Key Issues Memorandum

Dumfries and Galloway College

For the year ended 31 July 2012

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To the Audit Committee of Dumfries and Galloway College and the Auditor General for Scotland

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The purpose of this memorandum is to highlight the key issues affecting the results of the College and the preparation of the College's financial statements for the year ended 31 July 2012. It is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We take responsibility for this memorandum, which has been prepared on the basis of the limitations set out in 'The small print' (Section 11).

We would like to take this opportunity to record our appreciation for the kind assistance provided by the finance team and other staff during our audit.

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Contents

1 Executive summary

Financial performance
For the year ended 31 July 2012, the College reported a surplus of £24k (2011: £17k). The surplus reflects further savings in staff costs following a voluntary redundancy scheme in 2010/11.

For the year ending 31 July 2012, the College reported net funds of £47,097k (2011: £49,186k). The decrease in net funds is mainly due to an increase in the pension liability as a result of the impact of wage inflation and the economic recession on the financial performance of the pension fund.

Audit and financial reporting issues
We have issued an unmodified opinion on the College's financial statements for the year ended 31 July 2012. We conclude that the financial statements are prepared in the accordance with the Accounts Direction issued by the Scottish Funding Council and the Statement of Recommended Practice – Accounting for Further and Higher Education Institutions and the Companies Act 2006.

We have also concluded that in all material respects, income from the Scottish Funding Council, grants and income for specific purposes from other restricted funds administered by the College have been applied for the purposes for which they were received.

We are pleased to report that the financial statements and supporting working papers presented for audit were of a good standard.

Audit adjustments
The College processed 3 minor audit adjustments relating to the reallocation of credit balances and write out of debtors. There are no unadjusted misstatements to report. A summary of adjusted differences is included at section 7 of this memorandum.

Design effectiveness of internal controls
We have applied our risk methodology to the audit, which allows us to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

We have identified 3 findings to report on internal controls following the completion of our audit. Our detailed findings are summarised at Section 8 of this report.

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2 Financial Results

2.1 Income and expenditure account

Table 1: Income and Expenditure account

	2011-12 £'000	2010-11 £'000
Income	12,139	13,140
Expenditure	12,115	13,123
Surplus for the year	**24**	**17**

Source: 2011-12 financial statements

For the year ended 31 July 2012, the College reported a surplus of £24k (2011: £17k). Table 1 above highlights the financial results for the year.

The College originally budgeted for a surplus of £12k for 2011-12.

Income

Income has decreased overall by £1,001k (8%), reflecting a reduction in SFC grant income of £1,217k, decreased tuition fees of £2k and an increase in other income of £218k.

The decrease in SFC funding reflects a 10% decrease in the main recurrent teaching grant as a result in a cut in funding by the Scottish Government.

Overall student numbers have decreased by 19% which accounts for the decrease in tuition fees compared to the prior year (2012: £806k, 2011: £866k). Other contract income has increased by £118k due to an increase in teaching hours since various projects have been in operation such as Project Knowledge and Project Transform.

Other grant income has increased by 40% mainly due to amounts received from Dumfries and Galloway Council in relation to the delivery of employability courses.

Expenditure

Expenditure has decreased by £1,008 k (8%), mainly due to a decrease in staff costs of £1,690k (20%), an increase in other operating expenses of £406k (12%) and an increase in depreciation of £299k (27%) .

Overall staff numbers have decreased by 39 which accounts for the reduction in staff costs (2012: £6,840k, 2011: £8,530k) due to the associated severance costs in the prior year.

The other operating costs increase is mainly due to the additional Lennartz VAT scheme costs of £454k.

2.2 Balance sheet

Table 2: Balance Sheet

	2011-12 £'000	2010-11 £'000
Fixed assets	50,927	52,346
Current assets	4,744	4,501
Current liabilities	(2,550)	(5,110)
Creditors due over a year	(1,920)	-
Provisions	(985)	(746)
Pension Liability	(3,119)	(1,805)
Net Assets	**47,097**	**49,186**
Deferred capital grants	28,305	29,115
Revenue Reserve	6,528	6,082
Pension Reserve	(3,119)	(1,805)
Revaluation Reserve	15,383	15,794
Total Funds	**47,907**	**49,186**

Source: 2011-12 financial statements

For the year ending 31 July 2012, the College held net funds of £47,907k (2011: £49,186k). Table 2 highlights the key balance sheet items for the year.

Fixed assets
The decrease in the value of fixed assets is mainly due to depreciation charge for the year of £1,413k. There were no additions and vehicle disposals of £9k in the year ended 31 July 2012.

Current Assets
Debtors have decreased by £39k over the prior period due to the timing of payments of large invoices.

Cash balances have increased by £283k.

Current liabilities
Current liabilities decreased by £22,560k mainly due to a decrease of £1,851k in amounts due in relation to HMRC Lennartz Scheme. In the prior year HMRC attempted to abolish this Scheme and as such the College were under the impression that the full amount outstanding would be repayable within one year. This situation has since been resolved and the scheme is now being operated under the original conditions, therefore the amount has been reclassified as payable over the next 6 years with the financial statements.

Pension Liability
The pension deficit of £3,119k reflects the College's share of the assets and liabilities in the Dumfries and Galloway Council Pension Fund, which is accounted for as a defined benefit scheme under FRS 17. The movement of £1,314k mainly reflects a change in actuarial gains and losses from the prior year.

Deferred capital grants
The decrease in deferred capital grants of £810k relates to amounts released to the Income and Expenditure Account in the year.

3 Key audit issues

In this section we present our findings in respect of matters and risks identified at the planning stage of the audit and we provide details of additional matters that arose during the course of our work.

3.1 Status of audit

Our audit is complete following discussions with management and the Board.

3.2 Matters identified at the planning stage

In the conduct of our audit, we have not had to alter or change our audit plan, which we communicated to you in our Audit Approach Memorandum.

Our responses to the matters identified at the planning stage are detailed below.

3.3 Matters identified during the course of the audit in relation to fraud

During the course of the audit we have identified no issues in relation to fraud.

3.4 Matters identified during the course of the audit in relation to related parties

During the course of the audit we have identified no material issues in relation to related parties.

3.5 Matters identified during the course of the audit in relation to compliance with relevant laws and regulations

During the course of the audit we have identified no issues in relation to non-compliance with relevant laws and regulations.

3.6 Matters identified at the planning stage

	Issue	Auditor commentary
1	**Financial Statement Risks – Fixed Assets** There is a potential risk that fixed assets are not fairly stated in the financial statements for the year ended 31 July 2012.	Our testing involved reviewing valuations of land and buildings, physically verifying a sample of fixed assets and performing a depreciation reasonableness based on the accounting policies in place during the year. Based on our testing performed, we are satisfied that fixed assets are not materially misstated within the financial statements for the year ended 31 July 2012.
2	**Financial Statement Risks - Income** There is a potential risk that income is not completely and accurately stated in the financial statements for the year ended 31 July 2012.	Our testing involved documenting the various income streams following review of fund provider documentation and discussions with key members of the College finance team. We subsequently agreed the awards from the fund provider documentation to bank statements. We then performed analytical review of income to ensure material movements were reasonable and in line with expectations. Based on our testing performed, we are satisfied that income is not materially misstated within the financial statements for the year ended 31 July 2012.
3	**Financial Statement Risks – Employee Remuneration** There is a potential risk that employee remuneration expenses are not completely and accurately stated in the financial statements for the year ended 31 July 2012.	Our testing involved documenting the payroll process and subsequently agreeing monthly payroll reports through to nominal ledger posting and payments to bank statements. Based on our testing performed, we are satisfied that employee remuneration is not materially misstated within the financial statements for the year ended 31 July 2012.

4	**Financial Statement Risks – Operating Expenses** There is a potential risk that operating expenses are not completely and accurately stated in the financial statements for the year ended 31 July 2012.	Our testing involved agreeing a sample of significant operating expenses to source documentation and discussing significant variances with key members of the College finance team. Based on our testing performed, we are satisfied that operating expenses are not materially misstated within the financial statements for the year ended 31 July 2012.
5	**VAT – Lennartz Mechanism** We understand the College implemented the Lennartz mechanism to delay the payment of VAT in relation to campus development expenditure. We further understand there was a potential that the amount due under this mechanism would be payable immediately due to a change in HMRC rules and regulations.	Our testing of this issue involved reviewing HMRC documentation in relation to the Lennartz mechanism and your correspondence with Scott-Moncrieff on this subject. Based on our testing performed, we are satisfied that the Lennartz liabilities are correctly classified as amounts due within and over a year within the financial statements for the year ended 31 July 2012 in accordance with HMRC guidance.

3.7 Matters identified during the course of the audit for Dumfries and Galloway College

Other than the matters highlighted at planning stage there were no additional significant audit issues which arose through the course of our fieldwork.

4 Governance

4.1 Introduction

The Board are responsible for establishing arrangements for ensuring the proper conduct of its affairs, including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The Audit Committee has a role in monitoring these arrangements

	Issue	Auditor commentary
1	**Financial position** As part of our audit planning procedures we noted that the forecast for 2011-12 was a surplus of £53k against an original budgeted surplus of £19k. In the current economic climate publicly funded bodies are facing increasing financial constraints and consequently efficiency savings and cost reduction plans are a vital tool in staying within allocated budgets.	We have reviewed the processes in place in relation to budget monitoring, financial systems, cash flow forecasting and monitoring and treasury management as part of the audit field work and have noted no significant issues. Based on our review, we are satisfied these processes are being used effectively in controlling and monitoring of the financial position of the College.
2	**Procurement** Public procurement in Scotland is subject to stringent UK and European legislation, together with specific requirements of the Scottish Government and Scottish Funding Council. There is a potential risk that the policy is not always followed by all members of staff.	As part of our regulatory review of the College, we have reviewed the procurement policy against legislation and specific further education requirements and have noted no significant issues. Based on our review, no issues were noted in relation to the adopting of this policy by the College.

5 Performance

5.1 Introduction

All public bodies in Scotland have a duty to secure Best Value and continuous improvement. Dumfries and Galloway College continues to work with the Scottish Government to identify further areas of efficiencies and savings

	Issue	Auditor commentary
1	**Audit Scotland national reports** In August 2010, Audit Scotland published a national report on how public bodies are beginning to respond to the challenge of a significant reduction in budget. The report provides an overview of budgeting issues across the public sector and there is some key commentary on the reduction of the funding to the Further and Higher Education sector and the impact of the removal of the cap on tuition fees in England and Wales. In September 2010, Audit Scotland published a national report on the governance arrangements across the public sector. The report focused on three areas and provided recommendations on the following: • the role and accountability of boards • the skills and expertise of board members • how boards operate.	As part of our regulatory review of the College, we have reviewed the national reports and noted issues facing the College. Due to the regionalisation and the on-going movement in the governance arrangements for Colleges it was understandable that the evaluation against the report has not yet been undertaken. We recommend that going forward further consideration is given to the arrangements in place. **Management comment:** The College Board of Management are aware that this issue is affecting all Scottish Colleges and are currently awaiting Government guidelines.

6 Financial reporting matters

6.1 Commentary on key judgements and estimates

Going concern

We have reviewed management budgets for the period to July 2015 and management accounts with commentary to September 2012. We are satisfied that the College is projected to operate with adequate headroom within its funding.

We recommend that management continues to closely monitor operations and maintains tight control of its working capital.

6.2 Review of principal accounting policies

We have reviewed the financial statements and have noted no significant issues in relation to the key accounting policies, judgements and estimates.
Disclosure omissions

Our review found no significant omissions in the financial statements.

7 Audit adjustments

7.1 Misstatements

We are required to communicate all uncorrected misstatements to you, other than those considered to be clearly trivial. Management have corrected these misstatements and revised the financial statements for the year ended 31 July 2012 appropriately.

7.2 Impact of misstatements

There is impact on the result the adjusted misstatements had no impact on the reported surplus for the year ended 31 July 2012s.

7.3 Adjusted misstatements

Journal reference	Detail	Balance sheet Dr	Balance sheet Cr	Profit and loss Dr	Profit and loss Cr	Profit effect
Draft surplus						24,000
1	Dr FE Fees UK			29,000		29,000
	Cr Education Contracts				(29,000)	(29,000)
	Being reallocation of tuition fee income					
2	Dr Accruals	100,022				
	Cr Provision for Redundancy Costs		(100,022)			
	Being reallocation of staff redundancies					
3	Dr Accruals	88,000				
	Cr Provision for Heating System Defects		(88,000)			
	Being reallocation of heating system defects					
Surplus per final accounts						24,000

8 Design effectiveness of internal controls

8.1 Accounting system and internal control

Our audit is not designed to identify all significant weaknesses in the College's internal controls but is designed primarily for the purpose of expressing our opinion on the financial statements of the College. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work did not encompass a detailed review of all aspects of the internal controls and cannot be relied upon necessarily to disclose all defalcations or other irregularities or to include all possible improvements in internal control.

See 'The small print' for further details of our approach in respect of internal controls.

8.2 Key findings

Key to assessment of internal control deficiencies

● (red)	Material weakness - risk of material misstatement
● (yellow)	Significant deficiency - risk of significant misstatement
● (green)	Deficiency - risk of inconsequential misstatement

	Assessment	Issue and risk	Recommendation
1	● (green)	**Journal Entries** We understand journals entries can be posted by all members of the finance department, however these must be authorised by Karen Hunter (Financial Controller). We further understand that Karen Hunter can also post journals, however these are not authorised by another key member of the finance team. Poorly-controlled journal posting processes mean that errors or fraud can occur and go undetected. With the heightened risk of fraud caused by the current economic conditions, improving controls over journals should be an area of focus for the Board.	We would recommend all journals are authorised by a more senior member of the finance department. Alternatively, we would recommend that Karen no longer be permitted to post journals entries but solely act as an authoriser to reduce the fraud risk by way of management override. **Management response:** The current staffing within the Finance department does not provide an alternative member of staff with the expertise to post some of the monthly and annual journals. However, we will ask internal audit to incorporate a review of journal postings within their annual audit cycle.

9 Financial reporting and legislative developments

UK GAAP

Improvements to FRSs

What is proposed?

As we have noted in previous years the Accounting Council is planning to replace all current UK financial reporting standards with a new framework, incorporating two new standards. The standards are "The FRS", a 300 page standard which will be applied by the majority of UK companies, and the Reduced Disclosure Framework, an option of IFRS with reduced disclosures available for subsidiaries and parent company individual accounts.

For more information on the proposals and their implications, visit our website, http://www.grant-thornton.co.uk/services/audit_and_assurance/the_future_of_uk_gaap.aspx.

What would this mean for the College?

Under the proposals, the College would be considered to be a public benefit entity, as its main purpose is not the generation of profit. The FRS includes supplementary paragraphs which address issues specific to public benefit entities, for example non-reciprocal transactions such as donations.

The College will be required to undergo transition to The FRS, as will its subsidiary companies. When undergoing transition to the new financial reporting regime, there are likely to be recognition and measurement differences on transition, for example the requirement to accrue for unused holiday balances. These differences are likely to impact on the reported profit and also on the balance sheet.

As a consequence, there may be an impact on:

- the amount payable under any employee bonus arrangements the College might put in place.

What other issues do I need to consider?

There are also operational issues which may need to be addressed in preparing for transition, such as:

- training requirements
- possible systems changes to ensure all information is captured
- education of stakeholders
- potential need for additional resources.

What about the not-for-profit SORPs?

The Accounting Council intends to retain the three not-for-profit SORPs, for Charities, Registered Social Landlords and Higher and Further Education Establishments. However as stated above these SORPs will need to be updated to reflect the requirements of The FRS.

How should I plan for the transition?

From our experience in helping other entities transition between frameworks we note that the key to managing the process successfully is thorough planning and ensuring the time and resource commitments are not underestimated.

Although the final standards will not be published until the end of 2012, and will not be effective until accounting periods beginning on or after 1 January 2015 at the earliest, it is not too soon to start considering how you will address the transition process.

For the College this will mean the first reporting period is likely to be the year ended 31 July 2016, which will mean comparative balance sheets will be required for 31 July 2015 and 31 July 2014.

Timely actions and the right support will ensure that the process goes as smoothly as possible.

We would be pleased to discuss this matter further and provide detailed guidance in regard to this transition.

Real Time Information (RTI)

The introduction of Real Time Information (RTI) will significantly change the way that employers report PAYE deductions from April 2013. Instead of notifying HM Revenue & Customs (HMRC) of pay and deductions made from employees' wages at the end of the tax year, employers will be required to do this each and every time that any payment is made to an employee, on or before the time the payment is made.

Employers with fewer than 5,000 employees must start filing RTI returns from 6 April 2013.

Non-compliance with the new rules could lead to payroll processing failures, reputational damage with HMRC and employees, and potential penalties by HMRC for late or incorrect submission of data. All employers will need to review their policies, processes and systems to make sure that they are robust enough, and contain the correct data, to enable them to file in real time.

We would be pleased to discuss this matter further and provide detailed guidance in regard to this transition.

Disguised remuneration

The new disguised remuneration legislation results in an upfront income tax charge and National Insurance contributions where a reward or sum of money is earmarked for or loaned to an employee by a third party as part of an arrangement in connection with employment.

The original draft of the legislation was very wide ranging and caught many commercial arrangements with no tax avoidance element. Although the latest changes to the legislation do address many of the anomalies, there are still key issues which need to be considered when a company is to introduce any reward, benefit or incentive arrangement which includes a party other than the employee and employer in the structure

10 Independence

Ethical standards require us to give you full and fair disclosure of matters relating to our independence.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

In accordance with best practice, we analyse our fees below:

	£
Audit of College	13,500
Total audit	**13,500**

11 The small print

Purpose of memorandum

This Key Issues Memorandum has been prepared for the benefit of discussions between Grant Thornton, the Audit Committee and the Board of Dumfries and Galloway College.

The purpose of this memorandum is to highlight the key issues affecting the results of the College and the preparation of the College's financial statements for the year ended 31 July 2012.

This document is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We would point out that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements of the College.

This memorandum is strictly confidential and although it has been made available to management to facilitate discussions, it may not be taken as altering our responsibilities to the College arising under our audit engagement letter.

The contents of this memorandum should not be disclosed to third parties without our prior written consent.

Responsibilities of the directors and auditors

The directors are responsible for the preparation of the financial statements and for making available to us all of the information and explanations we consider necessary. Therefore, it is essential that the directors confirm that our understanding of all the matters in this memorandum is appropriate, having regard to their knowledge of the particular circumstances.

Clarification of roles and responsibilities with respect to internal controls

The College's management is responsible for the identification, assessment, management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance to the Audit Committee that it has done so.

The Audit Committee is required to review the College's internal financial controls. In addition, the Audit Committee are required to review all other internal controls and approve the statements included in the annual report in relation to internal control and the management of risk.

The Audit Committee should receive reports from management as to the effectiveness of the systems they have established as well as the conclusions of any testing conducted by internal audit or ourselves.

The Audit Committee are required to review the College's internal financial controls. In addition, the Audit Committee is required to review all other internal controls and approve the statements included in the annual report in relation to internal control and the management of risk

We have applied our audit approach to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We would be pleased to discuss any further work in this regard with the Audit Committee.

ISAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit work
- significant findings from the audit