South Lanarkshire College

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

For the year ended 31 July 2017

Contents

Executive summary

Purpose of this report
Our annual audit report summarises the work we have undertaken as the auditor for South Lanarkshire College ('the College') for the year ended 31 July 2017.

Our responsibilities are defined by the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice ('the Code') issued by Audit Scotland in 2016. The detailed sections of this report provide details on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of work	Summary
Financial statements opinion	Our unqualified opinion on the financial statements was issued on 6 December 2017 following the Board of Management's approval of the annual report and accounts on 5 December 2017.
Opinions on other matters	We also reported an unqualified opinion on the same day for: • The regularity of income and expenditure • The remuneration and staff report, performance report and governance statement.
Wider Scope work	We are required by the Code to form conclusions on four wider scope dimensions. Our conclusions on each dimension are summarised below:
Financial Management	• The College has effective arrangements, including budgetary control, that help Board members scrutinise finances.
Financial Sustainability	• The College has adequate financial planning arrangements in place.
Governance and Transparency	• The College has governance arrangements in place that provide appropriate scrutiny of decisions made by the Board.
Value for Money	• The College has an effective performance management framework in place that supports progress towards the achievement of value for money.
Independence	We have continued to consider any actual, potential or perceived threats to our independence as part of our ongoing risk assessment. We can confirm that no threats to independence have been identified since the issue of our Audit Strategy Memorandum in May 2017, and therefore we remain independent.

We would like to take this opportunity to thank all management and staff for their assistance and co-operation during our audit.

Financial statements

Financial statements opinion	**Unqualified**
Regularity opinion	**Unqualified**
Opinion on other prescribed matters	**Unqualified**

The scope of our audit and the results of our work

The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the financial reporting framework applicable to the College and whether they give a true and fair view of the College's financial position as at 31 July 2017 and of its financial performance for the year then ended.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by Audit Scotland, and International Standards on Auditing for the UK and Ireland (ISAs). These require us to consider whether:

- the accounting policies are appropriate to the College's circumstances and have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management in the preparation of the financial statements are reasonable; and
- the overall presentation of the financial statements provides a true and fair view.

Our approach to materiality

We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider the concept of materiality at numerous stages throughout the audit process, in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. As a result we have set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for audit testing (performance materiality), which is also dependent on the level of inherent risk assessed in the area being audited which may be due to the nature of these items or because they attract public interest. We also set a threshold for reporting identified misstatements to the Audit Committee. We call this our trivial threshold.

The table below provides details of the materiality levels applied in the audit of the financial statements for the year ended 31 July 2017:

Financial statement materiality	£297,000
Performance materiality	£238,000
Trivial threshold	£9,000

Our response to significant risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in the College's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit Committee within our Audit Strategy Memorandum and provide details below of how we responded to those risks. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Significant risk	How we addressed the risk	Audit conclusion
Management override of control In all entities, management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such overrides could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.	We addressed this risk through performing audit work over: • Accounting estimates impacting amounts included in the financial statements; • Consideration of identified significant transactions outside the normal course of business; and • Journals recorded in the general ledger and other adjustments made in preparation of the financial statements	Satisfactory assurance has been gained over the presumed risk of management override. We have no matters to report.
Revenue recognition There is a presumption under International Standards on Auditing that there is a significant risk of fraud and error in the timing of revenue recognition leading to the material misstatement of revenue overall. This is because revenue is an area of particular focus by users of financial statements and can be subject to judgements as to when grant income should be recognised and if clawback conditions apply to the funding.	We addressed this risk through performing audit work over: • the design and implementation of controls management has in place to ensure income is recognised in the correct period; • cash receipts around the year end to ensure they have been recognised in the right year; • the judgements made by management in determining when grant income is recognised; and • for major grant income, obtaining counterparty confirmation.	Satisfactory assurance has been gained over the presumed risk of revenue recognition. We have no matters to report.

Areas of audit focus

As part of our continuous planning processes, we carry out work to identify matters that will have a direct impact on the financial statements, but are not likely to represent a risk of material misstatement. The work we carried out in relation to these areas of audit focus is outlined below.

Audit focus	Work undertaken	Conclusion
Valuation of pension liabilities The College makes contributions to two pension schemes – the Scottish Teachers Superannuation Scheme (STSS) and the Strathclyde Pension Fund (SPF). While both are defined benefit schemes, it is not possible to identify the College's share of the underlying assets and liabilities in the STSS and it is therefore accounted for as a defined contribution scheme. The College's share of the SPF's underlying assets and liabilities is identifiable and a net liability is recognised in the accounts. As at 31 July 2017 the college accounts show a net liability of £2.742m, an increase of £182k in 12 months. Given the scale of the liability recognised in the accounts, a misstatement in the reported position could be material to the financial statements	We considered the College's arrangements, including the existence of any relevant controls, for making estimates in relation to pension entries within the financial statements. We also considered the reasonableness of the actuary's assumptions used in providing the College with information in the financial statements through the use of our internal experts.	Our audit work has provided satisfactory assurance over the valuation of the pension liability reported in the accounts and the actuarial assumptions used to calculate the liability. We have no matters to report.

Audit focus	Work undertaken	Conclusion
Valuation of fixed assets The College holds a significant level of fixed assets – reporting a net book value of £33.045m as at 31 July 2017. In line with the requirements of the Government Financial Reporting Manual, the College has adopted a formal revaluation policy of an external valuation every five years, with a desktop, interim valuation performed during the five year period. This meets the requirement of the FE SORP that assets are valued sufficiently regularly so that the carrying value of the asset is not materially different from its fair value. The college is also required to assess on an annual basis whether there are indicators of impairment to assets at the reporting date. Given the significance of the value of fixed assets held, a misstatement in the valuation could be material to the financial statements.	We undertook a range of substantive procedures including: • review and evaluation of the external valuer's report as at 31 July 2015; • review of the reconciliation between the College's asset register and general ledger; and • considered the College's impairment review for buildings.	Our audit work has provided satisfactory assurance over the valuation of buildings held as fixed assets in the accounts and we have nothing to report.

Internal control recommendations

As part of our audit we have considered the internal controls in place that are relevant to the preparation of the financial statements. We do this to design audit procedures that allow us to express an opinion on the financial statements; this does not extend to expressing an opinion on the effectiveness of internal control or to identify any significant deficiencies in their design or operation.

Our work has identified one recommendation for the improvement of internal controls at the College, which is set out in detail in Appendix 1 to this report. These recommendation relates to the operation of the payroll system.

Audit differences

There were no material adjustments to the draft financial statements arising from our audit. We discussed and agreed a number of disclosure and presentational adjustments that have been reflected in the final annual report and accounts.

The audit identified differences, which management have assessed as not being material, either individually or in aggregate to the financial statements, and does not plan to reflect in the final accounts. The overall net effect of these errors, had they been reflected in the financial statements would be to decrease income and increase liabilities by £1,738. The details of these unadjusted misstatements is set out in Appendix 2 to this report.

Qualitative aspects of the College's accounting practices

We are required to communicate to you our views on the significant qualitative aspects of the College's accounting practices, including the accounting policies used and the quality of disclosures.

Qualitative aspect	Our views
Accounting policies and disclosures	We have reviewed the College's accounting policies and disclosures and found these to be in line with the requirements of the 2015 Statement of Recommended Practice: Accounting for Further and Higher Education and the Government Financial Reporting Manual 2016-17. In line with our expectations, there have been no significant changes to accounting policies for the year ended 31 July 2017.
Quality of the draft financial statements	We received draft financial statements from management on 2 October 2017, with updates being provided for a number of the disclosure notes in the week following. The initial draft of the annual report followed on 9 October. The draft accounts were of a good quality, we found few errors in the draft provided to us.
Quality of supporting working papers	Producing high-quality working papers is as crucial part of compiling financial statements that are complete and materially accurate. They also support the delivery of an efficient audit. Working papers were good and staff were responsive to our requests when we were on-site.

Significant matters discussed with management

There were no such matters discussed with management.

Significant difficulties during the audit

During the course of the audit we did not encounter any significant difficulties and we have had the full co-operation of management.

Financial management

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

South Lanarkshire College has effective arrangements, including budgetary control, that help Board members scrutinise finances

Financial performance

FE/HE SORP Accounting	2016/17 £'000	2015/16 £'000
Operating Income	14,877	14,986
Staff Costs	(10,370)	(9,776)
Operating Expenditure	(4,492)	(4,593)
Operating Surplus for year before the actuarial gain/(loss) in respect of the pension scheme (FE/HE SORP basis)	**15**	**617**

The above table shows the financial performance of the College for the last two academic years, as reported under the FE/HE SORP. An operating surplus has been attained in both years. The College is therefore effectively demonstrating that it is operating sustainably within its funding allocation.

In addition:

- The College achieved its financial targets in line with its plan;
- There were no significant changes to the reported position during the year; and
- The College met its student credit target confirming the level of funding in the financial statements

Since Scotland's colleges were reclassified as Government bodies, they also have to report on a central government accounting basis. The purpose of this is to reflect additional budget received by the College to fund depreciation, which is not recognised under FE/HE SORP requirements. This is shown below:

Central Government Accounting	2016/17 £'000	2015/16 £'000
Operating Surplus for year (FE/HE SORP basis)	15	617
Add back: Non-cash allocation for depreciation	241	224
Less: Revenue funding relating to Lennartz repayments	(370)	(275)
Less: Non-Government capital grants	-	(611)
Operating Deficit on Central Government accounting basis	**(114)**	**(45)**

As can be identified above, the College would have been in a position to report an operating surplus, under central government accounting rules before taking account of the Lennartz repayment, arising from the repayment of VAT on the construction of the main campus building. The final payment is due to be made in January 2018.

Budgetary process

We have reviewed and considered the budgetary processes and controls and budget monitoring arrangements in place at the College. Our review consisted of review of budget monitoring reports, review of committee papers and attendance at committees. Overall, we consider that the Board of Management obtains regular and timely financial information that reflects the actual financial position.

Internal controls

As part of our audit we have considered the internal controls in place that are relevant to the preparation of the financial statements. We do this to design audit procedures that allow us to express an opinion on the financial statements; this does not extend to expressing an opinion on the effectiveness of internal control or to identify any significant deficiencies in their design or operation.

We have also considered the work of internal audit, from individual reviews of financial systems and their annual audit opinion on the control framework in place at the College. Internal Audit has provided assurance that 'In our opinion, with the exception of Business Continuity and Disaster Recovery where areas for improvement were identified and we understand that management has already taken action to address these, South Lanarkshire College has a framework of controls in place that provides reasonable assurance regarding the organisation's governance framework, 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'.

We conclude that the processes and controls in place at the College are operating effectively. We have identified some scope for improvement, which is outlined in Appendix 1 to this report.

Prevention and detection of fraud and irregularity

Management and the Audit Committee, as those charged with governance also have responsibilities in respect of fraud. They are responsible for safeguarding assets and for the prevention and detection of fraud, error and non-compliance with laws and regulations.

We have a responsibility to review the College's arrangements for the prevention and detection of fraud. Our audit work was planned to provide a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud and irregularity. We found the arrangements in place to be satisfactory and identified no material misstatements resulting from fraud or irregularity.

Conclusion

The College has effective arrangements, including budgetary control, that help Board members scrutinise finances

Financial sustainability

Financial sustainability extends the going concern assumption from the financial statements, looking forward two to five years, reviewing and assessing arrangements for financial planning and affordable and sustainable service delivery in this timescale.

South Lanarkshire College has adequate financial planning arrangements in place

Financial planning

Based on the College's quarterly monitoring reports a small financial surplus was planned and achieved in 2016/17, confirmed by our review of budget reports and the final reported position.

No going concern issues were identified as part of the audit however the College did have to rely on short term overdrafts in July 2016 and March 2017 as a result of the timing of SFC funding. Financial plans for 2017/18 indicate this will continue. The College have an unsecured overdraft facility of £350k with Clydesdale Bank. We understand that the college will soon be moving from Clydesdale Bank to the Scottish Government's banking services.

A review of the minutes of the Finance Committee and onwards to the Board demonstrated effective challenge of the financial position by members.

In its annual review of the FE sector, Audit Scotland's 'Scotland's Colleges 2017' recommended that Colleges should:

- prepare longer-term financial plans, as we recommended last year, in order to support financial decision-making that takes account of both immediate and future cost pressures
- calculate the cost of harmonising staff pay, terms and conditions and include these in their financial plans

The College prepared a 5 year financial forecast 2017/18 to 2021/22 (The Plan) which was discussed at the Finance Committee in May 2017 and recommended to the Board for approval. The Plan was considered by the Board and was accepted with the proviso that subsequent events may require College management to revisit this. The Plan will therefore be revisited annually and incorporated within the College's overall strategic plan.

The Plan identifies a small surplus in each of the 5 financial years whilst also identifying assumptions about inflation in the short and medium term.

The College is clear on the risks to sustainability it faces and the uncertainty of funding over the medium and long term for example national pay bargaining, the ending of ESF funding and the lack of clarity on future Scottish Funding Council (SFC) funding.

The 2017-18 budget was approved by the Board in May 2017. The College has a strategic plan for the period 2014-20, with financial plans prepared annually for the academic year ahead.

Monthly cash flow forecasts are prepared for the following academic year. As a result of this, Management have identified a cash flow shortfall forecast in March 2018, resulting from the timing of SFC funding. This shortfall is expected to be covered by the college's overdraft facility.

Asset management and estates strategy

In March 2008, the students and staff moved from the three campuses – in Cambuslang and East Kilbride – to one purpose built College Campus in the Scottish Enterprise Technology Park in East Kilbride. The project was funded with assistance from the European Regional Development Fund and the Scottish Funding Council and was delivered on time and under budget. A further teaching facility was constructed and opened in February 2016 – the Low Carbon Building. The College has an estate valued at £33m as at 31 July 2017.

An Estates Strategy 2009-2019 is in place. It was introduced to complement the College strategic and operational plans.

The Estates Strategy aims to support the current status and condition of the building and wherever possible recognise opportunities for improvement. It is reviewed annually and reported to the Senior Management Team and the Board.

An Estate Report is presented to each Finance and Resources committee to inform members of the current position. This report is then considered at the next Board Meeting. No significant capital spend is planned for the period of the five year plan.

Conclusion

South Lanarkshire College has adequate financial planning arrangements in place.

Governance and transparency

Governance and transparency covers the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information

South Lanarkshire College has governance arrangements in place that provide appropriate scrutiny of decisions made by the Board

Governance arrangements

Our work in this area has considered the overall governance and scrutiny arrangements in place at the College, reviewed the financial and performance reporting to the Board, and reviewed the minutes of committees to inform our assessment of the appropriateness of the governance structure. We have also attended Audit Committees during the year.

The College is managed by key Committees of the Board. Committees meet generally four times a year. The minutes of these meetings are considered as part of the agenda at the immediately following Board meeting.

The Board currently consists of 16 members, 9 female (including the Chair) and 7 male. This gender balance meets with the objective of the Gender Representation on Public Boards (Scotland) Bill which was introduced by the Scottish Parliament in June 2017 with an implementation date of 2022.

The Key Committees comprise of lay members, with each also containing the Principal and the Chair of the Board, with the exception to of the Audit Committee where the Principal cannot be a member. In addition, the Chair of the Board is also not permitted to be a member of the Audit Committee. A lay member of the Board chairs all Committees. Appropriate College officers attend committees and present reports as required.

The Finance and Resources Committee recommend to the Board the College's financial statements and its annual revenue and capital budgets. They also receive quarterly reports to allow them to monitor performance in relation to these approved budgets.

Committee meeting agenda items are supported by detailed reports each with a cover sheet describing the role of the committee in respect of the report, for example, 'For Information', 'For Action' so that members are aware of their role and what is expected of them.

South Lanarkshire College and New College Lanarkshire form The Lanarkshire Region, accountable to The Lanarkshire Board. In January 2017, Scott-Moncrieff, produced a report on corporate governance arrangements at the College, focussing on the requirements of the financial memorandum between The Lanarkshire Board and South Lanarkshire College. The report concluded that the College has adequate and effective controls in place to comply with the additional corporate governance requirements documented within the financial memorandum.

Governance Statement

As part of our audit we have read the governance statement included in the annual report. The governance statement sets out the corporate governance framework in place throughout the reporting year, the internal controls in operation, the work of internal audit and the overall efficiency and effectiveness of the governance framework.

For the first time in 2016/17, we are required to read and provide an opinion on the governance statement. In our opinion, the information contained within is consistent with the financial statements. We also consider that the governance statement has been prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and further directions made by the Scottish Funding Council.

Internal audit

An effective internal audit service is an important element of any organisation's governance arrangements. Internal audit provide the College with independent assurance on internal control and corporate governance processes. The internal audit function at South Lanarkshire College is provided by Scott-Moncrieff.

To allow for an efficient audit process, where possible, we gained assurance from the work of internal audit. We specifically gained assurance from the internal audit reports on Key Financial Systems and Corporate Governance Arrangements.

Transparency

Transparency means that service users and the public have access to understandable information about how the College is making decisions and using its resources.

There is a commitment to transparency, with the minutes and associated relevant papers of committee meetings being made available on the website.

Conclusion

College has governance arrangements in place that provide appropriate scrutiny of decisions made by the Board.

Value for money

Value for money concerns using resources effectively and continually improving services

South Lanarkshire College has an effective performance management framework in place that supports progress towards the achievement of value for money

Performance management
The College has a number of corporate Key Performance Indicators (KPIs) in place which are reported annually in the Key Performance Indicator report

In addition, there are a number of key financial KPIs that are reported quarterly to the Board.

The most recent data from SFC shows that the average SFC-funded in-year price per credit (2016-17 data) is £238.16. South Lanarkshire College receives an average of £224.17 per credit, well below the Scottish average.

The College has again delivered its core activity targets and achieved a small financial surplus along with high student satisfaction and progression rates.

Through delivery of the 2016/17 budget there is evidence that the college understands cost drivers and is in control of costs.

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

Regular expenditure and income is that which has been incurred / obtained in line with guidance issued by the Scottish Ministers and the terms and conditions of funding of the Scottish Funding Council.

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

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 available on the College's website. The tendering process provides evidence of scrutiny for value for money in the use of resources.

- *Reviewing regularity procedures*: - Our review found a strong control environment exists over regularity of expenditure and receipts.

No instances of non-compliance with Scottish Funding Council terms and conditions were noted

Conclusion
College has an effective performance management framework in place that supports progress towards the achievement of value for money

Our fees

Fees for work as the College's appointed auditor
We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to audit committee in May 2017.

Having completed our work for the 2016/17 financial year, we can confirm that our final fees are as follows:

Area of work	2016/17 proposed fee £	2016/17 final fee £
Auditor remuneration	12,470	12,470
Pooled costs	780	780
Contribution to Audit Scotland costs	710	710
Total fee	**13,960**	**13,960**

We confirm that these fees are in line with the scale fee set by Audit Scotland.

We also confirm that we have not undertaken any non-audit services for the College in the year.

Appendix 1 – Internal control recommendations

The matters reported are limited to those deficiencies and other control recommendations that we have identified during our normal audit procedures and that we consider to be of sufficient importance to merit being reported. If we had performed more extensive procedures on internal control we might have identified more deficiencies to be reported or concluded that some of the reported deficiencies need not in fact have been reported. Our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

Our findings and recommendations are set out below. We have assigned priority rankings to each of them to reflect the importance that we consider each poses to your organisation and, hence, our recommendation in terms of the urgency of required action. In summary, the matters arising fall into the following categories:

- **Priority 1 (high)**

  There is potential for financial loss, damage to reputation or loss of information. Weaknesses may have implications for the achievement of strategic objectives and our recommendations should be considered immediately by management.

- **(Priority 2 medium)**

  There is a need to strengthen internal controls or enhance efficiency. Our recommendations should be actioned in the near future.

- **Priority 3 (low)**

  Internal controls should be strengthened where practicable and where there is a cost benefit from doing so.

Deficiencies in internal control

Payroll system Priority 2

Description of deficiency	Our review of the payroll system found the following control weaknesses: Four members of staff have full access to the payroll system, which would allow them to access and amend their own records. A report of all changes made to the system in advance of the payroll being processed should be generated and formally reviewed. While a change report is being generated, it is not currently being formally reviewed. Finally, we note that there is the potential for BACS payments (for payroll and other payments) to be generated and processed by the Head of Finance.

Potential effects	The payroll system as it currently operates, would allow a staff member with full access to the system to make changes to their own pay. The change may not then be detected as the report of all changes is not formally reviewed. If the payroll BACS run were to be generated and processed by the same person, the fundamental segregation of duties control would be overridden.
Recommendation	We recommend that a system restriction is put in place to prevent individuals from accessing and having the ability to edit their own payroll records. In addition, we recommend that the change logs from the payroll system are generated and formally reviewed by a staff member independent from the payroll process to ensure all changes are accurate, appropriate and authorised. We further recommend that a clear segregation of duties introduced where BACS payments should be ideally produced, reviewed and authorised and processed by separate members of staff at each stage.
Management response	A system of review of changes to payroll records, concentrating on those who have access to the payroll system, will be implemented. A third party, i.e. someone who does not have access to either the payroll or the BACS processing systems, will review the BACS payments processed for the monthly payroll and all other BACS payments. Responsibility – Head of Finance; Deadline - December 2017

Appendix 2 – Summary of misstatements

The misstatements identified for adjustment during the course of the audit that are above the trivial level of £9,000, are set out below.

The below table outlines an audit difference due to the college recognising a provision for the potential repayment of an ERDF claim of £100k when the auditor would have recognised the full amount of £146k. Management has assessed this difference as not being material, either individually or in aggregate to the financial statements, and does not currently plan to adjust.

Unadjusted differences 2016/17					
		Statement of Comprehensive Income and Expenditure		**Balance Sheet**	
		Dr	Cr	Dr	Cr
1	Dr: Deferred Capital Grant			£44,262	
	Dr: SOCIE	£1,738			
	Cr: Other Creditors				£46,000
	Explanation Recognition of the full amount of ERDF claim potentially repayable.				

No adjusted misstatements have been identified and corrected in the financial statements.

Disclosure amendments

Our audit identified a small number of presentational and disclosure errors, all of which have been amended.