INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

Dumfries and Galloway College

Annual audit report to the Board of Management and Auditor General for Scotland
Year ended 31 July 2009

15 December 2009

AUDIT

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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 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.

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Executive summary

Financial commentary

The financial outturn for the year (£26,000) is slightly behind the forecast figure (£41,000). Income was greater than anticipated due to additional funding being received from the Scottish Funding Council for new projects during the year. However, this was offset by expenditure being greater than forecast, with additional costs associated with the completion of the new build.

The financial position at the end of the year has been adversely impacted by the accounting for the defined benefit pension scheme which has reduced the general reserve from £5,228,000 at 31 July 2008 to £2,846,000 at 31 July 2009.

The most recent financial plan forecasts a surplus of £61,000 for 2009-10 (excluding anticipated gains on the sale of fixed assets). Thus the College remains to be in a strong financial position in the immediate future with a significant cash balance.

Governance and risk management

Governance and risk management processes of the College are strong. These have been strengthened during the year through updates to risk management processes, ongoing updates to the risk register and changes in Board of Management membership.

The College's internal audit providers changed during the year following a competitive tendering exercise.

Internal audit's annual report concluded that the College's internal control systems were "adequate as far as they operated up to 30 June 2009". This supports the corporate governance statement accompanying the financial statements.

The operating and financial review has been updated this year in the light of new guidance.

Financial statements audit

On 15 December 2009 we issued unqualified opinions on the financial statements and the regularity of transactions.

We received a first draft of the financial statements prior to the commencement of our audit work. However, significant subsequent were then required to be made to produce the final financial statements.

Introduction

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice*. This, and supplementary planning guidance issued by Audit Scotland, specifies a number of objectives for our audit.

Audit framework

This was the third of our five-year appointment by the Auditor General for Scotland as external auditors of Dumfries and Galloway College ("the College"). This report to the College's Board of Management and the Auditor General provides our opinion and conclusions and highlights significant issues arising from our work.

We outlined the framework under which we operate, under appointment from Audit Scotland, in the audit plan overview discussed with the Board of Management's audit committee on 12 May 2009.

In accordance with Audit Scotland's Code, the scope of our work for 2008-09 was to:

- provide an opinion on the College's financial statements and, as required by the relevant authorities, the regularity of transactions;
- review and report on (as required by relevant legislation, the Code and any guidance issued by Audit Scotland):
  - 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; its financial position
  - aspects of the College's arrangements to manage its performance, as they relate to economy, efficiency and effectiveness in the use of resources.

Responsibilities of the Board and auditors

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 the stewardship of resources made available to its 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 the College principal, to make arrangements to secure Best Value.

Acknowledgement

Our audit work has again brought us into contact with a range of College staff. We wish to place on record our appreciation of the cooperation and assistance extended to us by staff again this year during the discharge of our responsibilities.

Service overview; overall position for year

- The net result for the year was a surplus of £26,000 compared to a forecast surplus of £41,000 and a surplus of £521,000 in the prior year.
- The 2009-10 financial plan forecasts a surplus of £61,000 (excluding gains on the sale of fixed assets) and a reduction in cash of £350,000 due to the payment of retention held in respect of the new build.

Service overview

The financial statements report a surplus for the year of £26,000 a decrease of £495,000 compared to the prior year and £15,000 less than the projected outturn anticipated in reporting to the Scottish Funding Council during the year. At 31 July 2009 there were retained general reserves of £2,846,000, down from £5,228,000 in the prior year.

Income

Overall, income for the year has increased by £58,000 (0.45%) compared to 2007-08, as summarised in the table below. This table demonstrates a significant increase in Scottish Funding Council income which is offset by decreases in investment income and income from tuition fees and education contracts year on year, giving the modest increase in total income for the year ended 31 July 2009.

The increase in Scottish Funding Council income is due to additional funding received from greater student headcount figures than in prior years and also due to new projects and initiatives being launched during the year for which funding was obtained, including the *Overcoming Rural Challenges* and *Blend2Learn* projects.

The decrease in investment income is due to a reduction in the cash balances held by the College due to the outflow of funds for the new campus in the current year.

The reduction in tuition fees income is due the cessation of local authority funding for the *Schools Link* programme.

Income	**2008-09 £'000**	***2007-08 £'000***	**Movement £'000**	**Movement %**
Scottish Funding Council grants	10,299	*9,639*	660	6.9
Tuition fees and education contracts	1,708	*1,894*	(186)	(9.8)
Other grant income	166	*267*	(101)	(37.8)
Other operating income	680	*587*	93	15.8
Investment income	106	*514*	(408)	(79.4)
Total	**12,959**	***12,901***	**58**	**0.5**

Source: financial statements

Expenditure

Expenditure

Expenditure has also increased in comparison to the prior year from £12,380,000 in 2007-08 to £12,933,000, as detailed in the table below.

The main impact in the increased expenditure is increased depreciation. In the prior year, the new building was not depreciated as it had not yet been completed. However, the 2008-09 financial statements reflect depreciation for the six months from February 2009 when the College obtained the practical completion certificate.

Staff costs have also increased since the prior year, due to a new level of middle management being created to cover the positions of heads of faculties, resulting in an increased salary base for a similar level of staff numbers. Also all staff were awarded a standard 3% pay rise with an effect for the full year.

Total expenditure shows an underlying decrease in the year with the main movement being an decrease of £495,000 in other operating expenses. This is due to expenditure in the prior year on fixed assets below the capitalisation threshold of £10,000 which was written off to the income and expenditure account in line with the College's accounting policy. In the prior year, significant expenditure was incurred on new computers and equipment for the new build which was below this limit.

Expenditure	**2008-09 £'000**	***2007-08 £'000***	**Movement £'000**	**Movement %**
Staff costs	8,376	*7,819*	557	7.1
Other operating expenses	3,877	*4,372*	(495)	(11.3)
Depreciation	680	*189*	491	259.8
Total	**12,933**	***12,380***	**553**	**4.5**

Source: financial statements

Balance sheet

The balance sheets at 31 July 2008 and 2009 are detailed in the table below. This shows a decrease of £2,104,000 in net assets since the previous year end. Significant movements are detailed on the following page.

Balance sheets	2009 £'000	2008 £'000	Movement £'000	Movement %
Fixed assets				
Tangible fixed assets	42,805	*40,556*	2,249	5.5
Current assets and liabilities				
Debtors	626	*1,254*	(628)	(50.1)
Cash at bank and in hand	2,950	*4,906*	(1,956)	(39.9)
Creditors due within one year	(2,684)	*(2,841)*	157	5.5
Net current assets	**892**	***3,319***	**(2,427)**	**(73.1)**
Creditors due after one year	(2,539)	*(2,568)*	29	1.1
Provision for liabilities	(735)	*(668)*	(67)	(10.0)
Pension liability	(2,838)	*(416)*	(2,422)	582.2
Net assets including pension liability	**37,585**	***40,223***	**(2,638)**	**(6.6)**
Deferred capital grants	30,490	*30,510*	(20)	(0.1)
Income and expenditure account, including pension reserve	2,846	*5,228*	(2,382)	(45.6)
Revaluation reserve	4,249	*4,485*	(236)	(5.3)
Total	**37,585**	***40,223***	**(2,638)**	**(6.6)**

Source: financial statements

Balance sheet

Fixed assets

Fixed assets now include the completed new build campus at the Crichton, including the Henry Duncan Building. In the previous year the campus was still held as assets in the course of construction. As it was completed during the current year it is now held in land and buildings and is depreciated accordingly. The only significant additions during the year ended 31 July 2009 were in relation to the new build.

Fixed assets also reflect the adjustment for the downwards revaluation of the Newton Stewart campus to open market value.

Net pension liability

The College's share of assets and liabilities of the Dumfries and Galloway Council Pension Fund have been valued and accounted for in accordance with FRS 17 *Retirement benefits*. There has been a significant increase it the net liability from £416,000 at 31 July 2008 to £2,838,000 at 31 July 2009. This is as a result of:

- a reduction in asset values due mainly to the poor performance of the stock market over the last year; and
- increased liabilities due to changes to the assumptions used by the actuary which reflect a worsening in wider financial conditions.

The impact of the change in the net pension liability in the financial statements has been to reduce the general reserve from £5,228,000 in the prior year to £2,846,000 at the end of 2008-09. This demonstrates the potential short term volatility of accounting for defined benefit pension schemes which is not possible to predict.

Debtors

Debtors have decreased £628,000 since the prior year end. The prior year balance included £556,000 in relation to funding from the EU for the new build which was received during 2008-09.

Financial forecasts

The following table summarises the forecast surplus for 2009-10 and cash balance at 31 July 2010 from the financial forecast submitted to the Scottish Funding Council in June 2009.

	£'000
Income	13,102
Expenditure	(13,041)
Forecast surplus for the year ending 31 July 2010	**61**
Cash balance at 31 July 2009	2,950
Forecast cash balance at 31 July 2010	2,575
Forecast movements in cash during 2009-10	**(375)**

Source: 2009 financial forecast return

Income and expenditure

In line with policy and prior years the College has forecast to achieve a small surplus in 2009-10. This is consistent with the actual result for 2008-09 of £26,000 before gains from the disposal of assets.

Income is expected to grow next year as a result of an increase in the Scottish Funding Council recurrent grant. The increase in Scottish Funding Council grant is driven by the increasing wSUMS scoring of the College.

Expenditure is expected to grow in similar proportions to revenue with increases year on year for staff costs. Staff costs are expected to grow due to the award of pay increases which have been budgeted at 3% across all staff. Further, depreciation is expected to double in the coming year as the new campus will be depreciated for the full year, as opposed to six months in the current year.

Cash position

Management forecast that the College's cash position will deteriorate somewhat in 2009-10. This is primarily due to the anticipated payment of the retention still held in relation to the construction of the new campus. However, given the College's strong cash position it is not expected that they will require the use of an overdraft facility at any point during the coming year.

Financial sustainability

Though the College has been financially secure for a number of years, it is important in the current economic climate with significant pressures on public sector funding that management fully consider financial sustainability and scenario planning. Following recent guidance issued by the Scottish Funding Council, we note that management are planning to review arrangements in relation to financial sustainability. This will include an operational-level management workshop and a Board of Management "away day" to discuss potential plans. Management have already identified that the current mix of part-time to full-time courses offered by the College is likely to result in decreased funding levels in the future unless the current arrangements for calculation of funding are changed.

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's annual report concluded that the College's internal control systems were "adequate as far as they operated up to 30 June 2009".
- The operating and financial review provides a comprehensive account of the College's activities and meets the requirements of the 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 publicly-funded bodies. Through the College 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 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 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.

Governance arrangements

The Board of Management comprises 14 members, including a number with significant skills and expertise in finance. A number of appointments to the Board of Management were made during the year. These appointments were reviewed and recommended by its nomination committee according to its guidelines. The Board of Management is ultimately responsible for the College's governance arrangements, but some responsibility for these duties are delegated to various Board sub-committees.

During the year the director of finance acted as clerk to the Board until January 2009 when an assistant principal assumed the role.

Risk management

The Board of Management has continued to review the risk management process to ensure compliance with best practice by introducing a formalised risk management strategy during the period. This document represents an integral part of the College's internal control and corporate governance arrangements. The strategy formally documents the roles and responsibilities of the Board of Management, the College management team and other key parties in relation to risk management.

A risk register is maintained and is available to all staff. This register is reviewed and updated each term and reported to the Board of management for final approval. The audit committee also considers the risk register during its own meetings.

Governance and risk management (continued)

Corporate governance statement

The corporate governance statement for 2008-09 provides details on how the Board of Management has established processes and controls in order to comply with the combined code on corporate governance, issued in 2008. The statement highlights that the College is committed to exhibiting best practice in all aspects of corporate governance. The corporate governance statement is informed by the results of internal consideration of the arrangements that have been put in place by the Board of Management.

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

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 other applicable correspondence. The College therefore considers all incoming guidance received from these bodies, and can demonstrate that appropriate action has been taken when required.

Internal audit

The approved internal audit programme for 2008-09 has been completed. The College changed internal auditors in the year from Armstrong Watson to RSM Bentley Jennison following a competitive tendering exercise.

Armstrong Watson concluded that, for the period to 30 June 2009, the College's internal control systems were "adequate as far as they operated up to 30 June 2009". The internal audit programme included work on various areas including bank/treasury management, fixed assets and purchasing and procurement. Internal audit commented via their reporting to management that controls in all areas covered were either strong or substantial.

RSM Bentley Jennison presented their three year internal audit plan to the audit committee on 29 September 2009. This includes coverage in 2009-10 of key financial systems, student activity, student support funds and EMA.

Internal controls

In accordance with our audit plan, we undertook testing in relation to both entity level and key financial controls. 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.

Governance and risk management (continued)

Prevention and detection of fraud and irregularity

The College has in place an over-arching fraud prevention policy, in addition to a specific whistle-blowing policy. Both policies are readily available to staff on the College's intranet. The fraud policy sets out procedures for the avoidance of fraud and corruption, while also detailing guidance for staff should such activities be suspected. The content of the policy meets the requirements and identifies responsibilities for the prevention and detection of fraud. The whistle-blowing policy provides guidance for those who wish to report suspected matters in confidence.

Management has not reported any frauds, material or otherwise, during 2008-09.

Standards of conduct

There are comprehensive policies and procedures in place at the College. All policies are readily accessible to staff via the College intranet. There are codes of conduct in place for general staff, senior management and members of the board of management. There is a formal register of interests for recording members of the Board of Management and senior managers' interests. This is considered to be best practice and assists in demonstrating consideration of independence in decision-making. The register of interests was updated fully in September 2009 for the beginning of the new financial period.

Best Value / value for money

The 2008-09 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. The College is committed to obtaining value for money and this is included in its financial objectives

Scottish Funding Council enquiry

On 9 June 2009 the Scottish Funding Council issued an enquiry letter to all further education colleges in Scotland as a result of findings by the Scottish Funding Council's internal auditors. These asked Colleges to ensure that:

- all non-trivial contracts entered into by institutions are committed to writing;
- statutory child protection requirements in relation to Enhanced Disclosure checks are adhered to;
- Boards of Management avoids the prospect of any actual perceived conflicts of interest for board members at all times; and
- colleges are aware of and adhere to guidance issued in relation to provision provided in collaboration with other organisations.

The College replied to this enquiry stating that it is compliance with best practice in each of these areas.

Key findings

- We issued an audit report expressing unqualified opinions on the financial statements and the regularity of transactions of the College for 2008-09.
- Management provided draft financial statements and supporting papers at the start of our audit work. A small number of significant adjustments were required to the financial statements prior to finalisation.

Audit opinion

On 15 December 2009 we issued an audit report expressing an unqualified opinion on the financial statements for the year ended 31 July 2009 and on the regularity of transactions reflected therein.

Financial statements – completion arrangements

Management provided draft financial statements prior to the commencement of our final fieldwork visit, but these were not fully completed (with narrative statements and deferred capital grants requiring significant amounts of further work), but these were of a high standard. The standard of documentation prepared by the finance staff to support the financial statements was of a high standard and made available quickly upon our request.

Corporation tax risk

As part of our audit of the financial statements of the College, we have performed a high-level review of the various potential corporation tax issues. We have involved our tax professionals in this to leverage their experience in the further education sector in this review.

There is always a risk when a charity has trading activities that this could expose them to a corporation tax charge from HM Revenue and Customs ("HMRC"). This could arise from generating a profit or a loss on an activity that is considered to be a non-primary purpose (NPP) trading activity. A NPP profit is subject to corporation tax. If a loss arises on NPP trading activities this creates a non-charitable expenditure charge which is equal to the loss. This non-charitable expenditure charge is subject to corporation tax. If the activities that this loss arose from are run on a commercial basis (with a view to making a profit) or the College itself is considered to be commercial (i.e. the College has a surplus in the year and in recent years) then the non-charitable expenditure charge can be sheltered by the corresponding loss thus self cancelling.

If there are NPP trading activities and the total income arising from these is less than £50,000 then normally this is covered by the small trading exemption available to charities. The specific risks we have identified cover two areas and our findings are detailed below.

Trading activities

The College does not operate any significant trading activities. The sports and conference facilities are occasionally made available to third parties, but this is seldom and the income would fall considerably below the small trading exemption.

Closed courses

Closed or restricted courses are deemed to be a non-primary purpose activity. A closed course is broadly one where the attendees are drawn form a narrow range of the public, or the criteria for selection for the course exclude the wider general public, or the benefit is not to a sufficiently wide sector of the public. A typical example would be where a College provides a course or training specifically for a single business. We understand does not operate any courses which would fall within the definition of a closed course.

Conclusion

Management believe that the activities we have identified represent low risks that the College will be exposed to a corporation tax charge on the assumption that these activities are very limited. Any trading activities undertaken in the future should be considered carefully to minimise the risk of a charge to tax.