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South Lanarkshire College

Annual audit report to the Board of Management of South Lanarkshire College and the Auditor General for Scotland

Period ended 31 March 2014

25 September 2014

Contents

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

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

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries.

Headlines

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

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

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

Area	Summary observations	Analysis
Strategic overview and use of resources		
Business issues	The College had a target to significantly increase its teaching activity from 42,282 wSUMs in 2012-13 to 52,707 wSUMs in 2013-14. Work is ongoing to develop additional teaching space and resources, with a significant capital project planned to commence in autumn 2014 following the design and contractor tender exercise and be completed by May 2015. This will provide the College with the capacity to continue to increase the number of students taught. A draft Scottish Statutory Instrument in respect to the Post-16 Education (Scotland) Act 2013 confirms that South Lanarkshire College will retain its fundable status in the Lanarkshire region, being assigned to New College Lanarkshire, as a regional strategic body, from 1 October 2014. The College continues to agree its wSUMs target with the Lanarkshire regional board. In 2013-14 the rate of funding received by the College per wSUM was £166 and the rate is expected to increase to £169 in 2014-15. Colleges in Scotland have been reclassified as public bodies from April 2014. One consequence has been the change in accounting reference date away from one which matched academic activity.	Page 6
Financial position	The College reported an overall deficit of £1,468,000 in the eight month period (2012-13: £48,000 surplus). This is primarily as a result of the transfer of £1.5 million to The South Lanarkshire College Foundation, without which the College surplus would have been £32,000. As a result of the planned increase in teaching activity, Scottish Funding Council recurrent grant income increased for the year to 31 July 2014 from £7.4 million to £8.4 million, with £5.7 million reflected in the income and expenditure account in respect of the shorter 2013-14 accounting period. Expenditure decreased by £1.1 million when compared to 2012-13, largely as a result of the change in accounting period and is after a transfer of £1.5 million to the Foundation. The balance sheet shows a decrease in net assets over the eight month period of £2.5 million, arising from the increase in the net pension liability and the operating deficit in the period. Period end comparisons have been impacted by the change in accounting reference date. There are significant increases in debtor and creditor balances as at 31 March 2014 compared with 31 July 2013 as the College's teaching activity remained ongoing at the time of preparation. The 2014-15 budget anticipates a surplus of £52,000.	Pages 7 - 8
Financial statements and accounting		
Audit conclusions	We have issued unqualified audit opinions on the 2013-14 financial statements and on the regularity of financial transactions.	Page 10

Headlines (continued)

Financial statements and accounting (continued)		
Significant risks	We have considered inherent significant risks that International Standards on Auditing require us to address covering risks in relation to revenue recognition and management override of controls and have satisfactorily concluded our work in these areas.	Pages 10 - 11
Audit focus areas	We have satisfactorily concluded work identified at the planning stage in relation to retirement benefits valuation, establishment of a charitable foundation, and the valuation of land and buildings.	Pages 11-12
Year end process	The unaudited financial statements were made available on a timely basis, in advance of the audit fieldwork.	Page 14
Control observations	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are in the main designed appropriately and operating effectively. We have not raised any recommendations over the operation of controls.	Page 14
Governance and narrative reporting		
Governance arrangements	The statement of corporate governance and internal control identifies no major weaknesses in governance or internal control arrangements. We have reviewed the statement of corporate governance and internal control and consider it consistent with our understanding of the process followed by the College during the year. The Board completed its annual self assessment exercise and allocates one meeting per year to strategic planning which supports a balance of retrospective review and forward planning. The College's risk management group focussed on ongoing maintenance of the risk register, development of a value for money policy and disaster recovery and business continuity planning during the year. Management has identified no fraud or irregularities.	Pages 16 and 17
Performance management		
Performance management	The College produces management accounts which compare actual expenditure to budget and developed a value for money policy during 2013-14. Performance against sector indicators is measured by the College.	Page 19

Scope and responsibilities

Purpose of this report

The Auditor General for Scotland ("the Auditor General") has appointed KPMG LLP as auditor of the Board of Management of South Lanarkshire College ("the College") under the Public Finance and Accountability (Scotland) Act 2000 ("the Act"). The period of appointment is 2012-13 to 2015-16, inclusive.

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

Responsibilities

Audit Scotland's *Code of Audit Practice* ("the Code") sets out South Lanarkshire College's responsibilities in respect of:

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

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

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

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

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

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

Service overview

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

Key business issues

The Scottish further education sector is undergoing significant structural reform. South Lanarkshire continues to retain its status as a distinct fundable body in respect of the changes enacted by the Post-16 Education (Scotland) Act 2013 and the subsequent creation of 13 new college regions.

Colleges have been re-classified as public bodies from April 2014, restricting the scope to build up or retain financial reserves. The accounting reference date has been altered as a consequence.

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

On 1 February 2012, the Scottish Government announced 12 newly created regions with a further one added in the following month. Since then, a number of colleges have merged on a regional basis.

Given the relative size and number of colleges envisaged in Lanarkshire there followed, in October 2013, consultation on the type of regional strategic body and structure in the region. No consensus was reached and a draft Scottish Statutory Instrument was provided to us by management which outlines the proposals to establish New College Lanarkshire as a regional college and regional strategic body, from 1 October 2014, with the College assigned to it. The proposals confirm that the College will remain a fundable body until the revised arrangements are confirmed as working well and a subsequent order is passed.

The College continues to agree its wSUMs target with the Lanarkshire regional board. In 2013-14 the rate of funding received by the College per wSUM was £166, but the rate is expected to increase to £169 in 2014-15.

The College significantly increased its planned teaching activity from 42,282 wSUMs in 2012-13 to 50,707 wSUMs in 2013-14. In addition, the Scottish Funding Council allocated an additional 4,000 wSUMs to the Lanarkshire region during 2013-14 and the College agreed to deliver half of that allocation (2,000 wSUMs).

In order to continue to deliver significantly increased levels of teaching activity, the College is progressing the development of a new teaching facility on its East Kilbride campus. In September 2013, the board of management approved a project to build a new, standalone teaching facility containing eight classrooms. Designs have been approved and a tender exercise is in progress for the award of a construction contract. The new facility is planned to be completed by May 2015.

Colleges in Scotland have been re-classified as public bodies from April 2014 and this will require them to operate within the same annual budget limits as other Scottish Government bodies. This will restrict the scope to build up financial reserves. A number of colleges – including South Lanarkshire – have established separate charitable foundations as a means of minimising some of the impact of this change. In addition to the restriction on reserves, another consequence of the re-classification has been the change in accounting reference date to 31 March from 2014.

During 2013-14 the College supported the creation of a Scottish Charitable Incorporated Organisation ("SCIO"), The South Lanarkshire College Foundation ("the Foundation"), for the purposes of receiving funding from the College to be held and used in future periods as directed by the trustees, primarily for the benefit of the College.

The Foundation was established on 20 February 2014 and we reviewed the proposed constitution and trustee membership of the Foundation and concluded that the College does not exercise control over the distribution of its funds, and therefore are satisfied that it should not be consolidated in group financial statements of the College.

The board elected to transfer £1.5 million of cash to the Foundation on 27 March 2014. This has resulted in net current liabilities of approximately the same amount as at 31 March 2014.

In its latest review of the college sector, Audit Scotland reported that, while the overall financial standing of the sector continued to be generally sound, the sector faces an overall 11 per cent real-terms reduction in revenue grant funding from the Scottish Government in the period to 2014-15.

The College has prepared a 2014-2020 strategic plan – *'20/20 vision'* – which links with the regional outcome agreement, Scottish Government priorities and national quality assurance and improvement arrangements.

Financial position

The College reported an overall deficit of £1,468,000 in the eight month period (2012-13: £48,000 surplus). This is primarily as a result of the transfer of £1.5 million to the Foundation, without which the College surplus would have been £32,000.

Scottish Funding Council recurrent grant income increased for the period to 31 July 2014 from £7.4 million to £8.4 million, associated with increased delivery, with £5.7 million reflected in respect of the shorter 2013-14 accounting period.

Expenditure decreased by £1.1 million when compared to 2012-13. However, this has been largely as a result of the change in accounting period and is after a transfer of £1.5 million to the Foundation.

The College is reporting a deficit for the eight month period to 31 March 2014 of £1,468,000. This compares to a surplus of £48,000 in the previous 12 month period. The budget for the 12 month period (academic year) to 31 July 2014 was for a surplus of £21,000.

The deficit arose primarily as a result of the transfer of £1.5 million on 27 March 2014 to the Foundation, without which the College would have reported a surplus of £32,000.

Total income decreased by £2.6 million when compared to 2012-13, but this has been largely as a result of the change in accounting periods. Overall, on a like-for-like basis:

- Scottish Funding Council recurrent grant income increased for the period to 31 July 2014 from £7.4 million to £8.4 million, associated with increased delivery. £5.7 million of the 2013-14 funding is recognised in the financial statements for the period to 31 March 2014, of which £300,000 is accrued income.
- Tuition fee and education grants have remained broadly consistent when considering the reduction in the accounting period from 12 to eight months, other than a like-for-like reduction in education contract income associated with the New College Learning Programme. £600,000 of tuition fee income has been received in advance and deferred as at 31 March 2014.
- Other grant and other operating income increased slightly in absolute terms when taking into consideration the shorter accounting period.

Expenditure decreased by £1.1 million when compared to 2012-13. However, this has been largely as a result of the change in accounting period and is after a transfer of £1.5 million to the Foundation.

- Staff costs reduced by £1.7 million, but have increased on a like-for-like basis when considering the shorter accounting period. Associated with the increased teaching delivery, staff on permanent full-time contracts increasing by 23 (FTE), and a 3.6% pay award was awarded from 1 August 2013. The College's revised salary scales are consistent with other colleges in the Lanarkshire region which will support staff retention.
- Other operating expenses decreased by £700,000. This is primarily due to the shorter accounting period. Management conducted an exercise to review non-staff costs and treat appropriate elements (£300,000) as prepaid expenditure as at 31 March 2014 where the costs incurred relate to the subsequent period.

	2014 £'000	2013 £'000
Income		
Funding council grants	7,017	8,409
Tuition fees and education grants	1,777	2,998
Other grant income	114	110
Other operating income	121	119
Investment income	56	68
Total	**9,085**	**11,704**
Expenditure		
Staff costs	(6,090)	(7,783)
Other operating expenses	(2,395)	(3,052)
Transfer to arms length foundation	(1,500)	-
Depreciation	(557)	(812)
Interest and other finance costs	(11)	(9)
Total	**(10,553)**	**(11,656)**
Surplus/(deficit) before the disposal of assets	**(1,468)**	**48**
Disposal of fixed assets	-	-
Surplus/(deficit) after the disposal of assets	**(1,468)**	**48**

Source: 2013-14 financial statements

Financial position (continued)

The balance sheet shows a decrease in net assets of £2.5 million, arising from the increase in the net pension liability and the operating deficit in the current year. Period end comparisons have been impacted by the change in accounting reference date.

There are significant increases in debtor and creditor balances as at 31 March 2014 compared with 31 July 2013 as the College's teaching activity is ongoing at the time of the revised accounting reference date.

The 2014-15 budget anticipates a surplus of £52,000.

The balance sheet shows a decrease in net assets of £2.5 million.

- Cash at bank and in hand decreased by £537,000. This is primarily associated with the transfer of £1.5 million to the Foundation on 27 March 2014. The College utilised a short term overdraft facility to manage cash flow requirements between the date of that transfer and receipt of the next tranche of grant funding from the Scottish Funding Council around two weeks later.
- Debtors increased by £1.3 million. This is primarily due to the change in the accounting period, and the associated increased trade debtors (£600,000) due from the local authority and nearby further and higher education providers on behalf of whom the College provides teaching or other services and from New College Lanarkshire which receives some funding which is subsequently transferred to the College. Accrued income increased in respect of £300,000 recurrent grant funding due at the period end and prepaid expenditure also increased by £300,000.
- Creditors falling due within one year increased by £900,000. This is primarily associated with deferred income in respect of tuition fees received for the period to 31 July 2014 (£600,000). Deferred, non-recurrent grant funding reduced by £200,000.
- Creditors falling due after one year reduced by £180,000 in respect of the continued repayment of Lennartz cash received in previous years.
- Net pension liabilities increased by £654,000 as a result of market conditions and assumption changes.

Budget 2014-15

The approved budget for 2014-15 reflects a £52,000 surplus for the year. This is primarily associated with continued high levels of WSUMs delivery and focus on managing other operating expenses.

31 March 2014 / 31 July 2013

	2014 £'000	2013 £'000
Fixed assets		
Tangible assets	28,105	28,269
Current assets		
Stocks	8	8
Debtors: Amounts falling due within 1 year	2,011	711
Cash at bank and in hand	108	645
Funds on bank deposit	-	1,800
Creditors: Amounts falling due within 1 year	(3,581)	(2,683)
Net current assets	**26,651**	**28,750**
Creditors: Amounts falling due after 1 year	(1,086)	(1,266)
Provisions for liabilities and charges	(544)	(604)
Net pension liability	(1,304)	(650)
Net assets including pension liability	**23,717**	**26,230**
Deferred capital grants	24,770	25,183
Reserves		
Income and expenditure reserve	251	1,697
Pension reserve	(1,304)	(650)
Total funds	**23,717**	**26,230**

Source: 2013-14 financial statements

Financial statements and accounting

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

Audit conclusions

We have issued an unqualified audit opinion on the financial statements and the regularity of transactions reflected in those financial statements.

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

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

Audit conclusions

We have issued an unqualified opinion on the truth and fairness of the state of the affairs of the College as at 31 March 2014 and of the College's income and expenditure, recognised gains and losses and cash flows for the period then ended. We have also issued an unqualified opinion on the regularity of the transactions reflected in those financial statements. There are no matters identified on which we require to report by exception.

In gathering the evidence for our opinion we have:

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

Significant risks

Income recognition	While fraud risk associated with grant income would ordinarily be rebutted, the change in accounting reference date to 31 March introduced a degree of judgement as to underlying activity measures and compliance with funding conditions. This included whether underlying activity was such that provision should be made for anticipated clawback of grant funding. We found that management had considered the different variables impacting recognition of grants and had arrived at an appropriate basis. Where there was room for some interpretation, we found management's judgement to have been balanced, for example in the consideration of the expected achievement of wSUMs in excess of the agreed target. Representing good practice, management also reviewed non-staff expenditure to determine balances which should be treated as prepaid as at 31 March 2014. As a result of the shorter accounting period, there are significant increases in debtor and creditor balances as at 31 March 2014 in line with our expectations. We did not identify any errors requiring adjustment in the financial statements or evidence of bias in determining income to be recognised.

Audit conclusions (continued)

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

- **retirement benefits valuation;**
- **Tangible fixed assets;**
- **Income recognition; and**
- **establishment of a charitable foundation.**

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

Significant risks (continued)	
Management override of controls	To address this risk, we have performed testing of journal entries during the period and at the period end, undertaken a review of unusual transactions in the period, made enquiries with employees outside the finance department, incorporated audit tests of an unpredictable nature and undertaken testing of controls, including 'higher level' controls and reviewed management's accounting estimates for bias. Our work did not identify any matters that required adjustment in the financial statements or which require to be brought to your attention.
Audit focus areas	
Retirement benefits valuation	The College accounts for its participation within the Strathclyde Pension Fund in accordance with FRS 17: *Retirement benefits* on a defined benefits basis using valuation information prepared by actuarial consultants. Our audit of the accounting for retirement benefits includes evaluation of the actuarial consultants as a third party expert, consideration of the data underlying the actuarial report, including the level of contributions made during the period, the financial assumptions and membership data provided to the actuary by the College, and estimates of the College's share of the pension fund assets. We found that the actuarial consultants as a third party expert was objective and had the appropriate experience and expertise to provide the information for use by the College. The level of contributions made by the College in the period is estimated based on data prior to the period end. It is important that this number is accurate as it is used to inform the calculation of the liabilities at the period end. Our testing included review of actual data against that used in the actuarial calculations. No issues were identified. For the Strathclyde Pension Fund, the actuaries use a number of assumptions in their calculations based on market conditions at the period end, including a discount rate to derive the anticipated future liabilities back to the period end date and assumptions on future salary increases. Using our own actuarial specialists, we have reviewed the assumptions and concluded that the overall assumptions proposed were slightly stronger than our central assumptions but are within our expected range. The rate of salary increases is set taking into account the College's expected long-term rate of salary increases, including incremental drift. Following discussion with management, the rate assumed for 2013-14 is 1% followed by RPI + 1.5% from 2015 onwards. The increases assumed in the period 2014-15 to 2015-16 represent management's estimation of the most likely increases and a period of collective bargaining. Management should ensure that in setting this assumption it reflects the College's long-term plans and strategy, in light of collective bargaining being introduced.

Audit conclusions (continued)

Audit focus areas	
Tangible fixed assets	The College is progressing the development of a new facility at its East Kilbride campus, but the development had not started construction by 31 March 2014. We have reviewed other capitalised expenditure by reference to underlying documentation and the principles of FRS 15 *Tangible fixed assets* and found this to have been correctly applied. In preparation for the ONS re-classification, the College considered early amendment its accounting policy to adopt a valuation basis, incorporating land and buildings at a valuation as at 31 March 2014. A third party valuation of tangible fixed assets has been carried out which indicated an increase in the value of the land, buildings and eco-house on the basis of depreciated replacement cost to £47.9 million. As there is not a requirement to adopt a revaluation basis until 2015, management elected to maintain accounting policy unchanged for 2013-14 and hold tangible fixed assets at depreciated historic cost. We have consider the accounting entries and disclosures in the financial statements relating to the tangible fixed assets and confirmed with management that there are no indications of impairment.
Charitable foundation	As a result of the college reclassification, colleges' abilities to spend existing reserves, eg. by operating at a deficit in a given year, will be restricted due to the Scottish Government funding mechanisms. In order to protect existing reserves levels, The South Lanarkshire College Foundation has been established as a Scottish charitable incorporated organisation ("SCIO") and registered with the Office of the Scottish Charity Regulator. We have considered the status of the Foundation against the relevant accounting requirements which determine whether it should be consolidated in the College's financial statements. This requires consideration of whether: ■ there is direct ownership or control of the Foundation; and ■ there is evidence of indirect control through established practices or other means. Following consideration of iterations of the Foundation's constitution and associated documentation and discussions with the College's legal advisers, we have agreed with management's intention that the Foundation is not required to be consolidated at 31 March 2014. In doing so, we note that there are a number of risks that should be considered by management where future actions may indicate that consolidation is required. £1.5 million was gifted to the Foundation in 2013-14.

Accounting framework; application of accounting policies

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

Accounting policies have been applied consistently.

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

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

Statement of Recommended Practice: *Accounting for Further and Higher Education* (2007) ("the SORP")	■ The 2013-14 financial statements have been prepared in accordance with the SORP. ■ During the year there have been no substantive changes in financial reporting requirements, and consequently there are no substantive changes to the College's accounting policies. ■ We are satisfied that the accounting policies remain appropriate to the business, and have been applied consistently.
Impact of revised accounting standards	■ There are no newly effective accounting standards which are considered to have a material impact on the College's financial statements for 2013-14. ■ In March 2013, the Financial Report Council issued FRS 102, the Financial Reporting Standard applicable in the UK and Republic of Ireland. This is the main part of the new UK GAAP regime and follows the issue in November 2012 of FRS 100 (overview of the framework) and FRS 101 (reduced disclosure framework). ■ FRS 102 is applicable for accounting periods beginning on or after 1 January 2015. In response, the Further and Higher Education SORP Board has recently completed the development of a new SORP. Management will need to consider the accounting and reporting implications of the revised SORP and prepare a transitional balance sheet as at 1 April 2014. ■ There are key differences to the existing SORP, particularly in respect of grant accounting, recognition of obligations arising from funding past deficits of multi-employer pension schemes, service concession arrangements and in respect of financial statement disclosures. Each of these will need careful consideration.
Going concern	■ Management has considered the funding available to the College in 2014-15 and consider it appropriate to adopt a going concern basis for the preparation of these financial statements. ■ We are satisfied that the going concern basis of preparation of the financial statements is appropriate. At 31 March 2014, the College had £108,000 cash but net current liabilities, primarily as a result of the transfer of £1.5 million to the Foundation during the period. We have reviewed relevant cash flow projections and note that that College will continue to receive significant levels of funding from the Scottish Funding Council.

Year end process; internal control; other matters

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

Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively.

Financial statements preparation	■ High quality working papers and draft financial statements were provided on 14 July 2014 in line with the agreed timetable. The operating and financial review and statement of corporate governance and internal control were provided separately towards the end of the onsite audit. ■ Management enhanced the financial accounting support available to the Head of Finance, through a new appointment during the period. This mitigates the risks in respect of business continuity associated with reliance on one individual and we recognise that there has been an increase in the sharing of responsibilities in respect of the preparation of the financial statements. ■ There are no non-trifling unadjusted audit differences, and there are no adjusted audit differences warranting disclosure.
Systems of internal control	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively over the following financial processes: ■ income and expenditure; ■ staff costs; and ■ cash and bank. During the course of our work in relation to the financial statements, we have not identified any control improvement opportunities.
Other matters	Mandatory communications required by International Standards on Auditing are given in Appendix one. There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content.

Governance and narrative reporting

Update on your governance arrangements

Our overall perspective on your narrative reporting

Corporate governance arrangements

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

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

Management has identified no significant fraud or irregularities.

Corporate governance and internal control arrangements	The College has made a compliant corporate governance and internal control statement. We are required to review this to assess whether the description of the process adopted by the College in reviewing the effectiveness of the system of internal control is consistent with our understanding of the process and report any inconsistencies. We are not required to provide an opinion on the College's system of internal control. The statement of corporate governance and internal control provides detail on the governance framework, the system of internal control, internal audit, internal financial controls and risk management arrangements, and analyses the effectiveness of these elements of the framework. It describes a number of sources of assurance for the accountable officer. We have reviewed the statement of corporate governance and internal control and consider it consistent with our understanding of the process followed by the College during the period.
Internal audit	As set out in our audit plan and strategy, we have evaluated the work of internal audit in the period, both to enhance our understanding of the key risks and issues facing the College and to rely on the work of internal audit where possible to avoid duplication. The content of the internal audit plan is in line with our expectations. We did not directly rely on internal audit work in the period, but reviewed relevant reports to inform our understanding and approach. Internal audit reported that *"South Lanarkshire College did have adequate and effective risk management, control and governance processes to manage its achievement of the College's objectives at the time of our audit work. In our opinion, the College has proper arrangements to promote and secure value for money."*
Regularity	As part of our audit of the College's financial statements, we are required by the Public Finance and Accountability (Scotland) Act 2000 to give an opinion on the regularity of expenditure and receipts shown in the financial statements. The senior management team considers all incoming correspondence relevant to its strategic management role from the Scottish Funding Council and other regulatory or advisory bodies, such as Audit Scotland to ensure it is appropriately aware of sector issues and developments and that it complies with the terms and conditions of funding. Our consideration of expenditure throughout the course of our audit did not identify weaknesses in the control environment over regularity of expenditure and receipts, or instances of non-compliance with Scottish Funding Council terms and conditions.

Corporate governance arrangements (continued)

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

Performance management

Our perspective on the performance management arrangements

Performance management

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

Performance against sector indicators is measured by the College.

Best value	In April 2002 the Scottish Ministers introduced a non-statutory duty on accountable officers to ensure arrangements exist to secure Best Value. Audit Scotland has been committed to extending the Best Value audit regime across the whole public sector for some time. Using the Scottish Executive's nine Best Value principles as a basis for audit activity, Audit Scotland previously selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). A series of toolkits covering financial, performance and governance processes are available for public sector organisations and auditor to use, but auditors have not been required to complete specific toolkit(s) during the period. The College produces quarterly management accounts which compare actual expenditure to budget and has a procurement strategy which seeks to use the most advantageous supplier that is available. A value for money policy was developed by the College in July 2013 and sets out the College's aims, objectives and strategy for achieving value for money.
Performance indicators	In accordance with Scottish Funding Council requirements, the College is required to publish and report progress against national priorities. These indicators monitor the implementation of the College's financial objectives.

KPI	Actual 2013-14	Actual 2012-13
Prompt payment to suppliers	27 days	21 days
Non-SFC income as a % of income	22.8	28.2
Gearing	5.5	5.7
Current assets : current liabilities	0.59:1	1.18:1

The activity target set by Scottish Funding Council for 2013-14 was 50,707 wSUMs, and an additional allocation of 2,000 WSUMs was agreed during 2013-14. As at 31 March 2014, the College has delivered its target wSUMs for the year.

As the accounting period of the College has changed and the basis of funding and allocation of wSUMs in the Lanarkshire region continues to develop, together with changes in the local market, it is important that the College considers the range of performance indicators that are relevant to be measured on an ongoing basis. These should include value for money indicators and annual targets or limits should be agreed with the Board.

Appendices

Mandatory communications

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

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	There were no audit adjustments required to the draft financial statements which impacted on the net assets or the net expenditure for the period. A small number of numerical and presentational adjustments were required to some of the financial statements notes; these have been adjusted by management.	-
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you. There are no unadjusted audit differences identified above our materiality thresholds agreed with the audit committee.	-
Confirmation of Independence Letter issued by KPMG LLP to the audit committee	We have considered and confirmed our independence as auditor and our quality procedures, together with the objectivity of our Audit Director and audit staff.	Appendix 2
Schedule of Fees Fees charged by KPMG for audit and non-audit services	The audit fee in respect of the period was agreed in accordance with the scale specified by Audit Scotland. There were no non-audit services in 2013-14.	-
Draft management representation letter Proposed draft of letter to be issued by the College to KPMG prior to audit sign-off	There are no changes to the standard representations required for our audit from last year and there are no specific representations required for our audit for this period to draw to your attention.	-

Auditor independence and non-audit fees

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

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

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

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

General procedures to safeguard independence and objectivity

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

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

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

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

Confirmation of audit independence

We confirm that as of 25 September 2014, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

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

Yours faithfully

KPMG LLP

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