cutting through complexity

Ayrshire College

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

Audit: year ended 31 July 2016

8 December 2016

Contents

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

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

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

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 (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) 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.

Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Phil Charles, who is the engagement leader for our services to Ayrshire College, telephone 0141 300 5892 or email: phil.charles@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6720 or email to alex.sanderson@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

Executive summary

Executive summary

Audit conclusions		
	■ We expect to issue an unqualified audit opinion on the 2015-16 financial statements of Ayrshire College, following their approval by the Board of Management in December 2016 and receipt of the management representation letter. We intend to issue a qualified audit opinion on the remuneration report.	Page 10
Financial position		
	■ The College reported a deficit of £0.7 million before exceptional costs in the 12 month period to 31 July 2016. After exceptional costs there was a deficit of £2.8 million.	Pages 6 – 8
	■ The College's net assets, before pension liabilities, increased by £5.4 million in 2015-16 to £34.4 million, after both prior and current year FRS 102 adjustments. The revaluation of land and buildings resulted in an increase in the revaluation reserve of £5.7 million.	
	■ Net assets have been negatively impacted from the prior year due to FRS 102 transition adjustments. The College adopted the accruals method of accounting for grant income which involves reallocation of deferred capital grants from reserves into the balance sheet liability.	
	■ The financial statements are prepared on a going concern basis. Income for 2016-17 is budgeted at £41.2 million with an allocation of 125,507 credits. We are satisfied that the going concern basis of preparation for the 2015-16 financial statements remains appropriate.	
Financial statements and related reports		
	■ We have concluded satisfactorily in respect of each of the significant risks and audit focus areas identified in the audit strategy and plan document. There are two corrected audit adjustments (see appendix two). We have no matters to highlight in respect of; unadjusted audit differences, independence and changes to management representations. We concur with management's accounting treatment and judgments.	Pages 10 - 15
Wider scope		
	■ As required by Audit Scotland, we considered the wider scope dimensions and concluded positively in respect of financial sustainability, financial management, value for money and governance and transparency.	Pages 17 - 21
	■ The College is required to present its financial statements under the new SORP 2015, applicable for the first time for the year ending 31 July 2016. The adoption is retrospective and required restatement of the comparative primary statements, supporting notes and the opening reserves.	
	■ We intend to issue an unqualified opinion in respect of regularity of expenditure and receipts shown in the 2015-16 financial statements, following their approval by the Board of Management in December 2016.	

Scope and responsibilities

Purpose of this report

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

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

Accountable officer responsibilities

The Code sets out Ayrshire College’s responsibilities in respect of:

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

Auditor responsibilities

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

Scope

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

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

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

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

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

Financial position

Financial position

Overview

The financial position of the College is reported for the 12 month period to 31 July 2016, with comparatives for the 16 month period to 31 July 2015. The College aims to break-even in resource terms within each Government financial year to 31 March.

The College was allocated a credit target of 125,507 for 2015-16, all of which were delivered. The College continued to operate from the existing campuses in 2015-16 with a move to the new campus in Kilmarnock in October 2016.

Financial position

The College is reporting a deficit for the 12 month period to 31 July 2016 of £2.8 million. The final deficit compares to a budgeted deficit of £0.8 million. The increased deficit is due to exceptional costs being the impairment of land and buildings due to the campus move and exceptional restructuring costs. This compares to a restated deficit of £0.1 million in the previous sixteen month period.

SFC grants have remained in line with budget as expected due to funding being agreed up front. Tuition fee income is slightly ahead of budget. A reclassification between other operating income and other grant income due to FRS 102 was agreed (appendix two).

Full time equivalent staff numbers increased from 750 to 755 in the 12 month period with staff costs remaining broadly in line with budget and incremental pay increases.

Impairments relating to Cumnock, Townholm and Craig campuses have been incurred. Judgment was made in assessing the level of provision to be recognised for dilapidations cost and lease charges on existing campuses. A reflection of the most likely outcome was used to calculate the provision. There is a residual risk that the actual cost is higher than the amount provided for. Appendix seven includes a summary of the campuses and charges.

Income and Expenditure Account

	2015-16 (12 months) Actual £'000	2015-16 (12 months) Budget £'000	2014-15 (16 months) Actual £'000
Income			
Scottish Funding Council Grants	35,336	35,599	47,855
Tuition Fees and Education Contracts	4,596	4,355	5,501
Other Grant Income	341	0	2,676
Other Operating Income	2,526	2,567	3,241
Endowment and Investment income	26	24	41
Total Income	**42,825**	**42,546**	**59,314**
Expenditure			
Staff Costs	(30,411)	(29,695)	(37,964)
Exceptional Restructuring Costs	(677)	(328)	(2,586)
Impairment of Buildings / Asset Write Down	(1,963)	0	0
Other Operating Expenses	(9,213)	(10,729)	(14,437)
Depreciation	(2,488)	(2,560)	(3,396)
Interest and Other Finance Costs	(945)	0	(1,258)
Total Expenditure	**(45,697)**	**(43,311)**	**(59,641)**
Gain on disposal of assets	30		201
Deficit on Continuing Operations after Depreciation of Assets at Valuation and Tax	**(2,842)**	**(767)**	**(126)**

Source: 2015-16 financial statements

Financial position (continued)

Balance Sheet

The College has net assets, excluding pension liability, at 31 July 2016 of £34.7 million (2014-15: net assets of £29.0 million). The key elements of the movement are set out below.

Assets

Tangible assets have increased by £7.8 million, primarily as a result of the revaluation as at 31 July 2016. There was an upward revaluation of £9.5 million on Ayr and Kilwinning campuses. There has also been £1.9 million of impairments in the year on the old Kilmarkock campus as well as Townholm, Cumnock and Craig campuses (appendix seven).

Debtors have decreased significantly by £1.8 million, due to recognition of the amount due from the Ayrshire College Foundation ("ACF") in income in the prior year, on transition to the FRS 102 based SORP (appendix two).

Liabilities

Short term creditors have decreased by £0.6 million, primarily due to transfer of an ESF accrual into provisions (£0.7 million).

Net pension liabilities in respect of participation in the Strathclyde Pension Fund increased by £3.0 million as a result of changes in demographic and financial assumptions in the actuarial valuation.

Deferred capital grants are now recognised on the balance sheet as a result of adopting the accruals method on transition to the FRS 102 based SORP.

Reserves

The income and expenditure reserve has decreased by £3.3 million mainly due to the movement in pension liability. The revaluation reserve has increased by £5.6 million due the revaluation of existing campuses. £8.7 million was taken to the revaluation reserve which was partially offset by impairments of £1.9 million.

Balance sheet

Fixed assets	**31 July 2016 £'000**	**31 July 2015 £'000**
Tangible assets	57,031	49,280
Current assets		
Stocks	34	21
Debtors: Amounts falling due within 1 year	1,069	2,875
Cash at bank and in hand	2,879	2,989
Creditors: Amounts falling due within 1 year	(4,711)	(5,300)
Net current assets	**(729)**	**585**
Creditors: Amounts falling due after 1 year	(8,330)	(9,182)
Deferred capital grants	(9,977)	(9,186)
Provisions for liabilities and charges	(3,582)	(2,443)
Net pensions liability	(13,253)	(10,272)
Net assets including pension liability	**21,160**	**18,782**
Reserves		
Income and expenditure reserve (including pension reserve)	(6,920)	(3,600)
Restricted Reserve	466	466
Capital reserve	-	-
Revaluation reserve	27,614	21,916
Total funds	**21,160**	**18,782**

Source: 2015-16 financial statements

Financial position (continued)

Financial plans 2016-17 and beyond

The approved budget for 2016-17 reflects a deficit of £1.4 million. This comprises £35.9 million of SFC funding, £7.0 million of tuition and other income, £30.4 million of staff costs and £13.9 million other expenditure. It does not include pension costs or credits as these are not known until year end.

The College has target credits of 125,507, consistent with 2015-16.

The College has a long term strategic plan, with financial plans prepared annually for the academic year ahead, however it does not have a long term financial strategy. Funding beyond the next financial year is dependent on the Scottish Government and their budget setting. The budget is generally set in December and will show general movement for SFC funding but will not give detailed allocations for colleges until the following February. As the College has little visibility on its finances as this is set by the SFC, longer term budgets are not able to be prepared.

Going concern

The college had net assets of £21.2 million at 31 July 2016 including the pension liability. This comprises negative unrestricted reserves at 31 July 2016 of £6.9 million. The negative reserves arise following the transfer of the pension reserve into unrestricted reserves on transition to FRS 102. There is a large offsetting revaluation reserve balance which increased by £5.6 million in the year due to the most recent valuation.

The working capital position is continually monitored and cash flow shows a net negative movement in 2016-17 of £0.4 million.

We concur with management's assessment that the going concern basis of preparation remains appropriate.

Conclusion

The College achieved a small deficit in 2015-16 before exceptional costs.

Whilst the College has net negative unrestricted reserves, due to the pension liability, we do not consider that this impacts the ability of the College to continue as a going concern given that pension funding is long term in nature.

We are content that the going concern assumption is appropriate for the College, in light of the matters set out above.

Financial statements and related reports

Audit conclusions

Audit conclusions

Our audit work is complete subject to receipt of management's representations and update of subsequent events. Following approval of the financial statements by the Board we anticipate issuing an unqualified opinion on the truth and fairness of the state of the College's affairs as at 31 July 2016, and of the College's deficit for the period then ended. We also have issued an unqualified opinion on the regularity of transactions within the year. We intend to issue a qualified audit opinion on the remuneration report; see page 15. 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;
- Reviewed internal audit reports as issued to the audit and risk assurance committee to ensure all key risk areas which may be viewed to have an impact on the financial statements have been considered;
- reviewed estimates and accounting judgements made by management and considered these for appropriateness;
- considered the potential effect of fraud on the financial statements through discussions with senior management and internal audit to gain a better understanding of the work performed in relation to prevention and detection of fraud; and
- attended Audit Committee to communicate our findings to those charged with governance, and to update our understanding of the key governance processes.

Financial statements preparation

Overall, good quality working papers and draft financial statements were provided at the start of the audit fieldwork on 3rd October 2016. The performance review, statement of corporate governance and internal control, statement of board of managements responsibilities and remuneration report were received on 28 November 2016 and we suggested minor presentational adjustments to ensure they were in line with guidance.

In advance of our audit fieldwork, we issued a 'prepared by client' request setting out a list of required analyses and supporting documentation. Reflective of the long standing working relationship with you the standard of documentation was good and there was evidence of accountability and ownership of working papers across the finance department.

- Throughout the course of the year we have had regular communication and discussion with the College's finance team to ensure that disclosure within the financial statements were consistent with the requirements of the new SORP, FRS 102 and the FReM.
- There are no significant matters in respect of; (i) auditor independence and non-audit fees; and iii) management representation letter content, as reported in appendix one.
- We consider that management has maintained a robust control environment.

Significant risks and audit focus areas

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

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

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Fraud risk from management override of controls Professional standards require us to communicate the fraud risk from management override of controls as significant. Management is typically in a unique position to perpetrate fraud – there is an ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.	We have not identified any specific additional risks of management override relating to the audit of the College. Our audit methodology incorporates the risk of management override as a significant risk, along with appropriate audit procedures to mitigate such as tests of controls, review of journals and procedures of an unpredictable nature..	We have no changes to the risk or our approach to addressing the assumed ISA risk of fraud in management override of controls. We do not have findings to bring to your attention in relation to these matters. No control overrides were identified.

Significant risks and audit focus areas

Focus areas	Our response	Audit findings
Fraud risk from income recognition Professional standards require us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk. As the majority of the College' income is received via grant-in-aid from the Scottish Funding Council and is agreed in advance of the year, we did not regard the risk of fraud from this revenue recognition as significant. The College's other income streams primarily relate to tuition fees and education contracts, which can be agreed to planned expenditure in the period. The risk of fraud is therefore not considered to be significant. We did however, recognise the appropriate recognition of income as an audit focus area.	Our audit work over income consisted of: ▪ SFC grant income was vouched to receipt and reconciled to the Ayrshire Outcome Agreement. ▪ For tuition fee income we performed predictive analytical procedures and corroborated income which varied from expectation. ▪ For other sources of income we performed analytical procedures and specific item testing over material balances. ▪ In respect of income from donations, we reviewed supporting documentation to confirm the clauses. In all cases, we considered the appropriateness of recognition under FRS 102 and the SORP.	We found that controls around income are operating effectively. One adjustment was required between other operating income and grant income as a result of FRS 102 recognition criteria (appendix two). This adjustment was made by management and we are satisfied that income is recognised appropriately, in the correct financial year and in line with the Code.
Pension liabilities The College accounts for its participation in the Strathclyde Pension Fund ('SPF') in accordance with FRS 102 and therefore recognises the actuarial valuation of the pension liabilities in respect of its share of the SPF. The Funds are valued by actuaries, the rates of contributions being determined by the trustees on the advice of the actuaries. The College'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.	Our audit approach includes: ▪ review of the financial assumptions underlying the actuaries' calculations and comparison to our central benchmarks; ▪ testing of the level of contributions used by the actuary to those actually paid during the year; and ▪ testing of membership data used by the actuary to data from the pension fund We will assess the assumptions for 2015-16 for appropriateness compared to our acceptable ranges, using pension specialists where required. We will also test underlying controls to verify the input data for staff costs and numbers.	We are satisfied that the retirement benefit obligation: ▪ is correctly stated in the balance sheet as at 31 July 2016 and 31 July 2015; ▪ has been accounted for and disclosed correctly in line with FRS 102 and the SORP; and ▪ assumptions used in calculating this estimate and management's judgements are appropriate and within the acceptable KPMG range.

Focus areas	Our response	Audit findings
FRS 102 The new SORP will result in a number of differences in disclosure as well as the requirement for restatement of the comparative primary statements and opening reserves. In addition to significant differences, such as grant income recognition, the SORP brings changes in respect of holiday pay accruals, leases and pension interest cost accounting on transition. The College is required to make a number of accounting policy choices as part of the transition process.	We completed the audit of the transition balance sheet and the audit of comparative primary statements, vouching implementation differences to supporting documentation. This included analysing judgements and estimates made by management. The following work was completed. ▪ The holiday pay accrual was assessed and recalculated and found to be insignificant. ▪ We verified the treatment of a sample of grants and other income to contracts. ▪ We confirmed that government grants had been appropriately recorded using the opted accruals method. This was correctly differentiated from the treatment of non government grants, which are recognised on entitlement to the grants in line with performance conditions. . ▪ The College went through a revaluation of their land and buildings in the current period under FRS 102 regulations, and opted to retain the revaluation reserve, a choice that is permitted under the new SORP. ▪ We reviewed management's assessment of the pension reserve and confirmed that the movement to unrestricted reserves is required per the new SORP. In addition we confirmed that the net interest pension finance cost was included appropriately within the statement of comprehensive income. ▪ We considered the appropriateness of the disclosures, including the transition accounting note, against the recommended Accounts Direction UK model statements as well as British Universities Finance Directors Group financial statements and completed a SORP 2015 disclosure checklist to identify any areas of omission or error.	We are satisfied that: ▪ the financial statements are correctly prepared in compliance with the SORP, Accounts Direction and Audit Scotland published guidance. ▪ the financial statements include all required disclosures as required by these accounting standards and in respect of transition adjustments; and ▪ transition adjustments to comparatives have been appropriately applied.

Focus areas	Our response	Audit findings
Fixed asset accounting Work is expected to conclude on the new £50 million campus at Hill Street in Kilmarnock in July/August 2016. Consideration will be required in respect of the associated accounting treatment of the arrangement depending on when this is finalised and the contract agreed. The build is being constructed with the assistance of the Scottish Futures Trust under a non-profit distributing contract. The land was donated to the College in 2013-14 and is reflected on the balance sheet.	It is expected that the arrangement with the operator will meet the definition of a service concession arrangement and require the associated asset and liability to be recognised by the College in either 2015-16 or 2016-17 depending on when the contract is agreed. We will review the accounting treatment required to bring the new campus at Hill street on to the College's balance sheet, together with the associated liability in respect of payments due to the operator. Additionally, we will consider the arrangement with the Scottish Government / Scottish Funding Council in respect of accounting for their contributions, receivable by the College in respect of the arrangement. This will include review of the mechanism under which proceeds from the sale of the Holehouse Road and Craig campuses, currently held for sale, are repayable to the Scottish Funding Council.	Work is now complete on the new £50 million campus at Hill Street in Kilmarnock however ownership did not transfer before year end, therefore no assessment of the approach to accounting for the asset as at 31 July 2016 has been completed. The build has been constructed with the assistance of the Scottish Futures Trust under a non-profit distributing ("NPD") model. A number of impairments have been made to existing campuses in preparation for the move. A full analysis of each campus and the movements in value in the year is provided in appendix seven. A revaluation took place at 31 July 2016 of remaining campuses which resulted in an upward valuation of £8.7million. Management will need to engage early with successor auditors regarding the proposed accounting treatment in respect of the new campus.

REPORT	SUMMARY OBSERVATIONS	AUDIT CONCLUSION
Performance review	The financial statements form part of the annual report of the College for the period ended 31 July 2016. We reviewed the contents of the annual report against the disclosure requirements and are content with the proposed reports. A performance and accountability report are now required to be included in the annual accounts. These outline the performance overview and the future plans and developments in line with their strategic objectives.	We are satisfied that the information contained within the annual report is consistent with the financial statements. We reviewed the contents of the management commentary against the guidance contained in the Accounts Direction and are content with the proposed report. We provided management with some relatively minor suggestions relating to how the management commentary could be enhanced and where additional information disclosures should be made.
Remuneration Report	The Scottish Funding Council's accounts direction requires the preparation of a remuneration report in accordance with the Government Financial Reporting Manual (FReM), to be included in the financial statements in 2015-16.	We are satisfied that the format of remuneration report is in line with the FReM. We will issue a qualified audit opinion on the remuneration report due to failure to disclose pension information for senior officials.
Statement of Corporate Governance and Internal Control	The statement for 2015-16 outlines the corporate governance and risk management arrangements in operation in the financial year. It provides detail on the College'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.	We consider the governance framework and annual governance statement to be appropriate for the College and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.

Wider Scope

Wider Scope

Audit dimensions introduction

Introduction

The Code of Audit Practice frames the wider scope of our audit in terms of four audit dimensions; financial management, financial sustainability, governance and transparency and value for money. At the centre of these dimensions is Best Value.

It remains the responsibility of the audited body to ensure that they have proper arrangements in place across each of these audit dimensions. These arrangements should be appropriate to the nature of the audited body and the services and functions that it has been created to deliver. We review and come to a conclusion on these proper arrangements.

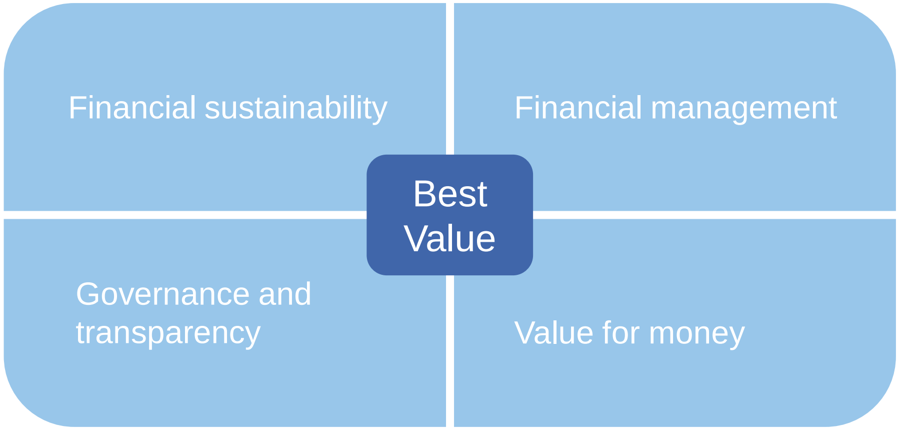
During our work on the audit dimensions we have considered the work carried out by internal audit and other scrutiny bodies to ensure our work meets the proportionate and integrated principles contained within the Code of Audit Practice.

Audit work and conclusions

We summarise over the next few pages the work we have undertaken in the year to obtain assurances over the arrangements in place for each audit dimension and our conclusions on the effectiveness and appropriateness of these arrangements.

The next page sets out those risks we identified during our audit planning stage, any emerging risks during the course of audit work and our overall conclusion on each audit dimension.

Where we have found arrangements to not be effective or are absent we have provided further narrative on the following pages and recommendations for improvement. Where we have found the arrangements to be generally effective and operating as expected we have identified this in the conclusions we have formed.



Wider scope
Financial sustainability

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Reviewing the financial position of the College at 31 July 2016 and future budgets and forecasts. The college made a small surplus before exceptional costs relating to provisions and impairments on fixed assets. There are sufficient reserves to support future operations. We provide further commentary on the financial position on pages six to eight.

Reviewing financial forecasting, financial strategies and key risks over financial sustainability. The Budget for 2016-17 (August 2016 – July 2017) was approved by the Finance Committee on 8 June 2016 and this draft Budget was presented to the Board for their approval on 21 June 2016. The College finance team also has to prepare a budget and outturn information for the 12 month period ended 31 March 2017 to provide information to the SFC who have a March year end. The team prepare quarterly and monthly resource returns based on this reporting period (April – March).

The 2016-17 budget shows a budgeted deficit for the year of £1.4 million, including £1million estimated depreciation on the new Hill Street campus expected to be 'on balance sheet' from August 2016. However there have been a number of known changes since the budget was approved such as the date of entry to the new campus and additional allocation of core grant funding from SFC. This has been adjusted in the management accounts to give an accurate assessment of performance against budget.

Budgets include efficiency savings across services. Management accounts are prepared monthly and approved by EMT. Commentary is given alongside the financial position to explain variances. The approved budget has in built efficiency savings

Regularity

As part of our audit of the College's financial statements, we are required by the Public Finance and Accountability (Scotland) Act 2000 to give an opinion on the regularity of expenditure and receipts shown in the financial statements.

The executive team considers all incoming correspondence relevant to its strategic management role from the Scottish Funding Council and other regulatory or advisory bodies, such as Audit Scotland to ensure it is appropriately aware of sector issues and developments and that it complies with the terms and conditions of funding.

Our review found a strong control environment exists over regularity of expenditure and receipts. No instances of non-compliance with Scottish Funding Council terms and conditions were noted.

Risk management

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

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

Conclusion:

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

Internal controls

The College management is responsible for designing and implementing appropriate internal control systems to ensure a true and fair view of operations within the annual accounts. Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively.

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

Prevention and detection of corruption

The College has arrangements including policies and codes of conduct for staff and board members, supported by a whistleblowing policy. Board members are responsible for setting the 'tone at the top' and for abiding by the code of conduct and disclosing interests which may be of importance – material or otherwise – to their work at the College. We consider these appropriate for the College's purposes to prevent and detect inappropriate conduct and corruption. No material fraud or other irregularities were identified during the year

Our conclusion below is derived from the following audit tests, carried out to determine the effectiveness of the financial management arrangements. This included:

- *Assessing the budget setting and monitoring processes within the College, including the approval of budget changes.* We found these to be robust, with regular accurate reporting and scrutiny by EMT and the board.
- *Review of the College's compliance with SFC funding requirements.* Effective management of cash ensured the College complied with these regulations. We tested payments authorised post year end to ensure they were correctly allocated pre year end if applicable.
- *Consideration of the finance function and financial capacity within the College.* Finance team members have appropriate skills, capacity and capability to support the College,

Conclusion:

The College's finance department has appropriate financial capacity for current operations. Budgetary processes are supported by a strong internal control environment, and no significant control deficiencies were identified. This is supported by regular reporting and scrutiny by senior management and those charged with governance

Wider scope
Audit dimensions (continued)

Value for money

Value for money is concerned with using resources effectively and continually improving services.

We consider value for money and Best Value throughout our testing. Areas where we had a specific focus on value for money and Best Value are:

- *reviewing the procurement policy;* the procurement policy was found to be in line with good practice. The tendering process provides evidence of scrutiny for value for money in the use of resources.
- *reviewing the process of capital expenditure to ensure projects are effectively managed;* additions were tested during our audit work and capital spend is closely monitored by committee with a clear focus on value for money.
- *review regularity procedures*. We are required by the Public Finance and Accountability (Scotland) Act 2000 to give an opinion on the regularity of expenditure and receipts shown in the financial statements. We reviewed regularity of expenditure through our controls and substantive procedures.

Conclusion:

The College has evidenced using its resources for the purposes of enhancing service delivery and ensuring value for money. Our review of expenditure throughout the course of our audit did not identify weaknesses in the control environment over regularity of expenditure and receipts, or instances of non-compliance with Scottish Funding Council terms and conditions.

Governance and transparency

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

In considering governance and transparency we performed the following work:

- *reviewing the organisational structure, governance reporting lines and scrutiny within the College.* The College demonstrates effective scrutiny, challenge and transparency on decision making through various levels of committee reporting reviewed. Decisions are transparent as actions are documented within detailed board minutes which are available to the College website.
- *reading the annual governance statement;* this includes the corporate governance framework, internal controls in operation, work of internal audit and analysis of the efficiency and effectiveness of the elements of the framework. We are satisfied that this is prepared in line with relevant guidance and is consistent with the governance framework; and
- *internal audit engagement.* We reviewed internal audit reports and conclusions, please refer to page 21.

Conclusion:

The College has adopted the code of good governance for Scotland's colleges the governance framework of the College is considered to be appropriate. The corporate governance statement is in accordance with guidance and reflects our understanding of the organisation. Internal audit is compliant with the Public Sector Internal Audit Standards.

Internal audit

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

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

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

Internal audit has completed its agreed plan for the period ended 31 July 2016 and the Annual Report states that Ayrshire College has a framework of controls in place that provides reasonable assurance regarding the effective and efficient achievement of the College's objectives and the management of key risks.

Summary of internal audit work

- Agreed plan completed for the year.
- Five reviews and follow up of prior year recommendations completed.
- Out of a total of 16 findings, there were no 'high' risk findings.
- Annual audit opinion provides reasonable assurance regarding the effective and efficient achievement of the College's objectives and the management of key risks.

Conclusion:

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

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

Appendices

Appendix one
Mandatory communications

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	There were two corrected audit adjustments required to the draft financial statements which impacted on the net assets and net operating cost for the year.	Appendix two
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you. There were no unadjusted audit differences to report.	
Confirmation of Independence Letter issued to the Audit Committee	We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Partner and audit staff.	Appendix three
Schedule of Fees Fees charged by KPMG for non-audit services	KPMG did not provide any non-audit services to the College in 2015-16	Appendix three
Draft management representation letter Proposed draft of letter to be issued by the College to KPMG	There are no changes to the standard representations required for our audit from last year.	
Materiality The materiality applied to audit testing.	We assessed materiality based on our knowledge and understanding of the College's risk profile and financial statements balances. Materiality was determined at £600,000; approximately 1.4% of total expenditure, and is consistent with the materiality identified in our audit strategy. We designed our audit procedures to detect errors at a lower level of precision, i.e. £450,000. We report identified errors greater than £30,000 to the audit committee.	

Adjusted audit differences

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

		Balance sheet £'000		Income and expenditure £'000	
Nature of adjustment	**Caption**	**DR**	**CR**	**DR**	**CR**
Corrected *Under FRS 102, non government expenditure is shown in the period the grant becomes available and so the results of 2014-15 have been restated to include income from ACF which has been agreed but not spent. Expenditure on certain assets has been capitalised as having future benefit to the college rather than being expensed as repairs / refurbishment.*					
Prior year adjustment to recognise ACF grant income in 2014-15	Other grants	-	-	-	1,800
	Accrued income	1,800	-	-	-
Effect on 2015-16 from prior year adjustment	Other operating income			1,800	
	Accrued income		1,800		
Current year adjustment	Revaluation reserve	1,800			
	Other operating income				1,800
Net impact			1,800	1,800	

Appendix two
Audit differences (continued)

Nature of adjustment	Caption	DR	CR	DR	CR
Corrected					
One asset was sold in the year and the gain on disposal incorrectly presented gross of the revalued amount. This would increase the deficit for the year but has no net effect on total comprehensive income. Proceeds were al disclosed as 'before exceptional' and should have been included as 'exceptional'.	Gain on disposal of fixed assets		-	375	-
	Disposal of properties in revaluation reserve	-		-	375
Net impact		-	-	-	-

Appendix three
Auditor independence

To the audit committee members

Assessment of our objectivity and independence as auditor of Ayrshire College (the College)

Professional ethical standards require us to provide to you at the conclusion of the 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 and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

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 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
- Communications
- Internal accountability
- Risk management
- Independent reviews

We are satisfied that our general procedures support our independence and objectivity except for those detailed below where additional safeguards are in place.

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the College.

Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the audit partner and audit staff is not impaired.

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

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully

KPMG LLP

Appendix four
Defined benefit obligations

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

Defined benefit pension liability					
2016 £'000	**2015 £'000**	**KPMG comment**			
(13,253)	(10,272)	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the FRS 102 pension scheme valuation. Details of key actuarial assumptions are included in the table, along with our commentary.			
	Assumption		**Ayrshire College**	**KPMG central**	**Comment**
	Discount rate (duration dependent)		Less than 17 years: 2.4% Between 17 and 23 years: 2.4% More than 23 years: 2.5%	17 years : 2.3% 20 years: 2.4% 23 years: 2.38%	Acceptable. The proposed discount rates are within an acceptable range of KPMG's central rates as at 31 July 2016.
	CPI inflation		RPI less 1.0%	RPI less 1.0%	Acceptable. KPMG's view is that the differential between RPI and CPI should be around 1%. Same assumption used.
	Net discount rate (discount rate – CPI)		0.5% - 0.6%	0.35%	Acceptable. The proposed assumptions are within the acceptable range of +/- 0.3% from the KPMG central range.
	Salary growth		In line with most recent actuarial valuation	Typically 0% - 1.5% above inflation	Acceptable. The proposed assumption is consistent with the latest valuation
		The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of more than 23 years. The closing deficit increased by £3.0 million compared to 2014-15, primarily due to changes to actuarial assumptions, including a decrease in the real discount rate and increased life expectancies. .			

Priority rating for recommendations		
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.
Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Journals exception reporting		**Grade three**
Journals are subject to high level review by the Head of Finance. Journals posted by the Head of Finance are not subject to secondary review. To mitigate the risk of journal posting errors being undetected, review controls should be strengthened.	Exception reports should be run quarterly to identify journals with higher risk of fraud or error, for example those posted on weekends, to cash, or with rounded amounts. Unusual journals should be reviewed to confirm their accuracy and appropriateness.	**Responsible officer:** Head of Finance **Implementation date:** 2015-2016 Management considered this recommendation however after review of the reports which the ledger produce it was concluded that a meaningful control could not be implemented in this area.
2 HR policies		**Grade three**
It was noted during the course of the audit that individual HR policies for the predecessor colleges have not been aligned for Ayrshire College. There is a risk that the HR policies are no longer appropriate for the new staffing structure of Ayrshire College.	Management should ensure HR policies are updated for the new Ayrshire College structure	**Responsible officer:** Director of HR **Implementation date:** 2015-2016 A review of HR polices has taken place and while this work is still ongoing, progress has been made in updating the policies and we consider the recommendation to have been implemented.

Appendix six
Action Plan

Priority rating for recommendations		
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.
Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Fixed asset register		**Grade three**
During the audit we became aware there are some assets on the fixed asset register which are now fully depreciated. There is a risk fully depreciated items are still held and should be removed from the fixed asset register.	We recommend on completion of the campus move, a review of all equipment and fixtures and fittings is conducted to identify any fully depreciated assets on the fixed asset register.	**Responsible Officer:** Head of Financial Services **Implementation Date:** 2016-17 **Management Response**; Agreed. A review will be undertaken to ensure any fully depreciated assets are identified.

Appendix seven
Summary of Campuses

Campus	NBV before revaluation	Valuation as at 31 July 2016	Ownership	Impairment cost in 2015-16	Dilapidation Provision cost in 2015-16	Future lease costs provision
Ayr – Dam Park	£9,489,723	£10,441,000	100% owned	n/a	n/a	n/a
Ayr – Riverside	£11,129,905	£16,226,000	100% owned	n/a	n/a	n/a
Ayr - Aeronautical	£2,567,038	£3,466,000	100% owned	n/a	n/a	n/a
Kilmarnock – Hill street	£800,000	£820,000	100% owned	n/a	n/a	n/a
Kilwnning – Main building	£17,055,268	£17,776,000	PFI	n/a	n/a	n/a
Kilwnning – Nursery	£90,321	£88,000	PFI	n/a	n/a	n/a
Kilmarnock – Holehouse Road	£3,377,000	£3,377,000 – not revalued by Gerald Eve	100% owned	n/a	n/a	n/a
Ayr - Cumnock	£25,000	£25,000 - not revalued by Gerald Eve	Part owned part leased	£364,362	£436,643	£115,000
Kilmarnock - Saltcoats	£151,000	£151,000 - not revalued by Gerald Eve	100% owned	n/a	n/a	n/a
Kilmarnock - Townholm	£0	£0 - not revalued by Gerald Eve	Leasehold	£279,588	£256,875	£350,000
Kilmarnock - Craig	£42,000	£42,000 -not revalued by Gerald Eve	100% owned	£158,212	n/a	n/a
Ayr – Car Park	£218,302	£218,302 -not revalued by Gerald Eve	Leasehold	n/a	n/a	n/a
Nethermains	£0	£0 -not revalued by Gerald Eve	Leasehold	n/a	£2,500	n/a
Irvine Royal	£619,802	£619,802 -not revalued by Gerald Eve	Leasehold	n/a	n/a	n/a
				£802,162	***£696,018***	***£465,000***
			Total Impairment / provisions	**£1,963,180**		

cutting through complexity

The contacts at KPMG in connection with this report are:

Phil Charles

Partner

Tel: 0131 527 6682

phil.charles@kpmg.co.uk

Michael Wilkie

Senior Manager

Tel: 0141 300 5890

michael.wilkie@kpmg.co.uk

Fiona Bennett

Assistant Manager

Tel: 0141 228 4229

fiona.bennett@kpmg.co.uk