cutting through complexity

Dundee and Angus College and Gardyne Theatre Limited

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

Audit: year ended 31 July 2016

14 December 2016

Contents

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 Dundee and Angus College ("the 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 introduction and responsibilities 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 (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) 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.

Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Andy Shaw, who is the engagement leader for our services to Dundee and Angus College, telephone 0131 527 6673 or email: andrew.shaw@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6720 or email to alex.sanderson@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

Executive summary

Executive summary

Audit conclusions		
●	■ We have issued an unqualified audit opinion on the financial statements for Dundee and Angus College Group ('The College') and for Gardyne Theatre Ltd ('GTL').	Page 10
Financial position		
●	■ The College reported a deficit of £2.4 million in the 12 month period to 31 July 2016, prior to an actuarial loss of £8.7 million. The College's net assets decreased by £11.2 million to £4.1 million, primarily as a result of the increased pension liability.	
●	■ GTL made a small loss before tax of £4,452 after having turnover of £291,604 compared to breaking even in the previous period.	Page 6
●	■ The financial statements are prepared on a going concern basis, reflecting the budgeted deficit for 2016-17 of £0.06 million and forecast cashflows.	
Financial statements and related reports		
●	■ We have concluded satisfactorily in respect of each of the significant risks and audit focus areas identified in the audit strategy and plan document. We concur with management's accounting treatment and judgements. We have no matters to highlight in respect of: unadjusted audit differences; independence; and changes to management representations. Two items were identified during the audit and have been adjusted.	Pages 12 to 15
Wider scope		
●	■ We considered the wider scope dimensions and concluded positively in respect of financial management, value for money, governance and transparency.	Pages 21 to 24
●	■ We note a risk in relation to financial sustainability. Due to the accounting changes brought about by the change to FRS102, the College was in breach of the bank covenants at the year end. Santander recognises that this is was due to an accounting change and not indicative of performance-related issues and have provided a breach waiver prior to the year end. It is expected that the covenants will be revised in early 2017 to acknowledge this sector-wide issue.	Page 20

Scope and responsibilities

Purpose of this report

The Auditor General for Scotland (“the Auditor General”) has appointed KPMG LLP as auditor of Dundee and Angus College (”the College”) under the Public Finance and Accountability (Scotland) Act 2000 (“the Act”).The period of appointment is 2011-12 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. 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.

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.

Accountable officer responsibilities

The Code sets out Dundee and Angus College’s responsibilities in respect of:

- preparation of financial statements that show a true and fair view;
- 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.

Auditor responsibilities

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code. Appendix six sets out how we have met each of the responsibilities set out in the Code.

Scope

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems.

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 directors and our presentation to the audit committee, together with previous reports to the audit committee throughout the year, discharges the requirements of ISA 260.

Financial position

Financial position

Overview

The financial position of the College is reported for the 12 month period to 31 July 2016, with comparatives for the 16 month period to 31 July 2015. The College aims to breakeven in resource terms within each Government financial year to 31 March.

The College achieved its core credit target. Due to late changes in the funding for all colleges during 2014-15, the College faced challenges in respect of additional credits during the period. It was granted extra funding for 2,000 additional credits in April 2016. These extra credits were subsequently not met and discussion with the Scottish Funding Council ('SFC') confirmed that a clawback will be required. The financial statements currently include a provision for £0.465 million.

Financial position

The College recognised a deficit £2.4 million for the year, compared to a surplus of £1.2 million in the previous 16 month period. The final outturn compares to a budgeted deficit of £0.8 million. The shortfall reflects a decrease in SFC non-recurring grants of £0.9 million, combined with increased salary costs of £0.5 million and greater premises costs of £0.2 million.

Statement of Comprehensive Income

	2015-16 (12 months) £000	2014-15 (16 months) £000
Scottish Funding Council grants	30,327	41,432
Tuition fees and education contracts	5,824	7,580
Other grant income	1,198	3,596
Other operating income	1,904	2,436
Investment income	9	29
Total income	**39,262**	**55,073**
Staff costs	26,598	33,454
Restructuring costs	-	836
Other operating expenses	9,623	13,661
Depreciation	4,834	5,781
Reversal of previous impairment charges	-	(1,011)
Interest and other finance costs	633	1,170
Total expenditure	**41,688**	**53,891**
(Deficit)/surplus before other gains and losses	(2,426)	1,182
Gain on disposal of fixed assets	-	27
Actuarial (loss)/gain in respect of pension scheme	(8,727)	3,140
Unrealised deficit on revaluation of fixed assets	-	(120)
Total comprehensive (expenditure)/income for the year/period	**(11,153)**	**4,229**

Source: Dundee and Angus College financial statements 2015-16

Financial position (continued)

Balance sheet

The College had net assets at 31 July 2016 of £4.1 million (2014-15: net assets of £15.2 million). The key movements from the prior year are set out below.

Assets

Tangible fixed assets decreased by £3.7 million. This is the result of depreciation in the year of £4.8 million exceeding additions of £1.1million.

Debtors decreased significantly by £2.1 million, primarily because of a £0.9 million decrease in accrued income and £0.1 million reduction in European funding.

Liabilities

Short term creditors decreased by £1 million, reflecting the ending of projects worth £0.38 million which previously had balances in deferred income which could now be recognised, as well as a £0.68 million decrease in the level of trade creditors, attributed to the timing of payment runs given the current year end fell on a Saturday.

Net pension liabilities in respect of participation in the Tayside Superannuation Fund increased by £9.3 million, reflecting changes in demographic and financial assumptions in the actuarial valuation.

Long term creditors decreased by £2.8 million, resulting primarily from government capital grants released to income in the year (net movement with additions of £2.2 million) and repayments of £0.6 million against the long term loan facility.

Consolidated balance sheet

	31 July 2016 £000	31 July 2015 £000
Tangible fixed assets	68,043	71,771
Stocks	17	15
Trade and other receivables	1,584	3,696
Cash and cash equivalents	3,206	2,961
Creditors: Amounts falling due within one year	(6,803)	(7,800)
Net current liabilities	**(1,996)**	**(1,128)**
Creditors: Amounts falling due after one year	(41,411)	(44,168)
Net pensions liability	(20,523)	(11,209)
Total net assets	**4,113**	**15,266**
Reserves		
Income and expenditure reserve	(8,557)	1,678
Revaluation reserve	12,670	13,588
Total reserves	**4,113**	**15,266**

Source: Dundee and Angus College financial statements 2015-16

Financial position (continued)

Financial plans 2016-17

The approved budget for 2016-17 shows a cash-backed trading deficit of £0.06 million. This reflects £26 million SFC funding, £8.7 million of tuition and other income, £27.3 million staff costs and £7.7 million other expenditure. Whilst staff costs include cash payments to the pension schemes, the result does not includes FRS 102 pension adjustments as these are not known until year end. The final reported outturn for 2016-17 is therefore expected to reflect accounting adjustments to the net pension liability.

The College has target credits of 108,333 (2015-16: 110,333) which it expects to meet.

The College has a strategic plan for the period 2014-20, with financial plans prepared annually for the academic year ahead. The long term financial strategy is to achieve cash breakeven each year. Cash flow forecasts are prepared for the following academic year.

Going concern

The College had net assets of £4.113 million at 31 July 2016, and net current liabilities of £1.996 million. This is despite an increase in the pension liability of £9.314 million. The drop in net assets from £15.367 million reflects the deficit for the year and the actuarial loss in respect of the pension scheme.

The working capital position is continually monitored and cash flow is affected by the phasing of SFC funding. The College draws down cash from the SFC to meet liabilities. The cashflow forecast for the year shows that the College is expected to operate within its facilities for the next twelve months, including the potential clawback from SFC.

We concur with the Board of Management's assessment that the going concern basis of preparation remains appropriate and further detail is included on page 14.

Financial statements and related reports

Audit conclusions

Audit opinion

We have issued an unqualified opinion on the truth and fairness of the state of the College's affairs as at 31 July 2016, and of the College's deficit for the year then ended. We have also issued an unqualified opinion on the regularity of transactions within the year and the remuneration report. There are no matters identified on which we are required to report by exception. We have issued an unqualified audit opinion on the truth and fairness of the subsidiary company, Gardyne Theatre Limited, for the same period.

Financial reporting framework, legislation and other reporting requirements

The College is required to prepare its financial statements in accordance with Financial Reporting Standard ("FRS") 102 and the Accounting for Further and Higher Education Statement of Recommended Practice 2015 ("the SORP"). It must also apply the Financial Reporting Manual 2015-16 ("the FReM"), although the SORP takes precedence where there is a direct conflict. Additional disclosures are required in accordance with the 2015-16 Accounts Direction for Scotland's Colleges and Universities ("the Accounts Direction"). Our audit confirmed that the financial statements have been prepared in accordance with the SORP and relevant legislation.

Regularity

Our audit work, as outlined on the following pages, concluded that in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

Statutory reports

We have not identified any circumstances to notify the Auditor General that indicate a statutory report may be required.

Other communications

We did not encounter any significant difficulties during the audit. There were no other significant matters arising from the audit that were discussed, or subject to correspondence with management that have not been included within this report. There are no other matters arising from the audit, that, in our professional judgement, are significant to the oversight of the financial reporting process.

Audit misstatements

There were two audit adjustments required to the draft annual financial statements as detailed in Appendix one and there are no unadjusted audit differences.

Management representations

There are no changes to the standard representations required for our audit from last year.

Materiality

We summarised our approach to materiality in our audit strategy. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that our planning materiality for 2015-16 of £680,000 (2% of forecast total expenditure) remains appropriate. We report all misstatements greater than £34,000.

Forming our opinions and conclusions

In gathering the evidence for the above opinions and conclusions we have:

- performed controls testing and substantive procedures to ensure that key risks to the annual financial statements have been covered and that the regularity of income and expenditure was in accordance with regulations;
- communicated with internal audit and reviewed its reports as issued to the audit committee to ensure all key risk areas which may be viewed to have an impact on the annual financial statements have been considered;
- reviewed estimates and accounting judgements made by management and considered these for appropriateness;
- considered the potential effect of fraud on the financial statements through discussions with senior management and internal audit to gain a better understanding of the work performed in relation to prevention and detection of fraud; and
- Attended audit committee meetings to communicate our findings to those charged with governance, and to update our understanding of the key governance processes.

Financial statements preparation

Good quality working papers were provided during the audit fieldwork, starting on 20 September. Draft financial statements, including the performance report and accountability report (including corporate governance report and remuneration and staff report) were received during the audit fieldwork and we suggested minor presentational adjustments to ensure they were in line with available guidance.

The financial statements preparation process took longer than expected, as a result of demands on the finance team's time, combined with the requirement to transition the prior year results to the new SORP.

Significant risks and other focus areas in relation to the audit of the financial statements

We summarise below the risks of material misstatement as reported within the audit strategy. We set out the key audit procedures to address those risks and our findings from those procedures, in order that the audit committee may better understand the process by which we arrived at our audit opinion.

Significant risk:

- management override of controls fraud risk

Other focus areas identified at audit planning:

- adoption of the FRS 102 based SORP
- valuation of properties
- income recognition fraud risk

Additional focus areas identified as the audit progressed:

- GTL and going concern

Significant risks

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Fraud risk from management override of controls Professional standards require us to communicate the fraud risk from management override of controls as significant. Management is typically in a unique position to perpetrate fraud; there is an ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.	Our audit methodology incorporated management override of controls as a default significant risk. We did not identify any specific additional risks of management override as part of the audit of the College. In line with our methodology, we carried out appropriate controls testing and substantive procedures, including testing over journal entries, accounting estimates and significant transactions that are outside the organisation's normal course of business, or are otherwise unusual.	We found no significant instances of management override of controls from our audit testing.
Valuation of properties In accordance with the FReM, properties are valued at market value, which is subject to external factors, both on a national and localised scale.	We considered the accounting entries and disclosures reflected in the financial statements relating to the valuation of tangible fixed assets, with reference to FRS 102 and the associated independent valuation expert's opinion. The College has opted for a quinquennial valuation, with interim valuations every third year. This is in line with options laid out under the FReM. We reviewed the prior year valuations in light of current year conditions and consider them to be appropriate.	We concur with the valuation of properties and disclosure in the financial statements.
Gardyne Theatre Limited Gardyne Theatre Limited ('GTL') is a company that owns and operates Gardyne Theatre, as well as promoting the performing arts. It is a 100% owned subsidiary of the College. GTL has 48% ownership of an associate company, Jackie the Musical Limited ('JTM'), responsible for the tour of Jackie the Musical.	We reviewed the appropriateness of accounting and disclosures within the GTL financial statements. We performed substantive procedures over the turnover, cost of sales and admin expenses accounts. Additionally we vouched specific items for the debtors and creditors balances to ensure they are appropriate.	Jackie the Musical was a loss-making tour. JTM is correctly accounted for within GTL financial statements as an associate. GTL prepares financial statements under FRS 102 Section 1A reporting, and are more concise than full FRS 102 financial statements. We are satisfied that the financial statements are prepared appropriately.

Other focus areas

OTHER FOCUS AREA	OUR RESPONSE	AUDIT CONCLUSION
Fraud risk from income recognition Professional standards require us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk. As the majority of the College's income is received via grant from the SFC and is agreed in advance of the year, we do not regard the risk of fraud from this revenue recognition as significant. The College's other income streams primarily relate to tuition fees and education contracts, which can be agreed to planned expenditure in the period. The risk of fraud is therefore not considered to be significant.	Our audit work over income consisted of: ▪ SFC grant income was vouched to receipt and reconciled to the SFC budget and funding allocation; ▪ for tuition fee income we performed predictive analytical procedures and corroborated income which varied from expectation; ▪ for other sources of income we performed analytical procedures and specific item testing over material balances; and ▪ we considered the treatment of the potential SFC clawback in respect of the additional credits. In all cases, we considered the appropriateness of recognition under the SORP and FRS 102.	The key findings from our audit work are: ▪ we did not identify instances of fraudulent revenue recognition. ▪ we are satisfied that income is appropriately recognised within the financial statements.

OTHER FOCUS AREA	OUR RESPONSE	AUDIT CONCLUSION
FRS 102 The new SORP resulted in a number of differences in disclosure as well as the requirement for restatement of the comparative primary statements and opening reserves. In addition to significant differences, such as grant income recognition, the SORP brought changes in respect of holiday pay accruals and pension interest cost accounting on transition.	We completed the audit of the transition balance sheet and the audit of comparative primary statements, vouching transition adjustments to supporting documentation. This included analysing judgements and estimates made by management. The following work was completed: ▪ The holiday pay accrual was assessed and agreed to source documentation. ▪ We confirmed that government grants are appropriately recorded using the accruals method. This is correctly differentiated from the treatment of non-government grants, which are recognised on entitlement to the grants in line with performance conditions. ▪ We reviewed the accounting treatment of operating leases and confirmed that any changes required to lease classifications under FRS 102 were immaterial in nature. ▪ We reviewed the defined benefit pension scheme disclosure note and verified it has been prepared in accordance with the new SORP. In addition we confirmed that the net interest pension finance cost was included appropriately within the statement of comprehensive income. ▪ We considered the appropriateness of the disclosures, including the transition accounting note, against the recommended Accounts Direction UK model statements as well as British Universities Finance Directors Group financial statements and completed a SORP 2015 disclosure checklist to identify any areas of omission or error.	We are satisfied that: ▪ the financial statements are correctly prepared in compliance with the SORP, Accounts Direction and Audit Scotland published guidance. ▪ the financial statements include all required disclosures as required by these accounting standards and in respect of transition adjustments; and ▪ transition adjustments to comparatives have been appropriately applied.

Other focus areas

OTHER FOCUS AREA	OUR RESPONSE	AUDIT CONCLUSION
Pension liabilities The College accounts for its participation in the Tayside Superannuation Fund (‘TSF’) in accordance with FRS 102 and therefore recognises the actuarial valuation of the pension liabilities in respect of its share of the TSF. The funds are valued by actuaries, with the rates of contributions determined by the trustees on the advice of the actuaries. The College’s actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases.	Our audit approach included: - review of the financial assumptions underlying the actuaries’ calculations and comparison to our central benchmarks set by our pension specialists; - testing of the level of contributions used by the actuary to those actually paid during the year; - testing of membership data used by the actuary to data from the pension fund; and - agreeing actuarial reports to financial statement disclosures. We also tested underlying controls to verify the input data for staff costs and numbers.	We are satisfied that the retirement benefit obligation: - is correctly stated in the balance sheet as at 31 July 2016 and 31 July 2015; - has been accounted for and disclosed correctly in line with FRS 102 and the SORP; and - assumptions used in calculating this estimate and management’s judgements are appropriate and within the acceptable KPMG range.
Going concern The College recognised a deficit in 2015-16 and is forecasting a small deficit in 2016-17. The College is restricted with its ability to hold cash and had net current liabilities as at 31 July 2016. Management considered the funding available to the College in 2016-17 and considers it appropriate to adopt a going concern basis for the preparation of these financial statements.	SFC grant funding for 2016-17 is budgeted to be in line with the 2015-16 academic year, with increases in ESF Priority 5 funding and tuition fee income. The budgeted deficit for 2016-17 is £59,000 however this is due to depreciation and supported in principle by the SFC in line with the College’s requirement to have a breakeven cash position. We corroborated budgeted SFC income to the regional outcome agreement with Dundee and Angus College 2014-17. The College has a loan with Santander during the 2015-16 year. As a result of the accounting adjustments brought about by FRS102 the College “breached” the covenants of the loan. Santander provided a letter of waiver, confirming that it is waiving any right this breach gives as it is understood that the breach is brought about by accounting adjustments rather than performance issues. It is noted that Santander aims to adjust the covenants early in 2017 as it acknowledges this sector-wide issue.	In assessing the College’s ability to continue as a going concern we reviewed the 2016-17 budget and 12 month cash flow forecast prepared by management. We concur with management’s view that the going concern assumption remains appropriate for the reasons noted. Management should continue to monitor the cash position closely in the event of any unplanned expenditure, and continue discussions with Santander in respect of the loan covenants.

REPORT	SUMMARY OBSERVATIONS	AUDIT CONCLUSION
Annual report and performance and accountability report	The financial statements form part of the annual report of the College for the period ended 31 July 2016. We reviewed the contents of the annual report against the disclosure requirements and are content with the proposed reports. Performance and accountability reports are now required to be included in the annual financial statements. These outline the performance overview and the future plans and developments in line with the College's strategic objectives.	We are satisfied that the information contained within the annual report is consistent with the financial statements. We reviewed the contents of the management commentary against the guidance contained in the Accounts Direction and are content with the proposed report. We provided management with some relatively minor suggestions relating to how the management commentary could be enhanced and where additional information disclosures should be made.
Remuneration and staff report	The Scottish Funding Council's Accounts Direction requires the preparation of a remuneration report in accordance with the Government Financial Reporting Manual ('FReM'), to be included in the financial statements in 2015-16. The remuneration and staff report is contained within the accountability report. The College's remuneration disclosures are derived from payroll information.	We are satisfied that the format of remuneration report is in line with the FReM. We verified remuneration data reported to underlying records and are satisfied that disclosures are accurate.
Corporate governance report	The corporate governance report for 2015-16, included within the accountability report, outlines the corporate governance and risk management arrangements in operation in the financial year. It provides detail on the College's governance framework, operated internal controls, the work of internal audit, and risk management arrangements and analyses the efficiency and effectiveness of these elements of the framework.	We consider the governance framework and annual governance statement to be appropriate for the College and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.

Qualitative aspects

ISA 260 requires us to report to those charged with governance our views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

We consider the accounting policies adopted by the College to be appropriate, with the transition to FRS 102 appropriately reflected in the 2015-16 financial statements. There are no significant accounting practices which depart from what is acceptable under FRS 102 and the SORP.

Significant accounting estimates relate to:

- *The present value of defined benefit obligations under FRS 102;* (as calculated by the College's actuary, Barnett Waddingham) using agreed financial assumptions. We found the assumptions and accounting for pensions to be appropriate, as discussed at appendix three.
- *The present value of fixed assets.* These were valued in 2014-15 with the value carried forward to 31 July 2016. We are satisfied that the valuation basis remains appropriate and that valuations in 2014-15 were applied accurately.

We did not identify indications of management bias.

Financial statement disclosures were considered against requirements of the SORP, the Accounts Direction and the FReM. No departures from these requirements were identified.

Future accounting and audit developments

There are no changes to the SORP for 2016-17 and no significant changes to the FReM that will impact upon the College.

ISA (UK & Ireland) 700 and 720 have been revised for accounting periods beginning on or after 17 June 2016. These revise the requirements for the structure and content of the independent auditor's report. Audit Scotland has extended the reporting requirement in the interests of transparency to all audits carried out under appointment, but requires the disclosures to be in the annual audit report rather than the independent auditor's report. This is effective for audits carried out from 2016-17.

The 2016-17 audit of the College financial statements will be carried out by Audit Scotland. In concluding our 2015-16 audit work, we will liaise with the incoming auditor.

Wider scope

Wider scope

Audit dimensions introduction

Introduction

The Code frames the wider scope of our audit in terms of four audit dimensions; financial management, financial sustainability, governance and transparency and value for money. At the centre of these dimensions is Best Value.

It remains the responsibility of the audited body to ensure that they have proper arrangements in place across each of these audit dimensions. These arrangements should be appropriate to the nature of the audited body and the services and functions that it has been created to deliver. We review and come to a conclusion on these proper arrangements.

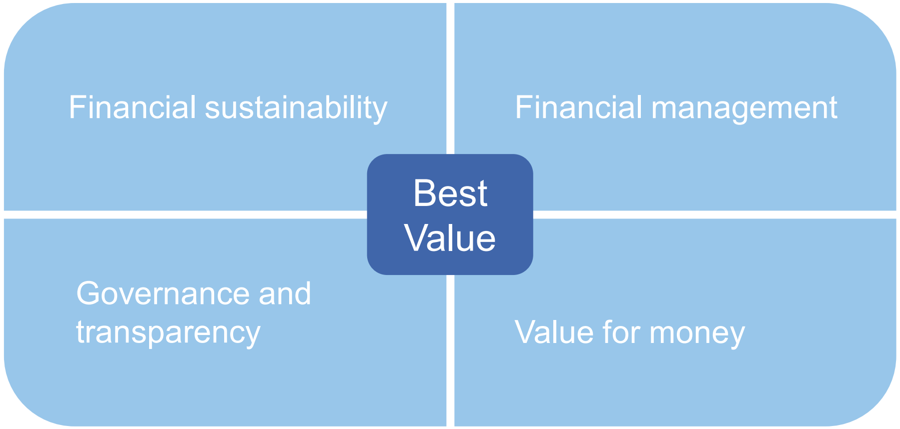
During our work on the audit dimensions we have considered the work carried out by internal audit and other scrutiny bodies to ensure our work meets the proportionate and integrated principles contained within the Code.

Audit work and conclusions

We summarise over the next few pages the work we have undertaken in the year to obtain assurances over the arrangements in place for each audit dimension and our conclusions on the effectiveness and appropriateness of these arrangements.

The next page sets out those risks we identified during our audit planning stage, any emerging risks during the course of audit work and our overall conclusion on each audit dimension.

Where we have found arrangements to not be effective or are absent we have provided further narrative on the following pages and recommendations for improvement. Where we have found the arrangements to be generally effective and operating as expected we have identified this in the conclusions we have formed.



Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

In considering financial sustainability of the College we performed the following work:

- *Reviewing the financial position of the College as at 31 July 2016.* We provide commentary on the financial position on pages six to eight. The College reports net assets of £4.1 million at 31 July 2016, down from £15 million in the prior year. As the changes to net assets and reserves position result primarily from FRS 102 transition adjustments and long-term pension debts, we do not consider these a risk to financial sustainability.
- *Reviewing future budgets and forecasts*. We reviewed the 2016-17 budget and cash flow forecasts. The 2016-17 budget is considered on page eight. The 2016-17 budget predicts a cash-backed deficit of £59,000. We note that, whilst this is a deficit, the College has sufficient cash reserves to maintain their operations.
- *Reviewing financial forecasting, financial strategies and key risks over financial sustainability*. The 2016-17 budget was approved by the College in June 2016. The College has a strategic plan for the period 2014-20, with financial plans prepared annually for the academic year ahead, however does not have a quantified long term financial strategy.
- *Reviewing covenant compliance.* As a result of the accounting adjustments brought about by FRS102 the College breached the covenants of the Santander loan during 2015-16. Santander provided a letter of waiver, confirming that it waives any right this breach gives it as it is understood that the breach is brought about by accounting adjustments rather than performance issues.

Conclusion:

We consider the College is financially sustainable. We are satisfied that the going concern basis of accounting is appropriate.

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

We carried out audit tests to determine the effectiveness of the financial management arrangements. This included:

- *Assessing the budget setting and monitoring processes within the College, including the approval of budget changes.* We found these to be robust, with regular accurate reporting and scrutiny by senior management and the finance committee.
- *Consideration of the finance function and financial capacity at the College.* We noted that the financial processes are efficient and effective. Finance team members have appropriate skills, capacity and capability to support the College and effectively manage the organisation.

Conclusion:

The College's finance department has appropriate financial capacity for current operations. Budgetary processes are supported by a strong internal control environment, and no significant control deficiencies were identified. This is supported by regular reporting and scrutiny by senior management and those charged with governance.

Internal controls

The College management is responsible for designing and implementing appropriate internal control systems to ensure a true and fair view of operations within the annual financial statements. 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 designed appropriately and operating effectively.

The findings of our controls testing relate only to those matters identified during our normal audit work, in accordance with the Code, and there may still be weaknesses or risks within the control environment which have not been identified through this work.

We raised one recommendation from our controls testing relating to the review of journals, which management acknowledges although considers that existing procedures are robust.

We also reviewed the higher level control environment relating to risk management and compliance with laws and regulations.

Conclusion: Internal controls we tested over risk management, financial, operational and compliance systems and procedures are designed, implemented and operating effectively.

Wider scope

Financial management (continued)

Arrangements for the prevention and detection of fraud and error

Testing over the processes to prevent and detect fraud and error included:

- *Inquiry with management as to procedures for the prevention and detection of fraud and error.* Based on inquiries, the procedures are considered to be appropriate for the College.
- *Testing of budget monitoring control.* Budget monitoring controls are designed and operating effectively to detect fraud and error in the financial statements.
- *Review of policies (financial regulations, code of conduct, whistleblowing, anti-bribery policies).* The College policies were found to be appropriate. The financial regulations detail responsibilities in relation to fraud, supported by anti-bribery and whistle-blowing policies.
- *Consideration of the accessibility of policies to staff and board members and if the policies had been implemented effectively.* The policies and processes tested are readily available to staff and had been implemented effectively. We note that the whistleblowing policy is not available from the College external website, however it is accessible to staff internally.

Conclusion: The College has appropriate arrangements to prevent and detect fraud.

Standards of conduct and the prevention and detection of corruption

Testing over the processes to prevent and detect corruption included in addition to the work detailed opposite:

- *Consideration of the overall control environment.* The College has arrangements including policies and codes of conduct for staff and board members, supported by a whistleblowing policy. Board members are responsible for setting the 'tone at the top' and for abiding by the code of conduct and disclosing interests which may be of importance – material or otherwise – to their work at the College.
- *Testing of completeness of registers of interest of senior staff and board members.* No errors were identified in this testing.
- *Review of reporting arrangements for conflicts of interest and whether these had been followed.* Conflicts of interest are a standing agenda item for committees.

Conclusion: The College has appropriate arrangements to prevent and detect inappropriate conduct and corruption.

Wider scope
Governance and transparency

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

In considering governance and transparency we performed the following work:

- *Reviewing the organisational structure, governance reporting lines and scrutiny within the College.* The College demonstrates effective scrutiny, challenge and transparency on decision making through various levels of committee reporting reviewed. Decisions are transparent as actions are documented within detailed board minutes which are available on the College website.
- *Reading the annual governance statement;* this includes the corporate governance framework, internal controls in operation, work of internal audit and analysis of the efficiency and effectiveness of the elements of the framework. We are satisfied that this is prepared in line with relevant guidance and is consistent with the governance framework.
- *Internal audit engagement.* We reviewed internal audit reports and conclusions for any findings relevant to our audit and to confirm the effectiveness of the internal audit function.

Conclusion:

The College has adopted the code of good governance for Scotland's colleges and the governance framework of the College is considered to be appropriate. The corporate governance statement is in accordance with guidance and reflects our understanding of the organisation. Internal audit is compliant with the Public Sector Internal Audit Standards.

Internal audit

Audit Scotland's Code of Audit Practice sets out the wider dimension of public sector audit. It requires external auditors to perform an annual assessment of the adequacy of the internal audit function. We considered the activities of internal audit against the requirements of Public Sector Internal Audit Standards ('PSIAS'), focusing our review on the public sector requirements of the attribute and performance standards contained within PSIAS. This included a review of the internal audit charter, reporting lines, independence, objectivity and proficiency and the range of work carried out by internal audit. We also considered the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*.

From this assessment, and considering the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*, we can apply internal audit's work to inform our procedures, where relevant.

Internal audit completed its agreed plan for the period ended 31 July 2016. The Internal Audit Annual Report 2015-16 states that the College has a framework of controls that provides reasonable assurance regarding the effective and efficient achievement of the College's objectives and the management of key risks.

Conclusion: We apply internal audit's work to inform our procedures, where relevant. The review of internal audit reports and conclusions did not indicate additional risks and there was no impact on our planned substantive testing

Corporate governance

We updated our understanding of the governance framework and documented this through our overall assessment of the College's risk and control environment. This included testing entity wide controls, including risk management, operational and compliance controls, as reported on page 21.

Conclusion: Governance controls were found to be operating effectively and we consider the governance framework to be appropriate for the College.

Value for money is concerned with using resources effectively and continually improving services.

We consider value for money and Best Value throughout our testing. Areas where we had a specific focus on value for money and Best Value are:

- *Sampling of payments made:* As part of our audit procedures, samples of invoices relating to operational and capital expenditure were selected and agreed. There were no items noted whereby value for money had not been considered.
- *Reviewing procurement policies*; the College has a procurement strategy which supports its commitment to obtaining value for money.
- *Reviewing regularity procedures*. 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. We reviewed regularity of expenditure through our controls and substantive procedures and did not identify any exceptions.

Conclusion:

The College evidenced using its resources for the purposes of enhancing service delivery and ensuring value for money. 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.

We are required to provide specific conclusions on the following areas which relate to governance and transparency and support our overall conclusion on this audit dimension.

Best Value

Scottish Government guidance for accountable officers on best value in public services requires a systematic approach to self-evaluation and continuous improvement. The guidance identifies the themes an organisation needs to focus on in order to deliver the duty of best value, but notes that implementation should be appropriate and proportionate to the priorities, operating environment, scale and nature of the body's business.

The College has a procurement strategy which supports its commitment to obtaining value for money.

Appendices

Appendix one
Audit differences

Adjusted and unadjusted audit differences

We are required by ISA (UK and Ireland) 260 to communicate all corrected and uncorrected misstatements, other than those which are trivial, to you. There were no audit adjustments required to the draft annual financial statements which impacted on the net assets and financial and investment income and expenditure for the year. There are no unadjusted audit differences.

A small number of minor numerical and presentational adjustments were required to some of the financial statement notes.

Consolidated		BALANCE SHEET		INCOME AND EXPENDITURE	
CAPTION	NATURE OF ADJUSTMENT	£000 DR	£000 CR	£000 DR	£000 CR
Accrued Income posted to wrong account	The employer's and employee's NIC were posted to the wrong account with a similar account code. This is adjusted through movement to the correct Er and Ee NIC codes.				
	Dr Prepayments	299	-	-	-
	Cr Other Taxation and Social Security	-	(299)	-	-

College Only		BALANCE SHEET		INCOME AND EXPENDITURE	
CAPTION	NATURE OF ADJUSTMENT	£000 DR	£000 CR	£000 DR	£000 CR
Write-down of GTL debtor in College only accounts	GTL owes £140,000 to the College, which is due to be repaid in 2016-17. Our assessment of GTL's ability to pay this debt finds that this is unlikely to be recoverable by the College. We proposed the provision of this amount in the College only balance sheet. There is nil impact on the consolidated figures.				
	Dr Bad Debt expense	-	-	140	-
	Cr Intercompany debtor	-	(140)	-	-

Appendix two
Auditor independence

To the audit committee members

Assessment of our objectivity and independence as auditor of the Dundee and Angus College (the College)

Professional ethical standards require us to provide to you at the conclusion of the 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 and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

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 partners 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
- Communications
- Internal accountability
- Risk management
- Independent reviews.

We are satisfied that our general procedures support our independence and objectivity except for those detailed below where additional safeguards are in place.

Independence and objectivity considerations relating to the provision of non-audit services

We have considered the £24,000 (ex VAT) charged by us to the College and its affiliates for professional services provided by us during the reporting period. No other fees were charged by us in the year.

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the College.

Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the audit partner and audit staff is not impaired.

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

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully

KPMG LLP

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

We present the identified findings across four audit dimensions:

- financial sustainability;
- financial management;
- governance and transparency; and
- value for money.

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 Journals Exception Reporting *Risk dimension: governance and transparency*		**Grade three**
Journals are subject to high-level review by the head of finance. Journals posted by the head of finance are not subject to secondary review. This brings a risk that fraud or error go undetected or unchallenged – journals inherently are not subject to transactional controls.	Exception reports should be run quarterly to identify journals with higher risk of fraud or error, for example those posted on weekends, to cash, or with rounded amounts. Unusual journals should be reviewed by someone other than the preparer to confirm their accuracy and appropriateness.	Agreed. **Responsible officer:** Head of finance **Implementation date:** Immediately

Appendix four
Prior year recommendations

We follow up prior year audit recommendations to determine whether these have been addressed by management. The table below summarised the recommendations made during the 2014-15 audit and their current status.

Grade	Number recommendations raised	Implemented	In progress	Overdue
One	-	-	-	-
Two	1	-	1	-
Three	-	-	-	-

We have provided a summary of progress against overdue actions below, and their current progress.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions	Status
Journal source information not automated When journals are entered manually, the "journal source" is not automatically generated. The person entering the journals has to enter their own initials. This was identified as some journals had an invoice number as the source rather than their initials. This creates a risk of input errors (for example typing errors or putting in a project code instead of initials) or that an individual could enter someone else's initials.	We recommend that either the journal source should be automated or a column implemented which will automatically input the username of the journal poster. This would remove the risk that a user inputs their initials incorrectly.	Source of Journals processed to SUN Financials using its Q&A vision tool can, unfortunately, be manually overridden or omitted. Our normal practice is that this be referenced from a prominent cell on the journal workbook to mitigate error or omission. This will be reinforced.	Implemented

In respect of employee benefits, each of the assumptions used to value the College's net pension deficit are within an acceptable range of KPMG's expectations.

We are of the view that this therefore represents a reasonable and balanced approach, in accordance with the requirements of IAS 19.

We set out below the assumptions in respect of defined benefit obligations.

Defined benefit pension liability

2016 £000	2015 £000	KPMG comment
(20,523)	(11,209)	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the FRS 102 pension scheme valuation. Details of key actuarial assumptions are included in the table, along with our commentary.

Assumption	The College	KPMG central	Comment
Discount rate (duration dependent)	2.6%	0.35%	Acceptable. The proposed discount rates are within an acceptable range of KPMG's central rates as at 31 July 2016.
CPI inflation	RPI less 0.9%	RPI less 1%	KPMG's view is that the differential between RPI and CPI should be closer to 1%. The College's assumptions could therefore be considered prudent (higher liability).
Net discount rate (discount rate – CPI)	0.4%	0.35%	Acceptable. The proposed assumptions are within the acceptable range of +/- 0.3% from the KPMG central range.
Salary growth	4%	Typically 0% - 1.5% above RPI	Acceptable. The proposed assumption is consistent with the latest triennial valuation and is acceptable under FRS102. It is more prudent than necessary.

The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of more than 23 years. The closing deficit increased by £9 million compared to 2014-15, primarily due to changes to actuarial assumptions, including a decrease in the real discount rate and increased life expectancies.

Appendix six
Appointed auditors responsibilities

Area	Appointed auditors responsibilities	How we've met our responsibilities
Corporate governance	Review and come to a conclusion on the effectiveness and appropriateness of arrangements to ensure the proper conduct of the bodies affairs including legality of activities and transactions, Conclude on whether the monitoring arrangements are operate and operating in line with recommended best practice.	Page 23 sets out our conclusion on these arrangements.
Financial statements and related reports	Provide an opinion on audited bodies' financial statements on whether financial statements give a true and fair view of the financial position of audited bodies and their expenditure and income Provide an opinion on whether financial statements have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements Provide an opinion on the regularity of the expenditure and income *(not required for local government).*	Page 10 summarises the opinions we expect to provide.
Financial statements and related reports	Review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns.	Page 10 reports on the other information contained in the financial statements, covering the annual governance statement, management commentary and remuneration report.
Financial statements and related reports	Notify the Auditor General or Controller of Audit when circumstances indicate that a statutory report may be required.	Page 10 sets out any notifications we have made to the Auditor General or Controller of Audit.
Financial statements and related reports	Review and conclude on the effectiveness and appropriateness of arrangements and systems of internal control, including risk management, internal audit, financial, operational and compliance controls.	Page 23 sets out our conclusion on these arrangements.

Appendix six

Appointed auditors responsibilities (continued)

Area	Appointed auditors responsibilities	How we’ve met our responsibilities
Standards of conduct – prevention and detection of fraud and error	Review and conclude on the effectiveness and appropriateness of arrangements for the prevention and detection of fraud and irregularities, bribery and corruption and arrangements to ensure the bodies affairs are managed in accordance with proper standards of conduct. Review National Fraud Initiative participation and conclude on the effectiveness of bodies engagement.	Page 23 sets out our conclusion on these arrangements. Page 23 concludes on the bodies participation in the National Fraud Initiative.
Financial position	Review and conclude on the effectiveness and appropriateness of arrangements to ensure that the bodies financial position is soundly based.	Pages 24 and 25 set out our conclusion on these arrangements.
Financial position	Review performance against targets	Pages 6 and 7 summarise our review of how the body has performed against it’s financial targets.
Financial position	Review and conclude on financial position including reserves balances and strategies and longer term financial sustainability.	Page 7 sets out our conclusion on the bodies financial position including reserves balances. Page 16 sets out our conclusion on the bodies financial strategies and longer term financial sustainability.
Best Value	Review and conclude on the effectiveness and appropriateness of arrangements of accountable officers specific responsibility to ensure that arrangements have been made to secure Best Value.	Page 24 sets out our conclusion of the bodies arrangements.

cutting through complexity

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