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Dundee and Angus College

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

Period ended 31 March 2014

8 October 2014

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 the Board of Management of Dundee and Angus College and is made available to Audit Scotland and the Auditor General for Scotland (together "the Beneficiaries"). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone.

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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Headlines

This annual audit report summarises our work at Dundee and Angus College for the eight month period ended 31 March 2014. Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* and guidance issued by Audit Scotland.

This report also includes those matters specified by ISA (UK and Ireland) 260: *Communication with those charged with governance* in relation to the financial statements for the period ended 31 March 2014.

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

Area	Summary observations	Analysis
Strategic overview and use of resources		
Business issues	Dundee and Angus College was established on 1 November 2013 to serve the Tayside region, as part of the process of creating 13 new college regions . The merger of Dundee College and Angus Colleague progressed as planned during 2013-14 and prior to the vesting date, management of the predecessor colleges held regular meetings at all levels, minimising the impact on education delivery. Colleges in Scotland were re-classified as public sector bodies from April 2014, resulting in a change in accounting reference date and the restriction on the ability to accumulate financial reserves. During the period, the College supported the creation of the Dundee & Angus Foundation and transferred £8 million to the Foundation. Funding for the college sector has decreased in recent years and the Scottish Government expects continued efficiencies from the merger programme and wider reforms to allow further reductions in funding. Notwithstanding the merger activity, the College continued to achieve its wSUMs target.	Page 6
Financial position	The College generated an overall deficit of £9.5 million in the eight month period (Budget deficit: £429,000). This large deficit is primarily a result of the transfer of £8 million to the Foundation, without which the College deficit would have been £1.5 million, in line with the College's revised forecast. The forecast deficit was greater than the original budget, primarily as a result of voluntary severance costs arising from the merger. The original budget was for a deficit of £0.43 million, revised to £0.31 million, although the first quarter management accounts forecast a deficit of £1.5 million primarily as a result of unbudgeted pay awards and voluntary severance costs. The balance sheet shows a decrease in net assets of £13 million from 31 July 2013, arising from an increase in the net pension liability and the operating deficit . Period end comparisons are impacted by the change in accounting reference date; debtors and creditors include amounts accrued and deferred respectively as at 31 March 2014 compared with 31 July 2013 as the College's teaching activity is ongoing at the time of the revised accounting reference date. The 2014-15 budget anticipates a small deficit of £429,000. GTL made a loss of £76,000 for the period, with turnover of £214,000. A loan of £140,000 was extended to GTL during 2013-14 by the College, repayable by 31 March 2017.	Pages 7 - 8
Financial statements and accounting		
Audit conclusions	We have issued unqualified audit opinions on the financial statements of the College and Gardyne Theatre Limited and the regularity of transactions reflected in the College financial statements.	Page 10

Headlines (continued)

Financial statements and accounting (continued)		
Significant risks	We have considered inherent significant risks that International Standards on Auditing require us to address covering risks in relation to revenue recognition and management override of controls and have satisfactorily concluded our work in these areas.	Pages 10 - 11
Audit focus areas	We have satisfactorily concluded work identified at the planning stage in relation to retirement benefits valuation, establishment of a charitable foundation and the combination of Dundee and Angus colleges.	Pages 11-12
Year end process	The draft financial statements were made available on a timely basis, in advance of the audit fieldwork. There were some presentational changes to the statements due to the change in accounting reference date together with changes arising as a result of management's internal review of the draft financial statements. Management encountered minor difficulties in analysing historical financial information pre-merger and verifying staff numbers for inclusion in the financial statements. Systems of internal control and policies continue to be integrated in the merger college.	Page 14
Control observations	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are in the main designed appropriately and operating effectively. Control recommendations are presented in appendix two.	Page 14
Governance and narrative reporting		
Governance arrangements	The statement of corporate governance and internal control identifies no major weaknesses in governance or internal control arrangements. We have reviewed the statement of corporate governance and consider it consistent with our understanding of the process followed by the College during the period. Management has identified no significant fraud or irregularities.	Pages 16 and 17
Performance management		
Performance management	The College produces management accounts which compare actual expenditure to budget and has a procurement strategy which seeks to use the most advantageous supplier that is available. Efficiency savings are planned and ongoing as part of the merger business case. Performance against sector indicators is measured by the College.	Page 19

Scope and responsibilities

Purpose of this report

The Auditor General for Scotland (“the Auditor General”) has appointed KPMG LLP as auditor of the Board of Management of Dundee and Angus College (“the College”) under the Public Finance and Accountability (Scotland) Act 2000 (“the Act”). The period of appointment is 2013-14 to 2015-16, inclusive.

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at Dundee and Angus College and the Auditor General for Scotland. The scope and nature of our audit were set out in our audit strategy document which was presented to the audit committee at the outset of our audit.

In addition to the audit of the College, this report also sets out certain matters which came to our attention during the course of our audit of the financial statements of Gardyne Theatre Limited (“GTL”) for the period ended 31 March 2014.

Responsibilities

Audit Scotland’s *Code of Audit Practice* (“the Code”) sets out Dundee and Angus College’s responsibilities in respect of:

- preparation of financial statements;
- systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- financial position; and
- Best Value.

This report reflects our overall responsibility to carry out an audit of the College in accordance with our statutory responsibilities under the Act, and of GTL in accordance with the Companies Act 2006, in both cases, in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code.

The Code sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements but also consideration of areas such as financial performance and corporate governance.

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Weaknesses or risks identified are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Under the requirements of International Standard on Auditing (UK and Ireland) (‘ISA’) 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity.

This annual audit report to the members of the College and the directors of GTL and our presentation to the audit committee, together with previous reports to the audit committee throughout the year, discharges the requirements of ISA 260.

Service overview

Our perspective on on key business issues
and the financial position of the College

Key business issues

The Scottish further education sector is undergoing significant structural reform. Dundee and Angus College was established in 2013 to serve the Tayside region.

Colleges have been re-classified as public sector bodies from April 2014, restricting the scope to build up financial reserves and altering the accounting reference date.

During the period, the College supported the creation of the Dundee & Angus Foundation and transferred £8 million to the Foundation.

Funding for the college sector has decreased in recent years and the Scottish Government expects continued efficiencies from the merger programme and wider reforms to allow further reductions in funding.

Formation of Dundee and Angus College

On 1 February 2012, the Scottish Government announced 12 newly created regions with a further one added in the following month. On 18 June 2012 the boards of management of Dundee and Angus colleges gave support to the creation of a "new" college for the Tayside Region. Both boards believed that the size and scale of the new college would allow it to operate more effectively within the regional structure for colleges across Scotland and ensure it meets the future education and skills development needs of the Dundee City and Angus regional area.

The establishment of the Tayside Region college, known as Dundee and Angus College, was effected by the transfer of all the activities and assets of Angus College to Dundee College as at 1 November 2013.

The College operates from the three main campuses; two in Dundee and one in Arbroath, together with a number of learning services throughout the region.

The merger progressed as planned during 2013-14 and prior to the vesting date of 1 November 2013, management of the predecessor colleges held regular meetings at all levels to review integration plans and progress merger workstreams. Due to departures of senior staff, primarily from the former Angus College, there was some loss of finance information and knowledge in respect of historical balances.

Reclassification of Colleges in Scotland

Colleges in Scotland were re-classified as public sector bodies from April 2014, requiring them to operate within the same annual budget limits as other Scottish Government bodies. This restricts the scope to build up financial reserves. A number of colleges, including Dundee and Angus, have established separate charitable foundations as a means of minimising some of the impact of this change.

A consequence of the re-classification was the change in accounting reference date to 31 March.

Dundee and Angus Foundation

During 2013-14 the College supported the creation of a charitable company limited by guarantee, The Dundee & Angus Foundation ("the Foundation"). The Foundation will receive funding from the College to be held and used in future periods as directed by the trustees, primarily for the benefit of the region.

Prior to its formation we reviewed the proposed constitution and trustee membership of the Foundation and concluded that the College does not exercise control over the distribution of its funds, and therefore are satisfied that it should not be consolidated in group financial statements of the College.

The Board of Management elected to transfer £8 million of cash to the Foundation on 28 March 2014. Despite this transfer, the College still has net current assets as at 31 March 2014 but has, as a consequence, reported a net deficit of £9.5 million for the period then ended.

Service delivery

In its latest review of the college sector, Audit Scotland reported that, while the overall financial standing of the sector continued to be generally sound, the sector faces an overall 11 per cent real-terms reduction in revenue grant funding from the Scottish Government in the period to 2014-15. Reducing staff numbers is likely to be the main way in which savings will be delivered, but that presents risks in terms of retaining skills and experience required to maintain quality of learning.

Since commencement of the voluntary severance schemes of Dundee and Angus colleges in 2012-13, 131 staff have left or agreed a future leaving date.

The College continues to achieve its wSUMs target. The target for 2013-14 was 144,593 wSUMs rising to 145,680 in 2014-15. Student applications for 2014-15 entry are strong and exceed available places by around two:one.

Financial position

The College generated an overall deficit of £9.52 million in the eight month period. This is primarily a result of the transfer of £8 million to the Foundation, without which the College deficit would have been £1.5 million, in line with the revised forecast.

The original budget was for a deficit of £0.43 million was revised to £0.31 million, although the first quarter management accounts forecast a deficit of £1.5 million primarily as a result of unbudgeted pay awards and voluntary severance costs.

GTL made a loss of £0.08 million for the period, on turnover of £0.21 million.

A loan of £0.14 million was extended to GTL during 2013-14 by the College, repayable by 31 March 2017.

The College reported a deficit for the eight month period to 31 March 2014 of £9.52 million. The original budget was for a deficit of £0.43 million, revised to £0.31 million, although the first quarter management accounts forecast a deficit of £1.5 million primarily as a result of £0.89 million additional staff costs due to unbudgeted pay awards and £0.8 million additional voluntary severance costs.

Excluding the transfer of £8 million to the Foundation, the underlying deficit of £1.5 million is in line with the College's quarter one forecast.

Total income decreased by £12.4 million when compared to 2012-13 but this has been largely as a result of the change in accounting periods. Overall:

- Scottish Funding Council recurrent grants awarded for the academic year were £25.2 million. £16.8 million was recognised in the eight month period to 31 March 2014 and is included within total funding council grant income of £21.7 million - in line with budget.
- Tuition fee and education grants remained broadly consistent when considering the reduction in the accounting period but were £1 million higher than the original budget. The quarter one forecast included £0.55 million additional income associated with UK and EU fees and a release of £0.65 million grant income to support general repairs and maintenance expenditure.
- Other grants and contracts income and other operating income both reduced by £0.5 million compared with 2012-13 but are broadly in line with the revised forecast.

Expenditure decreased by £3.6 million when compared to 2012-13. On a like for like basis expenditure was £10.9 million above the original budget and £1.5 million above the revised forecast. After taking into account the donation to the Foundation, the remaining variance is associated with the unbudgeted pay award and additional voluntary severance costs.

Due to the number of inherent assumptions associated with the merger, the budget setting exercise for 2013-14 and subsequent monitoring, management information was not as robust as in previous years. The ability to review prior year balances was limited by the availability and comparability of information in respect of the former Dundee and Angus colleges. Management focussed on regular cash flow monitoring during 2013-14 and the level of detail contained within management accounts was limited.

Recommendation one

Summary income and expenditure account	2013-14 actual (8 months) £'000	2013-14 budget (8 months) £'000	2012-13 actual (12 months) £'000
Income			
Funding council grants	21,700	21,148	31,326
Tuition fees and education grants	4.713	3,717	6,399
Research grants and contracts	670	657	1,212
Other operating income	1,453	1,389	1,933
Endowment and investment income	110	140	215
Total	**28,646**	**27,051**	**41,085**
Expenditure			
Staff costs	17,299	16,430	25,185
Restructuring costs	2,845	1,000	2,659
Other operating expenses	6,723	6,484	9,158
Depreciation	2,963	3,012	4,453
Interest and other finance costs	180	184	192
Donation	8,000	-	-
Total	**38,013**	**27,110**	**41,647**
Disposal of fixed assets	(150)	(250)	(208)
Deficit after the disposal of assets	**(9,517)**	**(309)**	**(770)**

Source: 2013-14 financial statements

Financial position (continued)

The balance sheet shows a decrease in net assets of £13 million, arising from the increase in the net pension liability and the operating deficit in the current year. Period end comparisons have been impacted by the change in accounting reference date.

Debtors and creditors include amounts accrued and deferred respectively as at 31 March 2014 compared with 31 July 2013 as the College's teaching activity is ongoing at the time of the revised accounting reference date.

The 2014-15 budget assumes a small deficit of £429,000.

The balance sheet shows a decrease in net assets of £13 million compared to 31 July 2013. Key variances are set out below:

- Short term investments reduced from £2.8 million during 2013-14 following the disposal to support cash requirements and the transfer to the Foundation.
- Cash at bank and in hand decreased by £5 million. This is primarily the result of the donation of £8 million made to the Foundation on 27 March 2014 in the current year. The College is satisfied that it has sufficient cash to continue to meet operational requirements and will make an application to the Foundation for funds to support future capital projects.
- Debtors remained consistent with the prior year and include £2 million due from the Scottish Funding Council as at 31 March 2014, primarily in respect of accrued recurrent grant funding and transformation funding to support the merger.
- Creditors also remained broadly consistent with the prior year and include £0.88 million deferred tuition fee and contract income in respect of the period 31 March 2014 to 31 July 2014.
- Net pension liabilities increased by £3.2 million as a result of market conditions and assumption changes.

Budget 2014-15

The approved budget for 2014-15 reflects a £429,000 deficit for the year. This is associated with savings arising from voluntary severance, efficiencies arising from the merger and after expected salary increases. The College has continued to progress the achievement of its vision, values and ambition although has not yet developed a clear operational plan, medium term financial plan or key performance indicators to support their delivery.

Recommendation two

31 March / 31 July	2014 £'000	2013 £'000
Fixed assets		
Tangible assets	68,855	70,397
Current assets		
Stocks	20	15
Assets held for disposal	160	660
Debtors: Amounts falling due within 1 year	5,163	5,186
Short term investments	-	2,885
Cash at bank and in hand	4,274	9,281
Creditors: Amounts falling due within 1 year	(8,085)	(7,822)
Net current assets	**1,532**	**10,205**
Creditors: Amounts falling due after 1 year	(7,429)	(7,429)
Net pensions liability	(13,502)	(10,358)
Net assets including pension liability	**49,456**	**62,815**
Deferred capital grants	43,830	44,587
Endowments	83	90
Reserves		
Income and expenditure reserve (including pension reserve)	(3,526)	7,106
Restricted reserve	-	1,264
Revaluation reserve	9,069	9,768
Total funds	**49,456**	**62,815**

Financial statements and accounting

Our perspective on the preparation of the financial statements and key accounting judgements made by management

Audit conclusions

We have issued unqualified audit opinions on the financial statements of the College and GTL and the regularity of transactions reflected in the College financial statements.

International Standards on Auditing require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk and that management override of controls is a significant risk.

We have satisfactorily carried out audit work to address these risks.

Audit conclusions

We have issued an unqualified opinion on the truth and fairness of the state of the affairs of the College as at 31 March 2014 and of the College's income and expenditure, recognised gains and losses and cash flows for the year then ended. We have also issued an unqualified opinion on the regularity of the transactions reflected in those financial statements.

We have also issued an unqualified opinion on the truth and fairness of the state of the affairs of GTL as at 31 March 2014.

There are no matters identified on which we require to report by exception.

In gathering the evidence for our opinion we have:

- performed a mixture of substantive and controls testing to ensure an efficient approach that covers all the key risks;
- reviewed internal audit reports to ensure all key risk areas having a potential financial statements impact have been considered;
- reviewed assumptions and judgements made by management and considered these for appropriateness;
- considered if the financial statements may be affected by fraud through discussions with senior management and internal audit to gain a better understanding of their work in relation to the prevention and detection of fraud with the potential to impact on the financial statements;
- held discussions with senior management; and
- attended meetings with those charged with governance to communicate our findings, but also to update our understanding of the key governance processes and obtain key stakeholder insights.

Significant risks

Revenue recognition	While fraud risk associated with grant income would ordinarily be rebutted, the change in accounting reference date to 31 March introduced a degree of judgement as to underlying activity measures and compliance with funding conditions. This included whether underlying activity was such that provision should be made for anticipated clawback of grant funding. We found that management had considered the different variables impacting recognition of grants and had arrived at an appropriate basis. Where there was room for some interpretation, we found management's judgement to have been balanced, for example in respect of the level of delivery of teaching activity and associated allocation of costs. We did not identify errors requiring adjustment in the financial statements or evidence of bias in determining income to be recognised.

Audit conclusions (continued)

In addition to the significant risks which International Standards on Auditing require us to address, our audit planning also identified areas of audit focus around:

- **retirement benefits valuation;**
- **establishment of a charitable foundation; and**
- **the combination of Dundee and Angus colleges**

Our work in each of these areas has been satisfactorily concluded.

Significant risks (continued)	
Management override of controls	To address this risk, we have performed testing of journal entries during the year and at the year end, undertaken a review of unusual transactions in the year, made enquiries with employees outside the finance department, incorporated audit tests of an unpredictable nature and undertaken testing of controls, including 'higher level' controls and reviewed management's accounting estimates for bias. Our work did not identify any matters that required adjustment in the financial statements or which require to be brought to your attention.
Audit focus areas	
Retirement benefits valuation	The College accounts for its participation in the Tayside Superannuation Fund ("the Fund") in accordance with FRS 17: *Retirement benefits* on a defined benefits basis using valuation information prepared by actuarial consultants. Our audit of the accounting for retirement benefits includes evaluation of the actuarial consultants as a third party expert, consideration of the data underlying the actuarial report, including the level of contributions made during the year, the financial assumptions and membership data provided to the actuary by the College, and estimates of the College's share of the pension fund assets. We found that the actuarial consultants as a third party expert was objective and had the appropriate experience and expertise to provide the information for use by the College. The level of contributions made by the College in the period is estimated based on data prior to the period end. It is important that this number is accurate as it is used to inform the calculation of the liabilities at the period end. Our testing included review of actual data against that used in the actuarial calculations. No issues were identified. Contribution estimates for the year included the accrued costs of voluntary severance payments made in the period. For the Fund, the actuaries use a number of assumptions in their calculations based on market conditions at the period end, including a discount rate to derive the anticipated future liabilities back to the period end date and assumptions on future salary increases. Using our own actuarial specialists, we reviewed the assumptions and concluded that the overall assumptions proposed were slightly stronger than our central assumptions but are within our expected range. The rate of salary increases is set taking into account the College's expected long-term rate of salary increases, including incremental drift. Following discussion with management, the rate assumed in 2013-14 is RPI + 1.4%. The increases assumed in the period represent management's estimation of the most likely increases taking into account a variety of factors including harmonisation costs in 2013-14 together with a 2% pay increase and headcount changes. Management should ensure that in setting this assumption it reflects the College's long-term plans and strategy.

Audit conclusions (continued)

In addition to the significant risks which International Standards on Auditing require us to address, our audit planning also identified areas of audit focus around:

- **retirement benefits valuation;**
- **establishment of a charitable foundation; and**
- **the combination of Dundee and Angus colleges**

Our work in each of these areas has been satisfactorily concluded.

Audit focus areas	
Charitable foundation	As a result of the college reclassification, colleges' abilities to spend existing reserves, eg. by operating at a deficit in a given year, will be restricted due to the Scottish Government funding mechanisms. In order to protect existing reserves levels, the Dundee & Angus Foundation was established as a charitable company limited by guarantee and registered with the Office of the Scottish Charity Regulator. We have considered the status of the Foundation against the relevant accounting requirements which determine whether it should be consolidated in the College's financial statements. This requires consideration of whether: ■ there is direct ownership or control of the Foundation; and ■ there is evidence of indirect control through established practices or other means. Following consideration of the Foundation's constitution and associated documentation, we agree with management's view that the Foundation does not require to be consolidated as at 31 March 2014. In so doing, we note, that there are a number of risks that should be considered by management where future actions may indicate that consolidation is required. £8 million was donated to the Foundation during 2013-14. At the time of our report, one of five independent trustees has yet to be appointed to the Foundation and the College has yet to appoint a representative to the Board.
The combination of Dundee and Angus colleges	The establishment of the Tayside Region college, known as Dundee and Angus College, was effected by the transfer of all the activities and assets of Angus College to Dundee College as at 1 November 2013. The Statement of Recommended Practice: Accounting for further and higher education (2007) requires that institutions must assess, in accordance with Finance Reporting Standard 6: *Acquisitions and Mergers*, whether a combination of an institution with another institution is an acquisition or merger. The key feature of merger accounting is that neither party is viewed as the acquiring entity and the combined results and balances are presented as if the merged entity existed in the comparative periods. Merger accounting is applicable for the formation of a new reporting entity which is a substantially equal partnership where no party is dominant and subject to satisfaction of certain criteria. We have liaised with management and are satisfied that those criteria can be demonstrated or rebutted. Specifically, the criteria in respect of the relative size of the parties combining has been rebutted by management and was required to be disclosed in the financial statements.

Audit conclusions (continued)

Audit focus areas	
The combination of Dundee and Angus colleges (continued)	Management's intention at each stage, from planning the business case, creation of the regional and partnership board and selection of the management teams included equal representation from the former Dundee and Angus colleges; although it is acknowledged that the majority of the Dundee senior management team ultimately were appointed into the new college leadership team. All public consultation documents and reports refer to the colleges merging and no college appears to have led the process or arrangements. On this basis, Angus College, despite its smaller size, is not deemed to have been subject to dominant influence from Dundee College. In advance of the merger management of Dundee and Angus colleges held regular meetings to review integration plans and progress merger workstreams. The financial ledgers were integrated in advance of the merger although some work was subsequently required to align 2012-13 categorisation of transactions to ensure consistency of presentation in the financial statements. The College has continued to operate multiple established payrolls with some staff members from the former Angus College continuing to be paid on a payroll processed on behalf of the College by Angus Council. Accounting policies of the former Dundee and Angus colleges were broadly consistent with additional alignment achieved in 2012-13 in advance of the anticipated merger. Consequently, no amendments to the valuation of assets, liabilities or other financial statement balances were required as a result of the merger, associated with harmonisation or alignment of accounting policies. In respect of the College's specific circumstances, FRS 6 requires disclosure of: ■ an analysis between the parties to the merger of the principal components of the income and expenditure account and statement of total recognised gains and losses for the previous financial year, which the College has presented in the financial statements; and ■ an analysis of the principal components of the current year's income and expenditure account and statement of total recognised gains and losses in respect of the components prior to and subsequent to the date of the merger; and ■ the aggregate book value of the net assets of each party to the merger at the date of the merger. The College has not been able to analyse financial transactions appropriately pre and post merger to present it accurately and consistently for both parties and has therefore not included this in the financial statements. We have requested a specific management representation to confirm that, in the board of management's opinion, the information required cannot be disclosed and that its omission does not affect the truth or fairness of the financial statements.

Accounting framework; application of accounting policies

There have been no substantive changes to the financial reporting framework as set out in the *Statement of Recommended Practice: Accounting for Further and Higher Education (2007)* ("the SORP").

Accounting policies have been applied consistently with those introduced in the previous year following the establishment of the College.

A new SORP, that draws on the principles of FRS 102, will be applied in respect of the year ending 31 March 2016. The College will need to prepare a transitional balance sheet as at 1 April 2014.

The financial statements have been prepared on a going concern basis.

Statement of Recommended Practice: *Accounting for Further and Higher Education* (2007) ("the SORP")	■ The 2013-14 financial statements have been prepared in accordance with the SORP. ■ During the year there have been no substantive changes in financial reporting requirements, and consequently there are no changes to the College's accounting policies. ■ We are satisfied that the accounting policies remain appropriate to the business, and have been applied consistently.
Impact of revised accounting standards	■ There are no newly effective accounting standards which are considered to have a material impact on the College's financial statements for 2013-14. ■ In March 2013, the Financial Report Council issued FRS 102, the Financial Reporting Standard applicable in the UK and Republic of Ireland. This is the main part of the new UK GAAP regime and follows the issue in November 2012 of FRS 100 (overview of the framework) and FRS 101 (reduced disclosure framework). ■ FRS 102 is applicable for accounting periods beginning on or after 1 January 2015. In response, the Further and Higher Education SORP Board has recently completed the development of a new SORP. Management will need to consider the accounting and reporting implications of the revised SORP and prepare a transitional balance sheet as at 1 April 2014. ■ There are key differences to the existing SORP, particularly in respect of grant accounting, recognition of obligations arising from funding past deficits of multi-employer pension schemes, service concession arrangements and in respect of financial statement disclosures. Each of these will need careful consideration.
Going concern	■ Management has considered the funding available to the College in 2014-15 and consider it appropriate to adopt a going concern basis for the preparation of these financial statements. ■ We are satisfied that the going concern basis of preparation of the financial statements is appropriate. At 31 March 2014, the College had £4.3 million cash and £1.5 million net current assets.

Year end process; internal control; other matters

The unaudited financial statements were made available on a timely basis.

Management encountered some minor difficulties in analysing historical financial information pre-merger and verifying staff numbers for inclusion in the financial statements.

Systems of internal control continue to be integrated in the merger college.

Financial statements preparation	■ High quality working papers and draft financial statements were provided on 19 May 2014 in line with the agreed timetable. The operating and financial review and statement of corporate governance and internal control were separately updated following the end of audit fieldwork. ■ As a consequence of the merger, management encountered some difficulties in analysing historical financial data on a like for like basis between Dundee and Angus college's in preparing the financial statement comparative balances for 2012-13. In addition, there was some uncertainty in respect of staff numbers associated with the operation of multiple payrolls in respect of former Angus and Dundee college staff, transfer of staff following changes in contract and voluntary severance. ■ There are no non-trifling unadjusted audit differences, and there were no adjusted audit differences warranting disclosure. There were a number of amendments during the audit, as management worked through the accounting and related disclosure consequences arising from the merger.
Systems of internal control	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively over the following financial processes: ■ income and expenditure; ■ staff costs; and ■ cash and bank.
Other matters	Mandatory communications required by International Standards on Auditing are given in Appendix one. There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content.

Governance and narrative reporting

Update on your governance arrangements

Our overall perspective on your narrative reporting

Corporate governance arrangements

The statement of corporate governance and internal control identifies no major weaknesses in governance or internal control arrangements.

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

Management has identified no significant fraud or irregularities.

Corporate governance and internal control arrangements	The College has made a compliant corporate governance and internal control 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. We are not required to provide an opinion on the College's system of internal control. The statement of corporate governance and internal control provides detail on the governance framework, the system of internal control, internal audit, internal financial controls and risk management arrangements, and analyses the effectiveness of these elements of the framework. It describes a number of sources of assurance for the accountable officer. We have reviewed the statement of corporate governance and internal control and consider it consistent with our understanding of the process followed by the College during the period. GTL maintains its own governance arrangements which are appropriate for its size and complexity, however due to the administrative relationship between GTL and the College, there are a number of shared systems between the two bodies. The corporate governance and financial control frameworks that govern GTL are consistent with those of the College.
Internal audit	As set out in our audit plan and strategy, we have evaluated the work of internal audit in the year, both to enhance our understanding of the key risks and issues facing the College and to rely on the work of internal audit where possible to avoid duplication. The content of the internal audit plan is in line with our expectations. We did not directly rely on internal audit work in the period, but reviewed relevant reports to inform our understanding and approach. Internal audit reported that *"with the exception of the matter noted…the College operates adequate and effective internal control systems. Proper arrangements are in place to promote and secure Value for Money".* Internal audit reported that they identified weaknesses in relation to budget setting and the general ledger processes, which arose as a result of the merger and bringing together systems, but that these were already being addressed by management.
Regularity	As part of our audit of the College's financial statements, we are required by the Public Finance and Accountability (Scotland) Act 2000 to give an opinion on the regularity of expenditure and receipts shown in the financial statements. The executive team 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 to ensure it is appropriately aware of sector issues and developments and that it complies with the terms and conditions of funding. Our review of expenditure throughout the course of our audit did not identify weaknesses in the control environment over regularity of expenditure and receipts, or instances of non-compliance with Scottish Funding Council terms and conditions.

Corporate governance arrangements (continued)

Prevention and detection of fraud	A key mechanism in the allocation of authority, accountability and responsibility and the prevention and detection of fraud is the existence and maintenance of strategic and financial documentation. We consider that the College has established appropriate processes for the prevention and detection of fraud. During 2013-14, management identified no significant fraud or irregularities.
Maintaining standards of conduct and the prevention and detection of corruption	The College has appropriate policies and codes of conduct for staff and members, including the use of a register of members' interests. These appear proportionate for the College's purposes. Work is ongoing to align the policies and day to day operational procedures of the former Dundee and Angus colleges.
Corporation Tax	Where colleges undertake non-primary purpose ("NPP") activities, they may be liable for corporation tax. Colleges are exempt from corporation tax on these activities (such activities might include conferences, non-student residences, consultancy) provided they do not exceed the threshold of £50,000, as a small trading exemption. In the case of a recently merged college, as all the various strands of NPP activity for the previously individual colleges will be consolidated, there is an increased risk of breaching the £50,000 small trading exemption threshold. It is therefore important management continue to consider these activities in more detail to determine whether the limit is breached each year and if so whether an overall profit or loss arises from these activities. If profitable, the College would have a corporation tax liability, however it is more likely there will be an overall loss once an allocation of overheads has been taken into account. Calculations should be retained as evidence that no corporation tax return requires to be submitted. Tax specialist assistance may be required to assist consideration of NPP activities and have a process going forward for identifying NPP activities and calculate whether a profit arises on those activities
Senior post-holders' emoluments	The Scottish Funding Council's Accounts Direction sets out certain disclosures required in respect of senior post-holders' emoluments. We tested these disclosures to ensure that they were prepared in accordance with the requirements of the Accounts Direction. No issues were identified with the accuracy of the disclosures.

Performance management

Our perspective on the performance management arrangements

Performance management

The College produces management accounts which compare actual expenditure to budget.

Some efficiency savings have been achieved and ongoing savings are planned as part of the merger.

Performance against sector indicators is measured by the College.

Best value

In April 2002 the Scottish Ministers introduced a non-statutory duty on accountable officers to ensure arrangements exist to secure Best Value. Audit Scotland has been committed to extending the Best Value audit regime across the whole public sector for some time. Using the Scottish Executive's nine Best Value principles as a basis for audit activity, Audit Scotland previously selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working).

A series of toolkits covering financial, performance and governance processes are available for public sector organisations and auditor to use, but auditors have not been required to complete specific toolkit(s) during the period.

Efficiency savings are planned and are ongoing as part of the merger business case. While the College produces management accounts which compare actual expenditure to budget and analyses variances, to support the development of efficient and effective operation we suggest that consideration is given to the use of these toolkits and formalisation of a set of key performance indicators to be included as part of monthly management accounts

Recommendation two

Performance indicators

In accordance with Scottish Funding Council requirements, the College is required to publish and report progress against national priorities. These indicators monitor the implementation of the College's financial objectives.

KPI	Actual 2013-14	Actual 2012-13
Non-SFC income a % of income	24.2%	23.8%
Gearing	75%	227%
Current assets : current liabilities	1.19:1	2.30:1

The activity target set by Scottish Funding Council for 2013-14 was 144,593 wSUMs. As at 31 July 2014, the College delivered around 145,923 wSUMs in 2013-14.

Appendices

Mandatory communications

Mandatory communications regarding audit adjustments, auditor independence and representation letter content are given here.

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	There were no audit adjustments required to the draft financial statements which impacted on the net assets or the net expenditure for the year. A small number of numerical and presentational adjustments were required to some of the financial statements notes; these have been adjusted by management.	-
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you. There are no unadjusted audit differences identified above our materiality thresholds agreed with the audit committee.	-
Confirmation of Independence Letter issued by KPMG LLP to the audit committee	We have considered and confirmed our independence as auditor and our quality procedures, together with the objectivity of our Audit Director and audit staff.	Appendix 3
Schedule of Fees Fees charged by KPMG for audit and non-audit services	There were no non-audit services in 2013-14.	-
Draft management representation letter Proposed draft of letter to be issued by the College to KPMG prior to audit sign-off	There are no changes to the standard representations required for our audit from last year and there are no specific representations required for our audit for this year to draw to your attention.	-

Action plan

The action plan summarises specific recommendations arising from our audit work, together with related risks and management's responses.

Priority rating for recommendations		
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 organisation or systems under consideration. The weaknesses 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 control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Management accounts		**Grade two**
Due to the number of inherent assumptions associated with the merger, the budget setting exercise for 2013-14 and subsequent monitoring, management information was not as well developed or robust as in previous years. The ability to review prior year to date balances was limited by the availability and comparability of information in respect of the former Dundee and Angus colleges. There is a risk that variances are not identified accurately such that remedial action is delayed or inappropriate leading to loss or error.	It is recommended that the format and frequency of preparation of management accounts is refreshed. These should be prepared every month and include; ■ income and expenditure and balance sheet summaries; ■ breakdowns of key balances; and ■ variance analysis with explanations and actions in respect of those in excess of a predetermined threshold	Due to the nature of income, full management accounts incorporating the recommendations opposite will be prepared on a quarterly basis. On a monthly basis, key income and expenditure streams and cash flow will be reviewed by the senior management team. **Responsible officer:** Assistant principal (finance and resources) **Implementation date:** November 2014 (2nd quarterly management accounts)

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Key performance indicators		**Grade three**
Efficiency savings are planned and are ongoing as part of the merger business case. While the College produces monthly management accounts which compare actual expenditure to budget and analyses variances, there are no key performance indicators included to measure efficiency or effectiveness. There is a risk that performance does not achieve best value or that the College does not have appropriate measures to ensure the delivery of its vision, values and ambitions.	To support the development of efficient and effective operation we suggest that consideration is given to the use of these toolkits and formalisation of a set of key performance indicators to be included as part of monthly management accounts.	Agreed, appropriate KPIs will be considered. **Responsible officer:** Assistant principal (finance and resources) **Implementation date:** November 2014 (2^{nd} quarterly management accounts)

Auditor independence and non-audit fees

Auditing Standards require us to consider and confirm formally our independence and related matters in our dealings with the College and GTL.

We have appropriate procedures and safeguards in place to enable us to make the formal confirmation in our letter included opposite.

Professional ethical standards require us to provide to you at the conclusion of an audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed. This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence.

We have considered the fees paid to us by the College and its related entities for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Regular communications
- Internal accountability
- Risk management
- Independent reviews

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the board of management.

Confirmation of audit independence

We confirm that as of 8 October 2014, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of audit committee and should not be used for any other purpose.

Yours faithfully

KPMG LLP

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