cutting through complexity

South Lanarkshire College

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

Audit: 16 month period ended 31 July 2015

11 December 2015

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"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

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 circumstances set out in the executive summary: scope and responsibilities.

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 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

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the *Code*"). This specifies a number of objectives for the audit.

In accordance with ISA (UK and Ireland) 260: *Communication with those charged with governance,* this report summarises our work in relation to the financial statements for the period ended 31 July 2015.

We wish to record our appreciation of the continued co-operation and assistance extended to us during the course of our work.

Area	Summary observations	Analysis
Strategic overview		
Key issues and update	As a result of organisational change within the further education sector, the College has changed accounting period for the second time in two years, from a 31 March year-end - changed to in 2014 - back to 31 July in 2015. The College has therefore prepared its financial statements for the 16 month period ended 31 July 2015 with comparatives for the 8 month period ended 31 March 2014. Due to late changes in the funding for all colleges during 2014-15, the College faced challenges in respect of student support funding during the period. These were successfully managed through agreement with New College Lanarkshire at a regional level and the reallocation of Scottish Funding Council ('SFC') funds for student support. The College is progressing the development of a new teaching facility on its existing site, which is due to be completed by December 2015. The College is forecasting increased student activity during 2015-16 and maintaining similar levels of core SFC funding with increased ESF funding. The College will be required to report 2015-16 accounts under the new FRS 102 accounting requirements, with the application of the new statement of recommended practice: *accounting for further and higher education* ("the SORP") 2014.	Page 7
Financial position	The College reported a deficit of £0.09 million in the 16 month period to 31 July 2015. The College's net assets decreased slightly by £0.26 million to £28.55 million as a result of the increased pension liability.	Page 8
Financial statements and accounting		
Audit conclusions	We intend to issue an unqualified audit opinion on the 2014-15 financial statements, following their approval by the Board of Management in December 2015. The financial statements were received by the start of audit fieldwork and were supported by high quality working papers.	Page 11

Headlines (continued)

Area	Summary observations	Analysis
Financial statements and accounting (cont.)		
Audit focus areas	The areas highlighted below are the specific audit focus areas identified within our audit strategy and additional areas identified during the course of the audit: ▪ student support funding; ▪ tangible fixed assets; ▪ retirement benefit obligations; ▪ change in accounting year end and income recognition; and ▪ treatment of net depreciation. The areas of audit focus were agreed with the management as part of our planning procedures and audit work has been completed to satisfy the requirements of ISA 330 'The auditor's procedures in response to assessed risks', including tests of key financial controls. In respect of each matter, we are content with management's judgements and accounting treatment.	Page 12
Going concern	Management has considered the funding available to the College in 2015-16 and consider it appropriate to adopt a going concern basis for the preparation of these financial statements. We have reviewed management's forecast for 2015/16, having due consideration of the agreement of SFC grant funding in respect of 2015-16, and are satisfied with management's assessment.	Page 15
Accounting policies	From April 2014 all Scottish colleges were reclassified by the UK office for national statistics ("the ONS") as public bodies. This has led to greater accountability for the use of public money in the college sector through additional financial reporting, since colleges must now comply with the requirements of the government financial reporting manual ("the FReM"), as well as the statement of recommended practice: *accounting for further and higher education* (2007). Colleges must therefore make additional disclosures, including a remuneration report and additional information about their estates strategy and resource outturn within the financial review. From April 2014 onwards, colleges must also adopt the current value basis for reporting their land and buildings. A new SORP that draws on the principles of FRS 102, will be applied in respect of the year ending 31 July 2016. The College will need to prepare a transitional balance sheet as at 1 April 2014 and a comparative balance sheet at 1 August 2015, together with restated comparative statement of comprehensive income for the period to 31 July 2015.	Page 15

Headlines (continued)

Area	Summary observations	Analysis
Governance and narrative reporting		
Governance	As public bodies, Scottish colleges have the new requirement for 2014-15 to take account of the Scottish public finance manual ("SPFM") in preparing their governance statement. In addition, colleges must demonstrate compliance with the code of good governance for Scottish colleges issued in December 2014 ("the code of good governance"). In the opinion of the Principal, the Chief Executive as Accountable Officer, and the Board, the College is compliant with its requirements under the code of good governance. Over-arching and supporting corporate governance arrangements remain primarily unchanged, in line with the core principles of the SPFM and the code of good governance and provide a sound framework for organisational decision-making.	Page 18
Internal controls	Testing of the design and operation of financial controls over significant risk points was undertaken. Our work concluded that controls relating to financial systems and procedures are designed appropriately and operating effectively. We raised two minor control recommendations, detailed at appendix five, relating to improving the effectiveness of journal review and documenting the review of reconciliations over an infrequently used bank account.	Page 20
Performance Management		
Performance management	The College produces management accounts which compare updated full year forecasts to budget and has a procurement strategy which supports the College's commitment to obtaining value for money. We raised one recommendations in respect of performance management relating to the format of management accounts and their reconciliation to the statutory position. Performance against sector indicators is measured by the College.	Page 23
Regularity	We intend to issue an unqualified opinion in respect of regularity of expenditure and receipts shown in the 2014-15 financial statements, following their approval by the Board of Management in December 2015.	Page 24

Scope and responsibilities

Purpose of this report

The Auditor General for Scotland ("the Auditor General") has appointed KPMG LLP as auditor of South Lanarkshire College under the Public Finance and Accountability (Scotland) Act 2000 ("the Act"). The period of appointment is 2011-12 to 2015-16, inclusive.

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

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

Board of Management responsibilities

Audit Scotland's *code of audit practice* ("the code") sets out South Lanarkshire College's responsibilities in respect of:

- preparation of financial statements that show a true and fair view;
- systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- financial position; and
- best value.

Auditor responsibilities

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

Scope

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.

Strategic overview

Our perspective on key business issues and financial position

Key business issues

The Scottish further education sector continues to undergo significant structural reform. Scotland's colleges have been reclassified as public bodies, which led to changes in accounting periods in each of the last two periods. This change restricts the scope for colleges to build up financial reserves.

Funding for the college sector has decreased in recent years and the College has faced challenges in meeting its student support funding commitments.

This context informed our audit strategy and audit focus areas, as detailed on pages 12-16.

Sector organisation and structural changes

In October 2010 the ONS reclassified incorporated further education colleges throughout the UK, so that from 1 April 2014 they would be treated as part of central government for financial budgeting and reporting processes. This also had the effect of requiring the College to prepare financial statements to 31 March 2014.

The Colleges of Further Education (Financial Year) (Scotland) Order 2015 came into force on 31 March 2015 with the effect of changing the College year end back to 31 July. The College has therefore prepared financial statements for a 16 month period, running from 1 April 2014 to 31 July 2015. The change has also impacted the College in a number of other respects:

- the College must continue to break-even, in resource terms, within each Scottish Government financial year (to 31 March), which results in reduced working capital balances and an increased focus on cash flow monitoring throughout the year, and in particular at 31 March 2015;
- additional accounting measurements and disclosures continue to be required to comply with the HM treasury financial reporting manual; the College had to revalue its land and buildings as at 31 July 2015; and
- management had to consider accounting entries required in respect of income recognition, which were more complex in respect of the shortened period in 2013-14 and the release or adjustment of which impacted on the longer accounting period in 2014-15.

Overall we are satisfied with management's response to the accounting impacts of these.

The sector organisation and structural changes informed our strategy and audit focus areas below. We detail our work against these areas on pages 12-16:

Tangible fixed assets
Following reclassification as a public body, land and buildings have had to be revalued and a restatement applied to the prior period.
The College is also undertaking a capital project in the development of a new teaching facility on site to increase capacity and improve its student offering.

Retirement benefit obligations
Participation in the Strathclyde Pension Fund results in a significant liability in the College accounts, valued annually by an external actuary and expected to fluctuate significantly depending on the actuarial assumptions year on year.

Treatment of net depreciation
The SFC requires that funding to the College in respect of depreciation must by used for specific approved purposes, including student support, regional pressures or paying down debt.

Student support funding
Reduced funding across the sector increasing the importance of managing student support funding. The College faced challenges in managing student support funding during 2014-15.

Change in accounting year end and income recognition
The change in accounting year end from 31 March back to 31 July increases the importance of income recognition and cut-off.

We are satisfied that these are appropriately addressed in the financial statements and did not identify any further areas for audit focus during the audit.

Financial position

The College is reporting a deficit of £0.09 million for the 16 month period (2013-14 £1.47 million).

On a like-for-like basis, income and expenditure are consistent with the prior period.

Financial position

The College is reporting a deficit for the 16 month period to 31 July 2015 of £0.09 million. This compares to a normal operating surplus of £0.03 million in the previous 8 month period after removal of a transfer of £1.5m to an arms length foundation. There were no such transfers during 2014-15. The reported position including the transfer was a deficit of £1.47 million.

The final outturn of a £0.09 million deficit compares to a budgeted surplus of £0.09m for management accounts purposes.

- This can be reconciled to the final outturn as follows:
  - FRS 17 adjustment not included in management accounts (£0.26m); and
  - Other immaterial adjustments to income and expenditure (£0.08m net).

Management accounts are not fully reconciled to the statutory reported position by management, during the period or at the period end. We raised a recommendation in respect of this at appendix five.

Income and expenditure account

Total income increased by £9.13 million when compared to 2013-14 but this is largely as a result of the change in accounting periods. Overall, on a like-for-like basis, based on management accounts information:

- Total income for the academic year 2014-15 decreased by 2%; and
- Total expenditure for the academic year 2014-15 decreased by 1%.

Full time equivalent staff numbers decreased from 237 to 235 in the 16 month period, however staff costs have increased slightly reflecting a pay award of 2.4% in August 2014. There have been no redundancies or severance packages in year.

Income and Expenditure Account

	2014-15 (16 months) £'000	2013-14 (8 months) £'000
Scottish Funding Council Grants	14,641	7,261
Tuition Fees and Education Contracts	3,480	1,777
Other Grant Income	147	114
Other Operating Income	94	121
Investment Income	102	56
Total income	18,464	9,329
Staff Costs	12,471	6,090
Other Operating Expenses	4,957	2,639
Transfer to arms length foundation	-	1,500
Depreciation	1,126	557
Interest and Other Finance Costs	-	11
Total expenditure	18,554	10,797
Deficit on continuing operations after depreciation of fixed assets and before taxation	(90)	(1,468)

Source: South Lanarkshire College financial statements 2014-15

Financial position (continued)

The College has net assets (including pension liability) at 31 July 2015 of £28.5 million (31 March 2014: net assets of £28.8 million).

Balance sheet

The College has net assets at 31 July 2015 of £28.5 million (2013-14: net assets of £28.8 million, restated). The key elements of the movement are set out below.

Assets

Tangible assets have decreased by £0.2 million. This is the result of depreciation in year of £1.1 million against existing assets exceeding capital additions of £0.9 million, primarily relating to the construction of a new teaching facility on site, expected to be complete in December 2015.

Debtors have decreased significantly by £1.4 million, primarily due to decreased amounts receivable from the SFC, with the realignment of the accounting year end with the academic year end.

Cash has increased by £0.4 million due to the timing of SFC funding receipts.

Liabilities

Short term creditors have decreased by £0.3 million, reflecting the re-alignment of the academic and financial year ends resulting in lower accruals and deferrals of income and expenditure.

Net pension liabilities in respect of participation in the Strathclyde Pension Fund increased by £0.6 million as a result of changes in demographic and financial assumptions in the actuarial valuation. This movement is considered in detail at appendix four.

Deferred capital grants increased by £0.3 million reflecting capital grants received in year for the development of the new teaching facility.

Balance sheet

	31 July 2015 £'000	31 March 2014 (as restated) £'000
Fixed assets		
Tangible assets	32,996	33,196
Current assets		
Stocks	8	8
Debtors	524	2,011
Cash	500	108
Creditors: Amounts falling due within 1 year	(2,215)	(3,581)
Net current liabilities	**(1,183)**	**(1,454)**
Creditors: Amounts falling due after 1 year	(783)	(1,086)
Provisions for liabilities and charges	(576)	(544)
Net pensions liability	(1,906)	(1,304)
Net assets including pension liability	**28,548**	**28,808**
Deferred capital grants	25,040	24,770
Reserves		
Pension reserve	(1,906)	(1,304)
Revaluation reserve	5,091	5,091
Income and expenditure account	323	251
Total funds	**28,548**	**28,808**

Source: South Lanarkshire College financial statements 2014-15

Financial statements and accounting

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

Audit conclusions

We intend to issue an unqualified audit opinion on the financial statements, the regularity of transactions reflected in those financial statements and the remuneration report.

The financial statements were accompanied by high quality working papers.

We communicated minor presentational adjustments to the governance statement to ensure it was in line with available guidance.

Audit conclusions

Our audit work is complete following receipt of management's representations and update of subsequent events. Following approval of the financial statements by the Board we intend to issue an unqualified opinion on the truth and fairness of the state of the College's affairs as at 31 July 2015, and of the College's deficit for the period then ended. We also intend to issue an unqualified opinion on the regularity of transactions within the year and the remuneration report. There are no matters identified on which we are required to report by exception. In gathering the evidence for our opinion we have:

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

Financial statements preparation

High quality working papers and draft financial statements were provided at the start of the audit fieldwork on 12 October 2015. The operating and financial review, governance statement and statement of responsibilities were received during the audit fieldwork and we suggested minor presentational adjustments to ensure they were in line with available guidance.

In advance of our audit fieldwork, we issued a 'prepared by client' request setting out a list of required analyses and supporting documentation. Reflective of the long standing working relationship with you, the standard of documentation was very good and there was evidence of accountability and ownership of working papers.

- Throughout the course of the year we have had regular communication and discussion with the College's finance team to ensure that disclosure within the financial statements was consistent with the requirements of the FReM. We provided feedback to management on the content of the financial statements, annual report, governance statement and we are pleased to report that these were consequently prepared appropriately.
- There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content, as reported in appendix two.
- We consider that management has maintained a robust control environment.

Significant risks and audit focus areas

The significant areas of risk identified in our audit strategy were in respect of:

- **management override of controls; and**
- **revenue recognition fraud risk;**

and other focus areas of:

- **student support funding;**
- **tangible fixed assets; and**
- **retirement benefit obligations.**

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

We have no changes to the risk or our approach to addressing the assumed ISA risks of fraud in management override of controls and risks of fraud in revenue recognition. We do not have findings to bring to your attention in relation to these matters. No control overrides were identified.

Focus area	Our response	Audit findings
Student support funding There was uncertainty regarding the level of funding for student support for 2014-15 and future years. The amounts due to be received from the SFC were reduced significantly in 2014-15 and the SFC required the College to utilise funding originally allocated for net depreciation to cover any funding gap.	We held discussions with management and corroborated student support funding received in the period to underlying accounting records. We reviewed internal audit findings on student support funds for the 2014-15 academic year and reconciled audited figures to those presented in the 16 month accounts. We inspected correspondence with SFC confirming student support funds for 2014-15 and 2015-16 financial years.	Student support funding was managed during the period and has been appropriately accounted for. Management held discussions with SFC and New College Lanarkshire (‘NCL’) during the year, resulting in the College securing additional funding to meet its student support needs. In total, SLC received £4 million in student support funds during the 16 month period and have confirmation of £2.8 million from SFC for the 2015-16 academic year. Management consider the 2015-16 funding for student support from SFC to be sufficient for the period.

Significant risks and audit focus areas

Focus area	Our response	Audit findings
Tangible fixed assets Following ONS re-classification, the College was required to update its accounting policy and adopt a valuation basis, incorporating land and buildings at a valuation as at 31 July 2015. As this is a change in accounting policy, a prior year adjustment is required in accordance with FRS 3 *reporting financial performance.* An external valuer was engaged by the College to value all its land and buildings. The College is progressing the development of a new facility on its East Kilbride campus, supported by a significant element of ERDF funding.	We tested the accounting entries for revaluation of the land and buildings and compared disclosure of restated prior year comparatives against SORP and FReM requirements. We corroborated valuations to valuer reports and assessed the objectivity of the College's valuer as a third party expert. We tested capital additions in the period and confirmed appropriate cut-off at year end.	We found that: ■ fixed assets were revalued in accordance with FRS 15; ■ the method of valuation, depreciated replacement cost, is in line with the FReM and appropriate for the nature of the assets; and ■ restatement of prior year comparatives is appropriately disclosed. ■ costs against assets under construction were accurately recorded;
Retirement benefit obligations The College accounts for its participation in Strathclyde Pension Fund in accordance with FRS 17: *Retirement benefits* on a defined benefits basis using valuation information prepared by actuarial consultants, recognising the pension liabilities in respect of its share of the scheme. The College's actuaries use membership data and 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.	We performed the following procedures to assess the College's retirement benefit liability: ■ KPMG specialists reviewed the financial assumptions underlying the actuary's calculations and compared these to our central benchmarks; ■ assessed the objectivity of the College's actuary as a third party expert; ■ tested the level of contributions used by the actuary to those actually paid during the year; ■ tested the membership data used by the actuary; and ■ agreed the financial statements disclosures to the actuarial report.	As at 31 July 2015 the College's liability in respect of retirement benefits has increased by £0.6 million to £1.91 million. We found that the actuarial consultant as a third party expert was objective and had the appropriate experience and expertise to provide the information for use by the College. Overall the assumptions used by the actuary were in line with our central benchmarks. The rate of increase to pension payments used by the actuary (RPI less 0.9%) fell slightly out with our expected range (RPI less 1%). We found that contributions and membership data used by the actuary were accurate, and that the financial statements disclosures agreed to the actuarial report.

Significant risks and audit focus areas

Focus area	Our response	Audit findings
Change in accounting year end and income recognition Income recognition remains a focus area due to the change in accounting reference date from 31 March back to 31 July. The requirement for the College to break-even, in resource terms as at 31 March 2015 for Scottish Government accounting and budgeting purposes, increases the risk of accounting adjustments during the accounting period subject to audit. The College's ability to spend and accumulate reserves remains restricted. Applications are made to the Foundation during the period, primarily to support capital expenditure. These must be accounted for in accordance with SFC communication number 14.	We audited income adjustments and recognition as part of our year end fieldwork, particularly in respect of year end cut-off. We considered applications for, and funding received from the foundation and the associated presentation and recognition in the financial statements.	We found that income was accounted for in the correct period, with appropriate year end cut-off applied. Applications to the foundation were appropriately approved on an arms-length basis and correctly presented in the accounts.
Treatment of net depreciation Following reclassification the College was given a cash budget to cover their costs, including depreciation (and a separate budget for fixed assets). An arrangement was agreed to allow this cash balance for depreciation in financial year 2014-15 to be spent by the College sector within certain parameters: either to bridge the student support funding gap; to address some specific regional pressures, or to pay down debt, where this represents value for money.	We considered the application of the depreciation budget cover as part of our year end audit procedures. We confirmed its use in the repayment of some of its Lennartz VAT liability, through corroboration to underlying records and bank statements. We reviewed the presentation of this repayment in the accounts.	The budget for net depreciation of £0.24 million was used for a repayment against a long term liability, in line with SFC guidance. This is appropriately presented in the accounts, as a reduction in the liability. The funding received in respect of this is correctly included within income. The College successfully applied for additional student support funding from the SFC to cover the cash shortfall and therefore this did not result in a significant increase to the budgeted deficit.

Accounting policies

The financial statements have been appropriately prepared on a going concern basis, having due consideration of the SFC grant agreement of SFC grant funding in respect of 2015-16.

Accounting framework and application of accounting policies		
Area	**Summary observations**	**Audit findings**
Accounting policies and financial reporting framework	From April 2014 all Scottish colleges were reclassified by the UK Office of National Statistics ("the ONS") as public bodies. This has led to greater accountability for the use of public money in the college sector through additional financial reporting, since colleges must now comply with the requirements of the Government Financial Reporting Manual ("the FReM"), as well as the Statement of Recommended Practice: *Accounting for Further and Higher Education* (2007) ("the SORP"). This change impacted the College's accounting policies in a number of respects: ■ additional disclosures, including a remuneration report and details about the College's estates strategy and resource outturn, must be included in the annual report; ■ the revaluation model for fixed assets was adopted from 2014-15 onwards with restatement of 2013-14 balances; and ■ it introduced a higher degree of judgement in the recognition of income for 2013-14, a shorter period, and the release of which impacted on the longer accounting period to 31 July 2015.	The College has prepared its accounts in line with the requirements of the SORP, the FReM, and the Scottish Funding Council's 2014-15 Accounts Direction for Scotland's colleges and universities. We are satisfied that the accounting policies remain appropriate to the College, and have been applied consistently.
Going concern	Management has considered the funding available to the College in 2015-16 and considers it appropriate to adopt a going concern basis for the preparation of these financial statements. SFC grant funding for 2015-16 is budgeted to be in line with the 2014-15 academic year, with increases in ESF Priority 5 funding and tuition fee income. The budgeted deficit for 2015-16 is £0.5m however this is due to depreciation and supported in principle by the SFC in line with the College's requirement to have a breakeven cash position. We have corroborated budgeted SFC income to the regional outcome agreement with New College Lanarkshire 2014-17. The College does not have any loan facilities at 31 July 2015 and does not plan to rely on any during 2015-16.	In assessing the College's ability to continue as a going concern we have reviewed the 2015-16 budget and 6 month cash flow forecast prepared by management. We concur with management's view that the going concern assumption remains appropriate for the reasons noted. Management should continue to monitor their cash position closely in the event of any unplanned expenditure.

Management reporting in financial statements

Our testing of the design and operation of financial controls over the production of the annual report and remuneration report are consistent with the financial statements.

Area	Summary observations	Audit findings
Annual report, including financial reviews	The financial statements form part of the annual report of the College for the period ended 31 July 2015. We have reviewed the contents of the annual report against the disclosure requirements and are content with the proposed reports. We provided management with some relatively minor suggestions relating to how the reports could be enhanced and where additional information disclosures should be made.	We are required to consider the annual report, including financial review, and provide our opinion on the consistency of it with the financial statements. We are satisfied that the information contained within the annual report is consistent with the financial statements.
Remuneration report	The Scottish Funding Council's accounts direction requires the preparation of a remuneration report in accordance with the Government Financial Reporting Manual (FReM), to be included in the financial statements for the first time in 2014-15.	We are satisfied that the format of remuneration report is in line with the FReM.
	The College received figures from the Scottish Public Pensions Agency ("SPPA") in support of the specific pension disclosures for senior officials, as required by the FReM. Other remuneration disclosures are derived directly from payroll information.	We have verified remuneration data reported to underlying records and information received from the SPPA and are satisfied that disclosures are accurate.

Governance and narrative reporting

Our overall perspective on your narrative reporting, including the remuneration report and annual governance statement

Update on controls findings from our audit

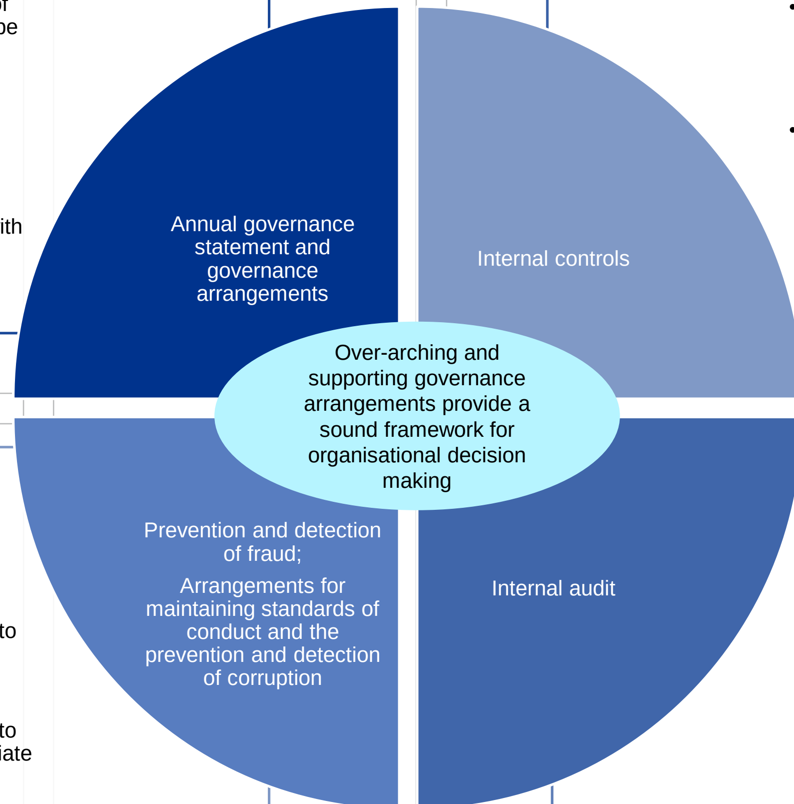
Corporate governance arrangements

We considered the College's corporate governance arrangements against a number of key areas which we consider to make up an effective governance framework.

Our audit findings against each key area are provided opposite.

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

- Controls relating to financial systems and procedures are designed appropriately and operating effectively.
- We raised two minor control recommendations in this report. We do not consider these to impact the overall control framework.



- The College's arrangements to prevent and detect fraud are appropriate.
- The College's arrangements to prevent and detect inappropriate conduct and corruption are appropriate

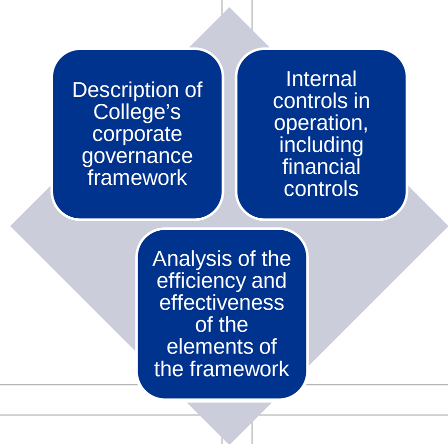
- Internal audit is compliant with the Public Sector Internal Audit Standards.

Corporate governance arrangements (continued)

Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.

Corporate governance statement

The College includes an annual governance statement within its annual accounts. The following elements have been included.



Governance arrangements

The College has a Board of Management which is supported by six committees, helping to ensure sound governance arrangements.

Compliance with the code of good governance for Scotland's colleges ("the code")

The code came into effect in December 2014, and since then the College's Board of Management has defined its overall responsibilities in accordance with the code. In the opinion of the Principal and Chief Executive as Accountable Officer, and the Board, the College is compliant with its requirements under the code.

Risk management

The Board has a risk management group which coordinates the College's risk management processes. Management is responsible for considering risks through the year at an operational level and escalating these to the risk management group as appropriate.

There is a main college risk register with risk scoring, controls and risk owners detailed. The risk management group is responsible for reviewing the top level risk register and ensuring effective links with departments.

Internal audit conducted a review of risk management in April 2015 and assessed the College's risk maturity as "risk managed", based on the Institute of Internal Audit's risk maturity scale, commenting that it is as well developed as any college they have reviewed and in the upper quartile of their clients across the public sector.

The risk management policy reviewed by the audit committee in September 2015 demonstrates a commitment to good practice.

We have updated our understanding of the governance framework and documented this through our overall assessment of the College's risk and control environment. We consider the governance framework to be appropriate for the College and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.

Corporate governance arrangements (continued)

We raised two recommendations from our controls testing in respect of journals exception reporting and review of a specific bank account reconciliation.

The College has procedures in place for the prevention and detection of fraud and corruption.

Internal controls

The College management is responsible for designing and implementing appropriate internal control systems to ensure a true and fair view of operations within the annual accounts. Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively.

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

We raised two recommendations from our controls testing relating to the review of journals and monthly reconciliations of the management expenses bank account.

Recommendations one and two

Prevention and detection of fraud

No material fraud or other irregularities were identified during the year. The financial regulations detail responsibilities in relation to fraud, supported by anti-bribery and whistle-blowing policies.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

The College has arrangements including policies and codes of conduct for staff and board members, supported by a whistleblowing policy. Board members are responsible for setting the 'tone at the top' and for abiding by the code of conduct and disclosing interests which may be of importance – material or otherwise – to their work at the College. We consider these appropriate for the College's purposes to prevent and detect inappropriate conduct and corruption.

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

We consider that the College has appropriate arrangements to prevent and detect fraud.

The College's internal auditors support management in maintaining sound corporate governance arrangements and internal controls. We have found internal audit to be compliant with the Public Sector Internal Audit Standards.

Internal audit

Internal audit supports management in maintaining sound corporate governance and internal controls through the independent examination and evaluation of control systems and the reporting of any weaknesses to management for action.

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

From this assessment, and considering the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*, we can apply internal audit's work to inform our procedures, where relevant. The review of internal audit reports and conclusions did not indicate additional risks and there is no impact on our planned substantive testing.

Internal audit has completed its agreed plan for the period ended 31 July 2015. The Internal Audit Annual Report 2014/15 states that the College has a framework of controls in place that provides reasonable assurance regarding the effective and efficient achievement of the College's objectives and the management of key risks. The graphic opposite provides a summary of internal audit's work during the year.

Summary of internal audit work

- Agreed plan completed for the year.
- Four reviews and follow up of prior year recommendations completed.
- Out of a total of 11 findings, there were no 'high' risk findings.
- Annual audit opinion provides reasonable assurance regarding the effective and efficient achievement of the College's objectives and the management of key risks.

We have concluded that the internal audit service operates in accordance with Public Sector Internal Audit Standards.

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

Performance management

Our perspective on the performance management arrangements, including follow up work on Audit Scotland reports

Performance management

Our work has identified that the College's best value and performance management arrangements are generally robust.

We raised one recommendation in respect financial performance management, relating to the reconciliation of management accounts to statutory outturn.

Performance management and best value

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

The College produces quarterly management accounts which compare budgeted income and expenditure with latest full year forecasts. We raised one recommendation in respect of the format of management accounting at appendix five.

Recommendation three

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

The College exceeded its weighted student units of measurement ("WSUMs") target for 2014-15 of 55,167, with 55,432 delivered.

In accordance with Scottish Funding Council requirements, the College is required to publish and report progress against national priorities. Within these are financial indicators as disclosed opposite.

Non-SFC income as a percentage of total income fell slightly to 20.8% (2013-14: 22.2%). This follows a slight reduction in tuition and other fees income, however does not indicate any significant increase in reliance on SFC funding. The College continues to seek additional non-SFC funding, as evident in their 2015-16 budget with increased tuition fee and ESF priority 5 funding.

Prompt payment to suppliers fell to 18 days (2013-14: 27 days). This was due to the management of cashflow following transfer to the foundation in 2014.

Indicator (by academic year)	Target 2014-15	Actual 2014-15	Actual 2013-14
Weighted student units of measurement ("WSUMs")	55,167	55,432	52,924
Indicator (by financial year)		**Actual 2014-15**	**Actual 2013-14**
Operating surplus / (deficit) before exceptional items as a % of income*		(0.5%)	0.3%
Non SFC income as a % of income		20.8%	22.2%
Current assets: current liabilities		0.47:1	0.59:1
Gearing**		3.6%	4.8%
Days cash to expenditure		10	5
Prompt payment to suppliers		18 days	27 days
Net assets including pension provision		£28.5m	£27.4m

Source: South Lanarkshire College financial statements 2014-15

*after removal of transfer of £1.5 million to arms length foundation in 2013-14
**including "Lennartz" mechanism liability

We have concluded that the College's best value and performance management arrangements are generally robust.

Performance management (continued)

We have prepared a return to Audit Scotland in 2014-15 in respect of our findings on financial capacity within the College.

We are required to provide an opinion on the regularity of expenditure and receipts shown in the financial statements.

Financial capacity in public bodies

Through the process of feedback through Annual Audit Reports, current issues reports and sector meetings, Audit Scotland has identified that overall reductions in staff numbers in public bodies may be affecting the capacity of back-office functions and specifically finance.

Audit Scotland has requested the collation of baseline data across the public sector to inform sector specific overview reports and may inform a follow-up to the joint report on the public sector workforce which was published in November 2013 or support the development of the future performance audit programme.

We have completed a return to Audit Scotland in respect of our findings. Our review in response to the request for data collection identified that there is appropriate financial capacity within the organisation to ensure effective management.

We note an improvement required in respect of the long term financial planning of the College. The College has a strategic plan for the period 2014-20, with financial plans prepared annually for the academic year ahead, however does not have a long term financial strategy.

We also note an improvement in respect of management accounts reporting. These are not fully reconciled to the statutory reported position, either during the period or at the period end. In addition, management accounts are based on forecast rather than actual data. We raised a recommendation in respect of this at appendix five.

Recommendation three

Regularity

As part of our audit of the College's financial statements, we are required by the Public Finance and Accountability (Scotland) Act 2000 to give an opinion on the regularity of expenditure and receipts shown in the financial statements.

The executive team considers all incoming correspondence relevant to its strategic management role from the Scottish Funding Council and other regulatory or advisory bodies, such as Audit Scotland to ensure it is appropriately aware of sector issues and developments and that it complies with the terms and conditions of funding.

Our review of expenditure throughout the course of our audit did not identify weaknesses in the control environment over regularity of expenditure and receipts, or instances of non-compliance with Scottish Funding Council terms and conditions.

We consider that the College has appropriate financial capacity to effectively manage the organisation.

We intend to issue an unqualified opinion in respect of regularity of expenditure and receipts shown in the financial statements.

Appendices

Mandatory communications

We identified one adjustment to the core financial statements, with no impact on net assets or net operating cost for the year.

There are no unadjusted audit differences

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	We identified one adjustment to the draft financial statements, with no impact on the net assets or net operating cost for the year. A small number of minor numerical and presentational adjustments were required to some of the financial statement notes.	Appendix two
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.	-
Confirmation of Independence Letter issued to the Audit Committee	We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Partner and audit staff.	Appendix three
Schedule of Fees Fees charged by KPMG for non-audit services	KPMG did not provide any non-audit services to the College in 2014-15	-
Draft management representation letter Proposed draft of letter to be issued by the College to KPMG	There are no changes to the standard representations required for our audit from last year.	-
Materiality The materiality applied to audit testing.	We assessed materiality based on our knowledge and understanding of the College's risk profile and financial statements balances. Materiality was determined at £247,500; approximately 1.5% of total expenditure, and is consistent with the materiality identified in our audit strategy. We designed our audit procedures to detect errors at a lower level of precision, i.e. £185,500. We report identified errors greater than £12,500 to the audit committee.	-

Adjusted audit differences

We identified one adjustment to the core financial statements, with no impact on net assets or net operating cost for the year.

There are no unadjusted audit differences

Adjusted and unadjusted audit differences

We are required by ISA (UK and Ireland) 260 to communicate all corrected and uncorrected misstatements, other than those which are trivial, to you. There was one adjusted audit difference and no unadjusted audit differences.

		Balance sheet £'000		Income and expenditure account £'000	
Nature of adjustment	**Caption**	**DR**	**CR**	**DR**	**CR**
Disclosure of student support funding relating to HE and FE childcare within income and expenditure					
Childcare student support funding is required to be shown gross within income and expenditure (unlike other categories of student support funding).	Income – Scottish Funding Council Grants - FE and HE childcare	-	-	-	(383)
An adjustment to this amount disclosed was identified by audit and corrected by management. Net nil impact to income and expenditure account.	Expenditure – Other operating expenses – FE and HE childcare	-	-	383	-
Net impact			-		-

Auditor independence

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.

Auditor independence

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 Partners and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- 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 directors.

Confirmation of audit independence

We confirm that as of 11 December 2015, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Partner and audit staff is not impaired.

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

Yours faithfully

KPMG LLP

Defined benefit obligations

In respect of employee benefits, each of the assumptions used to value the College's net pension deficit are within an acceptable range of KPMG's expectations, with the exception of pension increase rate which is considered to be prudent.

However, we are of the view that overall this represents a reasonable and balanced approach, in accordance with the requirements of FRS 17.

We set out below the assumptions in respect of employee benefits.

Defined benefit pension liability		
31 July 2015 £'000	**31 March 2014 £'000**	**KPMG comment**
(1,905)	(1,304)	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the IAS19 pension scheme valuation. Details of key actuarial assumptions are included in the table, along with our commentary.

Assumption	Hymans Robertson	KPMG central	Comment
Discount rate (duration dependent)	Less than 17 years: 3.50% Between 17 and 23 years: 3.60% More than 23 years: 3.70%	17 years : 3.60% 20 years: 3.65% 23 years: 3.70%	Acceptable. The proposed discount rates are within an acceptable range of KPMG's central rates as at 31 July 2015.
CPI inflation	RPI less 0.9%	RPI less 1.0%	KPMG's view is that the differential between RPI and CPI should be closer to 1%. The College's assumptions could therefore be considered prudent (higher liability).
Net discount rate (discount rate – CPI)	1.00% - 1.10%	1.20%	Acceptable. The proposed assumptions are within the acceptable range of +/- 0.3% from the KPMG central range.
Salary growth	RPI + 1.0%	Typically 0% - 1.5% above inflation	Acceptable. The proposed assumption is consistent with the latest triennial valuation and is acceptable under FRS 17.

The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of more than 23 years. The closing deficit increased by £0.4 million compared to 2013-14, primarily due to changes to actuarial assumptions, including a decrease in the real discount rate and increased life expectancies. A reconciliation from opening to closing deficit is included on the next page.

Defined benefit obligations

The table opposite shows the reconciliation of the movement in the statement of financial position.

Increases to the pension scheme deficit in the year have been driven primarily by increased service costs and altered actuarial assumptions, offset by increased contributions.

	£'000	Deficit / loss	Surplus / gain	Impact	Commentary
	Opening pension scheme deficit			**(1,304)**	The opening FRS 17 deficit for the Scheme at 1 April 2014 was £1.3 million, consisting of assets of £7.6 million and defined benefit obligation of £8.9 million.
I & E	Service cost			(736)	The employees' share of the cost of benefits accruing over the period is £0.7 million.
I & E	Past service cost			0	No past service cost relating to early retirement over the year is recognised.
I & E	Net interest			97	This is the interest on the opening deficit of £1.3 million. This is made up of £0.6 million interest income on plan assets, and £0.5 million interest cost on obligations.
Cash	Contributions			477	The College made contributions of £0.5 million. This is proportionately higher than contributions made in the previous period due to increased active members in the scheme (132 compared to 117)
STRGL	Actuarial losses – demographic and financial assumptions			(440)	Actuarial losses of £0.4 million are as a result of changed actuarial assumptions, including increased life expectancy assumptions and a decrease of 0.5% to the real discount rate.
	Closing pension scheme deficit			**(1,906)**	The closing FRS 17 deficit on the scheme at 31 July 2015 is £1.9 million consisting of assets of £8.5 million and defined benefit obligation of £10.4 million).

I&E – impacts on surplus /(deficit) within statement of comprehensive net expenditure
Cash – cash-flow impact
STRGL – charged through statement of total recognised gains and losses

Action plan

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

We raised three recommendations:

- **Journals exception reporting**
- **Review of bank reconciliation – specific bank account**
- **Review of management accounts format and reconciliation to statutory reporting**

Priority rating for recommendations

Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Journals exception reporting (page 20)		**Grade three**
Journals are subject to high level review by the head of finance. Journals posted by the head of finance are not subject to secondary review. To mitigate the risk of journal posting errors being undetected, review controls should be strengthened.	Exception reports should be run quarterly to identify journals with higher risk of fraud or error, for example those posted on weekends, to cash, or with rounded amounts. Unusual journals should be reviewed to confirm their accuracy and appropriateness.	**Responsible officer:** Head of Finance **Implementation date:** 31 December 2015 Hard copy exception reports will be run quarterly by the Financial Accountant, annotated with explanations for unusual entries and then discussed with the Vice-Principal who will initial as evidence of review.
2 Review of bank reconciliation – specific bank account (page 20)		**Grade three**
Monthly bank reconciliations are prepared appropriately for all bank accounts. For one bank account however, these are not subject to secondary review. Our testing of a sample of expenditure from this account found appropriate authorisation and did not identify any irregularities, however secondary review of reconciliations would mitigate the risk of inappropriate expenditure being undetected.	Monthly bank reconciliations for the management expenses bank account should be subject to secondary review by a senior member of the finance team. Review should be documented.	**Responsible officer:** Head of Finance **Implementation date:** 31 December 2015 Hard copy management expenses bank account reconciliations will be reviewed by the Financial Accountant and initialled as evidence of review.

Action plan

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
3 Management accounts preparation and reconciliation to statutory reporting (page 24)		**Grade three**
Management accounts are prepared on a quarterly basis and reported to the Board. Information presented includes a comparison of the original budget to the re-forecasted year end position with explanations for all significant variances, but does not include actual income and expenditure in the period and does not reconcile to statutory reporting. With significant changes in the reported surplus or deficit expected from the implementation of FRS 102, there is a risk that the Board does not receive full visibility of the forecast statutory position through the period.	The format of management accounts should be reviewed and revised to include: - Detail of actual income and expenditure in the period, taken from the general ledger, and compared to budget. - Detail of how the forecast position in management accounts would appear within statutory reporting. Reconciliation should be carried out at least annually between management accounts and statutory reporting.	**Responsible officer:** Head of Finance **Implementation date:** 31 December 2015 The management accounting system operated by the College has operated successfully for many years and the small differences between the forecast results as the audited results show. Over the past 18 months, we have been looking at ways to refine this process to both improve the quality of information reported to the Board and also make quarterly reporting to SFC less labour intensive. This is complicated by the information to be reported to SFC changing/evolving and also by the fact that the information reported to SFC is a mixture of cash and accruals accounting. Additional complexities are encountered working with two budgets, one for the period to 31 March and the other for the period to 31 July. Management reporting will be further complicated by the introduction of FRS 102 which will introduce differences in the way certain items are accounted for in future. Overall, reporting within the College sector is in a state of flux and until things settle down we see little merit in changing the way we successfully control the business with a focus on cash flows and forecast results. With breakeven accounting becoming the norm in the College sector, cash will be king and Boards will increasingly focus on cash, with statutory financial statements merely a compliance requirement We will carry out a reconciliation between management accounts and statutory accounts annually.

cutting through complexity