Edinburgh College

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

For the year ended 31 July 2016

14 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 Edinburgh College ("the College") and is made available to Audit Scotland and the Auditor General (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 Hugh Harvie, who is the engagement leader for our services to Edinburgh College, , telephone 0131 527 6682, email: hugh.harvie@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 financial statements for Edinburgh College ('The College').	Page 10
Financial position		
●	■ The College has reported a deficit of £7 million for the year. Additional support has been received from The Scottish Funding Council ("SFC") during the year in order to achieve financial balance.	Page 6
●	■ A three year transformation plan has been put in place which is designed to address the future financial sustainability of the College. The key elements of this encompass curriculum, workforce and student recruitment and retention. The success of the plan is dependent upon a number of matters, notably a curriculum review from which details of required changes to both workforce and estates will be identified and have to be actioned. The financial benefits of the plan come almost exclusively from a reduction in staff costs and without the ability to make targeted redundancies there is a risk savings and consequently financial sustainability will not be achieved.	Page 8
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. We concur with management's accounting treatment and judgements. We have no matters to highlight in respect of: adjusted and unadjusted audit differences; independence; and changes to management representations.	Pages 10-17
●	■ In order to support the going concern assertion in preparing the financial statements, management has sought and received confirmation of continuing support from SFC.	
Wider scope		
●	■ In the context of recurring difficulties in delivering the credit target the College has been unable to deliver on its budget in either 2014-15 or 2015-16. There is a transformation plan in place to address this and other issues in the College. As it is relatively early in the implementation phase of this plan it is too soon to conclude on whether this will be successful. Delivery of credits in 2016-17 is currently behind budget, however actions have been taken to address this. The financial effect of the under delivery has been partially offset by higher than anticipated savings realised by the first phase of voluntary severance.	Pages 19-22

Purpose of this report

The Auditor General for Scotland ("the Auditor General") has appointed KPMG LLP as auditor of Edinburgh College under the Public Finance and Accountability (Scotland) Act 2000 ("the Act"). The period of appointment is 2011-12 to 2015-16, inclusive.

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at Edinburgh College and the Auditor General. The scope and nature of our audit were set out in our audit strategy document which was presented to the Audit and Risk Assurance Committee at the outset of our audit.

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 Edinburgh College's responsibilities in respect of:

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

Auditor responsibilities

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code. Appendix five sets out how we have met each of the responsibilities set out in 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. Management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems.

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

SECTION 2

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 initial annual students credit target of 200,258 for 2015/16 was identified as being unlikely to be achieved and agreement was reached with SFC that this would be reduced to 186,258. The £2.8 million of grant funding related to this 14,000 credit shortfall was withheld by SFC. Subsequently the College delivered a total of 180,144 credits. This credits shortfall is a result of student numbers being lower than anticipated. Despite this shortfall SFC have not reduced funding for 2015-16 (which has been paid based on 186,258 credits). This funding, which amounts to £1.2 million, has been confirmed by SFC as having been clawed back and but has been reissued to the college as transformation funding which will not be subject to clawback.

Financial position

The College reports a deficit for the 12 month period to 31 July 2016 of £7.0 million. This compares to the deficit of £5.6 million in the previous 16 month period and a budgeted deficit for 2015-16 of £600,000, before FRS 102 pension adjustments. This can be further analysed as follows:

- Total income for the financial year 2015-16 at £64.4 million, was below expectation due to the College not achieving anticipated student numbers and the associated credit reduction by £2.8 million, and smaller reductions in SAAS, other tuition and commercial income.
- Total expenditure for the financial year 2015-16 was £71.5 million. The key movements were due to efficiencies being achieved in respect of other operating expenses through tighter cost control procedures being put in place; offset by an increase in staff costs brought about by national pay bargaining-related pay rises, and increases in national insurance and pension contributions. The national pay bargaining resulted in a 1% rise for lecturing and support staff as well as agreed one off payments to align with other institutions across the sector.

Exceptional staff costs of £1.1 million relate to approved voluntary severance packages confirmed during the year. A total of 41 (including 8 due to Senior Management Group restructure, which have not been funded by SFC) voluntary redundancies were agreed which follows on from the voluntary severance schemes in the prior year which resulted in over 90 redundancies. The Scottish Funding Council has provided funding to contribute to the costs of severance incurred by Edinburgh College. The scheme has been carried out in accordance with SFC guidance.

Statement of Comprehensive Income	12 months 2016 £'000	16 months 2015 £'000
Scottish Funding Council Grants	47,922	68,349
Tuition Fees and Education Contracts	10,838	14,522
Other Grant Income	1,493	1,953
Other Operating Income	4,180	5,270
Endowment and Investment Income	11	27
Total Income	**64,444**	**90,121**
Staff Costs – Recurring	46,890	59,936
Other Staff Costs – Exceptional	1,141	1,915
Other Operating Expenses	15,906	24,850
Depreciation	5,997	7,685
Interest and other Finance Costs	1,545	1,937
Gain on Revaluation of Assets	-	(576)
Total Expenditure	**71,479**	95,747
Deficit for the year	(7,035)	(5,626)
Unrealised surplus on revaluation of land and buildings	-	738
Actuarial loss in respect of pension schemes	(249)	(5,504)
Total Comprehensive income for the year	**(7,284)**	**(10,392)**

Source: 2015-16 financial statements

Financial position (continued)

Balance sheet

The College had net assets (including pension liability) at 31 July 2016 of £43.0 million (31 July 2015: net assets of £50.2 million).

Assets

The decrease in the carrying value of tangible assets of £5.3 million relates to £0.7 million of additions, offset by a £6 million depreciation charge. The revaluation model for land and buildings was applied in the prior year with a full revaluation being performed. A revaluation was not performed in the current year as the carrying value was deemed to be a reasonable approximation of fair value as at 31 July 2016.

Debtors have decreased by £1.2 million which is primarily driven by a decrease of £0.8 million in prepayments and accrued income. Around £0.5 million of the decrease is due to a reduction in amounts due from SFC as a capital grant was outstanding at the prior period end. The remainder of the decrease is due to the timing of invoicing.

Liabilities

Long term creditors have decreased by £3.9 million due largely to a £0.8 million Lennartz VAT repayment and a net release of deferred capital grants of £2.7 million during the year. In 2014-15 a grant creditor of £0.8 million reflected the credits in relation to additionality which at the time of finalisation of those financial statements were expected to be clawed back.

Net pension liabilities in respect of participation in the Lothian Pension Fund increased by £2.1 million this year as a result of changes in demographic and financial assumptions.

Reserves

The overall reserves position has worsened by £7.3 million this year due to the current year deficit of £7 million and the actuarial loss on the Lothian Pension Scheme of £0.3 million.

Balance sheet

	2016 £'000	2015 £'000
Fixed assets		
Tangible assets	150,179	155,436
Current assets		
Stocks	122	137
Debtors: Amounts falling due within 1 year	2,645	3,853
Cash	1,991	3,111
Creditors: Amounts falling due within 1 year	(12,097)	(10,649)
Net current (liabilities)	**(7,339)**	**(3,548)**
Creditors: Amounts falling due after 1 year	(69,507)	(73,383)
Provisions for liabilities and charges	(5,074)	(5,040)
Net pensions liability	(25,294)	(23,216)
Net assets including pension liability	**42,965**	**50,249**
Reserves		
Income and expenditure reserve	14,824	21,485
Revaluation reserve	28,141	28,764
Total funds	**42,965**	**50,249**

Source: KPMG analysis of Edinburgh College financial statements 2015-16

Financial position (continued)

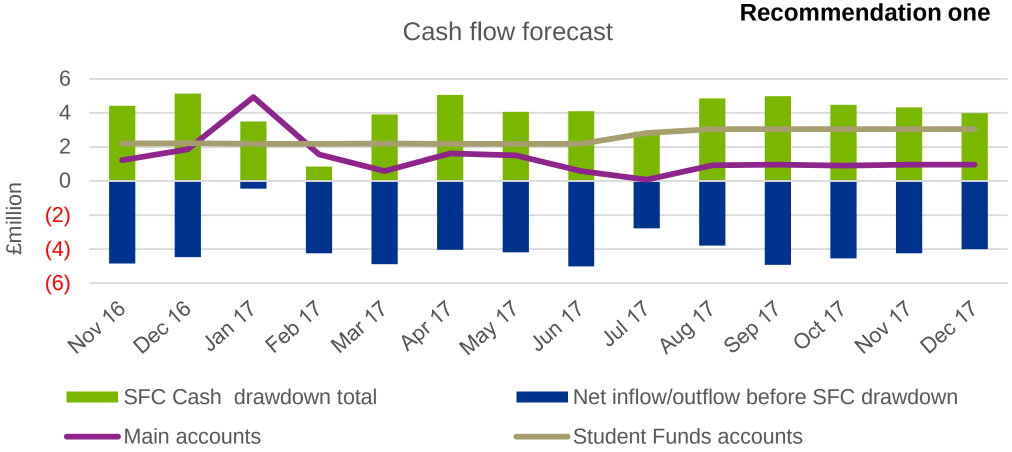
Going concern

The financial statements show the College has net current liabilities of £7.3 million as at 31 July 2016 and as such, without the commitment of support from SFC will be unable to meet its liabilities as they fall due. In order to understand the level of support required management has prepared detailed cash flow forecasts covering the period to December 2017. These indicate that available cash balances at various point throughout that period are very low, with March and July 2017 showing available cash of less than £600,000 and £100,000 respectively.

SFC support

With forecast cash balances at these levels all assumptions made in the cash flow forecasts become critical. Any reasonable adverse movements in student numbers, impacting credits, or international and commercial income in the period between now and March could result in the College having insufficient cash to pay its liabilities as they fall due. Adverse movements in forecast costs would have the same impact.

Recommendation one



Management have approached the SFC with a view to seeking support through the period until the full impact of the transformational plan takes effect, when an anticipated increase in income and reduction in costs from current levels should bring the College back into financial balance. Already included within the forecasts is receipt of £2.9 million of cash advance funding committed by SFC. A summary of the funding provided in 2015-16 and available to support to deliver the transformation plan in 2016-17 and 2017-18 is set out below:

SFC additional support

Nature of support	Value £ million	Timing of receipt	Subject to future clawback
Additional transformation Funding	1.1	2015-16	No
Additional transformation Funding	0.8	2015-16	No
Voluntary severance 1	0.65	2015-16	No
Total 15/16	**2.55**		
Cash advance funding	2.9	2016-17	Yes
Voluntary severance 2	0.6	2016-17	No
Voluntary severance 3 (not yet confirmed)	1.8	2016-17	No
Total 16/17	**5.3**		
Voluntary severance (not yet confirmed)	0.25	2017-18	No
Total 17/18	**0.25**		
Total	**8.10**		

The college will require the additional support of its funding body, the Scottish Funding Council, in order to meet its liabilities as they fall due. Specifically the Scottish Funding Council has provided a commitment of funding of £2.9 million to support the implementation of the transformation plan, repayable at some point in the future which will be determined at a later date, and up to £2.4 million to meet the costs of making voluntary severances. The Scottish Funding Council has provided written assurances that it will support the College during the period through to 2018/19 and until the transformation plan is fully implemented and, provided the College can demonstrate satisfactory progress against its transformation plan, provide such funding as is required to enable it to remain a viable organisation.

Financial position (continued)

Transformation plan 2017-18 onwards:

The future sustainable delivery of the curriculum plan is predicated on the successful delivery of the transformation plan focused on four interlinked programmes:

- financial sustainability;
- curriculum relevance;
- workforce development; and
- student recruitment and retention.

The College and SFC jointly commissioned a review of progress of the transition plan to be undertaken by the internal auditor. Twelve actions were identified including the need for clear alignment of the transformation to the strategy and outcome agreement. One action is fully implemented with the remaining actions being on track to be completed within agreed timescales.

The College has prepared a detailed plan which budgets for income (excluding transformation support) to remain largely constant at circa £64.5 million over the periods to 2018-19. Over the same period expenditure (excluding transformation costs) is budgeted to fall to £64.0 million returning the College to a surplus position. The greatest savings are planned to be realised in staffing where costs are anticipated to be reduced by £3.6 million. This change is to be achieved through three voluntary severance schemes as noted in Section 4 of this report. As demonstrated on page 8, SFC have committed to providing further funding of up to £2.9 million in 2016-17 to assist the College in realising these savings and, subject to the availability of funds and compliance of conditions of grant, up to £2.4 million to meet the costs of making voluntary severances. The timing of repayment of the £2.9 million will be determined at a later date.

The third, and most significant, element of the voluntary severance scheme will take place following conclusion of the curriculum review, when it is anticipated the academic workforce will be reduced in size. However, given that, in accordance with Scottish Government Public Sector Pay Policy 2016-17, there continues the expectation that all severance should be made on a voluntary basis, the College cannot specifically target roles with the academic workforce which may be identified as redundant. The College therefore faces a significant challenge in making the identified savings, which will ultimately impact its financial sustainability.

Financial statements and related reports

Audit conclusions

Audit opinion
Our audit work is substantially complete subject to receipt of management representations and an update for subsequent events. Following approval of the annual financial statements by the Board of Management, we expect to issue 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 year then ended. We also expect to issue an unqualified opinion on the regularity of transactions within the year and the remuneration report. There are no matters identified on which we are required to report by exception.
Financial reporting framework, legislation and other reporting requirements
The College is required to prepare its financial statements in accordance with Financial Reporting Standard ("FRS") 102 and the Accounting for Further and Higher Education Statement of Recommended Practice 2015 (the "SORP"). It must also apply the Financial Reporting Manual 2015-16 (the "FReM"), although the SORP takes precedence where there is a direct conflict. Additional disclosures are required in accordance with the 2015-16 Accounts Direction for Scotland's Colleges and Universities (the "Accounts Direction"). Our audit confirmed that the financial statements have been prepared in accordance with the SORP and relevant legislation.
Regularity
Our audit work, as outlined on the following pages, concluded that in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.
Statutory reports
The Auditor General raised a Section 22 report in relation to the 2014-15 financial performance of the College. This has continued to be debated at the Public Audit and Post Legislative Scrutiny Committee and the matter has not yet been formally closed. The Auditor General will consider the need for a statutory report following receipt of the financial statements and auditors annual report.
Other communications
We did not encounter any significant difficulties during the audit. There were no other significant matters arising from the audit that were discussed, or subject to correspondence with management that have not been included within this report. There are no other matters arising from the audit, that, in our professional judgement, are significant to the oversight of the financial reporting process.
Audit misstatements
There were no audit adjustments required to the draft annual accounts and there are no unadjusted audit differences.
Written representations
We require a specific representation this year on the key assumptions applied in the preparation of the cash flow forecast which underpins your going concern assessment.

Context of our audit

Materiality

We summarised our approach to materiality in our audit strategy. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that our planning materiality for 2015-16 of £1,072,000 remains appropriate. We report all misstatements greater than £54,000.

Forming our opinions and conclusions

In gathering the evidence for our opinion and conclusions we have:

- performed controls testing and substantive procedures to ensure that key risks to the annual accounts have been covered and that the regularity of income and expenditure was in accordance with regulations;
- Reviewed the 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 annual accounts have been considered;
- reviewed estimates and accounting judgements made by management and considered these for appropriateness; and
- considered the potential effect of fraud on the annual accounts through discussions with senior management to gain a better understanding of the work performed in relation to prevention and detection of fraud.

Financial statements preparation

High quality working papers and draft financial statements were provided at the start of the audit fieldwork on 20 September 2016. The performance report and accountability report (including corporate governance report and remuneration and staff report) were received after the audit fieldwork visit. Towards the end of our fieldwork we requested additional analysis in relation to cash flow forecasts which was received timeously.

Significant risks and other focus areas in relation to the audit of the financial statements

We summarise below the risks of material misstatement as reported within the audit strategy. 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.

Significant risks:

- management override of controls fraud risk;
- fraud risk from income recognition;
- adoption of the FRS 102 based SORP; and
- going concern.

Other focus areas:

- pension liabilities.

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. Two control deficiencies have been identified and are detailed at Appendix Two.

Significant risks

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.	Our audit methodology incorporated management override of controls as a default significant risk. We did not identify any specific additional risks of management override as part of the audit of the College. In line with our methodology, we carried out appropriate controls testing and substantive procedures, including testing over journal entries, accounting estimates and significant transactions that are outside the organisation's normal course of business, or are otherwise unusual.	We found no significant instances of management override of controls from our audit testing. There is further scope for improvement in the control environment related to segregation of duties of raising and authorising purchase orders. **Recommendation two**
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 have not previously regarded the risk of fraud from this revenue recognition as significant. However, due to the prior year under performance against WSUMS target and the shortfall in achieving the 2015-16 credit target which was agreed with SFC, we consider the risk of fraud of revenue recognition to be 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 in these areas is therefore not considered to be significant although the recognition of this income continues to be an audit focus area.	Our audit work over income consisted of: ▪ SFC grant income was vouched to receipt and reconciled to the SFC budget and funding allocation, including consideration of the extent of additionality claimed; ▪ the credits obtained were verified to the independently audited FES return; ▪ 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; and ▪ In all cases, we considered the appropriateness of recognition under the SORP and FRS 102.	The key findings from our audit work are: ▪ we did not identify instances of fraudulent revenue recognition; ▪ we did not identify any claims for additionality have been made for additionality which have not received the approval of the SFC; and ▪ we are satisfied that income is appropriately recognised within the financial statements.

Significant risks

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Going concern In 2015-16 forecast credits to be delivered were reduced by 14,000 to 186,258. This reduction translated into around £2.8 million of SFC grants. There was an under achievement against the revised credit targets with 180,144 being delivered in the year. This shortfall had a value of £1.2 million in SFC grants. Further detail on this matter is contained in Section 2. SFC has confirmed this £1.2 million can be retained, with no subsequent clawback. In addition £2.9 million of additional funding has been committed by SFC, to be received in 2016/17. Net current liabilities as at 31 July 2016 amount to £7.3 million indicating the College is unable to meet its liabilities as they fall due Cash flow forecasts prepared by management indicate that headroom on available cash will be very tight during 2017 with March and July being months where cash balances are below £600,000 and £100,000 respectively. This indicates a significant risk in relation to the going concern assertion in preparing the financial statements.	We have examined and challenged the forecast cash flows prepared by management. Our work indicated that reasonable downside assumptions applied to forecast income and expenditure would result in the College running out of cash. Consequently we requested that management discusses this matter with SFC in order to seek written assurance of financial support from SFC in order to allow the College to be confident it will be in a position to meet its liabilities as they fall due over the period of at least 12 months from the date of approval of the financial statements. This confirmation has been received.	We concur with the assertion that the financial statements can be prepared on a going concern basis. The continued support of SFC will be required in the period up until the financial impact of the transformation plan results in the College achieving cash surpluses sufficient to meet its liabilities as they fall due.

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Adoption of the FRS 102 based SORP The new SORP resulted 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 brought changes in respect of holiday pay accruals, leases and pension interest cost accounting on transition.	We completed the audit of the transition balance sheet and the audit of comparative primary statements, vouching transition adjustments to supporting documentation. This included analysing judgements and estimates made by management. The following work was completed: ▪ The holiday pay accrual was assessed and evaluated against industry benchmarks. ▪ We confirmed that government grants had been appropriately recorded using the 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. ▪ As the College went through a revaluation of their land and buildings in the prior period as required under FReM regulations, they retained fixed assets at valuation and with the corresponding revaluation reserve; a choice that is permitted under the new SORP. Other assets continue to be held at depreciated historical cost. ▪ We reviewed the accounting treatment of operating leases and confirmed that any changes required to lease classifications under FRS 102 were immaterial in nature. ▪ We reviewed the defined benefit pension scheme disclosure note and verified it has been prepared in accordance with 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.

OTHER FOCUS RISK	OUR RESPONSE	AUDIT CONCLUSION
Retirement benefit obligations The College accounts for its participation in the Lothian Pension Fund ('LPF') in accordance with FRS 102 and therefore recognises the actuarial valuation of the pension liabilities in respect of its share of the LPF. The funds are valued by actuaries, with the rates of contributions 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 work consisted of: ▪ KPMG specialists reviewed the financial assumptions underlying actuarial calculations and compared to our central benchmarks; ▪ testing of scheme assets and rolled-forward liabilities; ▪ testing the level of contributions used by the actuary to those actually paid during the year; ▪ testing membership data used by the actuary supplied by the College; and ▪ agreeing actuarial reports to financial statement disclosures. We set out further information in respect of the defined benefit obligation and the related assumptions at appendix four.	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.

REPORT	SUMMARY OBSERVATIONS	AUDIT CONCLUSION
Annual report and performance and accountability report	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. Performance and accountability reports are now required to be included in the annual accounts. These outline the performance overview and the future plans and developments in line with the College's 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 suggestions relating to how the management commentary could be enhanced to more fully disclose the financial position of the College and where additional information disclosures should be made.
Remuneration and staff 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. The remuneration and staff report is included within the accountability report.	We are satisfied that the format of remuneration report is in line with the FReM and Accounts Direction. We verified remuneration data reported to underlying records and are satisfied it is correctly stated. We also verified the voluntary severance disclosures to supporting workings and tested a sample to supporting documentation, ensuring the voluntary severance payments were made in compliance with the requirements of the College's scheme. The scheme was confirmed as having been approved by the Scottish Funding Council and is being run in accordance with their published guidance.
Corporate Governance Report	The corporate governance report for 2015-16, included within the accountability report, 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.

Qualitative aspects

ISA 260 requires us to report to those charged with governance our views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

We consider the accounting policies adopted by the College to be appropriate, with the transition to FRS 102 appropriately reflected in the 2015-16 financial statements. There are no significant accounting practices which depart from what is acceptable under FRS 102 and the SORP.

Significant accounting estimates relate to:

- *The present value of defined benefit obligations under FRS 102;* (as calculated by the College's actuary, Hymans Robertson) using agreed financial assumptions. We found the assumptions and accounting for pensions to be appropriate, as discussed at appendix four.
- *The present value of fixed assets.* These were valued in 2014-15 with the value carried forward to 31 July 2016. We are satisfied that the valuation basis remains appropriate and that valuations in 2014-15 were applied accurately.

We did not identify indications of management bias.

Financial statement disclosures were considered against requirements of the SORP, the Accounts Direction and the FReM. No departures from these requirements were identified.

Future accounting and audit developments

There are no changes to the SORP for 2016-17 and no significant changes to the FReM that will impact upon the College.

ISA (UK & Ireland) 700 and 720 have been revised for accounting periods beginning on or after 17 June 2016. These revise the requirements for the structure and content of the independent auditor's report. Audit Scotland has extended the reporting requirement in the interests of transparency to all audits carried out under appointment, but requires the disclosures to be in the annual audit report rather than the independent auditor's report. This is effective for audits carried out from 2016-17.

The 2016-17 audit of the College financial statements will be carried out by Audit Scotland. We have recently liaised with the incoming auditor and will ensure all of our statutory responsibilities are adhered to.

Wider scope

Introduction

The Code 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.

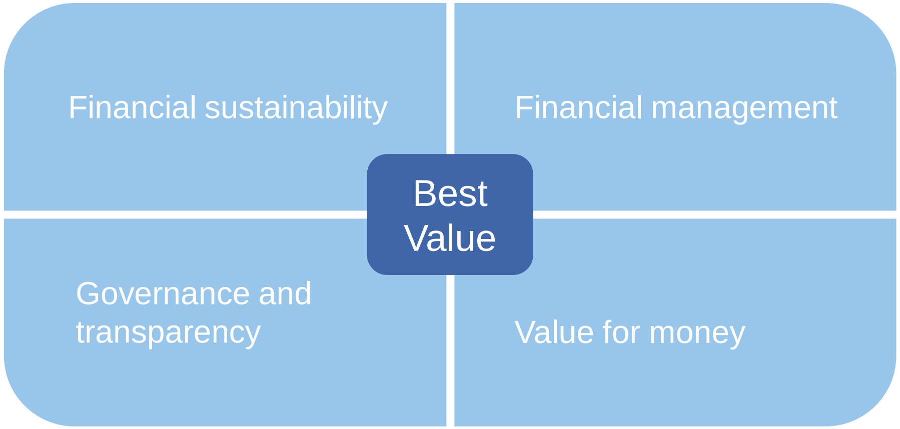
During our work on the audit dimensions we have considered the work carried out by internal audit and other scrutiny bodies to ensure our work meets the proportionate and integrated principles contained within the Code.

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

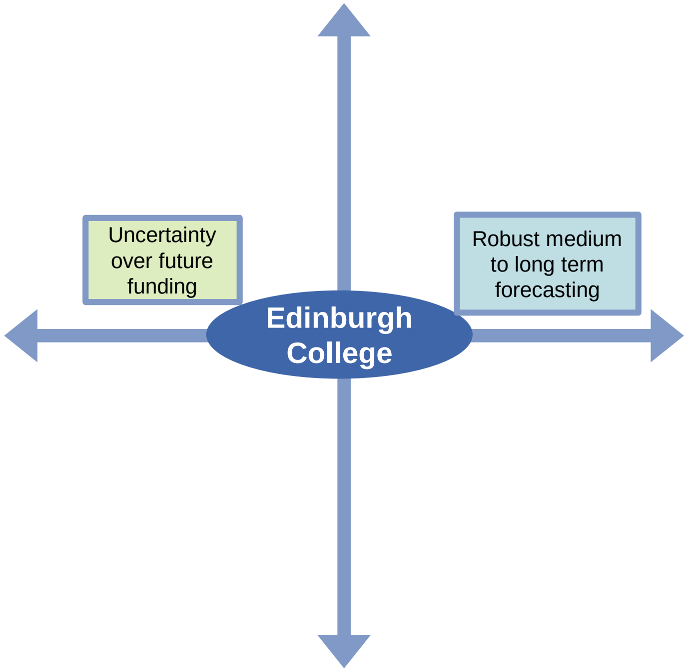
Audit dimensions risk map and conclusions

Financial sustainability (Page 22)

The financial sustainability of the College is dependent upon the success of the transformation plan in identifying and achieving sufficient cost savings to allow it to achieve financial balance. Without the ability to make targeted redundancies during the course of the plan achieving a sustainable financial position will remain challenging.

Governance and transparency (Page 23)

There has been an improvement in the provision of management information in 2015-16. This has facilitated Non Executives in the delivery of their scrutiny role by allowing a clearer focus on key issues and greater debate over emerging risks.



Risks identified during our audit planning procedures

Emerging risks identified during the course of our audit

Financial management (Page 22)

Financial management is intrinsically linked to financial sustainability. Whilst the College works through the transformation programme deficits are budgeted until 2018-19. Continued focus to deliver cost savings and ensure credit targets are delivered is vital to the long term sustainability of the College

Value for money

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 and did not identify any exceptions.

As part of our audit procedures, samples of invoices relating to operational and capital expenditure were selected and agreed. There were no items noted whereby value for money had not been considered.

> 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.

As referred to in Section 2 of this report, the College continues to operate in a particularly challenging financial environment reporting operating deficits in both 2014-15 and 2015-16. During this period additional support has been provided by SFC in the form of grants, despite WSUMs and credit targets not being reached, and advances in lieu of credit delivery in future years. In collaboration with SFC, a transformation programme has been developed with the aim of putting the College back on a stable financial footing in a manner which meets the educational needs of current and prospective students.

The College has identified that to achieve these aims it is critical that there is enhanced performance in:

- control of costs directly related to delivered programmes;
- appropriate delivery of a curriculum that is affordable and meets the needs of students; and
- tracking of applications to identify potential shortfalls in student recruitment.

Three voluntary severance schemes are planned to reduce FTE by circa 130. One is complete, the second is in progress with the third expected to release savings during 2017-18. The majority of posts affected are administrative staff across phases one and two; phase three is expected to be predominantly lecturing staff following curriculum redesign. The third scheme will include academic staff following curriculum redesign. The first scheme concluded with realised savings of £1.1 million per annum realised against a budgeted saving of £1.0 million.

It is recognised that the third scheme will be the most challenging as, following curriculum redesign, unless the College is able to target redundancies, there is uncertainty over whether anticipated savings can be achieved.

Conclusion: The financial sustainability of the College is dependent upon the success of the transformation plan in identifying and achieving sufficient cost savings to allow it to achieve financial balance. Without the ability to make targeted redundancies during the course of the plan achieving a sustainable financial position will remain challenging.

Standards of conduct and the prevention and detection of corruption

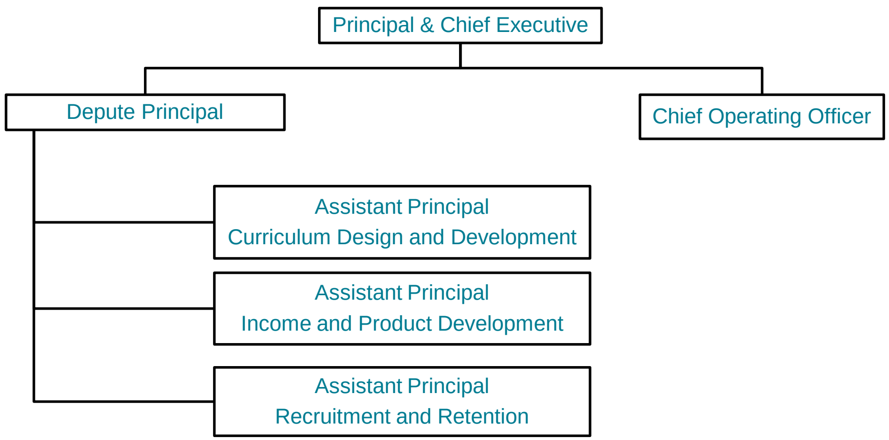
Testing over the processes to prevent and detect corruption included in addition to the work detailed opposite:

- *Consideration of the overall control environment.* 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.
- *Testing of completeness of registers of interest of senior staff and board members.* No errors were identified in this testing.
- *Review of reporting arrangements for conflicts of interest and whether these had been followed.* Conflicts of interest are a standing agenda item for committees.

Conclusion: The College has appropriate arrangements to prevent and detect inappropriate conduct and corruption.

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.

The College has significantly changed the management structure since the merger of the three colleges. The Principal & Chief Executive has reorganised the College per the organisational chart below:



The aim of the reorganisation is to increase accountability and transparency due to better articulation of responsibilities key to the effective operation of the College.

Corporate Governance

We have noted in the year an improvement in the quality of management information provided to the board and sub committees, in particular in relation to the management accounts and monitoring information related to student recruitment. This enhanced information has better enabled Non Executives to better hold management to account for their performance.

Internal audit

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)*.

We have reviewed the work of internal audit related to credits and have noted no significant issues which require us to amend our audit approach.

Appendices

To the Board of Management

Assessment of our objectivity and independence as auditor of Edinburgh 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.

Independence and objectivity considerations relating to the provision of non-audit services

We have considered the fees charged by us to the College for professional services provided by us during the reporting period.

The audit fee charged by us for the year ended 31 July 2016 was £29,000 (2015: £34,000). No other fees were charged in the period (2015: £nil). No non-audit services were provided to the College and no future services have been contracted or had a written proposal submitted.

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 College 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

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

Priority rating for recommendations

Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Financial forecasts *Risk dimension: financial management*		**Grade one**
With forecast cash balances at critically low levels the College is at risk of being unable to make payments to suppliers as they fall due. Any reasonable adverse movements in a combination of student numbers impacting credits or international and commercial income in the period between now and March could result in the College having insufficient cash to pay its liabilities as they fall due. Adverse movements in forecast costs would have the same impact. There is a risk that if payments to suppliers are delayed then additional late payment charges may be incurred further worsening the financial position of the College.	The College should perform detailed sensitivity analysis to identify the periods and extent of further support required from the SFC. The analysis should include consideration of: • delays in implementation or under-delivery against savings programmes including severance; • reductions in income as a result of under delivery of credits; and • increases in non fixed costs; Clear forecasts together with narrative explanations and potential mitigating factors should be used to discuss funding requirements with SFC on an ongoing basis in an effort to ensure that the risk of having insufficient funding is mitigated.	Agreed Detailed analysis of student numbers and income streams, along with expenditure, is completed on a monthly basis as part of the management accounts process and reviewed by the Head of Finance. Any adverse movements are reflected in revised cash flow projections. Additional sensitivity analysis will be undertaken to assess the effect on the highest risks areas of income shortfall and expenditure increase. **Responsible officer:** Head of Finance **Implementation date:** 30 November 2016

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Segregation of duties in raising purchase orders *Risk dimension: financial management*		**Grade two**
We identified an instance where an individual was able to raise a purchase order and subsequently approve it themselves on the PECOS system. This is mainly a risk for lower value purchases where only lower level approval (<£5,000) is required. This is counter to the expectation that the roles are segregated and that no individual should hold both roles at the same time. The purchases of the original individual identified were investigated with senior finance personnel and found to be reasonable for the individual's roles and responsibilities. We requested a complete user listing to investigate if any further instances of the same issue occurred during the year. It was identified that 20 further users had dual responsibility on PECOS. Our work identifies an overarching control issue that the listing of users on the PECOS system isn't appropriately maintained	To address the identified control deficiency, the following recommendations are suggested: • Introduce a monthly review of users on the PECOS system to ensure no user has the dual roles of raising and approving purchase orders. It is suggested that a member of the management team would be best placed to review the listing as they would also have a broader understanding of the appropriate level of authority that certain staff members should have. • Source and implement an automated system barrier to prevent the same individual from being able to both raise and approve the same purchase order. This would substantially reduce the risks present in the maintenance of the user listing. • Implement a stage in the Starters/Movers/Leavers process to ensure checks such as existing role responsibilities are considered before awarding new access or roles.	Agreed All individuals identified as having a dual role on PECOS have had their requisitioner status revoked and this process has been overseen by senior finance personnel. The College currently is in the process of rectifying the control deficiency to ensure there are procedures in place to prevent dual roles from being created in the future on the PECOS system. **Responsible officer:** Head of finance **Implementation date:** 30 November 2016

We follow up prior year audit recommendations to determine whether these have been addressed by management. The table below summarised the recommendations made during the 2014-15 audit and their current status.

Grade	Number recommendations raised	Implemented	In progress	Overdue
One	-	-	-	-
Two	-	-	-	-
Three	2	-	2	-

We have provided a summary of progress against overdue actions below, and their current progress.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions	Status
FTE calculation for financial statement disclosure The finance team receives FTE figures from HR for disclosure in the financial statements. It was identified during our testing that these figures were being manipulated by the finance team so that, although the FTE in total was correct, the split between job description was not. Since the equivalent staff costs by job description is also disclosed this was skewing average costs per FTE by job description.	FTE figures disclosed in the financial statements should be based on a staff members' contract.	A monthly staff return from HR in the format of the annual accounts will be received in order to ensure compliance at year-end **Responsible officer(s):** Head of finance **Implementation date:** Immediate	Report now accurate for monthly reporting purposes. Further minor analysis for yearend being implemented.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions	Status
PECOS Leavers Access to PECOS, the College's purchase ordering system, is granted to staff by the procurement department who are also responsible for the maintenance of the authorised users. Users are typically granted either requisitioner or approver status, but not both. When a member of staff leaves the College a system has been implemented for an automated email to be generated from iTrent to inform the procurement team that the user's access should be removed on PECOS. As PECOS is a system hosted online, if a user leaves the College but still has active user status there is a risk that they could raise or approve inappropriate orders. During our audit a listing of all departing staff in the year and a listing of all approved PECOS users were obtained. It was identified that 18 leavers still had access on the PECOS system and had not been removed. We understand that procurement have since reviewed the list of users identified and actioned their removal from the system.	The recommendation in the prior year to develop a process to ensure the procurement department is notified when a PECOS user leaves, has been implemented as already stated. As a number of leavers were identified as not being removed in the current year, we recommend that management highlight the importance of actioning the process effectively to ensure it operates as intended.	An automated email from iTrent was implemented in September 2016, this replaced the interim solution of Payroll generating emails manually. Head of Procurement have acknowledged some recent process slippages due to staffing changes but have given reassurance that the process and its importance will be reaffirmed going forward. **Responsible officer(s):** : Head of Procurement **Implementation date:** 30 November 2016	New Head of Procurement has reaffirmed the process with all relevant staff. In conjunction with actions in Recommendation 1 a monthly check has been introduced to ensure all leavers have been removed. A further annual check of all PECOS users to ensure they are still current employees will be put in place.

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

We are of the view that this therefore represents a reasonable and balanced approach, in accordance with the requirements of FRS 102 and the SORP.

We set out below the assumptions in respect of defined benefit obligations.

Defined benefit pension liability

2016 £'000	2015 £'000	KPMG comment
(25,294)	(23,216)	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	Hymans Robertson	KPMG central	Comment
Discount rate (duration dependent)	17-23 years: 2.40%	22 years: 2.37%	Acceptable. The proposed discount rate is 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. The proposed CPI inflation rates are within an acceptable range of KPMG's central rates as at 31 July 2016.
Net discount rate (discount rate – CPI)	0.50%	0.35%	Acceptable. The proposed assumptions are within the acceptable range of +/- 0.3% from the KPMG central range.
Salary growth	RPI plus 1.50%	Typically 0% - 1.5% above inflation	Acceptable. The proposed assumptions are within the acceptable range.

The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of around 22 years. The closing deficit increased by £2.1million compared to 2014-15, primarily due to changes to actuarial assumptions, including a decrease in the real discount rate and increased life expectancies.

Appendix five
Appointed auditors responsibilities

Area	Appointed auditors responsibilities	How we've met our responsibilities
Corporate governance	Review and come to a conclusion on the effectiveness and appropriateness of arrangements to ensure the proper conduct of the bodies affairs including legality of activities and transactions, Conclude on whether the monitoring arrangements are operating and operate in line with recommended best practice.	Page 22 sets out our conclusion on these arrangements.
Financial statements and related reports	Provide an opinion on audited bodies' financial statements on whether financial statements give a true and fair view of the financial position of audited bodies and their expenditure and income Provide an opinion on whether financial statements have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements Provide an opinion on the regularity of the expenditure and income.	Page 10 summarises the opinions we expect to provide.
Financial statements and related reports	Review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns.	Page 16 reports on the other information contained in the financial statements, covering the annual governance statement, management commentary and remuneration report.
Financial statements and related reports	Notify the Auditor General when circumstances indicate that a statutory report may be required.	Page 10 sets out any notifications we have made to the Auditor General.
Financial statements and related reports	Review and conclude on the effectiveness and appropriateness of arrangements and systems of internal control, including risk management, internal audit, financial, operational and compliance controls.	Page 10 sets out our conclusion on these arrangements.
WGA returns and grant claims	Examine and report on WGA returns Examine and report on approved grant claims and other returns submitted by local authorities.	N/A

Appointed auditors responsibilities (continued)

Area	Appointed auditors responsibilities	How we've met our responsibilities
Standards of conduct – prevention and detection of fraud and error	Review and conclude on the effectiveness and appropriateness of arrangements for the prevention and detection of fraud and irregularities, bribery and corruption and arrangements to ensure the bodies affairs are managed in accordance with proper standards of conduct. Review National Fraud Initiative participation and conclude on the effectiveness of bodies engagement.	Page 21 sets out our conclusion on these arrangements.
Financial position	Review and conclude on the effectiveness and appropriateness of arrangements to ensure that the bodies financial position is soundly based.	Page 21 sets out our conclusion on these arrangements.
Financial position	Review performance against targets	Pages 6 and 7 summarise our review of how the body has performed against it's financial targets.
Financial position	Review and conclude on financial position including reserves balances and strategies and longer term financial sustainability.	Page 7 sets out our conclusion on the bodies financial position including reserves balances. Page 11 sets out our conclusion on the bodies financial strategies and longer term financial sustainability.
Best Value – *all other sectors*	Review and conclude on the effectiveness and appropriateness of arrangements of accountable officers specific responsibility to ensure that arrangements have been made to secure Best Value.	Pages 21 to 22 sets out our conclusion of the bodies arrangements.
Performance information – *local authority bodies*	Review and conclude on the effectiveness and appropriateness of arrangements to prepare and publish performance information in accordance with Accounts Commission directions.	N/A

KPMG

cutting through complexity

The contacts at KPMG in connection with this report are:

Hugh Harvie

Partner

Tel: 0131 527 6682

hugh.harvie@kpmg.co.uk

Matt Swann

Senior Manager

Tel: 0131 527 6662

matthew.swann@kpmg.co.uk

Sean Aitken

Assistant Manager

Tel: 0131 527 6805

sean.aitken@kpmg.co.uk