HENDERSON LOGGIE
Chartered Accountants

# New College Lanarkshire

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

**External Audit Report No: 2016/03**

**Draft Issued: 22 November 2016**

**Final Issued: 1 December 2016**
**Final after accounts signing 12 December 2016**

HENDERSON LOGGIE
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## Notice: About this report

This report has been prepared in accordance with our responsibilities under International Standards on Auditing (ISAs) and those set out within Audit Scotland's Code of Audit Practice ('the Code') and Statement of Responsibilities of Auditors and Audited Bodies.

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Nothing in this report constitutes a valuation or legal advice.

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

This report is not suitable to be relied on by any party wishing to acquire rights against Henderson Loggie CA (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 Henderson Loggie CA does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

# Executive Summary

## Financial Statements

- On 12 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 (FRS 100, 101 and 102) came into force in 2015/16, with comparative figures for 2014/15 restated using these new standards. In addition, a new Education 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 is the Regional College for Lanarkshire, with South Lanarkshire College as an assigned college. Direction from the Scottish Funding Council indicates that consolidated regional accounts are likely to be required, however due to the timing of the Regional arrangements being fully introduced the Group accounts do not include South Lanarkshire College for 2015/16. The Group has shown a deficit for the year ended 31 July 2016 of £1.963 million, based on total income of £54.508 million, and after pension adjustments of £1.146 million (deficit of £5.121 million for the 16 months ended 31 July 2015, and total income of £76.418 million. The 2015/16 deficit included £6.103 million for impairment in the value of land and buildings and pension adjustments of £1.328 million). The Group has an Income and Expenditure Account balance of £7.464 million at 31 July 2016 (£11.521million at 31 July 2015).

- The College met its credit target for the academic year to 31 July 2016 (2014/15: target met).

- Income of £2.037 million from the Lanarkshire Further Education Foundation ('the Foundation'), an arms' length body, has been included in the Statement of Comprehensive Income which includes funds of £1.948 million which were received, and deferred, in 2014/15 and released to income in 2015/16 when the related assets were brought into use. A further £1.022 million was received from the Foundation in 2015/16 for a number of capital projects which is included within deferred income on the balance sheet and this will be released to income in 2016/17 once the related assets have been completed and brought into use. This treatment is in line with FRS102 and the new SORP.

- The College's LGPS pension liability increased in total by £3.304 million to £13.175 million at 31 July 2016 (2014/15: increased in total by £1.533 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 £0.706 million extra charge for the current cost of pensions under FRS102.

- The annual financial statements of the College comply with the Accounts Direction issued by the Scottish Funding Council (SFC), the Statement of Recommended Practice (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)

- One composite audit and accounting adjustment was made to the draft financial statements presented for audit; which had a nil impact on the reported 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 period in accordance with the principles of the Code of Good Governance for Scotland's Colleges, the Scottish Public Finance Manual (SPFM) and the new 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. A Self-Evaluation review of this, undertaken in conjunction with South Lanarkshire College during October 2016, found that most key targets had been met.

# Outlook

- The funding position will remain challenging going forward. Education contracts and commercial work have been an important income source to generate extra income for the College. 2016/17 will see the first full year impact of a number of external cost pressures totalling approximately £2.000 million, including the impact of national pay bargaining, and increases in national insurance costs and Teachers' pension employer's contributions, that the College will need to manage without additional income for these items. Robust budget setting and monitoring arrangements will be essential in helping to retain sustainability of these revenue streams.

- The College's total funding allocations for the 2016/17 academic year from the SFC for Teaching and Fee Waiver is £31.952 million (2015/16 - £31.380 million), which includes £1.826 million (2015/16 - £1.814 million) relating to additional European Social Fund (ESF) activity. This represents an increase of £0.572 million from 2015/16 and with the equivalent academic output (16/17: 138,849 credits; 15/16: 138,849 credits – both years include an ESF activity target of 8,860 credits). The College's original maintenance and capital allocation for 2016/17 from the SFC had decreased by £0.309 million to £1.213 million (2015/16: £1.522 million), however an additional £0.770 million has been allocated in-year.

- During 2015/16 the College continued to face significant cash flow pressures which were successfully managed through a combination of advance draw down of 2016/17 SFC maintenance and capital funding, cost savings and management of working capital. At 31 July 2016 a total of £1.023 million of SFC 2016/17 funding had been received which is included within deferred income. As the 2016/17 SFC grant in aid funding remains comparable with 2015/16 the College has identified that ongoing cash balances will remain under significant pressure going forward and the College is maintaining dialogue with the SFC.

- The Lanarkshire Regional College Board is now fully in place and fully fundable status was awarded to the College in August 2016. As a result consolidation of the Lanarkshire Region's colleges' accounts (New College Lanarkshire and South Lanarkshire College) will be required for financial year 2016/17. Governance and monitoring arrangements to support the new status will continue to develop during 2016/17.

# Introduction

## Background

1. 2015/16 was the fifth and final year in our five year appointment as external auditors of New College Lanarkshire ('the College') and its predecessor colleges. 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 a 12 month period to July 2016 and the comparative figures are for a sixteen 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 16 May 2016 and considered and approved by the Audit Committee at its meeting on 23 May 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;

   - 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 are summarised at paragraph 10 below.

## 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.

## Basis of Information (continued)

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.

HENDERSON LOGGIE
Chartered Accountants

# Financial Statements

## Audit Opinion

8. On 12 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 12 December 2016. No post balance sheet events were identified that required adjustment to be made to the financial statements or additional disclosure in a note thereto.

## 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 identify all material income sources, including grant in aid, student fees and education contracts, and reviewed income by month for reasonableness. We also planned to undertake detailed controls testing over student fees and reconciliations between the student records and finance systems.<br><br>For other income sources our approach was to review income balances against our expectations and follow up any unexpected variances with College staff. | During our controls testing we identified that throughout 2015/16 no reconciliations were undertaken of expected student fees per the student records system to student fees raised in the finance system. Substantive testing was performed to obtain assurance that fees were accurately raised in the finance system. In line with good practice the College should ensure that regular reconciliations between the two systems are conducted throughout the year and at the year end (see recommendation **R1** at Appendix II).<br><br>Testing undertaken on grant in aid and education contracts, and through analytical review on other income balances, was found to be satisfactory. |

| Key audit area | Our planned approach | Our findings |
|---|---|---|
| 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. | Results from our testing were satisfactory. |
| 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. 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. | We planned to review a sample of capital expenditure to ensure it was appropriate to capitalise this. We then reviewed significant accounts of a repairs and maintenance nature to determine whether it was appropriate to expense these items. Our approach regarding impairment was to discuss this with management, 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. | Overall results from our testing were satisfactory.<br><br>Approximately £5.6 million of fixed assets were disposed of in the year which relate to equipment fully written down and no longer used or held by the College. This high level of write-off indicates that the College's fixed asset disposal procedure is not operating effectively. After discussion with staff we concluded that there are no concerns regarding authorisation of disposals however Finance are not being notified at the point of disposal to allow the Fixed Asset Register and the appropriate accounting entries to be applied in a timely manner (see recommendation **R2** at Appendix II). |
| 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. |

| Key audit area | Our planned approach | Our findings |
|---|---|---|
| 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 accounts was appropriate. We also reviewed relevant evidence available, including management accounts and the Forecast Financial Return. | As part of auditing procedures, auditors must consider whether an entity can continue to operate for a period of twelve 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. |
| 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 have amended these for the final version of the financial statements. |

11. We told you materiality at the planning stage was £0.723 million, performance materiality set at £0.470 million, and the amount below which items were deemed to be clearly trivial was £0.047 million. We determined materiality based on the College's annual income. There was no change to our materiality calculation during the course of the audit.

## 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 20 October 2016, the first day of the audit fieldwork. The Performance Report, Accountability Report (including Corporate Governance information) was received on 24 October as agreed at the planning stage. Back up information for a small number of financial statement disclosures was received on 4 November 2016 after the audit fieldwork had been completed. The accounts were of a high standard and required minimal presentational changes as part of the audit process.

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

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

## Corporate Governance Statement

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.

15. The College's Governance Statement for 2015/16 confirms that corporate governance has been exercised throughout the period in accordance with the principles of the Code of Good Governance for Scotland's Colleges, the Scottish Public Finance Manual (SPFM) and the new 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 Report

17. 2015/16 is the second time a Remuneration and Staff Report has been required in college financial statements. 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 Reports. 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 20 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 24 October 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 adjustment to the financial statements made by management following the audit process. This had a nil impact on the 2015/16 deficit.

**Table 2: Audit and accounting adjustments**

| | Description | I&E DR £'000 | I&E CR £'000 | B/Sheet DR £'000 | B/Sheet CR £'000 |
|---|---|---|---|---|---|
| 1 | Other Income | 1,035 | | | |
| | Other Operating Expenses | | 1,035 | | |
| | *Being re-allocation of re-charge of bursary funds* | | | | |
| | **Total** | **1,035** | **1,035** | **-** | **-** |
| | | ===== | ===== | ====== | ====== |
| | **Overall increase / decrease in Deficit** | **nil** | | | |

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 15/16 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 2015/16 covered the 16 months from 1 April 2014 to 31 July 2015;

- The current financial period is for the 12 months to 31 July 2016; and

## Financial Reporting (continued)

- in April 2016 the College submitted the required Resource and other returns for 31 March 2016 to the SFC. In September, as allowed, in addition to the pension adjustments, an update was submitted which made the following adjustment:
  ♦ Other income - Reversal of FE fees income accrual - £1.200 million (timing adjustment).

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

### 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.

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, the SFC has allowed colleges to treat the depreciation allocation of their budgets as if it was a cash resource, thereby resulting in a deficit in the Income and Expenditure Account. 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 (year) Planned £000 |
|---|---|---|---|---|
| Financial outturn | | | | |
| Surplus/(Deficit) | (5,121) | (1,045) | (1,963) | (2,108) |
| Income and expenditure reserves (excluding pension reserve) | (21,392) | (20,746) | (20,639) | not available** |
| Cash balances | 2,724 | 1,975 | 2,373 | (2,101) |

Source: Audited financial statements, June 2016 Forecast Financial Return (FFR) and November 2016 Cash Return
** figures not required to be submitted to the SFC as part of the June 2016 FFR

32. The deficit of £1.963 million includes the following non-cash items:

| | £'000 | £'000 |
|---|---|---|
| Use of net depreciation cover: | | |
| Pay award re National Bargaining | 401 | |
| Repayment of Coatbridge ERDF funding | 206 | |
| Other pay awards and related pension contributions | 148 | |
| | | 755 |
| LGPS pension revaluation | | 1,146 |
| Loss on disposal of assets | | 10 |

The deficit in 2014/15 arose primarily as a result of the College making use of depreciation cover of £2.426 million, (£0.967 million of which was transferred to South Lanarkshire College to cover student support funding); the loss on revaluation of the College's assets of £6.102 million, and the increase for funded and unfunded pension liabilities of £0.444 million.

33. The College received notification from the Scottish Government in September 2015 that ERDF Funds amounting to £206,245 used on Campus Enhancement at Coatbridge College, pre-merger, were to be recovered following an Article 42 visit. Following discussions with the Scottish Funding Council (SFC) the College agreed to repay the ERDF funding using the Net Depreciation cash resource. The amount due to be repaid is included within accruals at 31 July 2016 and payment was made to the European Structural Funds Division of the SFC in September 2016.

## Financial Position (Continued)

34. A direct comparison of Group income in 2015/16 of £54.508 million (2014/15 £76.418 million) against 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 £0.535 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 regional restructuring (£0.525 million);
- Deferred income release has decreased due to some assets becoming fully depreciated and therefore not having any further deferred income to be released against; and
- Due to the impact of the new SORP other grant income has increased by £1.865 million in 2015/16 (2014/15: £4.600 million) due to the release of funds received from the Lanarkshire Further Education Foundation.

35. A direct comparison of Group expenditure in 2015/16 of £56.461 million (2014/15 £81.136 million) against last year is not possible given the change in accounting period from 16 months to 12 months. Points to note for 2015/16 include:

- there was a staff pay increase award of £0.400 million as a result of National Bargaining 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 £0.706 million increase in pension costs as a result of the calculation under FRS102 of the current pension cost versus the actual contributions;
- 2014/15 included £1.234 million of voluntary severance costs and no equivalent costs are included in 2015/16;
- other operating expenditure was down due to reduced activity from residencies and catering, reduced premises minor works and repairs due to less expenditure using SFC capital and maintenance funds (see related note under income above), and a range of other movements; and
- depreciation decreased due to the value of a range of assets being reduced as a result of impairments in the revaluation at 31 July 2015, and the useful life of those assets being extended.

### 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 outturn**

| | 2014/15 | 2015/16 |
|---|---|---|
| | WSUMs | Credits |
| WSUMs/Credits target (incl. ESF) | 174,544 | 138,849 |
| WSUMs/Credits actual (incl. ESF) | 174,554 | 139,301 |
| Excess | 10 | 452 |

Source: Audited SUMs/credits returns

## Financial Position (Continued)

### 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. This has significantly increased these balances. The main reason for short term creditors increasing is that there was a £0.750 million increase in student support funds that had underspent in 2015/16, and £0.850 million increase in deferred income due to 2016/17 SFC maintenance grant drawn down in 2015/16.

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.

### 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 £3.305 million to £13.175 million at 31 July 2016 (2014/15: increased in total by £1.533 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 £0.706 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 £1.417 million (31/07/15: £1.430 million relating to pension costs from early retirements awarded to former employees.

### Capital Income and Expenditure

42. Arrangements to access capital funding have changed under the FReM.

43. Capital additions of £1.954 million in 2015/16 related to the relocation of the dental facility at the Coatbridge campus (£1.663 million); replacement glazing (£0.198 million), fire safety improvements (£0.025 million) and room refurbishments (£0.155 million) at the Cumbernauld campus; equipment for the HGV facility (£0.130 million) at the Motherwell campus; and new vehicles (£0.028 million).

### Lanarkshire Further Education Foundation

44. An arms-length foundation, the Lanarkshire Further Education Foundation, was set up in January 2014. The objects of the Foundation include 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. The College previously donated £9.315 million to the Foundation in March 2014.

45. During the period the College made a number of applications to the Foundation for grants to contribute towards capital projects aimed at redeveloping the three main campuses. These were approved by the Foundation and a total £1.022 million was received by the College in 2015/16.

46. 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 be reviewed annually.

# Corporate Governance

## Corporate Governance

47. 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.

48. 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.

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

50. The Designation of Regional Colleges (Scotland) Order 2014 came into force on 3 March 2014. The Lanarkshire Colleges Order followed which came into force on 1 October 2014 and formally designated New College Lanarkshire as the Lanarkshire regional college of which South Lanarkshire College is an assigned college. A formal recruitment process for The Lanarkshire Board took place between May and August 2015 and, following the Cabinet Secretary's approval of the Chair's appointment recommendations, the new regional board met for the first time on 14 September 2015. The Lanarkshire Board includes representation from students and staff of New College Lanarkshire and also includes representation from South Lanarkshire College, as set out in The Lanarkshire Colleges Order 2014.

51. 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. 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. This code was further updated in 2015/16. Colleges will be expected to comply with the Code as condition of grant from the SFC or their regional strategic body. The SFC has considered governance arrangements prior to confirming fundable body status. We have not identified any non-compliance with the Code during our audit.

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

## Corporate Governance (Continued)

53. 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.

54. 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

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

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

57. The College has a Strategic Risk Register which is reviewed by the Audit Committee. Risk is a standing item on the agenda for the Senior Management Team, all Board committees and the Board. There are also risk registers which are compiled and reviewed by each operating area of the College. We have concluded these arrangements are good and our observation is that they work well in practice.

## Systems of Internal Control

### Control Environment

58. 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.

59. Some areas were however identified from our system controls testing undertaken during 2015/16 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 regular reconciliations are undertaken of the expected student fee income per the Unit-e student records system to the actual student fee income raised in the TechOne finance system; and
- implementing procedures to ensure that Finance are notified of all fixed asset disposals to ensure that the fixed asset register is updated and that the relevant postings are made in the finance system in a timely manner.

### Internal Audit

60. 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. Wyllie & Bisset provided internal audit services to the College in 2015/16.

## Systems of Internal Control (Continued)

61. 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.

62. 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

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

64. 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.

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

66. 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.

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

# Performance

## Introduction

68. 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.

69. No mandatory performance audit studies were identified by Audit Scotland for the College at the initial planning stage for2015/16. During the year, information relating to workforce planning was requested and Audit Scotland has requested auditors to provide information in a data set with the annual accounts to allow them to undertake sector comparisons.

## Education Scotland Review

70. 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.

71. Education Scotland last undertook an engagement review in March 2015 and feedback from this was positive. The College received the highest possible grading of Effective. No further reviews were undertaken in 2016.

## College Performance Arrangements

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

73. 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.

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

75. 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.

76. The College continues to work with South Lanarkshire College to achieve the outcomes of the Lanarkshire Regional Outcome Agreement. In October 2016 the College, together with South Lanarkshire 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.

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

# Outlook

## 2016/17 and beyond

78. The funding position will remain challenging going forward. Education contracts and commercial work have been an important income source to generate extra income for the College. 2016/17 will see the first full year impact of a number of external cost pressures totalling approximately £2.000 million, including the impact of national pay bargaining, and increases in national insurance costs and Teachers' Pension employer's contributions, that the College will need to manage without additional income for these items. Robust budget setting and monitoring arrangements will be essential in helping to retain sustainability of these revenue streams.

79. The College's total funding allocations for the 2016/17 academic year from the SFC for Teaching and Fee Waiver is £31.952 million (2015/16 - £31.380 million), which includes £1.826 million (2015/16 - £1.814 million) relating to additional European Social Fund (ESF) activity. This represents an increase of £0.572 million from 2015/16 and with the equivalent academic output (16/17: 138,849 credits; 15/16: 138,849 credits – both years include an ESF activity target of 8,860 credits). The College's original maintenance and capital allocation for 2016/17 from the SFC has decreased by £0.309 million to £1.213 million (2015/16: £1.522 million), however an additional £0.770 million has been allocated in-year.

80. 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.

81. During 2015/16 the College continued to face significant cash flow pressures which were successfully managed through a combination of advance draw down of 2016/17 SFC maintenance and capital funding, cost savings and management of working capital. At 31 July 2016 a total of £1.023 million of SFC 2016/17 funding had been received which is included within deferred income. As the 2016/17 SFC grant in aid funding remains comparable with 2015/16 the College has identified that ongoing cash balances will remain under significant pressure going forward and the College is maintaining dialogue with the SFC.

### ONS Reclassification

82. 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.

### Regional consolidated accounts

83. The Scottish Funding Council has confirmed in an addition to the Accounts Direction issued in November 2015 that consolidated accounts are likely to be required for the Lanarkshire Region. This would mean that the accounts of South Lanarkshire College would be consolidated with New College Lanarkshire. For 2015/16, as the Lanarkshire Regional Board was not fully in place for the whole 12 month period, and as fully fundable status was not awarded to the College until after the year end, in August 2016, it has been determined that the regional board did not exercise sufficient decision making and control over the Board of South Lanarkshire College to require consolidated accounts to be prepared. However, consolidated accounts will be required to be prepared in 2016/17. Governance and monitoring arrangements to support the new fully fundable status will continue to develop during 2016/17.

# 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 – 2015/16 Annual Audit Report Recommendations

| Para Ref. | Recommendation | Grade | Comments | Agreed Y/N | Responsible Officer/Time For Action | Agreed Completion Date |
|---|---|---|---|---|---|---|
| 10 | **Financial Statements**<br><br>**Identified Risks of Material Misstatement and Materiality**<br><br>**R1** To ensure completeness of student fee income ensure that regular reconciliations between the Unit-e and TechOne systems are conducted throughout the year and at the year end. | Medium | The re-configuration of the fee matrix within Unit-e for 2016/17, as opposed to within TechOne since 2015/16 will make this reconciliation easier | Y | AP Finance / Senior Accountant responsible for sales ledger | 31 December 2016 |
| 10 | **R2** Ensure that the fixed asset disposal authorisation form is amended to incorporate notification to Finance to allow the fixed asset register to be updated and the appropriate accounting entries applied in a timely manner. | Low | Agreed | Y | Senior Accountant responsible for Fixed Assets | 31 March 2017 |

**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. |

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

| Para Ref. | Recommendation | Grade | Comments | Agreed Y/N | Responsible Officer/Time For Action | Progress 2014/15 | Progress 2015/16 |
|---|---|---|---|---|---|---|---|
| 37 | **Financial Position**<br><br>**Arms-Length Foundation**<br><br>**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 college will consider the advice of the SFC and other advisors as appropriate | Y | Vice Principal (Resources) | This has been considered and consolidation is not required in 2014/15. This will be kept under review. | This has been considered and consolidation is not required in 2015/16. This will be kept under review. |

| Para Ref. | Recommendation | Grade | Comments | Agreed Y/N | Responsible Officer/Time For Action | Progress 2014/15 | Progress 2015/16 |
|---|---|---|---|---|---|---|---|
| | **Corporate Governance**<br><br>**Fraud and Irregularity, Standards and Conduct, and Prevention and Detection of Corruption** | | | | | | |
| 58 | **R3** The College should ensure that a timetable is established for the harmonisation of procedures/policies in relation to standards of conduct and prevention and detection of corruption, which incorporates the former Coatbridge, Cumbernauld and Motherwell Colleges. | Medium | Discussed and agreed. | Y | Clerk to the Board | Updated August 2015. To be presented to February 2016 Audit Committee | This was not presented to the February 2016 Audit Committee. The paper is ready and will be presented to the next available Audit Committee. |