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INFRASTRUCTURE, GOVERNMENT & HEALTHCARE

Dumfries and Galloway College

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

Audit: Year ended 31 July 2008
23 December 2008

AUDIT

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Contents

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 statements

On 19 December 2008 we issued an audit report giving our unqualified opinion on the financial statements of the College for 2007-08 and the regularity of transactions reflected therein.

Financial position

The College achieved a surplus of £521,000 in the year.

The College finished the year with £36 million of assets under construction in respect of the new campus.

The financial statements report retained general reserves of £884,000 and the Scottish Funding Council classifies the College as financially secure.

The 2008-09 financial plan forecasts a surplus of £50,000.

Governance and risk management

There are no significant weaknesses disclosed in the statement on internal control, and no significant control weaknesses were identified through our work on the control systems in the College.

The College has a policy of reviewing all procedures and policies every three years, with interim updates to documents as required. Key policies and procedures should be subject to annual review by the Board of management or one of its committees to ensure that all documents are kept up to date and are in line with the latest best practice.

The Internal Audit Annual Control Statement states:

"We consider that the internal control systems as defined in the Audit Needs Assessment and tested in the year under review are adequate".

Introduction

Audit framework

2007-08 was the second year of our five-year appointment as external auditors of Dumfries and Galloway College ("the College"). This report to the board of management 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 *Code*"), 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 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 high level of co-operation and assistance extended to us by staff during the second year of our work in the discharge of our responsibilities.

Financial commentary

- The College achieved a surplus of £521,000 in the year.
- The College finished the year £36 million of assets under construction in respect of the new campus.
- The financial statements report retained general reserves of £884,000 and the Scottish Funding Council classifies the College as financially secure.
- The 2008-09 financial plan forecasts a surplus of £50,000.

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 surplus for the year of £521,000, an increase of 139% compared to the 2007 and over 13 times higher than the forecast outturn of £40,000. The surplus is equivalent to 4% of annual turnover.

Income

Total income increased by £1,420,000 (12%) compared to 2006-07. Similar to previous years, the majority of income (75%) is received from the Scottish Funding Council; other grant income has decreased in 2007-08, primarily due to the timing of deferred capital grant releases. The most significant movements in income were:

- increase in the main recurrent grant from the Scottish Funding Council of £1,277,000;
- £296,000 increase in interest received on bank deposits; and
- decrease of £60,000 in other grant income, mainly due to the release in the prior year of the Heathhall grant, offset partly by an increase in European grants for the new campus.

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

	2007-08	***2006-07***	**2007-08**	***2006-07***
	£'000	***£'000***	**%**	***%***
Scottish Funding Council grants	9,639	*8,362*	75%	*72%*
Tuition fees and education contracts	1,894	*1,934*	15%	*19%*
Other grant income	267	*327*	2%	*2%*
Other operating income	587	*640*	5%	*6%*
Interest received	514	*218*	3%	*1%*
Total income	**12,901**	***11,481***	**100%**	***100%***

Expenditure

Overall, total expenditure has increased by £1,117,000 (10%) which is less than the equivalent movement in income. The most significant movements in expenditure were:

- £295,000 reduction on disposal of assets because 2006-07 had included £395,000 in relation to the sale of the Heathhall site;
- £656,000 increase in staff costs as a result of the pay award in the year (5%);

- £583,000 increase in premises costs relating to new build spend below the capitalisation threshold, which is therefore recognised as revenue expenditure; and
- £442,000 increase in administration costs due mainly to expenditure associated with the new campus including computing equipment, licences and admin equipment as well as an element of consultancy costs.

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

	2007-08 £'000	*2006-07 £'000*	2007-08 %	*2006-07 %*
Staff costs	7,819	*7,163*	63%	*64%*
Other operating expenditure	4,372	*3,525*	35%	*31%*
Depreciation	189	*575*	2%	*5%*
Total expenditure	**12,380**	***11,263***	**100%**	***100%***

Other operating expenditure has increased as a percentage of total expenditure by 4% compared to the prior year, which is due to costs associated with the new build.

Balance sheet

The College has reported a net increase in net assets of £23.4 million during the year, of which £27 million relates to expenditure on the new campus.

	2007-08 £'000	*2006-07 £'000*
Fixed assets	40,556	*11,231*
Current assets		
Debtors	1,254	*3,468*
Cash at bank and in hand	4,906	*6,116*
Creditors due within one year	(2,841)	*(3,716)*
Net current assets	**3,319**	***5,868***
Provisions	(668)	*(566)*
Creditors – amounts falling due after more than one year	(2,568)	*-*
Net assets excluding pension liability	**40,639**	***16,533***
Pension liability	(416)	*(370)*
Net assets including pension liability	**40,223**	***16,163***
Deferred capital grants	30,510	*8,810*
Income and expenditure account, including the pension reserve	5,228	*5,136*
Revaluation reserve	4,485	*2,217*
Total	**40,223**	***16,163***

Significant movements during the year include:

- an increase of £30 million in fixed assets in relation to the Crichton new build and formal valuation of other land and buildings at 31 July 2008;
- £2.2 million decrease in debtors relating to grant income accrued in the prior year for the new build;
- a decrease in accrued expenditure at 31 July 2008; and

- a decrease in VAT payable of £401,000 due to one off VAT creditors in 2006-07 in respect of the sale of the Heathhall site; and
- £3 million increase in creditors falling due after more than one year relating to VAT repayable under the Lennartz scheme.

Financial forecasting

The financial plan submitted to the Scottish Funding Council in June 2007 forecast a surplus of £40,000 as at 31 July 2008. The actual outturn as at 31 July 2008 was a surplus of £521,000.

The following table summarises the significant movements during the year.

	£'000
2007-08 forecast outturn per the financial plan	40
Increase in deferred capital grant releases in relation to new build	634
Release of infrastructure grant received	575
Increase in other income	222
Increase in interest receivable	420
Increase expensed capital assets in relation to the new build	(1,437)
Increase in other operating expenditure	(326)
Decrease in depreciation	393
2007-08 actual outturn at 31 July 2008	521

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

- increased grant income due to infrastructure grant received in the year;
- increased other income due to creche fees and other staff cover income not included in the original forecast;
- increased investment income from interest received on significant cash balance following the early sale of Heathhall Campus and higher interest rates available.
- increased expenditure due to minor capital additions for the new build expensed in the year, which were offset by capital grants appropriately recognised as income; and
- increased other operating expenditure mainly due to professional fees in relation to the Crichton campus and marketing costs not included in the 2007 forecast; and
- decreased depreciation charges for the year due to the early sale of the Heathhall campus.

The following table summaries the forecast surplus and cash balances for the College for 2008-09:

	£'000
Income	12,505
Expenditure	12,407
Forecast surplus for the year ending 31 July 2008	**98**
Cash balance at 31 July 2008	4,906
Forecast cash balance at 31 July 2009	6,150
Forecast movement in cash during 2008-09	**1,244**

The College is forecasting a small surplus in line with prior years. The College is also forecasting an increased bank balance from positive operating cashflow in 2008-09. As in the prior year, management believes that this strong cash position removes the need for any bank overdraft funding.

Governance and risk management

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 review 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

There have been no changes in the current year to the risk management procedures which were last updated and approved by the Board of management in July 2007. The risk register maintained by the College continues to be reviewed at both the audit committee and board of management meetings. No significant changes have been made to this in 2007-08.

A specific new build risk register was created and maintained in the year. This helped to ensure that the project was completed within budget.

Systems of internal control

Corporate governance statement

The compilation of the corporate governance statement is the responsibility of the head of finance who takes into account guidance in the revised SORP and findings reported by internal audit.

The audit committee is responsible for providing assurance to the board of management relating to corporate governance. Corporate governance is a standing item on board of management meeting agendas.

We are required to review the Colleges corporate governance statement 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.

As in prior years the College has made a fully compliant corporate governance statement which we have reviewed. We consider this consistent with our understanding of the process followed by the College during the year.

In accordance with its audit plan, internal audit performed completed audits on a number of areas in the year including information technology and staff recruitment and training.

As in the prior year internal audit did not make any 'grade A' key recommendations. This is reflective of the strong control environment in place at the College.

The internal audit annual report was issued on 2 December 2008. In their annual internal control statement, Internal Audit concluded that *"internal control systems as defined in the Audit Needs Assessment and tested in the year under review are adequate"*.

Internal controls

In accordance with our plan we undertook detailed testing in relation to both entity-level and key financial controls. No issues were noted in the year. In the prior year we identified that the College has a policy of reviewing all procedures and policies every three years, with interim updates to documents as required, but key policies and procedures should be subject to annual review.

Management have not actioned this in 2007-08 as the focus has been on the new build project, but this will be addressed in 2008-09.

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

We noted in our 2006-07 report that the College fraud and whilstleblowing policies were last updated in 2006 and 2003 respectively. This was also noted in an internal audit report in the prior year as a point for improvement and remains to be the case.

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

Standards of conduct

The various procedures and policies in place are the same as in the prior year. These can be by all staff through the intranet and include a staff code of conduct, board of management code of conduct and internet usage codes of conduct.

The formal register of interests maintained by the College was last updated in 2007. Additions were made to the register in the year as necessary following changes to the board membership and a declaration of interests is a standing item on all committee meeting agendas.

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

Audit opinion

On 19 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.

Crichton campus

Work on the new build was almost complete at the year end, with fixed assets totalling £36 million recognised in assets under construction. This was funded by a combination of grants from the European Regional Development Fund and the Scottish Funding Council. The College's accounting policy requires that fixed assets with an individual value of less than £10,000 are expensed to the income and expenditure account at the time of purchase. During 2007-08, assets totalling £1.3 million were expensed, mainly in relation to the new campus. There was also a corresponding release of deferred capital grants in the year totalling £0.6 million.

As a condition of the planning permission granted for the new campus, the College has a duty to promote sustainable transport to the new build, with a penalty being paid if the College fails to implement agreed actions and meet its targets. Management has started to address the various actions and has concluded that there is no contingent liability based on current plans. We agree with management's assessment.

Regularity

We have reviewed the minutes of the College's key committees during the financial year, including the Board of management and audit committee meetings. From these minutes, we have established that the College has procedures in place to ensure discussion of key guidance from the Scottish Funding Council, as well as other relevant laws and regulations.

Prior to January 2007 there was no formal system of recording the receipt of, and action taken in response to, circulars and other guidance. A new system was introduced in January 2007 which has addressed this, and all Scottish Funding Council guidance is now logged and retained on file, with details of action required and subsequent implementation of action. This system operated effectively during 2007-08.

Report to those charged with governance

At the audit committee meeting on 2 December 2008 we discussed our "report to those charged with governance" which is required under International Auditing Standard 260. This dealt with relevant aspects of the College's financial statements production process, amendments to draft financial statements during the audit process, the treatment of uncorrected audit differences and the content of the representation letter from the principal to us. There were no matters of significance included in that report which require to be reported here.

Appendix – action plan

Priority rating for performance improvement observations raised		
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 College or systems under consideration. The weakness 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 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.

No.	Issue and performance improvement observation	Management response	Officer and due date
1	Monthly reconciliations are performed between the sales ledger and the nominal ledger by the finance team, but there is no evidence to demonstrate that these are formally reviewed by management. We recommend that these are formally reviewed and evidenced on a monthly basis. *(Grade three)*	We will review our procedures to include evidencing the review of monthly reconciliations by management.	Finance Manager, January 2009
2	On a number of occasions, authorisation to recruit forms for new starters were not completed. We acknowledge that alternative evidence was in place. Management should formalise a consistent process to evidence authorisation of recruitment. *(Grade two)*	We will aim to use the 'Approval to Recruit' forms for all new starters, and only use an alternative format in exceptional circumstances.	Director of Human Resources, March 2009
3	There were some instances where there was no written evidence of resignation of employees. Management should implement a formal process to record all staff resignations. *(Grade two)*	We will formalise our process for recording all staff resignations to ensure appropriate evidence is held.	Director of Human Resources, March 2009

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