Board of Management
Audit Committee

Date: **20 Sept 2016**
Time: **14:00 pm**
Room: **1074b**

A G E N D A

				Presented by
1	Welcome and Apologies			HC
2	Declaration of Interest			HC
3	Minute of Meeting of 10 May 2016		(attached)	HC
4	Matters Arising			HC
5	Internal Audit Reports			
	5.1	Follow-up Report	(report attached)	PC
	5.2	Annual Report 2015-16	(report attached)	PC
6	Audit Scotland Reports			JB
	6.1	Coatbridge College	(report attached)	
	6.2	Glasgow Clyde College	(report attached)	
	6.3	Edinburgh College	(report attached)	
	6.4	Glasgow College Board	(report attached)	
	6.5	Scotland's Colleges 2016	(report attached)	
7	2015-16 Draft Audit Committee Annual Report		(report attached)	HC
8	Scottish Funding Council Financial Memorandum – Additional Requirements		(report attached)	JB
	8a	Scottish Funding Council Financial Memorandum	(report attached)	
	8b	Scottish Funding Council Guidance on seeking approval for severance schemes and settlement agreements	(report attached)	
9	Informing the Audit - Risk Assessment		(report attached)	AP
10	Update – Challenge to Lennartz Ruling		(report attached)	KH
11	Strategic Risk Register		(report attached)	JB
12	Any Other Business			
13	Date and Time of Next Meeting – Tuesday, 22 November 2016 at 2pm			
14	Good Governance - Annual discussion with internal and external auditors without members of college staff			HC

Board of Management

Minute of the Meeting of the Audit Committee of the Board of Management of Dumfries and Galloway College held on 20 September 2016 at 2 pm in Room 1074b

Present:	Hugh Carr (Chair) Delia Holland	
In attendance:	Carol Turnbull, Principal	Karen Hunter, Finance Manager
	Philip Church, Client Manager, RSM	Angela Pieri, Grant Thornton
	Jannette Brown, Vice Principal Corporate Services & Governance	
	Brian Johnstone, Chair Board of Management	
	Kay Bird, Secretary to the Board/Minute Taker	

1 Apologies

The Chair welcomed members to the meeting. Apologies for absence were intimated on behalf of Stuart Martin and Pat Kirby.

The Secretary to the Board confirmed the meeting was inquorate and no decisions could be made.

2 Declaration of Interest

Members agreed to indicate declarations of interest as appropriate throughout the meeting.

3 Minute of Previous Meeting

The Minute of the Audit Committee meeting held on 10 May 2016 could not be approved and will be carried forward to the next meeting to be held on 22nd November 2016.

4 Matters Arising

No matters arising.

5 Internal Audit Reports

5.1 Follow-up Report

Mr Church spoke to the report which had been issued, advising that out of the 12 recommendations 11 were medium priority and one high priority. Reasonable progress is being made, 8 have been fully implemented and one recommendation is one-going. Three are still to be implemented in relation to Institutional Sustainability, revised dates for implementation have been agreed, and is a reflection on what is happening within the Sector. The members noted the report.

5.2 Annual Report 2015-16

Mr Church spoke to the report which had been issued, and confirmed the College has an adequate and effective framework for risk management, governance and internal control. No issues need to be flagged. There were no significant issues raised in connection with Risk Management which is linked to the College's Risk Register and Student data. The Committee discussed the implementation of the internal audit recommendations, performance indicators and Annual Opinions. Delia Holland asked Mr Church to explain further the 'reasonable progress' indicator given and Mr Church advised he was comfortable with the reasoning behind the outstanding recommendations which was indicative with what was happening within the sector. The Chair of the Board of Management commented that there had been a lot of work and changes on governance and board development and Mr Church advised the college was making good steady progress in these areas. The members noted the report.

6 Audit Scotland Reports

The Vice Principal, Corporate Services & Governance, spoke to the reports which had been issued and the Committee discussed the individual reports and lessons to be learned, as follows:-

6.1 Coatbridge College

The key point was the governance weakness at the Coatbridge College in relation to severance arrangements. The Vice Principal, Corporate Services & Governance confirmed there is SFC guidance which has come to the Board and there are systems in place within the College on severance pay which should give the Committee assurances. The College publishes all agendas, minutes and reports on its website.

6.2 Glasgow Clyde College

The key point here was the Board of Glasgow Clyde College did not comply with the Code of Good Governance. The Vice Principal, Corporate Services & Governance confirmed this College complies with the Code of Good Governance.

6.3 Edinburgh College

The key point was the Edinburgh College did not deliver on its credit target and got into financial difficulties. The Vice Principal, Corporate Services & Governance advised the Committee can take reassurance from the Internal Auditor's reviews on Student Activity. The Principal further advised the SFC had further tightened up this area too.

6.4 Glasgow College Board

The key point is the college, which is a regional strategic body for the Glasgow region operates in a different way to Dumfries & Galloway College, lacked systems in place for internal control. The Vice Principal, Corporate Services & Governance gave reassurance to the Committee that this College has effective systems in place which is evidenced by internal audit reports.

6.5 Scotland's Colleges 2016

The Committee discussed the report. The recommendation is that colleges should develop long term financial strategies, for a minimum of 5 years. The Chair asked how practical was this and the

Vice Principal, Corporate Services & Governance advised that as the college is financed on a yearly basis it was a difficult exercise and would be based on aspirations, a worse case and best case scenario. It is not known what affect national pay bargaining will have on colleges. The Principal commented that it is disappointing this is a requirement as a lot of college resources will be used for little benefit to the college.

The members noted the reports

7 2015-16 Draft Audit Committee Annual Report

The Chair spoke to the report. The Vice Principal, Corporate Services & Governance advised there were two typographical errors, one at point 3.2 and one at 7.3 which she confirmed would be amended. The Chair was happy with the report, which he confirmed could be taken to the Board Meeting on 4th October 2016.

Action: The report will be amended and presented to the Board on 4 October 2016 for Board approval.

8 Scottish Funding Council Financial Memorandum – Additional Requirements

The Vice Principal, Corporate Services & Governance spoke to the report which had been issued, together with the Financial Memorandum and SFC Guidance documentation. The report summarised the revisions to the Financial Memorandum and the Vice Principal, Corporate Services & Governance confirmed that the College was compliant in all areas with the exception of 'Cash Management and Banking'. The College was waiting to hear from Royal Bank of Scotland and the deadline for implementation will be pushed back as there are delays with the Scottish Government and Royal Bank of Scotland. This matter will need to go to the Board in due course. Members noted the report.

9 Informing the Audit – Risk Assessment

Angela Pieri spoke to the report. The Auditors have a duty to ask set question and show management's responses and confirm these processes are in place. Brian Johnstone highlighted an error on page 7 of the report, the Committee is just called the Audit Committee and not the Audit and Risk Management Committee. Angela Pieri acknowledged this as an error. Brian Johnstone asked what procedures the College has in place for litigation matters. The Vice Principal, Corporate Services & Governance advised the procedure would depend on the matter and may go to the Chair of the relevant Committee and or Chair of Board of Management. The matter would be reported to the College's insurers. The Chair asked whether there was a financial limit that if exceeded the matter would be referred to the SFC. The Principal and the Vice Principal, Corporate Services & Governance advised that there were limits in relation to severance / settlement pay but not for legal claims.

10 Update – Challenging to Lennartz Ruling

The Finance Manager spoke to the report which was an update on her previous report. The Committee discussed the updates and members noted the report.

11 Strategic Risk Register

The Vice Principal, Corporate Services & Governance spoke to the report and the Committee was asked to review the College's Strategic Risk Register. It was reported there were no new issues identified since the previous risk register. The report could not be approved.
Action: The report will be tabled at the next Board meeting.

12 Any other Business

The Finance Manager confirmed that the external audit was to commence on 3rd October 2016 for three weeks and that there had been big changes to the accounting format and report. The Accounts will be going to the next Finance & General Purposes Committee. Brian Johnstone asked whether the Finance Manager could produce a one page key fact document on the accounts. It was suggested the Vice Principal, Corporate Services & Governance, the Finance Manager, the Chair of Audit, the Chair of F&GP and the Regional Chair could consider appropriate wording of notes to explain the technical deficit in the accounts.
Action: The Vice Principal, Corporate Services & Governance to circulate accounts to above mentioned once wording has been completed.

13 Date and Time of Next Meeting

The next meeting of the committee is to take place on Tuesday 22 November 2016 at 2 pm.

14 Good Governance

The Chair asked members of the Executive Team and the Finance Manager to withdraw from the meeting in order for the Committee to meet privately with internal and external auditors in accordance with the Code of Good Governance for Scotland's Colleges.

Angela Pieri and Philip Church both advised there was no issues with the college and everything was in order with a good risk management policy imbedded.

Minute of the Meeting of the Audit Committee of the Board of Management of Dumfries and Galloway College held on 10 May 2016 at 2 pm in Room 2009

Present:	Hugh Carr (Chair) Stuart Martin	Pat Kirby
In attendance:	Carol Turnbull, Principal Philip Church, Client Manager, RSM	Karen Hunter, Finance Manager Angela Pieri, Grant Thornton
	Jannette Brown, Secretary to the Board and Vice Principal Corporate Services & Governance Kay Bird, (new Secretary to the Board)	
Minute Taker:	Heather Tinning, Executive Team Assistant	

1 Apologies

The Chair welcomed members to the meeting, in particular Kay Bird, the new Secretary to the Board. Apologies for absence were intimated on behalf of Delia Holland.

The Secretary to the Board confirmed the meeting was quorate with enough members present to allow decisions to be made.

2 Declaration of Interest

Members agreed to indicate declarations of interest as appropriate throughout the meeting.

3 Minute of Previous Meeting

The Minute of the Audit Committee meeting held on 8 March 2016 was approved.

4 Matters Arising

In terms of the Account Year-End, the Principal confirmed that there was no update to report at present and that the Account Year-End will remain at 31st July.

5 Internal Audit Reports

5.1 Human Resources Effectiveness

Mr Church spoke to the report which had been issued, advising that the Human resources controls were found to be well designed and operating efficiently. Three management actions were identified. The college's policies and procedures are benchmarked against other colleges within the sector, and key findings are highlighted in the report. The findings summary identified issues relating to non-completion of four SD1 forms, and minor issues with the completion of two interview evaluation forms. In terms of the Rating identified as Amber/Green, Mr Church advised that this was based on RSM's methodology, and that the rating was more directed towards Green, which would have been applied if there had been no medium issue identified.

5.2 Procurement

Mr Church spoke to the report which had been issued, following an audit of Procurement as part of the approved internal audit periodic plan for 2015/16. It was identified that there was reasonable assurance that the college had adequate controls that were well designed and fully implemented. The key findings confirmed that all the procedures had been adhered to with the transactions in the PECOS system. Mr Church referred to the findings in terms of the supplier sourcing procedures in particularly in the case of Construction. The Finance Manager reported that the Finance Department contact firms to ensure that the information received is correct, especially with change of bank details, to help prevent any fraud.

5.3 Progress Report

Mr Church spoke to the report which had been issued. Mr Church identified the main areas of concern in the key findings of the assignments:

- Human Resources Effectiveness
- Procurement
- Follow Up

The Impact of findings had been extracted from the Human Resources Effectiveness and Procurement Reports. Appendix A identified the other reports that had previously been to the Committee. A summary on progress will be discussed at the September meeting.

5.4 Internal Audit Plan 2016-17

Mr Church spoke to the report which had been issued. He spoke of the recent fundamental changes resulting in the re-evaluation of the colleges' strategic aims and priorities, and highlighted the six Strategic Outcomes that had been identified by the college. In order to approve the Internal Audit Strategy, the committee were asked to confirm that the annual plan provides sufficient assurance to monitor the college's risk profile effectively and that the plan covers the key risks of the college. In order to alleviate pressure on the Student Funding team, Student Support Audit will take place week commencing 20th June. In terms of Income Generation, the Vice Principal CS&G advised that both campuses will be audited to ensure that processes and controls are in place in terms of best practice. The appendix B, included in the report, highlights how the strategy links into the college risk register.

Decision: The Committee formally approved the Internal Audit Plan 2016-17

6 External Audit Plan 2015-16

The Vice Principal, Corporate Services & Governance, spoke to the report which had been issued, advising that this is the last year of the college's five-year work under work of Audit Scotland Contract. The draft External Audit Plan had now been confirmed, with no fundamental changes to be made. The Vice Principal, Corporate Services & Governance highlighted the key areas in terms of the key changes resulting from FRS102. Accounts will be prepared for the year ending 31 July 2016 on an IFRS basis for the first time. In terms of the key phases of the audit cycle, following the final accounts visit in October 2016, the accounts will be presented to the committee in November for sign off. Discussion surrounded the fees for the college audit and other services, members were advised that indicative fees, which have remained stagnant, are set by Audit Scotland. A letter from Audit Scotland is received by the college informing of the fee level, which is also presented at the Audit Committee.

7 Strategic Risk Register

The Vice Principal, Corporate Services & Governance spoke to the report which had been issued highlighting the three changes that had taken place since the last committee meeting. The Vice Principal, Corporate Services & Governance sought member's views on risk number six, review of property and provision in Dumfries, and advised that the SRUC is not part of the discussion at this stage. Members discussed the report and approved the key changes.

Decision: Strategic Risk Registers changes approved

8 Review of Risk Management Policy

The Vice Principal, Corporate Services & Governance spoke to the report which had been issued, following review of the Policy by the Executive Management Team. The Secretary advised that the report highlights mainly terminology changes and that there was nothing significant to note.

Decision: The Committee agreed that the changes were robust and clear and approved the revised policy

9 Audit Scotland Letter re change of External Auditors

The Vice Principal, Corporate Services & Governance spoke to the Audit Scotland letter which had been issued advising that the college has a change of External Auditor from next year. The proposed Auditor for the college is Scott Moncrieff, to commence on 1st August 2016. The Vice Principal, Corporate Services & Governance advised that the College had no part in the selection process. Angela Pieri advised that she is currently working towards completing this financial year prior to the new appointment. She advised that the protocol when taking over or giving up new audits is for both parties to share new policies. The Principal advised that Audit Scotland are looking to meet with College Principals on an individual basis, as part of a review of regionalisation and looking at wider governance issues.

10 Any other Business

None.

11 Date and Time of Next Meeting

The next meeting of the committee planned to take place on Tuesday 20 September 2016 at 2 pm.

DUMFRIES AND GALLOWAY COLLEGE

Follow Up

REVISED FINAL

Internal Audit Report: 8.15/16

8 August 2016

RSM

CONTENTS

Debrief held	13 April 2016	**Internal Audit team**	Robert Barnett, Head of Internal Audit
Draft report issued	27 April 2016		Philip Church, Manager
Responses received	29 April 2016		Dulcie Hakin, Auditor
Final report issued	29 April 2016	**Client sponsor**	Karen Hunter, Finance Manager
Revised final report issued	8 August 2016	**Distribution**	Karen Hunter, Finance Manager

1 EXECUTIVE SUMMARY

1.1 Introduction

As part of the approved internal audit periodic plan for 2015/16 we have undertaken a review to follow up progress made by you to implement the previously agreed recommendations. The audits considered as part of the follow up review were:

- Student Support Funds
- Cashflow Forecasts
- Partnerships / Collaborative Arrangements
- Payroll
- Institutional Sustainability
- Follow Up

The twelve recommendations considered in this review comprised of one 'high' and eleven 'medium'. The focus of this review was to provide assurance that all actions previously made have been adequately implemented. For recommendations categorised as 'low' we have accepted management's assurance regarding their implementation.

1.2 Conclusion

Taking account of the issues identified in the remainder of the report and in line with our definitions set out in Appendix A, in our opinion Dumfries and Galloway College has demonstrated **reasonable progress** in implementing agreed management actions.

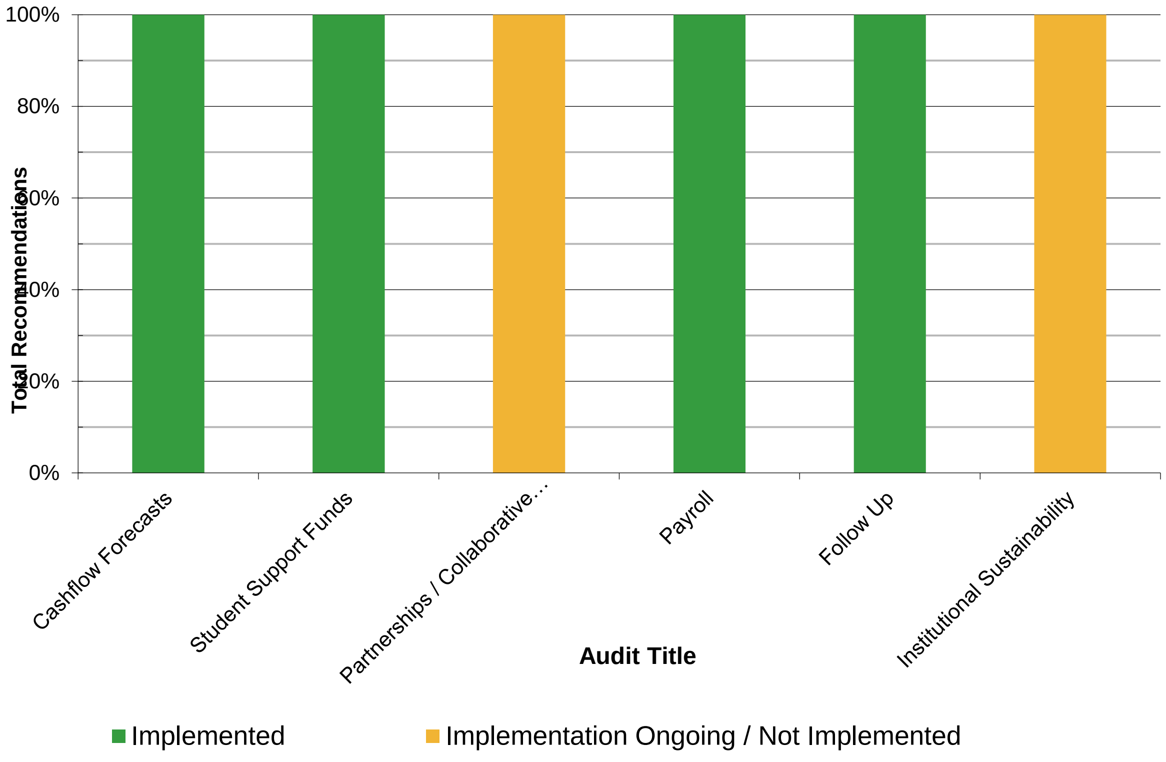
Of the nine management actions covered in this review, we confirmed eight were implemented and are detailed in Appendix C, and one was on-going at the time of the review as it was only partially implemented.

1.3 Action Tracking

Action tracking enhances an organisation's risk management and governance processes. It provides management with a method to record the implementation status of actions made by assurance providers, whilst allowing the Audit Committee to monitor actions taken by management.

We found that there was an action tracking spreadsheet in place at the College, however it had not been updated since November 2015. We recommend that this document is kept up to date by management and regularly presented to the Audit Committee so they are kept informed of actions taken.

The following graph highlights the number and categories of actions issues and progress made to date:



Further details of progress made are provided in Section 2 of this report. It is important to note that until a management action is fully implemented, the College is still exposed to risk.

1.4 Progress on Actions

Implementation status by review	Number of actions agreed	Status of management actions				
		Implemented (1)	Implementation ongoing (2)	Not implemented (3)	Superseded (4)	Confirmation as completed or no longer necessary (1)+(4)
Cashflow Forecasts	2	2	-	-	-	2
Student Support Funds	1	1	-	-	-	1
Partnerships / Collaborative Arrangements	1	-	1	-	-	1
Payroll	1	1	-	-	-	1
Institutional Sustainability	3	-		3		0
Follow Up	4	4	-	-	-	4

Implementation status by management action priority	Number of actions agreed	Status of management actions				
		Implemented (1)	Implementation ongoing (2)	Not implemented (3)	Superseded (4)	Confirmation as completed or no longer necessary (1)+(4)
High	1	-	-	1	-	-
Medium	11	8	1	3	-	11

2 FINDINGS AND MANAGEMENT ACTIONS

This report has been prepared by exception. Therefore, we have included only those actions graded as 2 and 3. Each action followed up has been categorised in line with the following:

Status	Detail
1	The entire action has been fully implemented.
2	The action has been partly though not yet fully implemented.
3	The action has not been implemented.
4	The action has been superseded and is no longer applicable.

Partnerships / Collaborative Arrangements									
Ref	**Original Recommendation**	**Original date**	**Original priority**	**Audit findings**	**Current status**	**Updated management actions**	**Priority issued**	**Revised date**	**Owner responsible**
1	The College should develop a framework surrounding the partnership process. The process should include: • Approval of partnership arrangements; • Contract management; • Quality assurance visits; • Due diligence checklist; • Risk Assessments; • Managing exposure to reputational risk; and • Governance	June 2015	Medium	We were informed by the Vice Principal of Corporate Services and Governance that at the time of the original audit the College was taking part in discussions around hosting another school which would require a partnership if it went ahead. However, nothing came of these discussions and no partnership was put in place. The only other partnership the College has is with a tenant that is renting a building to use as a nursery; however this is managed through a solicitor as a tenant's agreement; so there is no need to put a partnership in place for this. As the College had to bid for all of its partnerships and all partnerships were on the other party's terms, not the College's, it was decided that there was no need to put a partnership framework in place.	2	A partnership framework should be developed as and when the school implement partnerships in future.	Medium	Ongoing	Jannette Brown, Vice Principal

	arrangements. This will ensure that a consistent approach is adopted in terms of monitoring and reporting partnership arrangements..			The Vice Principle stated this recommendation is ongoing as the College will produce a Partnership framework as and when they need it, but to produce one when there is no potential partnership will lead to the document being too generic. A specific framework will be needed for each individual partnership that arises in future.					
Institutional Sustainability									
2	The College should review the Risk Register and update it to include the following areas of the Institutional Sustainability spreadsheet so that only one document is used: • Controls in order to diversify income streams and encourage efficient procurement practices in order to strengthen financial sustainability; • A risk surrounding the impact of a recession and political instability on the College's ability to continue; • A risk on if the College fails to	June 2015	High	We were informed by the Vice Principal of Corporate Services and Governance that due to the significant changes in the sector together with the new Economic Strategy and refresh of the Regional Skills Assessment the implementation of this recommendation has been delayed until December 2016.	3	Accepted. Implementation date extended to December 2016.	High	December 2016	Jannette Brown, Vice Principal

improve business processes;

- An overall staff risk covering quality of staff and governors, training and qualifications of staff, staff turnover and staff sickness;
- An overall estate risk covering quality of facilities, space utilisation, repairs to the estate and access to the estate for all;
- A risk surrounding the College's impact on the environment and how they plan to improve it;
- Controls to incorporate the risk of inappropriate support services on student funding; and
- An overall risk covering provision in terms of diversity, quality, range and widening participation.

	Once the Risk Register has been updated, the College should highlight on the Risk Register which risks relate to Institutional Sustainability and which are strategic risks.								
3	Once the Risk Register has been updated to include the relevant Institutional Sustainability items, then the Risk Register should continue to be reported to the Audit Committee and the Board on a quarterly basis in order to sufficiently monitor and challenge Institutional Sustainability as well as Risk Management.	Medium	June 2015	We were informed by the Vice Principal of Corporate Services and Governance that due to the significant changes in the sector together with the new Economic Strategy and refresh of the Regional Skills Assessment the implementation of this recommendation has been delayed until December 2016.	3	Accepted. Implementation date extended to December 2016.	Medium	December 2016	Jannette Brown, Vice Principal
4	The College should implement a Sustainability Statement, which details the College's policy in relation to social, environmental and economic sustainability and how this impacts on the College's strategy. The College should then communicate this to all relevant parties and	Medium	June 2015	We were informed by the Vice Principal of Corporate Services and Governance that due to the significant changes in the sector together with the new Economic Strategy and refresh of the Regional Skills Assessment the implementation of this recommendation has been delayed until December 2016.	3	Accepted. Implementation date extended to December 2016.	Medium	December 2016	Jannette Brown, Vice Principal

measure compliance with the Statement on a regular basis.

APPENDIX A: DEFINITIONS FOR PROGRESS MADE

The following opinions are given on the progress made in implementing actions.

This opinion relates solely to the implementation of those actions followed up and not does not reflect an opinion on the entire control environment

Progress in implementing actions	Overall number of actions fully implemented	Consideration of high actions	Consideration of medium actions	Consideration of low actions
Good	75%	None outstanding	None outstanding	All low actions outstanding are in the process of being implemented
Reasonable	51 – 75%	None outstanding	75% of medium actions made are in the process of being implemented	75% of low actions made are in the process of being implemented
Little	30 – 50	All high actions outstanding are in the process of being implemented	50% of medium actions made are in the process of being implemented	50% of low actions made are in the process of being implemented
Poor	< 30%	Unsatisfactory progress has been made to implement high actions	Unsatisfactory progress has been made to implement medium actions	Unsatisfactory progress has been made to implement low actions

APPENDIX B: SCOPE

Scope of the review

When planning the audit, the following areas for consideration and limitations were agreed:

Areas for consideration:

- Agreed management actions categorised as high and medium in 2014/15.

Limitations to the scope of the audit assignment:

- Only medium actions agreed by management were reviewed.
- We did not review the whole control framework of the areas listed above. Therefore, we are not providing assurance on the entire risk and control framework of these areas.
- Testing was completed, where appropriate, on a sample basis over the period since actions were implemented or controls enhanced.
- Our work does not provide any guarantee or absolute assurance against material errors, loss or fraud.

APPENDIX C: ACTIONS COMPLETED

From the testing conducted during this review we have found the following actions to have been fully implemented and are now closed:

Assignment title	Agreed Recommendation
Cashflow Forecasts	The Finance Team should ensure that all documentation concerning the preparation of the cashflow forecasts is retained to evidence the correct process has been followed each month, including evidence of sign off and review.
	In line with the SFC returns, the College should reconcile the figures in the return with the figures reported internally to ensure there are no discrepancies between the two, and that evidence of this reconciliation is retained.
Student Support Funds	The College should develop a framework surrounding the partnership process. The process should include: • Approval of partnership arrangements; • Contract management; • Quality assurance visits; • Due diligence checklist; • Risk Assessments; • Managing exposure to reputational risk; and • Governance arrangements. This will ensure that a consistent approach is adopted in terms of monitoring and reporting partnership arrangements.
Payroll	The payroll system, Payrite, and the Human Resources database, iTrent, should be reconciled on a periodic basis, to confirm that the staff are all current and bona fide employees.
Follow Up	The College should investigate why the system is missing debtors when reminder letters are being produced. In addition, as there is an inherent system errors the College should also perform a periodic check to ensure all debtors have been appropriately chased up and to identify any that the system may have missed, until this issue is resolved. For example, running of a report of aged debts once a quarter and check that they have all been chased up.
	The College should ensure that the Vehicle Cost Log is updated on an on-going basis and includes insurance and depreciation costs.

	The College should ensure the replacement of vehicles and their associated costs are incorporated into the College's annual budgeting.
	The College should plan the main aspects of key systems that will be tested during each test restore on a rolling basis to ensure that all key systems are tested.

FOR FURTHER INFORMATION CONTACT

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DUMFRIES AND GALLOWAY COLLEGE

Annual Internal Audit Report - Year ended 31st July 2016

Presented at the Audit Committee meeting of: 20th September 2016

RSM

CONTENTS

1 THE ANNUAL INTERNAL AUDIT OPINION

This report provides an annual internal audit opinion, based upon and limited to the work performed, on the overall adequacy and effectiveness of the organisation's risk management, control and governance processes. The opinion should contribute to the organisation's annual governance reporting.

1.1 The opinion

For the 12 months ended 31 July 2016, the head of internal audit opinion for Dumfries and Galloway College is as follows:

Head of internal audit opinion 2015/2016
The College has an adequate and effective framework for risk management, governance and internal control. **However, our work has identified further enhancements to the framework of risk management, governance and internal control to ensure that it remains adequate and effective.**

Please see appendix A for the full range of annual opinions available to us in preparing this report and opinion.

1.2 Scope of our work

The formation of our opinion is achieved through a risk-based plan of work, agreed with management and approved by the audit committee, which should provide a reasonable level of assurance, subject to the inherent limitations described below.

The opinion does not imply that internal audit has reviewed all risks and assurances relating to the organisation. The opinion is substantially derived from the conduct of risk-based plans generated from a robust and organisation-led assurance framework. As such, the assurance framework is one component that the Governing Body takes into account in completing its annual governance reporting.

1.3 Factors and findings which have informed our opinion

Based on the work we have undertaken on the systems of internal control, governance and risk management at the College, we do not consider that there are any issues that need to be flagged as significant internal control weaknesses.

Governance

We did not undertake a specific review of corporate governance arrangements during 2015/16. Therefore, our opinion for 2015-16 is based on our findings from testing the governance and management reporting arrangements that we identified as part of our Strategic and Financial Planning and Budgetary Control reviews. Both reviews received substantial assurance and no significant management actions were raised.

Risk Management

Our opinion is shaped by the risk based audits undertaken as part of the 2015/16 Internal Audit Plan. In particular, we reviewed the following areas that were linked to the College's risk register: Student Activity Data, Student Support Funds and Education Maintenance Allowances and Strategic and Financial Planning. All of which resulted in 'substantial' assurance and no significant management actions were raised.

Internal Control

We undertook seven internal audit reviews in 2015/16, which resulted in an assurance opinion, there were four reviews (57%) which resulted in substantial assurance level being given and three (43%) where reasonable assurance was given.

During the year we have raised a total of nine medium priority management actions and 13 low priority management actions. We reiterated one high management action in relation to a Follow Up of Previous Internal Audit Recommendations review. Further details of which are provided in section 2.2 of this report.

A summary of internal audit work undertaken, and the resulting conclusions, is provided at appendix B.

1.4 Topics judged relevant for consideration as part of your annual governance reporting

Colleges are required to include a Statement of Corporate Governance and Internal Control within their financial statements. As your internal audit provider, the assignment opinions and advisory reviews that we undertake and report on during the year are part of the framework of assurances that assist the Board (through the Audit Committee) prepare an informed statement and provide the opinions required.

Our overall opinion may be used by the Board in the preparation of the 2015/2016 Statement.

The matters raised in this report are only those which came to our attention during our internal audit work and are not necessarily a comprehensive statement of all the weaknesses that exist, or of all the improvements that may be required. This report is prepared solely for the use of the Governing Body and senior management of Dumfries and Galloway College.

2 THE BASIS OF OUR INTERNAL AUDIT OPINION

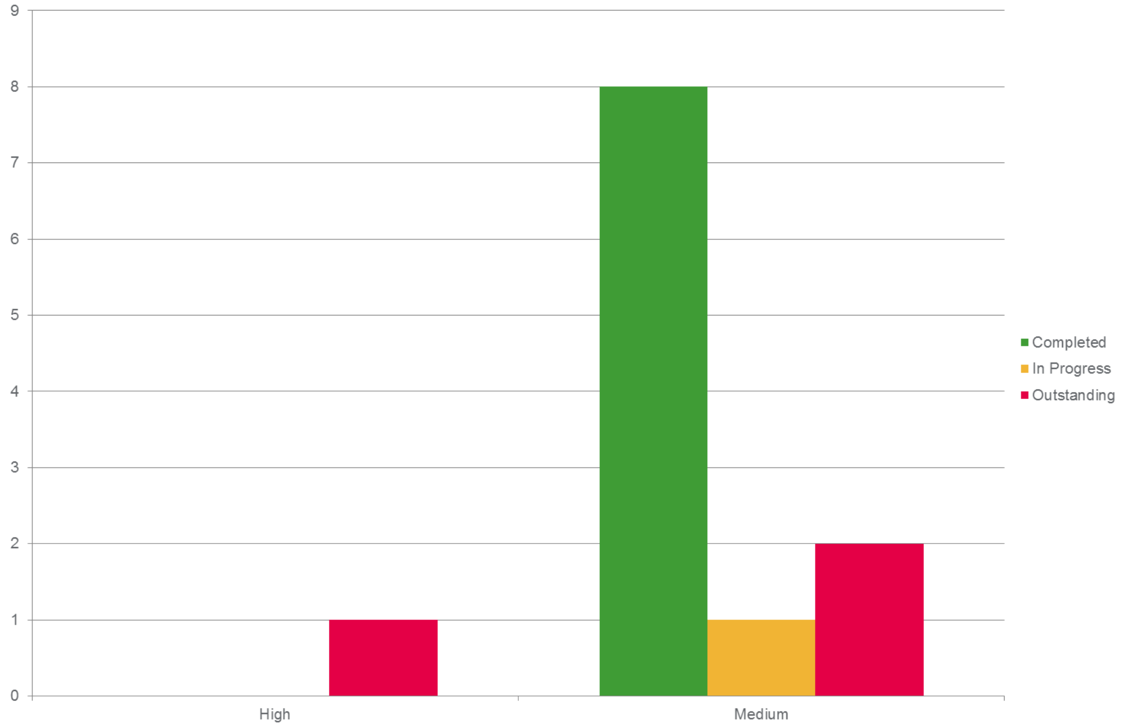
As well as those headlines discussed at paragraph 1.3, the following areas have helped to inform our opinion. A summary of internal audit work undertaken, and the resulting conclusions, is provided at appendix B.

2.1 Acceptance of internal audit recommendations

Management have agreed actions to address all of the findings reported by the internal audit service during 2015/2016.

2.2 Implementation of internal audit recommendations

Our follow up of the actions agreed to address previous years' internal audit findings shows that the organisation had made **reasonable progress** in implementing the agreed actions.



We substantiated 12 management actions where the implementation date had passed, and this comprised of one 'high' and 11 'medium' management actions. However, whilst we confirmed that eight actions had been fully implemented we noted four actions that were in the process of being completed. This related to, one Partnership/Collaboration Arrangements audit action and three Institution Sustainability actions. For the Institution Sustainability one high management action had not been fully implemented. Discussions with the Vice Principal confirmed that due to the significant changes in the sector, such as ONS reclassification of colleges, this recommendation had not been completed and revised implementation date was agreed.

2.3 Working with other assurance providers

In forming our opinion we have not placed any direct reliance on other assurance providers.

3 OUR PERFORMANCE

3.1 Conflicts of interest

RSM has not undertaken any work or activity during 2015/2016 that would lead us to declare any conflict of interests.

3.2 Conformance with internal auditing standards

RSM affirms that our internal audit services are designed to conform to the International Standards for the Professional Practice of Internal Auditing (the Standards).

Under the Standards, internal audit services are required to have an external quality assessment every five years. Our risk assurance service line commissioned an external independent review of our internal audit services in 2011 to provide assurance whether our approach meets the requirements of the International Professional Practices Framework (IPPF) published by the Global Institute of Internal Auditors (IIA).

The external review concluded that "the design and implementation of systems for the delivery of internal audit provides substantial assurance that the standards established by the IIA in the IPPF will be delivered in an adequate and effective manner". Work is in hand to arrange our next review.

The risk assurance service line has in place a quality assurance and improvement programme to ensure continuous improvement of our internal audit services. Resulting from the programme, there are no areas which we believe warrant flagging to your attention as impacting on the quality of the service we provide to you.

3.3 Performance indicators

A number of performance indicators were agreed with the audit committee. Our performance against those indicators is as follows:

Delivery			**Quality**		
	Target	**Actual**		**Target**	**Actual**
Audits commenced in line with original timescales	Yes	*All audits delivered in accordance with strategy timetable*	Conformance with IIA standards	Yes	*Yes*
Draft reports issued within 10 days of debrief meeting	100%	*12 days* [1] *(average)*	Liaison with external audit to allow, where appropriate and required, the external auditor to place reliance on the work of internal audit	Yes	*Discussion held with External Audit in October as part of their planning procedures*
Management responses received within five days of draft report	100%	*4.6 days (average)*	% of staff with CCAB/CMIIA qualifications	>50%	*88%*
Final report issued within three days of management response	100%	*1 day (average)*	Turnover rate of staff	<10%	*Nil*

% audit reports presented to agreed Audit Committee meetings	100%	*100%*	Respond to general enquiries for assistance within two working days	100%	*100%*
% of High and Medium actions followed up	100%	*100%*	Respond to emergencies or notifications of potential fraud within one working day	100%	*N/A*

Notes

1

The Budgetary Control and VfM – APUC Assessment reports took 19 and 20 days respectively to be issued following the debrief meeting.

APPENDIX A: ANNUAL OPINIONS

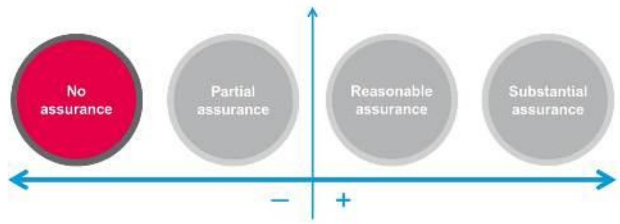
The following shows the full range of opinions available to us within our internal audit methodology to provide you with context regarding your annual internal audit opinion.

Head of internal audit opinion 2015/2016
The College has an adequate and effective framework for risk management, governance and internal control.
The College has an adequate and effective framework for risk management, governance and internal control. **However, our work has identified further enhancements to the framework of risk management, governance and internal control to ensure that it remains adequate and effective.**
There are weaknesses in the framework of governance, risk management and control such that it could be, or could become, inadequate and ineffective.
The College does not have an adequate framework of risk management, governance or internal control.

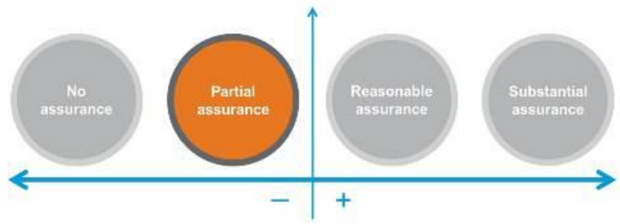
APPENDIX B: SUMMARY OF INTERNAL AUDIT WORK COMPLETED 2015/2016

Assignment	Executive lead	Assurance level	Actions agreed		
			H	M	L
Student Activity Data (SUMs)		Substantial	0	1	0
Student Support Funds and Education Maintenance Allowances (EMA)		Substantial	0	0	0
Strategic and Financial Planning		Substantial	0	0	1
Budgetary Control		Substantial	0	0	1
Human Resources Effectiveness		Reasonable	0	1	3
Procurement		Reasonable	0	1	2
VfM – APUC Assessment		Reasonable	0	3	6
Follow of Previous Internal Audit Recommendations		Reasonable Progress	1	3	0

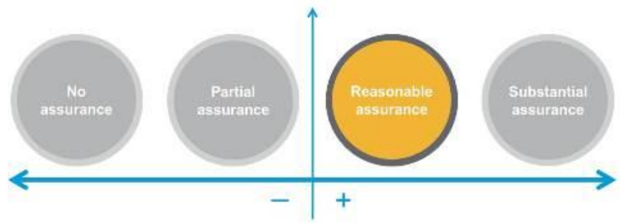
We use the following levels of opinion classification within our internal audit reports. Reflecting the level of assurance the board can take:



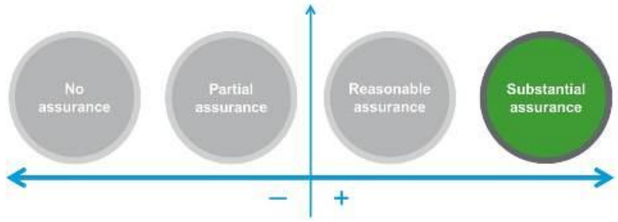
Taking account of the issues identified, the Board **cannot take assurance** that the controls upon which the organisation relies to manage this risk are suitably designed, consistently applied or effective.
Urgent action is needed to strengthen the control framework to manage the identified risk(s).



Taking account of the issues identified, the Board can take **partial assurance** that the controls to manage this risk are suitably designed and consistently applied.
Action is needed to strengthen the control framework to manage the identified risk(s).



Taking account of the issues identified, the Board can take **reasonable assurance** that the controls in place to manage this risk are suitably designed and consistently applied.
However, we have identified issues that need to be addressed in order to ensure that the control framework is effective in managing the identified risk(s).



Taking account of the issues identified, the Board can take **substantial assurance** that the controls upon which the organisation relies to manage the identified risk(s) are suitably designed, consistently applied and operating effectively.

FOR FURTHER INFORMATION CONTACT

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The 2013/14 audit of Coatbridge College

Governance of severance arrangements

AUDIT SCOTLAND

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under Section 22 of the Public Finance and Accountability (Scotland) Act 2000
June 2015

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Governance of severance arrangements

Introduction

1. I have received the audited accounts and the auditor's report for Coatbridge College for the period ended 31 March 2014. The purpose of this report is to draw to Parliament's attention serious weaknesses in governance relating to the severance arrangements for senior managers and one other member of staff at the college.

2. I am submitting the accounts and the auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

Background

3. Coatbridge College was one of three colleges that merged to form New College Lanarkshire, as part of the wider college reform programme in Scotland. Cumbernauld College and Motherwell College agreed to merge in January 2013. In February 2013, Coatbridge College agreed to join the merger, then withdrew later that month, before deciding to join again in August 2013. Cumbernauld College and Motherwell College merged in November 2013, and Coatbridge College joined in April 2014.

4. The merger resulted in a number of staff leaving the three colleges under voluntary severance. Thirty-three staff left Coatbridge College, at a total cost of £1.7 million, of which the Scottish Funding Council (SFC) contributed £1.3 million and the college contributed £397,945. The total severance cost for the Principal, five members of the senior management team and a member of staff within the Principal's office was £849,842. The Principal left the college on 31 October 2013, the member of staff in the Principal's office left on 31 January 2014 and the five senior managers left on 31 March 2014.

5. Due to delays in the preparation of the accounts by the college, and difficulties in securing information relating to the severance arrangements described above, the auditor was not able to conclude the audit until the end of March 2015. This meant that the accounts missed the statutory deadline for laying before the Parliament of 31 December 2014.

Context

6. In May 2013, I issued a joint report with the Accounts Commission, *Managing early departures from the Scottish public sector*, which set out a range of good practice principles that organisations should follow when designing, managing and monitoring their early departure, or severance, schemes (Exhibit 1). The circumstances of individual organisations will vary and it is up to those charged with governance to ensure that their organisation's early departure

schemes are tailored to their needs. However, the underlying principles of consistent policies, independent checks, value for money, and open reporting to the public apply to everyone.

Exhibit 1

Examples of good practice principles for early departure schemes

- There should be clear policies and procedures which are consistently applied.
- Proposals should be supported by business cases, showing the full additional costs of early departures and their anticipated savings.
- Councillors or board members should approve early departure schemes, ensuring that proposals represent value for money.
- Councillors or board members should approve proposals affecting senior managers to ensure each application is independently authorised.
- Compromise agreements should not be used to limit public accountability, for example by trying to silence whistleblowers or by hiding the full cost of departures.
- Organisations should be open in their annual reports and accounts about the costs of early departures and the savings they have generated.

Source: Managing early departures from the Scottish public sector, Audit Scotland, May 2013

The auditor's opinion

7. The auditor gave an unqualified opinion on the college's accounts for 2013/14, but included an 'Emphasis of matter' paragraph, in which she drew attention to serious governance weaknesses in how voluntary severance arrangements for the Principal, the senior management team and staff were considered, implemented and reported; and the arrangements for senior staffing and salary approval.[1] In her annual audit report, the auditor highlighted weaknesses in governance relating to how those charged with governance handled the severance arrangements for senior staff (Exhibit 2).

8. The auditor also highlighted problems in securing all of the information necessary to conclude the audit. The college's preparation of the annual accounts took significantly longer than would normally be expected, and the auditor required the college to make a large number of adjustments to address errors in the accounts. The auditor reported that a lack of corporate knowledge and continuity created difficulties for the audit. These difficulties arose as a result of the departure of key staff at Coatbridge College. Staff at New College Lanarkshire had to pick up the work, but needed time to understand the systems and records before they could address the auditor's enquiries. These problems ultimately resulted in delays to the conclusion of the audit, the finalising of the audited accounts and the auditor's report, and to the preparation of this report.

[1] An 'Emphasis of matter' in an auditor's report refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Exhibit 2

Extract from the auditor's report on the 2013/14 accounts of Coatbridge College

The College governance system has previously been assessed as robust by both us and internal audit and our observation had been that it operated well in practice. Work by internal audit, New College Lanarkshire and us has identified significant weaknesses in the operation of the governance system during 2013 and 2014. These weaknesses primarily stemmed from actions around how the voluntary severance arrangements for the Principal, the Senior Management Team and staff were considered, implemented and reported. No issues with voluntary severance governance arose in New College Lanarkshire. The weaknesses in governance included:

- The Principal making decisions he did not have authority to make
- Agendas and papers for Remuneration Committees either not being fully prepared or not kept
- Minutes for the Board and Remuneration Committee did not record fully the discussions and decisions made
- Minutes from Remuneration Committee meetings not being produced or reported to the Board timeously.

Source: Coatbridge College Annual Audit Report 2013/14 (paragraph 17)

Severance arrangements

There was a lack of clarity around the development, application and financial entitlements of the severance scheme for senior management

9. The proposed terms of the severance scheme for senior management were discussed at a meeting of Coatbridge College's Remuneration Committee on 28 January 2013. It is unclear who developed the terms but the terms included that senior management would receive a lump sum equivalent to 21 months' salary. The severance terms for the Principal were different. In addition to the 21 months' lump sum, it was proposed he would receive an additional three months' severance for taking the college successfully through to merger.

10. In January 2013, the Principal, five members of the senior management team and a member of staff in the Principal's office also received a pay rise of three per cent, backdated to August 2012. They received a further pay rise of two per cent in August 2013. Both of these pay rises were the same as those given to all staff in the college. In addition, the Principal was given a further three per cent in January 2013, 'in recognition of his leadership role', again backdated to August 2012. The pay rises were included in the calculation of severance payments. The Principal left on 31 October 2013 and was also granted six months' pay in lieu of notice. While there is evidence to suggest that the pay rises were considered and approved by the Remuneration Committee, only the decision to award the two per cent rise to all staff was recorded in the minutes.

11. The Remuneration Committee did not consider the minute of the 28 January 2013 meeting until its meeting on 23 October 2013. At the October meeting, two of the five committee members who had been present at the January meeting registered their disagreement with the minute, specifically the scheme parameters that had been agreed for senior management. One committee member indicated that she had not had enough information at the time to allow her to make the decision. However, the minute was agreed by a majority of those present. All members present agreed with the minute in respect of the Principal's severance.

12. The minutes of the Remuneration Committee for January 2013 indicated that the aspiration was that this scheme would be extended to all staff at the college. When the Coatbridge College Remuneration Committee met on 23 October 2013, it agreed to revise the terms of the severance scheme, reducing the maximum lump sum element to 13 months for all staff, including the senior management team. These terms were in line with the arrangements being applied at both Cumbernauld College and Motherwell College. However, the final payments to the five members of the senior management team and the member of staff in the Principal's office included additional payments that meant the severance payments exceeded the terms agreed by the Remuneration Committee on 23 October 2013. There is limited evidence of the reasons for these additional payments and of the decisions to award them. Further detail is provided below.

The college did not provide the Remuneration Committee with business cases in support of the severance packages or for salary enhancements for senior staff

13. There is no evidence that the Remuneration Committee or the Board were provided with detailed business cases setting out the costs and justification for severance payments to the Principal, five members of the senior management team or the member of staff in the Principal's office. The payments also included payments for accrued annual leave which the auditor could not verify. The total cost of the severance payments associated with accrued leave for the Principal, five members of the senior management team and the member of staff in the Principal's office was £41,183, for between 14 and 27 days per person. Other members of college staff also received such payments.

14. Following the departure of the Principal on 31 October 2013, the Depute Principal took on the role of Principal. The position of Depute Principal was not filled, with the Depute Principal's responsibilities distributed amongst the senior management team. These staff, along with the member of staff in the Principal's office, received salary enhancements of around ten per cent for these additional responsibilities. They received these salary enhancements until they formally left. The member of staff in the Principal's office left on 31 January 2014 and the four members of the senior management team left on 31 March 2014. The enhancements were included in severance calculations. The Remuneration Committee did approve the enhancements, although there is no record of a business case to support them.

15. Three of the five other members of the senior management team were on sick leave for several months leading up to their formal departure date. In March 2014, the remaining two members of the senior management team received further salary enhancements of £4,000

each, intended to reflect the additional contribution made during the period the others were absent. These enhancements were backdated to February 2014 and were also included in the calculation of their final severance payments.

16. In addition to the above, one of the members of the senior management team received a salary uplift of around ten per cent in May 2013. Emails held by the college suggest this was to reflect a re-evaluation of the post, but there is no documentation setting out how the post was evaluated. The member of staff in the Principal's office also received a separate increase of around 19 per cent in January 2013. This increase was approved by the Principal and was intended to reflect 'additional responsibility in relation to regionalisation', but there is no record of what these additional responsibilities were.

17. Finally, in addition to the above, six of the seven members of staff received payments in lieu of notice, ranging in value from one to six months' salary. The remaining member of staff also received an additional payment, but the reason for the payment was not documented.

The Chair and Principal of Coatbridge College did not provide the college's Remuneration Committee with advice provided by the SFC

18. The Scottish Funding Council's (SFC) guidance sets out a range of expectations around the approval of severance packages (Exhibit 3).[2]

Exhibit 3

Extracts from Scottish Funding Council guidance on severance arrangements to senior staff in further education colleges

Paragraph 13: Colleges have a responsibility to use both public and any 'private' funds in a prudent way that achieves value for money.

Paragraph 14: When agreeing individual cases of premature retirement or a severance package, colleges should delegate the task to their Remuneration Committee (or its equivalent), or to a specific committee set up for that purpose. Delegation must be within a specific remit, have full compliance with the college's policy on severance matters and with clear boundaries as determined by the Board of Management. Colleges should ensure that formal reports of severance packages, including all financial aspects, are made to the Board of Management although this may be carried out through the relevant finance or resources committee.

Paragraph 24: In general, public funds should only be used to meet contractual and other payments required by law. These obligations may include formally agreed severance schemes that are part of contractual terms and conditions and in the exercise of discretion granted to colleges by a specific scheme, such as pension enhancement within the limits set out in the relevant pension scheme rules. Exceptions to this general approach, which may be described as "being in the management interest", need careful justification and colleges should be mindful of the comments

[2] *Guidance on severance arrangements to senior staff in further education colleges*, Scottish Funding Council, January 2000 (Circular FE/03/2000). The SFC issued a further circular in 2004, to update the thresholds that indicate whether a member of staff should be considered a member of senior staff (Circular FE/13/04).

on individual performance referred to in paragraph 23. However, where an exceptional arrangement is being considered, clear and comprehensive documentation must be prepared (and retained) that fully demonstrates how the cost of severance terms, beyond contractual obligations, provide (and are seen to provide) the best value for money.

Source: Guidance on severance arrangements to senior staff in further education colleges, Scottish Funding Council, January 2000 (Circular FE/03/2000)

19. In response to an enquiry from the college, the Chief Executive of the SFC wrote to the Chair of Coatbridge College on 24 January 2013. He highlighted that:

- There should be a general severance framework to which all severance arrangements should adhere, except in "very exceptional circumstances".
- Where an exceptional arrangement is being considered, clear and comprehensive documentation should be prepared (and retained) that fully demonstrates how the cost of severance terms, beyond contractual obligations, provide (and are seen to provide) the best value for money.
- The SFC had not been supporting voluntary severance arrangements with payback periods in excess of one year, reflecting a general trend in the public sector; and he would strongly encourage the college to stay within these parameters. He acknowledged that such matters were ultimately a decision for the college's Board.
- Both internal and external auditors should be informed of any proposed exceptional settlements.

20. It is clear that the SFC had concerns about the proposed severance terms for the Principal and senior management team of Coatbridge College. The SFC reinforced its guidance to the college on several occasions:

- On 10 October 2013, the SFC wrote to the College Principal seeking assurance that the severance arrangement being offered to the college's senior management team was in accordance with good practice and represented good public value.
- On 16 October 2013, the SFC wrote to the Principal to request additional information, including details of governance processes around severance arrangements.
- The SFC's Chief Executive met with the college's Chair of the Board of Management and the Principal on 21 October 2013, to discuss issues around severance arrangements for the senior management team; and separately with the Chair only about severance arrangements for the Principal.
- On 22 October 2013, the SFC wrote to the College Chair to set out its expectations in relation to severance arrangements, referencing again the SFC's guidance and concerns about exceptional payments that had been highlighted in previous communications.
- On 23 October 2013, following the meeting of the Remuneration Committee, senior staff from the SFC discussed with the Board the terms of the severance packages offered to the Principal and senior management (the SFC was not present at the meeting of the Remuneration Committee). The SFC told the Board that it would not fund the Principal's package beyond 13 months, and that the college would need to meet the costs of any

payment above that. The SFC also indicated that if the Board did want to exceed 13 months, it would need to justify the decision to the SFC and formally record the reasons for the additional payment. The SFC again advised that the Board should seek the views of both the internal and external auditors and that those views should be incorporated into the report to the SFC.

- On 24 October 2013, the SFC wrote again to the (former) Chair and to the newly-elected Chair of Coatbridge College. The SFC emphasised its concerns about the terms the college was offering to the Principal. It also stated that the college should not commit to a deal that was in line with those terms until the Chair provided SFC with assurance that the arrangement was in accordance with good practice and represented good public value.

21. It is not clear from the available evidence whether all of the communications between the SFC and the Principal and the Chair of the college were shared with the Remuneration Committee and the Board. Where they are available, the minutes of meetings do not accurately reflect the advice provided by the SFC, detailed above. For example, the minutes of the Remuneration Committee meeting on 28 January 2013 record the following:

"The Chair noted that transitional support funding would be made available to the College as part of a merger process and thus the funding was not an issue at this time. The Chair also confirmed that he had spoken to Mark Batho, Chief Executive of the Funding Council and that these discussions [those of the Remuneration Committee] were in line with the Funding Council's guidance on severance arrangements for senior staff, and in particular, any potential arrangements in respect of the Principal."

22. It is clear that the terms being discussed by the Remuneration Committee were not in line with the advice of the SFC and so it appears that the Chair did not provide the Remuneration Committee with complete or accurate information about the advice provided by the SFC. The auditor also confirmed that she was not consulted at any time on the severance proposals. While it is possible that the Remuneration Committee may still have made the same decision, it should have been presented with the full facts to allow it to make an informed decision.

23. On 25 October 2013, the new Chair of the Coatbridge College Board wrote to the SFC to apologise that its advice had not been presented at the meeting of the Remuneration Committee on 23 October 2013.

Conclusions

24. My 2013 report on early departures recognised that voluntary severance can provide a cost-effective way of managing overall employee numbers and costs. This is particularly important in times of budget cuts or public sector mergers, where there is a need to implement relatively quick changes in the workforce. However, the report also highlighted that senior managers and board members should be fully aware of the costs and benefits when making decisions. Before approving any severance payments, those charged with governance must ensure that they represent a good use of public money, and a clear audit trail should be retained.

25. There were serious failings in the governance of severance arrangements at Coatbridge College. In particular:

- failure to meet the standards expected of public bodies in the use of public money and a lack of transparency in the decision-making process for voluntary severance arrangements
- payments were made that exceeded the terms of the college's severance scheme
- the proposed severance scheme for senior staff offered terms that were significantly higher than the SFC's guidance and the schemes of the other colleges that merged to form New College Lanarkshire
- the college did not retain sufficient evidence (minutes and business cases) that severance proposals, and salary enhancements, had been subject to a value for money assessment
- the absence of any evidence that the Remuneration Committee had access to the information and advice it needed to fulfil its responsibilities
- the fact that the Principal failed to take the steps needed to demonstrate that the inherent conflicts of interest were properly handled.

26. The poor decision-making and record-keeping has resulted in potentially unnecessary costs being incurred by the college and is likely to affect public perception of the quality of college governance.

The 2014/15 audit of Glasgow Clyde College

AUDITOR GENERAL

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
March 2016

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

Contents

Introduction

1. I have received the audited financial statements and the auditor's report for Glasgow Clyde College (GCC) for 2014/15.[1] The purpose of this report is to draw Parliament's attention to significant concerns about governance at GCC during 2014/15.

2. I am submitting these financial statements and the independent auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

3. My report is based on information provided through the 2014/15 audit of GCC and additional work undertaken by the auditor and Audit Scotland. This additional work focussed on documentary evidence and included a detailed review of the minutes of the GCC Board of Management (the Board) during both 2014/15 and 2013/14. The review of 2013/14 minutes allowed auditors to examine comparisons in practice between the two years. A fuller methodology and key sources of evidence for this work can be found in the Appendix.

4. Significant events took place at GCC during 2015 including: the suspension of the Principal in February; the decision by Scottish Ministers to remove the Board members (with the exception of the Principal) and appoint an Emergency Board in October; and the Principal's return to post in December. It is not within the remit of Audit Scotland to comment on any of these decisions or whether correct procedures were followed. This report is the result of specific concerns about governance identified as part of the 2014/15 audit of GCC.

5. On 8 January 2016, a former Board member launched a petition for a judicial review into the decision taken by Scottish Ministers in October 2015 to remove Board members (see paragraph 14). As at the date of this report, the judicial review proceedings were ongoing.

The auditor's opinion

6. The auditor has given an unqualified audit opinion on the GCC financial statements but draws attention to concerns relating to governance, as the Board did not comply with the *Code of Good Governance for Scotland's Colleges* (CoGG) throughout 2014/15.

7. The auditor also draws attention to the use of public funds incurred by the Board in relation to legal advice and services provided in 2014/15. GCC did not comply with the Scottish Funding Council's (SFC) *Financial Memorandum with Fundable bodies in the College Sector* throughout 2014/15.

Background

8. GCC came into being on 1 August 2013, as a result of the merger of Anniesland, Cardonald and Langside colleges. GCC is an independent legal body with charitable status as defined by

[1] The financial statements and auditor's report for 2014/15 cover the 16-month period from 1 April 2014 to 31 July 2015.

the Further and Higher Education (Scotland) Act 1992 (the 1992 Act). It is governed by a Board which is responsible for determining the overall strategy of the college and the proper use of public funds, the quality of provision and appointing the Principal and other senior staff.

9. In accordance with the 1992 Act, the Board is responsible for the administration and management of the college's affairs, including ensuring an effective system of internal control and the presentation of audited financial statements for each financial year. The Board is also required to comply with the terms and conditions of its grant from the SFC, including compliance with the SFC’s Financial Memorandum and the CoGG.

10. 2014/15 was a challenging period for GCC. In August 2014, the new regional strategic body, Glasgow Colleges’ Regional Board (GCRB), became responsible under the Post-16 Education (Scotland) Act 2013 for securing further and higher education for Glasgow's three colleges: City of Glasgow, Glasgow Clyde and Glasgow Kelvin. To operate fully as the regional strategic body, GCRB has to have operational fundable body status. Without operational fundable body status, the SFC will not allocate funding to GCRB and will instead administer funding to the three colleges directly. GCRB has yet to achieve operational fundable body status. Minutes from Board meetings at GCC during 2014/15 record tensions in the relationship between GCRB and GCC.[2]

11. There were also significant changes and events taking place within GCC. The Board Chair resigned in September 2014 and an interim appointment was made, which the GCRB made permanent in December 2014. On 5 February 2015, the Educational Institute of Scotland (EIS) sent a letter to the Board raising a number of issues that it felt to be matters of concern. On 12 February 2015, proposals to amend the Student Association staff structure were postponed. On the 18 February 2015, the Principal wrote to the GCC Board, SFC and Scottish Government outlining her own concerns in relation to governance although these were not addressed at the time. On 19 February 2015, the Principal was suspended on full pay by the Board Chair.

Summary of events at GCC between March and December 2015

12. In March 2015, the SFC commenced a review of governance at GCC and reported its findings to Scottish Ministers in June 2015. During June and July 2015, the Scottish Government was in regular correspondence with the Board Chair to request information required for Scottish Ministers to exercise their powers and perform their duties under Part 1 of the 1992 Act. In September 2015, the Cabinet Secretary wrote to the full Board and met subsequently with the Board Chair and some of the Board members to discuss concerns she had that the Board had committed repeated breaches of the terms and conditions of a grant made to it and may have mismanaged its affairs.

13. The suspension of the Principal and the subsequent SFC review of governance became a significant focus at Board meetings between February and September 2015. Analysis of

[2] I have prepared a separate report on the 2014/15 audit of GCRB.

Board minutes shows evidence that discussion around these issues dominated Board meetings. The Board met 11 times during this period (three ordinary and eight extra-ordinary meetings), compared to four times in the same ten-month period in 2014 (three ordinary and one extra-ordinary meeting).

14. On 8 October 2015, using powers under section 24(2)(a) of the 1992 Act, Scottish Ministers removed the Board from office with the exception of the Principal because "*it appeared to them that the Board of Management of Glasgow Clyde College had committed repeated breaches of terms and conditions of a grant made to them under section 12 of the Further and Higher Education (Scotland) Act 2005(b) and had mismanaged the affairs of that Board"*.[3] This is the only time Scottish Ministers have removed a college board.

15. Under section 24(2)(b) of the 1992 Act, Ministers may appoint another person in place of the removed member.[4] An Emergency Board was appointed on 8 October 2015 and will hold office until 30 September 2016. Thereafter, Ministers expect the Board posts to be filled through an open recruitment process as set out in the *College Sector Board Appointments: 2014 Ministerial Guidance.*

16. Following their appointment, the Emergency Board reviewed the case against the Principal's suspension and decided not to pursue any disciplinary action on 16 November 2015. The Principal was reinstated and returned to work on 7 December 2015.

17. The full timeline of key events during 2015 is outlined in Exhibit 1.

[3] The Glasgow Clyde College (Removal and Appointment of Board Members) (Scotland) Order 2015: Scottish Statutory Instrument 2015/348

[4] Where a removed member was appointed under paragraph 3A(2)(a) or (f) of Schedule 2 to the 1992 Act

Exhibit 1 – Timeline of key events at GCC during 2015[5]

Key event	Date (2015)
EIS send a letter to the Board raising a number of issues that it felt to be matters of concern.	5 February
Proposals to amend the Student Association staff structure were postponed.	12 February
Principal writes to the Board, the SFC and the Scottish Government raising governance concerns.	18 February
Principal suspended on full pay by the Board Chair pending a review.	19 February
Simpson & Marwick LLP [6] is appointed to provide legal advice relating to the suspension and issues an engagement letter to the Board Secretary.[7]	20 February
Depute Principal takes over responsibility for the operational running of GCC.	20 February
Extraordinary Board meeting to brief the Board about the Principal's suspension. Student Board members are excluded from parts of the meeting.	23 February
Board Chair writes to formally advise the SFC of the Principal's suspension.	4 March
SFC writes to the Board Chair stating its intention to carry out a review of governance and management at GCC.	6 March
GCC's Executive Management Team (EMT) become aware that financial limits are in danger of being breached in relation to spending on legal services from Simpson & Marwick LLP and alert the Board Chair and Board Secretary.	18 March
SFC begins a review of governance at GCC.	27 March
Depute Principal advises the Board Chair and Board Secretary that financial limits have been breached in relation to legal services from Simpson & Marwick.	30 March
Depute Principal contacts the SFC to seek retrospective permission to go beyond the £25,000 delegated limit, regarding the payment of fees to Simpson & Marwick.	22 April
SFC denies retrospective permission to exceed delegated limit and instructs GCC to cease using Simpson & Marwick LLP as there is a risk of GCC incurring additional costs.	23 April
Board takes further legal advice in relation to the legitimacy of the SFC governance review, the Student Association structure and its constitutional documents using GCC's lawyers, Brodies LLP. Terms of engagement agreed between the Depute Principal and Brodies LLP.	29 April
Board engages a further law firm, Thorntons Law LLP, through the APUC[8], for the provision of legal services relating to the Principal's disciplinary proceedings. Terms of engagement agreed between the Depute Principal and Thorntons LLP.	12 May
Chair of the Audit Committee commissions a special internal audit using BDO, into the procurement process and expenditure associated with legal and management consultancy	

[5] The Board engaged three law firms during 2015. For more information about what each of the firms were engaged to do, please refer to Exhibit 3.
[6] On 1 October 2015, Simpson & Marwick merged with Clyde & Co and now trades under this name.
[7] An engagement letter can be defined as the legal relationship (or engagement) between a professional organisation (the law firm) and its client (GCC).
[8] Advanced Procurement for Universities and Colleges (APUC) is the procurement centre of expertise for Scotland's universities and colleges.

advice at GCC.	
A Board member makes a formal complaint against the Board Chair to the Commissioner for Ethical Standards in Public Life in Scotland concerning an alleged contravention of the Code of Conduct for the Board.[9] *(In November 2015, the Commissioner concludes that the Board Chair did not contravene the Code).*	19 June
Outcome of the SFC governance review shared with the Board.	26 June
SFC provides a briefing to the Scottish Government based on its governance review.	30 June
Board Secretary resigns. No new appointment made.	30 June
Correspondence from the Scottish Government to the Board Chair requesting further information regarding governance issues.	30 July
Cabinet Secretary formally writes to the Board raising concerns that GCC may have breached the terms and conditions of the grant made to GCC by the SFC.	9 September
Cabinet Secretary meets the Board Chair and some Board members to discuss governance concerns.	14 September
Some of the Board members write to the Cabinet Secretary responding to the concerns raised, refuting many of the allegations made.	18 September
All Board members who were members between February and July 2015 (with the exception of the Principal) are removed by the Cabinet Secretary with immediate effect. An Emergency Board was appointed on the same day.	8 October
Principal returns to work.	7 December

Source: Audit Scotland/GCC/SFC

Outcome of audit investigations

18. Audit Scotland worked alongside GCC's auditor during November 2015 to February 2016 to carry out additional audit work focussing on governance. This work identified:

- significant concerns in relation to governance at GCC
- non-compliance with the principles of the CoGG
- non-compliance with the SFC's Financial Memorandum.

Governance

19. High standards of governance should underpin the use of public money. Citizens and taxpayers have an important and legitimate interest in the value for money provided by public bodies. *The Good Governance Standard for Public Services* sets out six core principles of good governance that public bodies should strive to achieve.[10]

[9] Allegations included breaching the key principles of paragraph 2.1 in terms of Duty, Objectivity, Accountability and Stewardship, Honesty, Leadership and Respect and paragraph 3.3 (General Conduct).
[10] *The Good Governance Standard for Public Services*, Independent Commission on Good Governance in Public Services, 2004.

20. Work undertaken to inform the auditor's report and additional work carried out by the auditor and Audit Scotland identify that GCC did not fully meet the six principles contained within the *Good Governance Standards*. Documentary evidence reviewed demonstrates significant concerns relating to governance, including a failure to meet the standards expected of public bodies in the use of public money and a lack of:

- strategic direction and focus (the suspension of the Principal and subsequent SFC governance review dominated discussions at Board meetings)
- focus on the quality of the student learning experience
- open and transparent decision-making (eg, minutes not circulated and agreed in a timely manner)
- effective engagement with a range of internal and external stakeholders (including the EMT, GCRB and the SFC).

Non-compliance with the Code of Good Governance

21. As a condition of their grant from either the SFC or their regional strategic body, all colleges must comply with the CoGG. The CoGG sets standards of good governance practice for all college boards across five areas - leadership and strategy, quality of the student experience, accountability, effectiveness and relationships and collaboration.

22. In their audit report for GCC, the auditor reported that the Board did not comply with the principles contained within the CoGG throughout 2014/15. Exhibit 2 outlines a number of particular examples, specific to the focus of the audit work, of non-compliance with the CoGG across each of the five key areas of governance.

Exhibit 2. Examples of non-compliance with the CoGG throughout 2014/15

What does good practice look like	Evidence from audit work at GCC
Leadership and Strategy	
The Board is responsible for formulating and agreeing strategy by identifying strategic priorities and providing direction within a structured planning framework.	• The suspension of the Principal and the SFC governance review dominated discussion at Board meetings from February - September 2015. • Other strategic items of business were not adequately considered at Board meetings, eg the Corporate Plan, the Regional Outcome Agreement and GCC's International Strategy. This is in contrast to previous years.
Quality of the Student Experience	
Staff and student Board members are full Board members and bring essential and unique, skills, knowledge and experience to the Board. Staff and student Board members must not be excluded from Board business unless there is a clear conflict of interest, in common with all Board members.	• Student Board members were excluded from parts of the Board meeting on 23 February 2015, when the Principal's suspension was discussed. • Minutes from Board meetings identify tensions between the Board Chair and Student Board members. • One Student Board member chose not to attend any Board meetings from April 2015 onwards. • In March 2015, a motion of vote of no confidence in the Board Chair was made by the GCC Student Association on the decision to exclude student Board members from parts of a meeting in February 2015. The motion was not supported.
Accountability	
Colleges must maintain and publically disclose a current register of interests for all Board members. *Boards …must ensure that there is effective reporting and two way communication between committees and the Board.*	• A register of Board members' interests was not available on GCC's website. • There was a reliance on verbal updates from Committees to the Board. • Committee minutes during 2014/15 were not routinely and timeously provided to the Board.
Effectiveness	
All Board members must have access to a board secretary who has an important governance role in advising the Board and individual Board members and supporting good governance.	**The Board Secretary** • Board meetings were regularly conducted in the absence of the Board Secretary from October 2014 until June 2015, when they left their post. • Board minutes were taken by a range of people

What does good practice look like	Evidence from audit work at GCC
	including; a Board member and a legal representative. In some cases it is unclear who took a formal note of the meeting. This led to an inconsistent approach to the way meetings were recorded and decisions minuted.
The Principal has an important role in supporting effective governance. The Principal, as a Board member, shares responsibility with the Chair and the Board, supported by the Board Secretary, for enabling good governance through supporting effective communication and interaction between the Board and the rest of the college.	**Principal and Chief Executive** • The Board did not seek further information about the governance concerns raised by the Principal immediately prior to her suspension.
The Board must keep its effectiveness under annual review and have in place a robust self evaluation process.	**Board evaluation** • There is no evidence of an annual self-evaluation process having been undertaken during 2014/15. This is in contrast to the previous year.
Relationships and Collaboration	
Colleges and/or regional strategic bodies must ensure effective consultation, local and regional planning and must follow the principles of effective collaborative working: mutual respect, trust and working towards commonly agreed outcomes.	**Partnership working** • Minutes demonstrate that there was a breakdown in relationships between the Board and the SFC as a result of the governance review, and tensions in GCC's relationship with GCRB.
The Board, via the board secretary, must ensure the Board agenda, minutes, policies and appropriate reports are published within appropriate time frames, ensuring and monitoring compliance with freedom of information legislation.	**Openness and Transparency** • Board meetings took place without agendas in April and May 2015. • At the time of the audit, Board minutes were not publicly available on GCC's website. This has only recently been addressed. • Board minutes were not consistently ratified at the next Board meeting. During 2015, minutes of meetings on 12 February, 23 February, 26 March, 25 June and 15 July were approved on 30 July.
The Board must encourage a strong and independent students' association.	**Staff and Students** • In 2014/15, no student put themselves forward for election to the Student Association. The planned election was postponed.

Sources: Code of Good Governance for Scotland's Colleges (December 2014); and work undertaken by the auditor and Audit Scotland.

Non-compliance with the SFC Financial Memorandum

23. All public bodies that spend public money, either in commissioning services or directly providing them, have a duty to strive for economy, efficiency and effectiveness in their work. During 2014/15, the Board sought legal advice on a range of issues relating to the suspension of the Principal and the legitimacy of the SFC review of governance. By 31 July 2015, GCC had spent a total of £213,850. A breakdown of the total costs incurred and the purpose of the expenditure for each service is outlined in Exhibit 3.

Exhibit 3. Costs incurred relating to Legal, HR and PR services during 2014/15[11]

Service	Expenditure	Purpose of Expenditure[12]
Simpson & Marwick LLP [13]	£90,956	• To provide advice in relation to employment law support • To provide assistance in conducting a disciplinary investigation
Brodies LLP	£68,283	To provide advice to the Board in respect of: • the SFC governance review • the proposal by GCC's student association for a revised structure • advice about its powers, duties and constitutional documents.
Thorntons Law LLP	£17,850	To advise GCC, the Board Chair and the Board in respect of various employment law matters related to the on-going disciplinary procedure involving the Principal, including: • advice to members of the disciplinary committee • administrative support in the disciplinary process.
John Brown PR Consultancy	£3,099	To provide PR/media services to the Board Chair and the Board following the decision to suspend the Principal.
Jan Scott HR Consultancy	£12,025	To provide HR support for the investigation into the Principal's suspension.
BDO	£20,451	An internal audit investigation into the process and expenditure associated with legal and management consultancy advice relating to: • expenditure in respect of Simpson & Marwick connected to the disciplinary process relating to the Principal and associated advice • legal fees in respect of Brodies LLP for the SFC's governance review • spending on management consultants.
Regus room booking	£1,186	Cancelled room bookings originally made for the disciplinary hearing.
Total	**£213,850**	

Source: Information provided by GCC

[11] Between 1 August and 31 December 2015, a further £34,400 was spent on these services.
[12] Summary of extracts from engagement letters and other correspondence provided by GCC.

24. As part of the terms and conditions of the grant colleges receive from the SFC, they must comply with the SFC's Financial Memorandum. This provides clear guidance about the delegated financial limits within which colleges must operate. GCC did not comply with this Financial Memorandum throughout 2014/15, as outlined in the audit report for GCC.

25. In February 2015, the Board Chair sought legal advice in relation to the suspension of the Principal. Simpson & Marwick LLP were appointed to provide this advice. Audit work has identified that:

- Simpson & Marwick LLP were appointed without a competitive process.
- GCC's own procurement processes were not followed in appointing Simpson & Marwick LLP.
- There were no cost monitoring or controls in place for the first month, following the appointment of Simpson & Marwick LLP.
- GCC exceeded the SFC's delegated limit of £25,000 for non-competitive action.
- There was a lack of shared understanding between the Board Chair, the Board Secretary and the EMT regarding the arrangements for managing this specific external contract and establishing and monitoring the costs.

26. In April 2015, GCC formally sought retrospective approval from the SFC for legal advice provided by Simpson & Marwick LLP between February and April 2015, as the delegated limit of £25,000 for non competitive action was exceeded. At that point, the SFC instructed GCC to cease using Simpson & Marwick LLP as there was a risk of them incurring additional costs.

27. During 2014/15, GCC sought further legal advice from two other law firms (Brodies LLP and Thorntons Law LLP). GCC followed the correct procurement processes for the appointment of both of these law firms; Brodies LLP are GCC's existing lawyers and Thorntons Law LLP were appointed using the APUC framework. Fee caps were also put in place for services provided by Thorntons Law LLP.

GCC is taking action to address concerns in governance

28. Following the appointment of the Emergency Board in October 2015, GCC has put in place a number of actions to ensure it complies with the CoGG. This includes the development of a governance action plan. Examples of other positive steps include:

- the appointment of a new Board Secretary in February 2016.[14] Prior to this, GCC secured temporary Board Secretariat support from the University of Glasgow to ensure continuity at Board meetings
- all Board and committee draft minutes are now distributed for agreement by the relevant Chair within ten days of a meeting. The minutes are then distributed to the Board members and the EMT

[14] This post has now been renamed Clerk to the Board.

- EMT attendance and involvement at Board meetings
- ongoing engagement with students including regular meetings between the Student Association and the EMT.

29. These actions lay the foundation in starting to address the significant concerns relating to governance at GCC during 2014/15.

30. GCC has developed an action plan in response to the key finding identified in the BDO report in relation to the procurement of legal services. This plan was discussed at a meeting of the Audit Committee on 25 November 2015. Examples of actions within the plan include:

- setting capped fees at agreed stages for all professional services appointments
- sharing contractual documentation with relevant finance staff for all professional services
- nominating a GCC staff member for any contract initiated by the Board, who will take responsibility for:
    - ensuring appropriate procurement processes are followed
    - establishing estimates of anticipated expenditure
    - monitoring ongoing costs
    - setting staged fees caps
- providing training sessions to Board members to ensure they understand the relevant regulatory and procurement requirements within which GCC must operate.

Looking forward

31. Audit Scotland's analysis of Board minutes since October 2015 indicates that the Emergency Board is complying with the principles of the CoGG. There is evidence of clear and transparent decision-making and joint working with the EMT. There are also clear linkages from meeting to meeting, demonstrated through the effective use of 'matters arising' at Board meetings.

32. The Board Chair has been appointed to another post within the college sector from June 2016 and the remaining Board members are in office until September 2016. This presents a risk to GCC in terms of both succession planning and maintaining good governance, as it seeks to appoint a new Board. GCC has put plans in place to address these issues. GCC advertised for new Board members in January 2016 and expects to have the first round of appointments concluded by the end of April 2016. In addition, the new Board Secretary took up post in March 2016.

33. A formal induction for new Board members and an accompanying training and development programme will be critical to the success of the new Board. Planning for this needs to begin now. A skills matrix was conducted by the former Board which provided an overview of their skills. A similar exercise will be important for new Board members to help inform and target relevant training. It must have a clear focus on the CoGG and the college's Articles of

Governance to help ensure Board members fully understand their individual and collective responsibilities. GCC should also make use of national training and development programmes available. The new Board Secretary will play a pivotal role in setting this up.

34. The Board's remit requires an annual self-evaluation exercise and a process for evaluating the Board Chair and committee Chairs. It is important that the Board keeps its effectiveness under annual review so that it is focussed on continuous improvement and the right priorities for the college. Sufficient resources must be put in place to support such self-evaluation activity.

Conclusion

35. There are examples of significant concerns relating to governance at GCC during 2014/15. This is of clear interest to the Parliament and to the public. The Emergency Board and the EMT have taken positive steps to address the weaknesses identified within this report and the auditor's report. I have asked the auditors of GCC to monitor progress as part of their 2015/16 audit.

Appendix: audit methodology

A wide range of documents were reviewed as part of the audit work. This information formed the basis of the audit judgements and included:

GCC Board papers and other documentation

- Ordinary and extra-ordinary Board meeting minutes during 2013/14
- Ordinary and extra-ordinary Board meeting minutes during 2014/15
- Committee meeting minutes during 2013/14 and 2014/15
- BDO internal audit report and subsequent action plan
- Letters of engagement and invoices from legal firms and consultants
- GCC Governance Action Plan (in response to the Scottish Government Policy Note)

Guidance

- The Good Governance Standard for Public Services
- Code of Good Governance for Scotland's Colleges
- Scottish Funding Council's Financial Memorandum with Fundable Bodies in the College Sector
- GCC's Constitution and Articles of Association (August 2013) and the updated Articles of Association (December 2015)

Other reports

- SFC Governance review
- SFC Advice to Scottish Ministers
- Scottish Government Policy note
- External Review by Education Scotland

Interviews also took place with relevant stakeholders to discuss the chronology of events and to identify and provide additional documentary evidence. They included:

- Members of the Executive Management Team
- The Scottish Funding Council

The 2014/15 audit of Edinburgh College

AUDITOR GENERAL

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
March 2016

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Introduction

1. I have received the audited accounts and the independent auditor's report for Edinburgh College for the 16-month period ended 31 July 2015.[1] I submit these accounts and the independent auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

2. The purpose of this report is to draw to the Scottish Parliament's attention to concerns relating to significant financial challenges facing Edinburgh College.

Auditor's opinion

3. The auditor gave an unqualified opinion on Edinburgh College's financial statements for 2014/15. However, the auditor's annual report highlights that the college had experienced financial difficulties at the end of 2014/15. He notes that an anticipated reduction in forecast cash resources of £3.3 million for 2015/16 would leave the college with severe financial challenges. The college approached the Scottish Funding Council (SFC) to secure additional financial support for 2015/16 in order to meet its operating expenses.

Findings

4. Edinburgh College was formed in October 2012 by the merger of Jewel and Esk, Telford and Stevenson colleges. The college has failed to meet its targets for learning activity in each year since its establishment, although the levels of under-delivery have been small - in the region of one to two per cent in each year. Missing this target can trigger a financial penalty as the SFC can seek to recover money for activity that was not delivered.

5. During autumn 2015, and following the period covered by the 2014/15 financial statements, the SFC notified the college that it was likely to recover funds (£0.8 million) as a result of the college failing to deliver agreed activity. The recovery was due to the college's use of 'additionality' to achieve its 2014/15 target. Additionality is the provision of additional learning to students who are already enrolled at the college, such as students completing extra units that better prepare them for the workplace. A change in SFC funding guidance in 2014/15 tightened the rules covering the volume of additionality for which a college could claim funding. The practice is now only permitted to specified levels and anything above these levels must be agreed in advance with the SFC. The SFC concluded that the college had not adhered to the new guidance in 2014/15.

[1] The decision by the Office for National Statistics to reclassify colleges as public bodies led to a change in some colleges' financial year-end. In 2013/14, Edinburgh College was required to prepare accounts covering only an eight-month period, from 1 August 2013 to 31 March 2014. In 2014/15, the year-end reverted to 31 July, resulting in a 16-month accounting period.

6. When the college became aware of the breach of rules and intended recovery of funds by the SFC, the recently appointed Principal (in post from May 2015) initiated a review of the college's activity targets from the point of merger. The review highlighted a number of underlying problems, including issues with the use of additionality, target setting and student recruitment and retention. The review led the Principal to conclude that the college's existing activity targets exceeded current demand. The college is undertaking further work to better understand the issues. Part of the review also led to the college agreeing with the SFC to reduce its activity target for the 2015/16 year by around six per cent. This reduction has placed the college under significant financial pressure and it sought additional funding from the SFC in order to meet its fixed costs in 2015/16.

7. For the 16 months to 31 July 2015 the college had an income of £91 million, of which £68.3 million comprised SFC grants. At the time of the annual audit, the college estimated a reduction in forecast cash resources of £3.3 million. In February 2016, the SFC notified the college that the Scottish Government had agreed that the college can retain, as part of a special support payment, the £0.8 million that was due to be recovered. This followed discussions between the college and the SFC about a recovery plan. The final version of that plan is due to be submitted to the SFC at the end of March 2016.

Conclusion

8. Edinburgh College will face extreme financial difficulties without further financial support. I have asked the auditor to keep the position under review. I have also asked Audit Scotland to undertake further work, to better understand the reasons for the difficulties and to examine the action being taken by the college to address these concerns. I will report back to Parliament in due course.

The 2014/15 audit of Glasgow Colleges' Regional Board

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

March 2016

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Introduction

1. I am making this report under section 22 of the Public Finance and Accountability (Scotland) Act 2000 to draw the Scottish Parliament's attention to:
   - the auditor's opinion on Glasgow Colleges' Regional Board's (GCRB) annual report and accounts for 2014/15 (paragraphs 8 to 11); and
   - significant problems relating to GCRB's governance arrangements and its relationships with the three assigned colleges in Glasgow and the Scottish Funding Council during 2014/15 (paragraphs 12 to 19).[1]

2. GCRB formally came into existence on 1 May 2014 and so 2014/15 was the first year for which there are audited financial statements for this public body. To complement the auditor's work on the 2014/15 financial statements and to inform this report, Audit Scotland reviewed a large amount of documentary evidence and met a number of individuals involved with GCRB during 2014/15.

Background

3. Across Scotland, there are three regions with more than one college: Glasgow, Highlands and Islands and Lanarkshire.[2] In contrast to the regional strategic bodies in the Highlands and Islands and Lanarkshire, GCRB was an entirely new organisation. The other two regional strategic bodies with more than one college in the region were incorporated into existing organisational structures.

4. In 2014/15, the three colleges in Glasgow (City of Glasgow, Glasgow Clyde and Glasgow Kelvin) spent a total of £119 million and trained over 50,000 students. Over two-thirds of the Glasgow colleges' funding comes from the Scottish Funding Council. Spending by the three Glasgow colleges accounts for nearly a fifth of all expenditure by Scotland's colleges and the number of students equates to just over a fifth of all college students in Scotland.

5. GCRB is the regional strategic body for the Glasgow region. Its role is to oversee the delivery of high quality further and higher education from Glasgow's three assigned colleges. It is responsible for:
   - strategic planning of college provision across the Glasgow region;
   - allocating funding to the three assigned colleges;
   - monitoring performance of the three assigned colleges; and
   - overseeing delivery of the Glasgow regional outcome agreement.[3]

6. The creation of GCRB meant a change in the financial and accountability relationships between the Scottish Funding Council and the three assigned colleges in Glasgow. Rather

[1] The financial statements and auditor's report for 2014/15 cover the 15-month period from 1 May 2014 when GCRB formally began operation to 31 July 2015.

[2] *Scotland's Colleges 2015*, Audit Scotland, April 2015.

[3] Regional outcome agreements set out what colleges in a region will deliver in exchange for funding.

than receiving funding directly from the Scottish Funding Council, the three assigned colleges would receive funding from GCRB as the regional strategic body, which in turn would receive funding from the Scottish Funding Council. In terms of accountability, the three assigned colleges would be accountable to GCRB and GCRB would be accountable to the Scottish Funding Council.

7. The establishment of GCRB as the regional strategic body for the three Glasgow colleges marked the latest stage in a period of major transformation in the college sector in Glasgow. The three assigned colleges had been formed from nine predecessor colleges.[4] Two of these colleges had come into existence during the second half of 2013. Furthermore, the college sector as a whole was managing the effects of significant budget reductions and the implications of the reclassification of all colleges as public bodies from 1 April 2014.[5]

The auditor's opinion

8. GCRB's financial statements for 2014/15 are unqualified but the auditor's report contains an emphasis of matter with regard to weaknesses of governance in GCRB.[6] This relates to an absence of key systems of assurance and internal control, namely:
   - an appropriate risk management framework;
   - key committees such as an Audit Committee and Performance and Resources Committee;
   - an internal audit function;
   - an approved scheme of financial delegation, standing orders or standard financial instructions; and
   - appropriate financial monitoring arrangements.

9. The auditor's annual report further notes that:

   "[…] *there were, and continue to be, a range of issues and challenges in relation to setting up the new organisation and attaining fully operational fundable body status. We understand that these challenges, particularly in relation to achieving a shared understanding of the relative roles and responsibilities of the GCRB, the SFC and the assigned colleges in the governance of further education provision in Glasgow in part, explain why full governance arrangements were not fully developed or implemented.*"

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[4] City of Glasgow College began operation in September 2010 following the merger of Central College Glasgow, Glasgow Metropolitan College and Glasgow College of Nautical Studies. Glasgow Clyde College began operation in August 2013 following the merger of Anniesland, Cardonald and Langside colleges. Glasgow Kelvin College was formed by the merger of John Wheatley, North Glasgow and Stow colleges and began operation in November 2013.

[5] *Scotland's Colleges 2015*, Audit Scotland, April 2015.

[6] An emphasis of matter in an auditor's report refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

10. To operate fully as the regional strategic body for the Glasgow region and its three assigned colleges, GCRB has to have operational fundable body status (Exhibit 1). Without operational fundable body status, the Scottish Funding Council will not allocate funding to GCRB, and GCRB cannot take responsibility for the allocation of funding to the three assigned colleges.

Exhibit 1

Scottish Funding Council's criteria for the granting of operational fundable body status to regional strategic bodies

The Scottish Funding Council has set criteria which it uses to assess whether to grant operational fundable body status to regional strategic bodies, including GCRB. These criteria include:

- composition of the board;
- the board's committee structure;
- the board's effectiveness, including its oversight of the assigned colleges;
- strategic planning;
- financial management;
- risk management; and
- internal audit.

The Scottish Funding Council assesses progress against these criteria through a combination of:

- document review and assessment;
- interviews with the chair, board members and the chairs of the assigned colleges; and
- observation of board meetings.

Source: Scottish Funding Council

11. The Scottish Funding Council has not yet granted operational fundable body status to GCRB due in part to the absence of key systems of assurance and internal control. This meant that GCRB's total expenditure during 2014/15 amounted to £278,617 (over two-thirds of which were the chair's remuneration and staff costs), and its financial transactions had to be handled by other organisations. During 2014/15, three different organisations handled GCRB's financial transactions. From 1 May 2014 to 31 December 2014, the Scottish Funding Council was responsible; from 1 January 2015 to 31 March 2015, Glasgow Caledonian University had this responsibility; and from 1 April 2015 to the present, City of Glasgow College had this role.

Summary of events during 2014/15

12. The chair of GCRB had been the "regional lead" for the Glasgow region since the summer of 2012. Scottish Ministers appointed him as chair, following a public appointment process, on 1 May 2014 (see Appendix for a timeline of key events). Membership of GCRB includes the chairs of the three assigned colleges, staff and student members from the assigned colleges and other members. The principals of the three assigned colleges attend GCRB meetings but

are not members. During 2014/15, GCRB was supported by two members of staff: an advisor to the board and an executive assistant, both of whom were secondees from two of the Glasgow colleges. The advisor to the board had been supporting the chair in his capacity as "regional lead" since February 2013. Before 1 May 2014, the Scottish Funding Council had offered support from an independent and experienced further education professional to assist the "regional lead" in developing induction materials for GCRB members.

13. GCRB first met on 28 May 2014. On 1 August 2014, Scottish Ministers formally assigned the three Glasgow colleges to the GCRB under the Further and Higher Education (Scotland) Act 2005. On 8 August 2014, the Scottish Funding Council wrote to GCRB stating its requirements for granting operational fundable body status to GCRB. It also set out its expectations around the permanent staffing arrangements that it viewed as essential for the effective operation of GCRB. The Scottish Funding Council considered that these staffing arrangements needed to be in place by October 2014, if it was going to be able to grant operational fundable body status by its intended date of 31 March 2015.

14. During 2014/15, the main focus of GCRB's work was to establish the necessary organisational and governance systems which would secure operational fundable body status. During 2014/15, this formed the primary focus for discussions at GCRB meetings. In late 2014, after an assessment of GCRB's progress, the Scottish Funding Council offered additional assistance to GCRB in the form of part-time support from its then director of finance to review and design key governance systems. In parallel to this activity, there was a major strategic review of the Glasgow colleges' curriculum and estate. This review was intended to ensure the optimal provision of college education and training in Glasgow for all students. The three assigned colleges carried out this review, with support from the Scottish Funding Council, through the Glasgow Colleges Strategic Partnership, largely independently of GCRB.

15. On 5 November 2014, the then Cabinet Secretary for Education and Lifelong Learning met the principals of the three assigned colleges and, separately, the chair of GCRB. Following these meetings, the Cabinet Secretary wrote to the chair of GCRB outlining three areas where he considered greater progress was required from GCRB. These three areas were:

- permanent staffing arrangements to support GCRB;
- the review of curriculum and estates; and
- GCRB's accommodation.

16. Over the next few months, there were tensions in the relationships between the assigned colleges and, in particular, their principals and GCRB's chair and advisor to the board.[7] The chief executive of the Scottish Funding Council commented on the deterioration in relationships between GCRB and the three principals in a letter to the chair of GCRB sent on 5 March 2015. In addition, he observed there had been no progress in resolving permanent staffing and office accommodation for GCRB as required by the Cabinet Secretary. He also criticised the extent of GCRB's progress as an organisation more generally. He offered to

[7] I have prepared a separate report on the 2014/15 audit of Glasgow Clyde College, focussing on governance issues that arose following the suspension of the principal by the chair in February 2015.

second a senior director from the Scottish Funding Council to act temporarily as its chief officer.

17. The chair and chief executive of the Scottish Funding Council followed up this letter by attending a meeting of GCRB on 16 March 2015. At this meeting, the chief executive of the Scottish Funding Council, in his capacity as accountable officer for the college sector, criticised GCRB strongly in terms of:

- its overall progress;
- its governance arrangements;
- the support provided to it by the advisor to the board; and
- the relationships between the principals of the assigned colleges and the chair and advisor to the board.

This criticism contrasted with comments made by the chair of the Scottish Funding Council at a GCRB meeting on 15 December 2014 when she recognised the progress made by GCRB towards operational fundable body status and praised the work of the colleges in the Glasgow region in completing the curriculum and estates review.

18. As a result of the meeting on 16 March 2015, GCRB made a formal complaint about the conduct of the chief executive of the Scottish Funding Council on 1 April 2015. The 16 March 2015 meeting of GCRB was followed by special meetings of GCRB on 25 March 2015 and 13 April 2015. The two significant items of business at these two special meetings were correspondence between GCRB and the Scottish Funding Council and developments at Glasgow Clyde College.

19. In the next few weeks, there were significant changes in personnel. On 25 March 2015, GCRB agreed to the secondment of a senior director from the Scottish Funding Council to act as interim chief officer.[8] The secondment of the advisor to the board from City of Glasgow College ended on 31 March 2015. On 2 April 2015, two members of GCRB resigned citing concerns about its leadership. On 7 April 2015, the two student members resigned. On 1 May 2015, the chair of GCRB resigned. Following these resignations, the Scottish Government appointed a board member of the Scottish Funding Council to act as interim chair from 1 May 2015.

Conclusion

20. It is now 22 months since GCRB formally began operation. It has failed to establish itself as a new organisation and to become the focal point for the college sector in Glasgow. It has not secured operational fundable body status from the Scottish Funding Council, which means it is not able to act fully as the regional strategic body. It experienced tensions in its relationships with the Scottish Funding Council and with the three assigned colleges and saw a number of resignations, including that of its chair.

[8] This was not implemented until 11 May 2015 to allow related aspects of the arrangement to be agreed.

21. Since the end of 2014/15, the situation has improved under the leadership of the interim chair and through the work of the interim chief officer. GCRB has now established some of the key systems of assurance and internal control necessary for proper management and oversight of a public body. GCRB's relationships with the Scottish Funding Council and the three assigned colleges have improved. The Scottish Funding Council's Audit and Compliance Committee considered operational fundable body status for GCRB at its meeting on 2 December 2015. It concluded that although GCRB had made significant progress, it was not yet able to recommend the granting of operational fundable body status. The three assigned colleges continue to receive funding directly from the Scottish Funding Council.

22. The appointment of a permanent chair and the anticipated appointment of a permanent chief officer in the near future should, following a period of effective operation, provide the Scottish Funding Council with the necessary assurances that it can transfer funding for the three assigned colleges to GCRB. At present, the Scottish Funding Council and GCRB are working towards 1 August 2016 for granting operational fundable body status. Once this has been secured, GCRB should be in a position to start adding value to the Glasgow college sector.

23. I have asked the auditors of the Scottish Funding Council and GCRB to monitor progress as part of the 2015/16 audit.

Appendix: Timeline of key events during 2014/15

1 May 2014	GCRB formally established. The Scottish Government appoints the chair and members of GCRB.
28 May 2014	First meeting of GCRB.
1 Aug 2014	City of Glasgow, Glasgow Clyde and Glasgow Kelvin colleges assigned to GCRB under the Further and Higher Education (Scotland) Act 2005.
5 Aug 2014	The Scottish Funding Council writes to GCRB outlining its requirements for the granting of operational fundable body status.
5 Nov 2014	The then Cabinet Secretary for Education and Lifelong Learning meets: (1) principals of three assigned colleges and (2) chair of GCRB to discuss progress with the establishment of the GCRB.
13 Nov 2014	Cabinet Secretary for Education and Lifelong Learning writes to chair of GCRB outlining three areas where progress is required.
15 Dec 2014	Chair and chief executive of Scottish Funding Council attend meeting of GCRB.
5 Mar 2015	The chief executive of Scottish Funding Council writes to chair of GCRB outlining significant concerns over GCRB's progress.
16 Mar 2015	Chair and chief executive of Scottish Funding Council attend meeting of GCRB and outline concerns over GCRB's progress.
25 Mar 2015	Special meeting of GCRB. GCRB agrees to accept secondment of a senior director from the Scottish Funding Council to act as interim chief officer.
31 Mar 2015	Advisor to board's secondment to GCRB ends.
1 Apr 2015	GCRB makes formal complaint to Scottish Funding Council about conduct of its chief executive at GCRB meeting on 16 March 2015.
2 Apr 2015	Two members resign from GCRB.

7 Apr 2015	The two student members resign from GCRB.
8 Apr 2015	Chair and some members of GCRB meet chair and chief executive of the Scottish Funding Council.
13 Apr 2015	Special meeting of GCRB.
1 May 2015	Chair of GCRB resigns.
1 May 2015	The Scottish Government appoints interim chair of GCRB.
11 May 2015	Interim chief officer begins work.

Scotland's colleges 2016

AUDITOR GENERAL

Prepared by Audit Scotland
August 2016

Auditor General for Scotland

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Contents

Links

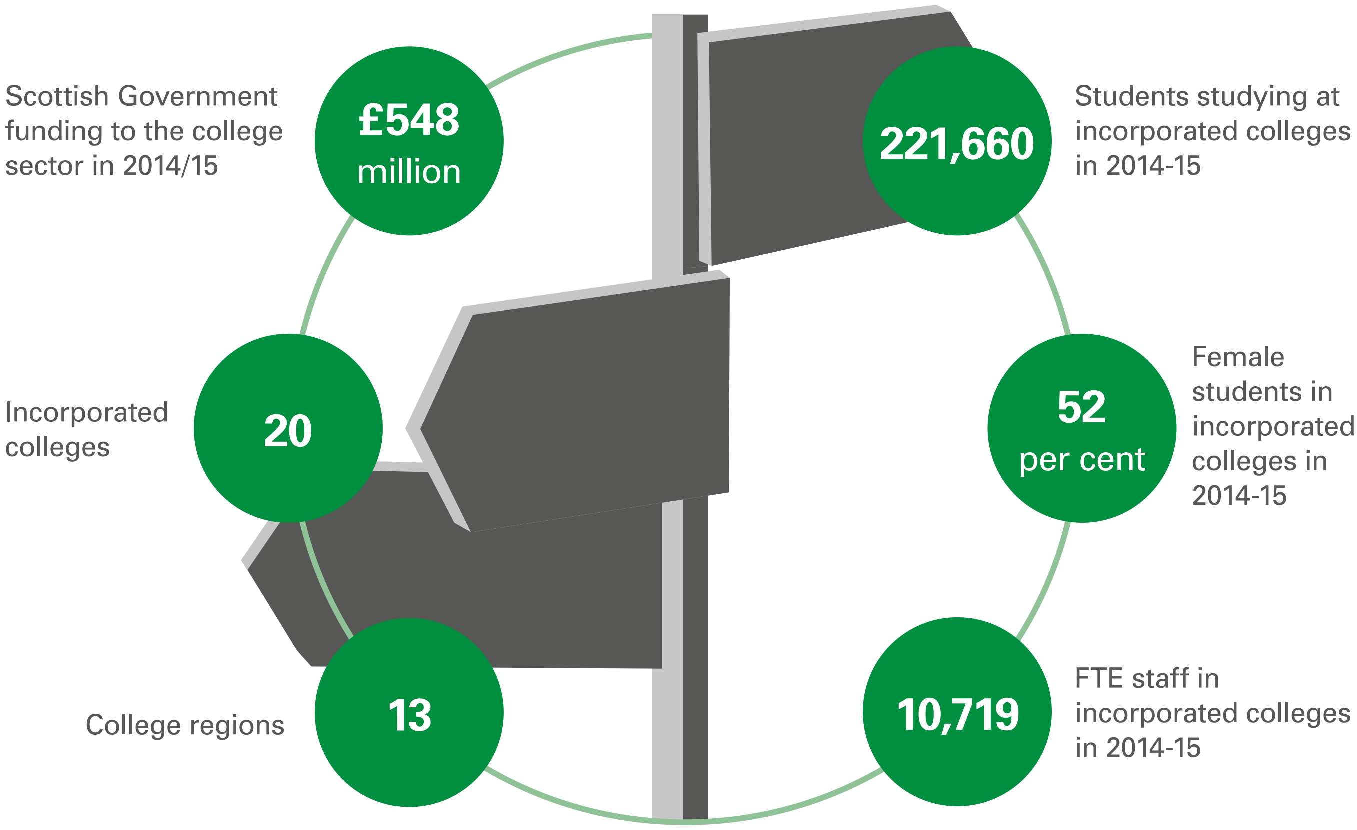
PDF download

Web link

Exhibit data

When viewing this report online, you can access background data by clicking on the graph icon. The data file will open in a new window.

Key facts


£548 million
Scottish Government funding to the college sector in 2014/15
221,660
Students studying at incorporated colleges in 2014-15
20
Incorporated colleges
52 per cent
Female students in incorporated colleges in 2014-15
13
College regions
10,719
FTE staff in incorporated colleges in 2014-15

Summary

Key messages

1 The college sector has continued to exceed activity targets but colleges are still adjusting to substantial changes that affect how they operate. The Scottish Government has not yet clearly articulated how it will measure and report the benefits of its programme of reform, and some of its proposed measures lack baseline information. The Scottish Funding Council (SFC) intends to publish its estimate of the total costs of mergers in August 2016. However, this will not include costs of harmonising staff terms and conditions, which could be significant. Only one of the three regional bodies was able to perform the role expected of it in 2014-15 and 2015-16.

2 The number of under-25 year olds in full-time education at college has increased by 14 per cent in the last eight years. Student numbers overall have decreased by 41 per cent over the same period, and part-time students by 48 per cent. Most of the reductions in student numbers have been among women and people aged over 25. The gender balance is now broadly equal overall but there are significant differences between subjects. The overall percentage of full-time further education students successfully completing their course increased year-on-year between 2009-10 and 2013-14, from 59 to 66 per cent, but dropped to 64 per cent in 2014-15. At least 82 per cent of students who left in 2013-14 went on to a positive destination.

the college sector has continued to exceed activity targets but colleges are still adjusting to substantial changes

3 Full-time equivalent staff (FTE) numbers decreased by nine per cent between 2011-12 and 2013-14 and increased by five per cent in 2014-15. Staff feedback on the impact of mergers is mixed.

4 The overall financial health of the sector is relatively stable. Our analysis indicates four colleges with underlying financial challenges. Colleges do not have long-term financial plans which would help them prepare for and address further financial pressures, such as national collective bargaining, estate maintenance and student support funding. The Scottish Government's current approach to funding colleges for depreciation is complex, and creates a degree of uncertainty for colleges.

5 The College Good Governance Task Group's recommendations should mitigate the risk of significant governance failures. While the SFC undertakes a range of monitoring and engagement within the college sector, this has not always resulted in timely and effective resolution of problems and issues. Despite the many changes in accountability arrangements in the sector, the Scottish Government has not

undertaken a comprehensive review of the SFC's role in the last ten years. The Scottish Government's end-to-end review of the enterprise and skills agencies in Scotland provides an opportunity to re-examine and clarify the SFC's role.

Recommendations

The Scottish Government and the SFC should:

- specify how they will measure and publicly report progress in delivering all of the benefits that were expected from regionalisation and mergers, in line with our recommendation from last year, which was endorsed by the Public Audit Committee
- publish information on the costs and savings achieved through the merger process, in line with our recommendation from last year, which was endorsed by the Public Audit Committee
- work with colleges to determine the current condition of the college estate and prepare a plan to ensure that it is fit for purpose
- use the Scottish Government's end-to-end review of the skills agencies in Scotland to re-examine, clarify and set out the role of the SFC, particularly in relation to college governance
- identify and implement a better approach to allocating depreciation budgets to colleges.

The SFC should:

- require colleges to report how they have spent depreciation cash funding in their accounts, including a breakdown of the spending
- explore with colleges a way to better assess demand for college courses across Scotland
- publish information about leaver destination at national, regional and college levels.

Colleges should:

- develop long-term (a minimum of five years) financial strategies. These should be underpinned by medium-term (between three and five years) financial plans that link to workforce plans and take account of significant financial pressures such as national collective bargaining, estate development and maintenance and student support funding
- implement a more systematic approach to workforce planning to ensure that they have the appropriate resources and skills to achieve their strategic goals

- make agendas, supporting papers and minutes (subject to confidentiality issues) for board and committee meetings publicly available within appropriate timeframes.

Glasgow Colleges' Regional Board should:

- put in place the arrangements necessary to become fully operational.

About the audit

1. This report provides an update on the various changes taking place in the college sector and, where possible, assesses their impact. It also comments on the financial standing of the sector and looks at student participation and outcomes. We set out our methodology in Appendix 1.

2. We use the term 'reform' in this report to cover mergers and regionalisation. The Scottish Government's reform programme has led to college mergers. The Post-16 Education (Scotland) Act 2013 included provisions to support the reform of the sector into 13 regions, including arrangements for how the merged colleges were to be run. There are a total of ten colleges formed through mergers, with City of Glasgow College having formed in 2010. The number of incorporated colleges decreased from 37 in 2011-12 to 20 in 2014-15. Appendix 2 provides an illustration of the current structure of colleges in Scotland.

3. Unless we state otherwise, all financial figures in the body of this report are in real terms, that is, allowing for inflation.

4. Colleges prepare their accounts based on the academic year (1 August to 31 July). This differs from the Scottish Government's financial year which runs from 1 April to 31 March. To help provide clarity, we use the convention '2014-15' when referring to figures from colleges' accounts, or relating to the academic year; and '2014/15' when referring to funding allocations made in the Scottish Government's financial year.

Part 1

Progress with reform

Key messages

1 Colleges are still adjusting to substantial changes that affect how they operate. Funding reductions, regionalisation, college mergers, reclassification, national collective bargaining and the implementation of a new funding model are some of the significant changes with which colleges are dealing.

2 The Scottish Government has not yet clearly set out how it will measure and report the benefits of its programme of reform. Some of its proposed measures lack baseline information. While the SFC completed all post-merger evaluations of colleges that merged in 2013-14, these did not provide a clear assessment of change. The SFC intends to publish its estimate of the total costs of mergers in August 2016. However, the total will not include the costs of harmonising terms and conditions, which could be significant.

3 Three of the 13 college regions are multi-college regions. These multi-college regions have regional bodies, intended to provide strategic direction and allocate funding and activity to colleges in the region. Only one of the three regional bodies was able to perform the role expected of it in 2014-15 and 2015-16. The costs of two of these regional bodies are not separately identified in published accounts.

only one of the three regional bodies was able to perform the role expected of it in 2014-15

Colleges are continuing to adjust to substantial changes that affect how they operate

5. Colleges are still adjusting to a number of significant changes that have taken place in recent years (Exhibit 1, page 10):

- The Post-16 Education (Scotland) Act 2013 included provisions to support the reform of the sector into 13 college regions, three of which are multi-college regions with regional bodies.
- Regionalisation led to college mergers. There are now 20 incorporated colleges across Scotland (see Appendix 2).
- In 2012, the SFC introduced regional outcome agreements (ROAs) to set out the aims and expectations for each region. These agreements specify the activities that regions will deliver in exchange for funding.

- The Office for National Statistics (ONS) reclassified colleges as public sector bodies with effect from April 2014, with implications for how colleges manage and report their finances.

- Changes in funding policy to prioritise full-time student places that lead to employment, reflecting the Scottish Government's response to the impact of the 2008/09 economic crisis.

- Colleges have an ongoing role in responding to the recommendations of the Commission for Developing Scotland's Young Workforce.[1] Colleges have been asked to place a particular focus on working with both schools and employers to facilitate the effective progression of young people from education into employment.

While not all colleges have merged, the other changes have affected all colleges.

6. Further changes lie ahead:

- The new further and higher education statement of recommended practice (SORP) will change how colleges report their finances from 2015-16 (see paragraph 76).

- Education Scotland and the SFC plan to implement, in August 2016, a new approach to providing assurance on the quality of leadership, teaching and learner attainment. The new approach also aims to promote improvement and innovation.

- The SFC is implementing a new funding model (see paragraphs 72 and 73).

- The sector has introduced national collective bargaining with staff trades unions.[2] Previously each college separately negotiated staff pay, terms and conditions (see paragraph 65).

7. Most aspects of merger have been completed by merged colleges. At the time of our audit:

- All ten merged colleges had reviewed their curriculum.

- Fife College had still to fully integrate its IT systems.

- City of Glasgow College had still to fully harmonise staff terms and conditions. It has halted local job evaluations so that this work can be completed nationally as part of national collective bargaining.

It remains unclear how much of the savings from reform are a direct result of college mergers

8. The SFC estimates the sector will deliver efficiency savings of £50 million from reform by 2015-16. In response to our report last year, the Scottish Parliament's Public Audit Committee (PAC) sought greater clarity from the Scottish Government and SFC on when detailed figures could be provided and when the £50 million of savings will be achieved. The SFC responded in January 2016 stating that the sector is on track to achieve the £50 million savings by 2015-16. These projected savings are based on the sector providing a slightly increased

Exhibit 1
Changes affecting the college sector

College sector reform and other changes have had a number of far-reaching consequences.

Source: Audit Scotland

level of activity with around the same level of funding. The savings arise mainly from a real-terms reduction in funding to the sector as a whole and not just merged colleges. Therefore, as we reported last year, it remains unclear how much of these savings are as a direct result of college mergers.

The Scottish Government and the SFC still have not set out how they will measure and report the benefits of mergers

9. The Scottish Government expected college mergers to lead to a number of benefits:

- improved engagement with local employers to better understand their needs
- efficiencies through reduced duplication and unnecessary competition
- better outcomes for learners.

10. Last year, we reported that the Scottish Government and SFC had not specified how they would measure the expected benefits of mergers.[3] The Scottish Government informed the PAC in December 2015 that it would work with the SFC to report the benefits, costs and savings of mergers, based on the SFC's two-year post-merger evaluations of colleges which merged in 2012-13 and 2013-14. Despite the final college merger taking place two years ago, the Scottish Government and the SFC have still not publicly set out when the benefits will be achieved and how they will measure them.

11. Colleges have reviewed their curricula to reduce duplication and support students' progression to employment or further study. While the SFC's post-merger evaluations include commentary on changes to curricula, they do not provide any indication of how significant these changes have been, ie how many courses have been combined. The evaluations comment on how merged colleges are working with employers, but they do not assess whether this is better than it was before merger. We contacted four employer representative groups to seek their views. The two groups that responded (the Federation of Small Businesses and the Scottish Council for Development and Industry) told us that, while they supported the regional approach, there was variable evidence that it had changed how colleges were engaging with their members and responding to the labour market. The Federation of Small Businesses suggested that having a better understanding of employers' skills needs and involving employers in curriculum reviews would help colleges deliver improvements.

12. The Scottish Government told us it intends to use five broad outcome areas to measure better outcomes for learners: attainment, retention, articulation (students progressing to university), positive destinations and student satisfaction. It has not specified what indicators it will use to measure these outcomes. While trend information is available for retention, attainment and articulation rates, positive destinations and student satisfaction lack baseline information. Destination data was published for the first time for students leaving college in 2013-14 following a recommendation from the PAC last year (see paragraph 47). A pilot student satisfaction survey has now been undertaken (see paragraph 48). The lack of published trend information means it will not be possible to identify whether mergers led to improvements. In developing outcome indicators, the Scottish Government should align these to its economic strategy and the national performance framework. We discuss student participation and outcomes in Part 2.

The SFC's two-year post-merger evaluations do not provide a clear comparison of colleges before and after merger

13. Between September 2015 and June 2016, the SFC carried out post-merger evaluations of the eight colleges that merged in academic year 2013-14. The SFC will use these to inform a report on overall progress which is due to be published in August 2016. Based on the evaluations to date, feedback from staff and students was mixed, with examples of benefits and concerns expressed in all colleges. We discuss the impact of mergers on staff and students in Part 2.

14. The SFC completed its two-year post-merger evaluations to agreed timescales. Each evaluation drew on:

- a self-evaluation submitted to the SFC by the college
- Education Scotland's intelligence and review work (including external reviews and annual engagement visits)
- SFC monitoring of the college's regional outcome agreement and finances
- SFC meetings with staff, students, union representatives, external stakeholders (including employers), senior management and the college board.

15. While the post-merger evaluations were based on a range of evidence from different sources, they lack baseline information to compare how a college has changed following merger. For example, they refer to employer engagement events as evidence of improvement but make no comparison with engagement pre-merger. Our 2015 report found that colleges had not detailed in their merger business cases how they would measure the benefits. The SFC did not specify at the time of mergers what comparative information and data it needed from colleges for the post-merger evaluations. As a result, there is no baseline information on employer engagement and some aspects of outcomes for learners such as positive destinations and student satisfaction. Colleges have also found it difficult to identify savings resulting directly from mergers because of the significant amount of change more generally in the sector.

The SFC intends to publish its estimate of the total costs of mergers in August 2016 but it will not include the costs of harmonising terms and conditions

16. The PAC endorsed our recommendation last year that the Scottish Government and the SFC should publish financial information on the costs and savings achieved through the merger process. The SFC provided around £59 million to colleges that merged. Most of this (£45 million) was used to fund voluntary severance payments. Colleges also used their own funds towards the costs of mergers. Some colleges provided the SFC with cost information as part of the post-merger evaluations. However, this did not include all of the costs of merger, such as the costs of harmonising employee terms and conditions. Therefore there is currently no comprehensive analysis of the cost of mergers incorporating: college contributions to severance payments; the integration of IT systems; harmonisation of terms and conditions; management time to plan and implement mergers; and specialist advice, such as legal services.

Only one of the three regional bodies was able to perform the role expected of it in 2014-15 and 2015-16

17. Colleges are organised into 13 college regions, of which ten are single college regions (Appendix 2). The college boards in single college regions have been designated as regional college boards. Regional college boards are responsible for planning the further and higher education that colleges will deliver and providing strategic direction within the region. In the three multi-college regions (Glasgow, Highlands and Islands, and Lanarkshire), the individual colleges are ‘assigned’ to the regional strategic body (regional body). This body is responsible for planning their assigned colleges' further and higher education, funding them and monitoring how they perform. The board at each assigned college continues to be responsible for the governance, financial management and operation of the college. Colleges in multi-college regions are still accountable to the SFC in a number of areas, such as financial reporting, but they are also accountable to their regional body. We reported last year that introducing regional bodies has resulted in a complex framework of accountability.

18. The three multi-college regions are arranged differently from one another:

- Glasgow – The region has three assigned colleges: City of Glasgow, Glasgow Kelvin and Glasgow Clyde colleges. Glasgow Colleges’ Regional Board (GCRB) was established in May 2014 as the regional body. The chairs of the three colleges are members of the GCRB board. The college principals attend GCRB board meetings but are not members.

- Highlands and Islands – The region has five incorporated colleges (Perth, Inverness, North Highland, Lews Castle and Moray colleges) and a further three non-incorporated colleges (Shetland, Orkney and West Highland). All eight colleges are academic partners within UHI.[4] The University of Highlands and Islands (UHI) was established as the regional body in August 2014, and existed prior to regionalisation. To separate the governance of its higher and further education responsibilities, UHI has established a committee of its Court, the Further Education Regional Board (FERB), to support it in its regional body role. Chairs of the eight colleges are members of the FERB. College principals are not members but may be invited to attend meetings for specific items. UHI has a number of working groups looking at specific regional operational issues, such as financial monitoring. Exhibit 2 (page 15) shows the complexity of these arrangements compared to what existed before regionalisation.

- Lanarkshire – There are two colleges in the region. New College Lanarkshire is a regional college. South Lanarkshire College is assigned to New College Lanarkshire. The Board of New College Lanarkshire (referred to as the Lanarkshire Board), established in October 2014, has a dual role as the college’s board and as the regional body. The Lanarkshire Board was enlarged to include members from South Lanarkshire College in recognition of its responsibilities for that college. This includes the chair and principal of South Lanarkshire College.

19. All regional bodies have associated costs such as the chair’s remuneration, members’ expenses, recruitment and other administrative support costs. This is funded from each region’s total allocation from the SFC. The costs of Lanarkshire and Highlands and Islands’ regional bodies are amalgamated in the accounts of

New College Lanarkshire and UHI, respectively, but are not separately identified. Although this is in line with reporting requirements, the separate reporting of the costs of running the regional bodies within the UHI and New College Lanarkshire accounts would improve transparency. UHI informed us that the costs of running its regional body in 2014-15 were around £190,000 while New College Lanarkshire stated its regional body's costs were £34,000. GCRB reports its accounts separately. It spent around £280,000 between May 2014 and July 2015.

20. The terms of the Further and Higher Education (Scotland) Act 2005 are set out in such a way that assigned colleges may be funded by their regional body or by the SFC. The Scottish Government's intention is that assigned colleges should be funded by the regional body if the SFC is confident that the regional body is able to perform this task. The regional body must first obtain 'operational fundable body' status from the SFC in order to receive and distribute funding to colleges.[5] In making this decision, the SFC considers:

- the composition of the board of the regional body
- the board's committee structure
- the board's effectiveness, including its oversight of the assigned colleges
- strategic planning
- financial management
- risk management
- internal audit.

21. Despite regional bodies being a key feature of recent college reform, none of the three is yet operating as intended. At the time of our audit, UHI had secured operational fundable body status (in April 2015) but it is still developing some of its governance arrangements (paragraphs 22–23). In the Glasgow and Lanarkshire regions, the SFC continued to fund the colleges directly in 2014-15 and 2015-16 (paragraphs 24–26)

More than a year after securing operational fundable body status, UHI has still to fully develop its monitoring and allocation processes

22. During 2015, UHI worked on establishing a financial memorandum with its assigned colleges and academic partners and refining the membership of the FERB. These were not easy to agree and took up a lot of time. As the FERB develops, it is expected to have a more prominent role in monitoring colleges' performance, allocating funding and activity and providing strategic direction on behalf of the UHI Court.

23. In March 2016, UHI established a strategy group to review the effectiveness of the governance structure, financial sustainability and opportunities, and the cultural change needed in the region. This group is due to complete its work in September 2016. A working group is also developing proposals for the allocation of funding and activity. Concluding this work should help UHI in its role of allocating funding and activity and providing regional strategic direction.

Exhibit 2

Highlands and Islands' college arrangements for further education provision, before and after regionalisation

The Highlands and Islands' regional arrangements are complex and involve many more groups than before regionalisation.

Before regionalisation

Scottish Funding Council

Directly funds colleges on behalf of the Scottish Government

Colleges

Deliver learning activity

Directors of finance practitioners group

Develop financial monitoring

After regionalisation

Scottish Funding Council

Transfers funding to regional body on behalf of the Scottish Government

UHI Court

The regional body for further education in the Highlands and Islands region. It also provides overall strategic direction and governance of the university

UHI strategy working group

Short-life group developing strategy proposals for the UHI Court that includes further education

Further Education Regional Board (FERB)

Committee of UHI dedicated to further education in colleges. It oversees colleges' performance, allocating funding and activity and providing strategic direction on behalf of the UHI Court

Associate principal of further education

Develops regional outcome agreement, as well as processes of oversight and accountability with college principals, is a member of FERB and reports to the UHI Court

Further Education Executive Board (FEEB)

Committee of the FERB, chaired by the associate principal of further education. College principals and deputy principal of the university are members

Colleges

Deliver learning activity

Directors of finance practitioners group

Develop financial monitoring

Funding working group

Developing recommendations for allocating funding and activity among colleges

Note: Blue boxes indicate permanent bodies/groups, a red box indicates a temporary group and a green box indicates an individual.

Source: Audit Scotland using information from University of Highlands and Islands

The Lanarkshire Board and GCRB have made progress in addressing governance issues but GCRB is still not operationally fundable two years after its creation

24. The Lanarkshire Board (acting as the regional body) has been addressing a number of issues raised by the SFC, including cross-membership between boards of the two colleges and consistent audit arrangements. The SFC concluded in July 2016 that the Board had satisfactory arrangements in place to fund its assigned college and the regional body became fully operational from 1 August 2016.

25. In March 2016, the Auditor General reported that, following months of deterioration in key relationships, GCRB had made limited progress towards securing operational fundable body status.[6] There were significant weaknesses in governance and an absence of key systems of assurance and internal control. Several members of the board resigned in 2015 and the Scottish Government appointed an SFC board member to act as interim chair. In December 2015, the SFC decided not to grant operational fundable body status to GCRB, pending the appointment of a permanent chair and executive director.

26. The situation has since improved. GCRB now has a permanent chair and two members of staff, an executive director and executive assistant. It has also established many of the systems of assurance and internal control needed to properly manage and oversee a public body. The SFC wants to see a period of stability and effective operation before it hands over responsibility for £80 million of funding in the region. It is now over two years since GCRB began operation, but the timescale for granting it operational fundable body status is not clear.

Part 2

Students and staff

Key messages

1 The number of under-25 year olds in full-time education at college has increased by 14 per cent in the last eight years. Student numbers overall have decreased by 41 per cent over the same period and part-time students by 48 per cent. Most of the reductions in student numbers have been among women and people aged over 25. The potential impact of a policy change on these groups was not assessed prior to implementation. The gender balance is now broadly equal overall but there are significant differences between subjects.

2 The sector has continued to exceed SFC targets for activity. The overall percentage of full-time further education students successfully completing their course increased year-on-year between 2009-10 and 2013-14, from 59 to 66 per cent, but dropped to 64 per cent in 2014-15. Retention rates followed a similar pattern. It is not possible to attribute these movements to any particular aspect of reform. At least 82 per cent of students who left in 2013-14 went on to a positive destination.

3 FTE staff numbers decreased by nine per cent between 2011-12 to 2013-14 and increased by five per cent in 2014-15. Staff feedback on the impact of mergers is mixed. Despite the significant changes that have taken place in the sector, colleges do not prepare organisation-wide workforce plans. Colleges Scotland is leading work to look at the future workforce requirements for the sector.

most of the reductions in student numbers have been among women and people aged over 25

The sector has consistently exceeded its activity targets

27. Colleges and the SFC agree targets for the amount of student learning that each college will deliver each year.[7] The sector has consistently delivered above this target each year, although the level of over delivery has fallen over time. At a regional level, nine of the 13 regions delivered above target in 2014-15, the highest being West Lothian at nearly seven per cent. Of those regions that under-delivered, all achieved at least 98 per cent of their target.[8]

Policy changes have led to an increase in full-time learning, and a steep decline in part-time learning

28. In 2009, the Scottish Government asked the SFC to focus funding on courses most likely to lead to employment. This led to less funding for courses that did not lead to a recognised qualification or were less than ten hours in duration.[9] This policy contributed to an increasing percentage of students on vocational courses and a rise of 14 per cent in the number of under-25s on full-time courses since 2007-08. However, this also contributed to a steep decline in the number of students on part-time courses.

29. In 2014-15, 221,660 students were studying at the 20 incorporated colleges. The largest college was West College Scotland, with 21,607 students, and the smallest was Lews Castle, with 1,237 students. Student numbers peaked in 2007-08 and declined by around 41 per cent between 2007-08 and 2014-15 (Exhibit 3). All colleges except West Lothian saw a decrease in overall student numbers during the period. In the last year, overall student numbers fell by six per cent. Over the same period of time, the number of FTE student places remained broadly static.

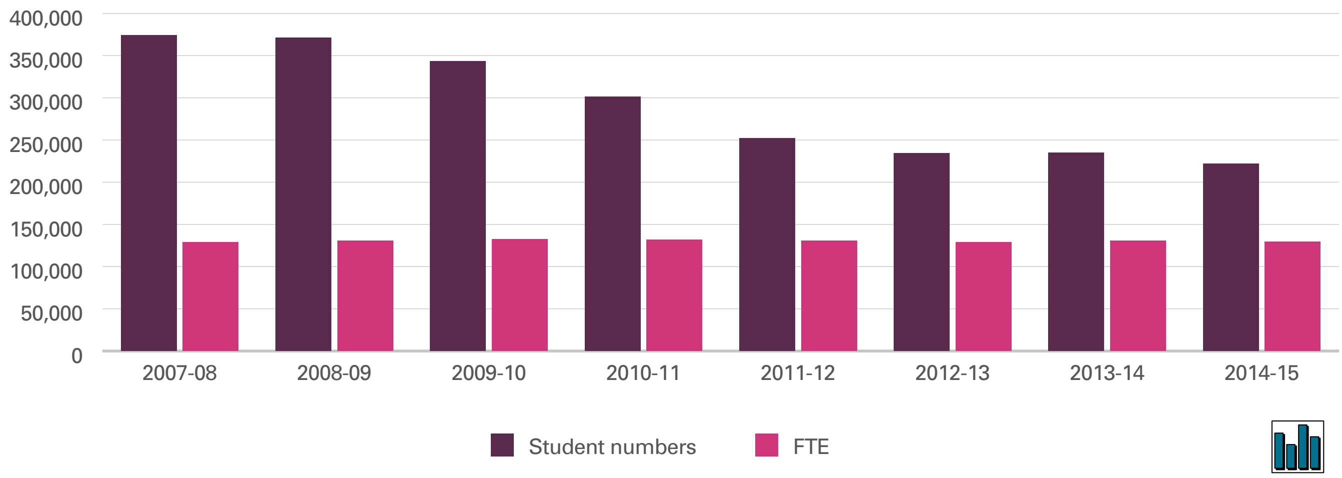
30. Following a peak in 2007-08, the number of part-time students has fallen by 48 per cent by 2014-15, from 321,281 to 165,853. During the same period, the number of full-time students increased by 18 per cent, from 66,534 to 78,318. Part-time student numbers had begun to decline when the 2009 funding change came in, but declined sharply after this.

31. There were falls in student numbers across all subjects between 2007-08 and 2014-15 (Exhibit 4, page 19). The biggest percentage falls were in printing (85 per cent), and minerals and materials (78 per cent). The Scottish Government has prioritised science, technology, engineering and maths (STEM) subjects, and these saw some of the smallest percentage falls.

Exhibit 3

College student numbers and FTE from 2007-08 to 2014-15

College student numbers fell by 41 per cent between 2007-08 and 2014-15, while full-time equivalent rose 0.5 per cent.



Source: SFC infact database

Exhibit 4
Number of students by subject in 2007-08 and 2014-15

Computing and health are still the most popular subjects, but have had large falls in numbers between 2007-08 and 2014-15.

Source: SFC infact database

The overall gender balance among college students is broadly equal, but there are some large differences between subjects

32. The fall in part-time places following the SFC policy change has had a disproportionate effect on female students. As the number of part-time places fell, the number of female part-time students fell at a steeper rate than male part-time students (Exhibit 5). The decrease was 53 per cent for women between 2007-08 and 2014-15, compared to 43 per cent for men.

Exhibit 5
Part-time student numbers by gender from 2007-08 to 2014-15

The number of part-time female students fell by 53 per cent during the period. Part-time male student numbers fell by 43 per cent.

Source: SFC infact database

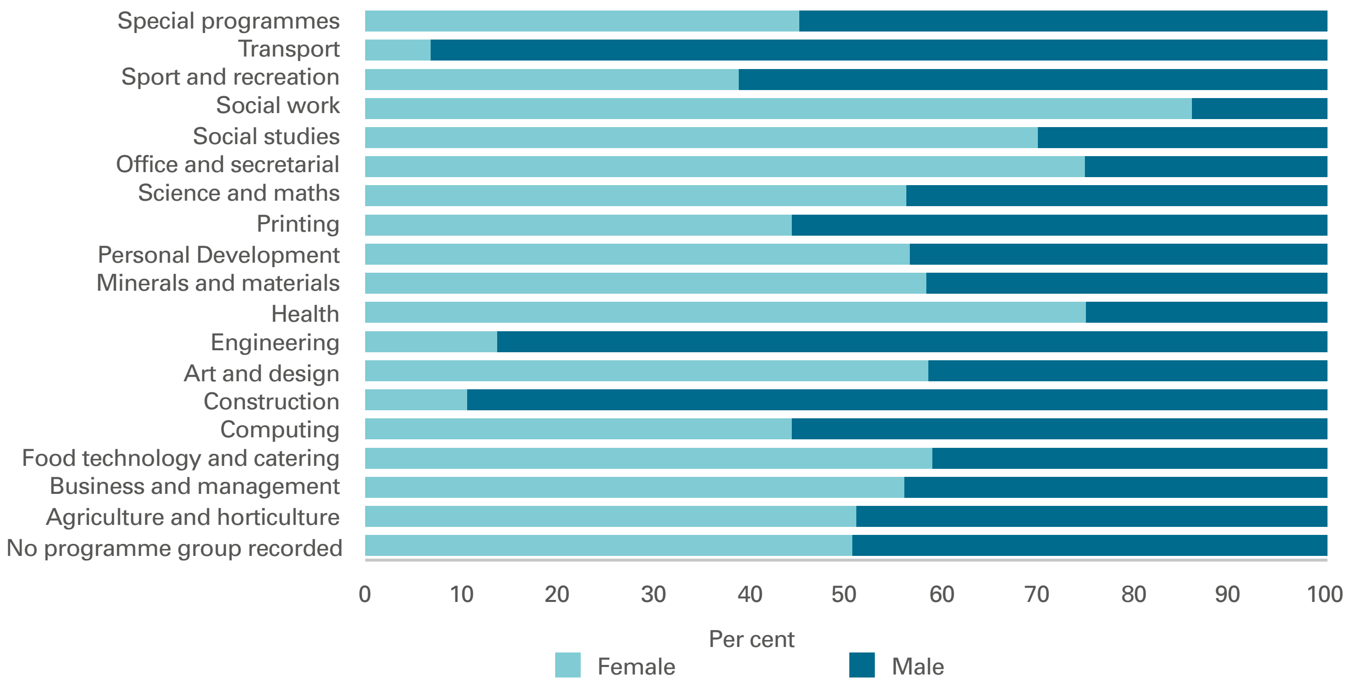
33. The number of male and female full-time students has been increasing, though the number of men fell slightly between 2013-14 and 2014-15. These changes have affected the overall gender balance of college students. Women made up 52 per cent of the total student population in 2014-15, a steady year-on-year decline from 56 per cent in 2007-08. At a college level, the gender balance varies between 45 per cent female at Glasgow Kelvin, Inverness and Lews Castle colleges, to 61 per cent female at West Lothian College. This variation across the country does not seem to reflect the general population of those areas, but may reflect course availability and local demand.

34. Although the overall gender balance was broadly equal in 2014-15, there are still large differences between subjects (Exhibit 6). The picture has remained much the same over the last ten years, particularly in the subjects with the most extreme differences, such as social work and engineering. Reducing gender inequality is a Scottish Government priority, and is being addressed through a number of policies and strategies, including the Economic Strategy and the Commission on Developing Scotland's Young Workforce. The SFC has published a report on progress with its gender action plan. This comments on how it plans to work with colleges to address these imbalances. The plan notes that gender imbalances can limit young people's individual potential, affect wages and create a system where they cannot make genuinely free choices about their future career options. A key performance indicator in the plan is to increase the minority gender share by five percentage points in the most unbalanced subjects by 2021, and to have no subjects with more than three-quarters of students being one gender by 2030. The SFC will use ROAs to specify what actions regions should take.

Exhibit 6

Male and female students by subject 2014-15

Some subject areas have large gender differences.



Source: SFC infact database

The number of older students, particularly those on part-time courses, has decreased significantly in recent years

35. Over-25 year olds are the largest age group among college students, representing 42 per cent of the student population (92,318 students). The percentage of over-25 year olds varies from 32 per cent at Ayrshire College, to 54 per cent at Dumfries and Galloway College. Students aged over 25 years experienced the largest reduction in numbers of all age groups, 51 per cent, between 2007-08 and 2014-15.[10] In 2011, the Scottish Government made its 'Opportunities for all' commitment. This involved prioritising a place in learning or training for young people aged 16-19 who are not in employment and led to an increase in the number of younger full-time students. This commitment may have contributed to this reduction, though the trend had already started when this commitment was made.

36. The number of part-time students aged over 25 years fell by 54 per cent between 2007-08 and 2014-15, from 179,685 to 82,402. The number of part-time 16-17 year olds fell by 24 per cent.

The fall in college places has had less impact on students from ethnic minority and deprived backgrounds

37. The policy changes, described in (paragraphs 28 and 35), have affected students from ethnic minorities and deprived areas less adversely than women and older students. In all these factors, there can be wide variation among colleges; in many cases, these patterns reflect the demography of the area.

38. The number of students from an ethnic minority background fell by less than the number of white students between 2007-08 and 2014-15, by 30 per cent compared to 42 per cent. The percentage of ethnic minority students has increased from five per cent to 6.3 per cent over the same period. According to the 2011 census, four per cent of the total Scottish population are from ethnic minority backgrounds.

39. The number of students from the most deprived areas also fell by less than the rest of the student population, by 24 per cent compared to 47 per cent, between 2007-08 and 2014-15. The percentage of students from the most deprived areas has increased from 17 to 22 per cent over the last ten years.

40. In 2014-15, around 13 per cent of students were recorded as having some form of disability. Trend information is less reliable in this area owing to large numbers of students being recorded as 'disability status unknown' in previous years.

The Scottish Government and the SFC did not assess the impact of all policy changes on student participation before implementation

41. The Equality Act 2010, and earlier Equality Act 2006, places duties on public bodies to use equality-impact assessments to assess the potential impact of proposals for new or revised policies or practices. This relates to characteristics like gender, race and disability. The SFC did not conduct an equality-impact assessment on the 2009 funding change (paragraph 28) that led to the fall in part-time student places. The Scottish Government did not carry out an impact assessment on its 2011 'Opportunities for all' commitment to focus on younger students, but the SFC did. The SFC identified that there was already a trend of decreasing numbers of older students at the point of the decision. While not mentioned in the impact assessment, this is likely to have been at least partly caused by the SFC's 2009 change to how it funded colleges.

42. Neither the SFC nor the Scottish Government have analysed how the fall in part-time places and the focus on younger students have affected those who have not been able to get a place at college, and what they chose to do instead. There is currently no way to tell if these decreases in student numbers reflect a fall in demand. Students currently apply to individual colleges and each college chooses how to record and classify applications. Having a national picture of demand would allow the SFC to identify levels of unmet demand. It would also allow the SFC to assess the effect of future policy changes, or changes in the wider environment, such as university admissions and employment levels. The Scottish Government and the SFC would also be able to draw on this data to inform future funding decisions. Our recent report on higher education in Scottish universities recommended that the Scottish Government and the SFC should undertake research to assess what impact the limits on funded places are having on Scottish students.[11] Without an accurate picture of total demand for Scottish colleges, it will be very difficult to assess the impact of the limits on funded places.

Further education attainment fell from 66 to 64 per cent in 2014-15

43. Attainment and retention data by college is available for six years for full-time students and for three years for part-time students. Between 2013-14 and 2014-15, further education attainment fell, while higher education attainment remained the same (Exhibit 7)

Exhibit 7

Attainment trends in colleges

Attainment has been generally increasing over the last few years, but either fell or remained the same between 2013-14 and 2014-15.

Full-time measure	Long-term trend, 2009-10 to 2014-15	2013-14 to 2014-15 trend
Further education full-time attainment	59-64% ↑	66-64% ↓
Higher education full-time attainment	63-71% ↑	71% ↔
Part-time measure	**Long-term trend, 2012-13 to 2014-15**	**2013-14 to 2014-15 trend**
Further education part-time attainment	76-75% ↓	77-75% ↓
Higher education part-time attainment	76-78% ↑	78% ↔

Source: SFC College Performance Indicators 2014-15 report

44. Full-time attainment fell in nine colleges between 2013-14 and 2014-15, by between one and eight per cent. Both merged and unmerged colleges experienced falls in attainment.

Retention rates for both higher and further education fell in 2014-15

45. Retention rates measure the percentage of students who completed all or part of their course. Like attainment rates, retention rates fell between 2013-14 and 2014-15. Between 2009-10 and 2013-14, retention rates in full-time further and higher education courses rose from 75 to 80 per cent, but fell to 78 per cent in 2014-15. Retention decreased in most colleges during this period, but increased slightly at Glasgow Clyde, South Lanarkshire, Moray and North Highland colleges.

46. Colleges suggested that the amount of change experienced by the sector in recent years could have contributed to the reductions in attainment and retention. They also suggested increased efforts to target harder to reach students could be a factor, for example widening access to students from more deprived areas. The SFC shares these views.

At least 82 per cent of students who left college in 2013-14 went on to a positive destination

47. The SFC published leavers' destinations for the first time in 2016, showing the destinations of 2013-14 college students. This highlighted that 82 per cent of college leavers were known to have gone on to a positive destination:

- 65 per cent went on to education or training
- 17 per cent went into employment, which compares to 25 per cent of school leavers and 51 per cent of university leavers entering work
- of the remaining 18 per cent, four per cent of leavers did not go on to further education or to employment and the outcome for the remaining 14 per cent of leavers is not known.

This data has not been published by college or region, as happens for schools and universities. Making this information available by college would provide a clearer picture of post-education employment opportunities at a local level, as well as whether the college curriculum is providing students with the skills employers in the area require.

Almost 90 per cent of students surveyed in 2015 were satisfied with their college experience

48. A pilot survey on student satisfaction by the SFC in 2015 found that 89 per cent of respondents were satisfied with their college experience. This survey took place at 16 volunteer colleges (both merged and non-merged), sampled just over 55,000 students, and had a 29 per cent response rate. It had no specific questions on mergers reflecting, in part, the generally shorter attendance duration of college students. As we note in Part 1, it is not possible to assess the impact of mergers on student satisfaction as there is no baseline data for this.

49. Colleges carry out regular surveys of their students. Some colleges provided us with results of surveys from before and after the merger period. However, since college students are often at college for a short period, many current students may not have been studying at college at the time of the mergers. For those colleges that sent us both pre-merger and post-merger information, the results indicated a drop in overall student satisfaction during this period. This mirrored the results from non-merged colleges over the same time period.

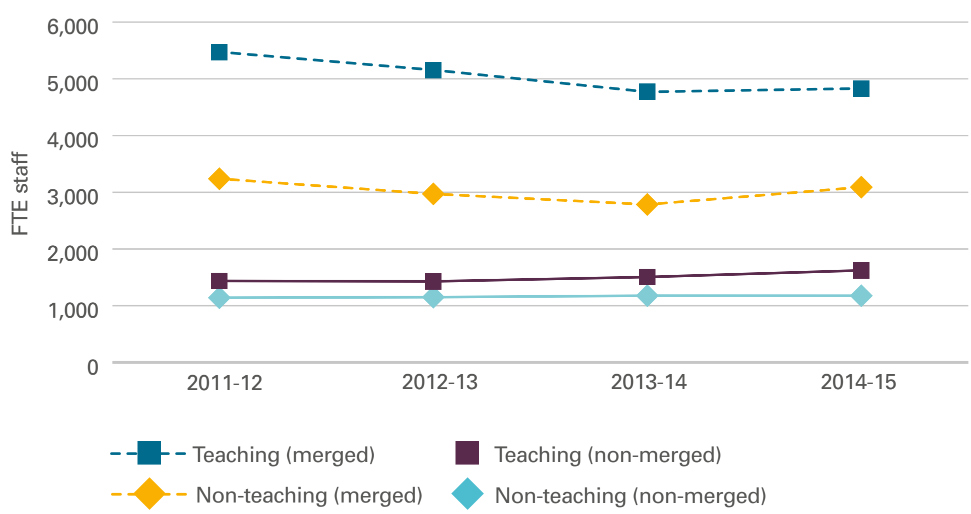
50. Student feedback gathered though the SFC's post-merger evaluations was mixed. Students in some merged colleges expressed concerns about the delays in receiving support payments caused by issues with IT systems integration, the impact of losing teaching staff mid-year, and worries that discontinuing part-time and recreational courses may affect the college's place in the community. Some students felt that there were additional learning opportunities, and more options for progression, whether on their original campus or at another one. The National Union of Students (NUS) told us it had concerns about courses being centralised within merger colleges and funding for student associations, but was not able to provide evidence to support these points at the time of our fieldwork. As part of the reform process, the SFC provided transitional funding for student associations for a finite period, after which time colleges require to fund these from their own resources.

Staff numbers had been falling, particularly in colleges that merged, but increased in 2014-15

51. Staff costs accounted for £539 million (62 per cent) of college expenditure in 2014-15.[12] This is an increase from 2013-14 (59 per cent), after adjusting for donations to arm's length foundation of £99 million. Colleges employed 10,719 FTE staff in 2014-15. Teaching staff (teaching and teaching support staff) accounted for 6,453 FTE, with the remaining 4,266 FTE being non-teaching staff.

52. Between 2011-12 and 2013-14, there was a nine per cent fall in FTE staff, made up of a nine per cent fall in teaching staff and a ten per cent fall in non-teaching staff (Exhibit 8). The numbers increased by five per cent in 2014-15, with a three per cent rise in teaching staff in 2014-15, and an eight per cent rise in non-teaching staff.

Exhibit 8
FTE staff in merged and non-merged colleges
FTE staff at merged colleges fell during the period, though rose between 2013-14 and 2014-15.



Source: College accounts

Staff feedback on mergers is mixed

53. The SFC's post-merger evaluations highlight staff concerns about the impact of voluntary severance on workloads and the reduced level of support staff. Some staff felt mergers had been successful and cited benefits from sharing best practice and more opportunities for development. This was based on the SFC speaking to around 600 staff, covering a range of different departments and campuses, and taking views from both teaching and support staff.

54. The two largest college staff trades unions, the Educational Institute of Scotland (EIS) (representing teaching staff) and UNISON (representing mainly non-teaching staff), surveyed their members in 2015. The EIS survey (largely from members in merged colleges) had a response rate of 20 per cent (950 respondents). Eighty-nine per cent of staff who responded considered that the mergers had not improved the quality of learning, and 81 per cent felt it had increased their workload. Respondents felt that there had been a negative impact on morale. The UNISON survey sought the views of 923 members from merged and non-merged colleges and had a response rate of 28 per cent. Among respondents from merged colleges, 63 per cent felt there was a lack of transparency about the merger process while only 16 per cent felt there was proper communication between management and staff during the merger process. Where staff were more positive, they said strong leadership and management made the difference.

55. Nine colleges provided us with a copy of their most recent staff survey. Of the remainder, two (Ayrshire and Dumfries and Galloway) stated that their survey had recently been completed. Fife College referred to the post-merger evaluation and Inverness College stated that in the last three years its surveys had focused on specific areas. None of the other seven colleges provided details. North East Scotland College's survey had specific questions on merger, with 69 per cent of respondents stating that they had seen benefits, such as increased opportunities to share knowledge and improved resources. A quarter said they had seen no benefit from the merger.

56. Four colleges (City of Glasgow, Glasgow Clyde, Glasgow Kelvin and North East Scotland) provided us with details of actions they took in response to the staff survey results. These included improving communication from management and performing a workload assessment.

Colleges do not prepare organisation wide workforce plans

57. A workforce plan allows an organisation to identify the size and skills mix it requires to meet its stated objectives. Alongside financial planning (covered in Part 3), this is a key element in helping organisations achieve their strategic goals. The PAC endorsed our recommendation last year that colleges should review workforce plans, to identify any gaps in the skills, knowledge and resources required to deliver high-quality learning. Even though colleges have been making significant staff changes (Exhibit 8), there is limited evidence of systematic workforce planning. Colleges review workforce requirements in response to curriculum changes; and five colleges covered workforce in other plans, such as ROAs or financial plans. Two were preparing a workforce plan and four had high-level workforce strategies. At the time of our audit, none had a workforce plan in place that was in line with our good practice guide issued in March 2014.[13] Colleges Scotland is taking forward a project – 'Workforce for the future' – that aims to create a workforce to meet future needs. It will involve a job evaluation exercise. This project should aid future workforce planning.

Part 3
College finances

Key messages

1 The overall financial health of the sector is relatively stable. Scottish Government funding to the sector has been reduced by 18 per cent in real terms since 2010/11, but remains broadly static for 2015/16. The financial performance of the sector in 2014-15 deteriorated from the previous year with four colleges experiencing underlying financial challenges.

2 Capital funding has decreased by over 77 per cent since 2010/11. The current method of allocating capital funding does not take account of need. This is due to the absence of a complete and up-to-date national condition survey of the college sector estate. The Scottish Government is supporting investment of over £300 million to the college sector through a form of public private partnership. Colleges still do not prepare long-term financial plans which would help them prepare for uncertainty and address further financial pressures, such as national collective bargaining, estate maintenance and student support funding.

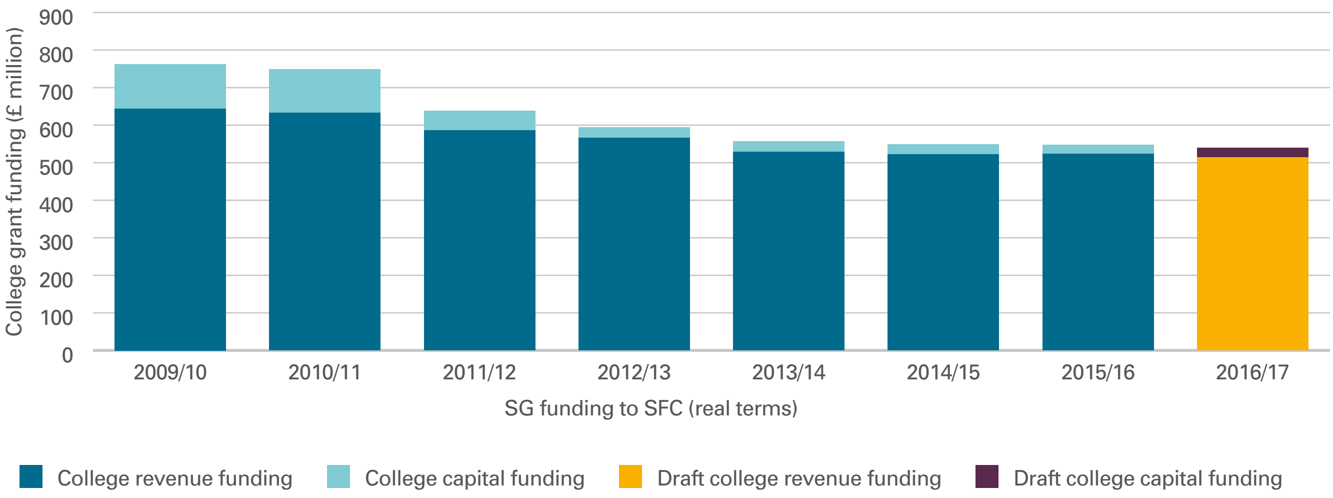
3 Colleges are adjusting to new arrangements arising from their reclassification as public bodies, in order to comply with HM Treasury and Scottish Parliament reporting requirements. While this has led to more work for colleges, with no direct business benefits, it provides the SFC with better and more timely information. It also enhances accountability for public expenditure in the sector. The Scottish Government's current approach to funding colleges for depreciation is complex, and creates a degree of uncertainty for colleges.

the overall financial health of the sector is relatively stable - with four colleges experiencing underlying financial challenges

Scottish Government funding to the sector is broadly static for 2015/16

58. Scottish Government funding to the sector decreased by 18 per cent between 2010/11 and 2014/15 (Exhibit 9, page 27). Overall funding for 2015/16 will be increased by 0.2 per cent from the 2014/15 level. The total proposed allocation for 2016/17 represents a reduction of 1.4 per cent (£7.9 million) from the 2014/15 level.

Exhibit 9
Scottish Government funding to colleges, 2009/10 to 2016/17
Funding to the sector is relatively stable from 2014/15 to 2016/17 following some significant reductions in previous years.



Source: Scottish Government budget publication

The underlying financial health of the overall sector is relatively stable

59. The sector reported an overall deficit of £28 million in 2014-15 in audited accounts. After adjustments (outlined in the following paragraphs) are taken into account, the deficit decreases to £3 million. This represents less than one per cent of total income. This is deterioration from an underlying surplus of £15 million in 2013-14 (Exhibit 10) which represented three per cent of total income.

Exhibit 10
College sector financial results 2014-15 and 2013-14
The underlying financial performance has deteriorated from a surplus in 2013-14 to a deficit in 2014-15.

	2014-15 (£m)	2013-14 (£m)
Reported surplus/(deficit)	(28)	(95)
Asset revaluation reductions	7	10
Pension adjustments	5	1
Donations to ALFs	7	99
Additional spend	6	0
Underlying surplus/(deficit)	**(3)**	**15**

Note: Further explanation of the additional spend in 2014-15 of £6 million is presented in paragraphs 69 to 71.

Source: 2013-14 and 2014-15 audited accounts

60. Colleges' accounts include technical accounting adjustments that do not reflect actions taken by colleges and are outside their immediate control. These include property asset valuation reductions and pension adjustments. These two items account for £12 million of the £28 million reported deficit in 2014-15.

61. We have also removed donations to arm's-length foundations (ALFs) from our analysis.[14] We adjusted for these in last year's report as they accounted for £99 million of expenditure but did not indicate any concerns relating to the financial sustainability of the college sector. Colleges can apply for and have received funding from ALFs, generally for capital purposes (referred to in paragraph 66).

62. We also used standard accounting ratios and analysis to assess the underlying financial health of the sector (Exhibit 11). Our analysis indicates that the sector overall was stable in 2014-15.

Exhibit 11

Analysis of college sector finances using financial ratios, 2014-15

The sector's financial position has deteriorated in the last year but remains stable overall.

Balance sheet measure	Finding
Net assets or liabilities	
The net asset position shows the value of an organisation's assets (such as buildings and money held in bank accounts) after deducting the value of its liabilities (amounts owed to other parties such as creditors and loans). A positive figure indicates solvency. A negative figure ('net liabilities') indicates insolvency.	Overall, colleges reported a combined net assets position on their balance sheets of £848 million. No individual colleges were in a net liabilities position. The net assets position decreased by £63 million from the previous year.
Liquidity ratio	
The liquidity ratio reflects an organisation's ability to pay off its short-term debt obligations. It does this by comparing its liquid assets (such as cash held in bank accounts and accounts receivable) to the amount it owes its creditors. Where the value of creditors outweighs assets, a result of less than 1 is shown. This may indicate underlying financial issues although different organisations will determine results which best fit their business model. The SFC's Financial Memorandum with colleges recommends that colleges should keep cash balances to the minimum level consistent with the efficient operation of the institution and the level of funds required to meet any relevant liabilities at the year end.	The sector returned an average of 1.05, compared to 1.07 the previous year. Ten colleges returned a result of less than 1 in 2014-15, compared to eight in 2013-14.

Source: 2013-14 and 2014-15 audited accounts

Four colleges had underlying financial challenges

63. In 2014-15, the annual audit reports of four colleges identified concerns about finances (Exhibit 12).

Exhibit 12

Colleges where the auditor raised concerns about finances in 2014-15

Two colleges had significant underlying deficits; and the auditors for another two colleges raised other concerns about their financial situation.

College	Explanation of deficit or financial challenge
Edinburgh	The reported deficit was £5.1 million, 5.7 per cent of total income. The college faces significant financial challenges after it agreed with the SFC to reduce its activity target by six per cent. This has resulted in a reduction of SFC income for 2015-16 of £2.5 million, while its main costs, such as staff and accommodation, remain the same. The Auditor General has prepared a separate report on Edinburgh College.
Moray	The reported deficit was £0.8 million, 6.7 per cent of total income. The college experienced difficulties in managing its finances within budget. Higher education funding had decreased but the college did not adjust budgets to reflect this. UHI paid a cash advance of £0.5 million to the college.
North Highland	The auditor concluded that the forecast deficits for 2015-16 and 2016-17 cast doubt on the college's ability to continue operating. The regional body (UHI) provided assurances that it would work with the college to improve the financial position.
Lews Castle	The auditor reported that the college was not likely to meet its activity targets, and that this could result in reduced SFC funding. As income from the SFC accounts for around two-thirds of the college's total income, this would significantly affect the college's financial sustainability.

Source: Annual audit reports 2014-15

64. In June each year, colleges submit Financial Forecast Returns (FFRs) to the SFC, for the current and two subsequent financial periods. The combined FFRs from June 2015 forecast deficits of £0.9 million and £4.0 million respectively for 2015-16 and 2016-17. Eight colleges are forecasting a deficit in 2015-16, and 11 in 2016-17.

National collective bargaining is likely to result in an increase in costs for colleges

65. Historically, colleges have negotiated their own staff terms and conditions. A review of college governance in 2012 recommended moving towards national terms and conditions across Scotland.[15] The Scottish Government, in the Post-16 Education (Scotland) Act 2013, sought to reintroduce national collective bargaining in the college sector. The sector has sought to meet this government policy on a voluntary basis, although there is scope within the legislation for Scottish Ministers to compel colleges to do so. The sector and the staff trades unions have established the National Joint Negotiating Committee to take this forward. The committee has agreed a one per cent pay offer for 2015-16 (and a further 1.5 per cent in 2016-17 for teaching staff, converted to a flat cash sum of money) with the unions. It has also given commitments on a number of aspects around terms and conditions which will result in new contracts for staff. Colleges Scotland is leading work to estimate the potential costs, which could be significant.[16]

Colleges face challenges in financing improvements to their estate

66. The Scottish Government reduced its capital funding to colleges by 77 per cent between 2010/11 and 2014/15 (from £90 million to £26.6 million). Before reclassification, colleges could use reserves to fund capital projects, but this is no longer possible. Colleges currently have two options. The first option is to apply for funds from ALFs. All applications must comply with the ALF's stated purpose. In 2014-15, colleges received £23 million of funding for capital projects from ALFs. The FFRs for June 2015 forecast that over £59 million of capital expenditure would be funded from ALFs over the subsequent four years to 2018-19.

67. The second option is through the Non Profit Distributing (NPD) programme.[17] The Scottish Government is supporting investment of over £300 million to the college sector through the NPD programme. Four colleges are funding capital projects under this programme. One of these projects has been completed (Inverness), while two more are ongoing (City of Glasgow and Ayrshire). The remaining college (Fife) is at the full business case stage of the project. The Scottish Government and the Scottish Futures Trust are considering the impact on the financing arrangements for future NPD projects in light of guidance issued by Eurostat.[18] Eurostat will provide additional clarification on that guidance in September 2016. No new NPD projects are being taken forward whilst this guidance is being considered. As a result, a project at Forth Valley College is being taken forward using traditional capital funding from the Scottish Government.

68. The SFC allocates capital funding to colleges largely on the basis of teaching activity. While this is reasonable, information on the condition of the college estate should also be considered in calculating this funding allocation. An up-to-date condition survey for the entire college estate is not available. An SFC-commissioned study in 2014 covered 29 per cent of the sector's gross floor area and focused on colleges that had not recently received significant capital funding. The study estimated that it would cost £256.3 million to bring these properties back to 'as new' condition, and £289.6 million to replace them altogether.[19] The SFC is working with four colleges (Dundee and Angus, Edinburgh, Moray and West College Scotland) to develop business cases with a view to bidding for future capital funding. The SFC and Colleges Scotland have also formed a Capital Working Group that is preparing a capital plan for the sector.

The Scottish Government's approach to funding colleges for depreciation is complex, and creates a degree of uncertainty for colleges

69. Before reclassification in April 2014, the Scottish Government included an amount for depreciation within its funding allocation for colleges. As depreciation did not require a cash spend in the year of allocation, colleges were able to spend this cash or set it aside to meet future needs. Following reclassification, the Scottish Government provided a non-cash budget to cover depreciation. But the cash allocation to colleges still includes a sum equivalent to the amount previously set aside for depreciation. Colleges are potentially left with an amount of unspent cash (referred to in the sector as 'net depreciation cash') but require approval from the Scottish Government to spend it. In 2014-15, following discussions among the Scottish Government, the SFC and the college sector, colleges spent this cash on student support funding, loan repayments and 'regional priorities'. Three colleges donated an element of the cash to ALFs.

70. Because the items on which this net depreciation cash may be spent are not approved until mid-way through the college financial year, colleges do not know if or how they will be able to spend it, creating uncertainty in determining how to spend their allocation. Additionally, while the SFC recommended that colleges disclose the impact of this spend on their operating position, this was not disclosed in all cases. The SFC worked with colleges to calculate a total spend of £17.5 million in 2014-15.[20]

71. We acknowledge that reclassification has led to a mismatch between Scottish Government accounting rules and the further and higher education SORP (Statement of Recommended Practice). However, the current approach to addressing this mismatch is complex and creates uncertainty for colleges. It was also intended as a short-term measure. The mismatch has existed since April 2014. The Scottish Government, SFC and the sector are working together to develop a solution but have not set a date by which the issue will be resolved.

The SFC has begun to introduce a new funding model for colleges

72. The SFC is changing the way in which it allocates funding to colleges. Allocations are based on the amount of learning activity that colleges provide. Historically, this learning activity was expressed in 'student units of measurement' (SUMs), where one SUM equated to 40 hours of learning. Therefore, a course that involved 640 hours of learning would equal 16 SUMs. Over and above this, the SFC applied a weighting for each subject in recognition that some courses cost more to run than others, eg engineering courses cost more than social studies courses. The adjusted units were referred to as weighted SUMs (WSUMs).

73. The SFC has developed a new funding model which removes the weightings applied under WSUMs and instead categorises courses in five price groups. Each group has a credit value attached to it. The SFC has also changed the way in which it provides funding for colleges to assist students with additional support needs. The new funding model is being introduced on a transitional basis, during which time no college will receive a reduction in funding of more than one per cent. This approach has been adopted to allow the sector to prepare for any changes it introduces. There is currently no timescale for full implementation.

Reclassification has resulted in more work but greater accountability

74. In addition to changes to rules on retaining reserves and borrowing, reclassification has resulted in new arrangements for colleges. This includes more financial returns to the SFC and the Scottish Government, and the use of ALFs. In addition, colleges' decision to revert back to an academic year-end (31 July) for their financial statements, whilst requiring to break even at the end of March, means they work with two financial year-ends. The requirement to break even in March has meant some colleges have had to adopt bureaucratic, and potentially risky, approaches to managing surpluses. For example, Forth Valley College donated £1.1 million to an ALF in March 2015 and then applied to the ALF for £1.8 million in June. In March 2016, the SFC allowed colleges to transfer any cash surplus held back to the SFC rather than donating to an ALF, thereby minimising the risk of not receiving the funding back at a later date. The SFC was then able to manage the cash through its funding of universities which are not subject to the same budgeting rules regarding the Scottish Government's financial year-end. There is a limit on how much cash the SFC can manage in this way. This option would not have accommodated the full amount of funds (£99 million) which were donated to ALFs in 2013-14.

75. The new reporting arrangements arising from reclassification are required for HM Treasury and Scottish Parliament reporting purposes. They mean more work for staff within colleges, particularly finance staff. While there is no direct business benefit for colleges, the SFC now has access to more timely information about the finances of the sector. This allows the SFC to make more timely financial returns to the Scottish Government and is consistent with the reports required from all public bodies. As such, accountability for public expenditure has been enhanced. The number of returns that colleges make is currently fewer than other public bodies.

76. The new Further and Higher Education SORP comes into effect in 2015-16. The new SORP requires colleges to present financial information differently from before. This creates further work for college finance staff and will also make it more difficult to compare trend information.

Colleges still do not prepare long-term financial plans

77. Colleges still do not prepare long-term financial plans. Colleges contend that the short-term nature of their funding allocations makes future planning difficult, but this uncertainty is similar to other public bodies. The volume of change in the sector was also highlighted as a factor which makes longer-term planning difficult. We recognise these challenges. However, in line with our report from last year, we recommend that colleges should work towards developing long-term financial plans. These should involve a long-term financial strategy (five or more years) supported by medium-term financial plans (three to five years). These would allow colleges to prepare for issues such as estate development, national collective bargaining and student support funding.

Part 4

Governance and the role of the SFC

Key messages

1. There have been a small number of high-profile governance failures in the college sector in recent years. The Auditor General has reported on failures relating to severance payments at the former North Glasgow and Coatbridge colleges, and on the issues that led to Scottish Ministers removing board members at Glasgow Clyde College. The College Good Governance Task Group's recommendations should help to mitigate the risk of such significant governance failures.

2. While the SFC undertakes a range of monitoring and engagement within the college sector, this has not always resulted in timely and effective resolution of problems and issues. Despite the many changes in accountability arrangements in the sector, the Scottish Government has not undertaken a comprehensive review of the SFC's role in the last ten years. The Scottish Government's end-to-end review of the enterprise and skills agencies provides an opportunity to re-examine and clarify the SFC's role.

3. College board activities are not sufficiently transparent. Only one college complied fully with the Code of Good Governance for Scotland's Colleges and published all agendas, minutes and papers within appropriate timeframes.

despite many changes in the sector, the Scottish Government has not reviewed the SFC's role

There have been a small number of high-profile governance failures in the college sector in recent years

78. The Auditor General prepared three statutory reports following the 2014-15 audits, two of which highlighted governance concerns (Glasgow Clyde College and GCRB). These are detailed in (Exhibit 13, page 34), which also includes an update on previous reports by the Auditor General on the former North Glasgow and Coatbridge colleges.

The College Good Governance Task Group's recommendations should help to mitigate the risk of significant governance failures

79. The Cabinet Secretary for Education and Lifelong Learning established the College Good Governance Task Group as part of the government's response to the governance failures at Coatbridge, Glasgow Clyde and North Glasgow colleges.

Exhibit 13
Summary of statutory reports prepared by the Auditor General in recent years

Body	Issues identified in statutory report
North Glasgow College (May 2014) update[1]	The PAC published its final report on the management of severance payments in October 2015. It concluded that poor governance and the lack of openness and transparency resulted in a lack of accountability in respect of the use of public funds. The PAC asked for further information from the Scottish Government and the SFC on options for disciplinary action in the event of failings. This was taken forward by the College Good Governance Task Group.
Coatbridge College (June 2015) update[2]	Following the publication of the Auditor General's report on the college in June 2015, the PAC undertook an extensive inquiry. The PAC concluded that information was deliberately withheld from the college's Remuneration Committee and that information about the severance arrangements was deliberately withheld from the college’s auditors. The PAC submitted its report to Police Scotland. The SFC wrote to the former principal to ask him to return some of the money he received but this did not result in any funds being returned. Legal advice obtained by the SFC suggested that there were no grounds to pursue this matter further. During 2014-15, New College Lanarkshire undertook work to identify any other legacy issues from Coatbridge College. Work is ongoing to resolve some identified issues and the auditor will report on progress in the 2015-16 annual audit report.
Edinburgh College (March 2016)[3]	The college exceeded the SFC limit for the level of additional education it provided to already enrolled students in 2014-15. This led to the SFC requesting that the college pay back £0.8 million. A review by the new college principal found other problems with how the college set activity targets. This led to the college agreeing with the SFC to reduce its activity target for 2015-16 by around six per cent, placing the college under significant financial pressure.
Glasgow Clyde College (March 2016)[4]	Scottish Ministers took the unprecedented decision to remove some members of the board of the college in October 2015. The Auditor General's report highlighted that the college board had failed to comply with a number of aspects of the sector's Code of Good Governance. This included not appropriately considering strategic business items and failing to seek further information about governance issues raised by the principal. The report highlighted a lack of open and transparent decision-making, with minutes not being circulated and agreed in a timely manner. The college also failed to comply with the SFC's Financial Memorandum on a delegated financial spending limit for procurement. The report recognised that the Emergency Board and the Executive Management Team had taken positive steps to address the weaknesses identified.
GCRB (March 2016)[5]	The statutory report found that GCRB had not put in place key systems of assurance and internal control. As a result, the SFC was not prepared to grant GCRB operational fundable body status. GCRB has made a number of improvements but, at the time of our audit, it had still not secured operational fundable body status. This means GCRB is not yet able to completely fulfil its role.

Notes:
1 *The 2012/13 audit of North Glasgow College: Governance and financial stewardship*, Auditor General for Scotland, May 2014.
2 *The 2013/14 audit of Coatbridge College: Governance of severance arrangements*, Auditor General for Scotland, June 2015.
3 *The 2014/15 audit of Edinburgh College,* Auditor General for Scotland, March 2016.
4 *The 2014/15 audit of Glasgow Clyde College,* Auditor General for Scotland, March 2016.
5 *The 2014/15 audit of Glasgow Colleges' Regional Board,* Auditor General for Scotland, March 2016.

Source: Audit Scotland

80. In March 2016, the group made recommendations to make governance in the sector more effective and focused on:

- board member recruitment, development and appraisal
- governance support for boards (introduce a national governance portal with links to guidance and good practice case studies; update guidance on board effectiveness; enhance and strengthen the board secretary role; provide resources and networking opportunities)
- external assurance (creating a more proactive, risk-based approach to monitoring by the SFC; and looking at how direct observation of board meetings could provide assurance)
- sanctions open to Ministers (the power to suspend any or all board members; the power to direct colleges in the face of a board not governing appropriately).

Implementation of these recommendations should help to mitigate the risk of significant governance failures.

College board activities are not sufficiently transparent

81. The College Code of Good Governance specifies that board agenda, minutes, policies and reports are published within appropriate timeframes.[21] Although the code does not specify the timeframes (and does not refer to committees), we consider good practice involves:

- agendas and reports for board and committee meetings made available at least a week before the day of the meeting
- board and committee minutes made available within one week after they are approved (likely to be at the first subsequent meeting).

82. Our review of college websites in February 2016 found that Glasgow Kelvin College complied fully with the code in terms of openness and transparency of board and committee activities. Glasgow Kelvin College published up-to-date agendas, minutes and relevant reports online. Eight colleges published up-to-date board and committee minutes but did not provide links to relevant reports. One college published reports (including the agendas) but not the approved minutes. Ten colleges published board minutes, but only seven of these were up-to-date.

The SFC's role in regulating college governance is not clear and it has not been effective in dealing with some issues

83. The SFC's statutory duty is to secure coherent, high-quality further and higher education by colleges and universities in Scotland. It is a non-departmental public body of the Scottish Government. The Cabinet Secretary for Education and Lifelong Learning issues Letters of Guidance (at least once a year) to the SFC. These set out the Scottish Government's expectations for the next academic year.

84. The SFC's relationship with the Scottish Government is formalised in a Management Statement and Financial Memorandum. This document was created in 2006 and states that the SFC's role is 'to promote sound governance and the highest standards of management by colleges and universities.' The document provides no further reference to the SFC's role specifically relating to college governance. A number of significant changes and issues have arisen in the sector since this was last reviewed. The PAC's report on Coatbridge College in January 2016 recommended that the Scottish Government look at the effectiveness of the SFC's supervisory role.[22] In May 2016, the First Minister indicated that the Scottish Government would undertake '*…an end-to-end review of the roles, responsibilities and relationships of our enterprise, development and skills agencies, covering the full functions of Scottish Enterprise, Highlands and Island's Enterprise, Skills Development Scotland and the Scottish Funding Council, to ensure that all of our public agencies are delivering the joined up support that our young people, universities, colleges and businesses need.*'[23]

85. The SFC has prepared a draft framework document with the Scottish Government which will replace the Management Statement and Financial Memorandum. This draft document proposes a more regulatory role for the SFC on governance arrangements in colleges, but it does not specify how the SFC should enforce this role.

86. The SFC introduced ROAs in 2012. The SFC now works with each college region to produce an ROA. This sets out the activities that the region will deliver in exchange for an agreed level of funding from the SFC. This essentially formalises pre-existing expectations and creates a contract between each region and the SFC. The SFC can enforce the contract by withholding or recovering funding.

87. The SFC created new posts for ROA managers, who are now colleges' nominated first point of contact with the SFC. ROA managers have also developed relationships with regional bodies. Both the sector and the SFC feel that this has improved relations and allows both parties to identify and resolve issues sooner than would have happened previously. Despite these improved relationships, the statutory reports at Coatbridge College and GCRB indicate that these have not been enough to quickly resolve some significant governance failures.

88. The Scottish Government specifies a national activity target and the SFC determines the contribution that each region will make to this national target. If a region does not meet the agreed targets, the SFC may decide to recover funding from the region. In 2014-15, the SFC sought to recover funding from three regions because they had not met their activity targets (Ayrshire, Dumfries and Galloway, and Edinburgh). Further details on Edinburgh College are provided in Exhibit 13. Ayrshire and Dumfries and Galloway colleges missed their targets by 1.2 per cent and 0.3 per cent, respectively. In these instances, the SFC normally reduces the following year's allocation by the amount equal to that to be recovered.

The SFC is currently preparing a workforce plan

89. The SFC employed 103 FTE staff in 2014/15 and had an operational budget of £7.6 million. SFC staffing reduced by around 13 per cent between 2010/11 and 2014/15, and its budget reduced by 16 per cent.

90. The SFC has restructured the organisation several times in recent years. Each of these has impacted negatively on staff morale. Its 2015 staff survey found that, while 87 per cent of respondents were committed to helping the SFC achieve its goals, only 49 per cent stated their intent to still be working there in a year's time. A staff survey in May 2016 reported that these responses had increased to 95 per cent and 57 per cent, respectively.

91. The SFC is currently managing a further operational funding reduction that is likely to require more voluntary severance. The SFC does not have a workforce plan to allow it to approach this from an informed position, although it is working on one. Having such a plan in place will help to ensure that the SFC has the right capacity and skills for the requirements under the new framework document it is preparing with the Scottish Government.

92. The SFC's financial plan only covers the period to 31 March 2017, owing to uncertainties surrounding grant settlements. The SFC's auditor has recommended that it develops a longer-term financial plan.

Endnotes

◀ 1 *Developing Scotland's Young Workforce final report*, June 2014.

◀ 2 Post-16 Education (Scotland) Act 2013 had a provision for collective bargaining in section 18.

◀ 3 *Scotland's colleges 2015*, Audit Scotland, April 2015.

◀ 4 UHI's 13 academic partners are made up of eight assigned colleges and Highland Theological College, Argyll College, Sabhal Mor Ostaig UHI, NAFC Marine Centre and Scottish Association of Marine Science.

◀ 5 It is an operational matter for the SFC to determine when a regional body should be funded by it. This involves the SFC making a judgement as to whether a regional body is in a position to administer effectively the funding for its assigned colleges. The Further and Higher Education (Scotland) Act 2005 empowers (but does not require) the SFC to fund a regional body.

◀ 6 *The 2014/15 audit of Glasgow Colleges' Regional Board*, Audit Scotland, March 2016.

◀ 7 Learning activity is measured by weighted student units of measurement (WSUMs), where one SUM means 40 hours of classroom-based learning and one Scottish Qualifications Authority credit. The SFC weights (W) these units by subject to reflect the differing costs of teaching different subjects. With the new funding model in the future this will be replaced by credits.

◀ 8 The four regions that under-delivered against their student learning targets in 2014-15 were Ayrshire, Dumfries and Galloway, Edinburgh and North East Scotland. The figures exclude European Social Fund activity and targets.

◀ 9 *Scottish Funding Council circular SFC/26/2009*, Para 22: 'The SUMs guidance gives early notice of a change to the eligibility for funding of short courses (less than 0.25 SUMs or 10 hours) that will be introduced from 2010-11.'

◀ 10 Excluding under-16s. In 2011-12, the SFC reduced funding for school students below S3 as these students are expected to study full-time in school.

◀ 11 *Audit of higher education in Scottish universities*, Audit Scotland, July 2016.

◀ 12 Staff costs cover wages and salaries, employers' national insurance contributions and pension contributions (including any accounting adjustments) but not severance payments which are accounted for as exceptional costs.

◀ 13 *Scotland's public sector workforce: Good practice guide*, Audit Scotland, March 2014.

◀ 14 Under reclassification, colleges are no longer permitted to retain reserves or take out new borrowing as this would count towards the Scottish Government's total spending. Colleges can therefore transfer any surplus to an ALF. In 2013-14, we adjusted the surplus/deficit position to take account of ALF transfers.

◀ 15 *Report of the Review of Further Education Governance in Scotland*, conducted by Professor Russel Griggs OBE, submitted to the Scottish Ministers, 20 January 2012.

◀ 16 Colleges Scotland is a charitable company which is funded through subscriptions from member colleges. It acts as the collective voice for Scottish colleges. The Colleges Scotland Board is made up of the 13 regional chairs plus four principals and the Chief Executive of Colleges Scotland.

◀ 17 The Scottish Futures Trust runs the NPD programme. The programme is a form of public private partnership and was developed as an alternative to Private Finance Initiatives.

◀ 18 Eurostat is the statistical office of the European Union.

◀ 19 RICS Building maintenance indicators other than A indicate some remedial work is required (A: As new; B: Sound, only minor deterioration; C: Operational, major repair or replacement needed; D: Inoperable, serious risk of failure).

◀ 20 Included within the SFC's analysis of the £17.5 million spend of net depreciation cash were loan repayments of £8.5 million that did not impact on the surplus/deficit position of colleges. The remaining £9 million, that did impact on the surplus/deficit position, included donations to ALFs from three colleges (City of Glasgow, Fife and Forth Valley) totalling £3 million, hence a net spend of £6 million in Exhibit 12.

◀ 21 The College Code of Good Governance was developed by a steering group which involved regional chairs, college chairs, principals, staff and student representatives, board secretaries, Colleges Scotland and the College Development Network. This was in response to a requirement as a result of the Post-16 Education (Scotland) Act 2013 provisions in relation to the identification of principles of good governance practice for the college sector. The first Code was produced in December 2014 and will be reviewed formally every three years but given the transformational changes that have been in the college sector specifically, and developments in good governance more generally, the Code will be kept under ongoing review.

◀ 22 *Report on The 2013/14 audit of Coatbridge College: Governance of severance arrangements, 1st Report*, Public Audit Committee, 2016.

◀ 23 *Taking Scotland Forward, First Minister: Priorities speech*, The Scottish Parliament, 25 May 2016.

Appendix 1

Methodology

Our audit involved:

- an analysis of information held by the SFC including performance and activity data, post-merger evaluations of merged colleges and communications with the sector

- interviews with a wide range of stakeholders. These included college principals, senior college finance staff, regional chairs, Colleges Scotland, staff and student unions, the Office of the Scottish Charity Regulator (OSCR), the Federation of Small Businesses, Education Scotland, the SFC and the Scottish Government

- a data request completed by auditors

- review of college documents such as financial plans, staff and student surveys and curriculum reviews

- analysis of relevant Scottish Government budget documentation and colleges' and Glasgow Colleges' Regional Board's audited accounts and auditors' reports covering the financial periods ending:

  - July 2015 (12-month period for the University of Highlands and Islands (UHI) colleges)
  - July 2015 (16-month period for non-UHI colleges)
  - These financial periods differ owing to a change in the accounting arrangements for non-UHI colleges which reported an eight-month period to the end of March 2014 in the previous set of accounts. This situation arose as HM Treasury confirmed to the Scottish Government in May 2012 that retaining a 31 July year-end for colleges was not possible and recommended that colleges would need to move to a March financial year-end. The SFC informed colleges in May 2013 that their financial year-end would be changing to March from 2014. In November 2013, HM Treasury offered the option for colleges to retain the academic year (August to July) for financial reporting. However, this required additional negotiations between HM Treasury and the Scottish Government, and consultations between the SFC and colleges, which were not concluded until June 2014. As a result, colleges were required to prepare accounts covering only an eight-month period, from 1 August 2013 to 31 March 2014. This did not apply to all colleges. UHI colleges continued to use a year-end of 31 July, and produced full-year accounts for the year ended 31 July 2014. This was to ensure

alignment of their financial year with UHI and other academic partners. In 2014-15, non-UHI colleges again used a different accounting period (16 months).These inconsistent accounting periods create difficulties in analysing some financial trend data. We refer to this in appropriate parts of the report.

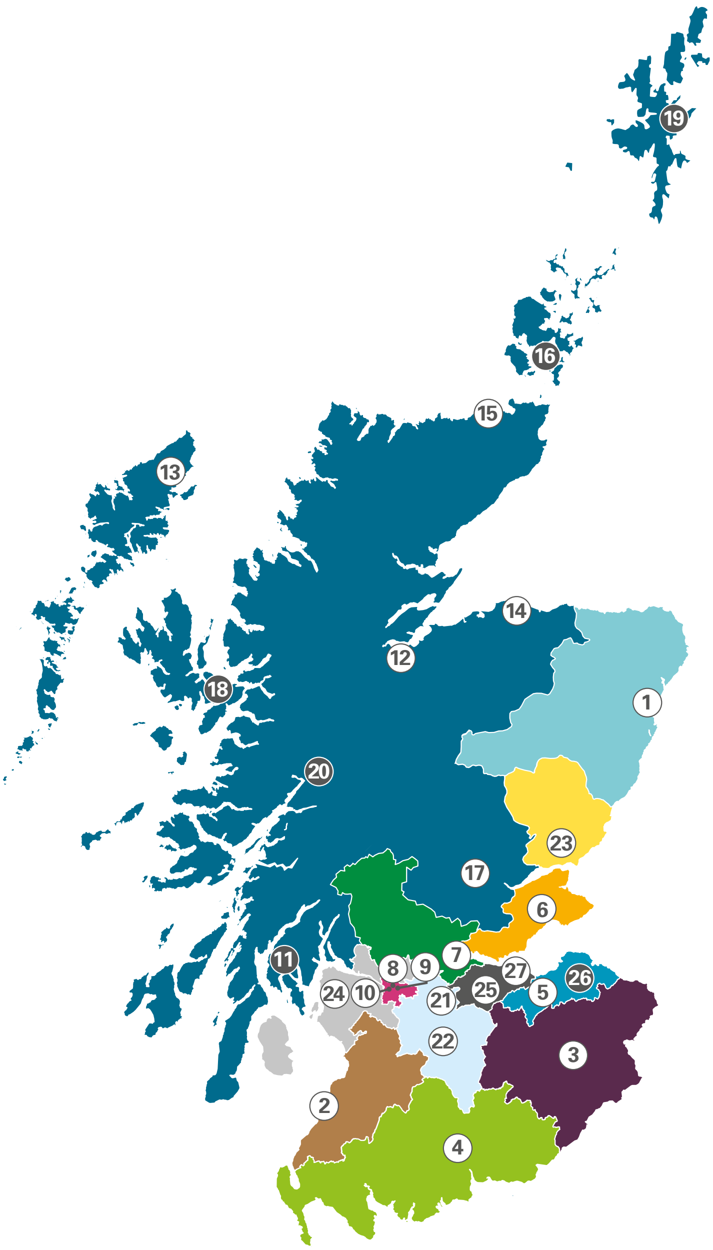
– These periods differ from the Scottish Government's financial year which runs from 1 April to 31 March. To help provide clarity, we use the convention '2014-15' when referring to figures from colleges' accounts, or relating to the academic year; and '2014/15' when referring to funding allocations made in the Scottish Government's financial year.

Our report reflects mainly the most recent college year (2014-15), unless particular issues arose from 2013-14, or where additional information helps in comparing different years. The longer financial period for non-UHI colleges in 2014-15 means it is not always appropriate to compare 2014-15 figures with previous years. We have applied different timescales in different sections of this report depending upon information available.

Figures and exhibits relating to colleges' audited accounts are for incorporated colleges only. Scottish Government budget information within this report refers to both incorporated and non-incorporated colleges; all other financial information relates to incorporated colleges only. Until 1992, all publicly funded colleges were run by local authorities. Under the Further and Higher Education (Scotland) Act 1992, most colleges established a distinct corporate body and board of management, which then assumed responsibility for financial and strategic management of the college. These 20 colleges are referred to as incorporated colleges and produce accounts subject to audit by the Auditor General for Scotland. The accounts of two of the three regional bodies are also subject to audit by the Auditor General for Scotland, those of the Glasgow Colleges' Regional Board and of New College Lanarkshire which is an incorporated college. Other publicly funded colleges are generally referred to as non-incorporated colleges.

Appendix 2

Scotland's colleges 2016



Region		College
Aberdeen and Aberdeenshire	1	North East Scotland College
Ayrshire	2	Ayrshire College
Borders	3	Borders College
Dumfries and Galloway	4	Dumfries & Galloway College
Edinburgh and Lothians	5	Edinburgh College
Fife	6	Fife College
Central	7	Forth Valley College
Glasgow	8	City of Glasgow College
	9	Glasgow Clyde College
	10	Glasgow Kelvin College
Highlands and Islands	**11**	**Argyll College**
	12	Inverness College
	13	Lews Castle College
	14	Moray College
	15	North Highland College
	16	**Orkney College**
	17	Perth College
	18	**Sabhal Mòr Ostaig**
	19	**Shetland College**
	20	**West Highland College**
Lanarkshire	21	New College Lanarkshire
	22	South Lanarkshire College
Tayside	23	Dundee and Angus College
West	24	West College Scotland
West Lothian	25	West Lothian College
n/a	**26**	**Newbattle Abbey College**
n/a	27	SRUC

Note: The map shows the 20 incorporated colleges, the six non-incorporated colleges in Scotland (in bold) and Scotland's Rural College (SRUC) which is classed as a higher education institution.

Source: Audit Scotland

Scotland's colleges 2016

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ANNUAL REPORT OF THE AUDIT COMMITTEE

1 PURPOSE OF REPORT

1.1 To advise the Board of Management of the activities and decisions of the Audit Committee during Financial Period 2015-16 and to provide opinions on matters specified by the Code of Audit Practice.

2 BACKGROUND TO REPORT

2.1 It is a requirement of the Code of Audit Practice and the College's Standing Orders and Financial Regulations that the Audit Committee provides the Board with an Annual Report so that all members of the Board can be fully informed of, amongst other things, aspects of the system of Internal Control.

3 ADMINISTRATIVE MATTERS

3.1 The period covered by this report is the twelve month period 1 August 2015 to 31 July 2016.

3.2 The membership of the Committee during the period was:

Hugh Carr, Chair
Janice Goldie (to 15 December 2015)
Delia Holland
Pat Kirby
Stuart Martin

3.3 Other attendees at Audit Committee meetings include:

Carol Turnbull, Principal
Jannette Brown, Secretary to the Board and Vice Principal Corporate Services and Governance
Kay Bird, new Secretary to the Board
Karen Hunter, Finance Manager
Representative from RSM Risk Assurance Services, Internal Auditors
Representative from Grant Thornton, External Auditors

3.4 During the relevant period, the Committee's formal meetings were as follows:

Date of Meeting:	Board members present:
22 September 2015	Hugh Carr Delia Holland Janice Goldie
24 November 2015	Hugh Carr Delia Holland Pat Kirby Stuart Martin
8 March 2016	Hugh Carr Delia Holland Pat Kirby Stuart Martin
10 May 2016	Hugh Carr Pat Kirby Stuart Martin

There was an average attendance of 4 members (78%).

4 INTERNAL AUDIT

4.1 RSM Risk Assurance Services (RSM) acted as internal auditors throughout the year.

4.2 RSM have provided their Annual Audit Report for 2015-16. The opinion for the 12 months ended 31 July 2016 was as follows:

'***Head of internal audit opinion 2015-2016***

The College has an adequate and effective framework for risk management, governance and internal control.

However, our work has identified further enhancements to the framework for risk management, governance and internal control to ensure that it remains adequate and effective.'

The full opinion and supporting information is detailed in RSM's Annual Internal Audit Report - Year ended 31st July 2016.

4.3 A summary of the internal audit undertaken, and the resulting opinions, is provided below:

Assignment	Assurance level	Actions agreed H	M	L
Student Activity Data	Substantial	0	1	0
Student Support Funds and Education Maintenance Allowances	Substantial	0	0	0
Strategic and Financial Planning	Substantial	0	0	1
Budgetary Control	Substantial	0	0	1
Human Resources Effectiveness	Reasonable	0	1	3
Procurement	Reasonable	0	1	2
VFM – APUC Assessment	Reasonable	0	3	6
Follow of Previous Internal Audit Recommendations	Reasonable Progress	1	3	0
Total (2015-16)		**1**	**9**	**13**
Total (2014/15)		1	6	1

4.4 The recommendations are categorised by the auditors according to the level of priority – High, Medium and Low, and are prioritised to reflect the auditors' assessment of risk associated with the control weaknesses.

In addition, Suggestions may be included as part of the Action Plan reported. These are not formal recommendations that impact the overall audit opinion, but used to highlight a suggestion or idea that management may want to consider.

Nine of the recommendations made during the year were categorised as Medium Priority, with 13 categorised as Low Priority.

One High Priority management action was reiterated in relation to a Follow Up of previous internal audit recommendations review.

4.5 Where a recommendation is not accepted this is documented in the individual audit reports considered by the Audit Committee. In general, recommendations may not be accepted where it is considered that the benefits of implementation are outweighed by the costs.

4.6 Assurance on the adequacy of internal controls within the College arises only from the results of reviews that have been completed during the period in accordance with the programme approved by the Audit Committee. In this context it is important to note that:

- It is management's responsibility to maintain internal controls on an ongoing basis;
- The internal audit function forms part of the overall internal control structure of the Board; and
- Whilst the Internal Auditors have planned their work so that they have a reasonable expectation of detecting significant control weakness, internal audit procedures do not guarantee that fraud will be detected.

It is the responsibility of internal audit to assess the adequacy of the internal control arrangements put in place by management and to perform testing to ensure that these controls were operating for the period under review.

5 EXTERNAL AUDITORS

5.1 The external auditors for the period to 31 July 2016 were Grant Thornton UK LLP, 7 Exchange Crescent, Edinburgh EH3 8AN. Grant Thornton have been engaged to carry out the external audit for financial years 2011-12 to 2015-16.

5.2 The fundamental objective of the planning, approach and execution of the audit is to enable the auditors to express an opinion on whether or not the financial statements, as a whole, give a true and fair view of the activities of the College since the last audit and of its state of affairs as at the Balance Sheet date.

5.3 We confirm that the external auditors have been approved by the Auditor General in accordance with the Code of Audit Practice and the letter from the Auditor General dated 20 April 2000 for provision of external audit services for the financial period 2013-14.

5.4 The external audit of the financial statements for the period ended 31st July 2016 will be undertaken during October 2016, and Grant Thornton are expected to issue their external audit report in November.

5.5 Audit Scotland have now completed their tender exercise, and have advised that Scott-Moncrieff have been proposed as the external auditor for Dumfries and Galloway College for the financial years 2016-17 to 2020-21. Confirmation of the formal appointment of auditors is expected by 3rd May 2016.

6 THE FINANCIAL STATEMENTS

6.1 The External Auditors will provide their Annual Report to the Board of Management following completion of their external audit work, as noted above.

7 VALUE FOR MONEY PROGRAMME (VFM)

7.1 Value for Money Audit work on APUC Assessment was undertaken during 2015-16.

7.2 The review was undertaken to provide the College with feedback on current systems and processes for procurement and to ensure that they are prepared for any future Procurement Capability Assessments by Advance Procurement for Universities and Colleges (APUC); as well as confirming that appropriate procurement systems and procedures are in place to ensure Value for Money is achieved.

7.3 The audit resulted in 3 Medium and 6 Low Risk recommendations being raised, and concluded that the Board can take reasonable assurance that controls upon which the organisation relies on to manage this area are suitably designed, consistently applied. However, issues were identified that need to be addressed in order to ensure that the framework is effective in managing this area.

8 OTHER MATTERS

8.1 There are no matters arising from trusts, joint ventures, subsidiary or associated companies.

8.2 There were no issues of alleged fraud/irregularity investigated during the audit period.

8.3 There are no foreseeable events that will affect the work of the Audit Committee.

9 GOOD GOVERNANCE

9.1 In line with the 'Code of Good Governance for Scotland's Colleges' the College Internal and External Auditors have access to the Audit Committee members to discuss any issues without College staff being present.

9.2 At the Audit Committee meeting held on 24 November 2015, the Chair asked members of the Executive Team and Finance Manager to withdraw from the meeting in order for the Committee to meet privately with internal and external auditors. The Chair sought feedback from internal and external auditors on any matters they wished to raise without staff present. Both reported strong and positive relationships with staff, and complimented them on the quality of cooperation received and working papers provided for audit. Neither raised any concerns or criticisms of management or staff.

10 OPINION

10.1 The Audit Committee's opinion will be reported for the final report following completion of the Financial Statements audit, when the External Auditors' reports are available.

Hugh Carr
Chair of Audit Committee
September 2016

Scottish Funding Council Financial Memorandum – Additional Requirements

1 Purpose of Report

The purpose of this report is to summarise the changes to the Scottish Funding Council Financial Memorandum and the actions which have been taken by the College in complying with the requirements.

2 Report

The Scottish Funding Council Financial Memorandum (FM) with the College Sector sets out the formal accountability relationship between Scottish Funding Council and colleges, and requirements with which the colleges are expected to comply with in return for payment of grant by Scottish Funding Council.

The previous FM had been introduced in 2006, and as a result of recent changes including implementation of the Post-16 Education (Scotland) Act 2013, the Office for National Statistics (ONS) reclassification of incorporated colleges as public sector bodies, and development of governance on the college sector, a revised FM was introduced. The current FM was issued in December 2014 following consultation with the sector. A copy of the FM is attached to this report.

A summary of the changes which have arisen from Part 3 of the revised Financial Memorandum, specifically the new requirements of the Scottish Public Finance Manual, and the Guidance on severance schemes has been drafted in order to track the actions taken in order to comply with the requirements and the assurances available.

The college is compliant with all changes with the exception of cash management and banking where the college is waiting on an implementation date from RBS.

3 Recommendation

Committee members are asked to note the key changes to the Financial Memorandum and severance schemes and severance payments, and the progress to date towards full compliance.

ACTION TRACKING - Changes to Financial Memorandum Revised 29.08.16

Scottish Funding Council - Financial Memorandum - additional requirements for Regional Colleges and Regional Boards (effective from 01.04.16)

Action Reference:	Requirement	*Action taken/ assurance available*	Current Status
Page 17 para. 5	**Scottish Public Finance Manual** - The institution must follow the requirements of the Scottish Public Finance Manual, except where any special actions or derogations have been agreed with the Scottish Ministers	*Training undertaken by Finance Manager and other staff as appropriate; 31.07.15 financial statements prepared in accordance with SPFM; budget returns to SFC compliant with SPFM; ongoing developments monitored for action by the Finance Development Network*	Fully compliant
Page 17 para. 8	**Borrowing -** All borrowing by incorporated colleges will require the approval of the Scottish Ministers. Requests to borrow must be submitted to SFC in the first instance.	*Budget and cash flow processes in place, monitored by EMT; no borrowing requirements forecast for the foreseeable future*	Fully compliant
Page 17 para. 10	**Cash Management and Banking -** Grant payment will not be made in advance of need, as determined by the level of unrestricted cash reserves and planned expenditure. Unrestricted cash reserves held during the course of the year should be kept to the minimum level consistent with the efficient operation of the institution and the level of funds required to meet any relevant liabilities at the year-end. Grant-in-aid not drawn down by the end of the financial year shall lapse. Grant-in-aid shall not be paid into any restricted reserve held by the institution. Transfers to arms-length foundations are not permitted.	*Cash Flow return process set up by SFC, monitoring of bank balances and cash management procedures all revised to comply with the FM; internal audit review of cash flow process in October '14 for assurance and feedback/ improvement*	Fully compliant

Page 17 para. 11	**Cash Management and Banking -** Banking arrangements should ensure they offer best value and comply with the banking section of the SPFM. The Scottish Ministers have approved a derogation which delays the move to the Government Baking Service (GBS) to 2016-17 at the earliest.	*Finance Development Network discussions with relevant RBS staff, timetable for the sector transition is currently being discussed, and is expected to be completed by 01.04.17*	Awaiting further information from RBS
Page 18 para. 13	**Cash Management and Banking -** the institution can operate bank overdraft facilities to assist in managing the timing of income and expenditure through its bank account. Overdrafts should not be used as a means of increasing borrowing.	*Cash Flow forecasts are prepared monthly, and will highlight any future requirement for overdraft facilities*	Fully compliant
Page 18 para. 14-16	**Contingent Commitments -** the institution must seek SFC's prior written consent if it intends to lend or give a guarantee, indemnity or letter of comfort. The institution must take steps to restrict the contingent liability to a minimum and should undertake a careful appraisal of the risks before accepting any contingent liability. (SFC's written consent is not required for such arrangements if the indemnity is of a standard type contained in contracts and agreements for 'day to day' procurement of goods and services in the normal course of business.)	*EMT review of plans and future developments will highlight any potential issues for discussion with SFC*	Fully compliant
Page 18 para. 17 and 22	**Delegated financial limits -** specific delegated financial limits are set out in Appendix A of the Financial Memorandum. The institution must obtain SFC's prior written approval before entering into any undertaking to incur any expenditure that falls out with these delegations. The levels for certain categories of expenditure above which the institution should report annually to SFC are set out in Appendix A of the Financial Memorandum. The report should describe the number of instances and total cost, by category of expenditure.	*Severance payments are covered by actions following SFC's Guidance on seeking approval for severance schemes and settlement agreements' as noted below; other areas are covered by financial statements disclosures and year-end accounting processes. The 2014/15 Severance Scheme was implemented in compliance with SFC's guidance, and any future schemes will comply with the guidance*	Fully compliant

Page 18 para. 18	**Delegated financial limits -** prior SFC approval must always be obtained before incurring expenditure for any purpose that is, or might be considered, novel, contentious or repercussive or which has or could have significant cost implications.	*EMT review of plans and future developments will highlight any potential issues for discussion with SFC*	Fully compliant
Page 18 para. 20	**Delegated financial limits** - any frauds that are detected must be reported to SFC as and when they occur.	*Policies are in place for Whistle blowing and Anti-fraud and corruption*	Fully compliant
Page 18 para. 21	**Delegated financial limits** - the institution must establish appropriate documented internal delegated authority arrangements consistent with the Delegated Authority section of the SPFM and the Financial Memorandum.	*Financial Regulations set out the approval arrangements. The Financial Scheme of Delegation will be incorported into College Procurement Procdures following the recommendations from an Internal Audit review of procurement*	Fully compliant
Page 19 para. 23	**Donation of surplus funds to arms-length foundations -** the institution may donate any surplus on its income and expenditure account as at 31 March each year to its arms-length foundation. The donation must take place in the financial year in which it arises, and is subject to sufficient cash and resource cover being available.	*Budget planning and forecasting processes have all been revised from April '14, and any potential commercial surpluses are identified for possible donation to the foundation as appropriate*	Fully compliant
Page 19 para. 26	**Early departures of staff -** The institution must follow the requirements of the SPFM in determining settlement agreements, severance, early retirement and redundancy arrangements and payments. In addition, the institution must have regard to the principles of good practice in managing early departures of staff contained in Audit Scotland's May 2013 report: Managing early departures from the Scottish public sector.	*Severance payments are covered by actions following SFC's Guidance on seeking approval for severance schemes and settlement agreements' as noted below*	Fully compliant
Page 19 para. 27	**Early departures of staff** - in line with the requirements of the SPFM, the institution's severance scheme must be approved by SFC. Provided a severance payment is within the parameters of a scheme, which has been approved by the SFC, there will be no need for the institution to seek approval to the individual payment from SFC.	*Severance payments are covered by actions following SFC's Guidance on seeking approval for severance schemes and settlement agreements' as noted below*	Fully compliant

Page 19 para. 28	**Early departures of staff -** special severance payments in excess of £1,000 must be approved by SFC, except where provision for such payments has been included in a severance scheme approved by SFC.	*Severance payments are covered by actions following SFC's Guidance on seeking approval for severance schemes and settlement agreements' as noted below.*	Fully compliant
Page 20 para. 29	**External business and management consultancy contracts** - any external consultancy contracts with a value of more than £100,000 must be approved in advance by the SFC	*Current procurement processes will identify any potential expenditure of this value for further approval as required*	Fully compliant
Page 20 para. 30	**Impairments, provisions and write-offs** - Assets must be recorded in the Balance Sheet at Depreciated Replacement Cost for Land and Buildings and at Historic Cost less depreciation for Equipment in accordance with the Financial Reporting Manual (FReM). Where an asset, including investments, suffers impairment, it is important that the prospective impairment and background is communicated to the SFC at the earliest possible point in the financial year to determine the budget implications. Any significant movement in existing provisions or the creation of new provisions must be discussed with the SFC.	*The financial statements to 31 July 2015 were prepared in accordance with the FReM, with impairment review being carried out annually as part of the year-end process*	Fully compliant
Page 20 para. 31	**Impairments, provisions and write-offs** - write-off of bad debt and / or losses score against Resource Departmental Expenditure Limits (DEL)	*Budget return procedures to highlight for SFC information*	Fully compliant
Page 20 para. 32	**Income generation** - the institution will be able to retain all commercial income, gifts, bequests or donations received. These funds will be in addition to any grant or funding the institution receives from the SFC.	*Budget planning and forecasting processes have all been revised from April '14*	Fully compliant
Page 20 para. 33	**Insurance -** the Scottish Ministers have agreed a derogation whereby institutions can extend their current commercial insurance arrangements for three years to 31 July 2018	*Scotland's Colleges to prepare evidence for Scottish Ministers to demonstrate value for money/ feedback to Finance Network*	Fully compliant

Page 20 para. 34	**Investments** - the institution must not make any investments of a speculative nature without the prior written approval of SFC	*EMT review of plans and future developments will highlight any potential issues for discussion with SFC*	Fully compliant
Page 20 para. 35	**Procurement and payment -** the institution's procurement processes must reflect the relevant guidance contained in the Advanced Procurement for Universities and Colleges, and relevant policy and advice issued by the Scottish Procurement Directorate. Procurement must be undertaken by appropriately trained and authorised staff and treated as a key component of achieving the institution's objectives consistent with the principles of Best Value, the highest professional standards and any legal requirement	*Procurement Improvement Plan in draft, in order to comply with FM and the Procurement reform Act duties. Internal Audit work in December '15 and February '16 to review and provide assurances and feedback*	Fully compliant
Page 21 para. 36	**Procurement and payment** - any proposal to award a contract without competition (non-competitive action) must be approved in advance by SFC. Specific delegated authority is given to award a contract without competition for £25,000 or less without advance approval	*Expenditure analysis is currently being carried out as part of the Procurement Improvement Plan; future expenditure plans will be planned in advance, and published on the College Contract Register in accordance with the requirements of the Procurement Reform Act*	Fully compliant

Scottish Funding Council - Guidance on seeking approval for severance schemes and settlement agreements (issued 23.02.16)			
Action Reference:	**Requirement**	***Action taken/ assurance available***	
Page 5 para. 12	**Governance** - In considering any severance, colleges must ensure that issues of regularity, propriety and value for money are fully taken into account. In doing so it is important that policies and procedures are established and applied in a timely manner, including: ensuring a business case, including justification and full expected cost, is prepared; decisions are made and approved in accordance with college delegation procedures; and decisions are fully documented and a clear audit trail of evidence supporting the decision is retained; and there is clear evidence of governance oversight	*'Code of Conduct for Members' adopted by the Board in June 2014/ robust training and development undertaken for board members. The 2014/15 Severance Scheme was implemented in compliance with SFC's guidance, and any future schemes will be planned and conducted in accordance with the guidance issued*	Fully compliant
Page 6 para. 13	**Governance** - the Remuneration Committee must undertake robust scrutiny of proposed severance schemes and settlement agreements before recommending approval to the Board. In order to preserve governance boundaries the Chair of the Remuneration Committee must not be the Chair of the Board	*As above - SFC guidance has already been used to plan and implement the 2014/15 severance scheme, which was subject to robust scrutiny by the Remuneration Committee*	Fully compliant
Page 6 para. 14	**Governance** - the Remuneration Committee must ensure there is no conflict of interest between those involved in approving severance arrangements and individual beneficiaries of such arrangements	*Already implemented as above*	Fully compliant
Page 15 para. 15	**Governance -** the Remuneration Committee also has a role in setting remuneration policy and in ensuring contractual terms for staff are not overly generous (e.g. long notice periods) which may result in large payments when employees leave	*Already implemented as above*	Fully compliant

Page 6 para. 16	**Governance** - Audit Scotland's recent report 'Scotland's colleges 2015' highlights weaknesses in the way some colleges managed and approved senior staff severance arrangements. Auditors at six colleges identified that the handling of severance arrangements fell short of good practice. In two of these cases (North Glasgow College and Coatbridge College) the Auditor General produced a separate statutory report (Section 22) setting out shortcomings in governance and reporting. Colleges should familiarise themselves with the contents of the above reports and the Public Audit Committee reports that were based upon them	*Audit Scotland report to be distributed to Board members for their information*	*Fully compliant*
Page 6 para. 17-18	**Governance** - SFC should be consulted in all cases where the possibility of compulsory redundancy is being considered. SFC should be notified at the earliest opportunity of such cases. In situations of sensitive or high profile payments, Ministerial views on the terms of the proposed severance will be sought, as and when required, by SFC	*Already implemented as above*	*Fully compliant*
Page 7 para. 19	**Key principles** - when considering any severance, colleges must ensure that the following principles are observed: • Public funds must not be used wastefully or to underwrite inequitable or over-generous conditions of service, including severance; • Decisions on severance arrangements and, in particular, limits on payments will be based on the conditions set in the SPFM and this guidance and not on the source(s) of funding; • Notice of termination of appointments must not be delayed in order to generate compensation payments in lieu of notice; • Where appropriate, ex-gratia severance or redundancy packages must be based on the arrangements set out within relevant extant terms and conditions of employment. In particular, prior consideration should be given to the availability of pension and compensation benefits within these conditions; • Special payments must be transparent and negotiated in a way which avoids conflicts of interest;	*Already implemented as above*	*Fully compliant*

	• Offers of subsequent employment or consultancy work must be exceptional and only made where they represent value for money; and • Any undertakings about confidentiality must leave transactions open to proper public scrutiny		
Page 7 para. 22-27	**Procedures for approval by SFC - Voluntary severance scheme applications** are assessed against set criteria which include the business case for releasing a member of staff early and the value for money which can be obtained as a result. The numbers of staff leaving through voluntary severance schemes and the associated costs will be reported in the College's annual accounts. A template setting out justification to business case should be completed for SFC. Schemes must be time limited and linked to a programme of managing early departure. Colleges must seek appropriate legal and independent professional advice in establishing and implementing the scheme, which must be provided for scrutiny by the Remuneration Committee and/ or Board prior to approval of the scheme and arrangements.	*Already implemented as above*	*Fully compliant*
Page 9 para. 33	**Procedures for approval by SFC - settlement agreements or proposals to secure a voluntary resignation -** settlement agreements should not be a standard feature of voluntary severance schemes. There should always be a presumption against the use of settlement agreements and colleges will have to justify their use. In cases where settlement agreements are part of a voluntary severance scheme, individual approval is required for each agreement and colleges should request approval by completing the template provided by SFC	*Already implemented as above*	*Fully compliant*

Page 10 para. 36-37	**Procedures for approval by SFC - Confidentiality clauses** - in seeking approval for the use of a settlement agreement, colleges must indicate whether a confidentiality clause is proposed and, if so, on what grounds. There should be a presumption against the use of confidentiality clauses except in exceptional circumstances. However, either party can request a confidentiality clause be inserted. In such a situation the terms of the clause must be agreed by both parties. Nothing in any confidentiality clause should restrict an individual's right to make a protected disclosure under the Public Interest Disclosures Act 1998. Where a confidentiality clause is included in a settlement agreement, the text should be included in the business case submission to SFC	*Already implemented as above*	*Fully compliant*
Page 10 para. 38	**Disclosure of information** - any clause in relation to disclosing of information should explicitly note that SFC and the Scottish Government will have sight of the information. SFC will collate the information for submission to the Scottish Government for the purpose of parliamentary scrutiny. A draft clause is included in the Scottish Government's settlement agreement guidance which could be adopted	*Already implemented as above*	*Fully compliant*
Page 11 para. 39	**Use of standard termination letter** - a standard termination letter or agreement can set out the terms of termination of employment, and an example letter is included in the guidance	*Already implemented as above*	*Fully compliant*
Page 11 para. 42	**Compulsory redundancies** - Colleges should be aware that the policy of no compulsory redundancies is a key pillar of public sector pay policy which colleges should have regard to (this is a term and condition of grant applied through the SFC 'Financial Memorandum with Fundable Bodies in the College Sector'. Any college considering compulsory redundancies should consult with SFC as early as possible	*Already implemented as above*	*Fully compliant*

Financial Memorandum with Fundable Bodies in the College Sector

Contents

FINANCIAL MEMORANDUM

Introduction

Purpose of this document

1. This Financial Memorandum (FM) sets out the formal relationship between the Scottish Further and Higher Education Funding Council (SFC) and fundable bodies[1] in the college sector, and the requirements with which fundable bodies must comply as a term and condition of grant from SFC.

2. The FM also makes it a term and condition of grant from SFC that Regional Colleges and Regional Boards comply with the requirements of the Scottish Public Finance Manual (SPFM) and sets out the special actions and derogations, which have been agreed with the Scottish Ministers.

Scope of this document

3. This FM applies to Regional Colleges and other colleges[2], Regional Boards and other Regional Strategic Bodies which receive payment of grant from SFC.

Definition

4. In this document the term 'institution' is used in place of 'fundable body in the college sector'. The term 'chief executive officer' refers to an institution's Principal or equivalent officer.

Compliance with the Financial Memorandum

5. The responsibility for ensuring that the institution complies with this FM rests with the governing body of the institution. Questions about the interpretation of the FM may be raised with officers of SFC at any time.

6. Where the institution's interpretation of the FM differs from that of SFC, the SFC will seek, wherever possible, to reach agreement in a spirit of partnership with the institution. However, the SFC's interpretation of this FM shall be final.

Effective date

7. This FM shall take effect from 1 December 2014.

Structure of this document

8. The FM is in four parts:

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[1] As defined by the Further and Higher Education Act (Scotland) 2005, as amended by the Post-16 Education Act (Scotland) 2013.

[2] In this context, a college is a fundable post-16 education body that is not a higher education institution.

<table>
<tr><td>Part 1: defines the relationship between SFC and the institution and the responsibilities of each for the proper stewardship of public funds</td><td rowspan="2">Parts 1 and 2 apply to Ayrshire College, Borders College, Dumfries and Galloway College, Dundee and Angus College, Edinburgh College, Fife College, Forth Valley College of Further and Higher Education, Newbattle Abbey College, New College Lanarkshire, North East Scotland College, Sabhal Mòr Ostaig, West College Scotland, West Lothian College, Regional Board for Glasgow Colleges, and the University of the Highlands and Islands</td></tr>
<tr><td>Part 2: contains the general requirements that apply to all institutions</td></tr>
<tr><td>Part 3 (A): contains additional requirements for Regional Strategic Bodies</td><td>Part 3 (A) applies to Regional Board for Glasgow Colleges, New College Lanarkshire, and the University of the Highlands and Islands.</td></tr>
<tr><td>Part 3 (B): contains additional requirements for Regional Colleges and Regional Boards</td><td>Part 3 (B) applies to Ayrshire College, Borders College, Dumfries and Galloway College, Dundee and Angus College, Edinburgh College, Fife College, Forth Valley College of Further and Higher Education, New College Lanarkshire, North East Scotland College, West College Scotland, West Lothian College, and Regional Board for Glasgow Colleges.</td></tr>
<tr><td>Part 4: contains additional requirements non-assigned, non-incorporated colleges</td><td>Part 4 applies to Newbattle Abbey College and Sabhal Mòr Ostaig.</td></tr>
</table>

Part 1: The relationship between SFC and the institution

Responsibilities of the Scottish Funding Council

1. SFC is the national, strategic body with responsibility for funding further and higher education, research and other activities in Scotland's colleges, universities and other higher education institutions. Its funding decisions support the Scottish Government's national priorities.

2. SFC is a Non-Departmental Public Body (NDPB) of the Scottish Government and undertakes its functions under the terms of the Further and Higher Education (Scotland) Act 2005 (the 2005 Act), as amended, including by the Post-16 Education (Scotland) Act 2013. In particular, SFC may make grants, loans or other payments to the governing bodies of colleges and Regional Strategic Bodies for the provision of further education, higher education, research and related activities.

3. The legislation also confers certain duties and responsibilities on SFC, including securing coherent, high quality further and higher learning provision, and the undertaking of research.

4. Under the terms of the 2005 Act, SFC may attach terms and conditions to the payment of grant made to institutions. It is a term and condition of grant payment from SFC that the institution's governing body and its designated officers comply with the requirements set out in this FM.

Accountability

5. SFC is accountable to the Scottish Ministers for the use of public funds provided to it under the terms of the relevant legislation.

6. The Chief Executive of SFC has also been appointed Accountable Officer under the terms of the Public Finance and Accountability (Scotland) Act 2000 and is responsible and accountable to the Scottish Parliament for ensuring that funds provided to SFC are used for the purposes for which they have been given, and in ways that comply with the conditions attached to them. The Accountable Officer has a personal responsibility for the propriety and regularity of the public finances provided to SFC, and for ensuring that funding is used economically, efficiently and effectively.

Assurance

7. In order to meet his or her responsibilities, the Chief Executive of SFC must be satisfied that the governing body of the institution meets the requirements of this FM as a condition of receiving grant funding from SFC. SFC will therefore

seek financial management and other information from the institution but, as far as possible, will rely on data and information that the institution has produced to meet its own needs. If further information is required, SFC will make a specific request in the context of its commitment to efficient regulation.

8. Where SFC has concerns or insufficient information to provide the assurance required, it will, in the first instance, seek to resolve matters with the chief executive officer of the institution. Where this has not proved possible, or in the case of significant concerns, SFC's Accountable Officer will inform the chair of the governing body and the institution's chief executive officer in writing – and without delay – and will specify what action is required to address these concerns.

9. Where circumstances warrant it, SFC's Accountable Officer may suspend the payment of any or all grants to the institution. SFC may also use its powers to attend and address a meeting of the governing body.

What the institution can expect of SFC

10. SFC will conduct its affairs to high standards of corporate governance and public administration. It will maintain a complaints procedure and a separate appeals process for funding decisions.

11. SFC will act reasonably on the basis of the fullest available evidence and objective analysis. Subject to any legal requirement to observe confidentiality, it will be open and transparent with the institution, and with other stakeholders, and will give or be prepared to give a public justification of its decisions.

12. SFC recognises that the institution is an autonomous body. SFC will not substitute its judgements for those which are properly at the discretion of the institution. In particular, SFC will seek to maximise the discretion of the institution to use grants provided to it by SFC.

13. In discharging its responsibilities, SFC will seek to make regulation efficient and effective.

14. SFC will seek at all times to work in a spirit of partnership with the institution, including maintaining regular dialogue with the institution and, where appropriate, its representative bodies. The aim of that partnership will be to help the institution deliver its strategic priorities through the agreement of an Outcome Agreement with SFC, and ensure that SFC can deliver its priorities and undertake its statutory and other functions. SFC recognises that the institution may also undertake activities, and have to comply with legislation and regulation, which may fall outside the scope of this partnership.

15. SFC will allocate and pay grant to the institution in accordance with current published policies and procedures. The institution will be consulted in advance and given reasonable notice of any significant change to these policies and procedures and of significant changes in overall funding levels.

SFC's governance requirements of the institution

16. The SFC must be able to rely on the whole system of governance, management and conduct of the institution to safeguard all funds of the institution deriving from the Scottish Ministers and achieve the purposes for which those funds are provided.

17. SFC requires the governing body to comply with the principles of good governance set out in the Code of Good Governance for Scotland's Colleges. SFC also requires the governing body to ensure that:

- Public funds are used in accordance with relevant legislation, the requirements of this FM and only for the purpose(s) for which they were given. Strategic, Capital or other grant funding must only be used for the purpose for which it is provided by SFC
- Subject to any legal requirement to observe confidentiality, the institution will be open and transparent with the SFC and other stakeholders, and will give, or be prepared to give, a public justification of its decisions in relation to the use of public funds
- The institution strives to achieve value-for-money and is economical, efficient and effective in its use of public funding
- There is effective planning and delivery of the institution's activities in accordance with its mission and its Outcome Agreement agreed with SFC
- The institution plans and manages its activities to remain sustainable and financially viable. An institution is being managed on a sustainable basis if, year on year, it generates sufficient income to cover its costs and allow for maintenance of and investment in its infrastructure (physical, human and intellectual) at a level which enables it to maintain adaptive capacity necessary to meet future demands
- The institution has a sound system of internal management and control, including an audit committee, an effective internal audit service, and adequate procedures to prevent fraud or bribery
- The institution has an effective policy of risk management and risk management arrangements
- The institution has regular, timely, accurate and adequate information to monitor performance and account for the use of public funds. Such information will be made available to SFC on request, as necessary, for the exercise of its functions and to gain assurance

- The institution is engaged actively in continuously enhancing the quality of its activities and involves students and other stakeholders in these processes

18. As well as being accountable directly to the governing body for the proper conduct of the institution's affairs, the chief executive officer is also accountable directly to SFC's Accountable Officer for the institution's proper use of funds deriving from the Scottish Ministers and its compliance with the requirements of this Financial Memorandum.

19. The chief executive officer of the institution must inform SFC's Accountable Officer without delay of any circumstance that is having, or is likely to have, a significant adverse effect on the ability of the institution to deliver its education programmes, research and other related activity, including delivery of its Outcome Agreement with SFC. He or she must also notify SFC's Accountable Officer of any serious weakness, such as a significant and immediate threat to the institution's financial position, significant fraud or major accounting breakdown or any material non-compliance with any requirement of this FM.

Revisions to the Financial Memorandum

20. SFC will make changes to the requirements in this FM only after consulting institutions or their representative bodies.

Part 2: General requirements

1. Unless otherwise stated, the following general requirements apply to the institution.

Financial Memorandum

2. It is a term and condition of grant payment from SFC that the governing body of the institution and its designated officers comply with the requirements set out in this FM.

Post-16 Education Body criteria

3. In undertaking its functions, the governing body of the institution must keep under review and have in place satisfactory provision in relation to the list of matters set out in section 7 (2) of the 2005 Act, as amended by the Post-16 Education (Scotland) Act 2013. This requirement does not apply to Regional Boards as these are not Post-16 Education Bodies.

Outcome Agreement

4. The institution must deliver its Outcome Agreement with SFC.

Payment of SFC Strategic, Capital or other Grants

5. Where the SFC makes a payment to the institution of a Strategic, Capital or other grant, the institution will be required to comply with any additional requirements attached to the grant, as well as with this FM.

Changes to grant payments

6. If the Scottish Ministers revise their payment of grant to SFC, then SFC reserves the right to make in-year adjustments to its payment of grant to the institution. In this case, SFC and the institution may renegotiate the institution's Outcome Agreement.

Repayment of grant

7. If the institution fails to comply with the requirements of this FM, and any other specific terms and conditions attached to the payment of grant from SFC, it may be required to repay SFC any sums received from it and may be required to pay interest in respect of any period during which a sum due to SFC in accordance with this or any other condition remains unpaid.

8. If, in the reasonable opinion of SFC, any provision set out in this FM is not observed by the institution, SFC will be entitled, in respect of the payment of grant from SFC:

- In the case of funding by way of grant: to require immediate repayment of any and all grants or any part or parts of any grants at any time after the SFC becomes aware of such failure to observe (without prejudice to further demands until the whole of all sums made available by way of grant shall have been paid in full)
- In the case of funding by way of loan (notwithstanding the terms of any agreement attached to the same): to require immediate repayment of the whole or part of each such loan at any time after SFC becomes aware of such failure to observe (without prejudice to further demands until the whole of all sums made available by way of loan shall have been repaid in full).

Public sector pay policy

9. The institution must have regard to public sector pay policy set by the Scottish Ministers.

Tuition fees

10. Where applicable, the institution must charge student tuition fees at the levels set by the Scottish Ministers under either the Student Fees (Specification) (Scotland) Order 2006 or the Student Fees (Specification) (Scotland) Order 2011, whichever is applicable.[3] However:

    - the tuition fee levels set by the Scottish Ministers under the Student Fees (Specification) (Scotland) Order 2006 do not apply to students who do not have a relevant connection with the United Kingdom and Islands or are not excepted students within the meaning of the Education (Fees and Awards) (Scotland) Regulations 2007; and
    - The tuition fee levels set by the Scottish Ministers under the Student Fees (Specification) (Scotland) Order 2011 do not apply to students who do not have a relevant connection with Scotland or are not excepted students within the meaning of the Education (Fees) (Scotland) Regulations 2011, but any tuition fees charged to students from the rest of the United Kingdom must not exceed £9,000 per year[4].

[3] The level of tuition fees in 2014-15 for full-time undergraduate first degree students is £1,820. The same fee applies for PGDE and PGDipCE courses. A higher medical fee £2,895 applies only to continuing students. For full-time higher education courses at sub-degree level, a fee of £1,285 should be charged.

[4] At the moment, this £9,000 limit is not set by legislation but will be once an order is made under section 9D of the Further and Higher Education (Scotland) Act 2005 (as inserted by the Post-16 Education (Scotland) Act 2013.).

Disposal of exchequer funded assets

11. In disposing of exchequer funded assets, the institution must follow the guidance in the relevant procedure notes on the SFC website as amended from time-to-time.

Student activity

12. Where appropriate, the institution must provide data returns requested by the SFC by the deadlines and to the standards specified. Our Student Activity Data Guidance for Colleges can be found on the SFC website.

Student support guidance

13. Where appropriate, the institution must follow SFC's Student Support Guidance.

European Social Funds

14. Where the institution is in receipt of European Social Fund funding, it must follow SFC's ESF guidance.

Audit and accounting

15. The governing body must appoint an audit committee and ensure the establishment and maintenance of effective arrangements for the provision of internal and external audit. For incorporated colleges and Regional Boards, Audit Scotland will appoint external auditors.

16. The Audit Committee must produce an annual report to the governing body of the institution.

Accounts direction

17. The institution must follow the SFC's current Accounts Direction in the preparation of its annual financial statements.

Internal audit

18. The institution must have in place an effective internal audit service. The operation and conduct of the internal audit service must conform to the professional standards of the Chartered Institute of Internal Auditors. For incorporated colleges and Regional Boards, the operation and conduct of internal audit must comply with Public Sector Internal Audit Standards and, where relevant, the Scottish Public Finance Manual.

19. The institution must inform SFC when an internal auditor is appointed and must inform SFC immediately if the internal auditor is removed or departs before the end of their term of office.

20. The internal audit service must provide the governing body and senior management of the institution with an objective assessment of adequacy and effectiveness of risk management, internal control, governance, and value-for-money.

21. The internal audit service must extend its review over all the financial and other management control systems, identified by the audit needs assessment process. It must cover all activities in which the institution has a financial interest, including those not funded by SFC. It must include review of controls – including investment procedures – that protect the institution in its dealings with organisations, such as subsidiaries or associated companies, Arms-Length Foundations, students' associations, and collaborative ventures or joint ventures with third parties.

22. The head of internal audit must produce an annual report for the governing body on its activities during the year. The report must include an opinion on the adequacy and effectiveness of the institution's risk management, internal control, and governance. The report must be presented to the institution's audit committee and a copy sent to SFC.

Value for money

23. The institution must have a strategy for reviewing systematically management's arrangements for securing value for money.

24. As part of its internal audit arrangements, the institution must obtain a comprehensive appraisal of management's arrangements for achieving value for money.

External Audit

25. The external auditor must be entitled to receive all notices of and other communications relating to any meeting of the governing body which any member of the governing body is entitled to receive. They must also be entitled to attend any such meeting and to be heard at any meeting which they attend, on any part of the business which concerns them as auditors.

26. The external auditor must also be entitled to attend the meeting of the governing body or other appropriate committee at which the institution's annual report and financial statements are presented.

27. The external auditor is expected to attend, as a minimum, any meetings of the audit committee where relevant matters are being considered, such as planned

audit coverage, the audit report on the financial statements and the audit management letter. It is the responsibility of the secretary to the audit committee to notify the external auditor of such meetings.

28. The external auditors, notwithstanding responsibilities to their clients, are expected to co-operate fully with any enquiries or routine monitoring that the SFC undertakes.

29. The institution must not in any way limit SFC's access to the institution's external auditors.

Part 3: Additional Requirements for Regional Strategic Bodies, Regional Colleges, and Regional Boards

Part 3 (A): Additional requirements for Regional Strategic Bodies

1. The following additional requirements apply to Regional Strategic Bodies only:

    - Regional Board for Glasgow Colleges (known as the Glasgow Colleges Regional Board)
    - New College Lanarkshire (known as the Lanarkshire Board)
    - University of the Highlands and Islands.

Financial Memoranda

2. The institution must put in place a financial memorandum with each of its assigned colleges, which sets out the formal relationship between the Regional Strategic Body and the assigned college, and which contains the terms and conditions for the use of grant to the assigned college. The financial memoranda should be agreed in advance with SFC's Accountable Officer.

Scottish Public Finance Manual

3. The institution must ensure that its assigned incorporated colleges follow the requirements of the SPFM except where any special actions or derogations have been agreed with the Scottish Ministers.

Part 3 (B): Additional requirements for Regional Colleges and Regional Boards

4. The following additional requirements apply to Regional Colleges and Regional Boards:

    - Ayrshire College
    - Borders College
    - Dumfries and Galloway College
    - Dundee and Angus College
    - Edinburgh College
    - Fife College
    - Forth Valley College of Further and Higher Education
    - North East Scotland College
    - West College Scotland
    - West Lothian College
    - New College Lanarkshire.
    - Regional Board for Glasgow Colleges

Scottish Public Finance Manual

5. The institution must follow the requirements of the Scottish Public Finance Manual, except where any special actions or derogations have been agreed with the Scottish Ministers.

6. The derogations and actions in the following paragraphs have been agreed with the Scottish Ministers and must be read in conjunction with the SPFM. Where reference is made to the SPFM, please refer to the relevant section for the detailed requirements.

7. In cases where the SPFM requires bodies to notify or request prior approval from the Scottish Government, the institution must, in the first instance, contact SFC.

Borrowing

8. All borrowing by incorporated colleges will require the approval of the Scottish Ministers. Requests to borrow must be submitted to the SFC in the first instance.

9. Under the terms of Schedule 2B to the Further and Higher Education (Scotland) Act 2005, inserted by the Post-16 Education (Scotland) Act 2013, Regional Boards may not borrow money.

Cash management and banking

10. Grant payment will not be made in advance of need, as determined by the level of unrestricted cash reserves and planned expenditure. Unrestricted cash reserves held during the course of the year should be kept to the minimum level consistent with the efficient operation of the institution and the level of funds required to meet any relevant liabilities at the year-end. Grant-in-aid not drawn down by the end of the financial year shall lapse. Grant-in-aid shall not be paid into any restricted reserve held by the institution. Transfers to arms-length-foundations are permitted.

11. Banking arrangements should ensure they offer best value and comply with the Banking section of the SPFM. The Scottish Ministers have approved a derogation which delays the move to the Government Banking Service (GBS) to 2016-17 at the earliest.

12. The institution may extend existing banking arrangements provided they are not extended beyond Financial Year 2016-17. Any extension beyond Financial Year 2016-17 requires the agreement of the Scottish Ministers.

13. The institution can operate bank overdraft facilities to assist it in managing the timing of income and expenditure through its bank account. Overdrafts should not be used as a means of increasing borrowing.

Contingent commitments

14. The institution must seek SFC's prior written consent if it intends to lend or give a guarantee, indemnity or letter of comfort. The value of the guarantee should be equal to the total contingent liability over the term of the guarantee. In all cases, the institution must take steps to restrict the contingent liability to a minimum and should undertake a careful appraisal of the risks before accepting any contingent liability.

15. The institution should also provide assurance that, in the event of the contingent liability arising, it can be met from within the institution's own resource, or that appropriate insurance cover has been arranged.

16. However, SFC's written consent is not required for such arrangements if the indemnity is of a standard type contained in contracts and agreements for 'day-to-day' procurement of goods and services in the normal course of business.

Delegated financial limits and annual reporting requirements

17. The institution's specific delegated financial limits are set out in **Appendix A**. The institution must obtain SFC's prior written approval before entering into any undertaking to incur any expenditure that falls outwith these delegations.

18. Prior SFC approval must always be obtained before incurring expenditure for any purpose that is, or might be considered, novel, contentious or repercussive or which has or could have significant future cost implications.

19. What might be regarded as novel or contentious inevitably involves a degree of judgement. Novel would include proposed expenditure or financial arrangements of a sort not undertaken previously or which is not standard practice. Contentious would include proposed expenditure or financial arrangements where there was any doubt as to its regularity – for example, its compliance with relevant legislation or guidance – or its propriety – for example, compliance with the standards expected of publicly funded bodies or their officials. Proposed expenditure or financial arrangements that might be considered to be sensitive politically would also be regarded as contentious.

20. In addition, any frauds that are detected must be reported to SFC as and when they occur.

21. The institution must establish appropriate documented internal delegated authority arrangements consistent with the Delegated Authority section of the SPFM and this FM.

22. **Appendix A** also sets out the levels for certain categories of expenditure above which the institution should report annually to SFC. The report should describe the number of instances and total cost, by category of expenditure.

Donation of surplus funds to arms-length foundations

23. The institution may donate any surplus on its income and expenditure account as at 31 March each year to its arms-length foundation. The donation must take place in the financial year in which it arises, and is subject to sufficient cash and resource cover being available.

Duties to provide information on certain expenditure as required by The Public Services Reform (Scotland) Act 2010

24. As soon as is reasonably practicable after the end of each financial year, the institution must publish a statement of any expenditure that it has incurred during that financial year on or in connection with the matters described below.

    - Public relations,
    - Overseas travel,
    - Hospitality and entertainment,
    - External consultancy.

25. As soon as is reasonably practicable after the end of each financial year, the institution must publish a statement specifying the amount, date, payee and subject-matter of any payment, relating to any of the matters listed above, made during that financial year which has a value in excess of £25,000.

Early departures of staff

26. The institution must follow the requirements of the SPFM in determining settlement agreements, severance, early retirement and redundancy arrangements and payments. In addition, the institution must have regard to the principles of good practice in managing early departures of staff contained in Audit Scotland's May 2013 report: *Managing early departures from the Scottish public sector.*

27. In line with the requirements of the SPFM, the institution's severance scheme must be approved by SFC. Provided a severance payment is within the parameters of a scheme, which has been approved by the SFC, there will be no need for the institution to seek approval to the individual payment from SFC.

28. However, special severance payments in excess of £1,000 must be approved by SFC, except where provision for such payments has been included in a severance scheme approved by SFC. (See Appendix A)

External business and management consultancy contracts

29. Any external consultancy contracts with a value of more than £100,000 must be approved in advance by the SFC.

Impairments, provisions and write-offs

30. Assets must be recorded in the Balance Sheet at Depreciated Replacement Cost for Land and Buildings and at Historic Cost less depreciation for Equipment in accordance with the Financial Reporting Manual (FReM). Where an asset, including investments, suffers impairment, it is important that the prospective impairment and background is communicated to the SFC at the earliest possible point in the financial year to determine the budget implications. Any significant movement in existing provisions or the creation of new provisions must be discussed with the SFC.

31. Write-off of bad debt and/or losses score against resource Departmental Expenditure Limits (DEL).

Income generation

32. The institution will be able to retain all commercial income, gifts, bequests or donations received. These funds will be in addition to any grant or funding the institution receives from the SFC.

Insurance

33. The Scottish Ministers have agreed a derogation whereby institutions can extend their current commercial insurance arrangements for three years to 31 July 2018.

Investments

34. The institution must not make any investments of a speculative nature without the prior written approval of SFC.

Procurement and payment

35. The institution's procurement processes must reflect the relevant guidance contained in the Advanced Procurement for Universities and Colleges, and relevant policy and advice issued by the Scottish Procurement Directorate. Procurement must be undertaken by appropriately trained and authorised staff and treated as a key component of achieving the institution's objectives consistent with the principles of Best Value, the highest professional standards and any legal requirement.

36. Any proposal to award a contract without competition (non-competitive action) must be approved in advance by SFC. Specific delegated authority is given to award a contract without competition for £25,000 or less without advance approval. (See Appendix A)

Appendix A

Delegated financial limits and annual reporting requirements for Regional Colleges and Regional Boards

Delegated financial limits

External Business and management consultancies	£100,000
Special severance payments	£1,000
Operating leases-non property	£250,000
Procurement non-competitive action	£25,000

Annual reporting requirements

Extra contractual payments	£5,000
Compensation payments	£5,000
Ex-gratia payments	£1,000
Claims waived or abandoned	£3,000
Write-off of bad debt	£3,000
Losses	£3,000
Overseas student irrecoverable loss	£6,000
Fraud loss	£5,000

Part 4: Additional requirements for non-assigned, non-incorporated colleges

1. The following additional requirements apply to non-assigned, non-incorporated colleges:

   - Newbattle Abbey College
   - Sabhal Mòr Ostaig.

Insurance

2. The institution is responsible for taking out and paying for adequate insurance in respect of its assets and activities.

Granting of security

3. As a result of a condition in SFC's Framework Document with the Scottish Government, the institution must seek SFC's prior written consent if it intends to offer as security for a loan any land or property which has been provided, improved, or maintained with the aid of grant.

Capital finance

4. As a condition of SFC's Framework Document with the Scottish Government, SFC is required to "make provision for the monitoring and control of borrowing by institutions to protect the public investment in institutions and to maintain accountability for the use of exchequer funds". In order that SFC can discharge this requirement, it has in place a threshold for capital finance above which the institution requires SFC's consent to undertake any new borrowing.

5. The governing body of the institution, in line with the Code of Good Governance for Scotland's Colleges, must, as a matter of course, satisfy itself that all of the following requirements on capital finance are met:

   - The institution can demonstrate its ability to repay the finance, and to pay interest thereon, without recourse to requesting additional grant from SFC
   - The institution can demonstrate that its ability to maintain financial and academic viability will not be impaired as a result
   - The institution can demonstrate the value to be generated by the transaction, whether it involves refinancing, or purchase of any new investment or assets, the acquisition of which is to be financed by the borrowing
   - The institution can demonstrate that any such new investment or asset acquisition is in accordance with the institution's strategic plan and, where appropriate, its estate strategy

6. For the purposes of this document, 'capital finance' includes borrowing, finance and operating leases, and other schemes, such as private finance initiative projects, non-profit distribution projects, loan support projects and revolving credit facilities where borrowing is the substance of the transaction, in line with relevant accounting standards.

When the Council's formal consent is required in respect of capital finance arrangements

7. The institution must obtain prior written consent from SFC before it undertakes a level of capital finance where the annualised costs of all capital finance (being the sum of the servicing and capital repayment costs of each loan or other arrangements spread evenly over the period of the relevant loan or arrangement) would exceed 4% of

   - Total income as reported in the latest audited financial statements; or
   - The estimated amount of total income for the current year, if that is lower.

8. In assessing total capital finance commitments, the institution must ignore low-value financial commitments, provided that the combined annualised servicing costs of such financial commitments do not exceed 0.5% of total income.

9. A revolving credit facility should be considered in the same way as an overdraft facility; for example, in terms of the institution's maximum exposure over the term of the facility. An even annual cost of capital finance is assumed, unless the institution can demonstrate otherwise. The institution is required to provide the annualised cost of the capital finance calculation with any request to SFC for borrowing consent.

10. The institution must also seek consent from SFC before raising capital finance on the security of assets in which the Scottish Ministers have an interest. For the purposes of this document, such an interest exists where the institution has used funds provided by the Scottish Ministers to acquire an interest in or to develop any land, building or other asset, and where those funds were provided subject to a condition which has the effect of requiring the institution to obtain Scottish Ministers' consent before raising capital finance on the security of those assets.

11. The Scottish Ministers have directed that SFC will exercise their functions in relation to any such interests.

12. In seeking SFC's approval, the institution must demonstrate to SFC, in writing, its compliance with the requirements set out above.

Contingent commitments

13. The institution must seek SFC's prior written consent if it intends to lend or give a guarantee, indemnity or letter of comfort. The value of the guarantee should be equal to the total contingent liability over the term of the guarantee. In all cases, the institution must take steps to restrict the contingent liability to a minimum and should undertake a careful appraisal of the risks before accepting any contingent liability.

14. The institution should also provide assurance that, in the event of the contingent liability arising, it can be met from within the institution's own resource, or that appropriate insurance cover has been arranged.

15. However, SFC's written consent is not required for such arrangements if:

    - An actual or effective value is less than 4% of total income as reported in the latest audited financial statements or of the estimated amount of total income for the current year if that is lower; or
    - the indemnity is of a standard type contained in contracts and agreements for 'day-to-day' procurement of goods and services in the normal course of business.

Severance payments

16. The institution must adhere to the following principles when taking decisions about severance payments, including settlement agreements:

    - The actions of those taking decisions about severance payments, and those potentially in receipt of such payments, must be governed by the standards of personal conduct set out by the Committee on Standards in Public Life (the Nolan Principles)
    - The governing body must take account of SFC's expectation of the institution in this FM regarding the use of public funds.

17. Based on the principles above, the following requirements must be met:

    - Institutions must have in place a clear policy on severance payments
    - Severance packages must be consistent with the institution's policy and take into account contractual entitlements, for example, salary and period of notice, and any applicable statutory employment entitlements. This means that, when entering into employment contracts, care must be taken not to expose the institution to excessive potential liabilities
    - The institution's policy must include a formal statement of the types of severance arrangements that should be approved by the Remuneration Committee or equivalent and approved formally by the governing body. These must include any severance package that is proposed for a member

of the senior management team, in recognition of the particular level of accountability that is attached to senior management positions, and also any severance package that would exceed a maximum threshold agreed by the governing body

- Where a severance package exceeds the maximum threshold agreed by the governing body, the institution must consult with SFC's Accountable Officer prior to approving the proposed severance package
- The remuneration committee or equivalent, when overseeing and approving severance arrangements for staff, must ensure that all decisions are recorded
- Negotiations about severance packages and payments must be informed, on both sides, by legal advice where appropriate
- When a severance arises following poor performance on the part of an individual, any payment must be proportionate and there should be no perception that poor performance is being rewarded
- Final year salaries must not be inflated simply to boost pension benefits
- Notice of termination of appointments must not be delayed in order to generate entitlement to payments in lieu of notice

18. The institution must ensure its internal auditor includes a regular review of systems for the determination and payment of severance settlements in their strategic audit plan.

19. The institution must seek the view of its external auditor if it plans to make what it considers to be any novel or potentially contentious severance payments, including those that exceed the maximum threshold agreed by the governing body.

20. The institution's external auditor must review severance settlements. Such a review will normally take place after settlements have been agreed (normally as part of their financial statements audit) and should be carried out by senior audit staff because of the complexity and sensitivity of the issues. If final settlements do not materially conform to the terms of this FM, auditors must report the facts to the institution in their management letter, and inform members of the governing body. The auditors must also recommend that the institution informs the SFC immediately.

21. Where there are settlement agreements, and it is felt that a confidentiality clause is necessary, this must not prevent the public interest being served and must be consistent with the institution's whistleblowing policy.

Guidance on seeking approval for severance schemes and settlement agreements

Issue date: 23 February 2016

Reference: SFC/GD/01/2016

Summary: Guidance to colleges and regional strategic bodies on meeting the requirements in the Scottish Public Finance Manual in relation to severance schemes and settlement agreements.

FAO: Principals and directors of Scotland's colleges and regional strategic bodies

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Index

Guidance on seeking approval for severance schemes and settlement agreements

Introduction

1. The purpose of this document is to provide further guidance to colleges and regional strategic bodies on meeting the requirements in the Scottish Public Finance Manual (SPFM) in relation to severance schemes and settlement agreements. These requirements are a term and condition of funding from the Scottish Funding Council (SFC) with which colleges must comply. Incorporated colleges must now obtain prior approval from SFC for all new severance schemes, changes to existing schemes and all settlement agreements. Incorporated colleges have been required to comply with SPFM requirements since 1 April 2014 and this guidance provides additional detail around the process and approvals which are currently in place. The scope of this guidance covers all severance schemes and severance payments made under the categories of early severance or retirement, redundancy or settlement agreements.

Applicability of guidance

2. This guidance applies to all incorporated colleges funded directly by SFC, and the Regional Board for Glasgow colleges[1]who must follow it as a term and condition of SFC's grant to them. This is in accordance with Part 3(B) of the Financial Memorandum with Fundable Bodies in the College Sector ("the Financial Memorandum")[2], which provides that incorporated colleges and the Regional Board for Glasgow colleges must comply with the requirements of the SPFM, including the provisions relating to settlement agreements, severance, early retirements and redundancy.

3. Regional strategic bodies (RSBs) must require incorporated colleges assigned to them to follow this guidance and this should form a term and condition of their funding of assigned colleges. This is in accordance with Part 3(A) of the Financial Memorandum which requires RSBs to ensure that their assigned incorporated colleges follow the requirements of the SPFM.

4. As a term and condition of grant, non-incorporated, non-assigned colleges are required to comply with Section 4 of the Financial Memorandum with SFC while non-incorporated assigned colleges will be required to comply with the Financial Memorandum with UHI. Non-incorporated colleges are not required

[1] The Board is known informally as the Glasgow Colleges' Regional Board.

[2] http://www.sfc.ac.uk/web/FILES/Guidance_Governance/Financial_Memorandum_with_the_College_Sector_-_1_December_2014.pdf

to comply with the SPFM. However, in negotiating severance payments with staff, non-incorporated colleges are expected to comply with the principles highlighted in this guidance.

5. This guidance replaces that issued by SFC in 2000 (FE/03/00) and 2004 (FE/13/04) for incorporated colleges and Regional Boards.

6. Within the following guidance, references to colleges mean incorporated colleges and the Glasgow Colleges Regional Board as organisations in their own right.

Requirements under the SPFM

7. Updated guidance from the Scottish Government on settlement agreements came into force on 1 April 2014.

8. The SPFM requires colleges and regional boards to seek prior approval from SFC for:

- Any new severance scheme;
- Any change to a previously approved scheme;
- Any payment, forming part of any scheme, considered to be sensitive or high profile;
- Any use of settlement agreements; and
- Any payment to an individual in excess of contractual entitlement outwith an approved voluntary severance scheme.

9. In the case of payments by assigned colleges, the regional strategic body will be responsible for obtaining approval from SFC. A flowchart is attached at **Annex A** showing the process to be followed depending on the type of college.

10. Colleges and regional strategic bodies must familiarise themselves with the requirements set out in the SPFM: (http://www.gov.scot/Topics/Government/Finance/spfm/severanceetcterms)

11. It will be particularly important for those committees dealing with severance schemes and arrangements, for example the Remuneration Committee, and the Board to understand the implications of the SPFM. Colleges should ensure that all Board members and appropriate college personnel are provided with a copy of this guidance.

Governance

12. In considering any severance, colleges must ensure that issues of regularity, propriety and value for money are fully taken into account. In doing so it is

important that policies and procedures are established and applied in a timely manner, including:

- Ensuring a business case, including justification and **full** expected cost, is prepared;
- Decisions are made and approved in accordance with college delegation procedures;
- Decisions are fully documented and a clear audit trail of evidence supporting the decision is retained; and
- There is clear evidence of governance oversight.

13. The Remuneration Committee, or equivalent Board committee, must undertake robust scrutiny of proposed severance schemes and settlement agreements before recommending approval to the Board. In order to preserve governance boundaries the Chair of the Remuneration Committee must not be the Chair of the Board.

14. The Remuneration Committee, or equivalent Board committee, must ensure there is no conflict of interest between those involved in approving severance arrangements and individual beneficiaries of such arrangements.

15. The Remuneration Committee, or equivalent Board committee, also has a role in setting remuneration policy and in ensuring contractual terms for staff are not overly generous (e.g. long notice periods) which may result in large payments when the employee leaves.

16. Audit Scotland's recent report 'Scotland's colleges 2015'[3] highlights weaknesses in the way some colleges managed and approved senior staff severance arrangements. Auditors at six colleges identified that the handling of severance arrangements fell short of good practice. In two of these cases (North Glasgow College and Coatbridge College) the Auditor General produced a separate statutory report (Section 22) setting out shortcomings in governance and reporting. Colleges should familiarise themselves with the contents of the above reports[4] and the Public Audit Committee reports that were based upon them.

17. SFC should be consulted in all cases where the possibility of compulsory redundancy is being considered. SFC should be notified at the earliest opportunity of such cases.

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[3] http://www.audit-scotland.gov.uk/docs/central/2015/nr_150402_scotlands_colleges.pdf
[4] http://www.audit-scotland.gov.uk/docs/central/2015/s22_150626_coatbridge_college.pdf
http://www.audit-scotland.gov.uk/docs/central/2014/s22_140507_north_glasgow_college.pdf

18. In situations of sensitive or high profile payments, Ministerial views on the terms of the proposed severance will be sought, as and when required, by SFC.

Key principles

19. When considering any severance, colleges must ensure that the following principles are observed:

- Public funds must not be used wastefully or to underwrite inequitable or over-generous conditions of service, including severance;
- Decisions on severance arrangements and, in particular, limits on payments will be based on the conditions set in the SPFM and this guidance and **not** on the source(s) of funding;
- Notice of termination of appointments must not be delayed in order to generate compensation payments in lieu of notice;
- Where appropriate, ex-gratia severance or redundancy packages must be based on the arrangements set out within relevant extant terms and conditions of employment. In particular, prior consideration should be given to the availability of pension and compensation benefits within these conditions;
- Special payments must be transparent and negotiated in a way which avoids conflicts of interest;
- Offers of subsequent employment or consultancy work must be exceptional and only made where they represent value for money; and
- Any undertakings about confidentiality must leave transactions open to proper public scrutiny.

Procedures for approval by SFC

20. The procedures for approval depend on whether the application is:

- A voluntary severance scheme
- Settlement agreement or proposal to secure a voluntary resignation

21. More detail of the procedures and assessment by SFC is given in the following paragraphs.

Voluntary severance schemes

22. Voluntary severance schemes have standard terms and conditions applying to all those staff who successfully apply to leave under the scheme. Statutory or contractual terms normally provide the bases for such schemes. Voluntary severance schemes are used to manage headcount reductions either across the organisation or in particular areas, and run for a specified length of time. Applications are assessed against set criteria which include the business case

for releasing a member of staff early and the value for money which can be obtained as a result. The numbers of staff leaving through voluntary severance schemes and the associated costs will be reported in colleges' annual accounts.

23. Colleges should complete the template at **Annex B** setting out details of any proposed voluntary severance scheme or changes to an existing scheme.

24. In setting out the justification or business case for the new or changed scheme, colleges should outline:

- The rationale for introducing/changing the scheme;
- Mitigating action already taken or planned to avoid the need for headcount reductions e.g. recruitment freeze, redeployment, reductions in working hours;
- The terms available under the relevant compensation/pension scheme and the rationale for offering terms other than the contractual minimum;
- The estimated annual costs and savings of the new/revised scheme over the payback period;
- Details of how, by whom and over what timescale the costs of the scheme will be funded;
- The impact that the restructuring/headcount reduction will have on the paybill;
- Any potentially sensitive or high profile cases forming part of the scheme; and
- Confirmation that relevant management and governance procedures have been followed.

25. Severance schemes must be time limited and linked to a programme of managing early departures. Colleges currently operating a voluntary severance scheme must ensure it has an appropriate end date and compare the terms of the scheme against this guidance. SFC will maintain a register of existing schemes. If colleges have any questions about this guidance in relation to a current voluntary severance scheme they should contact SFC.

26. Colleges considering the setup of a voluntary severance scheme must seek appropriate legal and independent professional advice in establishing and implementing the scheme. Such expert advice must be provided for scrutiny by the Remuneration Committee and/or the Board prior to approval of the scheme and arrangements

27. Assigned incorporated colleges must submit the business case to their regional strategic bodies which are required to consider and approve the business case prior to submission to SFC for approval. Minutes of Board meetings approving the scheme should be sent to SFC with the business case.

How SFC will appraise an application for setting up a voluntary severance scheme

28. The SFC's assessment of any proposed severance will look for confirmation that:

    - The principles listed in paragraph 19 have been observed;
    - The business case, including value for money, is clearly set out, includes all related costs (e.g. legal fee for employee to take advice; any associated pension costs) and costs are affordable;
    - The terms of severance packages are appropriate (including checking comparability with the arrangements across the college sector and wider public bodies in Scotland); and
    - Relevant management and governance procedures have been followed.

Settlement agreements or proposal to secure a voluntary resignation

29. As noted above, colleges require SFC's prior approval in **all** cases where a settlement agreement or non-contractual financial consideration is proposed to secure a voluntary resignation, outwith the terms of an existing and approved scheme.

30. In cases where settlement agreements are part of a voluntary severance scheme, individual approval is required for each agreement and colleges should request approval by completing the template at **Annex C**.

31. Settlement agreements are legally binding contracts entered into by an employer and employee to resolve an employment dispute. Settlement agreements are recognised in law and an accepted part of employment practice. These agreements normally relate to the termination of employment, but they can also be used to settle disputes during employment.

32. The terms of a settlement agreement reflect the circumstances under which the person is leaving and may include a sum for loss of office as well as any contractual payments due to the individual. They are designed to allow individuals to leave the organisation on mutually negotiated terms and avoid potentially protracted and more costly employment disputes.

33. Settlement agreements should not be a standard feature of voluntary severance schemes. There should always be a presumption against the use of settlement agreements and colleges will have to justify their use (see **Annex C**).

34. The Scottish Government submitted a report to the Scottish Parliament's Public Audit Committee in June 2014 [5]on the first year of operation of the new guidance. **Annex E** summarises the key messages from the Scottish Government's report in terms of when settlement agreements can be used and why scrutiny is important.

Confidentiality clauses

35. Settlement agreements may include a voluntary provision whereby the parties agree to keep the agreement itself confidential and not disclose its details to third parties.

36. In seeking approval for the use of a settlement agreement, colleges must indicate whether a confidentiality clause is proposed and, if so, on what grounds. There should be a presumption against the use of confidentiality clauses except in exceptional circumstances. However, either party (i.e. employee or employer) can request a confidentiality clause be inserted. In such a situation the terms of the clause must be agreed by both parties.

37. Nothing in any confidentiality clause should restrict an individual's right to make a protected disclosure under the Public Interest Disclosures Act 1998. Where a confidentiality clause is included in a settlement agreement, the text should be included in the business case submission to SFC.

Disclosure of information

38. Settlement agreements often include a clause in relation to disclosing of information. Any such clause should explicitly note that SFC, Regional Strategic Bodies (where relevant) and the Scottish Government will have sight of the information. SFC will collate the information for submission to the Scottish Government for the purpose of parliamentary scrutiny. The Scottish Government's settlement agreement guidance[6] sets out the following draft clause (which has been adapted to reflect regionalisation) which colleges might choose to adopt:

"The Scottish Government , SFC and Regional Strategic Board (where relevant) will be entitled to use the fact that an Agreement has been entered into to enable

[5]

http://www.scottish.parliament.uk/S4_PublicPetitionsCommittee/General%20Documents/20150603_PE1495_FF_Scottish_Government.pdf

[6] http://www.gov.scot/Resource/0045/00454087.pdf

them to collate and provide information on the number of settlement agreements entered into with the Scottish Government and across the wider public sector and also to provide collated information on the costs involved. The Scottish Government, SFC and Regional Strategic Board (where relevant) will not however disclose the terms or circumstances of the Agreement or the name of the Employee without the written consent of the Employee or as required by the Scottish Parliament solely for the purposes of Parliamentary scrutiny relating to the use of public money or as required by law."

Use of standard termination letter

39. Some colleges have advised SFC that a settlement agreement is necessary in order to set out the terms of the termination of employment. This is not the case. It is necessary to set out the terms of termination of employment, but this can be done through a standard termination letter or agreement. An example of such a letter is included at **Annex D** which colleges may wish to adopt.

Overview of SFC's assessment of proposals

40. The request to SFC or RSB as appropriate for approval of a settlement agreement or proposal to secure a voluntary resignation through the offer of a non-contractual financial consideration (outwith an approved scheme) must be in the form of a business case which should include, as a minimum:

- Justification of the need for a settlement agreement;
- An explanation of the circumstances of the case, including the legal assessment of the risk of litigation and likely outcome;
- Confirmation that relevant management and governance procedures have been followed;
- An assessment of the value for money offered by the proposal, including a breakdown of each of the constituent parts of the proposal and any associated contractual elements that may be relevant;
- Any non-financial considerations; and
- Confirmation as to whether the use of a confidentiality clause is proposed in the case.

41. Colleges should use the template provided at **Annex C** to submit business cases, the Employment Information Schedule (**Annex C1**) should also be completed.

Compulsory redundancies

42. Colleges should be aware that the policy of no compulsory redundancies is a key pillar of public sector pay policy which colleges should have regard to (this is a term and condition of grant applied through the SFC 'Financial

Memorandum with Fundable Bodies in the College Sector'[7], or its financial memorandum with a regional strategic body).

43. Any college considering compulsory redundancies should consult with SFC or RSB as appropriate as early as possible.

Procedure for submitting business cases

44. Business cases must be completed using the templates at **Annex B** or **Annex C,** signed by the College Principal and, where applicable, by the Chief Executive of the regional strategic body and submitted to the Director of Finance at SFC. Receipt of business cases will be acknowledged and processed within five working days (20 where Ministerial views are sought). Colleges should give SFC advance notice of any pending business cases and submit these as early as possible in case further information is required.

Failure to adhere to the severance requirements

45. Failure to adhere to the SPFM requirements constitutes non-compliance with the Financial Memorandum with SFC. Should the college breach the Financial Memorandum, SFC will consider various options, including clawback of grant or reductions in future funding. These options will be reviewed in light of any relevant recommendations arising from the College Good Governance Task Group.

Good practice and learning from poor practice

46. In addition to complying with the terms of this guidance colleges should look to wider sources of good practice, including reports from the Scottish Parliamentary Audit Committee and Audit Scotland. A list of good practice guidance is set out in **Annex F**. In particular, colleges must have regard to the principles of good practice set out in the Audit Scotland report 'Managing early departures from the Scottish public sector' May 2013[8].

Lorna MacDonald
Director of Finance

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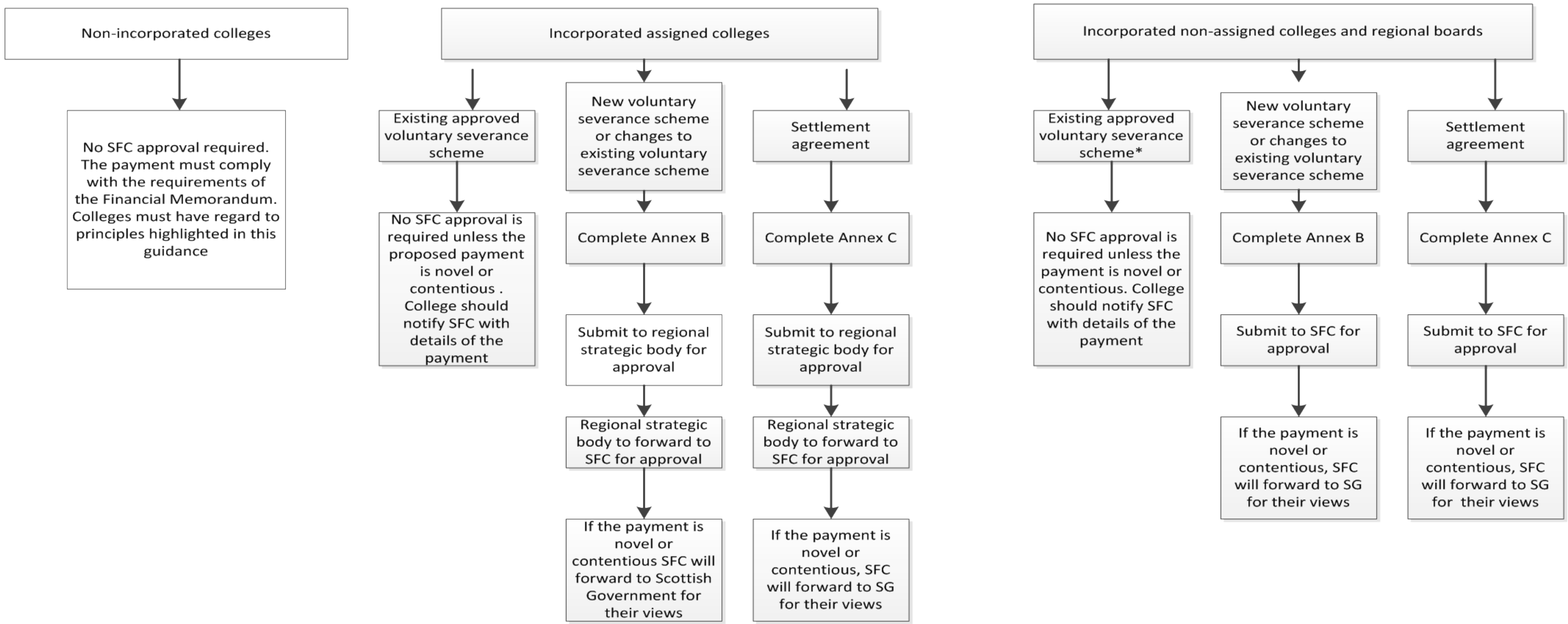
[7] http://www.sfc.ac.uk/web/FILES/Guidance_Governance/Financial_Memorandum_with_the_College_Sector_-_1_December_2014.pdf

[8] http://www.audit-scotland.gov.uk/docs/central/2013/nr_130523_early_departures.pdf

Annex A

Process for obtaining approval for severance schemes and settlement agreements



* All existing voluntary severance schemes must have a specified end date

Annex B

Business case for approval for new severance scheme or changes to a previously approved scheme

Name of college/regional board

New scheme or change to existing scheme?

End date of scheme

Rationale for introducing the scheme or changing old scheme

Outline of and confirmation that relevant management and governance procedures have been followed. A copy of the Board or Board committee minute approving the proposed scheme or change to scheme should be provided.

What mitigating actions have been taken or are planned to avoid the need for headcount reductions?

Outline the key terms proposed under the new/changed scheme and the rationale for offering over the contractual minimum.

What are the estimated annual costs and savings of the new/changed scheme over the payback period?

How will the full costs of the new/changed scheme be funded?

What impact will the headcount reduction have on the recurrent paybill?

Are there any potentially sensitive or high profile cases forming part of the scheme?

College Principal Signature /Regional Board chief officer

Date

Regional Board Chief Executive Officer (for assigned college applications only)

Date

Note: this form should be completed where a college intends to establish a new scheme or make changes to a previously approved scheme. The form should be sent to the Director of Finance, Scottish Funding Council

Colleges should also refer to the "Settlement agreements, severance, early retirements and redundancy terms" section of the Scottish Public Finance manual at the following link:

http://www.gov.scot/Topics/Government/Finance/spfm/severanceetcterms

Business case for approval of settlement agreement or proposal to secure a voluntary resignation through the offer of a non-contractual financial consideration

Name of college/regional board	
Confirm whether this is a proposed settlement agreement or a proposal to offer a non-contractual financial consideration to secure the voluntary resignation of an employee	

Justify the need for a settlement agreement where relevant

Background and circumstances of the case

Risks arising

Outline of and confirmation that the relevant management and governance procedures have been followed. A copy of the Board or Board committee minute approving the proposed settlement agreement or financial payment should be provided.

An assessment of the value for money offered by the proposal by reference to the completed (attached) Employment Information Schedule

Any non-financial considerations, e.g. where it is desirable to end a person's employment but dismissal is not warranted

Confirmation that the principles set out at paragraph 19 of "Guidance on seeking approval for severance schemes and settlement agreements" have been applied.

College Principal /Regional Board Chief Officer Signature	
Date	
Regional board Chief Executive officer Signature (for assigned college applications only)	
Date	

Note: this form should be completed where a college intends to make a settlement agreement or pay an employee an amount in excess of contractual terms. The form should be sent to the Director of Finance at the Scottish Funding Council.

Colleges should also refer to the "Settlement agreements, severance, early retirements and redundancy terms" section of the Scottish Public Finance manual at the following link: http://www.gov.scot/Topics/Government/Finance/spfm/severanceetcterms

Annex C1

Employment information schedule for business case

College name:			
Section 1 - Employee detail			
1.1 Employee name			
1.2 Job title			
1.3 Length of continuous service (years/months)			
1.4 Full Time Equivalent			
1.5 Age			
1.6 Current pay grade			
1.7 Contractual notice period			
1.8 Does contract provide for Payment in lieu of notice?			
1.9 Name of pension scheme			
Section 2 - Employment benefits and costs arising through normal course of employment			
Remuneration received by employee before deductions (last 12 months)			
2.1 Current annual salary rate			**£**
2.2 Any other remuneration received over last 12 months (specify)			**£**
Total remuneration received by employee before deductions			**£**
Other benefits received			
2.3 Benefit 1 (specify)			**£**
2.4 Benefit 2 (specify)			**£**
Total other benefits			**£**

Total remuneration and benefits received by employee before deductions					**£**
Employer on-costs of remuneration and benefits received					
2.5 Employer's Pension Scheme Contributions					**£**
2.6 Earnings Related National Insurance Contributions (ERNIC)					**£**
2.7 Other (including VAT)					**£**
Total employer on-costs of remuneration and benefits received					**£**
Total cost to employer of benefits received by employee					**£**
Section 3 – Contractual Termination costs					
3.1 Compensation In Lieu of Notice (CILON)					**£**
3.2 Payment in lieu of annual leave untaken					**£**
3.3 Other (e.g. Time Off In Lieu untaken)					**£**
Total					**£**
3.4 Employer cost of making up any pension shortfall					**£**
3.5 Other on-costs (specify, if any)					**£**
Total termination costs					**£**
Section 4 - Estimate costs of defending a case					
4.1 Can you confirm whether legal advice has been taken on whether the case should be defended? Please summarise advice given:					
Section 5 - Non-contractual and ancillary costs					
5.1 Gross value of any non-contractual sum to be offered					**£**
5.2 Net value of any non-contractual sum to be offered after any tax deducted					**£**
5.3 Other on-costs (N.I., pension)					
5.4 Maximum value of employee support for legal assistance					**£**

5.5 Other (specify)			**£**
e.g. cost of outplacement support for employee not available through normal course of employment. (Include any VAT)			
5.6 What are the estimated costs of negotiating and concluding an agreement? (Please provide a breakdown of costs – this should not include organisational staff time)			**£**
Total proposed terms of non – contractual element of agreement			**£**
Section 6 - Total costs			
6.1 Contractual termination costs – per Section 3			
6.2 Non-contractual termination cost – per Section 5			
Total			
Section 7– Settlement Agreement			
7.1 Does the settlement agreement include a confidentiality clause? If so, why? **7.2 Please include the text of the confidentiality clause**			
NB. Where the costs in section 5 are estimated, SFC should be provided with updated actual costs when these are known.			

Annex D

Example of standard termination letter

[Draft letter to the volunteer confirming their severance and giving notice]

[To be typed on headed paper and sent out in duplicate with sections in square brackets completed as appropriate and drafting notes removed]

Dear [◆]

NOTIFICATION OF THE OUTCOME OF THE COLLEGE'S INDIVIDUAL CONSULTATION WITH YOU ABOUT YOUR POTENTIAL VOLUNTARY SEVERANCE

I am writing to notify you of the outcome of the individual consultation process that has been undertaken with you recently. I have considered all of the issues that we have discussed when we met and the documents that have been provided to you during this process. I have also considered your request to volunteer for severance.

Voluntary severance

On the basis of all of the above, I have decided to confirm your severance, and to give you notice of termination of your employment. Your employment will continue until [***insert date***]. That will be your last day of employment with the College.

Although you have volunteered for severance, the College will nevertheless continue to look for suitable alternative employment for you within the College until your employment terminates.

Time off to look for new employment

We will allow you reasonable paid time off to look for new employment elsewhere during your notice period. If you do require time off for this purpose, please arrange this with [***insert name and job title***].

[***As you know, we have appointed outplacement consultants, [◆], and you can use their services.***]

If you find another job and wish to leave early, we will consider this request, [***subject to the terms of the Severance Policy & Procedure- insert name of policy***]. However, in these circumstances whilst you will receive the severance payments outlined below, you will not receive any payment for the unworked part of your contractual notice period.

Continuing salary, holiday pay and severance payments

You will be paid in the normal way up to and including [***insert date***], or earlier if your employment ends prior to this date.

[***You will receive payment in lieu of accrued but untaken holiday up to the date your employment terminates***.] ***OR*** [***You have agreed to take all of your outstanding leave entitlement accrued to the date your employment terminated during your notice period, therefore, no payment will be due on termination in respect of accrued but untaken holiday entitlement***.]

On [***date***], you will receive your severance payments (as outlined in the attached schedule, which you have already had a copy of) directly into your bank account. These payments [***along with the payment in lieu of notice outline below***] will, of course, only be due if your employment terminates on [***date***] for voluntary severance. If your employment terminates for any other reason prior to [***date***] (such as misconduct), you will not be entitled to these payments.

Information about your rights under the [***name of pension scheme***] and any insurance benefits can be obtained from [***name***] on [***phone number or email address***].

Notice

As regards a payment in lieu of notice, the situation is as follows. Your notice entitlement is [◆] weeks. This means that you will be [***working all of your notice period, and will receive no payment in lieu of notice***] OR [***working for part of your notice period, and will receive a payment in lieu for the remainder of your notice period***]. Your payment in lieu of notice will be [◆] weeks' pay, which will be £[◆]. This payment will be made to you after deduction of tax. It will be paid directly into your bank account with your severance payments on or around [***date***].

P45, expenses and return of property

Your P45 will be sent to you shortly after your last day of employment with the College.

You must submit your final expenses claim by [***date***] and return any keys and College property (including car park pass, ID badge, documents, IT equipment and mobile telephone) to [***name***] by [***date***]. Please be advised that you will not be able to access any College computer networks or files after [***date - termination***] so all arrangements to transfer personal information should be done before then.

Right of appeal

You may, if you wish, appeal against the termination of your employment. If you wish to do so, please write to me within seven days from the date of this letter, stating the grounds for your appeal. I will then write to you explaining the appeal procedure.

Waiver of contractual claims

The payments referred to in this letter are in full and final settlement of all claims under contract law or common law which you have or may have in the future against the College or any of its associated bodies whether arising from your employment with the College or its termination on [***insert date***], including without limitation claims for breach of contract and wrongful dismissal.

Thank you for your co-operation during this severance process. Please sign, date and return the enclosed copy of this letter within [***seven***] days from the date of this letter to acknowledge receipt and confirm your agreement to the terms of this letter. Of course, if you have any questions about the contents of this letter you would like to discuss before doing so, please do not hesitate to contact me.

I would also like to take this opportunity on behalf of the College to thank you for your service over the years and give you my personal best wishes for the future.

Yours sincerely

[**Name, job title and contact details**]

SEVERANCE PAYMENTS FOR [INSERT NAME OF EMPLOYEE]

Statutory Redundancy Payment (payable to employees with at least two years' continuous employment).

Start date: [***Date***]

Termination date: [***Date***]

Period of continuous employment: [***Number***] years

Age at termination: [***Number***] years

Gross weekly salary: £[***amount***]

Statutory cap on weekly salary: £[***475 - limit will be updated on 5 April 2016 and each year thereafter so ensure current figure is used***]

[**Number**] years at one and a half times gross weekly salary: £[***amount***]

[**Number**] years at one times gross weekly salary: £[***amount***]

[**Number**] years at half gross weekly salary: £[***amount***]

Total: £[***amount***]

Voluntary Severance Payment

[**Set out total figure, the relevant formula, the calculations done to reach that figure and any statutory deductions for payments over £30,000. If no deductions are to be made as the payment is under £30,000 state that the payment will be made free of income tax and national insurance contributions. Refer to any relevant policy which contains the formula for calculating voluntary severance payments**.]

Annex E

Key messages from the Scottish Government Annual report on the use of settlement agreements April 2014 to March 2015[9]

Settlement agreements are used in circumstances where:

- The employment relationship has broken down or been significantly impaired;
- The situation cannot be remedied through mediation or other personnel processes; and
- Alternative routes to resolution would involve disproportionate cost at a tribunal or otherwise at law; and impair the functioning of the service.

Consideration on the use of settlement agreements will take into account:

- The direct and indirect costs of alternative proceedings and of any other awards that might be made;
- Disruption to the effective and efficient operation of the service caused by an on-going dispute and the resultant stress on individuals; and
- The likely timescales involved, against the need to bring matters to a timely conclusion.

Scrutiny of settlement agreements by the college and SFC's Accountable Officer is undertaken because:

- They may involve payments to individuals above and beyond their normal contractual entitlement;
- Parliament and the public will want to be assured that, in all circumstances of the case, their use was appropriate and reasonable; and
- There is a need to ensure their use does not cut across the important protection offered to whistleblowers.

[9] http://www.scottish.parliament.uk/S4_PublicPetitionsCommittee/General%20Documents/20150603_PE1495_FF_Scottish_Government.pdf

Annex F

Good practice guidance and further information

Scottish Public Finance Manual

Chapter on Settlement agreements, Severance, Early Retirement and Redundancy Terms:
http://www.gov.scot/Topics/Government/Finance/spfm/severanceetcterms

Scottish Government report to Scottish Parliamentary Audit Committee:
http://www.scottish.parliament.uk/S4_PublicPetitionsCommittee/General%20Documents/20150603_PE1495_FF_Scottish_Government.pdf

Scottish Parliamentary Audit Committee reports

http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/93106.aspx

http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/95448.aspx

Audit Scotland

Report on "Managing early departures from the Scottish public sector" May 2013:
http://www.audit-scotland.gov.uk/docs/central/2013/nr_130523_early_departures.pdf

Report on Scotland's colleges 2015:
http://www.audit-scotland.gov.uk/docs/central/2015/nr_150402_scotlands_colleges.pdf

Section 22 reports:

http://www.audit-scotland.gov.uk/docs/central/2014/s22_140507_north_glasgow_college.pdf

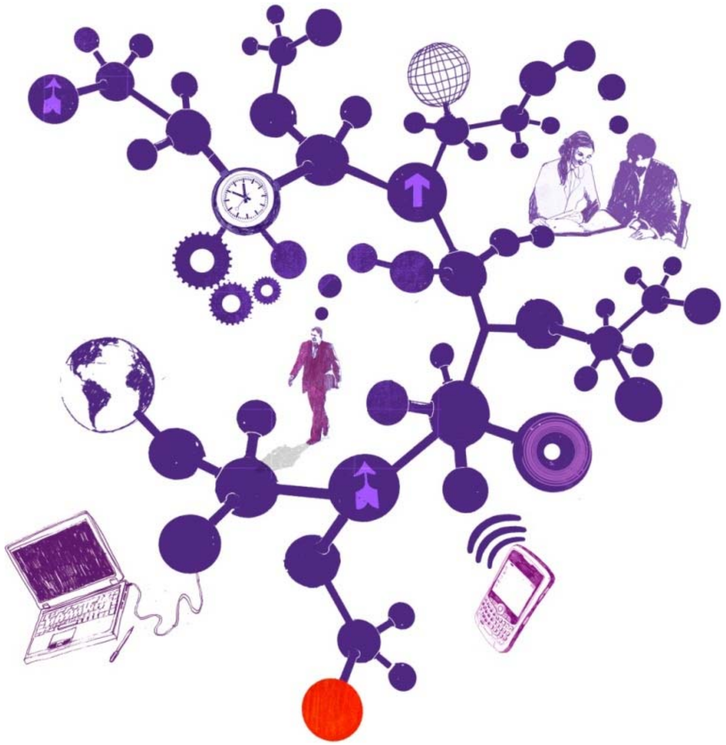
http://www.audit-scotland.gov.uk/docs/central/2015/s22_150626_coatridge_college.pdf

Agenda Item No 9
Audit 20.09.16

Informing the audit risk assessment for Dumfries and Galloway College

Year ended 31 July 2016

July 2016



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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect your business or any weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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Contents

Purpose

The purpose of this report is to contribute towards the effective two-way communication between auditors and the College's Audit and Risk Management Committee, as 'those charged with governance'. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of Management and the Audit and Risk Management Committee under auditing standards.

Background

Under International Standards on Auditing (UK and Ireland) (ISA(UK&I)) auditors have specific responsibilities to communicate with the Audit and Risk Management Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Audit and Risk Management Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit and Risk Management Committee in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from the Audit and Risk Management Committee, and supports the Audit and Risk Management Committee in fulfilling its responsibilities in relation to the financial reporting process.

Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Audit and Risk Management Committee's oversight of the following areas:

- fraud
- laws and regulations
- financial reporting and going concern.

This report includes a series of questions on each of these areas.

Fraud

Issue

Matters in relation to fraud

ISA(UK&I)240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the Audit and Risk Management Committee and management. Management, with the oversight of the Audit and Risk Management Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Audit and Risk Management Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls.
As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud
- process for identifying and responding to risks of fraud, including any identified specific risks
- communication with the Audit and Risk Management Committee regarding its processes for identifying and responding to risks of fraud
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Audit and Risk Management Committee oversees the above processes. We are also required to make inquiries of both management and the Audit and Risk Management Committee as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below.

Fraud risk assessment

Question	Management response / Those charged with governance additional comments
Has the College assessed the risk of material misstatement in the financial statements due to fraud? What are the results of this process?	Yes No instances of fraud have been identified, and controls remain in place to reduce the risk of fraud, and highlight any concerns.
What processes does the College have in place to identify and respond to risks of fraud?	There are controls in place across the College to ensure the likelihood of fraud is low, as set out in the Financial Regulations, and work instructions - including segregation of duties, review and authorisation of transactions at different levels, as well as monitoring and reporting. The College also has an established Fraud Policy.
Have any specific fraud risks, or areas with a high risk of fraud, been identified and what has been done to mitigate these risks? What have you determined to be the classes of accounts, transactions and disclosures in the financial statements that are most at risk of fraud?	No specific fraud risks have been identified. There are no unusual transactions or balances within the accounts to date which would increase the risk of fraud for the current period. Controls over access to College bank accounts are reviewed regularly to ensure that they remain appropriate. Controls over income and fees are in place to ensure that the risk of any fraudulent transactions is minimised.
Are internal controls, including segregation of duties, in place and operating effectively? If not, where are the risk areas and what mitigating actions have been taken?	Internal controls and segregation of duties are in place and operating effectively. The College Internal Audit process is planned with the aim of reviewing any areas which are assessed as a risk on an annual basis. No issues have been highlighted during the current period.
Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)?	The reporting requirements under ONS have tight deadlines for budget and cash flow monitoring, but the reporting is now embedded into the College financial processes and procedures. There is no impact on the financial reporting and year-end processes.

Fraud risk assessment

Question	Management response / Those charged with governance additional comments
How does the Audit and Risk Management Committee exercise oversight of management's processes for identifying and responding to risks of fraud? What arrangements are in place to report fraud issues and risks to the Audit and Risk Management Committee?	The College Internal Auditors plan their work each year, based on the Risk Register, and take account of any changes and plans. The Executive Management Team and Audit Committee have input to the plan before it is finalised. The Internal Auditors report to the Audit Committee on their findings for each review carried out during the year. In addition, the College Auditors have access to the Audit Committee to discuss any issues without College staff being present. The College has established procedures and policies including a Fraud Policy, Whistleblowing Procedure and Anonymous Allegations Against Staff or Students. These ensure that any issues and risks are reported to the Audit Committee.
How does the College communicate and encourage ethical behaviour of its staff and contractors?	The College has a Code of Conduct policy which staff are expected to comply with. In addition, any contractors working in the College are also asked to comply with the policy. The College Procurement processes require contractors to comply with these procedures.
How do you encourage staff to report their concerns about fraud? Have any significant issues been reported? Have any reports been made under the Bribery Act?	Per the College Whistle blowing Procedure. No issues have been reported. No
Are you aware of any related party relationships or transactions that could give rise to risks of fraud?	No
Are you aware of any instances of actual, suspected or alleged, fraud, either within the College as a whole or within specific departments since 1 August 2015?	No

Laws and regulations

Issue
Matters in relation to laws and regulations ISA(UK&I)250 requires us to consider the impact of laws and regulations in an audit of the financial statements. Management, with the oversight of the Audit and Risk Management Committee, is responsible for ensuring that the College's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements. As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and the Audit and Risk Management Committee as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the non-compliance and the possible effect on the financial statements. Risk assessment questions have been set out below.

Impact of Laws and regulations

Question	Management response / Those charged with governance additional comments
What arrangements does the College have in place to prevent and detect non-compliance with laws and regulations?	The Internal and External Audit processes are part of the arrangements in place to prevent and detect non-compliance with Laws and Regulations, in addition to other audit reviews by partner organisations (e.g. ILA/ SDS/ Education Scotland) and other External Verification work which takes place for teaching areas. A member of the Executive Management Team has responsibility for Freedom of Information and Data Protection. The College employs a Health and Safety Officer, and independent professional advice is taken when required - including dealing with any legal/ personnel issues arising, taxation and VAT, pensions, property valuations, building surveys, and insurance. A Staff Development procedure is also in place to ensure that staff are up to date with necessary legislation for their roles in the College.
How does management gain assurance that all relevant laws and regulations have been complied with?	The arrangements noted above should help to ensure that all relevant laws and regulations have been complied with, and reporting lines to the Executive Management Team and Board of Management highlight any issues arising, or risks identified.
How is the Audit and Risk Management Committee provided with assurance that all relevant laws and regulations have been complied with?	As above. In addition, the Internal and External Auditors report directly to the Audit Committee.
Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 August 2015, or earlier with an on-going impact on the 2015/16 financial statements?	None have been identified.
What arrangements does the College have in place to identify, evaluate and account for litigation or claims?	Reporting procedures have been established to ensure that the Executive Management Team are alerted to any potential issues. Accidents are logged via the Health and Safety Officer to the Vice Principal, and complaints received are logged through the College Complaints handling procedure. Any claims received are logged and forwarded to the College Insurers.
Is there any actual or potential litigation or claims that would affect the financial statements?	None identified
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	None

Financial Reporting and Going Concern

Issue
Matters in relation to financial reporting and going concern ISA(UK&I)570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements. The going concern assumption is a fundamental principle in the preparation of financial statements. Under this assumption entities are viewed as continuing in business for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. The code of practice on local authority accounting requires an authority's financial statements to be prepared on a going concern basis. Although the College is not subject to the same future trading uncertainties as private sector entities, consideration of the key features of the going concern provides an indication of the College's financial resilience. Financial reporting and going concern considerations have been set out below.

Financial Reporting Considerations

Question	Management response/ Those charged with governance additional comments
What has the College identified as the key events or issues that will have a significant impact on the financial statements for 2015/16?	The implementation of FRS 102 will have a significant impact on the College financial statements for 20154/16, due to the large balance of deferred capital grants in the balance sheet. The changes to disclosure will impact on the net reserves reported in the balance sheet at 31.07.16, as well as the total income for the year.
How do the College's risk management processes link to financial reporting?	The College has an established Risk Management policy. The Risk Register is determined by the Executive Management Team, and monitored by the Audit Committee. Finance is one of the factors taken into account when risks are identified, and provisions are made as required.
Has the College considered the appropriateness of the accounting policies adopted? Have there been any events or transactions that may cause the College to change or adopt new accounting policies?	Yes, the accounting policies have been reviewed and are considered appropriate. The accounting policies have been updated due to the implementation of FRS 102. The Board have already considered the changes to accounting policies, and the revised policies will be adopted in preparing the 2015/16 financial statements.
Have there been any changes to the College's regulatory environment that may have a significant impact on the financial statements?	The changes arising from the revised SORP and implementation of FRS 102 have been considered, and the revised accounting policies will be adopted in preparing the 2015/16 financial statements.
Have there been any significant transactions outside the normal course of business?	None have been identified.
Is the College aware of any changes in circumstances that would lead to impairment of non-current assets?	None have been identified.
Is the College aware of any new transactions, events and conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement?	None have been identified.

Going Concern Considerations

Question	Management response/ Those charged with governance additional comments
Does the College have procedures in place to assess the College's ability to continue as a going concern?	Yes, regular management reporting, budget reviews and forecasting take place during the year which helps to inform the Executive Management Team for their decision-making. The Finance Committee receive regular financial reports and updates through-out the year.
Is management aware of the existence of other events or conditions that may cast doubt on the College's ability to continue as a going concern?	No such events have been identified.
Are arrangements in place to report the going concern assessment to the Audit and Risk Management Committee?	Yes
Are the financial assumptions supporting the going concern assessment (i.e. future levels of income and expenditure) consistent with the College's Plans and the financial information provided to the College throughout the year?	Yes, the budget reporting/ review and forecasting have not identified any potential problems. In addition, the College now has a 3-year Outcome Agreement with SFC which is effective from 2014/15.
Are the implications of statutory or policy changes appropriately reflected in the College's Plans, financial forecasts and report on going concern?	Yes – the College Operational Plan continues to adapt to comply with Scottish Funding Council objectives, e.g. Developing the Young Workforce/ Gender Imbalance strategies. College forecasts and budgets are updated on a regular basis to take account of any changes arising. Changes to the budget assumptions for 2016/17 include an estimate of additional pay costs due to the implementation of National Bargaining, and increased national insurance costs.
Have there been any significant issues raised with the Audit and Risk Management Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	None have been raised.

Going Concern Considerations

Question	Management response/ Those charged with governance additional comments
Does a review of available financial information identify any adverse financial indicators including negative cash flow? If so, what action is being taken to improve financial performance?	The cash flow projections have been updated for the period to July 2016, and no problems have been identified.
Does the College have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the College's objectives? If not, what action is being taken to obtain those skills?	Yes. This is monitored by the Board of Management.

Audit Committee

Update on Challenge to the Lennartz Ruling

1. Introduction

The purpose of this report is to update members on recent discussions regarding the College's Lennartz agreement with HMRC.

2. Background

As reported previously, a test case in England has challenged the legality of HMRC's application of the technical rules and legality of output tax being accounted for on Lennartz arrangements. The Court Of Appeal has referred the case to the Court of Justice of the European Union for a preliminary ruling before a final decision is made, and it is likely to be a couple of years before the final decision is made.

Ernst & Young were appointed on a no-win-no fee basis to review the current position and ensure that the seven Scottish colleges which have Lennartz agreements are continuing to pay the correct amount of VAT.

Ernst & Young recommended that each college submits a voluntary disclosure in relation to overpaid tax and make a claim covering all Lennartz payments within the four year claim period. They have stated that HMRC is open to Lennartz claims due to changes in legislation, and have highlighted that any delay in submitting a claim will reduce any repayment due to the College.

Only two of the seven colleges have submitted a claim to date. HMRC are currently looking at the claims, and have requested further information. The other colleges are currently considering their options.

Ernst and Young have confirmed that no fees will be due if the College decides not to submit a claim.

3. Comments from Scott Moncrieff

Scott Moncrieff have acted as VAT advisers for the College throughout the period from initial discussion with HMRC on Lennartz in 2007, and advising on any changes to date. They have provided some comments on the options now available to the College.

Scott Moncrieff consider that there is no financial implication to making a claim under the test case- - the only potential issue is that it could have a reputational effect on the College. As Colleges are now public bodies, attempting to reclaim VAT under the test case could be described as making use of a 'tax loophole'.

Alternatively, they think it could be seen as poor management if the College doesn't make a claim. If the claim is made by a group of colleges, the claim would be seen as a prudent approach – if the use of Lennartz is unlawful, it can only be in the College interest to make a claim and use the VAT reclaimed to fund additional educational activities.

Scott Moncrieff have suggested that there might be a second option, which would be to unwind Lennartz. They looked at the possibility of the College unwinding its Lennartz position a number of years ago but at the time it was found to be too expensive as the interest the College would have to pay to HMRC was significant. Scott Moncrieff are currently in communications with HMRC on Lennartz for another client, as HMRC suggested previously that input tax due to be repaid to HMRC under Lennartz which was recovered more than 4 years ago would not attract an interest charge. They have asked HMRC for confirmation that interest will not be applied in this situation.

The principle behind unwinding Lennartz is that the College would be required to repay the input tax it has recovered on the asset while HMRC would be required to repay the output tax that the College has paid under Lennartz. These payments would be for the entire period that Lennartz has been in place, not just the last 4 years as noted in the test case. Pending confirmation from HMRC on the interest position, this may provide an attractive way of removing Lennartz payments by the College. The removal of interest payments could remove the significant interest costs previously associated with unwinding Lennartz.

Scott Moncrieff will advise further when they have received further information from HMRC.

4. Recommendation

It is recommended that the committee note the contents of this report.

Audit Committee

Strategic Risk Register

1. Introduction

1.1 The purpose of this paper is to provide the Audit Committee with the opportunity to review the College's Strategic Risk Register.

2 The Report

2.1 In line with the College's Risk Management Policy any risk with an inherent rating of 12 or above must have mitigating controls in place and where the residual rating remains above 12 should be reviewed at least quarterly in order to identify if any further actions could be taken to reduce the residual rating to below 12. For completeness all risks are included in the attached register, in order of high to low ratings.

2.2 The Principal and Executive Management Team routinely review the Strategic Risk Register to reflect the risks the College is facing and the mitigation that will be applied to each risk. There are currently 11 strategic risks, three of which are rated 12 or above.

2.3 Since the Committee last met, a full condition and a structural survey has been undertaken where no structural issues were identified. Therefore, the risk relating to 'Safety concerns relating to construction of the College by Miller Construction' has been removed from the register.

2.4 At this time there is no change to risk no4 'unable to achieve credit (activity) target'. However, further strike action by UNISON members may impact negatively on early retention.

3. Recommendation

3.1 It is recommended that the Audit Committee consider and, if so minded, approve the Strategic Risk Register.

Audit Committee

Risk No.	Risk Description	Inherent Risk			Controls in Place	Assurances	Internal / External	Residual risk			Further Action	Risk Owner
		Likelihood	Impact	Total				Likelihood	Impact	Total		
1	National Pay Bargaining	**4**	**4**	**16**	1. Detailed financial planning undertaken and approved by Finance and General Purposes Committee to ensure "affordability" of any offer. 2. National negotiation processes in place with recognised unions. 3. Government public sector pay guidance for 2016-17 is for maximum 1%.	1. Feedback to EMT and the Board 2. Included in budget which is monitored and reported through F&GP and Board 3. Sound internal planning and monitoring to ensure service continuity in event of industrial action	Internal/ External	**4**	**4**	**16**	Regular communication with staff and student association executive on sector developments and management position. Regular liaison with union bodies in college. Industrial action will be detrimental to learners achieving their aims/qualifications.	**EMT**
2	Public sector funding cuts - forecast for session 2017-18	**4**	**4**	**16**	1. Scenario planning undertaken and measures to offset reduction identified which is then used to inform curriculum planning. 2. Annual review of provision undertaken through planning and budgetary process to ensure match of income and expenditure.	1. Curriculum plans approved by EMT and L&T 2. Budget approved by the Board	Internal	**3**	**4**	**12**	Reduce curriculum provision and or student services in line with funding and implement cost savings. Seek to increase non SFC income.	**EMT**
3	Governance issues: Reclassification and other changes to governance reduce the flexibility of the College to manage financial and estates issues and meet targets in the Outcome Agreement.	4	4	**16**	1. Executive Management Team and Finance Manager representation at relevant briefings and ongoing monitoring of changes 2. External audit advice	1. Appropriate and robust internal planning and monitoring arrangements 2. Regular liaison with Scottish Funding Council	Internal/ External	3	4	**12**	Seeking support from Scottish College Foundation to support College's continuing development. SFC Guidance on Depreciation and Deficits	**EMT**
4	Unable to achieve credit (activity) target	**3**	**3**	**9**	1. Real time monitoring system. 2. Contingency plans in place to offer additional provision as required. 3. Annual review of staffing and provision to rebalance areas of growth with areas of decline. 4. Annual review carried out by internal audit	1. Reviewed by ET on a weekly basis 2. Reviewed by ET on a weekly basis 3. Review carried out by HR and presented to ET for consideration/approval. 4. Internal audit report presented to audit committee	Internal / External	**3**	**3**	**9**	Early warning strategies to be implemented to improve early retention. 30 August 2016 - UNISON informed of intention to strike on 6 September 2016 - this could impact on retention	**EMT**

Audit Committee

Risk No.	Risk Description	Inherent Risk			Controls in Place	Assurances	Internal / External	Residual risk			Further Action	Risk Owner
		Likelihood	Impact	Total				Likelihood	Impact	Total		
5	University of West Of Scotland - Review of property and provision in Dumfries.	**4**	**3**	**12**	1. Principal continue to discuss with Senior Management of UWS. 2. Principal and Vice Principal on the Joint Academic Strategy Group. 3. Regular reporting and discussion at EMT as information becomes available.		Internal/ External	**3**	**3**	**9**	Continue dialogue with UWS. Keep SFC informed of potential loss of contribution to college overheads from UWS for shared accommodation. Also potential loss of articulation opportunities for College students if UWS provision if reduced. 16 March 2016 agreement reached by College, UWS and SFC to prepare an outline business case for funding to build an extension to the College building to accommodate UWS.	**EMT**
6	Failure to achieve attainment targets	4	4	**16**	1. Real time monitoring systems in place 2. Strategies in place to improve retention. 2. Strategies in place to improve student success 3. Poorly performing programmes removed from the curriculum.	1. Monitored at course level and review by Vice Principal (Learning and Skills) 2. Monitored through self evaluation process and reported to ET and L&T committee	Internal/ External	1	4	**4**	Moving forward achieving attainment targets agreed with the SFC in the Regional Outcome may be a condition of grant. Low attainment can also be detrimental to college reputation.	**EMT**
7	Implications following the implementation of 'needs-led' funding model, in particular ELS and rural funding	**4**	**4**	**16**	1. Principal member of College Sector Funding Group. 2. Continuous review of curriculum and delivery by ET to ensure that adverse impact minimised.	1. Feedback to ET and Board meetings 2. Reports to L&T Committee	Internal	**2**	**2**	**4**	College to develop an access and inclusion strategy detailing how ELS funding be used	**EMT**
8	Disruption to business continuity due to Influenza pandemic, terrorism, fire or other disaster	**2**	**4**	**8**	1. Business continuity plan in place (check audit report recommendations)	1. Reviewed by ET and report to Board 2. Internal audit review carried out in 11/12	Internal / External	**2**	**2**	**4**	Implementation of audit recommendations	**EMT**

Audit Committee

Risk No.	Risk Description	Inherent Risk			Controls in Place	Assurances	Internal / External	Residual risk			Further Action	Risk Owner
		Likelihood	Impact	Total				Likelihood	Impact	Total		
9	Prevent Duty – disruption due to threat of extremism / risk of external influences	**3**	**4**	**12**	1. Vice Principal attendance at local multi-agency CONTEST group 2. Regular reporting of Prevent issues at EMT. 3. Constant scanning to identify new potential threats.	1. College Prevent Action Plan 2. CONTEST meetings/minutes 3. EMT meetings/minutes	Internal	**2**	**2**	**4**	Vice Principal leading on Prevent Action Plan, any issues would be identified through regular reporting at EMT. Immediate concerns to be raised with contact within Police Scotland. Review of evacuation procedures in relation to 'stay safe' principles planned for September 2016	**EMT**
10	Imbalance between demand for student support funds/bursaries and funds available	**2**	**3**	**6**	1. Detailed analysis and monitoring of spend undertaken on an ongoing basis by Finance Manager, discussed monthly with VP (CS&G) who updates ET. 2. Allocation and amounts reviewed on an annual basis to ensure funding constrained within amount available. 3. Annual review carried out by internal audit	1. ET meetings/minutes 2. ET meetings/minutes 3. Internal audit report presented to audit committee	Internal / External	**1**	**2**	**2**	No further action but continue to monitor expenditure and amend student funding policies to match demand with available budget.	**EMT**
11	Loss of collaborative partnership arrangements	**2**	**3**	**6**	1. Policy of limiting dependence on any one partnership. 2. Regular reporting of partnership issues at ET. 3. Constant scanning to identify new potential partnerships.	1. Currently not specifically reviewed 2. ET meetings/minutes 3. ET meetings/minutes	Internal	**1**	**2**	**2**	No further action. Although policy not specifically reviewed, any issues would be identified through regular reporting at ET.	**EMT**