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Barony College

Annual audit report to the Board of Management of Barony College

and the Auditor General for Scotland

Year ended 31 July 2011

21 December 2011

Contents

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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 Board of Management of Barony 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.

Headlines

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.

This report summarises our work for the year ended 31 July 2011. It also provides information required by ISA (UK and Ireland) 260: *Communication with those charged with governance*.

We wish to record our appreciation of the continued co-operation and assistance extended to us by Barony College staff during the course of our work.

Financial statements and accounting	
We have issued unqualified audit opinions on the 2010-11 financial statements and the regularity of transactions reflected in them.	-
There have been no changes in accounting policies in the year; policies remain appropriate for the underlying operations.	Page 4
A number of technical accounting matters were considered during the audit process, including the accounting for fixed asset valuation, contingent liabilities and stock valuation. These were concluded and reflected appropriately in the financial statements.	Page 4
Use of resources	
The College recorded a deficit of £207,000 for the year, due primarily to severance costs of £295,000 incurred around the year end.	Page 6
In accordance with accounting standards, management has prepared cashflow projections to 31 December 2012 in consideration of the going concern assertion. This indicates the College will be able to meet its liabilities as they fall due over this period, but significant risks remain.	Page 8
The College has announced its intention to purse a merger with Scotland's other land based colleges from 1 August 2012 and is currently involved in discussions to this end.	Page 9
Governance	
We have tested the operating effectiveness of key controls, with no significant issues identified. Arrangements to prevent and detect fraud are embedded in internal controls. No instances of fraud or irregularity have been identified during the year.	Page 10
Overall governance arrangements remain in line with the prior year; internal audit completed a review of arrangements during the year which found that reasonable assurance could be provided on these controls.	Page 10
Internal audit completed their plan and did not report any significant / high risk recommendations.	Page 10

Service overview

There is currently significant uncertainty surrounding the future of Barony College and the wider education sector.

Management has considered the period to December 2012 and is confident the College will be able to continue to operate.

The deficit for the year is primarily a result of redundancy costs in the year.

- There is currently considerable uncertainty in the Scottish further education environment and it is expected that financial and other pressures will increase in the future. This environment will have a significant impact on all further education institutions but particularly Barony College ("the College") due to uncertainty over future funding and the level of cash held.

Result for the year

- The outturn for the year was a deficit of £207,000, primarily due to severance costs of £295,000. These were financed through the overdraft facility and were incurred around year end and therefore did not generate savings in this financial year.
- Financial pressures during the year were mitigated by a budget holders' review of expenditure in key non-pay categories which resulted in significant in-year savings.

Going concern

- The balance sheet at 31 July 2011 reflects a deterioration in liquidity due to net cash outflows and severance accruals.
- As required by accounting standards, management has considered going concern through cashflow projections prepared for the period to 31 December 2012. This indicates that the College will continue to be able to pay its liabilities as they fall due, but, a number of risks exist including reliance on an overdraft facility which, at the date of writing, had still to be approved.
- Forecasts show limited head room against the anticipated overdraft level (less than 10%). Cashflows will therefore require to be closely monitored during the period and any reductions in income or increases in expenditure above forecasts will require timely and potentially significant action by management to rectify.

wSUMS

- The College again met its wSUMS target for the year; actual numbers were 10,449 against a target of 10,344 for 2010-11. Review of course provision is being considered in line with the in year severance scheme and wSUMS targets for 2011-12; management is confident that wSUMS numbers for 2011-12 will be achieved.

Governance

- Governance processes are largely unchanged since the prior year and have continued to operate effectively. This was evidenced through an internal audit review of governance processes during the year which raised a number of minor recommendations to further improve arrangements.
- Internal audit completed their plan for the year and provided positive assurance on the College's systems.
- The College has processes in place to appropriately identify, consider and take action relating to national reports and guidance to ensure the regularity of operations and transactions.

Merger

- On 10 October 2011 the College announced that management intended to pursue inclusion in the proposed merger of Scotland's land-based colleges, namely Scottish Agricultural College, Oatridge College, Elmwood College and theCollege. This is in line with current Scottish Government policy in the education sector.
- Discussions are currently at an early stage with due diligence procedures expected to commence by the of the calendar year. Timing for the merger has yet to be confirmed, but management is currently working towards a commencement date of 1 August 2012.

Accounting policies, financial statements preparation and audit process

There have been no changes to the College's accounting policies.

Risks around going concern, valuation of fixed assets, litigation and stock valuation were anticipated.

Accounting policies			
There have been no changes in accounting policies from prior years. We have considered the accounting policies applied for the year ended 31 July 2011 and consider that these remain appropriate for the preparation of the financial statements.			
Areas of HIGH audit risk			
	Value (£'000)		
Area	**2011**	**2010**	**KPMG comment**
Financial position / going concern	-	-	■ Accounting standards require management to consider wether the College will remain a going concern for a period of at least 12 months from the date of signing of the financial statements. In order to consider this, management has prepared cashflow projections for the period to 31 December 2012. These demonstrate that the College will be able to meet its liabilities as they fall due, but that a number of risks exist around this. ■ We have reviewed the relevant disclosures in the financial statements and consider them to be appropriate. Further information is provided on pages eight and nine.
Outstanding litigation	-	-	■ Legal action was initiated in the previous year against both the College and the Principal on environmental grounds following moving of the river Ae. This action progressed during 2010-11, but, at the date of writing, the outcome of the case is still outstanding. ■ Due to the uncertainty surrounding this issue, a contingent liability note has been included in the financial statements. Management has been advised that any exposure is unlikely to be material to the financial statements. Disclosures in this respect are appropriate and complete.
Fixed asset revaluation	200	-	■ The College's accounting policies requires that land and buildings are subject to full revaluation every five years with an interim valuation in year three of that cycle. An interim valuation was therefore carried out at 31 July 2011 which showed an upwards valuation in land of £200,000, an upwards revaluation in buildings of £69,000 and a decrease in valuation of the biomass facility by £59,000. The movement in valuation of land has been included in the financial statements; buildings and the biomass facility have not been amended on the grounds of materiality. ■ Adjustments and disclosures in the financial statements are materially complete and appropriate.
Stock valuation	705	605	■ Livestock, crops, consumables and other items used in the College's educational activities. In line with prior years, this was subject to independent valuation at the year end. The increase in valuation over the prior year is primarily due to increases in the open market valuation of livestock and is in accordance with available market data.

Accounting policies, financial statements preparation and audit process

Preparation of financial information

- Draft financial statements and supporting documentation were provided on 6 October 2011, in line with the agreed timetable. Prior to the audit commencing, it was agreed to delay the field work by three days to ensure documentation to support the financial statements was sufficiently advanced. Updated draft financial statements were received on 15 November 2011.
- Finance staff responded to our questions quickly and provided high quality information to support the balances in the financial statements.
- Overall, management adopts an efficient approach to preparing the financial statements.

Audit conclusions

- There are no matters to be brought to your attention regarding our independence or non-audit fees.
- We have issued unqualified opinions on the financial statements and the regularity of transactions reflected therein.

Financial position

The College reported a deficit of £207,000 for the financial year.

The outturns for both 2009-10 and 2010-11 were impacted by significant one-off items.

The financial statements report a deficit for the year of £207,000, a decrease of £570,060 compared to the 2009-10 surplus. This is primarily due to significant one off items in each year; the underlying result for 2010-11 is a surplus of £88,000 compared to a surplus of £60,000 in 2009-10.

The income and expenditure account is summarised opposite, with the key movements in relation to the previous year being:

Income

- Reductions in Scottish Funding Council grant income of £150,000.
- Reductions in education contract income due to reductions in attendance as a result of changes in College policy: students can now only attend courses if they are fully paid for 48 hours prior to the course starting.
- Other operating income has increased by £162,000 as a result of increases in income from farming activities, partly due to increased market prices.

Expenditure

- Staff costs have increased £372,000 since 2009-10, due partly to the one off pensions credit of £303,000 in 2009-10 relating to the change in measuring pension increases from RPI to CPI and partly due to increases in average staff numbers over the prior year.
- Expenditure includes exceptional redundancy costs of £295,000 incurred in 2010-11.
- Other operating expenditure has decreased by £114,000 as a result of a number of offsetting movements:
  - increases in farming expenditure of £126,000;
  - reductions in property costs of £233,000; and
  - reductions in teaching costs of £45,000.

Income and expenditure account	2010-11 £'000	2009-10 £'000
Income		
Scottish Funding Council grants	2,922	3,072
Tuition fees and education contracts	594	780
Other grant income	259	166
Other operating income	1,688	1,526
Investment income	-	-
Total income	**5,463**	**5,544**
Expenditure		
Staff costs	3,122	2,750
Exceptional costs - redundancy	295	-
Other operating expenses	1,967	2,081
Depreciation	245	251
Amortisation of intangible assets	13	13
Interest payable	41	86
Total expenditure	**5,682**	**5,181**
Gain/(loss) on disposal of fixed assets	12	(1)
(Deficit)/surplus	**(207)**	**363**

Result

The outturn for the year before exceptional severance costs is consistent with the budget approved by the board of management at the beginning of the year and the monitoring returns made to the Scottish Funding Council.

Financial position (continued)

The main movements in the balance sheet from the prior year have resulted in negative working capital.

Balance Sheet	2011 £'000	2010 £'000
Fixed assets		
Tangible fixed assets	6,713	6,680
Intangible assets	27	40
Investments	51	47
Current assets and liabilities		
Stock	705	606
Debtors	392	456
Cash at bank and in hand	60	159
Creditors due within one year	(1,221)	(1,018)
Net current (liabilities)/assets	**(63)**	**203**
Creditors due after one year	(515)	(700)
Pension liability	(521)	(696)
Net assets including pension liability	**5,691**	**5,574**
Deferred capital grants	1,390	1,436
Income and expenditure account, including pension reserve	671	588
Revaluation reserve	3,630	3,550
Total	**5,691**	**5,574**

Fixed assets

Fixed assets include £117,000 of additions, a £200,000 upwards revaluation of land and depreciation of £244,000. This has been agreed to the independent valuation carried out.

Stock

This value of stock at the year end varies according to the number of animals, changes in market value and movements in other stock items. The increase in the current year is mainly due to increases in open market value of livestock in the year, rather than the number of animals.

Debtors

Debtors have fallen 14% to £392,000 in the current year. This decrease is partly due to the new short courses policy requiring full payment 48 hours in advance.

Cash

At the end of the year cash balances had fallen to £60,000. This is due to outflows on trading activities and finance payments made in the year. Future cash flows are considered in more detail on pages eight and nine.

Creditors

Creditors due within one year have increased due to redundancy costs recognised as at 31 July 2011. Creditors due after one year have decreased primarily due to payments in line with agreed loan scheduling.

Net pension liability

There has been a decrease in the net liability from £696,000 at 31 July 2010 to £521,000 at 31 July 2011. 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*. The main reason for the decrease in the net liability is due to a strong return in assets during the year; movements in asset values and assumptions creates a volatility in the net pension liability recognised from year to year.

Financial position (continued)

Management has prepared cashflow projections to consider the sustainability of the College over the period to December 2012.

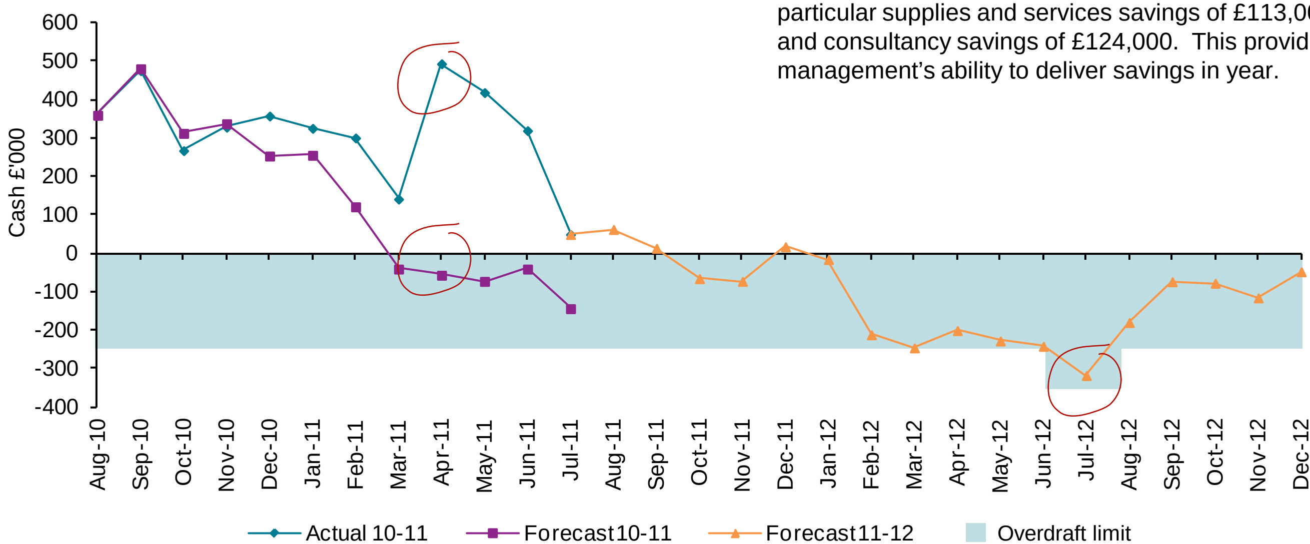
Projections indicate the College will be able to meet its liabilities as they fall due over this period, but significant risks and challenges exist.

Management is currently pursuing a merger with Scotland's other land based colleges in the medium term.

The financial statements report net debt of £658,000 at 31 July 2011, compared to £745,000; the movement reflects loan repayments in the year offset by a decrease in the cash balance from £159,000 at 31 July 2010 to £60,000 at 31 July 2011. Severance costs, the majority of which were paid out in early 2011-12 put pressure on the College's cash position and the College will require to utilise the overdraft facility to continue operations for 2011-12. We note that this position was formally approved by the board of management.

Accounting standards require management to consider wether the College will remain a going concern for a period of at least 12 months from the date of signing of the financial statements. Management has accordingly prepared cashflow projections covering the period to 31 December 2012 and auditing standards require us to consider these for the purposes of our audit.

Cash flow projections



Cashflow projections

We have considered the cashflow projections against the College's budget and against historical accuracy (using projections prepared in October 2010). The graph below reflects actual cashflows for 2010-11 against projections made in October 2010 and also projected cash balances for 2011-12.

Projections indicate that the College will require the use of the overdraft facility with this reaching £317,000 at July 2012, providing headroom in the overdraft of less than 10% at just £33,000 (this is circled below).

Historical accuracy

2010-11 projections suggested that the College's overdraft use would peak at £143,000 in July 2011, compared to an actual position of £60,000 in funds at that point. The main reason for this improvement against projections was a mid-year review of spend against budgets which identified a number of areas for savings, in particular supplies and services savings of £113,000 and financial and consultancy savings of £124,000. This provides evidence of management's ability to deliver savings in year.

Financial position (continued)

Assumptions

Projections have been completed based on the 2011-12 Forecast Financial Return submitted to the Scottish Funding Council in June 2011, adjusted for known changes. The predictability of 2011-12 grant funding and key expenditure lines (for example staff costs) aids the accuracy of projections. There is, however, considerable uncertainty over future periods (for example August to December 2012) due to funding uncertainties.

In September 2011, the Scottish Government released a pre-legislative paper; 'Government's Post-16 Education plans and a sector response to the Spending Review'. This paper considers the regionalisation of the college sector and reforming of funding within Scotland, with an emphasis on the Scottish Government not being able to afford a system of individual institutions serving overlapping areas. It is currently being considered by the College along with the Scottish Government 'Scottish Spending Review 2011 (published on 21 September 2011) and Draft Budget 2012-13'. This sets out fiscal plans for the next three years, stating that further education would have reduced funding in the future with SFC receiving a 6% reduction in funding in 2012-13.

The detailed funding announcement at an institution level is not expected from the Scottish Funding Council until January 2011. The proposed reform for the further education sector in Scotland, has resulted in uncertainty about future funding and service delivery for the further education sector.

Merger

In the face of these uncertainties, management announced on 10 October 2011 the intention to pursue inclusion in the proposed merger of Scotland's land based colleges, namely Scottish Agricultural College and Oatridge, Elmwood and Barony Colleges. This is in line with the direction of travel of current Scottish Government policy in the education sector.

Discussions are currently at an early stage with due diligence procedures expected to commence by end of the calendar year. Timing for the merger has yet to be confirmed, but management is currently working towards a commencement date of 1 August 2012

Sensitivity analysis

Management has prepared sensitivity analysis for a number of different scenarios. These are detailed in the table below.

Cash balances: sensitivity analysis	Maximum Balance £'000	Closing balance £'000
Base case projection	(317)	(47)
10% reduction in 2011-12 SFC grant / 10% reduction in payroll costs	(317)	(37)
10% reduction in non grant income / 10% reduction in purchases	(335)	(80)
10% reduction in non grant income / 5% reduction in purchases	(442)	(228)
10% reduction in non grant income / 5% reduction in purchases and 5% reduction in payroll	(442)	(173)

It should be noted that this analysis has been prepared on the basis of reductions in expenditure being identified and implemented on time to match reductions in income. This is unlikely for certain costs. For example, reductions in payroll would incur severance costs, thus mitigating and delaying any savings to a certain extent. There is also the risk that reductions in expenditure have a detrimental effect on course provision.

Corporate governance framework and supporting arrangements

Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.

Corporate governance framework	The overall corporate governance framework is unchanged from 2009-010 with terms of reference of the seven standing committees in place in line with prior years. In the interests of transparency, the statement of corporate governance and internal control details the basis of appointment of each of the board members. Various powers and functions of the board are delegated through terms of reference to the seven standing committees in place, each of which meet quarterly. The internal audit plan for the year included a review of corporate governance procedures which resulted in six recommendations and found that *'systems used by the College are substantial in this area'*.
Statement on internal control	The statement of internal control provides details of the internal financial control environment and risk management and control framework. The statement is informed by officers, the audit and standards committee, and the work of internal and external audit. The content of the statement is consistent with our understanding of Barony College.
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, subject to minor recommendations we raised, controls are designed appropriately and operating effectively.
Internal audit	Internal audit completed their plan for the year. A number of recommendations were made, but, none of these were rated high risk. Internal audit's annual report states that, *"reasonable assurance can be placed upon the adequacy and effectiveness of the College's internal control systems in the year to 31 July 2011".*
Fraud and irregularity	Management has not reported any frauds, material or otherwise, during 2010-11. The College has in place an over-arching fraud prevention policy and, in line with best practice, a specific whistle-blowing policy. The fraud policy sets out procedures for the avoidance of fraud and corruption, while also detailing guidance for staff should such activities be suspected.
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 applicable correspondence. The College therefore considers all incoming guidance received from these bodies, and can demonstrate that appropriate action has been taken where relevant.
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. In line with College policy, the risk register was updated and reviewed by the audit committee during the year.
Best Value/Value for Money	The financial memorandum with the SFC required that the Board of Management put in place processes and procedures to ensure the College strives to achieve best value from its use of public funds from all sources. Management believes that best value is embedded in the College's procedures through a stringent budget setting process and in recent years has utilised internal audit to perform work on value for money.

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