



INFRASTRUCTURE, GOVERNMENT &  
HEALTHCARE

## Barony College

Annual audit report to the  
board of management of  
Barony College and the Auditor  
General for Scotland

Audit: Year ended 31 July 2008

23 December 2008

AUDIT

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## **Notice: 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 only the board of management of Barony 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.

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# Executive summary

This report summarises our work for the 2007-08 year and our findings in relation to our audit of the financial statements, financial reporting and corporate governance arrangements.

## **Financial commentary**

The College recorded a deficit of £275,000, compared to a forecast surplus of £11,000. The primary reason for this was the consequences of a revaluation of certain fixed assets on an open market basis in line with the College's accounting policies. The results also reflect increased investment and operating income - offset by a corresponding increase in operating costs – and reduced staff costs.

The 2008-09 financial plan forecasts a surplus of £52,000.

## **Governance and risk management**

The corporate governance statement does not disclose any significant weaknesses in the systems of internal control. The content of the statement is consistent with our understanding.

Internal audit reviewed the College's corporate governance and risk management arrangements and concluded that "The College has strong systems and procedures appropriate to its operations in the areas audited of corporate governance and risk management".

There is a formal process to record, distribute and monitor action in response to key guidance and circulars.

The College has prepared an operating and financial review of the College's activities to meet the requirements of SORP 2007.

## **Financial statements**

We issued unqualified opinions on the financial statement and the regularity of transactions.

Management provided draft financial statements and supporting working papers, which were complete and of a high standard, in line with the agreed timetable.

Adjustments of £389,000 were made to the draft financial statements in relation to the valuation of fixed assets and there are no unadjusted audit differences.

# Introduction

## **Audit framework**

2007-08 was the second year of our five-year appointment as external auditors of Barony College (“the College”). This report to the board of management of the College and the Auditor General for Scotland summarises our opinion and conclusions and highlights significant issues arising from our work.

In accordance with Audit Scotland’s *Code of Audit Practice*, the scope of the audit was to:

- provide an opinion on the College’s financial statements and, as required by relevant authorities, the regularity of transactions;
- review and report on (as required by relevant legislation, the Code and any guidance issued by Audit Scotland):
  - the College’s corporate governance arrangements as they relate to: its review of systems of internal control; the prevention and detection of fraud and irregularity; standards of conduct, and prevention and detection of corruption; and its financial position
  - the College’s arrangements to achieve Best Value
  - other aspects of the College’s arrangements to manage its performance, as they relate to economy, efficiency and effectiveness in the use of resources.

The framework under which we operate under appointment by Audit Scotland was outlined in the audit plan for the year discussed with the College’s audit committee.

## **Financial reporting framework**

The statement of recommended practice: accounting for further and higher education (2007) (“the SORP”) was published in July 2007. The revised SORP is required to be adopted for accounting periods ending on 31 July 2008.

## **Basis of information**

External auditors do not act as a substitute for the board of management’s own responsibilities for putting in place proper arrangements to account for its stewardship of resources made available to it and its financial performance in the use of those resources, to ensure the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the effectiveness of those arrangements and, through its principal, to make arrangements to secure Best Value.

## **Acknowledgement**

Our audit has continued to bring us into contact with a range of College staff. We wish to place on record our appreciation of the co-operation and assistance extended to us by staff during the performance of our work in the discharge of our responsibilities. We also note the high quality of the College’s preparation for the audit and the co-operation of the finance manager.

## Financial commentary

- The College recorded a deficit of £275,000, compared to a forecast surplus of £11,000. The primary reason for this was the consequences of a revaluation of certain fixed assets on an open market basis in line with the College's accounting policies. The results also reflect increased investment and operating income - offset by a corresponding increase in operating costs – and reduced staff costs.
- The 2008-09 financial plan forecasts a surplus of £52,000.

This section of our report summarises the main features of the financial statements and key movements from the prior financial year.

The financial statements report a deficit for the year of £275,000, which is £286,000 lower than the forecast surplus of £11,000. The deficit is equivalent to 5.8% of annual turnover.

### Income

Income for the year has risen by £741,000, equivalent to a 17% year on year increase. The main components of this increase were:

- £247,000 increase in Scottish Funding Council grant income;
- increase of £61,000 in tuition fees and education contracts;
- £142,000 increase in other grant income; and
- an increase of £250,000 of other operating income, including an increase of £8,000 from residences and catering and £200,000 more from farming activities.

The following table identifies the sources of income in 2006-07 and 2007-08.

	<b>2007-08</b>	<b>2006-07</b>	<b>2007-08</b>	<b>2006-07</b>
	<b>£'000</b>	<b>£'000</b>	<b>%</b>	<b>%</b>
Scottish Funding Council grants	2,661	2,414	52%	55%
Tuition fees and education contracts	497	436	10%	10%
Other grant income	478	336	9%	8%
Other operating income	1,399	1,149	28%	26%
Investment income	63	22	1%	1%
<b>Total income</b>	<b>5,098</b>	<b>4,357</b>	<b>100%</b>	<b>100%</b>

The main difference in income levels compared to the prior year is the increased release of capital grants as a result of the fixed asset impairment, although underlying income levels have remained in line with those in 2006-07.

Other operating income has continued to rise from £985,000 in 2005-06 to £1,399,000 in 2007-08, an increase of 42% in two years, following construction and operation of the dairy technology centre, resulting in increased milk sales due to the increased milking capacity and increased prices.

## Expenditure

Overall, total expenditure has increased by £1,064,000 (20%), which is consistent with the equivalent movement in income. The most significant movements were:

- £873,000 of an impairment of fixed assets in relation to the impairment in the year;
- £19,000 decrease in staff costs;
- Other operating expenditure increased by £182,000; and
- interest payable increased by £19,000.

The majority of expenditure is incurred on staff costs. The following table identifies the key elements of expenditure in 2006-07 and 2007-08.

	<b>2007-08</b>	<b>2006-07</b>	<b>2007-08</b>	<b>2006-07</b>
	<b>£'000</b>	<b>£'000</b>	<b>%</b>	<b>%</b>
Staff costs	2,485	2,504	47%	59%
Other operating expenditure	1,762	1,578	33%	36%
Depreciation	187	180	3%	4%
Impairment	873	-	16%	-
Amortisation of intangible assets	13	13	-	-
Interest payable	51	32	1%	1%
<b>Total expenditure</b>	<b>5,371</b>	<b>4,307</b>	<b>100%</b>	<b>100%</b>

## Balance sheet

The College has reported an increase in net assets of £1,128,000 during the year. The balance sheets at 31 July 2007 and 2008 are summarised as follows:

	2007-08 £'000	2006-07 £'000
<b>Fixed assets</b>		
Tangible assets	6,268	5,016
Intangible assets	66	79
Investments	34	24
<b>Current assets</b>		
Stock	474	388
Debtors	229	486
Cash at bank and in hand	426	2
Creditors due within one year	(828)	(798)
<b>Net current assets</b>	<b>301</b>	<b>78</b>
Creditors due after one year	(634)	(452)
Pension liability	(170)	(8)
<b>Net assets including pension liability</b>	<b>5,865</b>	<b>4,737</b>
Deferred capital grants	1,317	1,862
Income and expenditure account, including the pension reserve	745	1,188
Revaluation reserve	3,803	1,687
<b>Total</b>	<b>5,865</b>	<b>4,737</b>

Reasons for significant balance sheet movements during the year include:

- a net increase of £1,252,000 in the value of land and buildings, primarily as a result of the full valuation of land and buildings at 31 July 2008;
- a decrease in the overdraft of £229,000 following the receipt of outstanding European debtors;
- increase in accruals and deferred income of £221,000, due mainly to the deferral of £168,000 of funding from the Scottish Funding Council for use in 2008-09; and
- an increase in creditors due after one year of £182,000 reflecting a new development loan from the bank.

## Financial forecasting

The original 2007-08 financial plan forecast a surplus of £11,000 to 31 July 2008. The actual outturn to 31 July 2008 was a deficit of £275,000. The following table summarises the significant movements during the year.

	£'000
<b>2007-08 forecast outturn per the financial plan</b>	<b>11</b>
Net impairment of tangible fixed assets	(387)
Increased endowment and investment Income	54
Additional other income	217
Reduced staff costs	100
Increased other operating costs	(237)
Impact of accounting for pension costs under FRS 17	(31)
Loss on disposal of fixed assets	(2)
<b>2007-08 actual outturn to 31 July 2008</b>	<b>(275)</b>

Source: Barony College (October 2008)

The main movements in income and expenditure from the original plan were as follows:

- impairment following the revaluation of the new dairy technology centre and silage pit of £873,000, offset by the release of capital grants totalling £486,000;
- increased endowment and investment income due to a higher than forecast level of interest received on bank balances and a higher than expected return on pension assets;
- additional other income primarily from increased dairy sales (as a result of herd size and milk price increases);
- reduced staff costs due staff leaving and timing differences between before replacements take up post; and
- increased other operating costs mainly due to increased farm costs (as a result of price increases) and over spend on bursaries.

The table below summarises the forecast income, expenditure and cash balances for the College for 2008-09.

	<b>£'000</b>
Income	4,800
Expenditure	4,748
<b>Forecast surplus for the year ending 31 July 2009</b>	<b>52</b>
Cash balance at 31 July 2008	427
Forecast cash balance at 31 July 2009	247
<b>Forecast movement in cash during 2008-09</b>	<b>(180)</b>

*Source: Barony College (June 2008)*

The College is again forecasting a small surplus, consistent with management's financial strategy and in line with prior years. At the end of 2007-08 the College had a higher bank balance than the prior year. The financial forecast for 2008-09 shows a net cash outflow of £180,000 due to finance repayments and capital expenditure, net of anticipated grant amounts. Management do not anticipate being as reliant on the use of overdraft facilities during 2008-09 as in the prior year, but it may be utilised to meet short timing differences between income and expenditure. Management has therefore obtained confirmation from its bankers that this facility is available until December 2009.

# Governance and risk management

- The corporate governance statement does not disclose any significant weaknesses in the systems of internal control. The content of the statement is consistent with our understanding.
- Internal audit reviewed the College's corporate governance and risk management arrangements and concluded that "*The College has strong systems and procedures appropriate to its operations in the areas audited of corporate governance and risk management.*"
- There is a formal process to record, distribute and monitor action in response to key guidance and circulars.
- The College has prepared an operating and financial review of the College's activities to meet the requirements of SORP 2007.

## Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all bodies.

Through the principal, the board of management is responsible for establishing arrangements for ensuring the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The Code requires auditors to review and report on the College's corporate governance arrangements as they relate to:

- the College's reviews of its systems of internal control, including its reporting arrangements;
- the prevention and detection of fraud and irregularity;
- standards of conduct and arrangements for the prevention and detection of corruption; and
- its financial position.

Management is responsible for establishing arrangements for the conduct of its affairs, including compliance with applicable guidance, ensuring legality of activities and transactions and monitoring the adequacy and effectiveness of these arrangements in practice.

## Risk management

The board of management updated its risk assessment procedures in April 2007 and complied with these requirements during 2007-08. The principal is currently reviewing the risk management process to ensure it continues to comply with best practice and meet the College's requirements. The risk register is available to all staff. The senior management team review and update the risk register each term and changes are reported to the board of management for approval. The audit committee also considers the risk register during each meeting.

## **Systems of internal control**

### **Corporate governance statement**

The principal is responsible for obtaining assurances, including from internal audit, to facilitate compilation of the corporate governance statement. In addition to internal audit, the principal gains assurance from the audit committee to inform the statement. The audit committee is responsible for providing assurance to the board of management relating to corporate governance arrangements. The board of management is also active in considering corporate governance arrangements, with particular attention being paid to the combined code and ensuring the College's compliance with relevant guidance.

Internal audit reviewed the College's corporate governance and risk management arrangements and concluded that *"The College has strong systems and procedures appropriate to its operations in the areas audited of corporate governance and risk management."*

The College has made a fully compliant corporate governance statement. We are required to review this to assess whether the description of the process adopted by the College in reviewing the effectiveness of the system of internal control is consistent with our understanding of the process and report any inconsistencies in our opinion. We are not required to provide an opinion on the College's system of internal control.

We have reviewed the corporate governance statement and consider it consistent with our understanding of the processes followed by the College during the year.

### **Internal audit**

The internal audit annual report confirms that the internal audit programme of 25 days was completed during the year and reports that the College's performance in areas reviewed is strong. Areas covered in the programme include personnel and payroll, corporate governance, risk management, fixed assets, estates management and inventories, budgetary and financial controls. Accordingly, based on the programme of work undertaken during the year, the internal auditors have concluded that *"the College did have adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives at the time of our audit work"*.

### **Internal controls**

Drawing on the work of internal audit, in accordance with our plan we undertook detailed testing in relation to both entity-level and key financial controls. We did not identify any errors or weaknesses in controls tested.

Testing of the design and operation of controls over significant risk points in terms of major financial systems confirms that controls are designed appropriately and operating effectively.

## **Prevention and detection of fraud and irregularity**

The College's fraud policy documents the procedures in place for the avoidance of fraud and corruption, providing guidance to staff on the action which should be taken when fraud, theft or corruption is suspected. Key elements of the College's strategy to combat fraud and corruption are: an open and honest culture; adequate preventative measures; systems for detection and investigation; understanding and awareness within the College; the adoption of a whistle blowing policy. The content of the policy meets the requirements and identifies responsibilities for the prevention and detection of fraud.

Management has not reported any material instances of fraud or irregularity in 2007-08.

### **Standards of conduct**

The College has comprehensive policies and procedures which provide guidance to staff; all documents are available to staff on the intranet and staff are made aware when updates are made.

There is also a formal register of interests for recording members of the board of management and senior managers' interests. Management are currently updating the policy to take account of changes in relationships during the year.

### **Best Value**

The 2007-08 planning guidance for further education colleges issued by Audit Scotland indicated that there was no requirement for auditors to undertake performance audit or other Best Value studies during the year.

## Financial statements audit

- We issued unqualified opinions on the financial statement and the regularity of transactions.
- Management provided draft financial statements and supporting working papers, which were complete and of a high standard, in line with the agreed timetable.
- Adjustments of £389,000 were made to the draft financial statements in relation to the valuation of fixed assets and there are no unadjusted audit differences.

### Audit opinion

On 23 December 2008 we issued an audit report expressing an unqualified opinion on the financial statements of the College for the year ended 31 July 2008 and on the regularity of transactions reflected in those financial statements.

### Valuation of fixed assets

The College accounts for its fixed assets on a valuation basis under FRS 15 *Tangible fixed assets*, which requires that fixed assets are valued every five years, with an interim valuation in year three. The College's estate was subject to a full revaluation at 31 July 2008 having previously been subject to a full revaluation at 31 July 2003 and an interim valuation at 31 July 2006. During the 2006-07 audit, and in response to our request, management obtained written confirmation from the College's independent valuer that the carrying value of the College's estate at 31 July 2007 was not inappropriate.

The College's estate is valued at market value, which was agreed as an appropriate basis with the independent valuer in 2003. SORP 2007 requires that fixed assets are valued on the basis of market value for existing use, but recognises that specialist buildings, such as further education colleges, may not have an ascertainable market value. The use of depreciated replacement costs is acceptable as a valuation basis in these circumstances. While there are no indications that market value is not an appropriate basis for the College, we recommended that management consider this fully during 2007-08 prior to requesting a full revaluation at 31 July 2008.

College management discussed the basis of the valuation with the appointed valuer who confirmed that even in the case of specialist facilities, open market value remained, in his opinion, an appropriate basis. Accordingly, management have reflected the valuation on this basis in the financial statements.

During 2007-08, the College completed the construction of the new dairy technology centre and a silage pit at a total cost of £1,534,000. This was funded by European Regional Development Fund grants of £543,000, Scottish Funding Council grants of £296,000, and other grants of £51,000. On an open market basis, the valuation at 31 July 2008 for these assets was a total of £600,000. The resulting impairment was charged to the income and expenditure account and the release of related deferred capital grants of £465,000 was accelerated. The net impact on the income and expenditure account was £408,000.

There was an uplift in the value of the College's other properties of £2,172,000. This has been credited to the revaluation reserve through the statement of total recognised gains and losses in accordance with FRS 15.



### **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, including organisations such as the Association of Scottish Colleges and Audit Scotland. Relevant communication is also considered by the audit committee. This allows management to demonstrate the College's approach to considering incoming guidance and taking action where appropriate.

### **Report to those charged with governance**

Management provided draft financial statements, which were complete and of a high standard, to us in advance of the audit fieldwork. The standard of documentation prepared by the finance department to support the financial statements was of a high standard and available to the audit team on the first day of the fieldwork. Adjustments of £408,000 were made to the draft financial statements in relation to the valuation of fixed assets and there are no unadjusted audit differences.

## Appendix – action plan

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

No.	Issue and performance improvement observation	Management response	Officer and due date
1	<p>The College has an outstanding loan in Euros, which was incorrectly translated into Sterling for the purposes of the financial statements. Management processed an adjustment of £20,000; reducing the reported surplus.</p> <p>Management should ensure that all foreign currency transactions are translated at the correct exchange rate.</p> <p><i>Grade two</i></p>	<p>Accept recommendation – all foreign currency transactions will be translated at the correct exchange rate. This has been amended in the 07/08 accounts.</p>	<p>Finance Manager, immediately (ongoing)</p>
2	<p>Bank reconciliations are prepared on a monthly basis, but are not subject to independent review.</p> <p>We note the limited scope for full segregation of duties at the College, but a process of independent review of bank reconciliations, a key control, should be implemented.</p> <p><i>Grade two</i></p>	<p>This has been highlighted in previous audit reports but given that the reconciliations are prepared by the Finance Manager there is no one in a more senior role with the relevant knowledge and expertise to carry out an independent review.</p>	<p>Not Applicable</p>

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