Annual Audit Report

to the Board of Management and the Auditor General for Scotland

New College Lanarkshire

Year ended 31 July 2018

MAZARS

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

MAZARS

Mazars LLP
Apex 2
97 Haymarket Terrace
Edinburgh
EH12 5HD

The Audit and Risk Committee
New College Lanarkshire
Motherwell Campus
1 Enterprise Way
Motherwell
ML1 2TX

3 December 2018

Dear Members

Annual Audit Report – Year ended 31 July 2018

We are pleased to present our Annual Audit Report for the year ended 31 July 2018. The purpose of this document is to summarise our audit conclusions from our audit of New College Lanarkshire, including the regional consolidated financial statements.

The scope of our work, including identified significant audit risks and other areas of management judgement, was outlined in our Audit Strategy Memorandum which we presented on 21 May 2018. We have reviewed our Audit Strategy Memorandum and concluded that the original significant audit risks and other areas of management judgement remain appropriate.

We would like to express our thanks for the assistance of the finance team during our audit.

If you would like to discuss any matters in more detail then please do not hesitate to contact me on 0738 724 2052.

Yours faithfully

Lucy Nutley
Mazars LLP

1. EXECUTIVE SUMMARY

Purpose of this report and principal conclusions

This Annual Audit Report sets out the findings from our audit of New College Lanarkshire ('the College') for the year ended 31 July 2018 and the audit of the Lanarkshire Regional consolidated accounts. This document will form the basis for discussion at the Audit and Risk Committee meeting on 3 December 2018.

The Lanarkshire Colleges Order 2014 designates the Board of New College Lanarkshire as the Regional Strategic Body for Lanarkshire – known as the Lanarkshire Board. The Order also assigns South Lanarkshire College to the Lanarkshire Board. In August 2016, the Scottish Funding Council awarded fully fundable status to New College Lanarkshire for the Region. As a consequence of this, and determination of accounting standards, the Lanarkshire Board have determined that consolidated regional accounts should be prepared.

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. Subject to the satisfactory completion of the outstanding work, at the time of issuing this report we have the following conclusions:

Opinion on the financial statements

We issued an unqualified opinion, without modification, on the financial statements on 18 December 2018.

Opinion on regularity

We issued an unqualified regularity opinion on 18 December 2018, meaning that in our opinion, in all material respects the expenditure and income recognised in the financial statements have been applied for the purposes intended .

Opinion on other requirements

We issued an unqualified opinion on the matters prescribed by the Auditor General for Scotland on 18 December 2018. Namely that the remuneration and staff report, performance report and governance statement have been properly prepared in accordance with the relevant legislation

Wider scope work

We concluded as follows against each of the four wider scope dimensions:

- The Lanarkshire Board has arrangements in place, including budgetary control, that help the Board members scrutinise finances. Currently, consolidated regional financial information is not available to Board members during the year.
- The Lanarkshire Board has adequate financial planning arrangements in place, however, financial sustainability concerns, initially raised in 2017, remain;
- The Lanarkshire Board has governance arrangements in place that provide appropriate scrutiny of decisions made. However, a review of governance arrangements at the RSB has not taken place to identify potential improvements to the regional governance framework; and
- The Lanarkshire Board has an effective performance management framework in place that supports progress towards the achievement of value for money.

1. EXECUTIVE SUMMARY (CONTINUED)

Misstatements and internal control recommendations

There have been no adjusting or unadjusted misstatements identified during the course of the audit above the trivial threshold of £33k for New College Lanarkshire, or above £44k for the consolidated financial statements

Section 3 sets out the internal control recommendations that we make, together with an update on any prior year recommendations.

Status of our audit work

We have completed our work on the financial statements and wider scope work for the year ended 31 July 2018.

Our audit approach

We provided details of our intended audit approach in our Audit Strategy Memorandum in May 2018. We have not made any changes to our audit approach since we presented our Audit Strategy Memorandum.

1. EXECUTIVE SUMMARY (CONTINUED)

Materiality

Materiality is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole. Misstatements in financial statements are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

We set materiality at the planning stage of the audit at £1,104k for the College and £1,441k for the Region using a benchmark (2%) of Gross Expenditure. Our final assessment of materiality, based on the final financial statements and qualitative factors is £1,086k for the College and £1,451k for the Region, using the same benchmark.

Threshold	Initial threshold College £'000	Final threshold College £'000	Initial threshold Region £'000	Final threshold Region £'000
Overall materiality	1,104	1,086	1,441	1,451
Performance materiality	883	869	1,153	1,161
Trivial threshold for errors to be reported to the Audit and Risk Committee	33	33	43	44

The assessment of what is material is a matter of professional judgement and is affected by our perception of the financial information needs of the users of the financial statements. In making our assessment we assume that users:

- have a reasonable knowledge of business, economic activities and accounts;
- have a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- will make reasonable economic decisions on the basis of the information in the financial statements.

We consider materiality whilst planning and performing our audit based on quantitative and qualitative factors.

Performance Materiality

Our audit testing is based on a level of performance materiality, which is a percentage of overall materiality, but also dependent on the level of inherent risk assessed on the area being tested. It is lower than overall materiality as it helps to reduce the risk that the total of the uncorrected or undetected misstatements does not exceed materiality for the financial statements as a whole. It is based on between 50 – 80% of overall materiality depending on the inherent risk level assessed. Our initial assessment of performance materiality is based on low inherent risk, meaning that we have applied 80% of overall materiality as performance materiality.

Misstatements

We aggregate misstatements identified during the audit that are other than clearly trivial. We set a level of triviality for individual errors identified (a reporting threshold) for reporting to the Audit and Risk Committee that is consistent with the level of triviality that we consider would not need to be accumulated because we expect that the accumulation of such amounts would not have a material effect on the financial statements. This level was set at 3% of materiality.

2. AUDIT OF THE FINANCIAL STATEMENTS

New College Lanarkshire has produced consolidated financial statements for the second time for the 2017/18 year. The consolidated financial statements incorporate the results of New College Lanarkshire, South Lanarkshire College and AMCOL Scotland Ltd, a subsidiary company of New College Lanarkshire which provides children's nursery services.

New College Lanarkshire is a registered charity, the Lanarkshire Board is not. Therefore, in order to meet requirements set by the Scottish charity regulator, OSCR, the regional accounts are named as New College Lanarkshire regional financial statements. For the purpose of clarity in this report, the regional accounts will be referred to as the consolidated financial statements. References to New College Lanarkshire, unless otherwise stated, are to the college as a single entity.

Set out below are the significant findings from our audit. These findings include:

- our audit conclusions regarding significant risks and key areas of management judgement outlined in the Audit Strategy Memorandum;
- our comments in respect of the accounting policies and disclosures that you have adopted in the financial statements. On page 8 we have concluded whether the financial statements have been prepared in accordance with the financial reporting framework and commented on any significant accounting policy changes that have been made during the year;
- any further significant matters discussed with management; and
- any significant difficulties we experienced during the audit.

Significant risks and key areas of management judgement

As part of our planning procedures we considered the risks of material misstatement in the College's financial statements that required special audit consideration. Although we report identified significant risks at the planning stage of the audit in our Audit Strategy Memorandum, our risk assessment is a continuous process and we regularly consider whether new significant risks have arisen and how we intend to respond to these risks. No new risks have been identified since we issued our Audit Strategy Memorandum.

Management override of controls

Description of the risk

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 override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.

How we addressed this risk

We addressed this risk through performing audit work over:

- Accounting estimates impacting on 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.

Audit conclusion

Satisfactory assurance has been gained in respect of presumed risk of management override. We have no matters to report.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Revenue recognition

Description of the risk

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.

The presumption is able to be rebutted, which we have done for the College's grant income, as it carries very low inherent risk of fraud or error in its recognition. However the risk does apply to non-grant income generated by the College.

How we addressed this risk

We addressed this risk through performing audit work over

- The design an implantation of controls management has in place to ensure income is recognised in the correct period;
- Cash receipts around year end to ensure they have been recognised in the appropriate year;
- The judgements made by management in determining when grant income is recognised; and
- Obtaining counterparty confirmation for major grant income.

Audit conclusion

Satisfactory assurance has been gained in respect of the presumed risk of revenue recognition. We have no matters to report.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Valuation of land and buildings

Description of the risk

The financial statements contain material entries for land and buildings, with the total for New College Lanarkshire being £92.9m as at 31 July 2017. Land and buildings are due to receive an interim valuation at 31 July 2018. It is likely that revaluation amounts will be material to the financial statements. Valuations will be performed by an expert valuer.

We further note that South Lanarkshire College will also receive an interim desktop valuation for land and buildings as at 31 July 2018 which will impact on the consolidated regional financial statements.

How our audit addressed this area of management judgement

We have addressed the risk by

- Examining the professional qualifications of the valuer;
- Challenging and substantiating the assumptions and the appropriateness of the date of valuations used by the valuer;
- Ensuring valuations and impairments have been completed on the appropriate basis and that movements are in line with expectation;
- Consider the appropriateness of the valuation for assets held for sale and whether they should be revalued upwards or downwards; and
- Review of property related provisions in the accounts ensuring that the requirements for recognition for a provision have been met and the amounts provided have been fairly stated

Audit conclusion

An interim desktop valuation of the New College Lanarkshire estate was performed as at 31 July 2018, assessing a value of £98.6m. This, and the net related increase in the value of land and buildings of £8.3m has been appropriately reflected in the financial statements. A small impairment of £323k was also recorded on some assets, which have been accounted for correctly.

A full revaluation of the South Lanarkshire College estate was performed as at 31 July 2018, assessing a value of £33.5m. This, and the corresponding increase in value (£1.795m) have been appropriately reflected in the consolidated financial statements.

Our audit work has provided satisfactory assurance that the valuation of land and buildings in the consolidated financial statements is not materially misstated.

Key areas of management judgement
Key areas of management judgement include accounting estimates which are material but are not considered to give rise to a significant risk of material misstatement. These areas of management judgement represent other areas of audit emphasis.

Valuation of pension liabilities	**Description of the management judgement** 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 is recognised in the accounts. Given the scale of the liability recognised, a misstatement in the reported position could be material to the financial statements.
	How we have addressed this management judgement We have addressed the risk by • Considering the arrangements put in place, including the controls, for making estimates in relation to pension entries in the financial statements; and • Consider 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
	Audit conclusion Our audit work has provided satisfactory assurance over pension valuations. We have no matters to report.

Consolidation process
We consider the preparation of the consolidated financial statements to be a key area of management judgement, given the complex nature of the accounting practices for the entities involved.

We note that the Colleges are aware of different property, plant and equipment revaluation policies in New College Lanarkshire and South Lanarkshire College, such that on an ongoing basis, there will be revaluations in different accounting periods. We do not anticipate that this would result in material misstatements in the future.

We consider that the preparation of the consolidated financial statements is appropriate, and that suitable arrangements are in place to ensure that there is a low risk of material misstatement in the consolidated financial statements.

Area of focus

Enhanced risks can arise from significant events occurring during the period under review. In 2017/18, the College will operate a voluntary severance programme. As the amounts involved are significant and are not routine transactions, we have assessed this as an area of audit focus.

Voluntary severance scheme	**Description of the area of focus** College with strategic funding for a voluntary severance scheme, as part of the ongoing Business Scenario Plan. A total of £1.09m has been obtained from the SFC that will be used to fund severances dating from 31 March to 31 July 2018.
	How we have addressed this area of focus We considered: • the severance pay amounts and how these have been calculated; • the communication of the voluntary severance scheme to those affected; • whether the funding received to fund the voluntary severance scheme has been utilised in accordance with the grant conditions; and • The accounting treatment of payments and disclosures made in the financial statements.
	Audit conclusion Our audit work has provided satisfactory assurance over the voluntary severance scheme. We have no matters to report.

Qualitative aspects of the entity's accounting practices

We have reviewed the College's accounting policies and disclosures and concluded they comply with the requirements of the 2015 Statement of Recommended Practice: Accounting for Further and Higher Education and the Government Financial Reporting Manual 2017/18 , appropriately tailored to the College's circumstances.

The New College Lanarkshire financial statements were received on 10 October – this was in advance or our audit fieldwork which commenced on 15 October. These financial statements were used for our audit of the College only numbers and the disclosures were not audited.

Draft consolidated financial statements and annual report were received from the College on 9 November 2018 which was in line with the agreed timetable. The draft consolidated financial statements and annual report had been shared with South Lanarkshire College in advance of them being presented for audit. The draft consolidated financial statements and draft annual report were of an adequate quality, with several disclosure amendments suggested. These related mainly to ensuring that both the College and Regional position were disclosed throughout the financial statements and annual report.

Producing quality supporting working papers is a crucial part of compiling financial statements that are complete and materially accurate. They also support the delivery of an efficient audit. Working papers provided for audit were of a good standard and staff were responsive to our requests during the audit.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Significant matters discussed with management

Throughout the year, we have had discussions with New College Lanarkshire regarding financial sustainability and progress being made with the Business Plan submission to the SFC. See page 15 for further details and conclusion of wider scope considerations of financial sustainability.

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 and staff.

3. INTERNAL CONTROL RECOMMENDATIONS

The purpose of our audit is to express an opinion on the financial statements. As part of our audit we have considered the internal controls in place relevant to the preparation of the financial statements. We do this in order to design audit procedures to allow us to express an opinion on the financial statements and not for the purpose of expressing an opinion on the effectiveness of internal control, nor to identify any significant deficiencies in their design or operation.

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

We identified no recommendations for the improvement of internal controls at New College Lanarkshire during the current year audit. One minor recommendation was raised and agreed for the improvement of internal controls at South Lanarkshire College, during our audit. We do not consider this finding significant to the consolidated financial statements and have therefore not re-raised the finding in this report.

The follow up from our prior year point identified in relation to the Lanarkshire Board can be found on page 13. However, as this point is considered ongoing as it not complete at the point of writing, it has been re-raised in this report.

We assign priority rankings to our points to reflect the importance that we consider they pose to your organisation and, hence, our recommendation in terms of the urgency of required action. In summary, the matters arising fall into the following categories:

Priority ranking	Description	Number of issues
1 (high)	In our view, there is potential for financial loss, damage to reputation or loss of information. This may have implications for the achievement of business strategic objectives. The recommendation should be taken into consideration by management immediately.	nil
2 (medium)	In our view, there is a need to strengthen internal control or enhance business efficiency. The recommendations should be actioned in the near future.	1
3 (low)	In our view, internal control should be strengthened in these additional areas when practicable.	nil

3. INTERNAL CONTROL RECOMMENDATIONS (CONTINUED)

Follow up of previous internal control points

We set out below an update on internal control points raised in the prior year.

Lanarkshire Board arrangements Priority 2

Description of deficiency

As set out in the Lanarkshire Colleges Order 2014, a number of South Lanarkshire College Board members are required to be members of the Lanarkshire Board. In addition, SLC representatives attend all of the committees of the Lanarkshire Board to present minutes and papers from the relevant South Lanarkshire College Board committees. The Chair of the Lanarkshire Board is a member of the South Lanarkshire College Board. The Finance Committee, with the support of the SFC, have instigated an independent review of regional financial arrangements.

Potential effects

The Accountable Officer for the RSB requires assurance over the arrangements in place across the region. As the RSB continues to evolve and develop, there is a risk that governance arrangements in place become, or are perceived to be less effective, reducing the assurance available to the Accountable Officer.

2017/18 update

During 2017/18, a review of regional financial governance arrangements was due to take place, but has not. We understand that members of the Finance Committee have met with the SFC to seek additional funding for the resources to maintain regional financial information, but there has been no decision on this. We note the recommendation made by Audit Scotland in 'Scotland's Colleges 2018' that the Lanarkshire Board should '*develop a clear plan for improving collaborative working across the region'.* Clearly, finance and financial governance are integral parts of the collaborative working required, and therefore we recommend again that a regional review of financial governance arrangements are in place.

4. WIDER SCOPE
FINANCIAL MANAGEMENT

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

Our conclusion
The Lanarkshire Board has arrangements in place, including budgetary control, that help Board members scrutinise finances for each college in the Region. Currently, no consolidated regional financial information is available to Board members during the year.

Financial performance
FE/HE SORP position

	Region 2017/18 £'000	College 2017/18 £'000	Region 2016/17 £'000	College 2016/17 £'000
Operating income	70,158	52,123	69,925	53,007
Staff costs	(51,943)	(38,327)	(51,233)	(38,728)
Operating expenditure	(20,616)	(16,294)	(20,802)	(16,459)
Operating Deficit for the year (FE/HE SORP basis)	**(2,401)**	**(2,498)**	**(2,110)**	**(2,180)**

The above table shows the financial performance of both the Region and the College for the last two years under the FE/HE SORP. Despite a deficit being shown over both years:

- Both New College Lanarkshire and South Lanarkshire College, and therefore the Region achieved their financial targets and spending was in line with the plan;
- There were no significant changes to the reported position during the year; and
- The student credit target was exceeded, confirming the level of funding in the financial statements.

As in 2016/17, New College Lanarkshire identified a shortfall in working capital requirements as at 31 July 2018, and agreed a cash advance with the SFC of £1.3m, which has been treated as deferred income as it has been taken from the College's 2018/19 funding.

Staff cost increases are primarily driven by the outcome of National Bargaining, which has raised salaries for lecturing and support staff. This increase is reflected across the College sector in Scotland.

New College Lanarkshire has reported a reduction in staff costs which is as a result of the Voluntary Severance programme, funded by the SFC that took place between March and July 2018. While some cost reductions have been noted this year, larger reductions are expected to be recognised in 2018/19 arising from the full year effect of lower staff costs.

The reduction in income at New College Lanarkshire is as a result of the Prison Education contract not being renewed, as this generated £2.4m of income in 2016/17 with similar costs being expended. Staff who worked on the contract have transferred to the new provider. The loss of the contract has therefore not affected the financial position of New College Lanarkshire.

South Lanarkshire College and AMCOL reported small surpluses during the year, thus reducing the operating deficit of the Region from that of New College Lanarkshire.

4. WIDER SCOPE
FINANCIAL MANAGEMENT (CONTINUED)

Adjusted operating position

The table on the previous page sets out the financial position in accordance with the SORP requirements. The table below reflects the 'adjusted operating position' as required by the Accounts Direction set by the SFC. The adjusted operating position removes more volatile accounting entries, such as the valuation of pensions. Full details of the adjustments included are shown in the Performance Report within the Annual Report and Financial Statements.

	Region 2017/18 £'000	College 2017/18 £'000	Region 2016/17 £'000	College 2016/17 £'000
Deficit before other gains and losses	**(2,401)**	**(2,498)**	**(2,110)**	**(2,180)**
Add back:				
- Depreciation (net of deferred capital grant release)	1,126	867	1,206	922
- Impairment of assets on revaluation	323	323	-	-
- Non-cash pension adjustment	2,394	1,910	1,919	1,520
Deduct:				
- Non government capital grants	-	-	(893)	(893)
- Revenue funding allocated to loan repayments (from Cash Budget for Priorities)	(86)	-	(254)	(27)
Adjusted operating surplus/(deficit)	**1,356**	**602**	**(132)**	**(658)**

The table above indicates that once the non cash and other applicable adjustments are made, both the Region and the College have achieved a surplus in the current year, compared with deficits in the prior year, indicating improvements on the underlying position of the Colleges.

Impact of Depreciation Budget

The Statement of Comprehensive Income and Expenditure is prepared under the FE/HE SORP, which does not permit the inclusion of the non-cash budget for depreciation. Colleges may show a deficit equivalent to net depreciation as a result of having to meet Government accounting rules.

	Region 2017/18 £'000	College 2017/18 £'000	Region 2016/17 £'000	College 2016/17 £'000
Operating deficit for the year (FE/HE SORP basis)	**(2,401)**	**(2,498)**	**(2,110)**	**(2,180)**
Add: Depreciation budget for government funded assets (net of deferred capital grant) for academic year	974	863	806	579
Operating deficit on Central Government accounting basis	(1,135)	(1,635)	(1,304)	(1,601)

The table above shows deficits for both the Region and College when the impact of the depreciation budget is taken as the only adjusting factor to the financial position. The Region and the College are therefore currently considered to be operating outwith their funding allocation. We have considered this in more detail in the Financial Sustainability section of this report.

Budgetary process

We have reviewed and considered the budgetary processes and controls and budget monitoring arrangements in place at both colleges and as a whole on a regional basis. Our review consisted of review of budget monitoring reports, review of committee papers and attendance at committees.

Finance officers produce monthly management accounts in a regular time frame in accordance with their established processes following the month end. Monthly management reports have reported a consistent position from both Colleges throughout the year. The financial position of South Lanarkshire College is reported regularly to the Lanarkshire Board, through provision of approved minutes and reports and written updates. Consolidated regional financial information is not produced regularly 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. The Finance Committee is attended by representatives from SLC, generally the Principal, Head of Finance and Financial Accountant. At each meeting minutes and papers from the SLC Finance Committee are presented and noted, following their approval by the SLC Board. While there were no finance papers produced on a consolidated regional basis during the year, we understand that members of the Finance Committee met with the SFC during the year to discuss support for resources to enable Regional Financial Reporting. These discussions are ongoing, and progress has been made in terms of a remit for the review of regional finance being received by the committee.

Given the Board reporting timetables of each College during 2017/18, this meant that there were sometimes significant delays in formal reporting to the Region – for example the Finance Committee on 12 March 2018, received minutes from the SLC Finance Committee of 6 November 2017. In such circumstances, this is covered with a written update report on the most recent meeting. We would encourage the practice of verbal updates, or short, albeit unapproved, notes of SLC Board Committees to ensure the regional financial position reported to the Lanarkshire Board is current. In the long term, each College may wish to review their Calendar of Board activities to increase the length of time between SLC and regional meetings, to allow for approved and current updates to be provided.

Overall, we consider that the Board of Management obtains financial information that reflects the actual financial position of New College Lanarkshire and South Lanarkshire College, but does not receive consolidated regional information.

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.

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 conclude that the processes and controls in place at New College Lanarkshire are operating effectively. Both New College Lanarkshire and South Lanarkshire College have all the expected control, risk, performance and financial arrangements in place. There are a series of regularity documents including standing orders, articles of governance, code of conduct, and financial regulations intended to ensure regularity of transactions. These are all currently written on an individual college basis.

Prevention and detection of fraud and irregularity

Management and the Audit and Risk 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

New College Lanarkshire is due to take part in the 2018/19 National Fraud Initiative (NFI) exercise, following their participation in 2016/17. Data was submitted in line with timescales and the Audit and Risk Committee have been informed of the exercise. We will report on any findings or issues arising from NFI during the 2018/19 audit process.

4. WIDER SCOPE

FINANCIAL SUSTAINABILITY

Dimension

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.

Our conclusion

The Lanarkshire Board has adequate financial planning arrangements in place, however, financial sustainability concerns, initially raised in 2017, remain.

Identified significant risks to our wider scope work

As part of our planning procedures we considered whether there were significant risks that would impact on any of the four areas of our wider scope work that would require special audit consideration. We set out the identified risk to this area of wider scope work and how we addressed the risk.

Financial Sustainability

Description of the risk

Our 2016/17 Annual Audit Report concluded that New College Lanarkshire had adequate planning arrangements in place, however, significant financial sustainability concerns had been identified.

In April 2018, the Auditor General for Scotland issued a report prepared under section 22(3) of the Public Finance and Accountability (Scotland) Act 2000. The purpose of the report was to draw Parliament's attention to the financial challenges the College faces and the potential impact on its longer-term financial sustainability.

The College continues to work with the SFC to agree their Business Scenario Plan and associated funding requirements, to enable it to deliver a sustainable business model.

How we addressed the risk

We have addressed the risk by reviewing and considering:

- the Business Scenario Plan (now the Region Business Plan) as it evolves to finalisation, considering key assumptions made for reasonableness;
- New College Lanarkshire's follow up to the Section 22 report and subsequent Parliament attendance;
- the forecast financial position in the FFR submitted to the SFC, including amounts budgeted for the outcome of National Bargaining costs and the cost of living increases not proposed to be funded by the SFC; and
- the financial reporting arrangements in place at the College.

Wider scope conclusion

New College Lanarkshire has adequate financial planning arrangements in place, however, financial sustainability concerns, initially raised in 2017, remain. Following over 12 months of discussion and negotiation, a final Regional Business Plan was submitted to the SFC on 28 September 2018. The aim of this plan is to agree a funding settlement that will see New College Lanarkshire's underlying operating position return to a surplus. There has been no formal response to the plan's submission at the point of writing, although the SFC has confirmed with New College Lanarkshire their ability to drawdown additional funding for further Voluntary Severance schemes, which were part of the Regional Business Plan. However, until the mitigating actions are put in place and additional funding obtained, there remains a risk that New College Lanarkshire is not financially sustainable.

New College Lanarkshire has received strategic funding during 2017/18 of £1.1m for voluntary severance packages, and in addition received a cash advance of £1.3m from its 2018/19 funding in July 2018. An accounting deficit of £2.5m and an underlying operating surplus of £602k were reported.

4. WIDER SCOPE
FINANCIAL SUSTAINABILITY (CONTINUED)

Section 22 reporting

In April 2018, the Auditor General for Scotland issued a report prepared under section 22(3) of the Public Finance and Accountability (Scotland) Act 2000. The purpose of the report was to draw Parliament's attention to the financial challenges the College faces and the potential impact on its longer-term financial sustainability.

Evidence was given by the Auditor General on the S22 report on New College Lanarkshire to the Public Audit and Post-Legislative Scrutiny (PAPLS) Committee on 4 June 2018, College representatives, including the Chair and the Principal, were called to give evidence on 28 June 2018, along with the SFC. Trade Union representatives (EIS-FELA) were also called to give evidence to the PAPLS committee on 20 September 2018.

Key points arising from the above sessions were the delayed finalisation and agreement of a five-year Regional Business Plan (previously referred to in our reports as the Business Scenario Plan (BSP)) with the SFC. The Committee also expressed concern that there had been no formal staff consultation regarding aspects of the business plan, which included voluntary severance agreements in order to reduce costs in future years and that a formal external review of the plan had not taken place.

Subsequent to the PAPLS hearings, New College Lanarkshire has undertaken a full staff consultation across all three campuses, with feedback received being factored into the final plans. A review of the plan was performed by the internal auditors to New College Lanarkshire before the final Lanarkshire Regional Business Plan was submitted to the SFC on 28 September 2018. There has been no formal confirmation of the continued support and funding from the SFC which has all been verbally agreed to date.

Financial Planning

The Lanarkshire Board has prepared a 5 year Regional Business Plan which has been compiled in close collaboration with the SFC. This was approved at a meeting of the Lanarkshire Board on 10 September 2018 and was submitted to the SFC on 28 September 2018. There has been no formal response to the plan's submission, at the time of writing, although the SFC has confirmed the drawdown of the first tranche of funding of £645k for the next Voluntary Severance scheme as per the Regional Business Plan. The plan includes assumptions about inflation in the short and medium term and highlights other financial stability risks. The Board is very clear on the risks to financial sustainability it faces and the uncertainty of funding over the medium and long term.

The Plan includes New College Lanarkshire receiving a Strategic Transformation Grant of £2.6m during 2018/19 from the SFC. The transformation funding will ensure that the College will achieve a recurring positive cash balance throughout the period of the plan and ensure that the underlying operating position returns to surplus. The Plan also requests further funding for voluntary severance payments which will take place, subject to funding availability, throughout the course of the Plan.

A summary of the Regional five-year Business Plan is included in the table below. The figures below form the basis of Board regional financial planning, and is based on SFC set assumptions.

	Regional Forecast 2018/19 £'000	Regional Forecast 2019/20 £'000	Regional Forecast 2020/2021 £'000	Regional Forecast 2021/22 £'000	Regional Forecast 2022/23 £'000
Total Income	59,134	57,517	58,380	58,663	57,762
Staff costs	39,088	39,806	39,830	39,851	38,913
Other expenditure	18,882	18,553	19,394	19,654	19,698
Operating surplus/(deficit) before other gains and losses	**1,164**	**(842)**	**(844)**	**(843)**	**(850)**
Operating position adjustments (e.g. non cash and exceptional items)	(1,746)	854	854	854	854
Adjusted operating surplus /(deficit)	**(582)**	**12**	**10**	**11**	**4**

We note that South Lanarkshire College has also prepared and submitted a separate FFR to the SFC.

4. WIDER SCOPE
FINANCIAL SUSTAINABILITY (CONTINUED)

The key assumptions in the Plan, and discussed with the SFC, are as follows:

- Credit values, national bargaining harmonisation and cost of living increases as per SFC and FFR guidance, with no funding provided for the cost of living increases;
- Severance schemes will be fully funded by the SFC;
- Other income is assumed to increase by 1.5% from 2018/19 adjusted for the credit reduction in 2022/23;
- Inflation is assumed to be 2.7% for non-payroll;
- Subsidiary (AMCOL) profit is assumed to drop from £53k to £20k in 2018/19 onwards; and
- No strategic capital funding will be available for restructure of learning spaces.

Clearly, in order to achieve financial sustainability in a climate of reduced core financial settlements, the main focus for the College is to reduce costs, and the largest cost is staffing. The plan includes assumptions of reduced support staff costs (through natural turnover, redeployment and ultimately, further voluntary severance schemes), by reducing numbers by 21.5 FTE over the course of the plan. This is intended to achieve a cumulative cost saving of £1.4m.

The plan also includes assumptions regarding reducing the teaching staff costs. This is a larger element of savings and there is an expectation of reducing teaching staff by 62.5 FTE over the five year plan, through further voluntary severance schemes which is expected to give cumulative cost savings of £4.2m. The College is clear that the reduced staffing will increase pressure on maintaining levels of credit delivery and performance levels and must ensure that teaching staff are timetabled correctly, to ensure these aims are met. We understand that the College is also considering increasing average class sizes. In order to increase average class sizes, they must place focus on recruiting sufficient numbers for classes, and reducing early withdrawal rates.

The plan seeks to increase non-SFC income, where possible. This will be done by focusing on generation of income by access to and use of the colleges assets, providing commercially viable education, training delivery, expanding SDS industry sector and partner funding of apprenticeships and opportunities to access the Flexible Workplace Development Fund (FWDF).

Each project stream of the Business Plan and its activities will be monitored and reported through the most appropriate Board committee, which will have oversight as the plan progresses. Tighter controls have been, and will continue to be applied internally over budgeting processes, and cost controls. A Budget Monitoring Group has been set up and detailed monthly reviews of management accounts by all senior staff, with a more enhanced analysis. On-going training will be provided to budget holders, and additional scrutiny to be placed on expenditure by senior accountants. Additionally, a focus is to be placed on achieving regional efficiencies, and NCL and SLC should be looking at shared resources where practical and possible. They have already made progress on sharing procurement, and the aim is that this will continue.

4. WIDER SCOPE
FINANCIAL SUSTAINABILITY (CONTINUED)

Asset Management and Estates Strategy

Each college has a significant estate, leading to a value of £133m being recorded in the consolidated financial statements for land and buildings as at 31 July 2018. New College Lanarkshire has three campuses spread across Lanarkshire and East Dunbartonshire. South Lanarkshire College operates from a single site in East Kilbride.

There is currently no regional Estates Strategy. A formalised plan exists for South Lanarkshire College, lasting to 2019. A formal Estates Strategy 2018-2028 was developed during the year for New College Lanarkshire and was approved in March 2018. This will be reviewed annually by the Vice Principal of Resources. Alongside the Strategy, the following Plans and Guidance have also been developed to be followed in conjunction with the Strategy, being:

- NCL Estates Action Plan
- NCL Carbon Management Plan 2018/19 – 2022/23
- NCL Planned Preventative Maintenance/Lifecycle Costing Schedule

National estates survey

Gardiner & Theobald were appointed by the Scottish Funding Council in January 2017 to provide a summary of the conditions of the estates within the Scottish Further Education sector, being the first independent review of the college estate in Scotland for 10 years. Across Scotland the estimated net total backlog of maintenance and renewals cost is £163 million excluding contingencies, any related operational and management costs of the colleges, professional fees, VAT, optimism bias and inflation allowance. When taking these items into account, the resulting total gross estimated backlog is £363 million. 10% of these costs were defined as urgent, requiring action within the next year, with the majority of the costs requiring action within 3-5 years.

The Scottish Funding Council is working with the Scottish Government and Scottish Futures Trust to produce a framework for college sector estate development to manage competing demands for estate development.

The New College Lanarkshire surveys for the three campuses showed an estimated total of £17.2 million of costs over the 5 year period from 2017-18 to 2022-23, with £4.8m being identified as very high priority back log maintenance.

The South Lanarkshire College survey showed an estimate of £1.7 million of costs over the 5 year period from 2017-18 to 2022-23, with £1.376m being identified as very high priority back log maintenance.

Funding is being made available from the SFC for the high priority back log maintenance that will be incurred in 2018/19, and this has been factored into the Business Plan with a £nil impact on I&E.

4. WIDER SCOPE
GOVERNANCE AND TRANSPARENCY

Dimension

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

Our conclusion

New College Lanarkshire has governance arrangements in place that provide appropriate scrutiny of decisions made by the Board. However, a review of governance arrangements at the Regional Strategic Board has not taken place to identify potential improvements to the regional governance framework.

Identified significant risks to our wider scope work

As part of our planning procedures we considered whether there were significant risks that would impact on any of the four areas of our wider scope work that would require special audit consideration. We set out the identified risk to this area of wider scope work and how we addressed the risk.

Governance and transparency

Description of the risk

Our 2016/17 Annual Audit report noted that New College Lanarkshire, as the Regional Strategic Body for Lanarkshire was intending to perform a review of regional financial governance arrangements to identify potential improvements to the governance framework in place.

The review is set to consider the following areas:

- Structural arrangements – including oversight, clarity of arrangements and requirements of the legal framework;
- Assurance – including assurances to the regional Accountable Officer; and
- Future planning – including what the framework should be.

How we addressed the risk

We have addressed the risk by considering:

- Progress and outcomes of the financial governance review; and
- The outcomes and any recommendations made by Audit Scotland as part of Scotland's Colleges 2018 (the annual review of the sector by Audit Scotland).

Wider scope conclusion

New College Lanarkshire has governance arrangements in place that provide appropriate scrutiny of decisions made by the Board. Similarly, South Lanarkshire College, operating singularly, has similar governance arrangements in place. A Regional Benefit Statement has been prepared which covers the 2017/18 period and a summary of this has been included within the Statement of Corporate Governance and Internal Control in the Annual Report.

However, a formal review of regional financial governance arrangements that was due to take place during 2017/18, has not begun. The review should be taken forward and incorporate recommendations made by Audit Scotland's 'Scotland's colleges 2018' report. We consider that the risk that the governance arrangements in place for the Region are inappropriate, remains.

Financial Governance review

There is no indication that a formal regional financial governance review has been undertaken during the year. As previously noted, members of the Finance Committee met with the SFC during the year to discuss support for Regional Finance Reporting as they currently do not consider that they have sufficient resource to produce regional finance information. These discussions are ongoing, and progress has been made in terms of a remit for the review of regional finance being received by the Finance Committee.

A Regional Benefit Statement has been prepared which covers the 2017/18 period and a summary of this has been included within the Statement of Corporate Governance and Internal Control in the Annual Report.

Scotland's Colleges 2018

Audit Scotland's annual report on FE Colleges – 'Scotland's Colleges 2018' specifically considered the multi-college regions in Scotland – Glasgow, UHI and Lanarkshire. While all three RSBs in multi-college regions showed varied progress in meeting the wider aims of regionalisation, it noted that '*the current regional arrangements in Lanarkshire add little to the aims of regionalisation*.' Audit Scotland recommended the Lanarkshire Board should develop a clear plan for improving collaborative working across the region. It reported on "*limited cooperation or integration between the colleges*", aside from working together on the Regional Outcome Agreement. However, it recognised that demographics and infrastructure are a barrier to greater cross-Lanarkshire course rationalisation, given the lack of transport links and ease of access. The report recommended that the Lanarkshire Board should '*develop a clear plan for improving collaborative working across the region*'. There is no indication that work has begun on development of this plan at the point of writing. This should be taken forward with the prior year recommendation on financial governance – see the recommendation on page 13.

Governance arrangements

Our work in this area has considered the overall governance and scrutiny arrangements in place for the Region, 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 considered the governance arrangements set out in the Financial Memorandum agreed between South Lanarkshire College and the Lanarkshire Board in January 2016 and their effect and implementation in practice. We have attended Audit Committees of the Lanarkshire Board and South Lanarkshire College during the year.

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 Lanarkshire Colleges Order requires that the Chair, Principal, two staff members and one student member of the South Lanarkshire College (SLC) Board are also members of the Lanarkshire Board. This arrangement has been in place for the full 2017/18 year. There is no requirement set in the Order for members of the Lanarkshire Board to become members of the SLC Board, or to attend Board meetings, but we note that the Chair of the Lanarkshire Board has been appointed as a member of the SLC Board, but there is no further New College Lanarkshire representation. Conversely, there are SLC representatives attending all committees of the Lanarkshire Board. There could therefore be a perception of a lack of reciprocity in the governance arrangements across the region. Albeit, these arrangements stem from the requirements of the Lanarkshire Colleges Order.

As is standard practice, the Board is reported to by 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.

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.

4. WIDER SCOPE
GOVERNANCE AND TRANSPARENCY (CONTINUED)

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. The governance statement confirms the college's compliance with the 2016 Code of Good Governance for Scotland's Colleges.

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 for New College Lanarkshire, and thus the region, is provided by Wylie and Bisset. The financial memorandum between the Lanarkshire Board and SLC requires that SLC has an effective internal audit service which has been provided by Scott-Moncrieff. Internal audit have attended Audit and Risk Committees throughout the year and have produced reports which have been reviewed.

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 papers of the Board of Management and key committees being available on the website.

4. WIDER SCOPE
VALUE FOR MONEY

Dimension
Value for money concerns using resources effectively and continually improving services.

Our conclusion
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 Region achieved its 2017/18 SFC core funded target by delivering 172,245 SFC funding Credits (the SFC's unit of measure for learner activity). In addition the College achieved European Social Fund (ESF) credits of 15,393, which was on target. The Region provided places for 12,509 full-time Equivalent learners.

Reviews of learning and teaching at colleges are performed by Education Scotland, in conjunction with the SFC. A new evaluation framework known as "How Good is Our College" (HGIOC) is in place, and both Colleges have engaged in this framework, reflecting on performance in 2017/18.

This process indicated that some areas of delivery require improvement in relation to full-time programme successful completion rates. It also confirms that they are led well, have sufficiently robust arrangements to address any identified minor weaknesses, and are likely to continue to improve the quality of the services for learners and other stakeholders.

Regularity
As part of our audit of the consolidated 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 at New College Lanarkshire has arrangements to monitor the requirements of the Scottish Funding Council, Audit Scotland and other regulatory or advisory bodies to ensure it complies with the terms and conditions of funding including regular reporting of financial and operational performance to the Board and its committees. They regularly correspond with South Lanarkshire College on matters that affect both colleges and those that require a regional response.

Our review found an effective 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 procurement and regularity.

We reviewed regularity of expenditure through our controls and substantive procedures and did not identify any exceptions.

5. OUR FEES

Fees for work as the College's appointed auditor

We reported our proposed fees for the delivery of our work in our Audit Strategy Memorandum, presented to the Audit and Risk Committee in May 2018. Having completed our work for the 2017/18 financial year, we can confirm that our final fees are as follows:

Area of work	Proposed fee 2017/18	Final fee 2017/18
Auditor remuneration	£37,120	£37,120
Pooled costs	£2,380	£2,380
Contribution to Audit Scotland costs	£2,060	£2,060
Total Fee	**£41,560**	**£41,560**

We confirm that these fees are in line with the scale fee set by Audit Scotland. We also confirm that we have not undertaken any non-audit services for the College in the year.

APPENDIX A INDEPENDENCE

As part of our ongoing risk assessment we monitor our relationships with you to identify any new actual or perceived threats to our independence within the regulatory or professional requirements governing us as your auditors.

We can confirm that no new threats to independence have been identified since issuing the Audit Strategy Memorandum and therefore we remain independent.