The 2016/17 audit of New College Lanarkshire

AUDITOR GENERAL

Prepared for the Public Audit and Post-Legislative Scrutiny Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
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Introduction

1. I have received the audited financial statements and the independent auditor's report for New College Lanarkshire for 2016/17. I am submitting these financial statements and the independent auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

2. The purpose of this report is to draw Parliament's attention to the financial challenges New College Lanarkshire faces and the potential impact on its longer-term financial sustainability.

The auditor's opinion

3. The auditor gave an unqualified opinion on New College Lanarkshire's financial statements for 2016/17 but has highlighted concerns about the college's financial sustainability. In 2016/17, the Scottish Funding Council (SFC) provided the college with £1.9 million advance funding from the college's 2017/18 allocation. The college's underlying deficit in 2016/17 was £560,000 (one per cent of total income).

Background

4. New College Lanarkshire is an independent body with charitable status as defined by the Further and Higher Education (Scotland) Act 1992. The college was established in November 2013 by the merger of Cumbernauld College and Motherwell College. Coatbridge College then joined in April 2014.

5. New College Lanarkshire is a regional college governed by the Lanarkshire Board. The Lanarkshire Board is the Regional Strategic Body. As well as being responsible for the governance of New College Lanarkshire, the Lanarkshire Board has statutory responsibilities in relation to South Lanarkshire College. The Lanarkshire Board has responsibility for ensuring that both colleges provide high-quality further and higher education.

6. In 2016/17, there were 16,385 learners at New College Lanarkshire and it employed 1,007 staff. Income for 2016/17 was £55.1 million.

7. Scotland's colleges 2017 reported that New College Lanarkshire had faced cash flow pressures during 2015/16.[1] The college's cash flow problems continued during 2016/17 and the college required financial support from the SFC.

Financial difficulties

8. New College Lanarkshire's financial difficulties became apparent in 2015/16. As Scotland's colleges 2017 noted, the college indicated its cash flow problems were due to a combination of lower than expected levels of fee income and higher than expected costs associated with

[1] Scotland's colleges 2017, Audit Scotland, June 2017. Exhibit 8, page 20.

national bargaining, pensions and national insurance contributions. Despite the college taking steps to address these pressures, the financial difficulties continued during 2016/17.

9. Colleges generally operate on narrow margins. This means that relatively small changes in income or expenditure can push a college from a surplus into a deficit position and vice versa. New College Lanarkshire has indicated that a number of factors contributed to it setting a very tight budget in 2015/16. As well as the cost increases for pensions and national insurance contributions, there were unexpected costs associated with Coatbridge College. While the costs presented the college with challenges, it had incorporated these into its financial plans for 2015/16 and had forecast a break-even position for that year.

10. The college's budget for 2015/16 included a target of £6.1 million for Fee and Educational Contract Income. However, this proved to be overly ambitious and the college received only £5.2 million. The college also did not plan fully for some of the costs associated with national bargaining. After 20 years of locally negotiating staff pay, terms and conditions, the Scottish Government reintroduced national bargaining to the college sector. In March 2016, the National Joint Negotiating Committee agreed pay increases for all college staff for 2015/16 (backdated to April 2015) and 2016/17. Scotland's colleges 2016 highlighted national bargaining as a cost pressure and recommended that colleges develop long-term financial strategies, underpinned by medium-term plans, which take account of significant financial pressures.[2]

11. Negotiations on national bargaining were ongoing when New College Lanarkshire set its budget, so the college could not have predicted a precise cost for this. However, it did not include any cost in its budget and the final additional cost was £400,000.

Initial action to address cash flow problems

12. During 2015/16, the college tried to manage its cash flow problems. It delayed payments to creditors and sought to receive quicker payments from debtors, but this did not address the underlying problems. In the summer of 2016, the Chair of the Lanarkshire Board and the college principal were concerned that there had been significant fluctuations in the college's financial position late in the financial year, when it was too late to take corrective action. In July 2016, at the same time as making internal enquiries of staff, the college began discussions with the SFC about these concerns. The college indicated that it was forecasting a deficit position for 2015/16 and that it was likely to experience cash flow problems. The SFC and New College Lanarkshire continued to discuss the financial position over the following months.

13. At the September 2016 meeting of the college's Finance Committee, the Chair of the Lanarkshire Board and college's principal informed members about financial reporting concerns. They also informed the committee of their decision to commission an external review of the college's finance function, including skills and reporting arrangements. The committee supported this action. The Board's Chairs' Committee considered the report in

[2] Scotland's colleges 2016, Audit Scotland, June 2016.

November 2016 and established a sub-committee to oversee the college's response to the findings.

14. The college's internal auditors also reviewed its budgetary controls processes. The internal audit identified major weaknesses in systems. The college's Audit Committee considered the internal audit findings in November 2016. The college put in place an action plan and has addressed the eight recommendations, including improving its financial reporting.

15. College management informed the Lanarkshire Board in October 2016 that the impact of the 2015/16 cost pressures would result in a forecast deficit for 2016/17. In December 2016, the college forecast that the cash shortfall would be £2 million by March 2017 and made a formal request for financial support to the SFC in January 2017. The SFC provided £1.9 million to the college in July 2017. This was advance funding, and the SFC reduced the college's 2017/18 funding by the same amount. The SFC provided the advance funding on the condition that the college develop a Business Scenario Plan to address the underlying cost pressures

Future financial sustainability

16. Since we reported our concerns in *Scotland's colleges 2017*, the college has been working closely with the SFC on its Business Scenario Plan. This proposes a number of actions to reduce costs over the period 2017/18 to 2021/22. Options include changes to operating structures and to infrastructure, all of which would require significant capital and revenue funding in the first instance.

17. Developing the plan has been an iterative process, with the SFC providing feedback to the college on the options. The college submitted a draft plan to the SFC for review in May 2017. A second draft was submitted in August 2017, and a further draft was submitted in April 2018. The college is starting to implement some approved elements of the plan. For example, in November 2017, the SFC agreed to provide the college with strategic funding of £866,000 for a voluntary severance scheme and, in February 2018, it agreed a further £225,000.These are one-off payments that the college does not have to repay.

18. The college's underlying deficit in 2016/17 was £560,000 (one per cent of total income), compared to an underlying deficit of £2.2 million in 2015/16 (four per cent of total income). While the college has yet to finalise the Business Scenario Plan, it implemented some cost saving measures in 2016/17, including reducing both its estate and its information and communication technology costs. This delivered savings of around £2 million. The draft Business Scenario Plan forecasts underlying deficits of £657,000 in 2017/18 and £346,000 in 2018/19. It is forecasting a surplus of £1.1 million in 2019/20, and surpluses of £997,000 in 2020/21 and £916,000 in 2021/22.

Conclusion

19. In Scotland's colleges 2017, I commented on the issues New College Lanarkshire faced during 2015/16. The college had to absorb a number of unexpected costs in 2014/15, which led to it setting a very tight budget for 2015/16. However, the college did not plan effectively

for all known additional costs and was overly optimistic in its assumptions for generating income in 2015/16. While the college made some savings these were not enough and its financial difficulties continued in 2016/17. It received an advance of its 2017/18 allocation from the SFC. The college also received additional strategic funding from the SFC in 2017/18 and expects it will require further additional funding to bring it to a stable financial position. At the time of this report, the SFC and the college had yet to agree the amount of funding. The college has taken steps to improve the quality of financial performance monitoring and forecasting. It is working with the SFC to deliver a sustainable business model. I have asked the auditor to keep the position under review.

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