



INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

Dumfries and Galloway College

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

Audit: Year ended 31 July 2010

20 December 2010

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 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 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.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

Financial statements

We have completed our audit of the financial statements for the year ended 31 July 2010 and have issued an unqualified audit opinion.

The financial outturn for the year (£754,000) is significantly ahead of the forecast figure (£61,000) due mainly to the impact of a one off past service credit in the year as a result of the change in the measurement basis of future pension increases. The underlying result for the year was a small deficit (£24,000) and the difference from the forecast was due to a number of increases in both income and expenditure categories.

Governance and risk management

The College has a responsibility to establish arrangements to ensure the proper conduct of College affairs and under the *Code* auditors are required to review and report on arrangements.

We have considered the corporate governance and risk management processes in place and have reviewed the corporate governance statement in the financial statements. There have been no significant changes in the year and we have identified no recommendations for improvements in this area.

The corporate governance statement has been completed in line with best practice for the sector and in line with the prior year. It does not disclose any significant weaknesses in the systems of internal control and this is consistent with our understanding of the College.

The existing fraud prevention and detection policies have operated throughout the period and no instances of known or suspected frauds have been identified.

Internal controls and internal audit

Our audit procedures included testing in relation to key internal controls and identified no significant issues. Internal audit also considered internal controls in a number of areas and also did not identify any significant risks or issues.

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("The Code"). This specifies a number of objectives for our audit.

Audit framework

This year was the fourth of our five-year appointment by the Auditor General for Scotland as external auditors of the Board of Management of Dumfries and Galloway College ("the College"). This report provides our opinion and conclusions and highlights significant issues arising from our work. We outlined the framework under which we operate, under appointment by Audit Scotland, in the audit plan overview discussed with the audit committee earlier in the year.

The purpose of this report is to report our findings as they relate to:

- the **financial statements** and our audit opinions;
- our review of 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, prevention and detection of corruption, and its financial position; and
- 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 principal and board members and its 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 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 the accountable officer, to make arrangements to secure Best Value.

Action plan

This report includes an action plan containing areas for development or improvement identified during our financial statements audit fieldwork.

Acknowledgement

Our work continues to bring us into contact with a range of College staff and we wish to record our appreciation of the continued co-operation and assistance extended to us by College staff during our work.

Service overview

Financial year 2009-10 was the second full year of operations at the new Dumfries Campus where the development has resulted in an enhanced student experience; towards the end of the year improvement work commenced to redevelop the Stranraer campus to enhance the experience of those students too. Management is currently in the process of reviewing the current course offering and the overall teaching structure to ensure it is cost effective and appropriate to meet the College's goals and funding requirements going forward.

Financial position

The financial statements report a surplus for the year of £754,000, an increase of £728,000 compared to the previous year and £693,000 higher than the projected outturn projected in the management accounts during the year. As at 31 July 2010, there are general reserves of £3,706,000. The surplus in the year is due to a significant pensions credit in the year following a change in the underlying assumption bases.

Income

Income for the year has risen by £629,000 compared to 2008-09, an increase of 4.8%, due to increases in income from the Scottish Funding Council ("SFC"). This has been due to:

- increased levels of deferred capital grant releases (£716,000 against £395,000 in 2008-09) as 2009-10 is the first full year of release following completion of the new campus;
- increased levels of infrastructure grants received from SFC (£763,000 against £417,000 in 2008-09) due to grants received to cover the costs of a refurbishment programme in Stranraer and corrective work on the new Dumfries site; and
- an increase of 2.8% (£243,000) in the SFC recurrent grant.

The reduction in other operating income is largely due to a decrease in bursary funding towards the cost of student support staff (down £123,000 since 2008-09).

Investment income has reduced from the prior year due to lower interest rates than in the prior year.

Expenditure

Overall expenditure has decreased since the prior year. However, this is mainly due to the significant pensions credit this year and underlying expenditure has in fact increased. The reasons for these movements are detailed over the page.

Income and expenditure account	2009-10 £'000	2008-09 £'000
<u>Income</u>		
Scottish Funding Council grants	11,206	10,299
Tuition fees and education contracts	1,670	1,708
Other operating income	682	846
Investment income	30	106
	13,588	12,959
<u>Expenditure</u>		
Staff costs	7,509	8,376
Other operating expenses	4,062	3,877
Depreciation	1,134	680
Interest payable	129	0
	12,834	12,933

Expenditure (continued)

The main movements in expenditure since the prior year are as follows:

- staff costs for 2009-10 have reduced since the prior year due to a credit of £778,000 in relation to pensions past service costs as a result of the change in measuring pension increases from RPI to CPI (described further on page six); underlying staff costs have decreased by £89,000 primarily as a result of reduced staff numbers;
- expenditure has increased as a result of the cost of refurbishment of the Stranraer campus and the purchase of new computer equipment below the capitalisation threshold; this has been offset to an extent by a number of cost savings made on the prior year through tighter control of budgets and costs;
- depreciation has increased since the prior year as 2009-10 is the first full year of depreciation on the new Dumfries campus; and
- interest payable relates to finance costs in relation to accounting for the College's participation in the Dumfries and Galloway Pension Fund; last year this balance was a credit of £12,000.

Balance sheet

Overall net assets have increased by £185,000 since the prior year; the key movements underlying this are as follows:

- tangible fixed assets have decreased since the prior year mainly due to depreciation charged during the year; no major additions or disposals were recorded during the year;
- cash has increased by £494,000 since the prior year primarily due to a net operating cash inflow for the year and an excess of capital grants received over capital expenditure;
- creditors have increased by £104,000 since the prior year due mainly to the timing of expenditure around the year end (more in 2009-10 than 2008-09) particularly in relation to work at the Stranraer campus; and
- net pension liabilities have decreased by £708,000 since the prior year, mainly as a result of changes in the assumptions used to calculate the liabilities. Following the UK Government's budget, it was announced that future pension increases will be linked to the Consumer Prices Index ("CPI") rather than the Retail Prices Index ("RPI"); CPI has historically been lower than RPI by around 0.5% to 0.7% and this results in a significant (£778,000) pension credit in 2009-10. There is currently some debate in the accounting profession as to how the effect of this should be reflected through financial statements; either through the income and expenditure account or the statement of total recognised gains and losses. Management has reflected this in the income and expenditure account in the financial statements; this is in line with our experience in the rest of the FE sector. This may require to be adjusted next year once accounting guidance on the issue is finalised.

Balance sheet	2010 £'000	2009 £'000
Tangible fixed assets	41,742	42,805
Debtors	568	626
Cash and short term investments	3,444	2,950
Creditors: Amounts falling due within one year	(2,788)	(2,684)
Creditors: Amount falling due after more than one year	(2,307)	(2,539)
Provisions for liabilities and charges	(759)	(735)
Pension liabilities	(2,130)	(2,838)
Net assets	37,770	37,585

The College has prepared its college plan for 2010-13, which sets the financial and operational context for the strategic objectives and priorities of the College for the financial years 2010-11 to 2012-13. In line with the rest of the sector, the College remains reliant on funding from the SFC; there is currently uncertainty over the level of SFC income that will be available to colleges over the coming financial years.

	£'000
Income	12,722
Expenditure	(12,691)
Forecast surplus	31
Cash balance at 31 July 2010	3,444
Forecast cash balance at 31 July 2011	3,049
Forecast movement in cash during 2010-11	(395)

Source: 2009-10 forecast financial return – July 2010

Income and expenditure

Income is expected to fall in 2011-12 as a result of cuts in public spending following the Scottish Government's response to the Comprehensive Spending Review impacting the level of grant income received from the Scottish Funding Council. The current forecast estimated falls in funding of 6.5%, although the actual fall in the year may be greater than this as the draft Scottish Government budget for 2011-12 has cut the SFC's budget by around 12%.

Expenditure in 2010-11 has been forecast at £12,691,000 which, after adjusting for the impact of the pensions credit in the 2009-10 results, is a reduction of £921,000. The reduction is due to reduced staff numbers in 2010-11 and the absence of a number of one-off costs from 2009-10 including expenditure at Stranraer and on IT equipment. Since completion of the original 2010-11 forecast, further savings in payroll costs of £250,000 to £300,000 have been identified.

Cash

Management forecast that the College's cash position will deteriorate by £632,000 in 2010-11 due to the anticipated payment of the retention still held in relation to the construction of the new campus. However, it is anticipated that the College will still have a strong cash position over the next year.

Financial sustainability

Although the College has been financially secure for a number of years, it is important in the current economic climate with increasing pressures on public sector funding that management fully consider financial sustainability and scenario planning. The board of management undertook two scenario planning sessions during the year and identified key priorities which will be used to produce detailed plans to respond to pressures. Difficult decisions will be required to be made over the next few years in order to deal with funding pressures, but management does not believe that the College's long term sustainability will be threatened.

2010-11 financial forecast

The original forecast for 2010-11 was for the College to achieve a surplus of £31,000 which is down considerably from the surplus in 2009-10, due to the absence of the one off pensions credit, but is in line with targets in recent financial years. Since preparing the original forecast, management has updated the budget and the current projection is a surplus of £250,000, the movement being due to reductions in staff costs.

The College constructs each year's budget based on input from each of the programme managers and budget holders to take into account known or expected changes and is then compiled by the finance team to give the overall College expenditure budget which is then compared to anticipated income levels.

The table opposite details the forecast income, expenditure and cash balances for the 2010-11 financial year based on the 2009-10 forecast financial return.

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 College principal, the board of management is responsible for establishing arrangements for ensuring the proper conduct of College 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 corporate governance arrangements as they relate to:

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

Framework

The board of management is ultimately responsible for the College's governance arrangements, but responsibility for certain duties are delegated to various board sub-committees, as appropriate. 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. Management is currently in the process of updating the board of management code of conduct which was last updated in 2005. We believe the overall framework and committee structure is appropriate for a College of this size.

Risk management

There have been no significant changes in the risk management processes since the prior year, but the board of management has continued to review processes to ensure compliance with best practice. A formalised risk management policy was introduced during the prior period. This document represents an integral part of the College's internal control and corporate governance arrangements. The policy formally documents the roles and responsibilities of the board of management, the College management team and other key parties in relation to risk management. The policy has recently been reviewed with a view to an enhanced version being approved by the board of management and implemented during 2010-11.

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.

The financial statements include information on the processes in place to manage the principal risks and uncertainties as well as detailing the specific key risks to the College.

Regularity

The board of management considers all incoming correspondence relevant to its strategic management role from the SFC and other regulatory or advisory bodies, such as Audit Scotland. The audit committee also considers any other applicable correspondence. The College therefore appropriately considers all incoming guidance received from these bodies, and can demonstrate that appropriate action has been taken when required.

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 2009-10.

Internal controls

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

Internal audit

The approved internal audit programme for 2009-10 has been completed. The College's internal auditors are RSM Tenon who took on the role during the prior financial year.

As part of the 2009-10 audit programme internal audit undertook assurance reviews seven areas including risk management, ICT strategy and key financial systems. Internal audit commented via their reporting to management and gave substantial assurance in all areas covered in the year.

Best Value / value for money

The 2009-10 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 specifically included in its financial objectives.