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Dumfries and Galloway College

Annual audit report to the Board of Management of

Dumfries and Galloway College

and the Auditor General for Scotland

Year ended 31 July 2011

20 December 2011

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The contacts at KPMG in connection with this report are:

David Watt
Director, KPMG LLP

Tel: +44(0)141 300 5695
Fax: +44(0)141 204 1584
david.watt@kpmg.co.uk

Brian Curran
Senior Manager, KPMG LLP

Tel: +44(0)141 300 5631
Fax: +44(0)141 204 1584
brian.curran@kpmg.co.uk

Sajid Tahir
Assistant Manager, KPMG LLP

Tel: +44(0)141 309 2548
Fax: +44(0)141 204 1584
sajid.tahir@kpmg.co.uk

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

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

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

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives 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 and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

Headlines

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

This report summarises our work for the year ended 31 July 2011, the final year of our five-year appointment as the College's auditors. It also provides information required by ISA (UK and Ireland) 260: *Communication with those charged with governance*.

We wish to record our appreciation of the continued co-operation and assistance extended to us by Dumfries and Galloway College staff during the course of our work.

Financial statements and accounting	Page
Draft financial statements and supporting work papers provided by management were complete, of a high standard, and provided in line with the agreed timetable. There were slight delays to the provision of information from the external valuer on asset valuation.	6 to 7
We have issued unqualified audit opinions on the 2010-11 financial statements and the regularity of transactions reflected in them.	5
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Use of resources	
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The College management are currently considering plans to deal with the anticipated funding cuts in the next few years. Management aims to manage these reductions and continue to provide a breadth of curriculum.	8
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Arrangements to protect and detect fraud are embedded in internal controls and remain appropriate for the College.	9
Internal audit completed their plan for the year and identified no significant weaknesses in the areas reviewed.	9
We assessed management's response to Audit Scotland's national reports and found that management has discussed these reports in detail at board level and taken reasonable action to mitigate risks and improve processes at a local level.	9

Service overview

The College reported a surplus of £17,000 for 2010-11.

The College continues to provide as many courses as possible to the local community, even in the current economic climate.

College management are currently considering their position in respect to a pre-legislative paper by the Scottish Government and proposed funding cuts.

- Dumfries and Galloway College operates from two campuses: the Crichton campus in Dumfries and the Stranraer campus. Each campus provides local residents with learning opportunities, as well as access to educational resources such as libraries and student services in each campus.
- The Crichton campus was completed in 2008 and also provides library services for students of the University of the West of Scotland and the University of Glasgow.
- The Stranraer campus underwent refurbishment in 2009-10 to enhance the quality of education provision to students.

Result for the year

- The College reported a surplus of £17,000 for the financial year. This includes underlying severance costs of £652,000 which were incurred with a view to reducing staff costs in future years.
- This result was in line with budgets and the forecast financial return made to the Scottish Funding Council ("SFC") prior to the start of the financial year.
- The balance sheet reflects a significant increase in the value of the Crichton campus following an interim valuation carried out in the year.

Student numbers/WSUMS

- The College delivered a slight reduction of 856 in WSUMS in 2010-11 compared to 2009-10. This was a result of decreased targets for funding and in line with forecasts.
- The College continued with its policy in recent years to avoid significant over deliver of WSUMS numbers due to financial pressures.

Course provision

- Management aims to continue to provide a breadth of curriculum, but in anticipation of further funding cuts, some courses are likely to be cancelled. Management is currently considering this along with the anticipated financial impacts.
- The economic downturn has resulted in more unemployment, particularly in school leavers, and management expects the demand for courses to remain strong. Conversely, the impact of the economic environment on local business has resulted in a reduction in the demand for courses from local businesses.

Future plans

- In September 2011, the Scottish Government released a pre-legislative paper; 'Government's Post-16 Education plans and a sector response to the Spending Review'. This paper considers the regionalisation of the college sector and reform of funding within Scotland, with an emphasis on the Scottish Government not being able to afford a system of individual institutions serving overlapping areas. Management are currently considering this alongside the Scottish Government's 'Scottish Spending Review 2011 and Draft Budget 2012-13' and anticipates these will have a significant impact on the student demographic.
- These papers have been considered by the board of management and the College has prepared a draft response to the consultation exercise which will be finalised in December 2011. The College will continue to communicate potential implications of these proposals to staff through the joint consultative committee and the Student Association to ensure that they are fully aware of the issues.

Accounting policies, financial statements preparation and audit process

There have been no changes to the College's accounting policies.

The audit plan anticipated significant risks around accounting for fixed asset valuation, pension liabilities, voluntary severance and compliance with tax authorities.

No audit adjustments were required and matters were concluded in a timely manner.

Accounting policies

There have been no changes in accounting policies from prior years. We have considered the accounting policies applied for the year ended 31 July 2011 and consider that these remain appropriate for the preparation of the financial statements.

Areas of HIGH audit risk

Area	Value (£'000) 2011	Value (£'000) 2010	KPMG comment
Fixed asset revaluation	11,779	-	■ The College's accounting policies requires that property is subject to full revaluation every five years with an interim valuation in year three of that cycle. An interim valuation was therefore carried out at 31 July 2011 which showed an increase in valuation of property of £11.8 million primarily in relation to the Crichton site. ■ The valuer has confirmed that this change in valuation over cost is due to increases in build costs from the time the original contract was secured and this has been adjusted for in the financial statements. A £79,000 downwards revaluation of land has not been reflected in the financial statements on the grounds of materiality. ■ Adjustments and disclosures in the financial statements are materially complete and appropriate.
Pension liabilities	(1,805)	(2,130)	■ The College accounts for its participation in the Dumfries and Galloway local government pension scheme in accordance with FRS 17 *Retirement benefits.* The net liabilities recognised at the year end depends on movements in asset values during the year and actuarial assumptions adopted to value the liabilities. ■ We have reviewed these liabilities against our benchmark rates and consider them reasonable.
Voluntary severance	(652)	-	■ The College operated a voluntary severance scheme during the year, with costs of £652,000 recognised in the financial statements. This was anticipated at the start of the year and funded through 2010-11 budget adjustments. ■ Disclosures and amendments in the financial statements in this respect are complete and appropriate.
Lennartz creditor	(1,916)	(2,307)	■ The College has a significant outstanding liability due to HM Revenue & Customs ("HMRC") in relation to the Lennartz scheme. The increase in the VAT rate to 20% during the year results in an increased liability where amounts are not repaid. During the year, the board of management approved early repayment of this amount to avoid this increased liability and duly notified HMRC; HMRC have yet to confirm acceptance of this. ■ Management has been advised that repayment will be accepted and accordingly no amendments have been made to the financial statements to increase the liability.
Compliance with tax authorities	-	-	■ In line with our audit plan, we performed an high level review of tax risks in relation to the College. There have been no significant changes to operations from prior years and we have not identified any significant tax risks.

Accounting policies, financial statements preparation and audit process (continued)

Preparation of financial information

- Draft financial statements and supporting documentation were provided on 3 October 2011, in line with the agreed timetable. There were some delays in obtaining valuation information from the external valuer which caused some delays in the audit process.
- Finance staff responded to our questions quickly and provided high quality information to support the draft financial statements.
- Overall, management adopts an efficient approach to preparing the financial statements.

Audit conclusions

- A summary of adjusted and unadjusted differences arising from the audit was discussed the board of management's audit committee.
- There are no matters to be brought to your attention regarding our independence or non-audit fees.
- We have issued unqualified opinions on the financial statements and the regularity of transactions reflected therein.

Financial position

The College reported a small surplus for the year.

Severance costs of £652,000 were managed in year.

The financial statements report a surplus for the year of £17,000, a decrease of £737,000 on the position recorded in the previous year, primarily due to a one-off credit in 2009-10 in relation to the change in measuring future pension increases.

The College's income and expenditure account is summarised opposite, with the key movements in relation to the previous year noted below.

Income

- A reduction in Scottish Fund Council ("SFC") grants of £312,000 (3%), due to a large decrease in infrastructure grants from the prior year. In 2009-10 three were grants received to cover the costs of the refurbishment programme in the Stranraer campus as well as to corrective work on the Crichton site and elements of these accordingly released in 2009-10; no such work was required in the current year.
- A reduction in the tuition fees and education contracts (down £273,000) largely due to the decrease in third party income. This related to a contract with a local housing association for providing courses; the weak local economy has resulted in reduced spending on these courses in 2010-11.

Expenditure

- Staff costs of have increased £1,021,000 since 2009-10. This is due to voluntary severance costs of £652,000 in 2010-11 and a one off credit of £778,000 in 2009-10 due to the change in measuring pension increases from RPI to CPI. These were offset to an extent by savings actions implemented in the prior year.
- Operating costs have reduced by £616,000 (15%) from 2009-10 for two main reasons. Firstly, a decline in one-off costs for refurbishment of the Stranraer campus as noted above. Secondly, there was a decrease in bursary maintenance awards following changes in the College's bursary policy.

Income and expenditure account	2010-11 £'000	2009-10 £'000
Income		
Scottish Funding Council grants	10,894	11,206
Tuition fees	1,397	1,670
Other income	321	186
Other operating income	502	496
Endowment and investment income	26	30
Total income	**13,140**	13,588
Expenditure		
Staff costs	8,530	7,509
Other operating costs	3,446	4,062
Depreciation and impairment	1,114	1,134
Interest payable	33	129
Total expenditure	**13,123**	**12,834**
Surplus for the year	**17**	**754**

Financial position (continued)

The largest change in the balance sheet since the prior year is in relation to the revaluation of fixed assets in the year, particularly the Crichton campus.

Balance sheet	2011 £'000	2010 £'000
Tangible fixed assets	52,346	41,742
Current assets and liabilities		
Debtors	519	568
Cash at bank and in hand	3,982	3,444
Creditors: amounts falling due within one year	(3,194)	(2,788)
Net current assets	**1,307**	**1,224**
Creditors: amounts falling due after more than one year	(1,916)	(2,307)
Provisions for liabilities and charges	(746)	(759)
Pension liability	(1,805)	(2,130)
Net assets including pension liability	**49,186**	**37,770**
Deferred capital grants	29,115	29,932
Income and expenditure account, including pension reserve	4,277	3,706
Revaluation reserve	15,794	4,132
Total	**49,186**	**37,770**

The balance sheets at 31 July 2010 and 2011 are detailed on the left. Significant movements year on year are detailed below:

- An increase in fixed assets of £10,604,000 is due to the revaluation of land and buildings in the year. This is primarily due to increases in the value of the Crichton campus.
- An increase of £538,000 in cash at bank and in hand; this can mainly be accounted for by the College receiving the 2011-12 SFC capital grant prior to the 2010-11 year end. Management anticipates using available cash to settle the debt due to HM Revenue and Customs in relation to the Lennartz scheme during 2011-12.
- Creditors due less than one year have increased by £406,000 mainly due to increases in accruals and deferred income. Accruals includes £636,000 relating severance payments outstanding at year end. These were paid in August 2011.
- The net liability has decreased from £2,130,000 at 31 July 2010 to £1,805,000 at 31 July 2011. The College's share of assets and liabilities of the Dumfries and Galloway Pension Fund have been valued and accounted for in accordance with FRS 17 *Retirement benefits*. The main reason for the decrease in the net liability is due to a strong return in assets during the year; movements in asset values and assumptions creates a volatility in the net pension liability recognised from year to year.
- The revaluation reserve increase reflects the increase from the revaluation of property.

Financial position (continued)

A lack of clarity over future financial resources is impacting on longer-term planning.

Financial forecasts

The College is in the process of finalising long term strategic and financial plans. A lack of clarity around the impact of funding announcements has delayed this.

The College is heavily reliant on funding from SFC. The recent issue of the pre-legislative paper; 'Government's Post-16 Education plans and a sector response to the Spending Review', and the Scottish Government 'Scottish Spending Review 2011 and Draft Budget 2012-13' has created further uncertainty over income and education provision within the further education sector.

As the paper is currently only at the consultative stage, management is preparing a draft response and considering the potential impact it could have.

2011-12 financial forecast

In line with prior years, the College has forecast a small surplus of £10,000 for 2011-12. This is due to the challenging environment faced by the College.

The table opposite compares forecast income and expenditure for the 2011-12 financial year against actual for 2010-11. The College uses a zero based budgeting approach based on a number of key assumptions and contextual issues, most of which are considered reasonably predictable for 2011-12.

Management has forecast reductions in income in 2011-12, primarily due to reductions in SFC funding. Forecast expenditure reductions are primarily due to reductions in staff costs and the absence of one-off severance costs in 2011-12.

Management is aware that further savings will be required in 2012-13 and beyond in the current, constantly changing environment. To this end management is producing scenario plans to consider the most appropriate way to achieve these with minimum impact on service provision (and therefore also on related income streams).

Course provision will be reviewed for 2012-13 in order to help drive required efficiencies.

Income and expenditure	2010-11 actual £'000	2011-12 budget £'000
Income	13,140	12,080
Expenditure	13,123	12,070
Surplus	17	10

Corporate governance framework and supporting arrangements

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

Corporate governance framework	There have been no significant changes in the corporate governance framework in the year. The College applies the principles set out in the UK Corporate Governance Code. This allows the College to maintain an integrated governance framework to provide an appropriate structure for maintaining decision making, accountability, control and behaviour.
Statement on internal control	The statement of corporate governance and internal control provides details of the purpose of the framework of internal control, along with an analysis of the major components of this system. We have reviewed this and consider that it is in line with guidance issued by SFC and the accounts direction.
Internal controls	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively. One minor recommendation to further enhance the system of internal control has been agreed with management.
Internal audit	Internal audit completed all of their audit reports for the year including the annual audit report. These reports found controls at the College were strong and highlighted some minor recommendations to further enhance them. The annual internal audit report concluded that all three areas of governance, risk management and internal control were operating and an appropriate level.
Fraud and irregularity	The College have a approved fraud and defalcation policy. Management did not identify any instances of fraud or irregularity during the year. During our audit of the financial statements we did not identify any known or suspected instances of fraud or irregularity.
Regularity	The board of management 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. The audit committee also considers any applicable correspondence. The College therefore considers all incoming guidance received from these bodies, and can demonstrate that appropriate action has been taken where relevant.

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