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 2007
18 December 2007

AUDIT

AUDIT ▪ TAX ▪ ADVISORY

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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 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 that 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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Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact David Watt, who is the engagement leader for our services to the College, telephone 0141 300 5695, email david.watt@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Lorraine Bennett, our Head of Audit in Scotland, either by writing to her at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 222 2000 or email to lorraine.bennett@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Director of Audit Strategy, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.

Executive summary

This report summarises our work for the 2006-07 year and our findings in relation to our audit of the financial statements, financial reporting and corporate governance arrangements.

Financial statements

On 18 December 2007 we issued an audit report giving our unqualified opinions on the financial statements of the College for 2006-07.

The financial statements reflect the disposal of the Heathhall and George Street campuses during the year. These disposals were originally planned for 2007-08; the recognition of the sale in 2006-07 resulted in a loss on disposal of £395,000, offset by a release of £328,000 from deferred capital grants.

Assets in the course of construction of the new campus on the Crichton site were £7 million at 31 July 2007, funded by grants from the European Regional Development Fund and the Scottish Funding Council.

Financial position

The surplus for the year of £218,000 is 2% of total income. The actual outturn is higher than the forecast surplus previously reported to the Scottish Funding Council, primarily due to increased interest receivable, decreased staff costs and the impact of pensions accounting. The results of the College's underlying operations have not varied significantly from the previous forecast outturn.

Governance and strategy

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.

Internal audit has concluded in their annual report that the College's internal control systems subject to review in the year were adequate.

In January 2007 the College implemented a system to manage the recording of the receipt and action of guidance and other regulations in order to have greater transparency.

Introduction

Audit framework

2006-07 was the first 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 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.

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 first year of our work in the discharge of our responsibilities.

Financial commentary

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

Income and expenditure account

The surplus for the year of £218,000 is 2% of total income (2005-06: deficit £7,000, 0.1%), consistent with the sector average in 2005-06. The College's strategic plans reflect surpluses in future years at under 0.5% of income.

Income

Total income increased by £1,055,000 (10%). The majority of income is received from the Scottish Funding Council, but the College has also reported a significant increase in other grant income. The most significant movements in income were:

- increase in the main recurrent grant from the Scottish Funding Council of £890,000;
- £83,000 increase in interest received;
- £471,000 net increase in other income, including a £402,000 increase in the release of deferred capital grants, a £74,000 increase in other grants, and a decrease of £5,000 in European funds.

The following table summarises the sources of income in 2005-06 and 2006-07.

	2006-07	***2005-06***	**2006-07**	***2005-06***
	£'000	***£'000***	**%**	***%***
Scottish Funding Council grants	8,362	*7,483*	73%	*72%*
Tuition fees and education contracts	1,934	*1,947*	17%	*19%*
Other grant income	327	*178*	2%	*2%*
Other operating income	640	*683*	6%	*6%*
Interest received	218	*135*	2%	*1%*
Total income	**11,481**	***10,426***	**100%**	***100%***

Income levels as a percentage of total income are consistent with those reported in 2005-06.

Expenditure

Overall, total expenditure has increased by £863,000 (8%), which is less than the equivalent movement in income and is primarily due to movements in other operating expenditure. The most significant movements were:

- £395,000 loss on disposal of assets, with no prior year comparative;
- increase of £175,000 in teaching department expenses, of which £140,000 related to additional expenditure incurred on curriculum materials and equipment, and a £133,000 increase in administration and central services expenses, mainly relating to increased expenditure on equipment in 2006-07; and
- planned maintenance costs increase of £40,000 and premises costs increase of £39,000.

£185,000 of equipment purchases and the increased maintenance and premises costs were expensed to the income and expenditure account during the year because they did not meet the definition of an asset. These costs were funded by Scottish Funding Council grants, which were recognised as income.

The majority of expenditure is incurred on staff costs. The following table identifies the key elements of expenditure in 2005-06 and 2006-07.

	2006-07	***2005-06***	**2006-07**	***2005-06***
	£'000	***£'000***	**%**	***%***
Staff costs	7,163	*7,121*	64%	*68%*
Other operating expenditure	3,525	*2,698*	31%	*27%*
Depreciation	575	*581*	5%	*5%*
Total expenditure	**11,263**	***10,400***	**100%**	***100%***

Expenditure levels as a percentage of total expenditure have decreased by 4% for staff costs, and increased by 4% for other operating expenditure. The impact of accounting for pensions under financial reporting standard 17 'retirement benefits' resulted in a credit of £58,000 to staff costs, and a change in the composition of the full time equivalents account for the decrease in staff costs as a percentage of expenditure.

Balance sheet

The College has reported an increase in net assets of £8,762,000 during the year. The balance sheets at 31 July 2006 and 2007 are summarised as follows:

	2006-07	***2005-06***
	£'000	***£'000***
Fixed assets		
Tangible assets	11,231	*8,863*
Current assets		
Debtors	3,468	*603*
Cash at bank and in hand	6,116	*2,568*
Creditors due within one year	(3,717)	*(1,448)*
Net current assets	**5,867**	***1,723***
Provisions	(567)	*(647)*
Net assets excluding pension liability	16,531	*9,939*
Pension liability	(370)	*(1,644)*
Net assets including pension liability	**16,161**	***8,295***
Deferred capital grants	8,810	*2,346*
Income and expenditure account, including the pension reserve	5,134	*(431)*
Revaluation reserve	2,217	*6,380*
	16,161	***8,295***

Significant movements during the year include:

- an increase of £2,368,000 in fixed assets in relation to the new campus being built at the Crichton;
- £3,548,000 increase in cash due to the sale of Heathhall and George Street campuses in the year;
- £2,881,000 increase in debtors relating to new build accrued grant income from the Scottish Funding Council.

Financial forecasting

The financial plan submitted to the Scottish Funding Council in June 2006 forecast a surplus of £14,000 as at 31 July 2007. The actual outturn as at 31 July 2007 was a surplus of £218,000. The significant movements in the surplus occurred towards the year end as a result of the sale of the Heathhall and George Street campuses (increased bank interest received on the proceeds) and accounting for the results of the valuation of pension assets and liabilities prepared by the College's actuaries. The results of the College's underlying operations have not varied significantly from the forecast outturn.

The following table summarises the significant movements during the year.

	£'000
2006-07 forecast outturn per the financial plan	**14**
Increase in interest received	83
Net impact of accounting for pension costs under FRS 17	88
Loss on disposal of Heathhall and George Street campuses	(395)
Release of deferred capital grant	328
Decrease in staff costs	70
Increase in course income	30
2006-07 actual outturn at 31 July 2007	**218**

Source: Dumfries and Galloway College (October 2007)

The following table summaries the forecast surplus and cash balances for the College for 2007-08.

	£'000
Income	10,945
Expenditure	10,905
Forecast surplus for the year ending 31 July 2008	**40**
Cash balance at 31 July 2007	6,116
Forecast cash balance at 31 July 2008	4,301
Forecast movement in cash during 2007-08	**1,815**

Source: Dumfries and Galloway College financial forecasting return (June 2007)

The forecast surplus of £40,000 was reported to the Scottish Funding Council in June 2007. Internally, management has revised this forecast to £445,000, which takes into account the impact of selling the Heathhall and George Street campuses in 2006-07 rather than 2007-08 as originally planned.

The cash balance is forecast to decrease during 2007-08 as the cash is used to fund capital expenditure on the new build. Management has confirmed that receiving the proceeds from the sale of the Heathhall and George Street campuses in 2006-07 removes the requirement for overdraft facilities during 2007-08.

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

The risk management procedures were updated and approved by the Board of Management in July 2007. These procedures document the College's approach to managing internal and external identified risks. The College maintains a risk register, with members of the senior management team being risk owners. Risk owners notify the assistant principal (quality and planning) if their risk requires to be updated and all risks are reviewed once a year as part of the strategic planning process.

The risk register is a standing item on both the audit committee and Board of Management meeting agendas. In addition, health and safety at work practices are managed through a separate risk management process.

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 Statement of Recommended Practice: Accounting for Further and Higher Education (SORP) 2003 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.

The Board of Management was involved in a self-evaluation during the year. The self-evaluation was developed internally and comprised a questionnaire for all Board of Management members to complete to identify strengths of the Board of Management and to identify areas for improvement. Overall, the Board of Management scored either 'good' or 'very good' with some areas for improvement, including implementing a communication strategy for all major board decisions and improving student member attendance at meetings. The Association of Scotland's Colleges' handbook now contains a toolkit for board self-evaluation, which the College intends to use in the future to continue its commitment to corporate governance.

During the year internal audit reviewed the corporate governance at the College. No high priority recommendations were made, and internal audit concluded that *"the work undertaken by us indicates that satisfactory corporate governance is practised within the College."*

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 process followed by the College during the year.

Internal audit

In accordance with its audit plan, internal audit performed testing of the following areas in the year: Crichton new build; marketing; corporate governance; general ledger; payroll and financial information and reporting. Internal audit did not make any 'grade A' key recommendations. Internal audit concluded that *"we consider that the internal control systems as defined in the audit needs assessment and tested in the year under review are adequate".*

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 identified some areas for enhancement, including:

- a lack of segregation of duties in respect of review and authorisation of the work of the finance manager, which is partly due to the comparatively small size of the finance department; and
- 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.

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

The Charities and Trustee Investment (Scotland) Act 2005

The Charities and Trustee Investment (Scotland) Act 2005 ("the Act") came into force in April 2006, introducing new duties and responsibilities for the Office of the Scottish Charity Regulator ("OSCR"). Over time OSCR intends to undertake a rolling review of charities entered in the Scottish charity register to assess whether they meet, and continue to meet, the charity test: purposes will have to be charitable in the context of the charity test set out in section 7 of the Act and charities will have to show that they provide public benefit.

OSCR recently reported the results of its pilot review and that six of the eight organisations satisfied the 'public benefit' test. OSCR's report clearly states that the results of the review cannot necessarily be applied to similar organisations but there is an expectation within the sector that the charitable status of further education colleges is at risk because the ministerial control identified by OSCR exists in the Further and Higher Education (Scotland) Act 1992 (as amended by the Further and Higher Education (Scotland) Act 2002.

We recognise that the Scottish Government has made a public commitment to amending the legislation as required to preserve the charitable status of further education colleges.

The College has identified and recorded the risk to its charitable status in the risk register. Management believe that the issue over ministerial control is the only issue that would prevent the College from retaining charitable status.

Prevention and detection of fraud and irregularity

The College has a fraud policy, which was updated in June 2006, and a professional malpractice procedure, also known as a whistleblowing policy, but this has not been updated since 2003. The professional malpractice procedure was established in line with the Nolan Committee recommendations, and details the steps to follow when raising a grievance. The clerk to the Board of Management has been designated as the whistleblowing officer. Both policies are on the staff intranet.

Management has not reported any material instances of fraud or irregularity in 2006-07.

Standards of conduct

The College has a variety of procedures and policies available to all staff on the intranet, including a staff code of conduct, which was devised taking into account the general principles of conduct identified by the Committee on Standards in Public Life. The code of conduct was updated in 2007 and details the College's expectations of staff, including compliance with all policies and the requirement to establish and maintain the good reputation of the College through behaving in a professional manner when dealing with students, parents, colleagues, and the wider community.

The College maintains a formal register of interests, with declaration of interests a standing item on all committee meeting agendas.

Best Value

The 2006-07 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 18 December 2007 we issued an audit report expressing an unqualified opinion on the financial statements of the College for the year ended 31 July 2007 and on the regularity of transactions reflected in those financial statements.

Sale of Heathhall and George Street campuses

Following approval of the full business case for the new build on the Crichton site, the College signed a sale agreement for the campuses at Heathhall and George Street during 2005-06. The carrying values of the campuses were written down at 31 July 2006 to reflect the net realisable value in the sale agreement, which, based on external advice, was consistent with the market value at the time. It was anticipated at that time that the sale would be concluded during 2007-08.

Subsequently, the purchaser of the two sites offered to meet the terms of the sale agreement in 2006-07 and to enter into an agreement to rent these premises to the College for up to five years. Management considered and accepted the offer in the summer of 2007. Management considered the accounting treatment of this transaction against accounting standards and reached the decision that the criteria of a sale and leaseback were not met. As a result, management has correctly recognised the disposal and proceeds in the financial statements for 2006-07.

When the carrying value was written down in 2005-06 it was anticipated that depreciation would continue to be charged for two years (until August 2008, when the new build should be complete) at £395,000 per year. Recognising the sale in 2006-07 resulted in a loss on disposal of £395,000, equal to the 2007-08 depreciation charge, offset by a release of £328,000 from deferred capital grants.

Crichton campus

Work on the new build commenced during the year and assets in the course of construction totalled £7 million at 31 July 2007. This is funded by a combination of grants from the European Regional Development Fund and the Scottish Funding Council. The timetabled date for completion is 24 July 2008, with the College undertaking a staged migration during the summer break as areas of the campus are completed. At present, the contractors are behind schedule, but there is a programme in place to ensure work is completed within the agreed timetable and to reverse this delay, which includes the requirement for the building to be wind and watertight prior to the Christmas 2007 break.

The Crichton Foundation has raised £1.5 million for a library, which will be donated to the College to allow it to build an annexe to the main building. The College and other education institutions on the Crichton site will share the running costs.

A condition of the planning permission granted by Dumfries and Galloway Council ("the Council") in relation to the new build is a green bond with a total value of £100,000. 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. There are 12 specific actions to be implemented over a five year period. In November 2007 the College had implemented six actions, and confirmed that the remainder will be completed within the five year deadline set by the Council.

Management has considered progress made to date and the plans in place for future action and concluded that there is no contingent liability. 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. We have obtained management representations from the principal that during 2006-07 the College has complied with all necessary 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.

Report to those charged with governance

At the audit committee meeting on 5 December 2007 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	There are areas where segregation of duties is lacking, including: • journals raised by the finance manager do not receive authorisation prior to being posted to the ledger; and • monthly reconciliations between both the students sales ledger and the fixed asset register to the general ledger are not evidenced as reviewed independently. We appreciate that the College's operations do not require additional finance staff, but recommend that the current allocation of duties is reviewed. *Grade two*	The segregation of duties will be reviewed. However, the small number of people employed within the team means that the total segregation of duties and/or separate authorisation is not always possible.	Head of finance 31 January 2008
2	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. *Grade two*	All College policies and procedures are reviewed every three years, or sooner if circumstances dictate. However, the Board of Management does currently undertake an annual review of all policies. We will therefore review our processes to ensure compliance with best practice.	Senior management team 31 March 2008

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