South Lanarkshire College

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

For the year ended 31 July 2016

9 December 2016

Contents

About this report

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

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

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

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

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

Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Phil Charles, who is the engagement leader for our services to the College, telephone 0141 300 5892 email: phil.charles@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6720 or email to alex.sanderson@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

Executive summary

Executive summary

Audit conclusions		
■ We issued an unqualified audit opinion on the financial statements of South Lanarkshire College, following their approval by the Board of Management in December 2016; the completion of our post balance sheet events work, and receipt of the management representation letter.	Page 10
Financial position		
■ The College reported a surplus before other comprehensive income of £0.6 million in the 12 month period to 31 July 2016. After the actuarial loss of £0.4 million, the total comprehensive income for the period was £218,000.	Pages 6 – 8
■ The College's net assets at 31 July 2015 were reduced by £24.1 million to £4.4 million as a result of FRS 102 transition adjustments, primarily the reallocation of £25 million deferred capital grants from reserves into current and non-current liabilities. Net assets increased slightly to £4.7 million to 31 July 2016 resulting entirely from the small surplus generated.	
■ The financial statements are prepared on a going concern basis. Scottish Funding Council ("SFC") funding for 2016-17 is confirmed at £11 million (including £1.2 million of European Social Fund, "ESF", monies) with an allocation of 46,884 credits. However, as set out below there is currently a cash flow shortfall in the forecasts for April 2017.	
Financial statements and related reports		
■ We have concluded satisfactorily in respect of each of the significant risks and audit focus areas identified in the audit strategy and plan document. We concur with management's accounting treatment and judgments. We have no matters to highlight in respect of: adjusted and unadjusted audit differences; independence; and specific management representations.	Pages 11 - 16
Wider scope		
■ As required by Audit Scotland, we considered the wider scope dimensions and concluded positively in respect of financial management, value for money, governance and transparency.	Pages 18 - 25
■ We noted one risk in relation to financial sustainability. The cash flow shortfall predicted in April 2017 results from adverse timing of payments from SFC, which coincides with the removal of the College's overdraft facility on transition to using the Government Banking Service. This is proactively being addressed by the College, and the draft financial statements currently include additional wording on the basis of preparation.	

Scope and responsibilities

Purpose of this report

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

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

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

Board of Management responsibilities

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

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

Auditor responsibilities

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code. Appendix four sets out how we have met each of the responsibilities set out in the Code.

Scope

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems.

Weaknesses or risks identified are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist.

Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity. This annual audit report to members and our presentation to the audit committee, together with previous reports to the audit committee throughout the year, discharges the requirements of ISA 260.

Financial position

Financial position

Overview

The financial position of the College is reported for the 12 month period to 31 July 2016, with comparatives for the 16 month period to 31 July 2015. The College aims to break-even in resource terms within each Government financial year to 31 March.

The College was allocated credits for 2015-16 of 46,884, all of which were delivered. The College continues to operate from a single site, including a newly completed teaching facility constructed by the College and brought into use in February 2016.

Financial position

The College reports a surplus for the 12 month period to 31 July 2016 of £218,000. This aligns to the restated surplus of £653,000 in the previous 16 month period. The final surplus before actuarial effects of £617,000 compares to a budgeted surplus of £91,000 for management accounts purposes. The variance primarily relates to the differing treatment of foundation grants in the statutory accounts from management accounts, as in the statutory accounts this funding (£611,000) is recognised in full in the year whereas in the management accounts and budget this amount was taken to the balance sheet and spread over the useful life of the asset.

Total income decreased by £4.4 million when compared to 2014-15 but this is largely as a result of the change in accounting periods. Overall, on a like-for-like basis, (based on annualised information to allow comparability): total income for the academic year 2015-16 increased by 3%; and total expenditure for the academic year 2015-16 increased by 4%.

Other operating expenditure reduced by 2% in comparative terms as a result of cost controls imposed by management in 2015-16.

The decrease in non-salary expenditure was offset by an increase in salary costs in the period. There was an increase in staff numbers to address additional activity. The move to collective bargaining was also a significant factor as the settlement date was moved back to 1st April from 1st August, resulting in an unbudgeted charge for the period from April to July 2015. In addition, the base salary level for the 2015-16 award was higher than anticipated and both awards were higher than guidelines.

Statement of comprehensive income

	2015-16 (12 months) £'000	2014-15 (16 months) £'000	Variance £'000
Scottish Funding Council Grants	11,671	14,641	(2,970)
Tuition Fees and Education Contracts	2,390	3,480	(1,090)
Other Income	312	221	91
Donations and endowments	611	950	(339)
Investment Income	2	5	(3)
Total income	**14,986**	**19,297**	**(4,311)**
Staff Costs	9,776	12,218	(2,442)
Other Operating Expenses	3,642	4,957	(1,315)
Interest and Other Finance Costs	76	83	(7)
Depreciation	875	1,126	(251)
Total expenditure	**14,369**	**18,384**	**(4,015)**
Surplus for the period	**617**	**913**	**(296)**
Actuarial loss in respect of pension scheme	(399)	(260)	(139)
Total comprehensive income for the period	**218**	**653**	**(435)**

Source: *KPMG analysis of South Lanarkshire College's annual accounts 2015-16.*

Financial position (continued)

Balance sheet

The College had net assets at 31 July 2016 of £4.7 million (2014-15: net assets of £4.4 million). The key elements of the movement are set out below.

Assets

Tangible assets increased by £0.8 million during 2015-16, with additions of £1.7 million primarily due to the construction of the new teaching facility, a two year project completed in January 2016 and now in use. These additions were offset by the annual depreciation charge of £0.9 million.

Tangible fixed assets are accounted for under a policy of revaluation. There is no requirement to undertake a revaluation in 2015-16 as a valuation exercise was undertaken in 2014-15. Assets continue to be held at their previously revalued amounts less their annual depreciation charge.

Debtors are comparable to the prior period with the realignment of the accounting year end with the academic year end. Cash decreased by £0.6 million to a net liability of £0.1 million, due to the timing of SFC and other grant funding receipts. We consider the impact of cash reserves on going concern further at pages 14 and 20.

Liabilities

Deferred capital grants of £24.8 million were correctly transferred into short and long term creditors on transition to FRS 102. This had a significant effect on net assets, with the 31 July 2015 position restated from £28.5 million to £4.4 million.

There were new capital grants from SFC of £0.3 million and the European Structural Fund of £0.5 million in 2015-16 for the new teaching facility. Following the accruals model of government grant recognition, these are initially held in creditors and released over the life of the related asset.

Net pension liabilities in respect of participation in the Strathclyde Pension Fund increased by £0.7 million as a result of changes in demographic and financial assumptions in the actuarial valuation. This movement is considered in detail at appendix three. The pension reserve was correctly transferred into unrestricted reserves on transition to FRS 102.

Balance sheet

	2015-16 (12 months) £'000	2014-15 (16 months) £'000	Movement £'000
Non current assets			
Tangible assets	33,805	32,996	809
Current assets			
Stocks	8	8	-
Trade and other receivables	652	524	128
Cash and cash equivalents	2	500	(498)
Creditors: Amounts falling due within 1 year	(2,668)	(2,945)	277
Net current liabilities	**(2,006)**	**(1,913)**	**(93)**
Total assets less current liabilities	**31,799**	**31,083**	**716**
Creditors: Amounts falling due after 1 year	(24,035)	(24,163)	128
Provisions for liabilities	(548)	(576)	28
Provision for pensions	(2,560)	(1,906)	(654)
Total net assets	**4,656**	**4,438**	**218**
Reserves			
Income and expenditure account – unrestricted	(433)	(1,603)	1,170
Income and expenditure account – restricted	-	950	(950)
Revaluation reserve	5,089	5,091	(2)
Total funds	**4,656**	**4,438**	**218**

Source: KPMG analysis of South Lanarkshire College's annual accounts 2015-16.

Financial position (continued)

Financial plans 2016-17 and beyond

The approved budget for 2016-17 shows a breakeven position. This reflects £11 million of SFC funding, £2.4 million of tuition and other income, £9.9 million of staff costs and £3.5 million other expenditure. Whilst staff costs includes cash payments to the pension schemes the result does not include FRS 102 pension adjustments as these are not known until year end. The final reported outturn for 2016-17 is therefore expected to reflect accounting adjustments to the net pension liability.

The College has target credits of 46,884 (2015-16: 46,884) which it expects to meet.

The College has a strategic plan for the period 2014-20, with financial plans prepared annually for the academic year ahead. The long term financial strategy is to achieve cash breakeven each year. Monthly cash flow forecasts are prepared for the following academic year. We consider cash flow forecasts in more detail on pages 14 and 20.

Going concern

The College had net assets of £4.7 million at 31 July 2016. This includes negative unrestricted reserves at 31 July 2016 of £0.4 million. The negative reserves arise following the transfer of the pension reserve into unrestricted reserves on transition to FRS 102.

The working capital position is continually monitored and cash flow is affected by the phasing of SFC funding. The College draws cash from the SFC on a monthly basis to meet forthcoming liabilities.

We concur with the Board of Management's assessment that the going concern basis of preparation remains appropriate.

Conclusion

The College achieved a surplus before actuarial adjustments of £0.6 million in 2015-16.

Whilst the College has net negative unrestricted reserves due to the pension liability, we do not consider that this impacts the ability of the College to continue as a going concern given that pension funding is long term in nature.

Our assessment of cash flow forecasts is detailed on pages 14 and 20.

We are content that the going concern assumption is appropriate for the College, in light of the matters set out above.

Financial statements and related reports

Audit conclusions

Audit opinion
Our audit work is complete subject to receipt of management representations and update of subsequent events. Following approval of the annual accounts by the Board of Management, we intend to issue an unqualified opinion on the truth and fairness of the state of the College's affairs as at 31 July 2016, and of the College's surplus for the year then ended. We also intend to issue an unqualified opinion on the regularity of transactions within the year and the remuneration report. There are no matters identified on which we are required to report by exception.
Financial reporting framework, legislation and other reporting requirements
The College is required to prepare its financial statements in accordance with Financial Reporting Standard ("FRS") 102 and the Accounting for Further and Higher Education Statement of Recommended Practice 2014 (the "SORP"). It must also apply the Financial Reporting Manual 2015-16 (the "FReM"), although the SORP takes precedence where there is a direct conflict. Additional disclosures are required in accordance with the 2015-16 Accounts Direction for Scotland's Colleges and Universities (the "Accounts Direction"). Our audit confirmed that the financial statements have been prepared in accordance with the SORP and relevant legislation.
Regularity
Our audit work, as outlined on the following pages, concluded that in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.
Statutory reports
We have not identified any circumstances to notify the Auditor General that indicate a statutory report may be required.
Other communications
We did not encounter any significant difficulties during the audit. There were no other significant matters arising from the audit that were discussed, or subject to correspondence with management that have not been included within this report. There are no other matters arising from the audit, that, in our professional judgement, are significant to the oversight of the financial reporting process.
Audit misstatements
There were no audit adjustments required to the draft annual accounts and there are no unadjusted audit differences.
Written representations
There are no changes to the standard representations required for our audit from last year.

Context of our audit

Materiality

We summarised our approach to materiality in our audit strategy. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that our planning materiality for 2015-16 of £265,000 (2% of forecast expenditure; 1.8% of actual expenditure) remains appropriate. We report all misstatements greater than £13,250.

Forming our opinions and conclusions

In gathering the evidence for the above opinions and conclusions we have:

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

Financial statements preparation

High quality working papers and draft financial statements were provided during the audit fieldwork, starting on 7 October 2016. The performance report and accountability report (including corporate governance report and remuneration and staff report) were received during the audit fieldwork and we suggested minor presentational adjustments to ensure they were in line with available guidance.

Significant risks and other focus areas in relation to the audit of the financial statements

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

Significant risk:

- management override of controls fraud risk

Other focus areas identified at audit planning:

- adoption of the FRS 102 based SORP
- pension liabilities
- income recognition

Additional focus areas identified as the audit progressed:

- cash flow and going concern

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

Audit focus areas

OTHER FOCUS AREA	OUR RESPONSE	AUDIT CONCLUSION
Adoption of the FRS 102 based SORP The new SORP resulted in a number of differences in disclosure as well as the requirement for restatement of the comparative primary statements and opening reserves. In addition to significant differences, such as grant income recognition, the SORP brought changes in respect of holiday pay accruals, leases and pension interest cost accounting on transition.	We completed the audit of the transition balance sheet and the audit of comparative primary statements, vouching transition adjustments to supporting documentation. This included analysing judgements and estimates made by management. The following work was completed. ▪ The holiday pay accrual was assessed and evaluated against industry benchmarks. ▪ We verified the treatment of a sample of research and other income to contracts and gift agreements. ▪ We confirmed that government grants had been appropriately recorded using the opted accruals method. This was correctly differentiated from the treatment of non government grants, which are recognised on entitlement to the grants in line with performance conditions. ▪ We confirmed accurate prior year restatement of the funding received from the arms length foundation, to recognise these at the point of entitlement in line with performance conditions. ▪ As the College went through a revaluation of their land and buildings in the prior period under FReM regulations, they retained fixed assets at valuation and opted to retain its revaluation reserve, a choice that is permitted under the new SORP. Other assets continue to be held at depreciated historical cost. ▪ We tested the operating lease disclosure to ensure the total minimum lease payment due was disclosed and confirmed that no changes to lease classifications were required under FRS 102. ▪ We reviewed managements assessment of the pension reserve and confirmed that the movement to unrestricted reserves in line with the new SORP. In addition we confirmed that the net interest pension finance cost was included appropriately within the statement of comprehensive income. ▪ We considered the appropriateness of the disclosures, including the transition accounting note, against the recommended Accounts Direction UK model statements as well as British Universities Finance Directors Group financial statements and completed a SORP 2015 disclosure checklist to identify any areas of omission or error.	We are satisfied that: ▪ the financial statements are correctly prepared in compliance with the SORP, Accounts Direction and Audit Scotland published guidance. ▪ the financial statements include all required disclosures as required by these accounting standards and in respect of transition adjustments; and ▪ transition adjustments to comparatives have been appropriately applied.

OTHER FOCUS AREA	OUR RESPONSE	AUDIT CONCLUSION
Pension liabilities The College accounts for its participation in the Strathclyde Pension Fund ('SPF') in accordance with FRS 102 and therefore recognises the actuarial valuation of the pension liabilities in respect of its share of the SPF. The funds are valued by actuaries, with the rates of contributions determined by the trustees on the advice of the actuaries. The College's actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases.	Our audit work consisted of: ▪ KPMG specialists reviewed the financial assumptions underlying actuarial calculations and compared to our central benchmarks; ▪ testing of scheme assets and rolled-forward liabilities; ▪ testing the level of contributions used by the actuary to those actually paid during the year; ▪ testing membership data used by the actuary supplied by the College; and ▪ agreeing actuarial reports to financial statement disclosures. We set out further information in respect of the defined benefit obligation and the related assumptions at appendix three.	We are satisfied that the retirement benefit obligation: ▪ is correctly stated in the balance sheet as at 31 July 2016 and 31 July 2015; ▪ has been accounted for and disclosed correctly in line with FRS 102 and the SORP; and ▪ assumptions used in calculating this estimate and management's judgements are appropriate and within the acceptable KPMG range.
Income recognition Professional standards require us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk. As the majority of the College' income is received via grant-in-aid from SFC and is agreed in advance of the year, we did not regard the risk of fraud from this revenue recognition as significant. The College's other income streams primarily relate to tuition fees and education contracts, which can be agreed to planned expenditure in the period. The risk of fraud was therefore not considered to be significant. We did however, recognise the appropriate recognition of income as an audit focus area.	Our audit work over income recognition consisted of: ▪ SFC grant income was vouched to receipt and reconciled to the Lanarkshire Outcome Agreement; ▪ for tuition fee income we performed predictive analytical procedures and corroborated income which varied from expectation; ▪ for other sources of income we performed analytical procedures and specific item testing over material balances; and ▪ in respect of income from donations we reviewed supporting documentation to confirm any clauses restricting usage. In all cases, we considered the appropriateness of recognition under the SORP and FRS 102.	The key findings from our audit work are: ▪ we did not identify instances of fraudulent revenue recognition. ▪ we concur with the recognition of income, including management's assessment of restrictions and are satisfied that income is appropriately recognised within the financial statements.

Financial statements and related reports
Audit focus areas (continued)

OTHER FOCUS AREA	OUR RESPONSE	AUDIT CONCLUSION
Cash flow and going concern Our inquiry of management during the audit identified a risk to going concern arising from a forecast cash shortfall in April 2017. This results from the transition from commercial banking facilities to Government Banking Services (“GBS”) by April 2017. Existing commercial banking arrangements include a £350,000 overdraft facility, whereas GBS does not allow for an overdraft. The College does not have any loan facilities at 31 July 2016 and does not plan to rely on any during 2016-17. Due to the timing of SFC and grant receipts in the year not exactly aligning with the timing of cash outflows, the overdraft has historically been used on a short term basis to bridge cash shortfalls arising from these timing differences During 2017 such temporary cash shortfalls are predicted, which the College will be unable to address without support from SFC or other funding. College management has worked proactively with SFC and others to find a solution. Management is of the opinion that the timing issue will be resolved and accordingly that the going concern basis of preparation of the financial statements remains appropriate.	In assessing the College’s ability to continue as a going concern we reviewed the 2016-17 budget and 12 month cash flow forecast prepared by management. SFC grant funding for 2016-17 is budgeted to be in line with the 2015-16 academic year, with increases in ESF Priority 5 funding and tuition fee income. We corroborated budgeted SFC income to the regional outcome agreement with New College Lanarkshire 2014-17. The budgeted surplus for 2016-17 is £7,000 (on a management accounts basis, before recognition of pension movements), however cash flow forecasting predicts a cash shortfall during 2016-17. The predicted cash shortfall coincides with the removal of the College’s overdraft facility of £350,000 as the College moves to Government Banking Service. Management has proactively worked with the SFC to address the shortfall, however we recognised a risk that in the event of this not being resolved, the College will not be able to pay its creditors as they fall due. We held discussions with senior management and are advised that further funding may be realised from ESF and SFC funding which could alleviate the cash shortfall. The application for these changes have been presented to the SFC, however are are not confirmed. This is reflected in the disclosures within the financial statements, and will be updated if any changes prior to signing of the financial statements. Our analysis of the cash flow shortfall and further considerations around the wider scope area of financial sustainability are detailed further on page 20.	We concur with management’s view that the going concern assumption remains appropriate, but have included within the draft financial statements additional wording reflecting the cash shortfall. We will liaise with management and ensure the disclosures in the final financial statements reflect the most up to date position prior to signing.

REPORT	SUMMARY OBSERVATIONS	AUDIT CONCLUSION
Annual report and performance and accountability report	The financial statements form part of the annual report of the College for the period ended 31 July 2016. We reviewed the contents of the annual report against the disclosure requirements and are content with the proposed reports. Performance and accountability reports are now required to be included in the annual accounts. These outline the performance overview and the future plans and developments in line with the College's strategic objectives.	We are satisfied that the information contained within the annual report is consistent with the financial statements. We reviewed the contents of the management commentary against the guidance contained in the Accounts Direction and are content with the proposed report. We provided management with some relatively minor suggestions relating to how the management commentary could be enhanced and where additional information disclosures should be made.
Remuneration and staff report	The Scottish Funding Council's Accounts Direction requires the preparation of a remuneration report in accordance with the Government Financial Reporting Manual ("FReM"), to be included in the financial statements in 2015-16. At the time of writing, the College is awaiting figures from the Scottish Public Pensions Agency ("SPPA") in support of the specific pension disclosures for senior officials, as required by the FReM. Other remuneration disclosures are derived directly from payroll information.	We are satisfied that the format of remuneration report is in line with the FReM and Accounts Direction. We verified remuneration data reported to underlying records and are awaiting information from the SPPA.
Corporate Governance Report	The corporate governance report for 2015-16, included within the accountability report, outlines the corporate governance and risk management arrangements in operation in the financial year. It provides detail on the College's governance framework, operated internal controls, the work of internal audit, and risk management arrangements and analyses the efficiency and effectiveness of these elements of the framework.	We consider the governance framework and annual governance statement to be appropriate for the College and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.

Qualitative aspects

ISA 260 requires us to report to those charged with governance our views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

We consider the accounting policies adopted by the College to be appropriate, with the transition to FRS 102 appropriately reflected in the 2015-16 financial statements. There are no significant accounting practices which depart from what is acceptable under FRS 102 and the SORP.

Significant accounting estimates relate to:

- *The present value of defined benefit obligations under FRS 102;* (as calculated by the College's actuary, Hymans Robertson) using agreed financial assumptions. We found the assumptions and accounting for pensions to be appropriate, as discussed at appendix three.
- *The present value of fixed assets.* These were valued in 2014-15 with the value carried forward to 31 July 2016. We are satisfied that the valuation basis remains appropriate and that valuations in 2014-15 were applied accurately.

We did not identify indications of management bias.

Financial statement disclosures were considered against requirements of the SORP, the Accounts Direction and the FReM. No departures from these requirements were identified.

Future accounting and audit developments

There are no changes to the SORP for 2016-17 and no significant changes to the FReM that will impact upon the College.

ISA (UK & Ireland) 700 and 720 have been revised for accounting periods beginning on or after 17 June 2016. These revise the requirements for the structure and content of the independent auditor's report. Audit Scotland is considering whether to early adopt the standards for 2016-17.

The 2016-17 audit of the College financial statements will be carried out by Mazars. In concluding our 2015-16 audit work, we will liaise with the incoming auditor.

Wider scope

Introduction

The Code frames the wider scope of our audit in terms of four audit dimensions; financial management, financial sustainability, governance and transparency and value for money. At the centre of these dimensions is Best Value.

It remains the responsibility of the audited body to ensure that they have proper arrangements in place across each of these audit dimensions. These arrangements should be appropriate to the nature of the audited body and the services and functions that it has been created to deliver. We review and come to a conclusion on these proper arrangements.

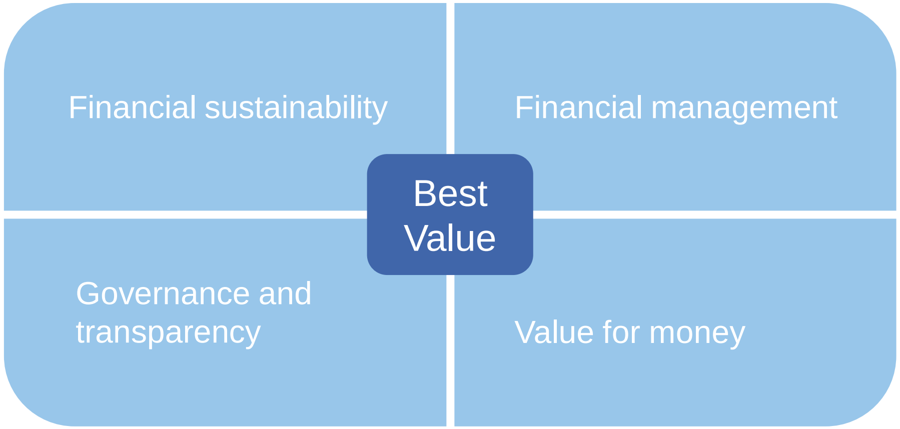
During our work on the audit dimensions we have considered the work carried out by internal audit and other scrutiny bodies to ensure our work meets the proportionate and integrated principles contained within the Code.

Audit work and conclusions

We summarise over the next few pages the work we have undertaken in the year to obtain assurances over the arrangements in place for each audit dimension and our conclusions on the effectiveness and appropriateness of these arrangements.

The next page sets out those risks we identified during our audit planning stage, any emerging risks during the course of audit work and our overall conclusion on each audit dimension.

Where we have found arrangements to not be effective or are absent we have provided further narrative on the following pages and recommendations for improvement. Where we have found the arrangements to be generally effective and operating as expected we have identified this in the conclusions we have formed.



Wider scope

Audit dimensions risk map and conclusions

Financial sustainability (Page 20)

The College has a strategic plan for the period 2014-20, with financial plans prepared annually for the academic year ahead.

We identify a risk to financial sustainability arising from a cash shortfall predicted for April 2017, resulting from the timing of SFC receipts and the removal of the College's overdraft facility.

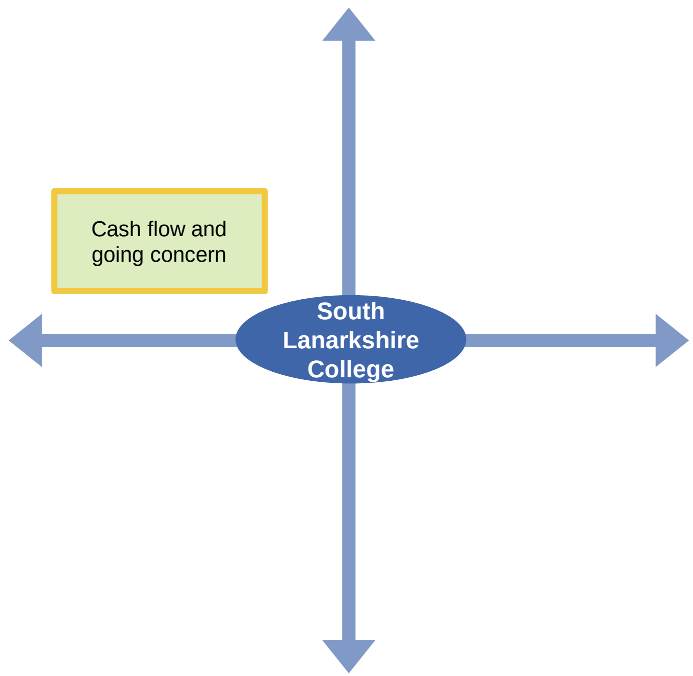
Subject to successful resolution of the 2016-17 cash shortfall, we consider the College is financially sustainable. We are satisfied that the going concern basis of accounting is appropriate.

Financial management (Page 21)

The College's finance department has appropriate financial capacity for current operations.

Budgetary processes are supported by a strong internal control environment, and no significant control deficiencies were identified.

This is supported by regular reporting and scrutiny by senior management and those charged with governance.



Governance and transparency (Page 23)

The College has adopted the code of good governance for Scotland's colleges. The governance framework of the College is considered to be appropriate.

The corporate governance statement is in accordance with guidance and reflects our understanding of the organisation. Internal audit is compliant with the Public Sector Internal Audit Standards.

Value for money (Page 24)

The College has evidenced using its resources for the purposes of enhancing service delivery and ensuring value for money.

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

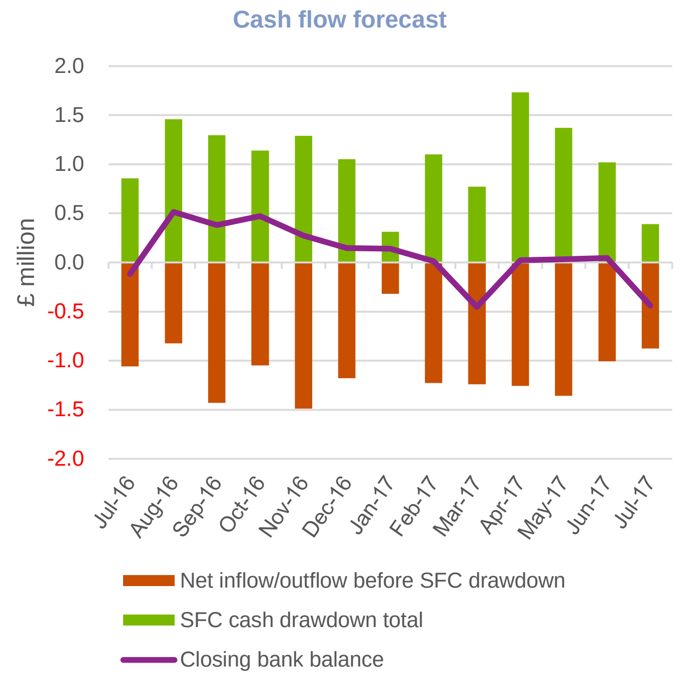
Risks identified during our audit planning procedures

Emerging risks identified during the course of our audit

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

In considering financial sustainability of the College we performed the following work:

- *Reviewing the financial position of the College as at 31 July 2016.* We provide commentary on the financial position on pages 6 to 8. The College reports net assets of £4.7 million at 31 July 2016 with negative unrestricted reserves of £0.4 million. Unrestricted reserves are negative due to the transfer of the pension reserve into unrestricted reserves on transition to FRS 102. As the changes to net assets and reserves position result primarily from FRS 102 transition adjustments, we do not consider these a risk to financial sustainability.
- *Reviewing future budgets and forecasts*. We reviewed the 2016-17 budget and cash flow forecasts. The 2016-17 budget is considered on page 8. Management advised us of a cash flow shortfall forecast for April 2017, resulting from the timing of SFC funding. Additionally, the College overdraft facility is no longer available as the College is required to transfer to Government Banking Service. A summary of the 2016-17 cash flow forecast is presented opposite, highlighting predicted shortfalls in April and July 2017. We identified a risk to financial sustainability arising from these forecast cash shortfalls, which is considered further at page 14.
- *Reviewing financial forecasting, financial strategies and key risks over financial sustainability*. The 2016-17 budget was approved by the College in May 2016. The College has a strategic plan for the period 2014-20, with financial plans prepared annually for the academic year ahead, however does not have a quantified long term financial strategy. Monthly cash flow forecasts are prepared for the following academic year.



Source: KPMG analysis of South Lanarkshire College's 2016-17 cash flow forecast

Conclusion:

Subject to successful resolution of the 2016-17 cash flow shortfall, we consider the College is financially sustainable. We are satisfied that the going concern basis of accounting is appropriate.

Wider scope
Financial management

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

We carried out audit tests to determine the effectiveness of the financial management arrangements. This included:

- *Assessing the budget setting and monitoring processes within the College, including the approval of budget changes.* We found these to be robust, with regular accurate reporting and scrutiny by senior management and the finance committee.
- *Consideration of the finance function and financial capacity at the College.* We noted that the financial processes are efficient and effective. Finance team members have appropriate skills, capacity and capability to support the College and effectively manage the organisation.

Conclusion:

The College's finance department has appropriate financial capacity for current operations. Budgetary processes are supported by a strong internal control environment, and no significant control deficiencies were identified. This is supported by regular reporting and scrutiny by senior management and those charged with governance.

We are required to provide specific conclusions on the following areas which relate to financial management and support our overall conclusion on this audit dimension.

Internal controls

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

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

No significant recommendations were raised. One 'grade three' (minor) recommendation was reiterated from prior year in relation to monthly reconciliation and review of a specific bank account.

A summary of the completion of prior year audit recommendations is provided at appendix two. Three 'grade three' (minor) recommendations were raised in 2014-15; two have been completed and the other relates the recommendation noted above.

We also reviewed the higher level control environment relating to risk management and compliance with laws and regulations.

Conclusion: Internal controls we tested over risk management, financial, operational and compliance systems and procedures are designed, implemented and operating effectively.

Arrangements for the prevention and detection of fraud and error

Testing over the processes to prevent and detect fraud and error included:

- *Inquiry with management as to procedures for the prevention and detection of fraud and error.* Based on inquiries, the procedures are considered to be appropriate for the College.
- *Testing of budget monitoring control.* Budget monitoring controls are designed and operating effectively to detect fraud and error in the financial statements.
- *Review of policies (financial regulations, code of conduct, whistleblowing, anti-bribery policies).* The College policies were found to be appropriate. The financial regulations detail responsibilities in relation to fraud, supported by anti-bribery and whistle-blowing policies.
- *Consideration of the accessibility of policies to staff and board members and if the policies had been implemented effectively.* The policies and processes tested are readily available to staff and had been implemented effectively. We note that the whistleblowing policy is not available from the College external website, however it is accessible to staff internally.

Conclusion: The College has appropriate arrangements to prevent and detect fraud.

Standards of conduct and the prevention and detection of corruption

Testing over the processes to prevent and detect corruption included in addition to the work detailed opposite:

- *Consideration of the overall control environment.* The College has arrangements including policies and codes of conduct for staff and board members, supported by a whistleblowing policy. Board members are responsible for setting the 'tone at the top' and for abiding by the code of conduct and disclosing interests which may be of importance – material or otherwise – to their work at the College.
- *Testing of completeness of registers of interests of senior staff and board members.* No errors were identified in this testing.
- *Review of reporting arrangements for conflicts of interests and whether these had been followed.* Conflicts of interest are a standing agenda item for committees to ensure appropriate reporting.

Conclusion: The College has appropriate arrangements to prevent and detect inappropriate conduct and corruption.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

In considering governance and transparency we performed the following work:

- *Reviewing the organisational structure, governance reporting lines and scrutiny within the College.* The College demonstrates effective scrutiny, challenge and transparency on decision making through various levels of committee reporting reviewed. Decisions are transparent as actions are documented within detailed board minutes which are available on the College website.
- *Reading the annual governance statement;* this includes the corporate governance framework, internal controls in operation, work of internal audit and analysis of the efficiency and effectiveness of the elements of the framework. We are satisfied that this is prepared in line with relevant guidance and is consistent with the governance framework.
- *Internal audit engagement.* We reviewed internal audit reports and conclusions for any findings relevant to our audit and to confirm the effectiveness of the internal audit function.

Conclusion:

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

We are required to provide specific conclusions on the following areas which relate to governance and transparency and support our overall conclusion on this audit dimension.

Internal audit

We reviewed internal audit reports and conclusions as part of our risk assessment processes.

We considered the activities of internal audit against the requirements of Public Sector Internal Audit Standards ('PSIAS'), focusing our review on the public sector requirements of the attribute and performance standards contained within PSIAS. This included a review of the internal audit charter, reporting lines, independence, objectivity and proficiency and the range of work carried out by internal audit. We also considered the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*.

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

Corporate governance

We updated our understanding of the governance framework and documented this through our overall assessment of the College's risk and control environment. This included testing entity wide controls, including risk management, operational and compliance controls, as reported on page 21.

Conclusion: Governance controls were found to be operating effectively and we consider the governance framework to be appropriate for the College.

Value for money is concerned with using resources effectively and continually improving services.

We consider value for money and Best Value throughout our testing. Areas where we had a specific focus on value for money and Best Value are:

- *Reviewing the procurement policy;* the procurement policy was found to be in line with best practice. The tendering process provides evidence of scrutiny for value for money in the use of resources.
- *Reviewing the process of capital expenditure to ensure projects are effectively managed*; ensuring this was closely monitored with a clear focus on value for money. The College delivered their new construction building in line with budget and has met expectations for teaching delivery.
- *Reviewing regularity procedures*. We are required by the Public Finance and Accountability (Scotland) Act 2000 to give an opinion on the regularity of expenditure and receipts shown in the financial statements. We reviewed regularity of expenditure through our controls and substantive procedures and did not identify any exceptions.

Conclusion:

The College has evidenced using its resources for the purposes of enhancing service delivery and ensuring value for money. Our review of expenditure throughout the course of our audit did not identify weaknesses in the control environment over regularity of expenditure and receipts, or instances of non-compliance with Scottish Funding Council terms and conditions.

Wider scope
Local follow up work

In November 2013 the Accounts Commission and Auditor General for Scotland published a report on Scotland's public sector workforce. The report highlighted a number of key messages on workforce changes across Scotland in the public sector and made a number of recommendations to the Scottish Government, central government bodies, the NHS, COSLA and local authorities.

We have performed follow up work on this report, and submitted a return to Audit Scotland summarising our findings and conclusions. This work covered the following key issues:

- Planning
- Service delivery
- Partnership working
- Challenge and scrutiny
- Reporting

The conclusions submitted to Audit Scotland are summarised below.

Planning

Departmental operational plans are prepared annually with workforce requirements and reviewed by the Senior Management Team. Any additional staffing requirements go through the College's HR Committee. These are revisited during the year so that changes in circumstances and staffing requirements are identified.

Service delivery

The main driver for the College in terms of workforce changes are the activity levels required of it by its major funders. The impact of any changes in staffing are considered in line with the plan. There is no early departure scheme currently in place, but the College has used these in the past and ensures these comply with appropriate guidance from Scottish Government and Scottish Funding Council.

Partnership working

The College has seconded staff to other organisations in the past, and College staff work extensively with colleagues at New College Lanarkshire and external assessment agencies.

Challenge and scrutiny

Individual operational plans are prepared by all departments in the College and passed to senior management for scrutiny and challenge. Any changes to workforce are passed through the Human Resources Committee of the Board of Management for approval. Clear visibility of this information provides accountability and encourages challenge and scrutiny.

Reporting

Regular reports are provided to both the Human Resources and Finance Committees of the Board of Management. All staff are surveyed on an annual basis and the College has a formal career review process in place led by managers.

Appendices

Appendix one
Auditor independence

To the Board of Management

Assessment of our objectivity and independence as auditor of South Lanarkshire College ("the College")

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

This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

General procedures to safeguard independence and objectivity

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

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

We are satisfied that our general procedures support our independence and objectivity.

Independence and objectivity considerations relating to the provision of non-audit services

We have considered the fees charged by us to the College for professional services provided by us during the reporting period.

The audit fee charged by us for the period ended 31 July 2016 was £14,710 (2015: £13,500). No other fees were charged in the period (2015: £nil). No non-audit services were provided to the College and no future services have been contracted or had a written proposal submitted.

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the College.

Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the partner and audit staff is not impaired.

This report is intended solely for the information of the College and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully

KPMG LLP

Prior year recommendations

We follow up prior year audit recommendations to determine whether these have been addressed by management. The table below summarised the recommendations made during the 2014-15 audit and their current status.

Grade	Number recommendations raised	Implemented	In progress	Overdue
One	-	-	-	-
Two	-	-	-	-
Three	3	2	1	-

We have provided a summary of progress against overdue actions below, and their current progress.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions	Status
Journals exception reporting (grade: three) Journals are subject to high level review by the head of finance. Journals posted by the head of finance are not subject to secondary review. To mitigate the risk of journal posting errors being undetected, review controls should be strengthened.	Exception reports should be run quarterly to identify journals with higher risk of fraud or error, for example those posted on weekends, to cash, or with rounded amounts. Unusual journals should be reviewed to confirm their accuracy and appropriateness.	Hard copy exception reports will be run quarterly by the Financial Accountant, annotated with explanations for unusual entries and then discussed with the Vice-Principal who will initial as evidence of review. Responsible officer: Head of Finance Implementation date: 31 December 2015	Implemented. A more effective control than that which was recommended has been implemented by the client. All manual journals are now reviewed by a senior member of the finance team. This was witnessed through our audit testing of journals. As all journals are now subject to secondary review the risk previously identified is sufficiently mitigated.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions	Status
Review of bank reconciliation – specific bank account (grade: three) Monthly bank reconciliations are prepared appropriately for all bank accounts. For one bank account however, these are not subject to secondary review. Our testing of a sample of expenditure from this account found appropriate authorisation and did not identify any irregularities, however secondary review of reconciliations would mitigate the risk of inappropriate expenditure being undetected.	Monthly bank reconciliations for the management expenses bank account should be subject to secondary review by a senior member of the finance team. Review should be documented.	Hard copy management expenses bank account reconciliations will be reviewed by the Financial Accountant and initialled as evidence of review. Responsible officer: Head of Finance Implementation date: 31 December 2015	In progress. This recommendation has not been implemented by the client in the year. We reiterate our recommendation for secondary review of reconciliation of this specific bank account.
Management accounts preparation and reconciliation to statutory reporting (grade: three) Management accounts are prepared on a quarterly basis and reported to the Board. Information presented includes a comparison of the original budget to the re-forecasted year end position with explanations for all significant variances, but does not include actual income and expenditure in the period and does not reconcile to statutory reporting. With significant changes in the reported surplus or deficit expected from the implementation of FRS 102, there is a risk that the Board does not receive full visibility of the forecast statutory position through the period.	The format of management accounts should be reviewed and revised to include: - Detail of actual income and expenditure in the period, taken from the general ledger, and compared to budget. - Detail of how the forecast position in management accounts would appear within statutory reporting. Reconciliation should be carried out at least annually between management accounts and statutory reporting.	A reconciliation between management accounts and statutory accounts will be carried out annually. Responsible officer: Head of Finance Implementation date: 31 December 2015	Implemented. The client has implemented an annual reconciliation between management accounts and statutory reporting. The risk that the Board will not receive full visibility of forecast and statutory position is therefore sufficiently mitigated.

Defined benefit obligations

In respect of employee benefits, each of the assumptions used to value the College's net pension deficit are within an acceptable range of KPMG's expectations.

We are of the view that this therefore represents a reasonable and balanced approach, in accordance with the requirements of FRS 102 and the SORP.

We set out below the assumptions in respect of defined benefit obligations.

Defined benefit pension liability

31 July 2016 £'000	31 July 2015 £'000	KPMG comment
(2,560)	(1,905)	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the FRS 102 pension scheme valuation. Details of key actuarial assumptions are included in the table, along with our commentary.

Assumption	Hymans Robertson	KPMG central	Comment
Discount rate (duration dependent)	Less than 17 years: 2.40% Between 17 and 23 years: 2.40% More than 23 years: 2.50%	17 years: 2.29% 20 years: 2.35% 23 years: 2.38%	Acceptable. The proposed discount rates are within an acceptable range of KPMG's central rates as at 31 July 2016.
CPI inflation	RPI less 1.0%	RPI less 1.0%	Acceptable. The proposed CPI inflation rates are within an acceptable range of KPMG's central rates as at 31 July 2016.
Net discount rate (discount rate – CPI)	0.50% - 0.60%	0.35%	Acceptable. Although higher than the KPMG central rate, the proposed assumptions are within the acceptable range.
Salary growth	In line with most recent valuation	Typically 0% - 1.5% above inflation	Acceptable. The proposed assumption is consistent with the latest triennial valuation and is acceptable under FRS 102.

The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of more than 23 years. The closing deficit increased by £655,000 compared to 2015-16, primarily due to changes to actuarial assumptions, including a decrease in the real discount rate and increased life expectancies.

Appendix four
Appointed auditors responsibilities

Area	Appointed auditors responsibilities	How we've met our responsibilities
Corporate governance	Review and come to a conclusion on the effectiveness and appropriateness of arrangements to ensure the proper conduct of the bodies affairs including legality of activities and transactions, Conclude on whether the monitoring arrangements are operate and operating in line with recommended best practice.	Page 23 sets out our conclusion on these arrangements.
Financial statements and related reports	Provide an opinion on audited bodies' financial statements on whether financial statements give a true and fair view of the financial position of audited bodies and their expenditure and income Provide an opinion on whether financial statements have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements Provide an opinion on the regularity of the expenditure and income.	Page 10 summarises the opinions we expect to provide.
Financial statements and related reports	Review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns.	Page 15 reports on the other information contained in the financial statements, covering the annual governance statement, management commentary and remuneration report.
Financial statements and related reports	Notify the Auditor General or Controller of Audit when circumstances indicate that a statutory report may be required.	Page 10 sets out any notifications we have made to the Auditor General or Controller of Audit.
Financial statements and related reports	Review and conclude on the effectiveness and appropriateness of arrangements and systems of internal control, including risk management, internal audit, financial, operational and compliance controls.	Page 21 sets out our conclusion on these arrangements.

Appendix four

Appointed auditors responsibilities (continued)

Area	Appointed auditors responsibilities	How we've met our responsibilities
Standards of conduct – prevention and detection of fraud and error	Review and conclude on the effectiveness and appropriateness of arrangements for the prevention and detection of fraud and irregularities, bribery and corruption and arrangements to ensure the bodies affairs are managed in accordance with proper standards of conduct. Review National Fraud Initiative participation and conclude on the effectiveness of bodies engagement.	Page 22 sets out our conclusion on these arrangements.
Financial position	Review and conclude on the effectiveness and appropriateness of arrangements to ensure that the bodies financial position is soundly based.	Page 20 sets out our conclusion on these arrangements.
Financial position	Review performance against targets.	Pages 6 to 8 summarise our review of how the body has performed against it's financial targets.
Financial position	Review and conclude on financial position including reserves balances and strategies and longer term financial sustainability.	Page 7 sets out our conclusion on the bodies financial position including reserves balances. Page 20 sets out our conclusion on the bodies financial strategies and longer term financial sustainability.
Best Value	Review and conclude on the effectiveness and appropriateness of arrangements of accountable officers specific responsibility to ensure that arrangements have been made to secure Best Value.	Page 24 sets out our conclusion of the bodies arrangements.

cutting through complexity

The contacts at KPMG in connection with this report are:

Phil Charles

Partner

Tel: 0141 300 5892

phil.charles@kpmg.co.uk

Michelle Dixon

Engagement Manager

Tel: 0131 527 6885

michelle.dixon@kpmg.co.uk

Julie Robinson

Audit in-charge

Tel: 0141 300 5772

julie.robinson@kpmg.co.uk