HENDERSON LOGGIE
Chartered Accountants

New College Lanarkshire

Annual Audit Report for 2013/14 to the Board of Management and the Auditor General for Scotland

External Audit Report No: 2014/02

Draft Issued: 2 September 2014
15 September 2014

Final Issued: 30 September 2014

Contents

Notice: About this report

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

This report is for the benefit of only New College Lanarkshire and is made available to Audit Scotland (together with the beneficiaries), and has been released to the beneficiaries on the basis that it shall not be copied, referred to or disclosed, in whole or in part, without prior written consent.

Nothing in this report constitutes a valuation or legal advice.

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

This report is not suitable to be relied on by any party wishing to acquire rights against Henderson Loggie CA (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law Henderson Loggie CA does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

Financial Statements

- On the 1 November 2013 Cumbernauld College merged with Motherwell College to form New College Lanarkshire, with Motherwell College as the host. Coatbridge College merged on 1 April 2014. The Cumbernauld and Motherwell combination has been treated as a merger for accounting purposes as opposed to an acquisition. The subsequent joining of Coatbridge College will also be treated as a merger.

- The Cumbernauld College (Transfer and Closure) (Scotland) Order came into force on 1 November 2013. The Order made provision for all property, rights, liabilities and obligations of Cumbernauld College Board to be transferred to the Motherwell College Board. Contracts of employment of all employees were also transferred and the Cumbernauld Board was wound up.

- On 22 September 2014 we issued an audit report with an unqualified opinion on the financial statements of the College for the eight month period ended 31 March 2014 and on the regularity of the financial transactions reflected in those financial statements.

- The annual financial statements of the College comply with the Accounts Direction issued by SFC and the Statement of Recommended Practice (SORP) on Accounting for Further and Higher Education.

- Four potential adjustments were identified during the audit process. Following discussion with management, it was agreed not to make these adjustments which, if adjusted for, would have decreased the deficit by £0.002 million.

- A small number of disclosure and clarification adjustments were made to the financial statements to ensure SORP and Accounts Direction compliance and improve the overall presentation of the financial statements.

- One impact of the Office for National Statistics (ONS) decision to reclassify incorporated colleges as Central Government bodies from 1 April 2014 is that college year-ends have changed to 31 March and in 2013/14 the accounting period for New College Lanarkshire was for the eight months to 31 March 2014. The Scottish Government secured a concession from HM Treasury to allow University of the Highlands and Islands (UHI) incorporated colleges to retain 31 July for accounting purposes only. The latest update from the ONS Project Board, dated 25 March 2014, advised non-UHI incorporated colleges that further clarification about a possible July year end in 2015 would follow in due course once negotiations between HM Treasury, the Scottish Government and the Scottish Further and Higher Education Funding Council (SFC) have been concluded.

- The Group has shown a deficit for the eight months to 31 March 2014 of £9.574 million (2012/13 - £0.634 million surplus), and an Income and Expenditure Account balance of £12.922 million at 31 March 2014 (31/07/13 - £24.530 million).

- The College's position is a deficit for the period of £9.579 million (2012/13 – surplus £0.471 million) and an Income and Expenditure Account balance of £11.585 million at 31 March 2014 (31/07/13 - £23.198 million). The deficit for the period for both the Group and the College is largely due to the transfer of cash reserves to the Lanarkshire Further Education Foundation of £9.315 million and additional depreciation due to the revaluation at Motherwell Campus.

Financial Statements (continued)

- The College allowed staff the opportunity for voluntary severance during the period to 31 March 2014 with costs of early retirements/voluntary severance payments for 2013/14 totalling £1.560 million. It is understood that the costs of this voluntary severance scheme will be funded by SFC, up to a maximum limit set by SFC, with the expectation that voluntary severance packages will have a collective one year payback period.

- The College's pension liability increased by £2.453 million up to £5.818 million at 31 March 2014 (2012/13: decreased by £2.324 million) which was largely due to changes in key actuarial assumptions relating to discount rates.

- Two estates projects, costing £2.386 million to date, have been undertaken by the College during the period; the Student Hub and HGV Facility both at the Motherwell campus. Future commitments, including the two projects above, total £4.613 million.

- The College's land and buildings at the Cumbernauld campus were revalued at the end of 2013/14 financial period and the revaluation was incorporated into the financial statements.

Corporate Governance

- The College's Corporate Governance Statement confirms that the College complies with all of the provisions of the 2010 UK Corporate Governance Code in so far as they apply to the further education sector, and it has complied throughout the period ended 31 March 2014.

- Cumbernauld and Motherwell Colleges maintained their governance arrangements until merger on 1 November 2013. The College adopted the Motherwell College governance structures as an interim measure pending further merger with Coatbridge College (on 1 April 2014) and the creation of the Regional Board for Lanarkshire (with effect from 1 October 2014).

- The financial systems at Cumbernauld and Motherwell Colleges continued to operate throughout the period. No material weaknesses in the accounting and internal control systems at either campus were identified during the 2013/14 financial statements audit which would adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

- We did not identify any matters of concern relating to the College's corporate governance arrangements regarding the prevention and detection of fraud, or standards of conduct and the prevention and detection of corruption. The legacy college arrangements continued to operate at each campus.

- The College has an on-going process for identifying, evaluating and managing its significant risks.

- The Post-16 Education (Scotland) Act 2013 includes provisions in relation to the identification of principles of good governance practice for the college sector. A draft 'Code of Good Governance for Scotland's Colleges' has been issued for consultation and, once finalised, colleges will be expected to comply with the new Code as condition of grant from the SFC or their regional strategic body.

Performance

- The Colleges' management and committee structures included mechanisms to monitor and manage financial and non-financial performance. This appeared to work well in practice.

- Education Scotland made their first annual engagement visit to the College in May 2014. Their report noted that despite the complexities and challenges faced by the College during the merger period a number of positive outcomes have been achieved for both students and staff. Several examples of excellent practice were identified.

Outlook

- An order designating New College Lanarkshire as the Regional College for Lanarkshire, with South Lanarkshire College as an assigned college, comes into force on 1 October 2014 at which point the composition of the Board will change to reflect this.

- The College faces a challenging period during which governance structures for the Regional College will need to be put in place, and systems and cultures across the three campuses of Coatbridge, Cumbernauld and Motherwell will need to be harmonised.

- As a result of ONS reclassification, Scottish Colleges are now classified as central government bodies from 1 April 2014. This limits the future use of surpluses and cash reserves. Taking SFC advice and in line with other Colleges in the sector in order to protect existing cash reserves the College established an Arms-Length Foundation during the period and £9.315 million was transferred to the Foundation in March 2014. The Foundation is overseen by an independent Board of Trustees and the College will be required to apply to the Foundation each time a funding need is identified. This will include funding for building projects in course at 31 March 2014.

- The reclassification as a Central Government body has a number of implications for budgeting, reporting and accounting practices. Other than the change in financial year-end the main practical impact of this change is that colleges are required to request monthly cash transfers from the SFC to ensure that they only draw down sufficient funding to meet forecast expenditure. The format of financial statements will also have to change from 1 April 2014 as Central Government bodies use the Government Financial Reporting Manual ('the FReM'). The changes for 2014/15 are not likely to be significant as the Education SORP is expected to take precedence over the FReM.

- In September it was announced that the accounting year will return to 31 July from 2015, making 2014/15 a 16 month accounting period.

- Incorporated colleges and Regional Boards are also required to comply with the requirements of the Scottish Public Finance Manual (SPFM), except where directed by SFC's Accountable Officer.

- The funding position will remain challenging going forward. However the voluntary severances undertaken in recent years have helped to reduce pay costs and assist the College in coping with the funding reductions. Robust budget setting and monitoring arrangements will be essential in helping to retain sustainability.

- A draft of a new Financial Memorandum with Colleges has been issued by the SFC for consultation, setting out the formal relationship between the SFC and fundable bodies in the college sector, and the requirements with which fundable bodies are expected to comply in return for payment of grant by the SFC.

- Three new accounting standards (Financial Reporting Standard (FRS) 100, 101 and 102) come into force for accounting periods commencing on or after 1 January 2015. A new Education SORP has been developed incorporating these, which will be effective from 2015/16. Revised comparative figures for 2014/15 will be required.

Background

1. We were the appointed external auditors of Cumbernauld and Motherwell Colleges 2013/14 for the two years prior to the merger. 2013/14 was the first period of our appointment by Audit Scotland as external auditors of New College Lanarkshire ('the College'). Our appointment will also cover the 2014/15 and 2015/16 periods.

2. This report summarises our opinion and conclusions and highlights significant issues arising from our work for the 2013/14 audit. It covers the communication of findings from the audit required by International Standard on Auditing (ISA) (UK and Ireland) 260: Communication of Audit Matters with Those Charged with Governance.

3. The audit framework is outlined in our Strategic Planning Memorandum and 2013/14 Annual Audit Plan issued on 28 February 2014 and considered and approved by the Audit Committee on 9 June 2014. The scope of the audit was to:

   - provide an opinion on, to the extent required by the relevant authorities, the financial statements and the regularity of transactions in accordance with the standards and guidance issued by the Auditing Practices Board;

   - review and report on the College's corporate governance arrangements in relation to systems of internal control, the prevention and detection of fraud and irregularity, standards of conduct, and prevention and detection of corruption; and the College's financial position; and

   - review and report on the College's arrangements to manage its performance, as they relate to the economy, efficiency and effectiveness in the use of resources.

4. Our audit approach focused on the identification of the significant risk areas facing the College and the significant classes of transactions, estimates, other account balances and disclosures impacting upon the financial statements. These include;

   - compliance with legislation and financial regulations;

   - fixed assets transactions, including consideration of any impairment, revaluation of land and buildings and the potential impact on the financial statements; the estates development strategy implementation; on-going estate improvements and maintenance; and compliance with relevant financial reporting standards;

   - recoverability of debtors;

   - recognition of funding provided for specific purposes and the regularity of corresponding expenditure. There was increased risk in this area for 2013/14 given that SFC funding is provided on an academic year basis to 31 July and the financial year-end has moved to 31 March;

   - compliance with Financial Reporting Standard (FRS) 17 Retirement Benefits and provision for pension liabilities for early retirals;

   - the financial results of the College's subsidiary company and the impact on the Group financial statements; and

   - compliance with the SORP on Accounting for Further and Higher Education.

Basis of Information

5. External auditors do not act as a substitute for the College's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

6. To a certain extent the content of this report comprises general information that has been provided by, or is based on discussions with, management and staff of the College. Except to the extent necessary for the purposes of the audit, this information has not been independently verified. The contents of this report should not be taken as reflecting the views of Henderson Loggie CA except where explicitly stated as being so.

7. As our audit is designed primarily to enable us to form an opinion on the financial statements taken as a whole, our report cannot be expected to include all the possible comments and recommendations that a more extensive special examination would bring to light. Weaknesses or risks identified by us are only those that have come to our attention during our normal audit work in accordance with the Audit Scotland Code of Audit Practice, and may not be all that exist.

Acknowledgement

8. Our audit has brought us in contact with a range of College staff. We wish to place on record our appreciation of the co-operation and assistance extended to us by staff in the discharge of our responsibilities. This year was a complex year in accounting terms and the staff in Cumbernauld and Motherwell campuses were well prepared and worked well with us to complete the necessary work.

Audit Opinion

9. On 22 September 2014 we issued an audit report with an unqualified opinion on the Financial Statements of the College for the eight month period to 31 March 2014 and on the regularity of the financial transactions reflected in those financial statements.

10. We are required to undertake audit work from the Balance Sheet date up to the date of signing the financial statements and this will be undertaken for the period up to 22 September 2014. No post balance sheet events have been identified to the date of this report that required adjustment to be made to the financial statements or additional disclosure in a note thereto other than those already included. These are changes as a result of reclassification as Central Government bodies from 1 April 2014, the merger with Coatbridge College on 1 April 2014, and the designation of the College as the Regional College for Lanarkshire from 1 October 2014, with South Lanarkshire College as an assigned college.

Audit Completion

11. An important measure of proper financial control and accountability is the timely closure and publication of audited financial statements. Table 1 summarises the three key elements of the audit process. This year the process was more complex due to the merger of the two colleges and the maintenance of separate systems previously run by the legacy colleges. Despite this complexity we are pleased to report that the accounts preparation and audit ran well.

Table 1: Key elements of the audit process

Completeness of draft financial statements
A set of draft financial statements for the individual Motherwell campus was received prior to the start of the final audit visit. The Cumbernauld campus draft financial statements were received during the first week of the audit due to non-availability of key staff. The consolidated financial statements of New College Lanarkshire were received after the fieldwork at the individual campuses was complete. These were of a high standard and required minimal presentational changes as part of the audit process.

Quality of supporting working papers
Full sets of supporting working papers were provided at the outset of the audit and were of a high standard.

Response to audit queries
We are pleased to note that all audit queries were dealt with in a timely manner.

Corporate Governance Statement

12. Colleges are required to include a statement on their corporate governance arrangements within their annual financial statements. The statement describes the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management.

13. We are required to review the statement to assess whether the description of the process adopted in reviewing the effectiveness of the system of internal control appropriately reflects the process and report where the statement is not consistent with our knowledge of the body and report if the statement does not comply with SFC requirements.

Corporate Governance Statement (Continued)

14. The College's corporate governance statement for 2013/14 states the College complies with all of the provisions of the June 2010 UK Corporate Governance Code in so far as they apply to the further education sector, and it has complied throughout the period ended 31 March 2014.

15. From our audit work and our review of the College's statement we have no issues to report within our audit opinion.

Audit and Accounting Adjustments and Confirmation

16. There were no audit and accounting adjustments made to the accounts presented for audit. A small number of potential adjustments were identified during the audit but due to their immaterial individual value and nature, as well as the overall impact on the accounts, it was agreed not to adjust for them.

For audit purposes, material items are considered to be those above £0.262 million with trivial those below £0.012 million. Table 2 summarises the potential audit and accounting adjustments that were considered to be above the trivial level. The impact on the reported deficit, if these adjustments were made, would be a reduction of £0.002 million.

Table 2: Potential audit and accounting adjustments

Description	**I&E DR £'000**	**I&E CR £'000**	**B/Sheet DR £'000**	**B/Sheet CR £'000**
Prepayments and accrued income			14	
Tuition fees and Education Contracts		14		
Post period-end sales invoice not included				
Other operating expenses	12			
Accruals and deferred income				12
Post period-end purchase invoice not included				
Trade creditors			73	
Other creditors				73
Reallocation of funds held on behalf of student association				
	---------	----------	----------	----------
	12	14	87	85
	---------	----------	----------	----------
Net decrease in deficit if adjusted		**2**		
		----------		

17. In addition, a small number of disclosure and clarification adjustments were made to the financial statements to ensure SORP and Accounts Direction compliance and improve the overall presentation of the financial statements.

Audit and Accounting Adjustments and Confirmation (continued)

Confirmations and Representations

18. We confirm that as at the date of this report, in our professional judgement, Henderson Loggie CA was independent within the meaning of regulatory and professional requirements and the objectivity of audit staff was not impaired.

19. In accordance with auditing standards, we obtained representations from the College on material issues.

Financial Position

20. SFC circular SFC/31/2009, issued on 16 October 2009, defines a sustainable college as one which 'continually develops the quality of its learning activities to meet the changing needs of its customers, society and the economy, controls its costs, and year on year secures sufficient income to resource its planned activities and enable a level of current and future investment necessary to maintain its assets.'

21. One impact of the ONS decision to reclassify incorporated colleges as Central Government bodies from 1 April 2014 is that college year-ends have changed to 31 March and in 2013/14 the accounting period for New College Lanarkshire was for the eight months to 31 March 2014. The Scottish Government secured a concession from HM Treasury to allow UHI incorporated colleges to retain 31 July for accounting purposes only. In September 2014 the SFC confirmed that all colleges would return to a 31 July accounting year-end from 2015. Resource Return information will still be required at March each year for Government accounting purposes. There will be arrangements in place to allow amendments to the figures, if required, before the end of September each year.

22. Table 3 provides a summary of the Group's planned and actual financial results, based on the formal returns submitted by the College to the Funding Council.

Table 3: Comparison of planned and actual financial results

	2013/14 Planned £000	2013/14 Actual £000	2014/15 Planned £000
Financial outturn Surplus / (Deficit) (before transfer to Foundation)	-	(259)	(104)
Financial outturn Deficit (after transfer (to)/from Foundation)	(10,020)	(9,574)	1,896
Income and expenditure reserves	12,412	12,922	14,308
Cash balances (net)	3,042	2,121	2,102

Source: Audited financial statements and Financial Forecast Return (FFR)

Financial Position (continued)

23. A direct comparison of College income in 2013/14 of £30.450 million against last year is not possible given the change in accounting year-end. Points to note for 2013/14 include:

- Overall, the Group's income in for the eight month period 2013/14 has decreased by £9.347 million (23.5%) over 2012/13 to £30.450 million. This represents a £3.917 million increase (14.8%) over the same period in 2012/13. Voluntary service costs reimbursement from the SFC of £1.550 million is included.

- The Group's expenditure has increased by £0.861 million (2.2%) over 2012/13 to £40.024 million. This represents a £13.915 million increase (53.3%) over the same period in 2013/14. The majority of this increase is due to the transfer of cash reserves to the Foundation (£9.315 million) and voluntary severance costs (£1.560 million).

24. Given that SFC grant allocations follow the academic year to 31 July the College needed to consider how much teaching grant income had been 'earned' up to 31 March 2014 and should be recognised in the financial statements. Similarly, consideration also needed to be given as to how much tuition fee income should be recognised up to 31 March 2014. These issues were subject to discussion amongst all auditors at the Audit Scotland Further Education Sector Meeting in March 2014 and we had further discussions with the College's Vice Principal (Resources) on the accounting treatment. In relation to income recognition, while no single methodology was seen as more correct, it is for individual colleges to demonstrate to their auditors that they had applied an appropriate methodology to arrive at an acceptable estimate. The College has recognised eight twelfths of total SFC teaching grant and fee income received for the eight months of the 2013/14 academic year. This was considered to provide an acceptable estimate of the income 'earned' up to 31 March 2014.

25. The 2012/13 surplus and 20131/4 deficit were arrived at following significant charges for exceptional items (see paragraph 31) and additional bank charges (see paragraph 36) which means that the underlying position for both and years is sustainable. Income in both years includes SFC economic downturn funding.

2013/14 SUMs Outturn

26. The College's projected outturn against its 2013/14 SUMs target is shown in table 4.

Table 4: 2013/14 projected SUMs outturn

	2012/13	2013/14
WSUMs target (including ESF target)	123,090	134,958
WSUMs actual/projected	125,547	135,143
Excess	2,457	185

Source: 2012/13 - Audited SUMs returns; 2013/14 projected taken from College management information systems.

27. The audit of the SUMs return for the 2013/14 academic year is still to be carried out. To gain assurance over whether the College would meet its WSUMs target we considered the up to date position and placed reliance on work performed by Internal Audit who undertook an analytical review of WSUMs figures.

Financial Position (continued)

FRS 17 Retirement Benefits

28. In 2013/14 the College accounted for its participation in the local government pension scheme as if it were a defined benefit scheme. This is consistent with the accounting treatment adopted in previous years.

29. The College's pension liability increased in total by £2.453 million to £5.818 million at 31 March 2014 (2012/13: decreased in total by £2.324 million) which was largely due to changes in key actuarial assumptions relating to discount rates.

Provisions

30. The College has a provision in its balance sheet for £1.387 million (31/07/13 - £1.423 million) relating to pension costs from early retirements awarded to former employees. The College's approach to the valuation of the provision is to apply SFC actuarial tables on a consistent basis. The SFC issued guidance for the use of a net interest rate of 2% (2012/13 – 2%) which has been used by the College for 2013/14. We concluded that the provision has been correctly calculated, included and disclosed in the financial statements.

31. The College opened a new voluntary severance scheme in response to the merger on 12 September 2013 with a closing date for applications of 11 October 2013. An estimated cost of approximately £0.935 million for these applications has been included in the period end voluntary severance provisions (31/07/13 - £0.140 million). The total costs of early retirements/voluntary severance payments for 2013/14 was £1.517 million (2012/13 - £0.101 million) and are disclosed as part of the exceptional staff costs detailed in note 6.02 of the financial statements. Costs of this voluntary severance scheme will be funded by the SFC, up to a maximum limit set by SFC, with the expectation that the collective voluntary severance packages will have a one year payback period.

Capital Income and Expenditure

32. The Group purchased tangible fixed assets with a value of £0.399 million in the period (2012/13 - £0.960 million) relating to property, plant and equipment. Of these assets £0.195 million have been funded from SFC formula capital funding. Deferred capital grants have been correctly treated in line with relevant fixed assets.

33. Two large capital projects are currently underway within the College at the Motherwell campus. Prior to ONS reclassification and the transfer of cash reserves to the Foundation funding of these was planned from accumulated reserves. The College now plans to apply to the Board of Trustees of the Foundation in order to fund the balance remaining on these projects.

34. The College's Cumbernauld campus land and buildings were revalued at 31 March 2014 by an external firm of Chartered Surveyors. The small overall loss on revaluation of £0.087 million reduced the value of these assets to £13.410 million and has been properly accounted for and disclosed in the financial statements.

Financial Position (Continued)

35. In the past, Motherwell College componentised its fixed assets into sub categories in order to apply the most relevant depreciation rates. Following on from the revaluation of fixed assets in 2012/13 componentisation of assets held at the Motherwell campus was continued in the 2013/14 financial statements. Component accounting would be applicable for the College's properties at the Cumbernauld campus but has not been applied in 2013/14. This was discussed with College management and it has been accepted that, particularly with the corresponding release of deferred capital grants, it would not give rise to a material difference in the depreciation charge to the Income and Expenditure Account if this was applied. The land and buildings at the Cumbernauld campus were revalued at 31 March 2014 and suitable component values identified in order to facilitate componentisation of assets from 2014/15 (see recommendation **R2** Appendix II).

Bank Loan

36. During the period, the College management agreed to the early repayment of the Clydesdale bank loan of £1.966 million which was inherited from the former Cumbernauld College. This resulted in additional bank charges of £0.246 million which have been included in the Income and Expenditure account for the period.

Arms-Length Foundation

37. An arms-length foundation was set up in January 2014 into which the College has transferred £9.315 million by way of a donation in March 2014 and intends to transfer any future surpluses. The objects of the Lanarkshire Further Education Foundation "are to advance the charitable purposes of New College Lanarkshire to include the advancement of education by making grants and providing financial support for projects and activities being carried out by and supported by New College Lanarkshire". The main reason for setting up the Foundation is that the Central Government budget mechanisms mean that the ability to use college reserves and surpluses in future periods is restricted. The College will need to apply to the Foundation to access the money held there.

38. To ensure that the Foundation is not consolidated into the College's financial results, thereby most likely losing the ability to spend the money, it requires to be independent of the College. During 2013/14 we have had discussions with College management in relation to the Foundation, including with regard to the composition of the Board and the steps needed to maintain the Foundation at arms-length. At 31 March 2014 we have determined that the Foundation is at arms-length from the College and does not require to be consolidated. This position will be reviewed annually looking at the ongoing operation of the Foundation. The College should ensure that procedures are in place to ensure that the Foundation is considered independent on an ongoing basis (see recommendation **R1** Appendix II).

Corporate Governance

39. The College is responsible for ensuring that governance arrangements follow the three fundamental principles of openness, integrity and accountability and that these arrangements are in place to ensure the proper conduct of its affairs. Mechanisms to monitor the adequacy and effectiveness of these arrangements should also be in place.

40. Our responsibility, as noted in the Code of Audit Practice, is to review and report on audited bodies' corporate governance arrangements as they relate to:

- Bodies' reviews of corporate governance and systems of internal control, including reporting arrangements
- The prevention and detection of fraud and irregularity
- Standards of conduct and arrangements for the prevention and detection of corruption
- The financial position of audited bodies

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

42. The 2013/14 period encompassed governance structures in Cumbernauld, Motherwell, and New College Lanarkshire. At its initial meeting in December 2013 the College's Board of Management agreed that the structure of the Board and its Committees would remain the same, as far as possible, as the previous Motherwell College had in place, with a review to be undertaken following merger with Coatbridge College on 1 April 2014.

43. The senior management team of New College Lanarkshire became involved with the running of Coatbridge College from January 2014 following a request from the Coatbridge Board. Whilst this placed additional demands on the team's time the involvement has been seen as beneficial to the merger process.

44. We have considered the governance arrangements of Cumbernauld College, Motherwell College and New College Lanarkshire through formal review of documents and procedures and informal observation of the operation of committee arrangements and the relationships between Board members and staff. In particular we have considered arrangements for risk management and reporting to committees. The Boards of the two legacy colleges continued to operate good governance arrangements until the merger date and the arrangements in New College Lanarkshire have been appropriate, recognising their transient nature awaiting merger with Coatbridge College and the move to Regional College status. There is work to do in the new Regional College to ensure appropriate new governance structures and procedures are put in place.

45. The Post-16 Education (Scotland) Act 2013 includes provisions in relation to the identification of principles of good governance practice for the college sector. In anticipation of them coming into effect, the SFC invited the Regional Leads to convene a Steering Group to develop a draft 'Code of Good Governance for Scotland's Colleges'. The first stage of consultation took place in December 2013 when stakeholders were invited to provide comments on what should be included in the new Code, for consideration by the Steering Group. On 24 April 2014 the second stage of consultation commenced, with comments invited from all interested parties by 2 June 2014.

Corporate Governance (Continued)

46. The Steering Group has taken a very deliberate decision to keep the Code focussed on the principles of good governance and not include practical guidance on best practice. In so doing, the aim is to achieve a more concise, accessible and unambiguous document that sets out clearly what is required of colleges. The draft Code sets out the principles of good governance across five main areas: Leadership and Strategy; Quality of the Student Experience; Accountability; Effectiveness; and Relationships and Collaboration. Colleges will be expected to comply with the new Code as condition of grant from the SFC or their regional strategic body.

Systems of Internal Control

Control Environment

47. Following the merger of Cumbernauld and Motherwell Colleges on 1 November 2013 the financial systems and procedures operated by both colleges continued to be used at the two campuses. Plans are in place to harmonise systems after merger with Coatbridge College, with an expectation that this will be completed during 2015.

48. In addition to work undertaken by the College's Internal Auditors, which found financial controls to be "strong", we performed testing during the period-end audit. We concluded that in general the key controls for the main financial systems tested in both campuses were in place and operating as expected. No significant weaknesses or issues were found that would impact adversely on the accounts or our period-end audit.

Internal Audit

49. Audit Scotland's Code of Audit Practice directs us to maintain effective co-ordination with internal audit and place the maximum possible reliance on their work. Wyllie and Bisset provided internal audit services to the College in 2013/14.

50. We have reviewed the scope and extent of work performed by internal audit during the period and considered the impact of their findings and conclusions on our work, where appropriate. This included reviewing the work carried out on internal financial controls. We have also considered the adequacy of the provision and are content that the audit service is of good quality.

51. The annual internal audit report issued in September 2014 did not identify any issues that affect our audit conclusions.

Risk Management

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

53. The College had an on-going process for identifying, evaluating and managing its significant risks. A risk management policy and risk management procedures were in place that actively monitored and reported on risk at an operational and strategic level. There are clear links drawn between the key risks in the register and the College's Strategic Plan.

54. During the period the risk management approach was changed to encompass the merger and planned merger with Coatbridge College on 1 April 2014. We agreed the approach taken was appropriate.

55. The major estates projects utilise professional project managers who have detailed project risk registers which are monitored and updated on a regular basis.

Fraud and Irregularity, Standards and Conduct, and Prevention and Detection of Corruption

56. During 2013/14 we had regard to ISA 240: The Auditor's Responsibility to Consider Fraud in the Audit of Financial Statements.

57. No frauds were identified during 2013/14 or in the period since 31 March 2014 up to the date of this report.

58. The College has yet to formally establish its own procedures/policies in relation to standards of conduct and prevention and detection of corruption. The College should ensure that a timetable is established for the harmonisation of procedures/policies which incorporates the former Coatbridge, Cumbernauld and Motherwell Colleges (see recommendation **R3** Appendix II). During the period the College has been following the procedures/policies which were in place under the legacy colleges. Our previous assessment of these arrangements was that they were good. These include:

    - Code of Conduct for Board Members
    - Register of Board Members' and Senior Staff Interests
    - Fraud and Corruption Policy (including Bribery Act)

59. The arrangements for maintaining standards of conduct and the prevention and detection of corruption are considered to have been appropriate.

Performance Audit

Introduction

60. The terms of appointment from Audit Scotland include a requirement for a proportion of our audit time to be spent on performance audit work. Performance audit work covers a variety of areas, both financial and non-financial, including Audit Scotland centrally directed studies and locally determined studies based on agreement between each organisation and their auditors.

61. No mandatory performance audit studies were identified by Audit Scotland for 2013/14 although auditors were requested to provide information in a data set for potential use in a sector report. In particular it has requested information about voluntary severance schemes and payments. Details of the payments made under the voluntary severance scheme during the 2013/14 period can be found at paragraph 31 in this report.

Education Scotland Review

62. We are required by Audit Scotland's Code of Audit Practice to contribute to the 'whole organisation' approach to inspection through co-ordination amongst auditors, inspectors and other scrutiny bodies. We therefore place reliance on the reported results of the work of statutory inspectorates in relation to corporate or service performance.

63. The College received its first annual engagement visit by Education Scotland in May of this year. The report issued by Education Scotland noted that despite the complexities and challenges faced by the College during the merger period a number of positive outcomes have been achieved, including; learners from all campuses enjoy their programmes and are positive about their college learning experience; and the college has made sure that learners have been consulted and kept well informed throughout the merger process. The report also highlighted that *'there is a recognition within the college that much focus is currently on establishing infrastructure which will enable the college to move forward and address regional issues comprehensively'* and that *'most staff in the college are committed to making the new college a success and are building positive relationships with colleagues across the campuses'.* Several examples of excellent practice in place at the College were identified by Education Scotland.

College Performance Arrangements

64. Audit Scotland reports were considered by the Senior Management Team (SMT) and where appropriate the Principal updated the Board or appropriate committee where the content and recommendations were relevant to the College.

65. Arrangements for financial and non-financial management were well established in the College, through the operation of the SMT and the Board and its various committees.

66. The performance arrangements in both Cumbernauld and Motherwell Colleges continued to operate until the merger. These have previously been reviewed and were considered good. New College Lanarkshire adopted the arrangements of Motherwell College. The Board of Management's Constitution and Articles of Governance and its Schemes of Delegated Authority record the performance management aspects of the Board and each committee, and where appropriate, their responsibility to take action to address issues in performance. Discussion with managers and our review of meeting papers and minutes confirms these responsibilities appeared to be undertaken in an appropriate manner in all three organisations.

67. A full Strategic Plan for New College Lanarkshire has yet to be developed and it is anticipated that this will be completed once the full Regional Board has been appointed. As an interim measure the College has adopted the former Motherwell College Strategic Plan as an outline until 31 July 2014. An annual Operational Plan was in place for the College for 2013/14.

Performance Audit (continued)

68. Key performance indicators are set out in the Operating and Financial Review in the College's annual report.

69. The College has a Regional Outcome Agreement which is aimed at responding to the national objectives and priorities for post-16 education, and works with Local Authorities, Community Planning Partnerships, Skills Development Scotland and employers to ensure its education provision meets the needs of learners and the community. The College continues to work in partnership with organisations to achieve economies of scale and better efficiency.

70. Arrangements for performance management as outlined above are considered appropriate.

2014/15 and Beyond

Post-16 Education (Scotland) Act 2013

71. The Post-16 Education (Scotland) Act 2013 makes provision: about the support for, and the governance of, further and higher education institutions, including provision for the regionalisation of colleges; for reviews of how further and higher education is provided; for sharing information about young people's involvement in education and training; and for connected purposes. The Act was passed by the Parliament on 26 June 2013 and received Royal Assent on 7 August 2013.

72. Under the Act, the College (as of 1 April 2014) is part of the Lanarkshire region, along with South Lanarkshire College. An order designating New College Lanarkshire as the Regional College, with South Lanarkshire College as an assigned college, comes into force on 1 October 2014 at which point the composition of the Board will change to reflect this.

73. In order to be ready for merger with Coatbridge College on 1 April 2014, both Colleges undertook a substantial amount of work prior to that date. A significant amount remains to be completed by New College Lanarkshire to harmonise financial systems and procedures and put in place new governance and performance arrangements to fulfil the responsibilities of the Regional Board. Plans are in place to take this forward however there are a number of cultural obstacles to overcome.

74. The Boards of Management have been kept up-to-date regularly with information about the merger and regionalisation processes throughout the period, including the duties of regional colleges.

75. The governance structure for the New College Lanarkshire was approved by the Board in December 2013. Further changes will be required following the move to being the Regional College in October.

ONS Reclassification

76. The reclassification of incorporated colleges in Scotland as Central Government bodies from 1 April 2014 has a number of implications for budgeting, reporting and accounting practices and issues for consideration which the SFC has addressed through a series of Reclassification Communications and ONS Project Board Updates.

77. Other than the change in financial year-end (see paragraph 79) the main practical impact of this change is that colleges are required to undertake significantly more reporting to the SFC, including monthly requests for funding to ensure that they only draw down sufficient funding to meet forecast expenditure. The format of financial statements will also have to change from 1 April 2014 as Central Government bodies use the Government Financial Reporting Manual ('the FReM'). The changes for 2014/15 are not likely to be significant as the Education SORP is expected to take precedence over the FReM. No changes in accounting treatment are likely to be required although additional disclosure will be required, particularly in relation to remuneration and out-turn against budget.

78. Incorporated Colleges and Regional Boards are also required to comply with the requirements of the Scottish Public Finance Manual (SPFM), except where directed by SFC's Accountable Officer.

79. In September 2014 the SFC confirmed that from 2015 the accounting year end will revert back to 31 July. Other ONS reclassification impacts will not change. 2014/15 will therefore be a 16 month accounting period. The Resource Return at 31 March will be used for Government accounting purposes. If required this can be amended before the end of September each year. From 2015/16 Whole of Government Accounts returns will also be required.

2014/15 and Beyond (continued)

SFC Financial Memorandum with Colleges

80. A draft of a new Financial Memorandum with Colleges has been issued by the SFC for consultation, setting out the formal relationship between the SFC and fundable bodies in the college sector, and the requirements with which fundable bodies are expected to comply in return for payment of grant by the SFC.

81. The new Financial Memorandum shows a significant number of changes from the previous version, reflecting all the recent governance changes in the sector and the reclassification of incorporated colleges in Scotland as Central Government bodies.

FRS 102 'The Financial Reporting Standard' and new Education SORP

82. The FRC has been implementing a convergence programme aligning UK Generally Accepted Accounting Practice (GAAP) to International Financial Reporting Standards (IFRS) and published three new FRSs (FRS 100, 101 and 102) with the substantive FRS 102 'The Financial Reporting Standard' representing the final step towards IFRS convergence. These three new FRS' become the new UK GAAP, which is fully IFRS-based. The new accounting standards come into force for accounting periods commencing on or after 1 January 2015 which means that 2015/16 will be the first reporting year. However, comparative figures for 2014/15 will be required.

83. A new Education SORP has been developed following the publication of the new FRSs and this received final approval from the FRC on 26 March 2014 following an extensive consultation process. This will be effective from 2015/16. The new SORP was formally published in May 2014 and is available on www.fehesorp.ac.uk.

Regional Outcome Agreement

84. A Regional Outcome Agreement with the SFC has been finalised for the Lanarkshire Federation of Colleges and the regional allocation of funding agreed for 2014/15.

85. The region's final allocations for 2014/15 are teaching grant of £37.820 million and capital funding of £2.637 million.

86. In March 2014 the Vice Principal (Resources) presented a draft budget for the College for 2014/15 to the Finance Committee for recommendation to the Board of Management. This showed a break-even position.

Appendix I
Audited Bodies' Responsibilities

Extracts from the Audit Scotland Code of Audit Practice

The Scottish ministers, elected members, governing bodies, boards, accountable officers, managers and officials have primary responsibility for ensuring that public business is conducted in accordance with the law and proper standards, and that public money is handled with integrity and spent appropriately. Public bodies and those responsible for conducting their affairs must discharge this accountability by establishing and maintaining proper governance arrangements and effective stewardship of the resources at their disposal.

Financial statements
Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources. Audited bodies are responsible for:

- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority
- maintaining proper accounting records
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice)
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return

Many audited bodies publish other information, such as an annual report, alongside the financial statements.

Audited bodies should prepare financial statements in accordance with statutory timescales or in good time to allow audits to be completed by any dates specified by sponsoring directorates or other bodies. Financial statements should be prepared in accordance with all relevant regulatory requirements and be supported by accounting records and working papers prepared to an acceptable professional standard.

Corporate governance arrangements
The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer

Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements.

Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

Systems of internal control
Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls.

They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.

Rigorous self-evaluation should be a central part of audited bodies' performance management to support continuous improvement.

Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity.

This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions
- developing and implementing strategies to prevent and detect fraud and other irregularity
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity
- participating, when required, in data matching exercises carried out by Audit Scotland

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers
- promoting appropriate values and standards
- developing, promoting and monitoring compliance with standing orders and financial instructions

Financial position of audited bodies

Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified
- compliance with any statutory financial requirements and achievement of financial targets
- balances and reserves, including strategies about levels and future use
- the impact of planned future policies and foreseeable developments on their financial position

Best Value

The Scottish Public Finance Manual explains that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure Best Value. Best Value is defined as the continuous improvement in the performance of functions. This includes having regard to the concepts of economy, efficiency and effectiveness and the need to meet equal opportunity requirements, and contributing to the achievement of sustainable development.

Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

Appendix II
2013/14 Annual Audit Report Recommendations

Para Ref.	Recommendation	Grade	Comments	Agreed Y/N	Responsible Officer For Action	Agreed Completion Date
37	**Financial Position** **Arms-Length Foundation** **R1** The College should maintain an ongoing review of its involvement with the Foundation to ensure that this remains independent and that the Foundation does not need to be consolidated in the College financial statements in future.	Medium	The college will consider the advice of the SFC and other advisors as appropriate	Y	Vice Principal (Resources)	On-going
35	**Capital Income and Expenditure** **R2** Cumbernauld campus assets should have component accounting applied **in** 2014/15.	Low	Valuation made at 31 March 2014 to enable this for 2014/15	Y	Assistant Principal Finance	2014/15 period-end

Appendix II
2013/14 Annual Audit Report Recommendations

Para Ref.	Recommendation	Grade	Comments	Agreed Y/N	Responsible Officer For Action	Agreed Completion Date
58	**Corporate Governance** **Fraud and Irregularity, Standards and Conduct, and Prevention and Detection of Corruption** **R3** The College should ensure that a timetable is established for the harmonisation of procedures/policies in relation to standards of conduct and prevention and detection of corruption, which incorporates the former Coatbridge, Cumbernauld and Motherwell Colleges.	Medium	Discussed and agreed.	Y	Clerk to the Board	Timetable in place by 31 December 2014

High	Issue subjecting the organisation to material risk and which should be dealt with as a high priority
Medium	Issue subjecting the organisation to significant risk and which should be addressed by management.
Low	Less significant matters, which would enhance efficiency, or do not require urgent attention but which should be followed up within a reasonable timescale.