HENDERSON LOGGIE
Chartered Accountants

Forth Valley College

Annual Audit Report for 2013/14 to the Board of Management and the Auditor General for Scotland

External Audit Report No: 2014/02

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HENDERSON LOGGIE

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Nothing in this report constitutes 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 the limited circumstances set out in the scope and objectives section of this report.

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Executive Summary

Financial Statements

- On 26 June 2014 we issued an audit report with an unqualified opinion on the financial statements of the College for the period ended 31 March 2014 and on the regularity of the financial transactions reflected in those financial statements.

- One impact of the Office for National Statistics (ONS) decision to reclassify incorporated colleges as Central Government bodies from 1 April 2014 was that college year-ends changed to 31 March and in 2013/14 the accounting period for Forth Valley College was for the eight months to 31 March 2014, although the Scottish Government secured a concession from HM Treasury to allow University of the Highlands and Islands (UHI) incorporated colleges to retain 31 July for accounting purposes only. The update from the ONS Project Board, dated 25 March 2014, advised non-UHI incorporated colleges that further clarification about a possible July year-end in 2015 would follow in due course once negotiations between HM Treasury, the Scottish Government and the Scottish Further and Higher Education Funding Council (SFC) had been concluded. The SFC formally advised colleges of the outcome of these negotiations on 5 September 2014, when it was confirmed that the Cabinet Secretary for Education had accepted the Chief Secretary to the Treasury's offer of derogation to all colleges to change their year-end from 31 March to 31 July. This offer was subject to colleges meeting HM Treasury budgeting and reporting requirements.

- The College has shown a surplus for the eight month period ended 31 March 2014 of £0.240 million (2012/13: surplus of £0.495 million for the year ended 31 July 2013). The College has an Income and Expenditure Account balance of £(3.477) million at 31 March 2014 (31/07/13: £(4.379) million).

- The annual financial statements of the College comply with the Accounts Direction issued by the SFC and the Statement of Recommended Practice (SORP) on Accounting for Further and Higher Education.

- 10 composite audit and accounting adjustments were made to the draft financial statements presented for audit; which had the impact of increasing the reported surplus for the period by £0.809 million.

- A number of disclosure and clarification adjustments were made to the financial statements to ensure SORP and Accounts Direction compliance and improve the overall presentation of the financial statements.

- The College expects to meet its WSUMs target for the academic year to 31 July 2014 (2012/13: 229 WSUMs (0.2%) over target).

- The College's pension liability increased in total by £3.024 million to £10.202 million at 31 March 2014 (2012/13: decreased in total by £1.955 million) which was largely due to changes in key actuarial assumptions relating to discount rates.

Corporate Governance

- The College's Corporate Governance Statement confirms that the College complies with all of the provisions of the UK Corporate Governance Code 2010 in so far as they apply to the further education sector, as well as Colleges Scotland's Guide for College Board Members 2012, and it has complied with these throughout the period ended 31 March 2014.

Corporate Governance (Continued)

- No material weaknesses in the accounting and internal control systems were identified during the 2013/14 financial statements audit which would adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements. Some areas were however identified from our systems controls testing during 2013/14 where controls could be further improved to bring them more into line with good practice.

- We did not identify any matters of concern relating to the College's corporate governance arrangements regarding the prevention and detection of fraud, or standards of conduct and the prevention and detection of corruption.

- The College had an on-going process for identifying, evaluating and managing its significant risks.

- The Post-16 Education (Scotland) Act 2013 includes provisions in relation to the identification of principles of good governance practice for the college sector. A draft 'Code of Good Governance for Scotland's Colleges' has been issued for consultation and, once finalised, colleges will be expected to comply with the new Code as condition of grant from the SFC or their regional strategic body.

Performance

- The College management and committee structure included mechanisms to monitor and manage financial and non-financial performance which are considered appropriate.

- A Regional Outcome Agreement with the SFC was in place for 2013/14.

Outlook

- The funding position will remain challenging going forward. However the voluntary severances undertaken in recent years has helped to reduce pay costs and assist the College in coping with the funding reductions, and increased commercial work is helping to generate extra income. However robust budget setting and monitoring arrangements will be essential in helping to retain sustainability.

- The College's total funding allocations for the 2014/15 academic year from the SFC for Teaching and Fee Waiver is £19.767 million, the same as that received for 2013/14 and with the same WSUMs target (118,503). The College's capital allocation for 2014/15 from the SFC is £1.411 million (2013/14: £1.414 million).

- The Designation of Regional Colleges (Scotland) Order 2014 came into force on 3 March 2014 and formally designated Forth Valley College, and the other nine colleges in single college regions, as regional colleges.

Outlook (Continued)

- The reclassification of incorporated colleges in Scotland as Central Government bodies from 1 April 2014 has a number of implications for budgeting, reporting and accounting practices. Other than the change in financial year-end for 2013/14 the main practical impact of this change is that colleges are required to undertake monthly cash forecasts and report these to the SFC to ensure that they only draw down sufficient funding to meet forecast expenditure. The format of financial statements will also have to change from 1 April 2014 as Central Government bodies use the Government Financial Reporting Manual ('the FReM'). The changes for 2014/15 are not likely to be significant as the Education SORP is expected to take precedence over the FReM.

- Incorporated colleges and Regional Boards are also required to comply with the requirements of the Scottish Public Finance Manual (SPFM), except where directed by SFC's Accountable Officer.

- A draft of a new Financial Memorandum with Colleges has been issued by the SFC for consultation, setting out the formal relationship between the SFC and fundable bodies in the college sector, and the requirements with which fundable bodies are expected to comply in return for payment of grant by the SFC.

- Three new accounting standards (Financial Reporting Standard (FRS) 100, 101 and 102) come into force for accounting periods commencing on or after 1 January 2015 which means that 2015/16 will be the first reporting year. However, comparative figures for 2014/15 will be required. In addition, a new Education SORP has been developed following the publication of the new FRSs, which will also be effective from 2015/16.

Introduction

Background

1. 2013/14 was the third year in our five year appointment as external auditors of Forth Valley College ('the College'). This report summarises our opinion and conclusions and highlights significant issues arising from our work. It covers the communication of findings from the audit required by International Standard on Auditing (ISA) (UK and Ireland) 260: Communication of Audit Matters with Those Charged with Governance.

2. The audit framework is outlined in our Strategic Planning Memorandum and 2013/14 Annual Audit Plan issued on 10 April 2014 and considered and approved by the Audit Committee at its meeting on 1 May 2014. The scope of the audit was to:

   - provide an opinion on, to the extent required by the relevant authorities, the financial statements and the regularity of transactions in accordance with the standards and guidance issued by the Financial Reporting Council;

   - review and report on the College's corporate governance arrangements in relation to systems of internal control, the prevention and detection of fraud and irregularity, standards of conduct, and prevention and detection of corruption; and the College's financial position; and

   - review and report on the College's arrangements to manage its performance, as they relate to the economy, efficiency and effectiveness in the use of resources.

3. Our audit approach focused on the identification of the significant risk areas facing the College and the significant classes of transactions, estimates, other account balances and disclosures impacting upon the financial statements. These include:

   - compliance with legislation and financial regulations;

   - fixed assets transactions, including consideration of any impairment, on-going estate improvements and maintenance; and compliance with relevant financial reporting standards;

   - recoverability of debtors;

   - recognition of funding provided for specific purposes and the regularity of corresponding expenditure. There was increased risk in this area for 2013/14 given that SFC funding is provided on an academic year basis to 31 July and the financial year-end has moved to 31 March;

   - the setup of, and accounting for transfers made to, the Forth Valley College arms-length foundation;

   - compliance with FRS 17 – Retirement Benefits and provision for pension liabilities for early retirals; and

   - compliance with the SORP on Accounting for Further and Higher Education.

Basis of Information

4. External auditors do not act as a substitute for the College's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

5. To a certain extent the content of this report comprises general information that has been provided by, or is based on discussions with, management and staff of the College. Except to the extent necessary for the purposes of the audit, this information has not been independently verified. The contents of this report should not be taken as reflecting the views of Henderson Loggie CA except where explicitly stated as being so.

6. As our audit is designed primarily to enable us to form an opinion on the financial statements taken as a whole, our report cannot be expected to include all the possible comments and recommendations that a more extensive special examination would bring to light. Weaknesses or risks identified by us are only those that have come to our attention during our normal audit work in accordance with the Audit Scotland Code of Audit Practice, and may not be all that exist.

Acknowledgement

7. Our audit has brought us in contact with a range of College staff. We wish to place on record our appreciation of the co-operation and assistance extended to us by staff in the discharge of our responsibilities.

Audit Opinion

8. On 26 June 2014 we issued an audit report with an unqualified opinion on the financial statements of the College for the period ended 31 March 2014 and on the regularity of the financial transactions reflected in those financial statements.

9. We are required to undertake audit work from the Balance Sheet date up to the date of signing the financial statements and this was undertaken in the period up to 26 June 2014. No post balance sheet events were identified that required adjustment to be made to the financial statements or additional disclosure in a note thereto other than those relating to the changes as a result of reclassification as Central Government bodies from 1 April 2014.

Audit Completion

10. An important measure of proper financial control and accountability is the timely closure and publication of audited financial statements. Table 1 summarises the three key elements of the audit process.

Table 1: Key elements of the audit process

Completeness of draft financial statements A set of draft financial statements was received on 8 May 2014, on the second day of the audit fieldwork. The first draft did not include the Operating and Financial Review, Corporate Governance information and a number of financial statement disclosures and these were received after the audit fieldwork had been completed. These were of a high standard and required minimal presentational changes as part of the audit process.
Quality of supporting working papers Working papers provided to support financial statement figures were of a satisfactory standard.
Response to audit queries Audit queries were dealt with in a timely manner.

Corporate Governance Statement

11. Colleges are required to include a statement on their corporate governance arrangements within their annual financial statements. The statement describes the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management.

12. We are required to review the statement to assess whether the description of the process adopted in reviewing the effectiveness of the system of internal control appropriately reflects the process and report where the statement is not consistent with our knowledge of the body and report if the statement does not comply with SFC requirements.

13. The College's corporate governance statement for 2013/14 states the College complies with all of the provisions of the UK Corporate Governance Code 2010, in so far as they apply to the further education sector, as well as Colleges Scotland's Guide for College Board Members 2012, and it has complied with these throughout the period ended 31 March 2014.

14. From our audit work and our review of the College's statement we have no issues to report within our audit opinion.

Audit and Accounting Adjustments and Confirmation

15. In Table 2 we draw attention to the agreed audit and accounting adjustments to the financial statements made by management following the audit process which had the impact of increasing the 2013/14 surplus by £0.809 million.

Table 2: Audit and accounting adjustments

	Description	**I&E DR £'000**	**I&E CR £'000**	**B/Sheet DR £'000**	**B/Sheet CR £'000**
1	Wages and salaries	991			
	Social security costs	72			
	Accruals				1,063
	Being creation of accrual for holiday pay at 31/03/14				
2	SFC Grant Income		1,154		
	Tuition Fees	26			
	SQA Fees and Charges		217		
	Accrued Income			1,154	
	Accruals and deferred income			191	
	Deferred Income				
	Being reversal of accrued exam fees (as exams did not take place in period) and deferral of income relating to exam fees. Also, increase in Grant in Aid income recognised, which is based on staff costs in the period as a percentage of 2013/14 academic year estimated staff costs, as a result of the holiday pay accrual being included (see adjustment 1 above)				
3	SFC Grant Income		493		
	Deferred Income			493	
	Being release of deferred income relating to SFC capital grants received but not utilised, which have been transferred to the Forth Valley College Foundation				
4	Income		73		
	Expenditure		6		
	Accrued Income			69	
	Deferred Income			10	
	Being adjustments for changes in income recognised due to inclusion of holiday pay in income recognition percentage (see above) and other miscellaneous accruals.				
5	Accruals			42	
	Fixed Assets Cost				42
	Being adjustment to year end accrual for fixed asset expenditure on Weir / Mezzanine capital project				
	Carried forward				
		1,089	1.943	1,959	1,105

Audit and Accounting Adjustments and Confirmation (Continued)

Table 2: Audit and accounting adjustments (Continued)

	Description	I&E DR £'000	I&E CR £'000	B/Sheet DR £'000	B/Sheet CR £'000
	B/F	1,089	1,943	1,959	1,105
6	SFC Grant Income	44			
	Depreciation		44		
	Deferred Capital Grants				44
	Accumulated Depreciation			44	
	Being transfer of assets between fixed asset categories and recalculation of depreciation and capital grant income released as a result				
7	SFC Grant Income		6		
	Other operating expenses	13			
	Accruals				13
	Deferred Capital Grants			6	
	Being late accrual of invoices and funding of part of these using capital grant				
8	Pension provision				26
	Pension reserve			24	
	Other pension costs	3			
	Income and Expenditure Account				1
	Being adjustments to FRS17 figures for updated actuarial report				
9	Tuition fees and education contracts		8		
	Other operating expenses	32			
	Accrued income			8	
	Accruals				32
	Being further late invoice accruals and adjustments to accrued income				
10	Staff costs	139			
	Pension provision charge		129		
	Interest cost	1			
	Actuarial loss in respect of pension scheme				11
	Being adjustment to correct error in FRS17 report				
	Total	**1,321**	**2,130**	**2,041**	**1,232**
		=====	=====	======	======
	Overall change to Net Surplus		**809**		

16. In addition, a number of disclosure and clarification adjustments were made to the financial statements to ensure SORP and Accounts Direction compliance and improve the overall presentation of the financial statements.

Confirmations and Representations

17. We confirm that as at the date of this report, in our professional judgement, Henderson Loggie CA was independent within the meaning of regulatory and professional requirements and the objectivity of audit staff was not impaired.

18. In accordance with auditing standards, we obtained representations from the College on material issues.

Financial Position

19. SFC circular SFC/31/2009, issued on 16 October 2009, defines a sustainable college as one which 'continually develops the quality of its learning activities to meet the changing needs of its customers, society and the economy, controls its costs, and year on year secures sufficient income to resource its planned activities and enable a level of current and future investment necessary to maintain its assets.'

20. One impact of the ONS decision to reclassify incorporated colleges as Central Government bodies from 1 April 2014 was that college year-ends changed to 31 March and in 2013/14 the accounting period for Forth Valley College was for the eight months to 31 March 2014, although the Scottish Government secured a concession from HM Treasury to allow UHI incorporated colleges to retain 31 July for accounting purposes only. The update from the ONS Project Board, dated 25 March 2014, advised non-UHI incorporated colleges that further clarification about a possible July year end in 2015 would follow in due course once negotiations between HM Treasury, the Scottish Government and the SFC had been concluded. The SFC formally advised colleges of the outcome of these negotiations on 5 September 2014, when it was confirmed that the Cabinet Secretary for Education had accepted the Chief Secretary to the Treasury's offer of derogation to all colleges to change their year-end from 31 March to 31 July. This offer was subject to colleges meeting HM Treasury budgeting and reporting requirements.

21. Table 3 provides a summary of the College's planned and actual financial results.

Table 3: Comparison of planned and actual financial results

	2012/13 (year) Actual £000	2013/14 (8 months) Planned £000	2013/14 (8 months) Actual £000	2014/15 (year) Planned £000
Financial outturn Surplus/(Deficit)	495	(98)	240	138
Income and expenditure reserves (excluding pension reserve)	(4,379)	(4,530)	(3,477)	(2,720)
Cash balances	6,292	4,880	786	1,159

Source: Audited financial statements and College budgets

22. A direct comparison of College income in 2013/14 of £23.840 million, before exceptional items, against last year is not possible given the change in accounting year-end. Points to note for 2013/14 include:

- SFC capital grants totalling £1.104 million have been released directly to income in 2013/14. This includes £0.493 million of grants previously included in deferred income as they had not been utilised by the College, which the SFC has confirmed can be transferred to the Forth Valley College Foundation; and £0.476 million of grants used to fund small items mostly related to the new Oil and Gas facility that have not been capitalised;
- there has been increased income from tuition fees and education contracts, including collaboration with universities and major new commercial contracts; and
- other income includes two one-off receipts totalling £0.434 million including the recovery of input VAT under-recovered in previous years.

There was also exceptional income of £3.000 million from the release of a provision made in previous years (refer paragraph 34 below).

Financial Position (Continued)

23. Given that SFC grant allocations follow the academic year to 31 July the College needed to consider how much teaching grant income had been 'earned' up to 31 March 2014 and should be recognised in the financial statements. Similarly, consideration also needed to be given as to how much tuition fee income should be recognised up to 31 March 2014. These issues were subject to discussion amongst all auditors at the Audit Scotland Further Education Sector Meeting in March 2014 and we had further discussions with the College's Director of Finance & Corporate Services on the accounting treatment. In relation to income recognition, while no single methodology was seen as more correct, Audit Scotland stressed that it was for individual colleges to demonstrate to their auditors that they had applied an appropriate methodology to arrive at an acceptable estimate. The College has recognised 73% of total SFC teaching grant and fee income received for the 2013/14 academic year. This is based on a calculation of staff costs in the eight month period ended 31 March 2014, including accrued holiday pay, as a percentage of estimated staff costs for the academic year to 31 July 2014. This was considered to provide an acceptable estimate of the income 'earned' up to 31 March 2014.

24. A direct comparison of College expenditure in 2013/14 of £26.600 million against last year is not possible given the change in accounting year-end. Points to note for 2013/14 include:

- staff costs include a holiday pay accrual of £1.063 million made at 31 March 2014. The College's holiday year runs from September to August. At the previous 31 July accounting year-end no holiday pay accrual was made as this was considered to be immaterial. With the change to a 31 March accounting year-end a material holiday pay liability arises and this has been accrued;
- expenditure includes a donation of £4.400 million made to the Forth Valley College Foundation (refer paragraph 35 below). This also accounts for a large part of the decrease in the cash balances between 31 July 2013 and 31 March 2014. There was no equivalent donation made in 2012/13; and
- a revaluation adjustment to the early retirement pension provision at 31 March 2014 resulted in a charge of £0.594 million to the Income and Expenditure Account. This was due to the actuary's assumptions being amended, including using a lower discount rate on liabilities. The revaluation adjustment at 31 July 2013 resulted in a credit of £0.005 million to the Income and Expenditure Account.

25. In recent years, voluntary severance costs, accounting for estates developments and the donation to the Forth Valley College foundation has led to the College reporting an Income and Expenditure Account reserve deficit (£3.477 million at 31 March 2014). The underlying position in 2013/14 continues to be robust and projections show that the College should be able to manage the position long term.

2013/14 SUMs Outturn

26. The College's estimated outturn against its 2013/14 Weighted SUMs target is shown in Table 4 below.

Table 4: 2013/14 Weighted SUMs estimated outturn

	2012/13	2013/14
WSUMs target (including ESF and PACE WSUMs)	112,233	118,503
WSUMs 2012/13 actual / 2013/14 estimate	112,462	118,636
Excess	229	133

Source: Audited SUMs returns (2012/13) and College management information system (2013/14)

Financial Position (Continued)

27. At the time of signing the financial statements the audit of the SUMs return for the 2013/14 academic year had still to be carried out. To gain assurance over whether the College would meet its WSUMs target we performed an analytical review on WSUMs figures per Dominant Programme Group against last year and checked figures to FES reports from the student records system. At 30 May 2014 the student records system was showing that 117,609 WSUMs had been earned for 2013/14 and the College was forecasting that the remaining 894 WSUMs to target would be achieved before 31 July 2014.

FRS 17 Retirement Benefits

28. In 2013/14 the College accounted for its participation in the local government pension scheme as a defined benefit scheme. This is consistent with the accounting treatment adopted in previous years.

29. The College's pension liability increased in total by £3.024 million (2012/13: decreased in total by £1.955 million) to £10.202 million at 31 March 2014 which was largely due to changes in key actuarial assumptions relating to discount rates.

Capital Income and Expenditure

30. The main capital additions in 2013/14 related to the completion of the College's new Oil and Gas facility, which was funded by the SFC, and renovation of a number of parts of the main Falkirk campus buildings to enable staff and students from the Middlefield building to be relocated there.

31. The College plans to decommission and demolish the Middlefield building as it has now reached a condition where it is uneconomical to operate and unsuitable to accommodate staff or students. At 31 July 2013 Middlefield was included in the College's financial statements at an existing use value and this was revisited based on the current plans for the site. In line with the Education SORP a valuation was obtained by the College from an independent valuer on the basis of market value, with expected directly attributable selling costs deducted where material. Based on the valuation obtained we are content that the Middlefield site is included in the financial statements at an appropriate valuation.

32. FRS 15 – Tangible Fixed Assets and the SORP require that where a tangible fixed asset comprises two or more major components with substantially different useful economic lives, each component should be accounted for separately for depreciation purposes and depreciated over its individual useful economic life. The requirements of FRS 15 to capitalise and depreciate separately the components of what could previously have been treated as a single item ensures that the assets are charged to the Income and Expenditure Account over the periods in which they are consumed. We noted in last year's Annual Report that the new Alloa and Stirling campuses were depreciated on a component accounting basis in 2012/13 for the first time. We noted however that the Falkirk campus buildings had been depreciated over 32 years as a whole and not as separate components and recommended that component accounting was considered further for the College's other buildings in future years. Management advised that the College does not intend to adopt component accounting for the current Falkirk Campus. If and when a new Falkirk Campus is brought into use component accounting will be adopted for that building.

Financial Position (Continued)

Provisions

33. The College has a provision in its balance sheet at 31 March 2014 of £7.536 million (31/07/13: £7.200 million) relating to pension costs from early retirements awarded to former employees. The College's approach to the valuation of the provision is to have an independent actuarial firm calculate this provision annually.

34. At 31 July 2013 there was a provision in the College's financial statements for £3.000 million for amounts that had to be repaid to the SFC when the College sells surplus land at Branshill, Alloa, up to a maximum of £3.000 million. The requirement to return these proceeds to the SFC was included as a specific condition of an offer of additional capital grant support of £3.000 million made to the College by the SFC on 6 July 2011. Following further discussion during 2013/14 the SFC has now rescinded this specific condition and the College has released the provision to the Income and Expenditure Account.

Forth Valley College Foundation

35. An arms-length foundation, the Forth Valley College Foundation, was set up in December 2013 into which the College has transferred £4.400 million by way of a donation in March 2014, and intends to transfer future surpluses. The objects of the Foundation are to advance the charitable purposes of the College to include the advancement of education by making grants and financial support for projects and activities being carried out by and supported by the College. The main reason for setting up the Foundation is that the Central Government budget mechanisms mean that the ability to use college reserves and surpluses in future periods is restricted.

36. To ensure that the Foundation is not consolidated into the College's financial results it requires to be independent of the College. During 2013/14 we have had discussions with College management in relation to the Foundation, including with regard to the composition of the Board, the accounting treatment of donations from the College to the Foundation and the amount that can be transferred. At 31 March 2014 we have determined that the Foundation is at arms-length from the College and does not require to be consolidated. This position will reviewed annually looking at the ongoing operation of the Foundation. The College should ensure that procedures are in place to ensure that the Foundation is considered independent on an ongoing basis (see recommendation **R1** Appendix II).

Corporate Governance

37. The College is responsible for ensuring that governance arrangements follow the three fundamental principles of openness, integrity and accountability and that these arrangements are in place to ensure the proper conduct of its affairs. Mechanisms to monitor the adequacy and effectiveness of these arrangements should also be in place.

38. Our responsibility, as noted in the Code of Audit Practice, is to review and report on audited bodies' corporate governance arrangements as they relate to:

- Bodies' reviews of corporate governance and systems of internal control, including reporting arrangements;
- The prevention and detection of fraud and irregularity;
- Standards of conduct and arrangements for the prevention and detection of corruption; and
- The financial position of audited bodies.

39. Comments on the financial position and the College's Corporate Governance Statement are covered in the Financial Statement section of this report.

40. We have considered the College's governance arrangements through formal review of documents and procedures and informal observation of the operation of committee arrangements and the relationships between Board members and staff. In particular we have considered arrangements for risk management and reporting to committees. We did not identify any areas of concern regarding the College's governance arrangements.

41. The Post-16 Education (Scotland) Act 2013 includes provisions in relation to the identification of principles of good governance practice for the college sector. In anticipation of them coming into effect, the SFC invited the Regional Leads to convene a Steering Group to develop a draft 'Code of Good Governance for Scotland's Colleges'. The first stage of consultation took place in December 2013 when stakeholders were invited to provide comments on what should be included in the new Code, for consideration by the Steering Group. On 24 April 2014 the second stage of consultation commenced, with comments invited from all interested parties by 2 June 2014.

42. The Steering Group has taken a very deliberate decision to keep the Code focussed on the principles of good governance and not include practical guidance on best practice. In so doing, the aim is to achieve a more concise, accessible and unambiguous document that sets out clearly what is required of colleges. The draft Code sets out the principles of good governance across five main areas: Leadership and Strategy; Quality of the Student Experience; Accountability; Effectiveness; and Relationships and Collaboration. Colleges will be expected to comply with the new Code as condition of grant from the SFC or their regional strategic body. The draft 'Code of Good Governance for Scotland's Colleges' was provided to the Audit Committee on 1 May 2014 for information purposes and the College's procedures will be benchmarked against the final Code once issued.

Risk Management

43. Risk management is important for the development and on-going review of systems of internal control.

44. The College's Risk Management Policy and Procedure details the College's approach to risk capture, monitoring and reporting.

45. The College has a Strategic Risk Register which is reviewed by the Audit Committee. Risk is a standing item on the agenda for the Senior Management Team, all Board committees and the Board. There are also risk registers which are compiled and reviewed by each operating area of the College.

Systems of Internal Control

Control Environment

46. No material weaknesses in the accounting and internal control systems were identified during the 2013/14 financial statements audit which would adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

47. Some areas were however identified from our system controls testing undertaken during 2013/14 where controls could be further improved to bring more into line with good practice. These have been raised with management in order to consider possible mitigating action and some have already been addressed. Actions for improvement included:

- incorporating further segregation into the Sun finance system access controls for some members of staff;
- making sure that staff do not have the ability to both raise and authorise a purchase request on the FIDO purchase order authorisation system;
- remind staff that purchase orders must be completed for all transactions with the exception of those where the finance procedures do not require this;
- considering what controls could be put in place to ensure that transactions processed by the administrator of the FIDO and Sun systems are appropriate;
- reviewing the BACS transaction limits and requiring two electronic signatories;
- ensuring that all cash income banking sheets are correctly completed and signed-off and that till rolls are always attached where available; and
- implementing procedures to ensure that all journals and month-end reconciliations are reviewed and evidence of review is recorded.

Internal Audit

48. Audit Scotland's Code of Audit Practice directs us to maintain effective co-ordination with internal audit and place the maximum possible reliance on their work. Baker Tilly provided internal audit services to the College in 2013/14.

49. We have reviewed the scope and extent of work performed by internal audit during the year and considered the impact of their findings and conclusions on our work, where appropriate. We have also considered the adequacy of the provision and are content that the audit service is of good quality.

50. The annual internal audit report for the period ended 31 March 2014 did not identify any issues that affect our audit conclusions although highlighted some weaknesses identified in reviews undertaken during the period. These issues are currently being addressed by College management.

Fraud and irregularity, standards and conduct, and prevention and detection of corruption

51. During 2013/14 we had regard to ISA 240: The Auditor's Responsibility to Consider Fraud in the Audit of Financial Statements.

52. The College has appropriate arrangements in place regarding the prevention and detection of fraud, including Standing Orders and Operating Guidelines and Code of Conduct, Financial Regulations and an Anti-Fraud and Anti-Corruption Policy and Procedure.

53. No frauds were identified during the period from 1 August 2013 up to the date of signing the financial statements.

Fraud and irregularity, standards and conduct, and prevention and detection of corruption (Continued)

54. The College has in place the following procedures / policies in relation to standards of conduct and prevention and detection of corruption:

- Standing Orders and Operating Guidelines and Code of Conduct;
- Register of Board Members' Interests;
- Anti-Fraud and Anti-Corruption Policy and Procedure;
- Anti-Bribery Policy; and
- Whistleblowing Policy.

55. The arrangements for maintaining standards of conduct and the prevention and detection of corruption are considered to be appropriate.

Performance Audit

Introduction

56. The terms of appointment from Audit Scotland include a requirement for a proportion of our audit time to be spent on performance audit work. Performance audit work covers a variety of areas, both financial and non-financial, including both Audit Scotland centrally directed studies and locally determined studies based on agreement between each organisation and their auditors.

57. No mandatory performance audit studies were identified by Audit Scotland for the College during 2013/14 although Audit Scotland has requested auditors to provide information in a data set for use in a sector report. In particular it has requested information about voluntary severance schemes and payments. The College did not make any payments under a voluntary severance scheme during the 2013/14 period.

Education Scotland Review

58. We are required by Audit Scotland's Code of Audit Practice to contribute to the 'whole organisation' approach to inspection through co-ordination amongst auditors, inspectors and other scrutiny bodies. We therefore place reliance on the reported results of the work of statutory inspectorates in relation to corporate or service performance.

59. Education Scotland undertook their annual engagement review in April 2014 and feedback from this was positive.

College Performance Arrangements

60. The College does not have a formal mechanism to consider Audit Scotland reports however we have been advised this will be implemented in future when any new reports are received.

61. Arrangements for financial and non-financial management are established in the College, through the operation of the Senior Management Team and the Board and its various committees. This includes budget setting and monitoring structures.

62. The College's Standing Orders and Operating Guidelines and Code of Conduct, including its Scheme of Delegation records the performance management aspects of the Board and each committee, and where appropriate, their responsibility to take action to address issues in performance. Discussion with managers and our review of meeting papers and minutes confirms these responsibilities appear to be undertaken in an appropriate manner.

63. The College has a Corporate Plan 2014-18 and an annual 2013/14 Operational Plan.

64. Key performance indicators are set out in the Operating and Financial Review in the College's annual report.

65. The College has a Regional Outcome Agreement which is aimed at responding to the national objectives and priorities for post-16 education, and works with Local Authorities, Community Planning Partnerships, Skills Development Scotland and employers to ensure its education provision meets the needs of learners and the community. The College continues to work in partnership with organisations to achieve economies of scale and better efficiency.

66. In October 2013 the College undertook a self-evaluation against the targets set out in the 2012/13 Regional Outcome Agreement and this is planned to be done for the 2013/14 academic year as well.

67. The College's arrangements for performance management as outlined above are considered to be appropriate.

2014/15 and beyond

68. The funding position will remain challenging going forward. The voluntary severances undertaken in the College in recent years has helped to reduce pay costs and assist the College in coping with the funding reductions. Commercial business and collaboration work has increased in 2013/14 which has helped grow income. However robust budget setting and monitoring arrangements will be essential in helping to achieve sustainability.

69. The College's total funding allocations for the 2014/15 academic year from the SFC for Teaching and Fee Waiver is £19.767 million, the same as that received for 2013/14 and with the same WSUMs target (118,503). The College's capital allocation for 2014/15 from the SFC is £1.411 million (2013/14: £1.414 million).

Post-16 Education (Scotland) Act 2013

70. The Post-16 Education (Scotland) Act 2013 makes provision: about the support for, and the governance of, further and higher education institutions, including provision for the regionalisation of colleges; for reviews of how further and higher education is provided; for sharing information about young people's involvement in education and training; and for connected purposes. The Bill for this Act of the Scottish Parliament was passed by the Parliament on 26 June 2013 and received Royal Assent on 7 August 2013.

71. The Scottish Government has identified Forth Valley College as making up the Central region and the College is not included in a regional grouping with any other college. The Designation of Regional Colleges (Scotland) Order 2014 came into force on 3 March 2014 and formally designated Forth Valley College, and the other nine colleges in single college regions, as regional colleges.

72. The Board of Management has been kept up-to-date regularly with information about the regionalisation process including the duties of regional colleges.

ONS Reclassification

73. The reclassification of incorporated colleges in Scotland as Central Government bodies from 1 April 2014 has a number of implications for budgeting, reporting and accounting practices and issues for consideration which the SFC has addressed through a series of Reclassification Communications and ONS Project Board Updates.

74. Other than the change in financial year-end for 2013/14 the main practical impact of this change is that colleges are required to undertake monthly cash forecasts and report these to the SFC to ensure that they only draw down sufficient funding to meet forecast expenditure. The format of financial statements will also have to change from 1 April 2014 as Central Government bodies use the Government Financial Reporting Manual ('the FReM'). The changes for 2014/15 are not likely to be significant as the Education SORP is expected to take precedence over the FReM. No changes in accounting treatment are likely to be required although additional disclosure will be required, particularly in relation to remuneration and out-turn against budget.

75. Incorporated colleges and Regional Boards are also required to comply with the requirements of the Scottish Public Finance Manual (SPFM), except where directed by SFC's Accountable Officer.

SFC Financial Memorandum with Colleges

76. A draft of a new Financial Memorandum with Colleges has been issued by the SFC for consultation, setting out the formal relationship between the SFC and fundable bodies in the college sector, and the requirements with which fundable bodies are expected to comply in return for payment of grant by the SFC.

77. The draft Financial Memorandum shows a significant number of changes from the existing version, reflecting all the recent governance changes in the sector and the reclassification of incorporated colleges in Scotland as Central Government bodies.

FRS 102 'The Financial Reporting Standard' and new Education SORP

78. The FRC has been implementing a convergence programme aligning UK Generally Accepted Accounting Practice (GAAP) to International Financial Reporting Standards (IFRS) and published three new FRSs (FRS 100, 101 and 102) with the substantive FRS 102 'The Financial Reporting Standard' representing the final step towards IFRS convergence. These three new FRS' become the new UK GAAP, which is fully IFRS-based. The new accounting standards come into force for accounting periods commencing on or after 1 January 2015 which means that 2015/16 will be the first reporting year. However, comparative figures for 2014/15 will be required.

79. In addition, a new Education SORP has been developed following the publication of the new FRSs and this received final approval from the FRC on 26 March 2014 following an extensive consultation process, and will also be effective from 2015/16. The new SORP was formally published in May 2014 and is available on www.fehesorp.ac.uk.

Appendix I
Audited Bodies' Responsibilities

Extracts from the Audit Scotland Code of Audit Practice

The Scottish ministers, elected members, governing bodies, boards, accountable officers, managers and officials have primary responsibility for ensuring that public business is conducted in accordance with the law and proper standards, and that public money is handled with integrity and spent appropriately. Public bodies and those responsible for conducting their affairs must discharge this accountability by establishing and maintaining proper governance arrangements and effective stewardship of the resources at their disposal.

Financial statements

Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources. Audited bodies are responsible for:

- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority
- maintaining proper accounting records
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice)
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.

Many audited bodies publish other information, such as an annual report, alongside the financial statements.

Audited bodies should prepare financial statements in accordance with statutory timescales or in good time to allow audits to be completed by any dates specified by sponsoring directorates or other bodies. Financial statements should be prepared in accordance with all relevant regulatory requirements and be supported by accounting records and working papers prepared to an acceptable professional standard.

Corporate governance arrangements

The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer

Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements.

Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

Systems of internal control

Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls.

They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.

Rigorous self-evaluation should be a central part of audited bodies' performance management to support continuous improvement

Prevention and detection of fraud and irregularities
Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity.
This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions
- developing and implementing strategies to prevent and detect fraud and other irregularity
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity
- participating, when required, in data matching exercises carried out by Audit Scotland.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers
- promoting appropriate values and standards
- developing, promoting and monitoring compliance with standing orders and financial instructions

Financial position of audited bodies
Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified
- compliance with any statutory financial requirements and achievement of financial targets
- balances and reserves, including strategies about levels and future use
- the impact of planned future policies and foreseeable developments on their financial position.

Best Value
The Scottish Public Finance Manual explains that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure Best Value. Best Value is defined as the continuous improvement in the performance of functions. This includes having regard to the concepts of economy, efficiency and effectiveness and the need to meet equal opportunity requirements, and contributing to the achievement of sustainable development.

Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

Para Ref.	Recommendation	Grade	Comments	Agreed Y/N	Responsible Officer For Action	Agreed Completion Date
36	**Financial Position** **Forth Valley College Foundation** **R1** The College should maintain an ongoing review of its involvement with the Foundation to ensure that this remains independent and that the Foundation does not need to be consolidated in the College financial statements in future.	Medium	The Board of Management believes that it holds no control over the operations of Forth Valley College Foundation. The College however has recognised the risk that if the Foundation's operations are not seen to be independent this may lead to consolidation. This risk will be monitored by the Audit Committee to ensure independence is maintained.	Yes	Alison Stewart, Director of Finance	N/A as will need to be reviewed year on year

Grade

High	Issue subjecting the organisation to material risk and which should be dealt with as a high priority
Medium	Issue subjecting the organisation to significant risk and which should be addressed by management.
Low	Less significant matters, which would enhance efficiency, or do not require urgent attention but which should be followed up within a reasonable timescale.

Observation	Recommendation	Priority	Original College Response, Responsibility and Timescale	Update
Corporate Governance The UK Corporate Governance Code requires the Chair should hold meetings with the non-executives without the executives present. The non-executive members should meet without the chair present at least annually to appraise the chair's performance and on such other occasions as are deemed appropriate. This is not done at the College.	We recommend that the non-executive directors meet periodically without the chair in order to appraise their performance.	Low	Agreed. Annual appraisal will be implemented. Ken Thomson September 2012	**November 2012:** Owing to the upcoming changes to the governance framework for further education in Scotland, the College has decided to hold implementation of this recommendation until the new systems / structure become clear. This was reported to, and approved by, the Audit Committee on 9 May 2012. **November 2013:** This did not happen in 2012/13 but arrangements are in place for this to be undertaken in 2013/14. **June 2014:** The Chair has the ability to meet with the non-executive Board member should they choose to. The Chair can also ask executives to leave the Board meeting for discussion of particular items is they feel this is appropriate. A survey was issued on 28 August 2013 to Board members and included a Board Skills Matrix, Fit and Proper Persons test Declaration, Board Member Annual Review (appraisal of members' own input), and Appraisal and Evaluation the Chair. The findings from this process were reviewed by the Vice-Chair and there were no points highlighted that required follow-up action.

Grade
Low Priority – Recommendation which, although not addressing significant weaknesses, would either improve efficiency or ensure that the College matches current good practice.