HENDERSON LOGGIE
Chartered Accountants

Forth Valley College

Annual Audit Report for 2015/16 to the Board of Management and the Auditor General for Scotland

External Audit Report No: 2016/02

Draft Issued: 21 November 2016
Final Issued: 8 December 2016

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Executive Summary

Financial Statements

- On 8 December 2016 we issued an audit report with an unqualified opinion on the financial statements of the College for the year ended 31 July 2016 and on the regularity of the financial transactions reflected in those financial statements.

- Three new accounting standards (Financial Reporting Standard (FRS) 100, 101 and 102) came into force in 2015/16, with comparative figures for 2014/15 restated where relevant using these new standards. In addition, a new Education Statement of Recommended Practice (SORP) has been implemented for the 2015/16 financial statements.

- The current financial period covers the year to 31 July 2016. The comparative period is the 16 months from 1 April 2014 to 31 July 2015. Colleges have been allowed to align their financial year to the academic year, although they are still required to meet HM Treasury budgeting and reporting requirements at a March year end.

- The College has shown a deficit for the year ended 31 July 2016 (before 'other comprehensive income') of £2.085 million (deficit of £2.299 million (restated) for the 16 months ended 31 July 2015). The College has an Income and Expenditure Account balance of £(21.158) million at 31 July 2016 (including pension reserve of £(16.804) million) (31/07/15: £(17.076) million (restated) including pension reserve of £(13.416) million).

- The College met its Credits target for the academic year to 31 July 2016 (14/15: target met).

- Income of £0.339 million from the Forth Valley College Foundation, an arms' length body, has been included in the Statement of Comprehensive Income. This is part of the £1.800 million grant that on 24 June 2015 the Forth Valley College Foundation agreed to award to the College for assistance with the new Falkirk campus redevelopment project.

- There was expenditure of £1.739 million during the year (14/15: £0.176 million) by the College on consultants and other costs related to the Full Business Case for a new Falkirk campus. This has been included in the Statement of Comprehensive Income.

- The College's Local Government Pension Scheme (LGPS) pension liability increased in total by £3.388 million during the year to £16.804 million at 31 July 2016, which was largely due to changes in key actuarial assumptions relating to discount rates, along with net interest on the increased pension liability and a £0.399 million extra charge for the current cost of pensions under FRS102.

- The College's Middlefield site was revalued at 31 July 2016, which led to an impairment of £1.650 million being recognised against the revaluation reserve through other comprehensive income. The reason for the impairment was that ground surveys identified that significant piling works would be required before building on the site which had not previously been known.

- The annual financial statements of the College comply with the Accounts Direction issued by the Scottish Funding Council (SFC), the SORP on Accounting for Further and Higher Education and, as far as applicable, the Government Financial Reporting Manual 2015/16 ('the FReM').

Financial Statements (Continued)

- There was a prior period adjustment made to the enhanced early retirement provision expenditure for 2014/15 as a result of an actuarial error, and this reduced the 2014/15 deficit by £1.543 million.

- Six audit and accounting adjustments were made to the draft financial statements presented for audit; which had the impact of increasing the reported deficit for the year by £1.525 million. The main reason for this was the impact of the error in the actuarial calculations (£1.525 million), with the other five items not having any net impact on the deficit for the year.

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

Corporate Governance

- A Performance Report and Accountability Report (including a Governance Statement and Remuneration and Staff Report) are included in the annual report, replacing the Operating and Financial Review that was included in previous years.

- The College's Governance Statement confirms that corporate governance has been exercised throughout the year in accordance with the principles of the Code of Good Governance for Scotland's Colleges (with one exception in relation to the role of the Secretary to the Board, which has been explained in the report and financial statements), the Scottish Public Finance Manual (SPFM) and the SFC Financial Memorandum with colleges.

- No material weaknesses in the accounting and internal control systems were identified during the 2015/16 financial statements audit which would adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements. Some areas were however identified from our systems controls testing during 2015/16 where controls could be further improved to bring them more into line with good practice.

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

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

Performance

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

- A Regional Outcome Agreement with the SFC was in place for 2015/16 and the Self-Evaluation review of this found that most key targets had been met.

Outlook

- The funding position will remain challenging going forward. Commercial work has been an important income source to generate extra income for the College. However the downturn in the oil and gas sector, which is affecting commercial income, and the impact of national pay bargaining proposals are of significant concern and robust budget setting and monitoring arrangements will be essential in helping to retain sustainability.

- The College's total funding allocations for the 2016/17 academic year from the SFC for Teaching and Fee Waiver is £20.148 million, an increase of £0.375 million from 2015/16 and with the equivalent academic output (16/17 and 15/16: 83,984 Credits). The College's capital allocation for 2016/17 from the SFC has increased by £0.225 million to £1.281 million (2015/16: £1.056 million).

- The College's planned Falkirk campus redevelopment project is progressing with a Full Business Case having been developed by the College in conjunction with appointed consultants. This is planned to be funded by the SFC through capital funding and approval to progress the project into procurement was received from the Scottish Government on 29 November 2016.

Introduction

Background

1. 2015/16 was the fifth and final year in our five-year appointment as external auditors of Forth Valley College ('the College'). This report summarises our opinion and conclusions and highlights significant issues arising from our work. It covers the communication of findings from the audit required by International Standard on Auditing (ISA) (UK and Ireland) 260: Communication of Audit Matters with Those Charged with Governance. The financial statements for 2015/16 cover the 12-month period to 31 July 2016 and the comparative figures are for the 16-month period to 31 July 2015. Paragraph 27 explains the reasons for this.

2. The audit framework is outlined in our Strategic Planning Memorandum and 2015/16 Annual Audit Plan issued on 19 May 2016 and considered and approved by the Audit Committee at its meeting on 2 June 2016. The scope of the audit was to:

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

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

   - audit specific parts of the remuneration report;

   - read and express an opinion on whether the Performance and Accountability Reports are consistent with the financial statements; and

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

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

   - compliance with legislation and financial regulations;
   - fixed assets transactions, including consideration of any impairment as a result of revaluation or asset conditions, on-going estate improvements and maintenance; and compliance with relevant financial reporting standards;
   - recoverability of debtors;
   - recognition of funding provided for specific purposes and the regularity of corresponding expenditure;
   - review of expenditure on the Full Business Case;
   - compliance with FRS102 regarding the provision for pension liabilities and provision for early retirals; and
   - compliance with the SORP on Accounting for Further and Higher Education, FReM and Accounts Direction.

Basis of Information

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

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

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

Acknowledgement

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

Financial Statements

Audit Opinion

8. On 8 December 2016 we issued an audit report with an unqualified opinion on:

- the financial statements of the College for the year ended 31 July 2016;
- the regularity of the financial transactions reflected in those financial statements; and
- other prescribed matters, being the part of the Remuneration Report to be audited and the consistency of the information in the Performance and Accountability Reports, governance statement and other annual report sections with the financial statements.

9. We are required to undertake audit work from the Balance Sheet date up to the date of signing the financial statements and this was undertaken in the period up to 8 December 2016 to determine if there are any post balance sheet events that require adjustment to be made to the financial statements or additional disclosure in a note thereto. Scottish Ministers approval of the Full Business Case for a new Falkirk campus was given on 29 November and this has been disclosed in note 35 of the accounts.

Identified Risks of Material Misstatement and Materiality

10. At the planning stage of the audit we identified some key areas of focus which we considered had the greatest effect on the overall audit strategy, the allocation of resources in the audit, and directing the efforts of the audit team. The findings from our audit work on these items are set out below. Management override of controls and income recognition are included below as there is a presumption within international auditing standards for all audits to take account of these areas.

Key audit area	Our planned approach	Our findings
Completeness of income	We planned to review all significant revenue streams and transactions and, through a combination of analytical review, compliance testing of key controls and detailed substantive testing, obtain comfort that these transactions appear reasonable based on our knowledge of the College.	Our review of key income streams did not identify any items which had been omitted or accounted for incorrectly.
Management override of controls	Our approach was to review any significant unusual transactions to ensure that they appeared reasonable in the context of our knowledge of the business.	We did not identify any significant unusual transactions or manual postings that did not have adequate back-up or management explanations.

Key audit area	Our planned approach	Our findings
The College may not comply with legislation and financial regulations	We planned to identify major areas of legislation and financial regulations that the College is required to comply with, consider the risk of non-compliance of each, and consider whether there may be a material financial impact from these. We then planned to discuss with management what key controls are in place to ensure compliance and asked whether any actual, suspected or known instances of non-compliance had been noted.	Results from our testing were satisfactory.
The College may not properly account for its capital projects expenditure and related funding or fixed assets transactions. This includes consideration of any impairment as a result of revaluation or asset conditions, on-going estate improvements and maintenance; and compliance with relevant financial reporting standards	We planned to review a sample of capital expenditure to ensure it was appropriate to capitalise this. We also planned to review significant accounts of a repairs and maintenance nature, and expenditure on the Full Business Case for the new Falkirk campus, to determine whether it was appropriate to expense these items. Our approach regarding impairment was to identify all significant assets and consider whether there were any conditions that might give rise to an impairment, and check that any impairments made had been correctly treated.	Results from our testing were satisfactory.
The College may fail to recognise funding provided for specific purposes appropriately	Our approach was to review all significant ring fenced funds and check whether grant terms and conditions had been met before recognising income.	Results from our testing were satisfactory.
The College may not achieve its planned budget resulting in a deterioration of the financial position, non-compliance with financial covenants and going concern issues	We considered the process undertaken by management to satisfy themselves that the going concern basis of preparation of the financial statements was appropriate. We also reviewed relevant evidence available, including management accounts and the Forecast Financial Return to the SFC.	As part of auditing procedures, auditors must consider whether an entity can continue to operate for a period of 12 months from the date of signing the financial statements. This needs to be considered on an annual basis. Based on our review we consider the College is a going concern.

Key audit area	Our planned approach	Our findings
Compliance with the SORP on Accounting for Further and Higher Education, FReM and Accounts Direction	We planned to check whether disclosures and accounting treatment was in line with the SORP, FReM and Accounts Direction through reviewing the requirements and completing checklists to ensure that the requirements were being met.	Our review found a small number of items requiring amendment. The College amended these for the final version of the financial statements.

11. We told you materiality at the planning stage was £0.299 million. This was revised once draft financial statements were received to £0.335 million. Performance materiality was revised to £0.234 million from £0.209 million, and the amount below which items were deemed to be clearly trivial became £0.023 million. We determined materiality based on the College's annual income.

Audit Completion

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

Table 1: Key elements of the audit process

Completeness of draft financial statements
A set of draft financial statements was received on 17 October 2016, the first day of the audit fieldwork. The first draft did not include the Performance Report, Accountability Report (including Corporate Governance information) and a number of financial statement disclosures. These were received on 14 November 2016 after the audit fieldwork had been completed. These were of a high standard and required minimal presentational changes as part of the audit process.

Quality of supporting working papers
Working papers provided to support financial statement figures were of a good standard.

Response to audit queries
Audit queries were dealt with in a timely manner.

Corporate Governance Statement

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

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

Corporate Governance Statement (Continued)

15. The College's Governance Statement for 2015/16 confirms that corporate governance has been exercised throughout the year in accordance with the principles of the Code of Good Governance for Scotland's Colleges (with one exception in relation to the role of the Secretary to the Board, as detailed in paragraph 58 below, and which has been explained in the report and financial statements), the SPFM and the SFC Financial Memorandum with colleges.

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

Remuneration and Staff Report

17. 2015/16 is the second time a Remuneration Report has been required in college financial statements and this has been expanded for 2015/16 to include additional information in a Staff Report. The information to be included is prescribed by the FReM.

18. We are required to audit part of the Remuneration and Staff Report and review the remainder as part of our review of the Performance and Accountability Report. We express a specific opinion on whether the audited part has been properly prepared.

19. We received the Remuneration and Staff Report for audit on 17 October 2016. From the work done we were satisfied that we could give an unqualified opinion.

Performance Report and Accountability Report

20. The SORP sets out the requirements for a Performance Report and Accountability Report (which replaces the Operating and Financial Review prepared in previous years) to be included in the financial statements. The content is prescribed through the Accounts Direction from the SORP and the FReM.

21. We review the information provided in the Performance Report and Accountability Report and consider whether or not it is consistent with the financial statements and other information we have gathered in the course of our audit. We are not required to verify, or report on, the completeness of the information in the Performance Report and Accountability Report, with the exception of the audited element of the Remuneration and Staff Report.

22. We received the Performance Report and Accountability Report on 14 November 2016 and concluded that an unqualified opinion could be provided for this.

Audit and Accounting Adjustments and Confirmation

23. In Table 2 we draw attention to the agreed audit and accounting adjustments to the financial statements made by management following the audit process which had the impact of increasing the 2015/16 deficit by £1.525 million. With the exception of item 2, which processed the actuarial error on the early retirals pension provision, none of the adjustments were material.

Audit and Accounting Adjustments and Confirmation (Continued)

Table 2: Audit and accounting adjustments

	Description	I&E DR £'000	I&E CR £'000	B/Sheet DR £'000	B/Sheet CR £'000
1	*14/15 (prior period adjustment)*				
	LGPS pension liability			100	
	Income and Expenditure Reserve				100
	15/16				
	Income and Expenditure Reserve			4	
	Interest and other finance costs		4		
	Being adjustment for actuarial error relating to LGPS pension				
2	*14/15 (prior period adjustment)*				
	STSS pension liability			1,543	
	Income and Expenditure Reserve				1,543
	15/16				
	Pension Provision Charge	1,529			
	STSS pension liability				1,529
	Being adjustment for actuarial error relating to STSS early retirement pension				
3	Staff costs	12			
	Accruals				12
	Being accrual of pension costs on holiday pay entitlement not initially included				
4	Staff costs	19			
	Accruals				19
	Being accrual for voluntary severance for one staff member				
5	Accrued income			31	
	Other grant income		31		
	Being extra accrual for income from the Forth Valley College Foundation				
6	Accrued income			113	
	Other creditors				113
	Being accrual of income from SFC for Student Support Funds				
	Total (2015/16 impact only)	**1,560**	**35**	**148**	**1,673**
		=====	=====	======	======
	Overall increase in Deficit	**1,525**			

Audit and Accounting Adjustments and Confirmation (Continued)

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

Confirmations and Representations

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

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

Financial Reporting

27. Scottish colleges were reclassified as Government Bodies from 1 April 2014, resulting in a change of financial year-end to 31 March. From 1 April 2014 Incorporated Colleges and Regional Boards were required to comply with the SPFM, except where directed by SFC's Accountable Officer. Financial reporting is now undertaken in accordance with HM Treasury's FReM 2015/16 in addition to the SORP on Accounting for Further and Higher Education and the SFC's Accounts Direction. As a result:

- in 2013/14 colleges prepared financial statements for an eight month period to 31 March 2014;

- following this change colleges were allowed to return to the 31 July financial year-end although they are still required to meet HM Treasury annual budgeting and reporting requirements at March. The financial period for 2014/15 covered the 16 months from 1 April 2014 to 31 July 2015;

- the 2015/16 financial period covered the 12 months to 31 July 2016;

- in April 2016 the College submitted the required Resource and other returns for 31 March 2016 to the SFC. In September, as allowed, an update was submitted which made the following adjustments:
  - ♦ Other income – reduction in grant from Arm's Length Foundation to College £(0.011) million
  - ♦ Operating costs – Reversal of accrued costs £0.011 million
  - ♦ Pension liability adjustment (to reflect impact of pension on the Comprehensive I&E Statement as at 31 July 2016 £0.089 million

28. The application of the FReM results in some changes and additional disclosure, including a Performance Report and Accountability Report.

Financial Reporting (Continued)

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

29. The FRC has been implementing a convergence programme aligning UK Generally Accepted Accounting Practice (GAAP) to International Financial Reporting Standards (IFRS) and published three new FRSs (FRS 100, 101 and 102) with the substantive FRS 102 'The Financial Reporting Standard' representing the final step towards IFRS convergence. These three new FRS' became the new UK GAAP, which is fully IFRS-based. The new accounting standards came into force in the 2015/16 financial statements, which included comparative figures for 2014/15 being restated in the 2015/16 financial statements. The main areas of change for the College related to the treatment of deferred capital grants, pension costs and the interest rate swap.

30. In addition, a new Education SORP was effective for 2015/16 which follows FRS102, and provides specific details on disclosure of the main statements. The new SORP is available at www.fehesorp.ac.uk.

Financial Position

31. Colleges are required to break even in line with their agreed spending budgets each year to 31 March. For 2015/16, as noted in the financial statements at note 36, the SFC has allowed colleges to treat the depreciation allocation of their budgets as if it was a cash resource, thereby contributing to the deficit in the Statement of Comprehensive Income. There are also a number of other non-cash items impacting on the deficit position. Table 3 provides a summary of the College's planned and actual financial results.

Table 3: Comparison of planned and actual financial results

	2014/15 (16 months) Actual £000	2015/16 (12 months) Planned £000	2015/16 (12 months) Actual £000	2016/17 (12 months) Planned £000
Financial outturn Surplus/(Deficit) (before 'other comprehensive income')	(2,299) restated	63	(2,085)	(603)
Income and expenditure reserves (excluding pension reserve)	(3,660) restated	(2,822)	(4,354)	(4,986)
Cash balances	1,609	1,735	926	1,324

Source: Audited financial statements and June 2015 and June 2016 Forecast Financial Return (FFR)

32. The deficit of £2.085 million includes the following non-cash items:

	£'000
Use of depreciation cover	608
STSS Early retirement pension revaluation	547
LGPS pension revaluation	889
Increase in fair value of derivatives	441

Financial Position (Continued)

33. A direct comparison of College income in 2015/16 of £33.522 million against the last financial period is not possible given the change in accounting period from 16 months to 12 months. Points to note for 2015/16 include:

- SFC Capital and Maintenance Grant recognised has decreased as £0.500 million of the 2015/16 grant allocation (relating to 1 April 2015 – 31 March 2016) was used in 2014/15 as well as the prior year having one off items including grant funding for the demolition of the Middlefield building (£0.500 million);
- Deferred income release has decreased due to some assets becoming fully depreciated in the year;
- Other grant income has increased due to £0.370 million of income being accrued from the Forth Valley College Foundation as a contribution towards the Full Business Case costs for the new Falkirk campus; and
- there has been increased income from education contracts, including collaboration with universities and continuation of major commercial contracts.

34. Similarly, a direct comparison of College expenditure in 2015/16 of £35.607 million against the last financial period is not possible. Points to note for 2015/16 include:

- there was a staff pay increase award and small increase in staff numbers, increase in the STSS pension contribution rate, and removal of national insurance rebates on some national insurance categories which led to increased pay and related costs;
- a £0.399 million increase in pension costs as a result of the calculation under FRS102 of the current pension cost versus the actual contributions;
- there was an increase in the enhanced early retirement provision cost by £0.388 million largely due to changes in actuarial provision as a lower discount rate on liabilities was applied by the actuary;
- other operating expenditure was down as there was no Middlefield demolition expense, less expenditure using SFC capital and maintenance funds (see related note under income above), and a range of other movements;
- depreciation decreased due to a range of assets becoming fully depreciated in 2014/15 and 2015/16;
- Interest and finance costs increased due to the fair value of the College's interest rate swap (which is a liability) worsening;
- there was a significant increase in expenditure on the Full Business Case for the new Falkirk campus (up £1.563 million from the previous period); and
- The 2014/15 expenditure included a donation of £1.100 million to the Forth Valley College Foundation. No donation was made in 2015/16.

35. In recent years, voluntary severance costs, accounting for estates developments and the donation to the Forth Valley College foundation has led to the College reporting an Income and Expenditure Account reserve deficit (£4.354 million at 31 July 2016 (excluding pension reserve)). As demonstrated from the information in paragraphs 31 to 34 the underlying position in 2015/16 continues to be robust and projections show that the College should be able to manage the position long term as long as it reacts to any negative changes on a timely basis.

Financial Position (Continued)

2015/16 Credits Outturn

36. The College's outturn against its 2015/16 Credits target is shown in Table 4 below.

Table 4: 2015/16 Credits/Weighted SUMs outturn

	2014/15 (Weighted SUMs)	2015/16 (Credits)
Target (including ESF)	121,664	86,214
Actual	121,781	86,272
Excess	117	58

Source: Audited Credits and SUMs returns

Short and Long Term Creditors

37. In 2015/16, due to the application of FRS102, deferred capital grants have been reclassified from reserves into current and long term creditors. Comparative figures at 31 July 2015 have also been restated. The main reason for short term creditors reducing between 31 July 2015 and 31 July 2016 is that there were a number of student support funds that had underspent in 2014/15 which had creditor balances included, but there are no similar underspends this year.

38. The long term creditors have decreased due to deferred capital grants decreasing (due to release of income) and repayment of part of the long term loan, offset by an increase in the fair value of the College's interest rate swap liability.

Pension Provisions

39. In 2015/16 the College accounted for its participation in the local government pension scheme as a defined benefit scheme. This is consistent with the accounting treatment adopted in previous years.

40. The College's LGPS pension liability increased in total by £3.387 million to £16.804 million at 31 July 2016 (2014/15: increased in total by £3.315 million) which was largely due to changes in key actuarial assumptions relating to discount rates, along with net interest on the increased pension liability and a £0.399 million extra charge for the current cost of pensions under FRS102.

41. The College has a provision in its balance sheet at 31 July 2016 of £7.317 million (31/07/15: £7.169 million (restated balance – refer to paragraph 42 below for reason for restatement) relating to pension costs from early retirements awarded to former employees. The College's approach to the valuation of the provision is to have an independent actuarial firm calculate this provision annually.

42. There was a prior period adjustment made to the enhanced early retirement provision expenditure for 2014/15 as a result of an actuarial error being identified for that year, and this reduced the 2014/15 deficit by £1.543 million.

Financial Position (Continued)

Capital Income and Expenditure

43. Arrangements to access capital funding have changed following Office of National Statistics (ONS) reclassification.

44. All of the £0.155 million of capital additions in 2015/16 related to the purchase of IT equipment.

45. The Middlefield site was revalued at 31 July 2016, which led to an impairment of £1.650 million being recognised against the revaluation reserve through other comprehensive income. The reason for the impairment was that ground surveys identified that significant piling works would be required before building on the site which had not previously been known. Based on the valuation obtained we are content that the Middlefield site is included in the financial statements at an appropriate valuation.

46. In December 2014 an Outline Business Case for a new Falkirk campus was completed. It set out that £19 million of backlog expenditure on the existing Falkirk campus had been identified and that with the future of the Grangemouth petro-chemical complex secure it was important that the College had a modern fully equipped facility to support the oil and gas industry as well as the needs of other local employers and residents. The need for a new campus was also identified as important in order to achieve the College's curriculum strategy and to become a national and international centre of excellence.

47. An external project manager for the project was appointed in March 2015, along with a Falkirk Campus Project Board which includes the project manager, Scottish Futures Trust, Senior Management Team (SMT) members, and some Board members.

48. The College submitted the Full Business Case to the SFC in September 2016 and approval to progress the project into procurement was received from the Scottish Government on 29 November 2016.

49. Legal issues with the Non-Profit Distribution model planned to be used by the Scottish Futures Trust to part fund the project have led to the project now planned to be funded using capital funding.

50. FRS102 section 17 'Property, Plant and Equipment' and the SORP require that where a tangible fixed asset comprises two or more major components with substantially different useful economic lives, each component should be accounted for separately for depreciation purposes and depreciated over its individual useful economic life. The requirements of FRS 102 to capitalise and depreciate separately the components of what could previously have been treated as a single item ensures that the assets are charged to the Statement of Comprehensive Income over the periods in which they are consumed. We noted in previous years' Annual Reports that the new Alloa and Stirling campuses were depreciated on a component accounting basis in 2012/13 for the first time. We noted however that the Falkirk campus buildings has been depreciated over 29 years as a whole and not as separate components and previously recommended that component accounting was considered further for the College's other buildings in future years. Management advised that the College does not intend to adopt component accounting for the current Falkirk Campus. It is proposed that if and when the new Falkirk Campus is brought into use component accounting will be adopted for the new building.

Financial Position (Continued)

Forth Valley College Foundation

51. An arms-length foundation, the Forth Valley College Foundation, was set up in December 2013. The objects of the Foundation are to advance the charitable purposes of the College to include the advancement of education by making grants and financial support for projects and activities being carried out by and supported by the College. The main reason for setting up the Foundation is that the Central Government budget mechanisms mean that the ability to use college reserves and surpluses in future periods is restricted.

52. On 24 June 2015 the College made an application to the Forth Valley College Foundation for a £1.800 million grant towards the new Falkirk campus redevelopment project. This was approved by the Foundation and is still to be received by the College however £0.370 million of this amount has been accrued and included in income in the 2015/16 financial statements.

53. To ensure that the Foundation is not consolidated into the College's financial results it requires to be independent of the College. College management determined, and we concur, that the Foundation is at arms-length from the College and does not require to be consolidated at 31 July 2016. This position will need to be reviewed annually.

Corporate Governance

Corporate Governance

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

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

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

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

57. The Designation of Regional Colleges (Scotland) Order 2014 came into force on 3 March 2014 and formally designated Forth Valley College as the Central regional college.

58. The Post-16 Education (Scotland) Act 2013 includes provisions in relation to the identification of principles of good governance practice for the college sector. In December 2014 the 'Code of Good Governance for Scotland's Colleges' was published which is mandatory for Colleges to comply with. An updated version of the Code was published in August 2016. The review of the Code took into account recommendations made by the Cabinet Secretary's Good Governance Task Group. The Code sets out the principles of good governance across five main areas: Leadership and Strategy; Quality of the Student Experience; Accountability; Effectiveness; and Relationships and Collaboration. Colleges are expected to comply with the Code as condition of grant from the SFC or their regional strategic body. The College has undertaken an evaluation of its compliance with the Code and we reviewed this for reasonableness. The College has highlighted one area of non-compliance with the Code in that the Board of Management has appointed the Associate Principal and Executive Director of Finance as Secretary to the Board. The Code states that the Board Secretary may be a member of the SMT in their Board Secretary capacity but cannot hold any other SMT position at the same time. The Board of Management believes that risks relating to a potential conflict of interest are being mitigated and that governance is strengthened rather than weakened by the Associate Principal and Executive Director of Finance having a dual role within the SMT.

59. Incorporated colleges and Regional Boards are required to comply with the requirements of the SPFM, except where directed by the SFC's Accountable Officer. The College's procedures have been updated to reflect SPFM / FReM requirements.

Corporate Governance (Continued)

60. A Financial Memorandum with colleges has been agreed with the SFC setting out the formal relationship between the SFC and fundable bodies in the college sector, and the requirements with which fundable bodies are expected to comply in return for payment of grant by the SFC.

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

Risk Management

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

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

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

Systems of Internal Control

Control Environment

65. No material weaknesses in the accounting and internal control systems were identified during the 2015/16 financial statements audit which would adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

66. Some areas were however identified from our system controls testing where controls could be further improved to bring more into line with good practice. These have been raised with management, an action plan has been agreed and some items have already been addressed. Actions for improvement included:

- ensuring that the checks performed to ensure that all changes made to supplier standing data in the Sun finance system are bona fide is undertaken by someone who cannot make changes to supplier standing data on Sun;
- making sure that staff do not have the ability to both raise and authorise a purchase request on the P2P purchase order authorisation system;
- considering what controls could be put in place to ensure that transactions processed by the administrator of the P2P and Sun systems are appropriate;
- reviewing the BACS transaction limits and requiring two electronic BACS signatories;
- considering changing SAGE payroll users authorisation limits to strengthen controls; and
- implementing procedures to ensure that all journals are reviewed and evidence of this review is recorded.

Systems of Internal Control (Continued)

Internal Audit

67. Audit Scotland's Code of Audit Practice directs us to maintain effective co-ordination with internal audit and place the maximum possible reliance on their work. Scott Moncrieff provided internal audit services to the College in 2015/16.

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

69. The annual internal audit report for the year ended 31 July 2016 found that, based on the work undertaken, the College has a framework of controls in place that provides reasonable assurance regarding the effective and efficient achievement of objectives and the management of key risks, and proper arrangements are in place to promote value for money and deliver best value.

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

70. During 2015/16 we had regard to ISA 240: The Auditor's Responsibility to Consider Fraud in the Audit of Financial Statements.

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

72. No frauds were identified during the period from 1 August 2015 up to the date of signing the financial statements.

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

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

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

Performance

Introduction

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

76. One specific piece of audit follow-up work was identified by Audit Scotland for the College during 2015/16, to follow-up on the Accounts Commission and Auditor General report on Scotland's public sector workforce, and a questionnaire provided by Audit Scotland was completed and returned. Audit Scotland also requested auditors to provide information in a data set to inform sector-wide reporting.

Education Scotland Review

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

78. Education Scotland undertook an external review of the College in March 2016 and a report on the findings from this was published in May 2016. The overarching judgement from the review was that the College has in place effective arrangements to maintain and enhance the quality of its provision and outcomes for learners and other stakeholders. This judgement means that, in relation to quality assurance and enhancement, the College is led well, has sufficiently robust arrangements to address any identified minor weaknesses, and is likely to continue to improve the quality of its services for learners and other stakeholders.

College Performance Arrangements

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

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

81. The College has a Corporate Plan 2014-18 and an annual 2015/16 Operational Plan.

82. Key performance indicators are set out in the Performance Report in the College's annual report.

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

84. In October 2016 the College undertook a self-evaluation against the targets set out in the 2015/16 Regional Outcome Agreement and this found that most targets had been met.

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

Outlook

2016/17 and beyond

86. The funding position will remain challenging going forward. Commercial work has been an important source of extra income. However the downturn in the oil and gas sector, which is affecting commercial income, and the impact of national pay bargaining proposals are of significant concern and robust budget setting and monitoring arrangements will be essential in helping to maintain sustainability.

87. The College's total funding allocations for the 2016/17 academic year from the SFC for Teaching and Fee Waiver is £20.142 million, an increase of £0.375 million from 2015/16 and with the equivalent academic output (16/17 and 15/16: 83,984 Credits). The College's capital allocation for 2016/17 from the SFC has increased by £0.225 million to £1.281 million (2015/16: £1.056 million).

88. It is expected that the use of depreciation allocations as if they were a cash allocation will be allowed again in 2016/17, resulting in a further deficit in the financial statements if the money is spent.

ONS Reclassification

89. Arrangements between colleges and the SFC to manage the revised funding mechanisms are likely to develop further as lessons are learned from the initial period of change.

HENDERSON LOGGIE
Chartered Accountants

Appendix I - Audited Bodies' Responsibilities

Extracts from the May 2016 Audit Scotland Code of Audit Practice

17. The audited bodies have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives.

Corporate governance

18. Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including audit committees or equivalent) in monitoring these arrangements.

Financial statements and related reports

19. Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:

- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation
- maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures
- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority
- maintaining proper accounting records
- preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body.

20. Further, it is the responsibility of management of an audited body, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.

21. Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.

Standards of conduct for prevention and detection of fraud and error

22. Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

Financial position

23. Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:
such financial monitoring and reporting arrangements as may be specified

- compliance with any statutory financial requirements and achievement of financial targets
- balances and reserves, including strategies about levels and their future use
- how they plan to deal with uncertainty in the medium and longer term
- the impact of planned future policies and foreseeable developments on their financial position.

Best Value

26. The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.

Appendix II – Follow Up of 2014/15 Annual Audit Report Recommendations

Para Ref.	Recommendation	Grade	Comments	Agreed Y/N	Responsible Officer/Time For Action	Progress 2015/16
	Financial Position **Forth Valley College Foundation**					
36	**R1** The College should maintain an ongoing review of its involvement with the Foundation to ensure that this remains independent and that the Foundation does not need to be consolidated in the College financial statements in future.	Medium	The Board of Management believes that it holds no control over the operations of Forth Valley College Foundation. The College however has recognised the risk that if the Foundation's operations are not seen to be independent this may lead to consolidation. This risk will be monitored by the Audit Committee to ensure independence is maintained.	Yes	Alison Stewart, Director of Finance Will need to be reviewed year on year	This has been considered and the Foundation remains at arms-length

Grade

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