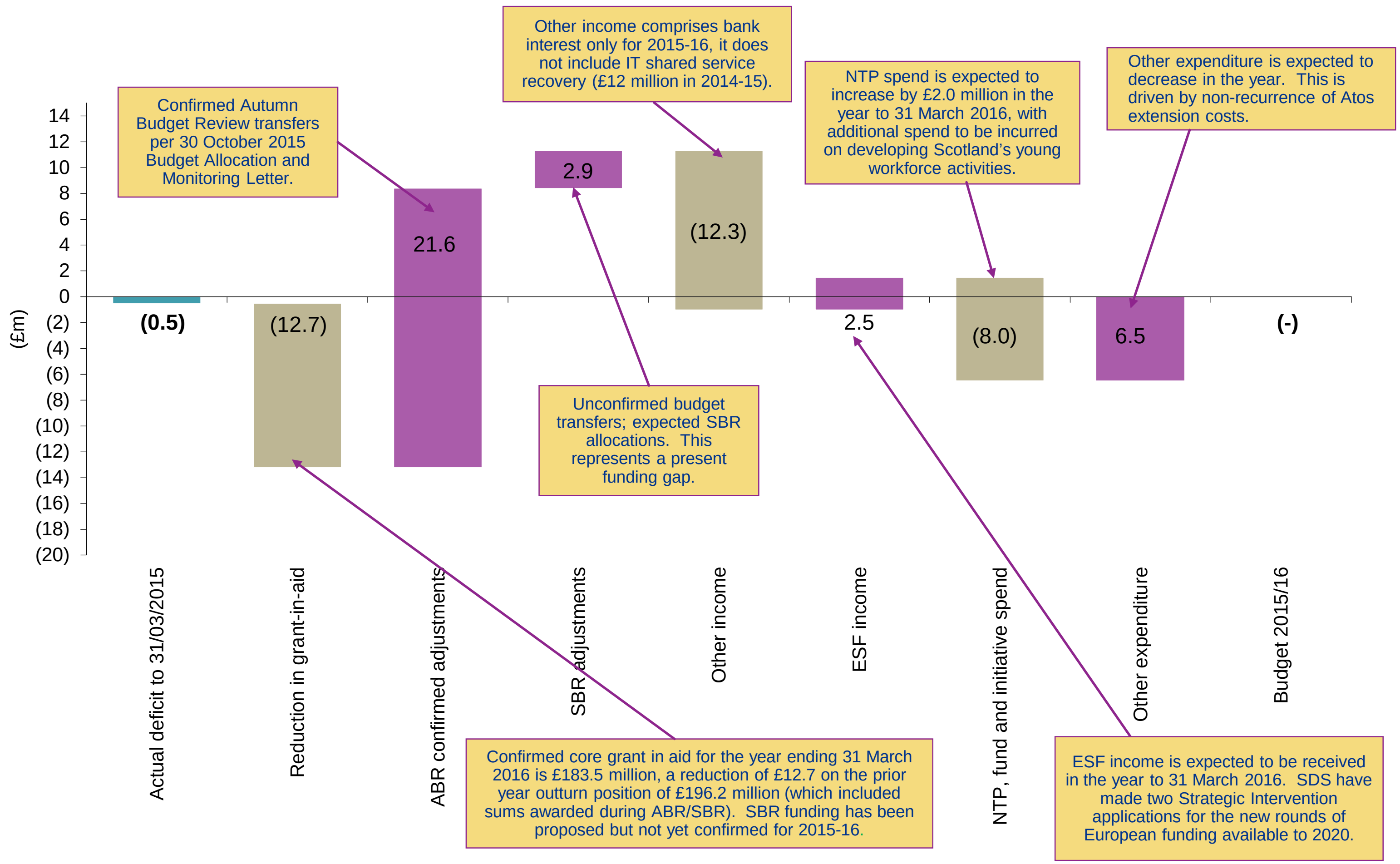
The forecast exercise was undertaken by management to understand the effects of future funding conditions within the public sector environment and will be used as a tool for scenario planning.

Financial position (continued)

The 2015-16 budget published in the annual operating plan assumed a break-even position with decreased core grant-in-aid funding offset by proposed ring-fenced funding. The budget was technically at risk given £24.5 million required funding in addition to core grant-in-aid, although £21.6 million was confirmed on 30 October 2015 as part of the Autumn Business Review. There is £2.9 million required funding which is not yet confirmed.

The 2015-16 budget includes proposed IT spend on Project Apollo.

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



Financial statements and accounting policies

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

Audit conclusions

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

The financial statements, including the governance statement and strategic 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 SDS's affairs as at 31 March 2015, and of SDS's deficit for the year then ended. We also have 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 their reports as issued to audit and risk 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; and
- attended audit and risk 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 strategic report, directors' report, remuneration report and governance statement.
- 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 SDS, 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 SDS'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, strategic report, directors' report, remuneration 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 in the year to 31 March 2015. The compliance team has implemented a number of changes in the year which are designed to ensure that high-risk training providers are reviewed frequently, and that assurance is obtained across all payments made.

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:

- **working capital balances;**
- **pensions; and**
- **national training programme ('NTP') expenditure and compliance.**

A further significant risk relating to cut-off of expenditure was identified during planning for final audit procedures.

We summarise below the risks of material misstatement as reported within the audit strategy document along with additional risks identified during the course of 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 risk 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
Expenditure cut-off at 31 March 2015 Arising from pre-audit discussions with management, we considered there to be a significant risk over the recognition of expenditure in the year to 31 March 2015 due to: ■ increased budget pressures as a result of reduced funding and committed annual targets for NTPs; ■ the receipt of £3.0 million of funding close to the year end within grant in aid in respect of the Developing Scotland's Young Workforce funds; and ■ the delay to the IT transition programme and subsequent reduction of planned spend. There is an inherent risk that management could incorrectly recognise, or defer spend, in order to meet the requirement of achieving a breakeven position at year end.	Cut-off testing was performed, agreeing balances to third party evidence to verify that expenditure is recorded in the correct financial year. A search for unrecorded liabilities was completed, agreeing amounts presented in the bank statements post year to third party evidence. Expenditure (and income) on the existing IT contract was agreed to third party evidence to verify the amounts presented as expenditure and income related to the 2014-15 financial year. Sample prepayments and accrued income were vouched to invoices to verify they related to the 2015-16 financial year. For grants relating to the Developing Scotland's Young Workforce, with expenditure split over the two financial years, we agreed amounts to third party evidence on a sample basis, we recalculated the split between expenditure and prepayments.	No exceptions were noted from the testing performed. In respect of the expenditure items noted, we are satisfied that expenditure reported in the financial statements for the year to 31 March 2015 relates to the 2014-15 financial year, and expenditure related to 2015-16 has been deferred in the financial statements.

Significant risks and audit focus areas (continued)

<table>
<tr><th>Audit focus areas</th><th>Our response</th><th>Audit findings</th></tr>
<tr><td>Working capital balances

The outturn for 2013-14 was reflected in the relatively high cash balance. A deficit budget was approved, in conjunction with discussions with Scottish Government, and cash balances are expected to reduce.</td><td>To address this other focus area we performed the following audit work:
We discussed the financial position with management and have narrated our understanding of this in the strategic overview section of this report.
We agreed the year end cash balance to third party confirmations.
We performed corroborating analytical reviews over the trade payables and receivables balances, comparing these to the prior year to confirm reasonableness and to assess the use of working capital in the year.</td><td>The financial statements show a cash balance as at 31 March 2015 of £11.5 million, a reduction of £5.1 million from the prior year.

From the procedures noted, we are satisfied that cash, and other working capital balances presented as at 31 March 2015 are correctly stated in the financial statements.</td></tr>
<tr><td>Retirement benefits

SDS accounts for its participation in the Strathclyde Pension Fund and Highland Council Pension Fund in accordance with IAS 19 Retirement benefits, using a valuation report prepared by actuarial consultants. SDS'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. 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.</td><td>Our audit work consisted of:
KPMG specialists reviewing the financial assumptions underlying actuarial calculations and comparison to our central benchmarks, the result of which are on page 32;
testing the scheme assets and rolled-forward liabilities;
testing the level of contributions used by the actuary to those actually paid during the year;
testing the membership data used by the actuary to data from SDS; and
agreeing actuarial reports to financial statement disclosures.</td><td>We are satisfied that the retirement benefit obligation:
is correctly stated in the balance sheet as at 31 March 2015;
has been accounted for and disclosed correctly in line with IAS19 Retirement benefits; and
assumptions used in calculating this estimate and managements judgements are appropriate and within the acceptable KPMG range.
We set out further information in respect of the defined benefit obligation in appendix three. The defined benefit obligation increased by £59.6 million compared to 31 March 2014, driven by a reduced discount rate and increased mortality assumption.</td></tr>
</table>

Significant risks and audit focus areas (continued)

Audit focus areas	Our response	Audit findings
Accounting for NTP expenditure NTP expenditure comprises the largest element of SDS's spend and there are inherent risks surrounding disclosure and presentation of related creditor balances. In previous years, significant balances were accrued as at 31 March in respect of claims made by training providers. It was anticipated for 2014-15 that cut-off procedures with providers would be formalised to better reflect cash movements and reduce accruals in the year-end financial statements. Cut-off was not formalised as at 31 March 2015 and there is a corresponding accrual of £1.5 million in relation to NTP spend. As a response to irregularities within training providers in 2013-14, management reviewed and updated compliance processes in 2014-15 to provide further comfort over regularity of spend.	We tested the design, implementation and operating effectiveness of the following controls to verify that management had an appropriate control framework over NTP expenditure and the regularity of this spend: ■ visits performed by the compliance team, in line with corporate risk bandings; and ■ assurance testing over payments made to training providers. As part of our final audit procedures, we performed work over clawbacks from training providers in the year to understand the reasons for recovery of funding. The actual clawback was £0.2 million and was predominantly driven by provider failure to retain correct documentation in respect of trainees. Recoveries were made based on sampled NTP spend of £3.8 million. These recoveries tended to relate to NTP providers claiming funds prior to all documentation being formalised. Corroborating analytical reviews were performed over NTP expenditure and related creditors, comparing these amounts to budget and prior year actual expenditure. Cut-off testing was performed, agreeing balances to third party evidence to verify that expenditure had been appropriately recorded in the correct financial year.	The controls were found be designed, implemented and operating effectively. We are satisfied that updates to compliance controls implemented in the year show progress in achieving appropriate enforcement of the terms and conditions of NTP agreements. One recommendation was raised in our interim report in relation to ensuring that providers re-assessed as high risk in the year receive a minimum of two visits. We note that not all high risk providers had received two compliance visits in the year as required by SDS procedures. Implementation of these actions will further assist with achievement of best practice. NTP expenditure recognised in the year has been correctly recognised and presented in the financial statements. The accruals balance in respect of NTPs, of £1.5 million, is significantly reduced from prior years as a result of improved cut-off procedures in the year. We do not consider the identified clawbacks to be indicative of the wider NTP expenditure population, due to the nature of the reasons for clawback.

Accounting policies

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

Accounting framework and application of accounting policies		
Area	**Our response**	**Audit findings**
Accounting policies	■ There have been no changes to adopted accounting policies in the year. ■ Critical accounting judgements continue to relate to the present value of defined benefit obligations under IAS 19 (as calculated by SDS's actuary, Hymans Robertson) using agreed financial assumptions. We considered the appropriateness of these assumptions and the accounting for pensions on page 16.	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.
Going concern	■ The group has net liabilities of £75.1 million as at 31 March 2015 (*2013-14: £15 million*) and the parent company has net liabilities of £80.6 million (*2013-14: £20.5 million*). The increase in net liabilities is due to the deficit for the year and the significant increase in the defined benefit obligation. ■ The directors consider it appropriate to adopt a going concern basis for the preparation of the financial statements for the year ended 31 March 2015. They consider that the core grant in aid of £183.5 million, £21.6 million ABR budget transfer and the available cash balance are sufficient to ensure that SDS is able to meet debts as they fall due. Whilst there is technically some risk in the £2.9 million unconfirmed grant in aid, required to deliver the 2015-16 expenditure budget, discussions with Scottish Government indicate that this will be forthcoming. These circumstances have been disclosed within the financial statements. ■ In respect of the defined benefit obligation: based on the 2014 triennial valuation of the Strathclyde Pension Fund, a deficit repayment of £1.5 million a year from 2015-16 will be required to improve the funding position of liabilities which are currently at 95%, down from 99% as at the last triennial valuation. The full obligation of £94.1 million does not fall due within one year and therefore does not impact on the going concern assumption.	We concur with management's view that the going concern assumption remains appropriate for the reasons noted. 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, although contributions will be increased to improve funding position.

Accounting policies (continued)

Accounting framework and application of accounting policies		
Area	**Our response**	**Audit findings**
Financial reporting framework	▪ SDS prepares financial statements in accordance with the Companies Act 2006 and follows the principles of the Government's Financial Reporting Manual ("FReM"). Management provides the additional disclosures required by the FReM where these go beyond the requirements of the Companies Act 2006. ▪ There have been no changes to the financial reporting framework in the year, other than those required under the first-time adoption of updated consolidation standards. Minor changes were made to the disclosure of compensation payments within the remuneration report, however these have had no impact for SDS. ▪ We have performed a substantive review of the charitable subsidiary, Careers Trust Scotland Limited, as part of our final audit procedures. The results of this testing and an evaluation of continuing consolidation is set out on page 22.	We are satisfied that the accounting policies adopted remain appropriate to SDS, and have been correctly applied.

Management reporting in financial statements

Our testing of the annual report and remuneration report confirms that these are consistent with the financial statements and with required disclosures per the FReM.

Area	Our response	Audit findings
Annual report, including the strategic and directors' reports	The financial statements form part of the annual report of SDS for the year ended 31 March 2015. We 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 minor suggestions relating to how the reports could be enhanced, ensuring that the financial commentary is reflective of the annual results.	We are required to consider the strategic and directors' reports, and provide our opinion on the consistency of it with the financial statements. We are satisfied that the information contained within the strategic and directors' report is consistent with the financial statements.
Remuneration report	The remuneration report was included within the draft financial statements and supported by good quality information and working papers. During the audit it was agreed that a revised report would be prepared by management to better reflect the executive leadership group's structure. There have been a number of changes to the composition of the Board and executive leadership: ■ the co-option of two new Board members in July 2014; ■ a revised structure of the executive leadership group, with lines of responsibility and strategic focus being better defined; and ■ the payment to a third-party for a member of the executive leadership group. We discussed the presentation of the above matters with management, and confirmed that the disclosures made in respect of sums paid to third parties are in accordance with the requirements of the FReM and Companies Act.	We are satisfied that the information contained within the remuneration report is consistent with the underlying records, the financial statements and the structure of the executive leadership group. The changes to the executive leadership group composition as at 31 March 2015 are appropriately explained and, in respect of payments to third parties, the arrangements have been adequately disclosed.

Subsidiaries

We have undertaken an audit of the subsidiary of SDS, Careers Trust Scotland Limited. Our main findings are included for information.

Subsidiary	Our response	Audit findings
Careers Trust Scotland Limited ('CTSL")	CTSL is a registered charitable company with one member, SDS, as at 31 March 2015. The principal activity of the charity is to provide career information and guidance to the people of Scotland and, where appropriate, to provide financial support to projects which are consistent with this aim. We considered IFRS 10 in respect of the consolidation of CTSL. IFRS 10 states that control over an entity exists where an investor holds existing rights which confer the ability to direct activities of the entity. As one of the Trustees of CTSL sits on the executive leadership group of SDS, we continue to consider that control over the entity exists and that CTSL must therefore be consolidated within the SDS financial statements. CTSL held £5.6 million in cash as at 31 March 2015 and there were no other significant transactions in the year. We agreed the cash held at bank to third party evidence. We considered the recommendations raised in Audit Scotland's "Following the Public Pound" report in respect of arms-length bodies. We are satisfied that outwith the Trustees, there is limited non-cash support provided to CTSL and that appropriate accounting records are kept. No income was received from SDS in the year to 31 March 2015. CTSL intend to use all existing resources held within the charity to support innovative approaches to delivering career information in line with the recommendations of the Commission for Developing Scotland's Young Workforce. It is anticipated that these initiatives will focus on raising awareness of science, technology, engineering and mathematics ("STEM") careers and that their delivery will be performed in conjunction with strategic partners from across the commercial and education sectors of Scotland, including SDS. Management has indicated that in future years CTSL may cease to be consolidated into the financial statements of SDS, following the appointment of directors who are independent of SDS's management.	We intend to issue an unqualified audit opinion on the 2014-15 financial statements of CTSL, following their approval by the Trustees in June 2015.

Governance and narrative reporting

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

Update on controls findings from our audit

Corporate governance arrangements

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

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

We raised two low-level recommendations in the interim audit report, in respect of delegated authorities for procurement and planned compliance testing.

Area	Our response	Audit findings
Annual governance statement and governance arrangements	The statement for 2014-15 outlines the corporate governance and risk management arrangements in operation in the financial year. It provides detail on SDS's governance framework, operated internal controls, the work of internal audit, and risk management arrangements and analyses the efficiency and effectiveness of these elements of the framework. SDS is overseen by a Board of directors and its work is supported by five committees which meet regularly : audit and risk; finance and operational; remuneration and human resources; service development; and nominations. Reports from each are presented to the Board for consideration. The Board was strengthened in the year through the co-option of two new Board members from July 2014, in addition to the adoption of three new directors. SDS operates a risk management framework which is compliant with guidance issued by Scottish Ministers. Covalent, a risk information management system, is used to monitor and report on risk on a regular basis to all levels of management and those charged with governance. Risk registers are operated for the organisation as a whole and for individual directorates and are also regularly reviewed. Actions within registers are assigned owners to ensure the accountability of actions to reduce and mitigate risk. SDS's system of internal control is designed to manage risk and is based on a framework of financial regulations, accountability and regular review of financial management information. Internal controls are reviewed annually by management to ensure effective operation of controls over financial, operational and risk management processes. Internal audit provides assurance over the effective management of the internal control framework. Internal audit completed 15 reviews in the year to 31 March 2015, none of which identified significant weaknesses in controls.	We have updated our understanding of the governance framework and documented this though our overall assessment of SDS's risk and control environment. We consider the governance framework and annual governance statement to be appropriate for SDS and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.
Internal controls	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. An ISAE 3402 report on the IT controls at the Atos service centre identified two high grade recommendations which are being considered by management, they did not impact on our audit testing given their nature (user accounts and user access rights) and the results of our consideration of user access at SDS.	Our work concluded that that controls relating to financial systems and procedures are designed appropriately and operating effectively.

Corporate governance arrangements (continued)

Area	Our response	Audit findings
Internal controls (continued)	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. As part of our interim audit report, we raised low-level recommendations in respect of internal controls. These related to: ■ review of appropriateness of delegated authorities listed in the procurement policy; and ■ amendments to planned compliance work in respect of escalated risk bandings in-year. The recommendation in respect of compliance testing was due for implementation by 31 March 2015. We tested a sample of 40 NTP providers, and from this sample 18 were categorised as high risk and in line with SDS's procedures should receive two compliance visits per year. Four of the 18 high risk providers received only one compliance visit in the year. Of the four NTP providers, two had all programmes' expenditure tested, however two only had expenditure on the Employability Fund assured. This was due to the overall materiality of payments made under the Modern Apprenticeship scheme for these two providers. The recommendation in respect of the review and updated of the procurement policy was due to be implemented by 30 June 2015, following the conclusion of our on-site fieldwork and as such no follow-up has been performed. We will consider the implementation of this recommendation as part of the 2015-16 audit.	Since the conclusion of our interim work there have been no changes to the operation of the controls subject to review.
Prevention and detection of fraud	No material fraud or other irregularities were identified during the year and we consider that SDS has appropriate arrangements to prevent and detect fraud both within itself and, through the work of the compliance team, within training providers on a reasonable assurance basis. The arrangements include policies and codes of conduct for staff and board members of SDS, supported by a fraud prevention policy and response plan. Enhanced compliance controls, implemented in 2014-15, include standardised levels of payment assurance testing over training provider claims as well as trainee interviews.	We consider that SDS has appropriate arrangements to prevent and detect fraud.

Corporate governance arrangements (continued)

Area	Our response	Audit findings
Maintaining standards of conduct and the prevention and detection of corruption	SDS has arrangements including policies and codes of conduct for staff and board members, supported by a whistleblowing policy. Board members are responsible for setting the 'tone at the top' and are responsible for abiding by the code of conduct and disclosing interests which may be of importance, material or otherwise, to their work at SDS.	We consider that SDS has appropriate arrangements to prevent and detect inappropriate conduct and corruption.
Internal audit	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. 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. From this assessment, and considering the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*, 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. Internal audit has completed its agreed plan for the year ended 31 March 2015 and the annual report states that *"SDS has a framework of controls in place that provides reasonable assurance regarding the effective and efficient achievement of corporate objectives and the management of key risks."*	We have concluded that the internal audit service operates in accordance with Public Sector Internal Audit Standards. Internal audit has concluded that SDS has a framework which supports management of key risks. The internal audit annual report also states that SDS has arrangements to deliver best value and secure regularity in the organisation's operation.
National Fraud Initiative NFI")	The National Fraud Initiative ("NFI") is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use for uploading data and monitoring matches. Our review of SDS's NFI participation resulted in a satisfactory grading and our findings have been separately reported to Audit Scotland, in accordance with issued guidance.	We consider that SDS has participated appropriately in the NFI process and that all recommended matches have been appropriately investigated in a timely manner.

Performance management

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

Performance management

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

Area	Our response	Audit findings
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. Key performance targets continue to relate to the attainment of government objectives for NTPs; for example achieving 25,000 Modern Apprenticeship starts in the year. Reports on progress against performance targets are regularly discussed at executive level and are presented to each meeting of the Board. This ensures appropriate governance over performance and facilitates the identification of mitigating actions in a timely manner for underperforming areas. Management remains committed to leveraging resources in the best possible way and doing more within decreasing resource settlements . This requires solid financial management and innovative ways of working, embracing technology and service redesign. To consider the controls and processes to support Best Value aims, internal audit has performed reviews in the year to 31 March 2015 over: ■ workforce planning; ■ human resource policies; ■ ICT contract management; and ■ change management. Our consideration of the work of internal audit, as part of our extended control work, did not indicate high risk findings within these areas. The strategic internal audit plan 2013 -16 aims to provide assurance of Best Value through reviews covering corporate, finance, human resources, communications and operations. These reviews will be linked to the Audit Scotland Best Value toolkits, where appropriate.	We consider that SDS has appropriate arrangements to effectively manage performance and achieve Best Value in processes.

Performance management (continued)

Area	Our response	Audit findings
Local response to national studies	Audit Scotland periodically undertakes national studies on topics relevant to the performance of central government bodies. To ensure that added value is secured through the role of Audit Scotland and its appointed auditors, auditors will continue to ensure that audited bodies respond appropriately to reports from Audit Scotland's programme of national performance audits. SDS's finance and audit team review Audit Scotland report outputs on a quarterly basis and seek assurance from service directors that plans are in place to address recommendations, as appropriate. Reports on the implications for SDS from Audit Scotland's national reporting are provided at audit and risk committees throughout the year; this ensures that sector and national issues are identified and that there is appropriate challenge for management in addressing any potential weaknesses in SDS's processes.	We consider that SDS has appropriate arrangements to effectively respond to national studies.
Financial capacity in public bodies	Through the process of feedback through annual audit reports, current issues reports and sector meetings, Audit Scotland identified that overall reductions in staff numbers in public bodies may be affecting the capacity of back-office functions and specifically finance. Audit Scotland 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, however performance of strategic level financial planning could be increased. We note that changes in roles and responsibilities are intended to provide this strategic oversight.	We consider that SDS has appropriate financial capacity to effectively manage the organisation. Financial management could be further improved through the greater strategic level financial plans.

Appendices

Mandatory communications

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

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	There were no audit adjustments required to the draft financial statements which impacted on the net assets or net operating cost for the year.	-
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you. There are no unadjusted audit differences.	-
Confirmation of Independence Letter issued to the Audit and Risk Committee	We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Director and audit staff.	Appendix two
Schedule of Fees Fees charged by KPMG for non-audit services	We have concluded that non-audit fees of £1,500 for the year in respect of corporation tax compliance do not compromise our independence.	Appendix two
Draft management representation letter Proposed draft of letter to be issued by SDS to KPMG	There are no changes to the standard representations required for our audit from last year.	-
Materiality The materiality applied to audit testing.	We assessed materiality based on our knowledge and understanding of SDS's risk profile and financial statements balances. Materiality was determined at £4.3 million; approximately 2% of total expenditure, and is broadly 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. £3.2 million. We report identified errors greater than £215,000 to the audit and risk committee.	

Auditor independence

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

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 SDS and its related entities for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Regular communications
- Internal accountability
- Risk management
- Independent reviews

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the board of directors.

Confirmation of audit independence

We confirm that as of 3 November 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

Defined benefit obligation

In respect of employee benefits, each of the assumptions used to value SDS'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
(94,126)	(34,541)	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the IAS19 pension scheme valuation. Details of key actuarial assumptions are included in the table, along with our commentary.

Assumption	SDS 2013-14	SDS 2014-15	KPMG central	Comment
Discount rate (duration dependent)	4.30%	3.20%	3.21% - 3.36%	Acceptable. The corporate bond yield curve used to calculate the discount rate has been updated from the prior year.
CPI inflation	RPI – 0.8%	RPI – 0.9%	RPI – 1.0%	We consider that the CPI inflation used in calculating the liability is prudent, resulting in a higher liability. Taken into consideration with the net discount rate (below), however, we are comfortable that the assumption is within the acceptable range.
Net discount rate (discount rate – CPI)	1.40 – 1.50%	0.80%	1.02% - 1.05%	Acceptable. SDS's assumption falls within the acceptable range of +/- 0.3%.
Salary growth	1% pa until 31 March 2015; 1.5% above RPI	1% pa until 31 March 2016; 1.0% above RPI	Typically 1.0 – 1.5% above RPI	Acceptable. The assumption is acceptable under IAS19.

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 £59.6 million compared to 2013-14, primarily due to changes in financial assumptions, driven by the decrease in discount rate and changes to demographic assumptions, the latter having been driven by the latest triennial valuation as at 31 March 2014. SDS assumptions are towards the prudent end of KPMG's acceptable range.

Defined benefit obligation (continued)

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 SDS's pension scheme.

	£'000	Deficit / loss	Surplus / gain	Impact	Commentary
	Opening pension scheme deficit			**(34,541)**	The opening IAS19 deficit at 31 March 2014 for the Scheme was £34.5 million (consisting of assets of £200.3 million and defined benefit obligation of £234.8 million).
I & E	Service cost			(11,429)	The Scheme remains open to accrual. The employer's share of the cost of benefits accruing over the year is £11.4 million.
I & E	Net interest			(1,561)	This is the interest on the opening deficit of £34.5 million, adjusted for contributions paid during the period.
Cash	Contributions			7,852	The Company made cash contributions over the year of £7.8 million, which is broadly in line with contributions made last year, allowing for assumed salary increases.
OCI	Actuarial loss – demographic assumptions			(10,193)	There was an actuarial loss on the demographic assumptions of around £10.2 million as a result of the mortality rates increasing by 1.1 to 22.1 for males and 0.2 for females.
OCI	Actuarial loss – financial assumptions			(47,029)	There was an actuarial loss on the financial assumptions of around £47.0 million. This is primarily due to a 1.1% decrease in the discount rate assumption as a result of falls in corporate bond yields. This is broadly what we would expect for a scheme with liabilities of £234.8 million and a duration of 22 years.
OCI	Return on assets			22,873	The return on Plan assets, excluding interest on assets of £8.7million, was £22.9 million.
OCI	Actuarial loss – other experience adjustments			(20,098)	There was an actuarial loss of around £20.1 million, as a result of worse than expected experience between the 2011 and 2014 triennial valuations in respect of mortality, salary growth, and member movements.
	Closing pension scheme deficit			**(94,126)**	The closing IAS19 deficit for the Scheme at 31 March 2015 is £94.1 million (consisting of assets of £237.9 million and defined benefit obligation of £332.0 million).

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

Cash – cash-flow impact

OCI – charged through other comprehensive income

Data analytics

Data analytics supplements existing control and substantive testing.

Data analytics takes mass data sets and analyses them to draw out potential control weaknesses or value for money concerns.

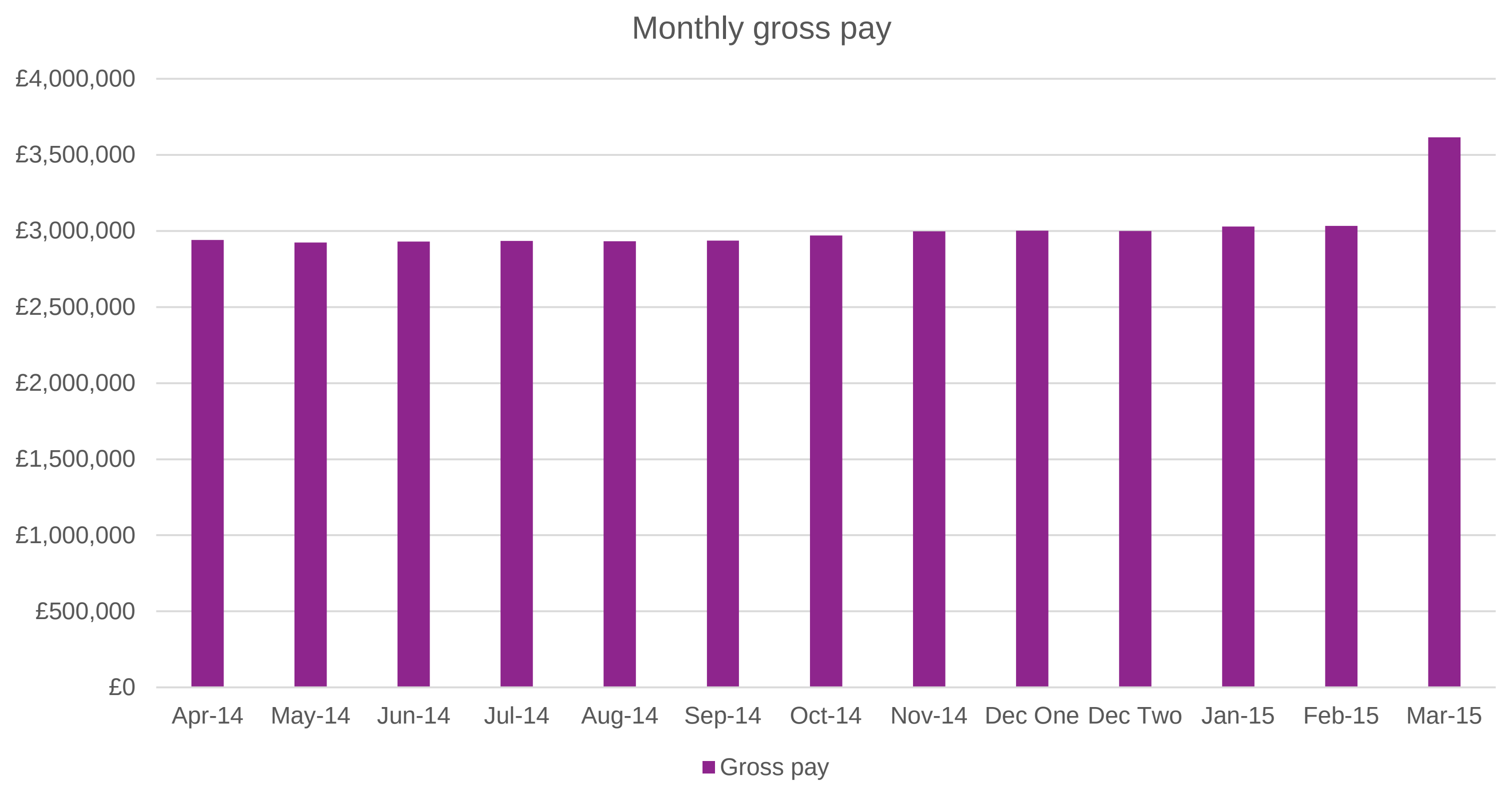
We have used data analytics within our work on:

- **payroll; and**
- **NTP expenditure**

to identify trends and support our conclusions on the balances.

Payroll trend analysis

Analysis of the payments made to staff across the 13 pay periods indicated that pay costs were relatively stable month-on-month. A variance of £0.6 million in March 2015 (representing a 19.21% increase on the previous month) is due to the backpay awards made in March and applied as at 01 October.

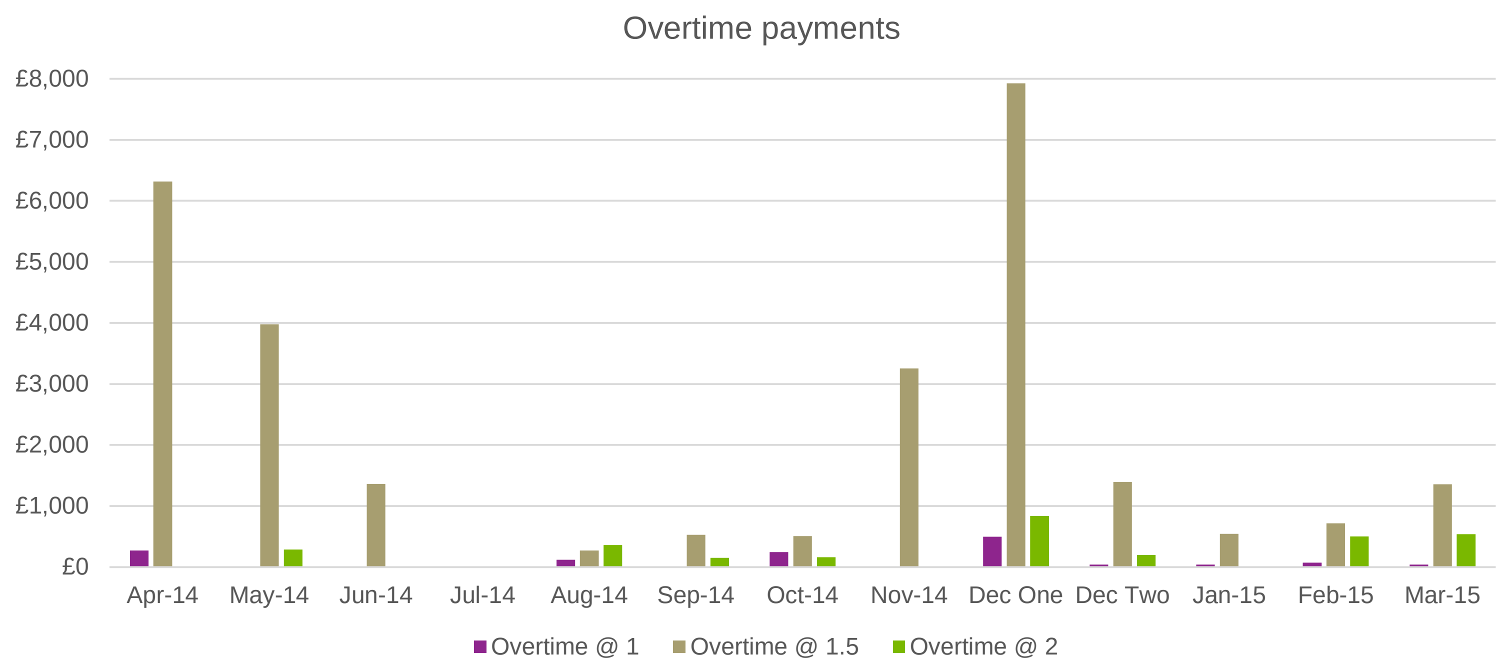


Data analytics (continued)

Overtime trend analysis

0.08% of total gross pay, or £0.03 million, is paid in overtime. Analysis of the overtime payments made indicated that 86.62% of overtime paid is paid at time-and-a half. This is because only Sunday and Bank Holiday working is paid at double time, and part-time employees are only paid at time-and-a half where there working hours exceed 35 hours; up to this point, part time employees are paid at time.

There are four peaks in the year – April, May, November and December – and analysis indicated that the overtime payments in these periods predominantly relate to one directorate, operations, who account for c.91% of overtime in these periods. The overtime in these periods relates to a cold-call exercise undertaken in the evenings by operations staff in order to complete the School Leaver Destination Return. In addition to this national return, SDS complete a similar exercise in January and June. The timing of the publication of these reports correlates directly with the overtime payments made. Overall, £0.03 million is considered to be a low level of overtime worked.



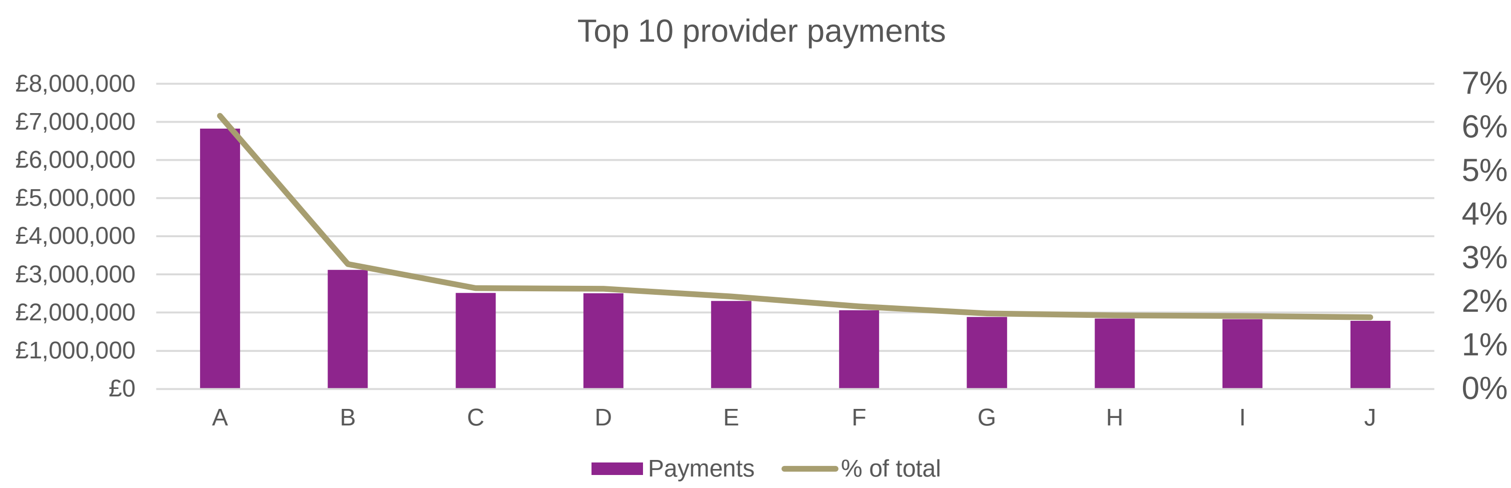
Data analytics (continued)

National Training Programme data

KPMG reviewed data from the Corporate Training System which is used to make payments to providers. Data was analysed to identify the top ten payments made in the year to providers.

Together the providers account for 24.5% of payments made whilst accounting for only 3% of 331 training providers who received payments in the year.

Provider	Payments (£)	% of total CTS payments
A	6,820,588.51	6.26%
B	3,117,459.45	2.86%
C	2,515,035.57	2.31%
D	2,505,196.55	2.30%
E	2,308,408.00	2.12%
F	2,065,419.00	1.89%
G	1,887,728.00	1.73%
H	1,842,663.00	1.69%
I	1,823,021.22	1.67%
J	1,786,264.00	1.64%



Data analytics (continued)

Our data analytics testing also considered full data sets for the year in payroll to provide assurance over the population.

Exception routines were run over data sets to identify duplicates or anomalies which were then discussed with management for review and explanation. The satisfactory conclusion of identified duplicates or exceptions provides comfort that the population as a whole is low risk for fraud or error.

Data population	Exception reporting	Conclusion
Duplicate bank details	■ KPMG obtained gross-to-net reports for all 13 pay periods of the year to 31 March 2015. ■ KPMG identified four instances of duplicate bank details in the year (one duplicate in January, February and March; one further duplicate in March). Investigation with management, and corroboration to change of bank detail forms, satisfactorily explained these exceptions.	Satisfactory.
Duplicate National Insurance details	■ KPMG obtained gross-to-net reports for all 13 pay periods of the year to 31 March 2015. ■ KPMG did not identify any duplicates in the annual population.	Satisfactory.
Leavers	■ KPMG obtained gross-to-net reports for all 13 pay periods of the year to 31 March 2015. ■ Data was processed to identify leavers who had been paid after their departure date. ■ Testing identified 47 instances of leavers having been paid after departure across 11 pay periods in the year: ➢ 26 related to final payments made in the month following departure; ➢ 18 related to backpay awards made in March 2015 and applied from October 2014. KPMG confirmed that leavers had been serving employees in October 2014 but had subsequently left, and therefore that adjustment payments were valid; and ➢ one related to a settlement payment made to an employee after they had left the employ of SDS.	Satisfactory.

cutting through complexity