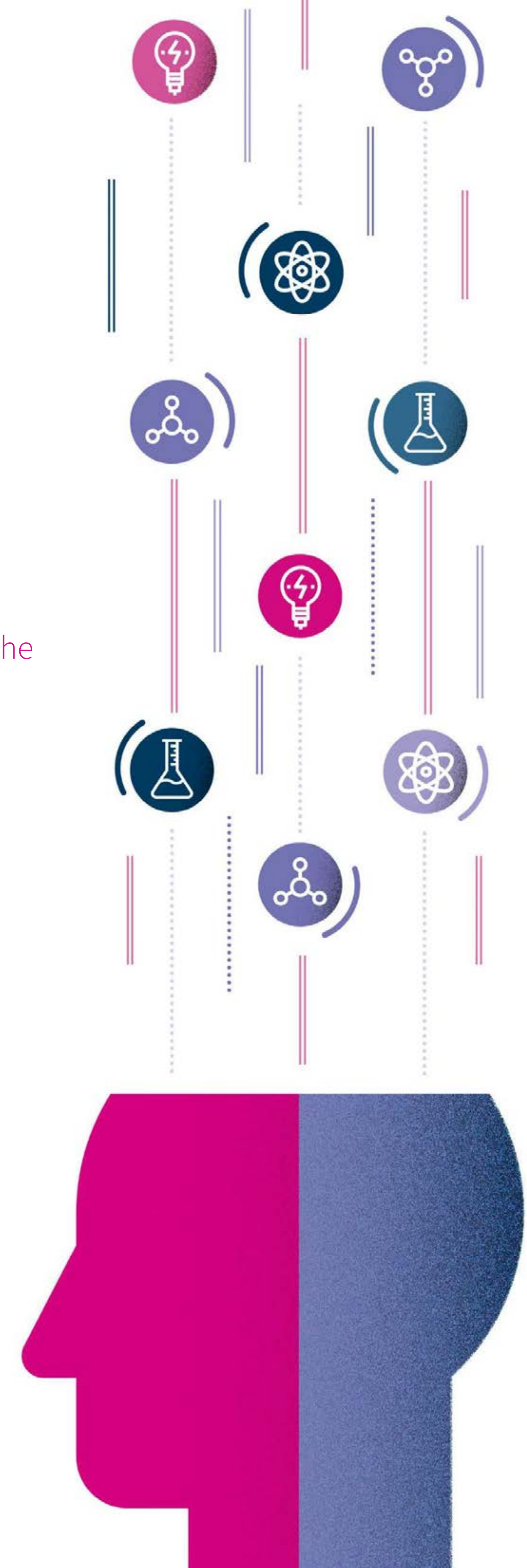
Scott-Moncrieff
business advisers and accountants

Dumfries and Galloway College

2018/19 Annual Audit Report to the Board of Management and the Auditor General for Scotland

December 2019



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1. Key messages

Financial statements audit

The annual report and financial statements for the year ended 31 July 2019 were approved by the Board on 10 December 2019.

We report within our independent auditor's report an unqualified opinion on the financial statements, the regularity of transactions, and on other prescribed matters. There are no matters which we are required to report by exception.

Our thanks go to management and staff for their assistance with our work.

Wider scope audit

As outlined in our External Audit Plan, our annual audit work in respect of our wider scope audit responsibilities was restricted to:

- Audit work to allow conclusions to be made on the appropriateness of the disclosures in the Annual Governance Statement; and
- Consideration of the financial sustainability of the organisation and the services that it delivers over the medium and longer term.

Our conclusions and key observations at the time of writing are set out below:

Governance statement

- We reviewed the Annual Governance Statement and identified several continuous improvement opportunities against the requirements of the Government Financial Reporting Manual and the SFC Accounts Direction. Management have considered and incorporated these into the revised annual report.
- The College has adequate systems in place to record, process, summarise and report financial and other relevant data. We have not identified any significant issues which would require to be disclosed in the governance statement.

Financial sustainability

- The College has effective arrangements in place for short, medium and long term financial planning, although it continues to face significant challenges in operating within tight financial parameters. Effort and activity continues to reach a long term sustainable position. The Board approved the revised 2019/20 budget in October 2019 which shows an underlying deficit of £91,000 as a result of Transformation costs.
- Staff costs continue to be a significant pressure and 2019/20 projections indicate that current staffing costs are not sustainable. Staff costs increased by 6.8% in 2018/19 and are expected to increase a further 9.4% in 2019/20.
- The Financial Forecast Return has been prepared on the basis that a staffing re-structure and Transformation Plan will be implemented in 2019/20 with the aim of reducing staff costs. The Transformation Plan is currently being drafted and initial projections have been included in the FFR based on a reduction of 10 full-time equivalent numbers from 2020/21.

Conclusion

This report concludes our audit for 2018/19. Our work has been performed in accordance with the Audit Scotland Code of Audit Practice, International Standards on Auditing (UK) and Ethical Standards.

Scott-Moncrieff
December 2019

2. Introduction

This report is presented to those charged with governance and the Auditor General for Scotland and concludes our audit of the College for 2018/19.

We carried our audit in accordance with Audit Scotland's Code of Audit Practice (May 2016). This report also fulfils the requirements of International Standards on Auditing (UK) 260: Communication with those charged with governance.

We have designated the College's Board of Management as "those charged with governance".

Introduction

1. This report summarises the findings from our 2018/19 audit of Dumfries and Galloway College ("the College").

2. We outlined the scope of our audit in our External Audit Plan, which we presented to the Audit Committee at the outset of our audit. The core elements of our work include:

   - an audit of the 2018/19 annual report and financial statements and related matters;
   - consideration of the College's arrangements against the audit dimensions within the Code of Audit Practice (Exhibit 1). As detailed in section 4, we do not deem the application of full wider scope to be appropriate and therefore have restricted the scope of our work;
   - monitoring the College's participation in the National Fraud Initiative (NFI); and
   - any other work requested by Audit Scotland.

Exhibit 1: Audit dimensions within the Code of Audit Practice

3. The College is responsible for preparing an annual report and financial statements which show a true and fair view and for implementing appropriate internal control systems. The weaknesses or risks identified are only those that have come to our attention during our normal audit work and may not be all that exist. Communication in this report of matters arising from the audit of the annual report and 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.

4. We discussed and agreed the content of this report with the Head of Finance. We would like to thank all management and staff for their co-operation and assistance during our audit.

Confirmation of independence

5. International Standards on Auditing in the UK (ISAs (UK)) require us to communicate on a timely basis all facts and matters that may have a bearing on our independence.

6. We confirm that we will comply with the Financial Reporting Council's (FRC) Revised Ethical Standard (June 2016). In our professional judgement, the audit process is independent, and our objectivity has not been compromised in any way.

7. We set out in Appendix 1 our assessment and confirmation of independence.

Adding value through the audit

8. All of our clients demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to the College through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the College promote improved standards of governance, better management and decision making and more effective use of resources.

Feedback

9. Any comments you may have on the service we provide, the quality of our work and our reports would be greatly appreciated at any time. Comments can be reported directly to the audit team or through our online survey: www.surveymonkey.co.uk/r/S2SPZBX

10. This report is addressed to the College and the Auditor General for Scotland and it will be published on Audit Scotland's website www.audit-scotland.gov.uk.

3. Annual report and financial statements

The College's annual report and financial statements are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources.

In this section we summarise the findings from our audit of the 2018/19 annual report and financial statements.

Annual report and financial statements

An unqualified audit opinion on the annual report and financial statements

We report unqualified opinions on the annual report and financial statements for the year ended 31 July 2019 within our independent auditor's report. We did not identify any significant adjustments to the unaudited annual report and financial statements.

The College has good administrative processes in place to prepare the annual report and financial statements and the required supporting working papers. Our thanks go to management and staff at the College for their assistance with our work.

Arrangements were in place to enable the annual report and financial statements to be submitted to the Scottish Funding Council (SFC) and Auditor General for Scotland by the 31 December deadline.

Overall conclusion

An unqualified audit opinion on the annual report and financial statements

11. The annual report and financial statements for the year ended 31 July 2019 were considered by the Audit Committee on 12 November 2019 and approved by the Board on 10 December 2019. We report within our independent auditor's report:

    - An unqualified opinion on the financial statements;
    - An unqualified opinion on regularity; and
    - An unqualified opinion on other prescribed matters.

12. We are also satisfied that there are no matters which we are required to report by exception.

Good administrative processes in place for the audit

13. We received the unaudited annual report and financial statements and supporting papers of a good standard. Our thanks go to staff at the College for their assistance with our work.

Our assessment of risks of material misstatement

14. The assessed risks of material misstatement described in Exhibit 2 are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the audit team. Our audit procedures relating to these matters were designed in the context of our audit of the annual report and financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the annual report and financial statements is not modified with respect to any of the risks described in Exhibit 2.

Exhibit 2 – Our assessment of risks of material misstatement and how the scope of our audit responded to those risks

1. Management override

In any organisation, there exists a risk that management have the ability to process transactions or make adjustments to the financial records outside the normal financial control processes. Such issues could lead to a material misstatement in the financial statements. This is treated as a presumed risk area in accordance with ISA 240(UK) – *The auditor's responsibilities relating to fraud in an audit of financial statements.*

Excerpt from the 2018/19 External Audit Plan

15. We have not identified any indications of management override in the year. We have reviewed the College's accounting records and obtained evidence to ensure that transactions outside the normal course of business were valid and accounted for correctly. In 2017/18 we identified a number of instances where supporting documentation held by the College was inadequate to evidence fully the authorisation process. Appropriate controls have since been implemented and we received adequate evidence of the authorisation of all journals tested in 2018/19.

Prior year action plan point 1

16. We have also reviewed management estimates and the journal entries processed in the period and around the year end. We did not identify any areas of bias in key judgements made by management and judgements were consistent with prior years.

2. Revenue recognition

Under ISA 240 (UK) – *The auditor's responsibilities relating to fraud in an audit of financial statements* there is a presumed risk of fraud in relation to revenue recognition. The presumption is that the College could adopt accounting policies or recognise revenue transactions in such a way as to lead to a material misstatement in the reported financial position.

Excerpt from the 2018/19 External Audit Plan

17. At the planning stage of our audit, we considered the nature of the revenue streams at the College against the risk factors set out in ISA (UK) 240. We identified that for the Scottish Funding Council (the SFC) grant funding, the risk of revenue recognition can be rebutted due to a lack of incentive and opportunity to manipulate revenue of this nature. We concluded, however, the risk of fraud in relation to revenue recognition is present in all other income streams.

18. We have gained reasonable assurance over the completeness and occurrence of income and we are satisfied that income is fairly stated in the financial statements. To inform our conclusions, we evaluated the College's key revenue streams and performed detailed testing over the College's revenue accounting. We also carried out testing to confirm that the revenue recognition policy is appropriate and that it was applied consistently throughout the year.

3. Risk of fraud in the recognition of expenditure

In 2016, the Public Audit Forum issued Practice Note 10 "*the Audit of Public Sector Financial Statements*" which applies to the audit of public sector financial statements for periods commencing after June 2016. This Practice Note recognise that most public sector bodies are net spending bodies and notes that there is an increased risk of material misstatement due to improper recognition of expenditure.

Excerpt from the 2018/19 External Audit Plan

19. While we did not suspect incidences of material fraud and error, we evaluated each type of expenditure transaction and documented our conclusions. We have gained reasonable assurance over the completeness and occurrence of expenditure and are satisfied that expenditure is fairly stated in the financial statements. To inform our conclusion, we carried out testing to confirm that the College's policy for recognising expenditure is appropriate and has been applied consistently throughout the year.

4. Estates developments

The College continues to make significant investment in the estate. £4million is expected to be invested in the campus on new buildings, interior fit out and refurbishment by the end of 2019 as part of a significant tranche of work and development. Around half of this total project spend is expected to be capital additions. By year end (31 July 2019), a significant element of this activity is expected to be reflected in the financial statements. The Finance Team is working on this at time of writing, and is engaging external expert support to ensure progress, values and related narrative disclosure reflects accounting requirements for 2018/19.

Excerpt from the 2018/19 External Audit Plan

20. The College incurred expenditure of £1.288million on assets under the course of construction in 2018/19, which have been capitalised at cost in line with accounting policies. Detailed testing provided assurance that these costs are accurate and that they have been appropriately capitalised.

21. The College will continue to incur significant capital spend in 2019/20. A revaluation will be completed in 2019/20 once current work has been completed and the assets have been brought into use. As a result, we will continue to monitor this as a significant risk in 2019/20.

Our application of materiality

22. The assessment of what is material is a matter of professional judgement and involves considering both the amount and the nature of the misstatement. This means that different materiality levels will be applied to different elements of the financial statements.

23. Our initial assessment of materiality for the financial statements was £245,000. We recalculated materiality on receipt of draft financial statements and assessed fieldwork materiality to be £280,000. Our assessment of materiality equates to approximately 1.8% of the College's expenditure. We consider this to be a principal consideration for the users of the accounts when assessing the performance of the College.

Performance materiality

24. Performance materiality is the amount set by the auditor for each financial statement area, to reduce to an appropriately low level the probability that collectively any uncorrected and undetected misstatements are less than materiality for the financial statements as a whole.

25. We set a performance (testing) materiality for each area of work which was based on a risk assessment for the area. We perform audit procedures on all

transactions and balances that exceed our performance materiality. This means that we are performing a greater level of testing on the areas deemed to be of significant risk of material misstatement. Performance testing thresholds used are set out in the table below:

	Area risk assessment £		
	High	Medium	Low
Performance materiality	126,000	154,000	196,000

26. We agreed that we would report on all material corrected misstatements and uncorrected misstatements with a value in excess of £12,500, as well as other misstatements below that threshold which, in our view, warranted reporting on qualitative grounds. We also report on disclosure matters that we identified when assessing the overall presentation of the financial statements.

Audit differences

27. We are pleased to report that there were no material adjustments to the draft financial statements. We identified one unadjusted error which has no material impact on the financial position. Full details are included in Appendix 3.

28. In addition, we identified some disclosure and presentational adjustments during our audit which have been reflected in the final set of financial statements.

An overview of the scope of our audit

29. The scope of our audit was detailed in our External Audit Plan, which was presented to the College in May 2019. The plan explained that we follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the College. This ensures that our audit focuses on the areas of highest risk. Planning is a continuous process and our audit plan is subject to review during the course of the audit to take account of developments that arise.

30. At the planning stage we identified the significant risks that had the greatest effect on our audit. Audit procedures were then designed to mitigate these risks.

31. Our standard audit approach is based on performing a review of the key financial systems in place, substantive tests and detailed analytical procedures. Tailored audit procedures, including those designed to address significant risks, were completed by the audit fieldwork team and the results were reviewed by the audit management team. In performing our work we have applied the concept of materiality, which is explained earlier in this report.

Other matters identified during our audit

32. During the course of our audit we noted the following:

The performance report

33. The performance report provides information on the entity, its main objectives and strategies and the principal risks that it faces. It comprises an overview of the organisation and a detailed summary of how the entity measures performance.

34. We were provided with the performance report in the third week of our audit. We have concluded that the performance report has been prepared in accordance with directions from the SFC and is consistent with the financial statements.

The accountability report

35. The accountability report is required in order to meet key parliamentary accountability requirements and comprises three sections: a corporate governance report (including the governance statement), remuneration and staff report, and a parliamentary accountability report.

Governance statement

36. While we are satisfied the content of the Governance Statement is not inconsistent with information gathered during the course of our normal audit work, we have identified a number of disclosure improvements to help improve the level of compliance with the SFC guidance. We have provided further detail on our work and findings within the Wider Scope section of our report (section 4).

Remuneration report

37. Our independent auditor's report confirms that the part of the Remuneration Report to be audited has been properly prepared.

Regularity

38. We have planned and performed our audit recognising that non-compliance with statute or regulations may materially impact on the annual report and accounts. We did not identify any material instances of irregular activity.

Pension Liability

39. As at 31 July 2019 the net LGPS pension liability was £6.773million, an increase of £4.680million in comparison to the net pension liability as at 31 July 2018 (£2.093million).

40. Due to the significant movement in comparison with the prior year, we have conducted a more detailed analysis of the assumptions put in place by the actuary.

41. The movement at the College is in line with movements across the sector which are primarily as a result of changes in actuarial assumptions and related scheme and market conditions.

Accounting and internal control systems

42. The College has adequate systems in place to record, process, summarise and report financial and other relevant data. We have not identified any significant weaknesses or governance issues in the accounting and internal control systems. We identified three areas for improvement in the 2017/18 Annual Report on the Audit and can confirm that adequate action has been taken to address two recommendations. We outline the prior year recommendations and progress in implementing them at Appendix 2.

National Fraud Initiative

43. The National Fraud Initiative (NFI) is a counter-fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies to identify fraud and error.

44. The NFI exercise produces data matches by comparing a range of information held on various public sector bodies' systems to identify potential fraud or error. Bodies are required to investigate these matches and record appropriate outcomes based on their investigations.

45. Participating bodies were required to submit data in October 2018 and received matches for investigation in January 2019. Match investigation work was to be largely completed by 30 September 2019 and the results recorded on the NFI system.

46. In June 2019 we assessed the NFI match progress to date and submitted the output to Audit Scotland for review. This assessment concluded that the College was actively managing the NFI progress and good progress has been made. Further progress has since been made and match investigation work has been completed.

Qualitative aspects of accounting practices and financial reporting

47. During the course of our audit, we consider the qualitative aspects of the financial reporting process, including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the financial statements. The following observations have been made:

Qualitative aspect considered	Audit conclusion
The appropriateness of the accounting policies used.	We have reviewed the significant accounting policies, which are disclosed and are satisfied with the appropriateness of the accounting policies used.
The timing of the transactions and the period in which they are recorded.	We did not identify any concerns over the timing of transactions or the period in which they were recognised.
The appropriateness of the accounting estimates and judgements used.	We are satisfied with the appropriateness of the accounting estimates and judgements used in the preparation of the financial statements. Estimates have been made in relation to the valuation and depreciation of property, plant and equipment and pension provisions. Where available, the College has utilised the work of independent experts or industry practice to support the estimate applied. Pension estimates have been informed by advice from qualified, independent experts. We evaluated the competence, objectivity and capability of managements' experts in line with the requirements of ISA (UK) 500.
The appropriateness of the going concern assumption	We have reviewed the financial forecasts for 2019/20. Our understanding of the legislative framework and activities undertaken provides us with sufficient assurance that the College will continue to operate for at least 12 months from the signing date.
The potential effect on the financial statements of any uncertainties, including significant risks and related disclosures that are required.	We have not identified any uncertainties, including any significant risk or required disclosures, which should be included in the financial statements.
The extent to which the financial statements have been affected by unusual transactions during the period and the extent that these transactions are separately disclosed.	From the testing performed, we identified no significant unusual transactions in the period.
Apparent misstatements in the annual report or material inconsistencies with the financial statements.	The annual report contains no material misstatements or inconsistencies with the financial statements.
Any significant financial statements disclosures to bring to your attention.	There are no significant financial statements disclosures that we consider should be brought to your attention. All the disclosures required by relevant legislation and applicable accounting standards have been made appropriately.
Disagreement over any accounting treatment or financial statements disclosure.	While disclosure and presentational adjustments were made during the audit process there was no material disagreement during the course of the audit over any accounting treatment or disclosure.
Difficulties encountered in the audit.	There were no significant difficulties encountered during the audit.

4. Wider scope

Following consideration of the size, nature and risks of the College, the application of the full wider scope audit is judged by us not to be appropriate. Our annual audit work on the wider scope has therefore been restricted to:

- **Audit work to allow conclusions to be made on the appropriateness of the disclosures in the governance statement; and**
- **Consideration of the financial sustainability of the organisation and the services that it delivers over the medium and longer term.**

Wider scope conclusions

Governance statement

We reviewed the Annual Governance Statement and identified several continuous improvement opportunities against the requirements of the Government Financial Reporting Manual and the SFC Accounts Direction. Management has considered and incorporated these into the revised annual report.

The College has adequate systems in place to record, process, summarise and report financial and other relevant data. We have not identified any significant issues which would require to be disclosed in the governance statement.

Financial sustainability

The College has effective arrangements in place for short, medium and long term finaical planning, although it continues to face signifcant challenges in operating within tight financial parameters. Effort and activity continues to reach a long term sustainable position. The Board approved the revised 2019/20 budget in October 2019 which shows an underlying deficit of £91,000 as a result of transformation costs.

Staff costs continue to be a significant pressure and 2019/20 projections indicate that current staffing costs are not sustainable. Staff costs increased by 6.8% in 2018/19 and are expected to increase a further 9.4% in 2019/20.

The Financial Forecast Return has been prepared on the basis that a staffing restructure and Transformation Plan will be implemented in 2019/20 with the aim of reducing staff costs. The Transformation Plan is currently being drafted and initial projections have been included in the FFR based on a reduction of 10 full-time equivalent numbers from 2020/21.

Our approach to the wider scope audit

48. Our approach to the wider scope audit (as set out in our 2018/19 External Audit Plan) builds upon our understanding of the College which we developed from previous years, along with discussions with management and review of committee minutes and key strategy documents.

49. During our audit we also considered the following risk areas as they relate to the College:

- EU withdrawal
- Changing landscape of public financial management
- Dependency on key suppliers
- Openness and transparency

Impact of EU withdrawal	The College has been able to demonstrate consideration of the potential impact on staff, students, funding and legislation. The College has considered the risk it faces as a result of EU withdrawal and reflected this in the strategic risk register. The College deems the potential impact to be low but is continuing to monitor the situation to ensure the risk can be appropriately mitigated. In addition, the College has participated in a number of different forums with both the SFC and Colleges Scotland to ensure it remains informed about potential impacts to the sector as they develop.

Changing landscape of financial management	The Scottish Government's five-year outlook for the Scottish budget as set out in the Medium-Term Financial Strategy provides useful context for financial planning. The new budget process places greater emphasis on assessing outcomes and the impact of spending. We have considered the impact on financial planning and budgeting below.

Dependency on key suppliers	Following the collapse of major infrastructure companies, it became apparent that public sector bodies face significant risks where key suppliers are experiencing difficult trading conditions. The College did not identify any key suppliers at the planning stage of our audit. The College is a member of Advanced Procurement for Universities and Colleges (APUC) Ltd which is the Procurement Centre of Expertise for 62 Universities and Colleges. APUC Ltd works collaboratively with Universities and Colleges in setting up contracts on behalf of the Higher and Further Education Sectors in Scotland. The College is not directly involved in the assessment of risk for suppliers; this assessment rests with APUC. APUC is responsible for the monitoring of procurement which is reviewed and reported on annually. At the time of this audit report, the 2019 monitoring report was not currently available. Due to the use of this centralised approach, the College has transferred and shared the risk in respect of dependency on key suppliers in this area.

Openness and transparency	There is an increasing focus on how public money is used and what is achieved. In that regard, openness and transparency supports understanding and scrutiny. We consider the College to exhibit aspects of good practice with respect to openness and transparency arrangements through the following; • Key publications including the annual report and accounts, strategic plans and regional outcome agreements are available on the College's website • Up to date registers of interest are available on the College's website covering all Board members • Minutes and papers (where appropriate) for the Board and supporting committees are published on the College's website.

Governance statement

Our audit work includes consideration of the appropriateness of the disclosures in the governance statement.

50. The College's Governance Statement explains that the College was compliant with the principles of the 2016 Code of Good Governance for Scotland's Colleges. This is deemed to be in accordance with the requirements outlined in the 2018/19 Accounts Direction, released by the SFC.

51. While we are satisfied the content of the Governance Statement is not inconsistent with information gathered during the course of our normal audit work, we have identified a number of disclosure improvements to help improve the level of compliance with the SFC guidance.

52. The Government Financial Reporting Manual requires a Corporate Governance Report to be included in the Accountability Report, comprising of three sections; a directors' report, a statement of accounting officer's responsibilities, and a governance statement. The College's draft Corporate Governance Report did not follow this structure and there was no separately identifiable Governance Statement.

53. Disclosure requirements for each section are set within the Government Financial Reporting Manual, the 2018/19 Accounts Direction and the Scottish Public Finance Manual. Whilst the structure of the Corporate Governance Report required amendment, we are satisfied that all necessary disclosures had been prepared.

54. The College has taken on board our comments and has revised the Governance Statement for the annual report and financial statements which were approved on the 10 December 2019.

Financial sustainability

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

Significant audit risk

55. Our audit plan identified a significant risk in relation to financial sustainability under our wider scope responsibilities

Financial sustainability

As is the case across the sector, the financial sustainability of the College remains challenging. The College is currently working through detailed budgets and projections, taking account of pressure factors such as cost inflation, national pay bargaining implications (unresolved as at time of writing), general pay uplifts, and backlog maintenance. Including elements of zero-based budgeting for 2018/19 has led to Finance and senior management driving a more fundamental review of the cost structure underpinning the College's activities. Management anticipate that savings of around £0.25 million will be required and are moving forward with a 3% efficiency savings target.

Excerpt from the 2018/19 External Audit Plan

56. The College reported an operating deficit of £1.513million for the year ended 31 July 019, equating to 11% of the College's total income. This is mostly due to increased staff costs resulting from national bargaining and the cost of living pay award. Adjusting the operating position for technical accounting factors as per SFC directions, covering areas such as pensions and net depreciation) the College shows an "adjusted" underlying surplus of £0.054million (deficit of £0.069million as at 31 July 2018).

57. The College has prepared a five year financial forecast as part of the Financial Forecasting Return (FFR) process. The latest FFR reported actual financial performance for 2018/19, the budget for 2019/20 and forward forecasts through to 2023/24. Our work and conclusions on the budget and financial forecasts for 2019/20 onwards is set out below and notes the ongoing challenges the College continues to face.

2019/20 budget

58. National Bargaining and harmonisation have led to additional unfunded payroll costs. Coupled with an unconfirmed increase in employer pension costs, Scotland's College sector is currently facing and extremely challenging financial situation.

59. The SFC published indicative funding allocations in February 2019 and final allocations in May 2019.

60. A 'zero-based' approach to budgeting was taken for 2019/20 within the College, with each budget holder asked to set out their requirements for 2019/20, as well as any areas where savings could be made.

61. The Board approved the 2019/20 budget in June 2019. This identified an operating deficit of £0.659million, arising from budgeted income of £12.930million (3% lower than 2018/19 actual income) and total budgeted expenditure of £13.589million (6% less than 2018/19 actual expenditure). Once adjusted for non-cash and exceptional items, the College has budgeted an underlying surplus of £3,000.

62. The budget has subsequently been revised to reflect changes to the College's staffing structure and pay harmonisation costs. This resulted in substantially increased projected pay costs and the initial revised budget showed a projected underlying deficit of £0.607million (increase of £0.604million from June budget). A detailed review of income, staffing and other costs has since been completed and a revised budget was presented to Board in October 2019, showing a reduction in the underlying operating deficit to £0.091million.

63. The College, in partnership with Borders College, is currently undergoing an investment of just over £6.6million as part of plans approved by the South of Scotland Economic Partnership (SoSEP). The investment aims to enable the creation of a digital learning platform and infrastructure that intends to provide access to learning opportunities for individuals of all ages, irrespective of location. Planned activity has been reflected in the 2019/20 budget and we will continue to monitor SoSEP activity over the course of our 2019/20 audit.

Financial Forecasts

64. Colleges now prepare five year financial forecasts as part of the FFR process. In seeking to achieve the use of consistent assumptions across Scotland's further education sector, the SFC has developed a set of common, indicative assumptions for Colleges to use when developing their FFR.

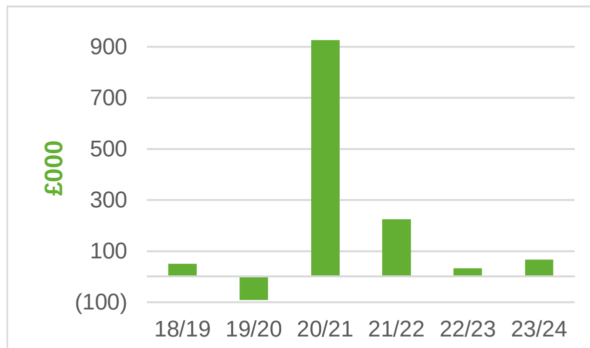
65. Assumptions include:

- Credits targets will remain stable until 2022-23, when they will decrease by 3%;
- Core grant will remain at 2019/20 levels (flat cash) until 2022-23, when it will decrease by 4%;
- Core grant will cover National Bargaining pay and harmonsiation costs but not cost of living pay awards;
- SFC grant funding will return to a formula based on a price x volume model from 2020-21;
- Capital maintenance grant will be based on the allocation for the current year;
- Cost of living pay awards should be included in line with agreed pay award until August 2020 and thereafter based on public sector pay policy;
- SFC will meet the additional costs for the STSS pension scheme; and
- Colleges are expected to deliver at least 3% efficiency savings each year, which should be taken into consideration in meeting cost of living pay awards.

66. We confirmed that the College has applied these assumptions when preparing their FFR.

67. The FFR shows an underlying deficit in 2019/20, in line with the budget approved in October 2019, and an underlying surplus in all other years., as shown in Exhibit 3.

Exhibit 3: Projected underlying surplus/(deficit



68. To provide meaningful projections, additional scenarios have been explored for both forecasted costs and income. The following scenarios have been modelled;

- Cost increases above FFR assumptions – relating to pay increases, pension increases and inflation;
- Curriculum Planning – based on the under or over delivery of credits
- Changes to Income – considering a range of scenarios relating to all key income streams
- Staffing and Workforce Planning – based on staff reductions and increases in efficiency
- Estates and Digital Strategy – considering the impact of increased costs

Staff costs

69. The projected salary costs for 2019/20 indicate that the current staffing costs are not sustainable. Staff and pay costs have increased by 6.8% in 2018/19 compared to the prior year and are expected to increase a further 9.4% in 2019/20.

70. National pay scales for lecturing staff were fully implemented in April 2019 and 2019/20 represents the first full year of costs based on the revised pay scales. The cost of living pay award for lecturing staff has increased the initial forecast costs for lecturing staff by £420,000 for 2019/20 and the estimated costs for the job evaluation exercise has been reflected in support staff pay costs.

71. In line with the set assumptions, future salary costs have been forecasted to included annual pay awards in line with public sector pay policy. Based on current staffing levels, staff costs represent a substantial proportion of overall expenditure across the five year financial forecasts.

72. The FFR has been prepared on the basis that a staffing re-structure and Transformation Plan will be implemented in 2019/20 with the aim of reducing staff costs. An initial estimate of £1.030 million of restructuring costs has been considered for the 2019/20 budget, resulting in an overall operating deficit for the year of £1.121million. However, the College is continuing to explore this cost.

73. The Transformation Plan is currently being drafted and initial projections have been included in the FFR based on a reduction of 10 full-time equivalent staff numbers from 2020-21. In addition, a further reduction of 5 FTE is required from 2022-23 to offset the reduction in SFC credit targets and core grant funding.

74. The College has undertaken scenario analysis on the phasing and length of the re-structuring period, concluding that a longer period would result in a delay to the realisation of savings and the opportunity to achieve further savings through re-investment.

75. The College needs to take further action in 2019/20 to ensure the future financial sustainability of staff costs. We will continue to monitor the development and implementation of the Transformation Plan and long-term planning forecasts as part of the 2019/20 audit to ensure appropriate and timely action is taken.

5. Appendices

Appendix 1: Respective responsibilities of the College and the Auditor

Responsibility for the preparation of the annual report and financial statements

Within the terms and conditions of the financial memorandum between the SFC and the Board of Management of the College, the Board, through the Principal, is required to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the College and the surplus or deficit for that year.

In preparing the annual report and financial statements, the Board is required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare financial statements on the going concern basis unless it is inappropriate to assume that the College will continue in operation.

The Board is also responsible for:

- keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the College and enable it to ensure that the financial statements comply with the Further and Higher Education (Scotland) Act 1992, together with the Financial Memorandum issued thereunder, and are presented in accordance with the Accounts Direction issued by the SFC.

Auditor responsibilities

We audit the annual report and financial statements and give an opinion on whether:

- they give a true and fair view in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the SFC of the state of the body's affairs as at 31 July 2019 and of its surplus for the period then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice;
- have been prepared in accordance with the requirements of the Further and Higher Education (Scotland) Act 1992 and directions made thereunder, the Charities and Trustee Investment (Scotland) Act 2005, and regulation 14 of The Charities Accounts (Scotland) Regulations 2006;
- 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;
- the part of the Remuneration Report to be audited has been properly prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Ministers; and
- the information given in the Performance Report for the financial period for which the financial statements are prepared is consistent with the financial statements.

We are also required to report, if in our opinion:

- proper accounting records have not been kept; or
- the financial statements and the part of the Remuneration and Staff Report to be audited are not in agreement with accounting records; or
- we have not received all the information and explanations we require for our audit; or
- the governance statement does not comply with Scottish Funding Council requirements.

Wider scope of audit

The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the financial statements, but providing audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.

The Code of Audit Practice frames a significant part of our wider scope responsibilities in terms of four audit dimensions: financial sustainability; financial management; governance and transparency; and value for money.

We have concluded that the full application is not appropriate due to the size of the organisation. As part of our annual audit we consider and report against:

- appropriateness of the disclosures in the governance statement; and
- financial sustainability of the body and the services that it delivers over the medium to longer term.

Independence

International Standard on Auditing (UK) 260 "Communication with those charged with governance" requires us to communicate on a timely basis all facts and matters that may have a bearing on our independence.

Non-audit services

At the request of the College, Scott-Moncrieff provided VAT/tax services during the year totalling £4,000. This work did not involve management decision making and was undertaken by the Scott-Moncrieff specialist team, entirely separately from the Public Sector External Audit team.

In line with Audit Scotland planning guidance, approval was obtained from the Scott-Moncrieff ethics partner and Audit Scotland before commencing non-audit work.

Confirmation of independence

We confirm that we have complied with the FRC's Revised Ethical Standard (June 2016). In our professional judgement, the audit process is independent and our objectivity has not been compromised in any way. In particular there are and have been no relationships between Scott-Moncrieff and the College, its Board and senior management that may reasonably be thought to bear on our objectivity and independence.

Appendix 2: Follow up of prior year recommendations

Of the three recommendations raised within our 2017/18 annual audit report, we note that two have been fully implemented and one partially implemented. Details are given below.

Action plan grading structure

To assist the College in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated.

The rating structure is summarised as follows:

Grade	Explanation
Grade 5	Very high risk exposure - Major concerns requiring immediate attention.
Grade 4	High risk exposure - Material observations requiring management attention.
Grade 3	Moderate risk exposure - Significant observations requiring management attention.
Grade 2	Limited risk exposure - Minor observations requiring management attention
Grade 1	Efficiency / housekeeping point.

1. Documentation of journal authorisation

Initial rating	Issue & recommendation	Management comments
Grade 3	**Issue** A hard copy file is maintained with all authorised journals. However, during testing we identified 6 journals which were not present in the folders. While we were able to review supporting documentation for these journals, we were unable to confirm the extent to which they had been appropriately authorised. **Risk** There is a risk that incorrect or fraudulent postings could be made without detection by the College's management team. **Recommendation** While our audit review in respect of the 2017/18 financial year did not identify any indications of incorrect or fraudulent journal postings, we recommend that the College investigates the finance system capabilities and whether electronic journal authorisation of journals is possible. In whatever system is used, the College should ensure there is clear evidence of approval for all manual journals.	We will liaise with our software provider to investigate if an approval procedure could be set up within the finance system. If that isn't possible, we will include a manual check for authorisation of all journals as part of the monthly process **Action owner:** Head of Finance **Due date:** 30.11.2018

Current status	Audit update	Management response
Complete	Appropriate evidence of authorisation was provided for all journals tested in 2018/19. A manual check of journals in the system against the hard copy file is performed as part of the monthly process to ensure compliance.	N/A

2. UWS contract

Initial rating	Issue & recommendation	Management comments
Grade 2	**Issue** The College does not have a formal arrangement with University of the West of Scotland in respect of charges for teaching hours delivered. This lead to a significant movement in the amount of income disclosed as a consequence of over-accrual in the prior year. **Risk** There is a risk that the College cannot accurately budget income due as a result of a lack of formal contract with UWS resulting in failure to achieve a sustainable financial position. **Recommendation** The College has invoiced (as opposed to accruing) for 2017/18 teaching hours. However, going forward, the billing arrangements should be agreed in sufficient detail that the College is able to estimate the amount of income it will receive	We will liaise with the University of the West of Scotland to establish a formal agreement for the teaching contract **Action owner:** Head of Finance **Due date:** 31.12.18

Current status	Audit update	Management response
In progress	The Head of Finance is liaising with UWS to set up a Service Level Agreement	A draft Service Level Agreement (SLA) is currently being discussed, which will aim to be consistent with other SLA's which the College now has in place with other partners. **Action owner**: Head of Finance **Due date**: 31.01.20

3. Financial regulations and authorised signatory listings

Initial rating	Issue & recommendation	Management comments
Grade 2	**Issue** The College's financial regulations and authorised signatory listing were due for review in May 2017 however they are still to be updated. **Risk** There is a risk that the financial regulations and authorised signatory listings are not up-to-date and staff are following incorrect and/or inefficient procedures. **Recommendation** The College should complete the review of the Financial regulations and authorised signatory listing and ensure these are appropriately authorised by the Finance and General Purposes Committee.	We will complete the update of the Financial Regulations and authorised signatories as part of the 2019-20 budget planning process **Action owner:** Head of Finance **Due date:** 31.03.19

Current status	Audit update	Management response
Complete	Financial regulations and authorised signatory listing were updated in June 2019.	N/A

Appendix 3: Audit differences

A summary of the net effect of the unadjusted items is shown below. This is not material, but is above our stated reporting threshold.

Unadjusted difference	SOCI		Balance Sheet	
	DR £	CR £	DR £	CR £
Non-current assets			13,644	
Expenditure		13,644		
Being the amount charged for a new air conditioning unit on College premises which is deemed to be an enhancement				