New College Lanarkshire

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

For the year ended 31 July 2017

Contents

This report has been prepared in accordance with our responsibilities as appointed auditors as set out in Audit Scotland's *Code of Audit Practice* ('the Code'). Reports and letters prepared by appointed auditors and addressed to the College are prepared for the sole use of the College and we take no responsibility to any member or officer in their individual capacity or to any third party.

Mazars LLP is the UK firm of Mazars, an international advisory and accountancy group. Mazars LLP is registered by the Institute of Chartered Accountants in England and Wales.

Executive summary

Purpose of this report

Our annual audit report summarises the work we have undertaken as the auditor for New College Lanarkshire ('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 15 December 2017 following the Board of Management's approval of the annual report and accounts on 11 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, however, it has identified significant financial sustainability concerns.
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	£1,104,000
Performance materiality	£883,000
Trivial threshold	£33,000

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 provided details of how we responded to those risks in our Audit Completion Report. 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 management override. We have no matters to report.

Significant risk	How we addressed the risk	Audit conclusion
Land and building valuations The College holds a significant level of fixed assets – reporting a net book value of £95.272m 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.

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 £14.110m, an increase of £935k 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.

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.

We have identified no recommendations for the improvement of internal controls at the College, during our audit.

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.

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 a draft version of the annual report and accounts from management on 13 October 2017 in advance of our audit fieldwork. The draft accounts were of a good quality and 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

Given the current and predicted future financial position of the College, we have discussed the reasonableness of the Going Concern assumption with senior officers. Advance funding will be required during 2017/18 with the College forecasting cashflow issues, resulting in significant overdrawn cash balances from March to July 2018. We have therefore sought assurance from the Scottish Funding Council, as the College's primary funder, that core funding will continue to be advanced, as required, for a period of at least 12 months from the approval of the financial statements. The response from the SFC recognises the scale of change that the College needs to make, as outlined in the College Business Scenario Plan, to return to financial balance. It also recognises that the College may require further financial support, beyond what is covered in current SFC grants to achieve this. The SFC commit to working with the College to 'identify and consider any such requirements for the provision of additional grant funding necessary to ensure that it remains a viable organisation.' This will, of course, be subject to the SFC having sufficient resource within its own budget.

On 27 November 2017, the Scottish Funding Council offered the College additional strategic funding for the 2017/18 financial year. In light of this additional funding, the commitment of the SFC to working with the College, and our review of the College's Business Scenario Plan, we consider that preparation of the financial statements on a Going Concern basis, is appropriate.

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.

New College Lanarkshire 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	55,097	54,508
Staff Costs	(40,863)	(39,214)
Operating Expenditure	(16,355)	(17,266)
Operating Deficit for year (FE/HE SORP basis)	**(2,121)**	**(1,972)**

The above table shows the financial performance of the College for the last two academic years, as reported under the FE/HE SORP. Although a deficit was shown over both years:

- There were no significant changes that were not fully documented and explained to the reported position during the year; and
- The student credit target was met confirming the level of funding in the financial statements.

The College received £1.9m of advance funding from the SFC in July 2017 to assist with in-year financial demands. This has been treated as deferred income as it has been taken from their 2017/18 funding. This financial position was previously identified by the College and discussed with SFC in advance of need.

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 Deficit for year (FE/HE SORP basis)	(2,121)	(1,972)
Add back: Non-cash allocation for depreciation (net of deferred capital grant)	633	863
Add back: Non-cash pension adjustments for the Strathclyde Pension Fund	1,520	1,074
Less: Non-Government Capital Grants	(893)	(2,037)
Less: Revenue funding allocated to loan repayments	(54)	(108)
Operating Deficit on Central Government accounting basis	**(919)**	**(2,170)**

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 –

- capital grant income received from non-government sources which are recognised as income when specific conditions are met; and
- £54k used to repay HMRC under the Lennartz VAT scheme.

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.

Finance officers produce monthly management accounts within 3 weeks of the month end. Monthly management reports have reported a consistent position of approximately a £2.0m deficit (under the FE/FE SORP accounting method) throughout the year.

Monitoring reports are included on the agenda of every Finance committee. A review of these minutes and onwards to the Board demonstrated effective challenge of the financial position by members.

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.

New College Lanarkshire and South Lanarkshire College form The Lanarkshire Region, accountable to The Lanarkshire Board. Work carried out by internal audit on corporate governance arrangements concluded that adequate and effective controls were in place to comply with the additional corporate governance requirements documented within the financial memorandum.

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 concluded that '*New College Lanarkshire as a region did have adequate and effective risk management, control and governance processes to manage its achievement of the Region's objectives at the time of our audit work. In our opinion, the Region has proper arrangements to promote and secure value for money''*

We conclude that the processes and controls in place at the College are operating effectively. We have identified no recommendations for the improvement of internal controls at the College, during our audit.

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.

National Fraud Initiative

The College took part in the National Fraud Initiative (NFI) for the first time in 2016/17. NFI is a counter-fraud exercise co-ordinated by Audit Scotland that analyses data held by public sector bodies to identify 'matches' that may indicate the existence of fraud or error.

National Fraud Initiative 2016/17	
Total number of matches	171
Number recommended for investigation	6
Completed	171

No significant findings arose from the work on NFI, however, the College identified a duplicate payment as one of the matches for £2,188.92 which they have now recovered.

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.

New College Lanarkshire has adequate planning arrangements in place, however, it has identified significant financial sustainability concerns.

Financial planning

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*

Going concern issues were identified as part of the audit. The College had to rely on £1.9m of advance funding from the SFC in the 2016/17 year to assist with in-year financial demands. This has been treated as deferred income as it has been taken from the College's 2017/18 core funding. Consequently, there are concerns that this will potentially lead to further funding difficulties at the end of 2017/18.

Following receipt of advance funding, the College was requested by the SFC to produce a forward plan that would address known cost pressures. The College has produced a Business Scenario Planning (BSP) 2017-2022 document which is aligned with the 2017 FFR.

The College has completed a five year Financial Forecast Return (FFR), supported by a detailed annual budget that has been submitted to the SFC. The FFR identifies a deficit in each of the financial years from 2017/18 until 2020/21 before returning to a small surplus in 2021/22. In addition, the College is forecasting significant cashflow issues in 2017/18 with overdrawn cash balances being between the values of £1,775k and £2,796k from March to July 2018.

In recognition of the significant financial difficulties facing the College, they have produced alternative 5 year financial plans, with various different operating structures as part of their (BSP), that is envisaged will bring the College back to a surplus position in 2019-20. The BSP along with the 2017/18 Annual Budget was presented to the Finance Committee in June 2017 and recommended to the Board for consideration.

The BSP includes alternative 5 year financial plans, using various different operating structures and contains impact assessments of each structure. Management have carried out a detailed risk assessment in the BSP, using a red, amber and green approach. This has been prepared by qualified and competent staff before being reviewed at Board level.

Management have included various assumptions when preparing the BSP and forecast, which we consider to be reasonable. These include:

- removal of the income/associated costs from the prisons contract;
- variations in SFC credit targets;
- inflation;
- pension costs;
- changes to infrastructure; and
- funding & costs of National Bargaining

Each option in the BSP will require significant additional capital and revenue funding and it has therefore been submitted to the SFC for approval. The College have been engaged in responding to queries from the SFC and work in this area is ongoing.

On 27 November 2017, the College received an offer of £866k in the 2017/18 academic year from the SFC's Strategic Funds to initiate a Voluntary Redundancy Scheme, that will generate future cash savings. This was one of the operating structures proposed by the College in the BSP. As a result of this additional funding offer the College will now look to formalise plans in further detail and are carrying out consultation with staff as appropriate, ensuring the funding requirements of the SFC are met.

Asset management and estates strategy

The College has an estate valued at £95.272m as at 31 July 2017. It has six campuses spread across Lanarkshire and East Dunbartonshire.

The Estates Strategy is currently under review and will be finalised on completion of the full review of the property portfolio. Life-cycle costings have recently been completed for the current portfolio and the College have agreed 2017/18 capital plans and in addition have provisional 2018/19 plans. Any further work on the estates strategy will be dependent on the outcome of discussions on the BSP as this may entail future capital works to update the infrastructure of the estate.

Conclusion

The College has adequate planning arrangements in place, however, it has identified significant financial sustainability concerns. It has produced costed plans containing options to reduce the predicted deficit and has obtained additional strategic funding from the Scottish Funding Council to fund a voluntary redundancy scheme which should decrease costs going forward. Without action and additional funding, the college will operate at a significant deficit in the future, which could in turn, impact on performance.

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

New College Lanarkshire 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 Key Committees are set up in line with the agreed Terms of Reference for each. Appropriate College officers attend committees and present reports as required.

The Board currently consists of 21 members, 11 male and 10 female, including the Chair. The College is aware of the objective of the Gender Representation on Public Boards (Scotland) Bill and will continue to seek to maintain gender balance on the Board by 2022.

The Finance Committee receive financial reports at each meeting to allow them to monitor performance in relation to approved annual 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 e.g. For Information, For Action etc. so that members are aware of their role.

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 New College Lanarkshire is provided by Wylie and Bisset.

To allow for an efficient audit process, where possible, we gained assurance from the work of internal audit.

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 papers of committee meetings being made available on the website.

Conclusion

New College Lanarkshire 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

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

Performance management

The performance report identifies that the College achieved its 2016/17 SFC core funded target by delivering 129,989 SFC funding Credits (the SFC's unit of measure for learner activity). In addition the College achieved European Social Fund (ESF) credits of 8,448, which was slightly under the target of 8,860. The College provided places for 16,385 learners which represents 9,229 Full-time Equivalent learners.

At the last independent Education Scotland and the Scottish Funding Council. Review in March 2015, the quality of the College's learning and teaching was assessed as "Effective", being the highest level available.

Overall, Student Outcomes identify a mixed picture and in some areas remain a cause for concern, for example, the percentage of further education students who enrol on full-time recognised qualifications (FEFT) has also shown a downward trend for early and further withdrawals over the three year period. In addition, the 2016/17, early and further withdrawal rates have continued to increase and remain higher than the national average.

However, for higher education student enrolments on part-time recognised qualifications (HEPT) the percentage of completed successful students has increased by 7.5% in 2016/17 and whilst still being below the sector average, the gap has closed significantly to 1.6% (previously 9.1%).

Monthly management accounts are produced and shared with budget holders. In addition, budget monitoring reports are included on the agenda of every Finance committee before being presented to the Board.

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.

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.

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 (FIN07 Tendering Policy) is 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*: -** 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.

In addition, the College has a Value for Money Policy which highlights how the College recognises its responsibility to achieve value for money (VFM) and economy, efficiency and effectiveness from all of its activities, regardless of the method of funding.

Conclusion

New College Lanarkshire 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	31,140	31,140
Pooled costs	1,950	1,950
Contribution to Audit Scotland costs	1,770	1,770
Total fee	**34,860**	**34,860**

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.

During the year, the Lanarkshire Board took the decision to prepare consolidated accounts for the region. An additional audit fee of £10,050 is proposed for this work.