

# Scottish Funding Council

## Annual Report to the Board and the Auditor General for Scotland for the financial year ended 31 March 2016

Aug 2016



# Key Messages

It has been a challenging year for the Scottish Further and Higher Education Funding Council (the Council) with a number of high profile governance failures within the college sector and questions being raised about the role of the Council. The Council has taken action to improve the governance framework across both the college and university sectors and continue to develop their approach to monitoring institutions.

The Council has reviewed their internal governance and management structures in year, in line with their aim to develop a high performing organisation. The Council is starting a journey to develop a strong culture, which will be critical to the successful delivery of the Strategic Plan 2015-18. Looking ahead it is important the Council is able to clearly articulate its role and how it works with stakeholders to help to deliver a world class further and higher education system for Scotland.

The Council has delivered services within the overall budget from the Scottish Government with approved re-profiling of funds of £5.87 million (0.35% of overall budget). The Council will face on-going challenges to help deliver effective and efficient education services in an environment of increasing cost pressures.

## ISA 260 requirements

We issued an unqualified opinion on both the financial statements of the Council and on the regularity of transactions undertaken for the 2015-16 financial year on 29 June 2016. The draft financial statements were provided on 6 May 2016 along with supporting working papers.

We did not have to change our audit plan during the year and we did not find any fundamental weaknesses in the general IT control environment or the systems surrounding the disbursement of grant funding to institutions based on the work undertaken.

There were no proposed adjustments arising from our audit work, however we did request some minor disclosure changes to the narrative to bring disclosures in line with the 2015-16 FReM.

Despite the over-commitment the Council has managed to report a small surplus of £0.56 million in year.

A total of £5.87 million (0.35% of overall budget) of funding was re-profiled between higher education and further education grant-in-aid with the approval of the Scottish Government.

The Council currently prepare budgets on an annual basis for both running costs and grant allocations to institutions. There is an opportunity for the Council to develop its medium to long term planning in conjunction with the new spending review.

The Council has arrangements in place to review the sustainability of both colleges and universities, which has been effective in identifying institutions of concern. With the cost pressures on the sectors increasing the Council are in the process of moving to a risk based approach to deliver improvements in the efficiency and effectiveness of the monitoring process.

There were a number of governance failures within the college sector in 2014-15 which were reported to the Scottish Parliamentary Audit Committee in 2015-16. These failures are reflected in the Governance Statement and the Council has put in place improvements including producing a revised financial memorandum and endorsing a new Code of Governance, which was issued to institutions in 2014-15.

The Council is revisiting its financial memorandum with the Scottish Government to reflect the changes in the sectors since 2006. In our view this provides a good opportunity to clarify the role of the Council going forward.

## Best Value and Performance

The Council introduced a revised Strategic Plan in 2015-18 which has been designed to align with Scotland's Economic Strategy. A performance management framework is in place and is currently being reviewed by the Board and Management.

The Council continue to be on track with the majority of their indicators but have noted behind target performance for effective use of resources and high performing colleges and universities. Action plans are in place for each of the performance indicators.

The Council is committed to continuous improvement and sees outcome agreements as a key driver of improvement at colleges and universities. The academic year 2017-18 will be the first year of a new three-year cycle of outcome agreements and the Council is considering revised guidance to reflect the new strategic plan and lessons learned from the first three years.

## Public Sector audit impact dimensions

Our external audit work is undertaken in accordance with the Audit Scotland Code of Practice (May 2011).

Our annual report is structured to reflect our wider responsibilities under the Code, and this year we have shaped this around the four Public Sector impact dimensions reflected in the Audit Scotland Corporate Strategy 2015-2018.

## Financial management and sustainability

The Council has had a challenging year in 2015-16 with a net over-commitment of £10 million in the Higher Education funding allocation identified early in the year. The Council has worked to mitigate the impact on the sector and reviewed the control environment surrounding the allocation of grant funds. A series of improved controls have been identified and a significant proportion have been addressed prior to the year end.

## Governance and Transparency

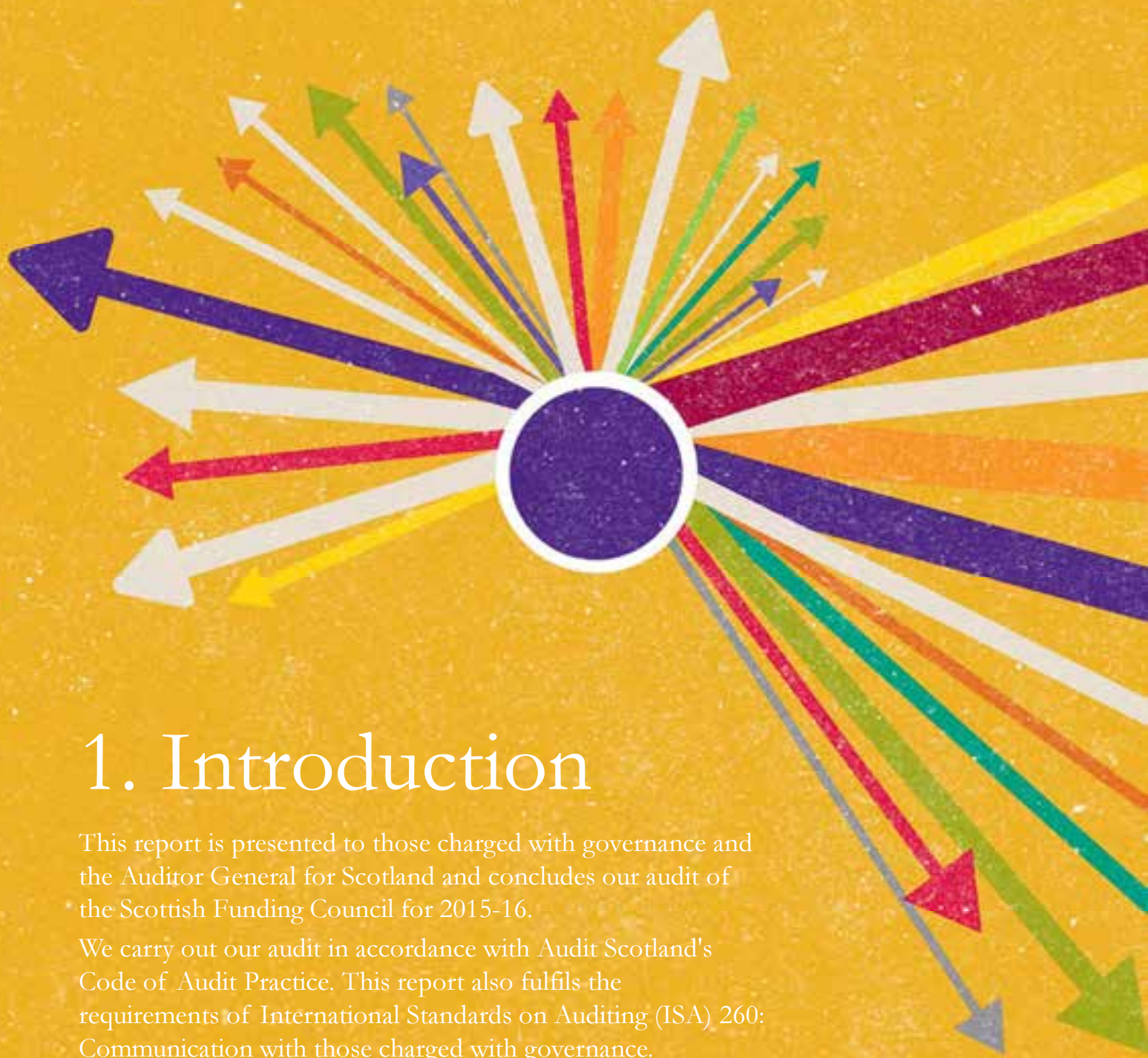
The Council's Governance Statement is balanced and in line with the requirements of the Scottish Public Finance Manual.

The Council considers the effectiveness of the Board on an annual basis and has an external evaluation on a triennial basis. An external assessment was concluded in 2014-15 with no significant issues arising.

During the year the Council has reviewed the management structure and moved to four directorates. This change was to ensure that the Council is as efficient and effective as possible.

Arrangements for standards of conduct are appropriate with an up to date Code of Conduct and Register of Interests in place

The Council has effective arrangements in place to prevent and detect fraud and corruption.



# 1. Introduction

This report is presented to those charged with governance and the Auditor General for Scotland and concludes our audit of the Scottish Funding Council for 2015-16.

We carry out our audit in accordance with Audit Scotland's Code of Audit Practice. This report also fulfils the requirements of International Standards on Auditing (ISA) 260: Communication with those charged with governance.

# Contents



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	Page
Introduction	5
ISA 260 communication with those charged with Governance	7
<b>Public Sector Audit Impact dimension commentary:</b>	
Financial management and sustainability	14
Governance and transparency	20
Best Value and performance	26
Appendices	29

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# Introduction

## Purpose of this report

The Auditor General for Scotland appointed Grant Thornton UK LLP as auditor of the Scottish Funding Council ('the Council') for the 5-year period 2011-12 to 2015-16. This appointment is made under the Public Finance and Accountability (Scotland) Act 2000.

Our annual audit report is addressed to those charged with governance at the Council, and the Auditor General for Scotland. The report summarises our opinion and conclusions on significant issues arising from our audit. The scope of our audit work was set out in our Audit Plan, which was presented to the Audit and Compliance Committee on 2 December 2015.

## The Council's responsibilities

It is the responsibility of the Council and the Accountable Officer to prepare the financial statements in accordance with the HM Treasury Government Financial Reporting Manual (the FReM).

This means the Council must:

- prepare financial statements which give a true and fair view of the financial position of the Council and its income and expenditure for the year to 31 March 2016
- maintain proper accounting records which are up to date
- take steps to prevent and detect fraud and other irregularities.

The Council is also responsible for establishing proper arrangements to ensure that:

- public business is conducted in accordance with the law and proper standards
- public money is safeguarded and properly accounted for
- economy, efficiency, effectiveness and Best Value is achieved in the use of resources.

## Our responsibilities

It is a condition of our appointment that we meet the requirements of the Code of Audit Practice ('the Code') which was published in May 2011, and is approved by the Accounts Commission and the Auditor General for Scotland.

The Code highlights the special accountabilities that are attached to the conduct of public business and the use of public money. This means that audits in the public sector must be planned and undertaken from a wider perspective than the private sector. Our responsibilities are outlined in **Figure 1**.

We are required to provide an opinion on the financial statements and Annual Governance Statement. Under the Code we are also required to review and report on the governance arrangements, Best Value, use of resources, and performance.

Under the requirements of the International Standard of Auditing (UK and Ireland) ('ISA') 260: Communication with those charged with governance, we are required to communicate audit matters arising from the audit of the financial statements to those charged with governance. This annual report to the Council, together with previous reports to the Audit and Compliance Committee throughout the year, discharges our ISA 260 commitments.



## Acknowledgements

We would like to take this opportunity to record our thanks for the assistance provided by the Director of Finance, the Senior Management Team and the finance team during the course of our work.

Figure 1: Our responsibilities under the Code of Audit Practice

**Financial Statements** ▶

- Provide an opinion on:
- whether the financial statements provide a true and fair view of the financial position of the Council
  - whether the financial statements have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
  - the regularity of expenditure and income

**Corporate governance** ▶

- Review and report on the Council's corporate governance arrangements as they relate to:
- the Council's corporate governance and systems of internal control, including reporting arrangements
  - the prevention and detection of fraud and irregularity
  - standards of conduct and arrangements for the prevention and detection of corruption

**Best Value and performance** ▶

- The Public Finance and Accountability (Scotland) Act 2000 gives the Auditor General the right to initiate examinations into the economy, efficiency and effectiveness with which the Council and other public bodies have used their resources to discharge their functions.
- In accordance with guidance issued by Audit Scotland, the Auditor General may require auditors to consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of Best Value.
- In accordance with guidance issued by Audit Scotland, auditors may be requested to participate in a performance audit, an examination of the implications of a particular topic for the Council at a local level or a review of the Council's response to national recommendations. In 2015-16 we have completed an assessment of workforce planning at the Council.

*An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Weaknesses or risks are only those that have come to our attention during our normal audit work in accordance with the Code and may not be all that exist.*

*Communication of the matters arising from our audit work does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.*



# 2. Financial statements



# Financial Statements

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## Introduction

Within this section of the report, we present our audit findings to management and those charged with governance in accordance with the requirements of International Standard on Auditing (UK & Ireland) (ISA) 260.

We have not had to alter or change our audit approach, which we set out in our Audit Plan dated December 2015.

We presented an initial version of this report to Audit and Compliance Committee at its meeting on the 8 June 2016 and the Council Board at the meeting on 10 June 2016.

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## Our Review of the Financial Statements

The draft financial statements were of good quality and we identified no significant errors or misstatements.

As part of our work on the financial statements we are required to review the narrative elements (including Chair's Foreword, Performance Report, Sustainability Report and the Accountability Report). In 2015-16 the Government Financial Reporting Manual (the FReM) was substantially changed to reflect new requirements for the narrative element of the Annual Report and Accounts. The new requirements include a Performance and Accountability Report:

- The Performance Report is designed to provide a fair, balanced and understandable analysis of the Council's performance.
- The Accountability Report should include a corporate governance report, remuneration and staff report and a parliamentary accountability and audit report.

We are required to review the narrative elements of the financial statements for compliance with required FReM disclosures, for consistency with other areas of the financial statements and our knowledge of the Council.

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We worked alongside the Council to ensure the requirements of the FReM were included in the 2015-16 financial statements and noted that good progress was made in year to improve disclosures. We have concluded that the disclosures are consistent with our knowledge of the Council and offer a balanced reflection on their activities in year.

The draft financial statements did not include a parliamentary accountability and audit report. This has been discussed with the client and included in the final version.

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## Financial Statements Opinion

Our audit did not identify any adjustments to the primary financial statements, we have not identified any material errors or uncertainties in the Council's financial statements.

On 29 June 2016 we issued an unqualified opinion on the financial statements of the Council for the year ended 31 March 2016.

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## Regularity

We did not identify any instances of irregular expenditure or non-compliance with laws and regulations.

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## Whole of Government Accounts

The deadline for receipt of the audited Whole of Government Accounts (WGA) has not been issued to date. We anticipate this will be in line with prior years and intend to carry out the work on this area in July 2015 and will therefore provide our certificate of assurance in advance of the deadline for audit.

We will liaise and report any issues arising from the WGA audit to the Audit and Compliance Committee.



# Our audit plan: a reminder

## Scope of the Audit

Our audit plan outlined that we operate a risk based approach to the audit of the financial statements. We consider the inherent risks to the Council and how these may result in a material misstatement in the accounts. At the planning stage we identified two areas with increased risk of material misstatement as outlined on pages 10 and 11.

Our audit approach requires increased audit focus on those areas where we have identified an increased risk of misstatement which includes consideration of the control environment for systems linked to those areas. Our substantive procedures include analytical review, confirmations with third parties and sample testing. Where we have identified a significant or other risk we require a higher level of testing to provide assurance. In performing those tests we have due regard to materiality as outlined below.

We recognise that planning is a continuous process and we monitor events at the Council for any areas which may impact our planned audit work. In 2015-16 we did not identify any new areas of risk which would require us to change from the approach outlined in our Audit Plan.



## Application of Materiality

As outlined in our audit plan we apply the concept of materiality in line with the requirements of ISA 320: Materiality in planning and performing an audit. The assessment and application of materiality is a matter of auditor judgement.

The primary focus of the Council is to deliver funding for further and higher education through the award of grants to institutions. We believe this would be the key consideration for the users of the financial statements and therefore we have used this as the benchmark upon which to base materiality.

Performance materiality is used to drive the level of testing conducted at the Council. All balances or transactions that exceed the set level are subject to audit testing. This measure, along with the assessed level of inherent risk, is used to drive the level of sample testing.

In line with ISA 320 we also considered areas where account balances or disclosures for which misstatements lower than materiality could reasonably be expected to influence the economic decisions of users. We identified that cash and cash equivalents and disclosure of senior management salaries fall within this category.

In line with ISA 540 we reported in our audit plan an amount below which misstatements would be clearly trivial and would not be reported to the Audit and Compliance Committee. We have defined the amount below which misstatements would be clearly trivial to be £250k.

# Audit findings against significant risks

Set out below is our response to the significant risks of material misstatement identified in the Audit Plan. There are two presumed significant risks which are applicable to all audits under auditing standards. However, as set out in our plan and below, we rebutted the risk around revenue recognition.

Risks identified in our Audit Plan	Work completed	Assurances and issues arising
<p><b>1 Management override of controls</b> Under ISA 240 there is a presumed risk that the risk of management over-ride of controls is present in all entities.</p>	<ul style="list-style-type: none"> <li>Review of accounting estimates, judgments and decisions made by management</li> <li>Testing of journal entries</li> <li>Review of unusual significant transactions</li> </ul>	<p>Our audit work has not identified any evidence of management override of controls. In particular the findings of our review of journal controls and testing of journal entries has not identified any significant issues.</p> <p>We set out later in this section of the report our work and findings on key accounting estimates and judgements.</p>
<p><b>2 The revenue cycle includes fraudulent transactions</b> Under ISA 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p>	<p>Having considered the risk factors set out in ISA 240 and the nature of the revenue streams at the Council, we determined the risk of fraud arising from revenue recognition can be rebutted, because:</p> <ul style="list-style-type: none"> <li>there is little incentive to manipulate revenue recognition</li> <li>opportunities to manipulate revenue recognition are very limited</li> <li>the culture and ethical frameworks of central government, including the Council, mean that all forms of fraud are seen as unacceptable.</li> </ul> <p>The most significant area of revenues was grant funding totalling £1,644 million (99.5% of revenues). We have substantively agreed grant funding to award letters and monthly remittances from the Scottish Government.</p>	<p>Our work confirmed that revenue had been recognised appropriately in the financial statements.</p>

Source: External Audit Plan



*Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty*

(ISA (UK&I) 315).

# Audit findings against other identified risks

In this section we detail our response to the other risks of material misstatement which we identified in the Audit Plan.

Table 2: Reasonably possible risks identified at the planning stage

Transaction cycle	Description of risk	Work completed	Assurances gained and issues arising
<b>Grants paid to HE/FE bodies</b>	<p><b>Misstatement of grant payments to institutions</b></p> <p>The main activity of the Council is the award and payment of grants to colleges and universities. There is an inherent risk that grants paid to institutions are incorrectly recorded in the financial statements.</p>	<p>We gained assurance over the risk through:</p> <ul style="list-style-type: none"> <li>• Review and walkthrough of the processes and controls in operation for payment of grants.</li> <li>• Review and walkthrough of calculation basis for main teaching grant award to individual institutions</li> <li>• Sample testing of 60 grant payments to HE/FE bodies</li> <li>• Sample testing of 30 grant commitments at the year end</li> </ul>	<p>Our audit work has not identified any misstatement of grant payments to institutions.</p> <p>The control environment was considered to be operating effectively with numerous controls in place over the payment of grant funding.</p> <p>Our sample selection covered both payments in year and commitments for funds due, relating to the remainder of the academic year 2015-16.</p>

Source: External Audit Plan



*"Other risk areas are those which we have identified as an area where the likelihood of material misstatement cannot be reduced to remote, without the need for gaining an understanding of the associated control environment, along with the performance of an appropriate level of substantive work".*

# Accounting estimates and significant judgements

## Assessment

- Marginal accounting policy which could potentially attract attention from stakeholders
- Accounting policy appropriate but scope for improved disclosure
- Accounting policy appropriate and disclosures sufficient

In this section we report on our consideration of accounting policies, in particular revenue recognition policies, and key estimates and judgements made and included with the Council's financial statements.

Table 3: Accounting estimates and significant judgements

Accounting area	Summary of policy	Our comments	Our assessment
<b>Revenue recognition</b>	<ul style="list-style-type: none"> <li>• <b>Grants receivable:</b> Grant-in-aid received for revenue, capital and running costs purposes and other Government grants are regarded as financing and are credited to the income and expenditure reserve.</li> <li>• <b>Other grants:</b> European Structural Funds and European Regional Development Fund income are treated on a cash basis.</li> <li>• <b>Recoverable grants:</b> Recognised at the dates agreed with the organisations concerned.</li> <li>• <b>Claw back and penalties:</b> Recognised when the amount of the funding adjustment has been established and approved by Council.</li> </ul>	<ul style="list-style-type: none"> <li>• The revenue recognition policies are appropriate under the Government Financial Reporting Manual.</li> <li>• The disclosure in the draft accounts was found to be reasonable and in line with prior years.</li> </ul>	<span style="color: green; font-size: 2em;">●</span>
<b>Contingent liabilities</b>	<ul style="list-style-type: none"> <li>• The Council has an on going legal case with a former employee which was heard in court in December 2015. As it is not possible to predict whether there will be a cost to the Council this has been recorded as a contingent liability.</li> <li>• The Council has provided financial guarantees of £33.9 million to two institutions for loan support liabilities. The principal outstanding at 31 March 2016 is £18.4 million. The College has deemed the risk of realising payment to be low and therefore judged that these should be disclosed as contingent liabilities in line with IAS 37.</li> </ul>	<ul style="list-style-type: none"> <li>• We have contacted the Council solicitors who have confirmed the status of the legal case. We have deemed the Council's judgement to disclose as a contingent liability to be appropriate.</li> <li>• The financial guarantees would only be required to be repaid by the Council if the institutions were in financial difficulty. The council monitor the position throughout the year and this informs the judgement over the risk. We have concluded in year the accounting treatment in year is appropriate.</li> </ul>	<span style="color: green; font-size: 2em;">●</span>
<b>Other estimates and judgements</b>	<p>Other key estimates and judgements are:</p> <ul style="list-style-type: none"> <li>• Useful life of assets and capital equipment</li> <li>• Additions to assets over £5,000 are capitalised</li> <li>• The Council do not account for any accruals or prepayments which are under £10,000</li> </ul>	<ul style="list-style-type: none"> <li>• Estimates and judgements applied in the financial statements were considered to be reasonable.</li> </ul>	<span style="color: green; font-size: 2em;">●</span>

## Other areas of audit focus

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### Internal controls

We update our understanding of the Council's operations and key financial control systems each year and tailor our audit strategy to focus on key risk areas.

Our audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. During our interim audit, we conducted testing on the following areas:

- grants payable (disbursement of funding)
- IT control environment.

We did not identify any significant deficiencies or material weaknesses arising from our testing of the systems above. Overall, the results of our interim testing confirmed that there is a sound system of internal control covering key financial systems operated by the Council.

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### Going Concern

Going concern has been interpreted by the FReM as applicable for non-trading entities if there is an anticipated continuation of the provision of a service in the future as evidenced by inclusion of financial provision for the service in published documents.

We considered management assessment of going concern and obtained assurance through:

- review of financial factors including levels of liabilities, arrears, operating cash flows and reserves
- review of financial factors including the Scottish Government draft budget, the published funding agreements with colleges and universities.

Overall we conclude that it is appropriate for the Council to prepare the financial statements on a going concern basis.

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### Related Parties

We are not aware of any related party transactions which have not been disclosed.

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### Sustainability reporting

The FReM requires central government bodies to include a section in their annual report which outlines the economic, social and environmental factors impacting the organisation. This is to be presented in a Sustainability Report.

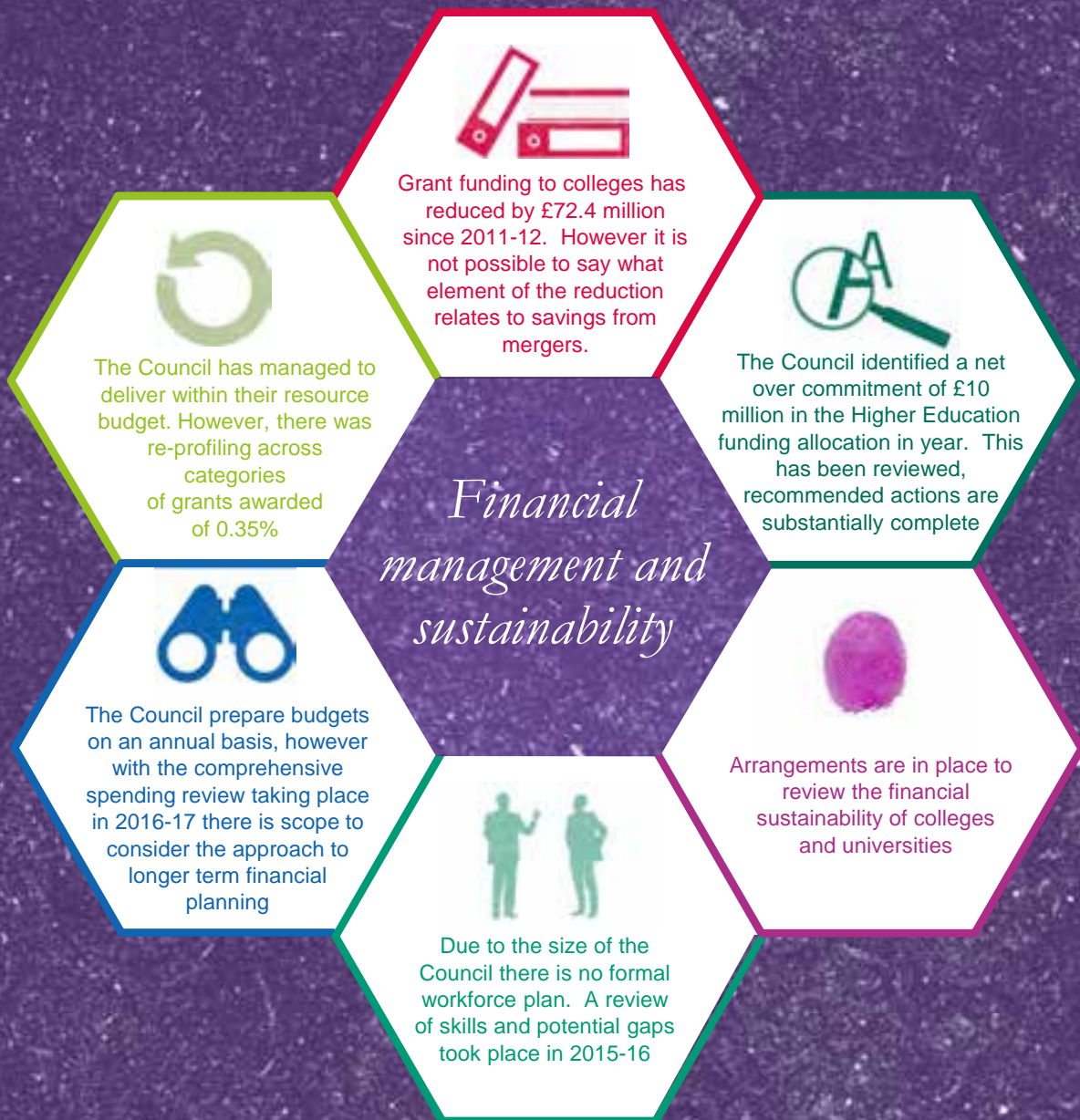
Public Sector Sustainability Reporting- Guidance on the Preparation of Annual Sustainability Reports was published by the Scottish Government and outlines the minimum reporting requirements covering areas such as:

- greenhouse gas emissions
- waste minimisation and management
- finite resources
- action on biodiversity
- sustainable procurement.

In prior years it has been noted that there were issues regarding the collection of data. The Council has made progress in this area through liaison with the landlord and so the only area where it has not been possible to collect data is with regards to water consumption. This means the minimum reporting requirement has not been met. The Council has disclosed in the accounts the areas where it has been unable to get data, which is in line with previous years.

The Council has increased the disclosures in the Sustainability Report to include summary sustainability and social responsibility information within the report which is in line with the reporting requirements of the Scottish Government.

# 3. Financial Management and Sustainability



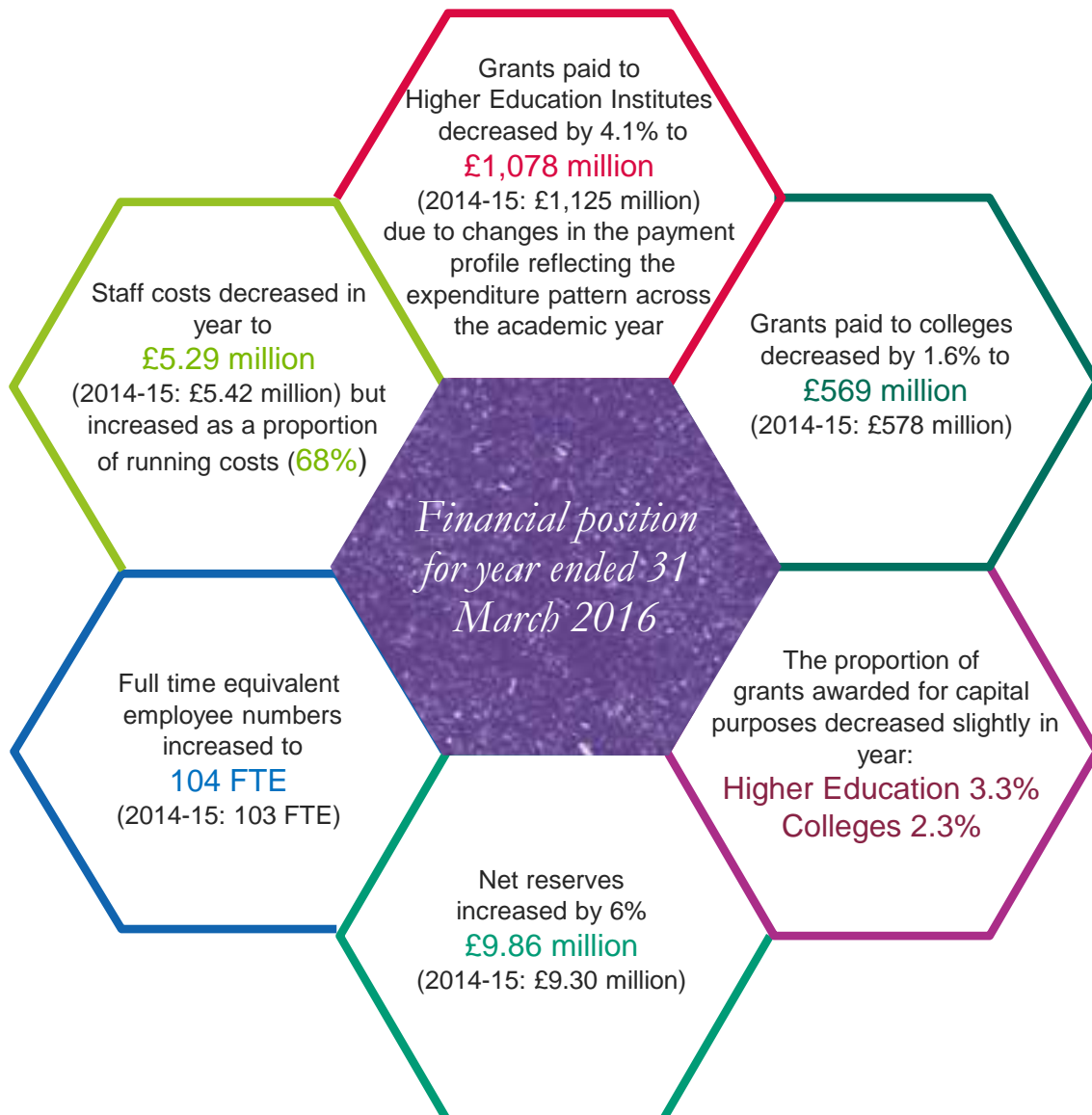
# Financial Management

## Introduction

Good financial management is underpinned by sound budgetary process and a robust control environment. In order to be financially sustainable the Council will require good financial management in the short term but will also need to look forward to the medium and longer term to establish the ability to deliver services within the available resources.

In this section we review and comment on the Council's achievement of financial objectives and assess the Council's financial management and sustainability arrangements.

## Key Financial Statement highlights for the financial year ended 31 March 2016 were:



## Grant Funding to institutions

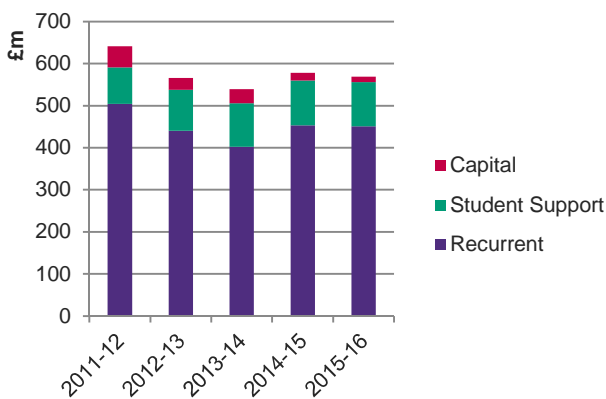
The Statement of Comprehensive Net Expenditure shows that total grants paid to institutions in year was £1,647 million a decrease of 3% compared to the prior year (2014-15: £1,703 million). The majority of this decrease was due to changes in the HE payment profile, reflecting the expenditure pattern across the academic year.

The majority of grant funding continues to be for recurring activities at colleges and universities with capital expenditure remaining relatively constant as a proportion of total grant funding.



Source: Scottish Funding Council Accounts 2011-12 to 2015-16

Recurrent funding in the university sector consists of the main teaching grant, research and knowledge exchange grants, ring fenced grants and strategic grants.



Source: Scottish Funding Council Accounts 2011-12 to 2015-16

The majority of funding to the college sector relates to the teaching and fee waiver grants. Under the Strategic Plan 2012-2015, the Council aimed to generate efficiencies of around £50 million in real terms by the 2015-16 academic year. As shown by the graph above the grant funding to the sector has decreased by £72.4 million since 2011-12. However, an analysis of how much of the decrease is attributable to the regionalisation of Colleges has not been undertaken.

## Re-profiling of grant funding

Grants to colleges and universities are allocated for the academic year ending 31 July, however the council receive their funding on a financial year basis (year ending 31 March). The Council therefore create a payment profile for each institution which allocates grant funding over an academic year but allows the Council to meet its budgetary requirements for the sector as a whole within the financial year.

There are, however, instances where the payment profile is changed. This can be for a number of reasons:

- the institution does not meet the required milestones to receive strategic project grants
- the college sector can not draw down in advance of need and may not require funding in the same pattern as predicted, and;
- in year budget revisions mean that the payment profile has to be altered.

Where there are changes the Council undertakes a re-profiling exercise to vire funds between institutions and in some instances between categories of grant funding. This does not aim to change the institutions' overall funding out of line with the payment profile as agreed but merely adjusts the timing of when the payments are made to the sector. Any re-profiling as a result of increased cash grants from the Scottish Government are offset by a reduction in the following year grant-in-aid allocation.

In the financial year 2012-13 the Council received an increased budget to the Higher Education sector which was not fully utilised in year. This was, therefore, re-profiled in line with the Council's standard approach.

In 2015-16 the Council identified a net over-commitment of £10 million had been made in the 2015-16 academic year universities' funding allocation.

The Council has worked with the Scottish Government to manage the over-commitment, while still delivering the funding outlined in the allocation letters to institutions.

Internal audit conducted an investigation into the events leading to the over-commitment and the controls around the funding allocation process. The internal audit review concluded that a number of factors led to the over commitment of funding, including a lack of scrutiny and transparency over financial reporting, the separation of funding and finance processes and a breakdown in the funding allocation process.



## Re-profiling of grant funding

The following recommendations were made to the Council in year:

- review and documentation of the funding allocation process, setting out the responsibilities of the teams involved
- a clear process for agreeing and authorising spending decisions to ensure funds are available in the short, medium and long term
- greater transparency of reporting to ensure that all relevant information is presented in the funding allocation reports
- a more transparent means of managing the spending profile that highlights financial and academic year underspends to the Scottish Government.

The Council is taking action to implement the recommendations including the creation of the Finance Committee and increased communication with the Scottish Government. The Council has put in place the most significant actions with only a small number of lower priority areas still to be completed at the time of our report.

The Council recognise the importance of implementing all recommendations in 2016-17.

[Refer to action plan point 1](#)

## Financial management and budgetary control

The Council has established budget setting and monitoring arrangements in place, however, reporting in the past was restricted to the Chief Executive's Group with only high level reporting to the Council members. The scrutiny by the Council has increased in 2015-16 with the introduction of a Finance Committee.

The role of the Finance Committee includes:

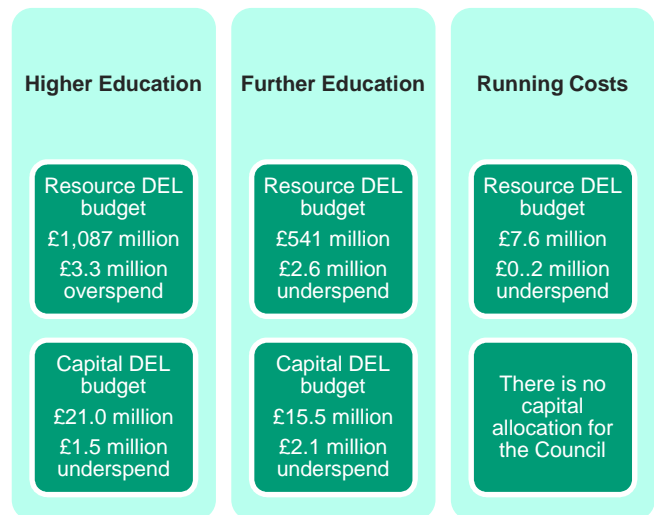
- scrutiny of annual budgets for both financial and academic years
- scrutiny of the financial position against the plan and budgets
- review of the annual report and accounts for consistency with in year financial information.

In 2015-16 the Finance Committee met five times and received a number of reports outlining key financial issues. This is a new Committee of the Council and its role will continue to develop. We recommend that the Finance Committee conducts an assessment exercise to review its effectiveness and role going forward.

[Refer to action plan point 2](#)

The Council is required to work within the resource limits and cash requirements as set by the Scottish Government. The final allocations were provided in March 2016 as set out below.

The Council monitor the position throughout the year via the resource returns to the Scottish Government and were predicting a mix of underspends (colleges) and overspends (universities) in the financial year. The Council has managed the budget in year through their annual re-profiling exercise as follows:



Source: Scottish Government Spring budget revision and report to April 2016 Finance Committee

The total re-profiling exercise in year totalled £5.87 million which equates to 0.35% of the total grant-in-aid budget from the Scottish Government. The virement of the funding has been formally approved by the Scottish Government.

Overall the Council are working to improve financial management and progress has been made in 2015-16. The link between financial year budget requirements of the Council and the academic year allocations to institutions is becoming clearer and is now being reported to members via the Finance Committee.



# Financial sustainability

## Financial planning

The Council outlined a revised Strategic Plan covering the period 2015-18, which contains high level objectives on the use of resources, however there are no detailed financial plans to support the Strategic Plan.

The Council develop budgets on an annual basis with budgets prepared for running costs on a financial year basis and plans for colleges and universities being based on the academic year. From 2016-17 there is a clear reconciliation between the financial year and academic year budget allocations.

An update outlining the on-going work on the Council's running cost budget was presented to the Finance Committee in March 2016 and predicts an overspend against the approved DEL of £0.22 million. The budget for 2016-17 is £7.2 million, a reduction of £0.40 million compared to 2015-16. This has been noted as a risk in 2016-17 and the Council are exploring options to deliver the required savings.

In 2015-16 the UK and Scottish Government undertook spending reviews which meant the Council did not receive confirmation of their 2016-17 funding allocation until December 2015. The Council published the final funding allocations to colleges and universities in May 2016.

The college funding allocation confirms that grant funding will be maintained at £530.3 million through grant-in-aid with the Council having over-committed in the allocations by £12.2 million as a result of discussion with the Scottish Government over the Autumn Budget Revision. The allocations are based on the college sector maintaining student credits in 2016-17 at 1,690k.

The university funding allocation letter confirms funding to the sector of £1,028.7 million in the academic year 2016-17

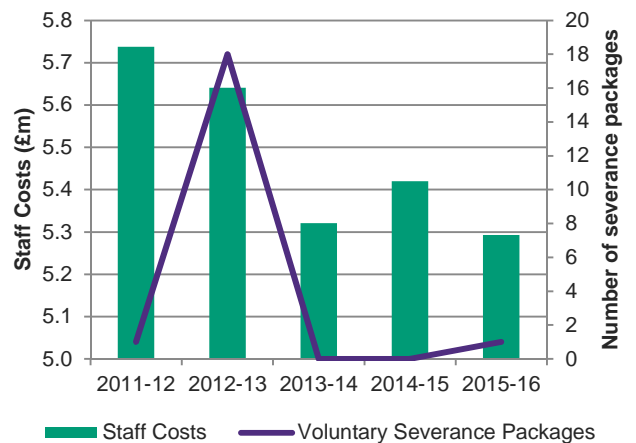
The Council do not currently prepare medium to long term budgets. We understand that there has been a degree of uncertainty with regard to funding allocations. Looking forward, there is an opportunity for the Council to consider their approach to longer term financial planning along side the spending review due to take place in 2016-17.

[Refer to action plan point 3](#)

## Workforce planning

Costs of employment account for 68% of total running costs (£5.29 million in 2015-16) and are budgeted to increase to £5.63 million (78%) of running costs in 2016-17. There is a need for the Council to have an effective and efficient workforce in order to maintain service delivery while meeting budget requirements.

In the past the Council has utilised voluntary severance schemes to assist in creating an efficient work force.



Source: Scottish Funding Council Accounts 2011-12 to 2015-16

The most significant use of severance packages was in 2012-13, which resulted in a 5% reduction in staff costs which has been maintained to 2015-16. In year there was only one voluntary severance which was subject to audit testing and was supported by a business case and appropriately organised.

The Council is a small organisation with only 104 full time equivalent employees and therefore they do not consider there to be a need for a formalised workforce plan. The Council recognises that employees play a key role in delivering their services and therefore did conduct a review of the workforce in 2015-16. This review aimed to identify any skills gaps or the need for succession planning. The key message from the review was that the Council needed to invest in learning and development of staff at a number of levels to allow for progression and movement. This work also identified areas with a higher level of risk of a skills shortage arising should an individual leave the organisation.

The Council should consider the implications of the changing workforce requirements when preparing their running costs budgets.

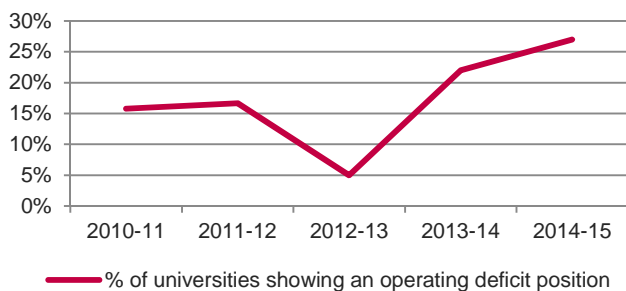
[Refer to action plan point 4](#)

## Financial sustainability of institutions

The Strategic Plan 2015-18 outlines the aspirations of the Council which includes colleges and universities being financially sustainable and making the best use of their resources. As part of the Council's aim to have high performing colleges and universities the Council has committed to monitor the sustainability of colleges and universities.

The Council monitors the financial sustainability of institutions through financial returns. Universities provide two returns in year through the Strategic Plan Forecast and their audited financial statements. In addition to the annual forecast and audited financial statements, colleges are required to provide quarterly returns throughout the year and this increases to monthly in the final quarter. The returns are provided to the Council's financial analysts who report the findings to the Audit and Compliance Committee as a standing agenda item.

The results for the academic year 2014-15 were presented at the March 2016 Audit and Compliance Committee.



Source: Financial Health of Institutions report presented to March Audit and Compliance Committee

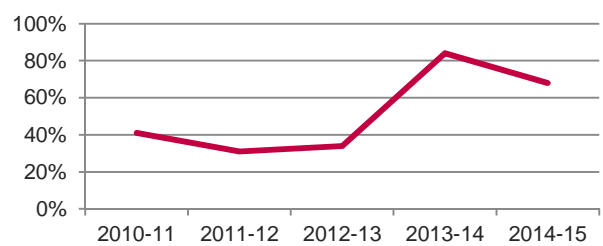
It was noted in year that five universities were reporting an operating deficit position. The trend analysis above shows there has been a degree of fluctuation across the years with the number of universities reporting a deficit.

Despite five universities showing a deficit position in year the Council has not identified any specific risks to the financial sustainability of the sector. This follows a review of the financial position, including forecasted figures of the universities and discussions with the universities to gain an understanding for the reasons for the deficit.

As outlined in the financial planning section, funding allocations for 2016-17 show that there is a reduction in funding of 3.4% compared to 2015-16 but the universities are predicting that this can be managed through cost savings programmes.

The college sector is split into two categories: incorporated and non-incorporated. As a result of a reclassification exercise in 2014-15 incorporated colleges came under the boundary of central government. This meant that from 1 April 2014 the incorporated colleges came under the government budgeting requirements.

The trend analysis below shows that the move to government budgeting has had an impact on the position reported in the college financial statements. We reported in the prior year that a high proportion of the deficit related to donations of surplus cash to Arm's Length Foundation Trusts (ALF). After adjusting the deficits reported for ALF donations, but not taking into account any other one off adjustments, the percentage of colleges showing a deficit position was 30% which is in line with prior years.



— % of colleges showing an operating deficit position

Source: Financial Health of Institutions report presented to March Audit and Compliance Committee

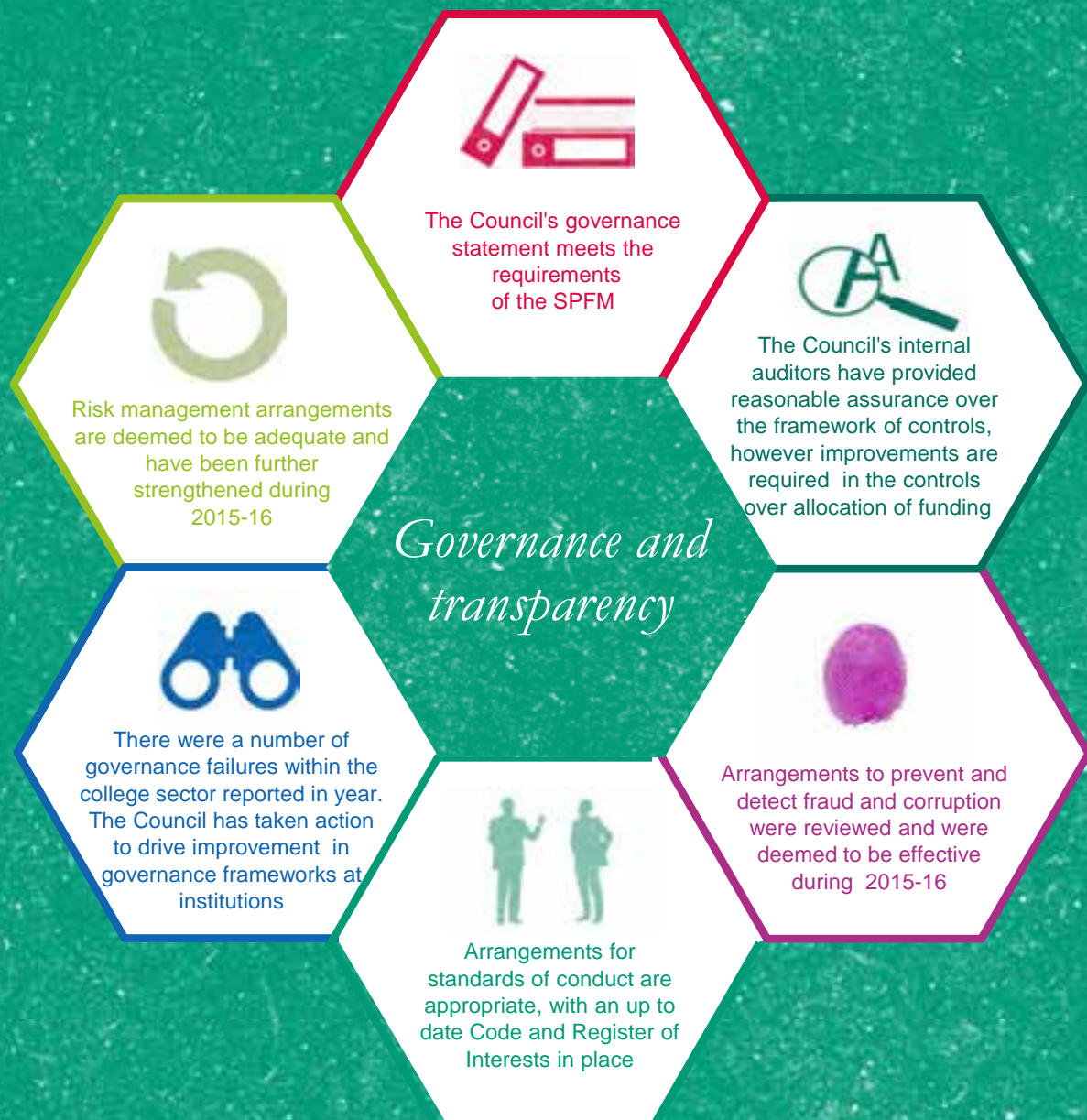
Technical accounting adjustments arising from reclassification have led to deficits being recorded in the financial statements of colleges. Looking forward the transition to FRS 102 will also have implications on the reported financial positions of colleges and universities. This will include deferred grant funding being moved into creditors, and the need to reflect contractual commitments from pension schemes, which may result in a movement from a net asset to a net liability position. Whilst these changes will not directly impact the financial sustainability of colleges and universities in the short term it is important that the underlying financial health and cash position continues to be assessed.

When the effects of the technical accounting adjustments are taken into consideration the number of colleges reporting a deficit position reduces from 2013-14 to broadly in line with the levels pre-reclassification. The Council has committed to maintain grant levels for 2016-17, however the colleges will have to maintain student numbers against an increasing cost base. There are therefore significant challenges involved in maintaining a breakeven position across the sector.

The Council is in the process of developing a more formalised risk based approach to reviewing the financial performance of colleges. The risk based approach is designed to provide a high level of focus and support to those institutions with the greatest need. The risk assessment will take a more holistic view of the institutions so that the year end financial results are only one of a suite of indicators which inform the Council's assessment of performance.

The Council has assessed a number of colleges as having increased risk. The Council Institutional Finance and Governance Team are directing their efforts towards those identified as higher risk through additional dialogue and a more intensive monitoring regime.

# 3. Governance and transparency



# Governance and transparency

## Governance Statement

Under the Treasury's Financial Reporting Manual (FReM), the Board must prepare a Governance Statement within the Annual Report and Financial Statements. Guidance is set out within the Scottish Public Finance Manual (SPFM) for the content of the Governance Statement as it forms a key summary of the Council's governance ethos, and provides assurances around the achievement of the organisation's strategic objectives.

The SPFM does not prescribe a format for the Governance Statement, but sets out minimum reporting requirements and methodology for obtaining assurance for central government bodies. In line with the SPFM the Directors complete a self assessment on an annual basis using the Scottish Government Internal Control Checklist.

The governance statement highlighted a number of issues in year including:

- governance arrangements in the college sector
- achievement of student number targets at Edinburgh College
- instances of fraud within the sector
- budgeting of the higher education programme funds
- internal capacity
- stakeholder relationships.

For each issue identified the Council has outlined the action which has been taken.

We have reviewed the Council's Governance Statement as part of our audit procedures and concluded that disclosures are in line with the requirements of the FReM and guidance issued from Scottish Ministers, though the SPFM. The statement is sufficiently balanced, reflecting key aspects of the Council's governance structure and key issues in year.

## Governance and scrutiny arrangements

The corporate governance framework within the Council is centred around the full Council Board supported by six committees split between policy (50%) and regulatory (50%) functions.

The Board, supported by its committees, is responsible for the strategic direction of the Council and aims to fulfil the legislative powers of the organisation along with those outlined in the Management Statement and Financial Memorandum with the Scottish Government.

The Management Statement sets out the broad framework within which the Council will operate covering:

- the rules and guidelines relevant to the exercise of the Council's functions, duties and powers;
- the process for establishing the Council's overall aims;
- the planning framework within which objectives, targets and budgets in support of the Council's aims and Scottish Ministers' wider strategic objectives are developed and agreed;
- the conditions under which any public funds are paid to the Council; and
- how the Council will account for its performance.

The Financial Memorandum sets out in detail the elements of the financial framework within which the Council is required to operate. This is considered when completing our work on the regularity of transactions. As noted in the Financial Statements section of the report we did not identify any instances of irregular expenditure in 2015-16.

The Management Statement and Financial Memorandum were agreed with the Scottish Government in 2006. The Council has noted that there have been significant changes to the further and higher education sectors since 2006. The Council has engaged with the Scottish Government to develop a new framework going forward and this exercise is close to completion.

The issue of the revised financial memoranda with the colleges and universities is an opportune time to consider the Management Statement and Financial Memorandum between the Council and the Scottish Government. The completion of this exercise will help clarify the role of the Council and its stakeholders.

[Refer to action plan point 5](#)

The Board considers its performance annually and every 3 years has external facilitation of the assessment process. In 2014-15 Polley Solutions Ltd were commissioned to undertake an evaluation of Board Governance. The report was in general positive but recommended development in the following areas:

- Setting clear strategic direction for the organisation
- Giving greater focus to stakeholder engagement
- Board team building
- The Board's role as an employer

The Board have delegated responsibility for scrutiny to the Audit and Compliance Committee which meets on a quarterly basis. Grant Thornton are in attendance at every meeting and we have noted that scrutiny is exercised across a number of key areas including:

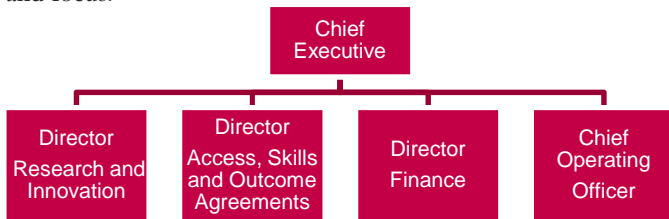
- financial health of institutions
- internal audit work programme and reports
- external audit reports
- risk management
- whistle blowing and fraud
- legislative compliance.

Each year the Audit and Compliance Committee undertake a self assessment exercise with both internal and external audit contributions. We have not identified or raised any areas of concern over the functioning of the Committee in year.

## Management restructure

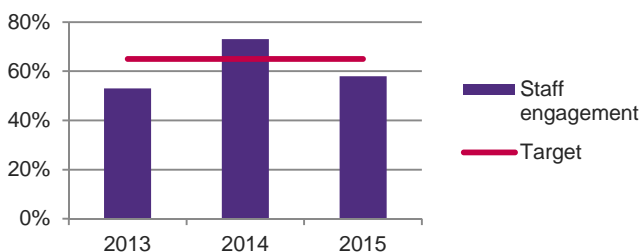
One of the key aims of the Council's strategic plan is to create a high performing organisation which is innovative and effective at leading and delivering change. The Council made the decision to restructure their workforce and management team in year to contribute to the achievement of this objective.

Four directorates were created in year each with a clear purpose and focus.



In conjunction with the change in structure the Chief Executive Group was disbanded and replaced with a Senior Management Team (SMT) attended by the Chief Executive and Directors. The SMT has been focused on the strategic direction of the Council, linking to the Scottish Government three step Improvement Framework for transformational change.

The Council recognise the importance of the workforce in achieving objectives and conduct an annual staff survey to monitor engagement.



Source: Scottish Funding Council Accounts 2015-16

The Council has noted a slight decline in engagement in year and are below the target scoring. The Council has recognised there is work to be done to develop their culture and have taken steps to make improvements including improved organisation, wider communication and line manager training.

Our work within bodies in England has found that high performing organisations pay equal attention to both strategy (what they do) and culture (how they do it). The right culture is as central to sustainable organisational success as the right strategy.

The change in leadership is a good opportunity for the Council to explore their culture and to develop new and different ways of working with in the changing education environment.

## Governance arrangements at institutions

The Post-16 Education (Scotland) Act 2013 (the Act) was established to provide support for the governance of further and higher education institutions.

We reported in 2014-15 that the Council published a financial memorandum for each regional board, regional college and university which was a compulsory guidance document. The Council also endorsed a Code of Corporate Governance, written by the sector groups, for each of the college and university sectors.

The Council require all institutions to report any areas of non-compliance with the published guidance, along with an explanation for non-compliance.

Reliance is placed on the Governance Statements published in the institutions financial statements combined with the internal and external audit annual reports.

It was noted there were a small number of institutions in 2014-15 who were not fully compliant with the new governance requirements. The Council is currently engaging with those institutions to make the required improvements or provide explanations for any issues regarding compliance.

There were some significant governance failures within the college sector which were reported to the Scottish Parliamentary Audit Committee under section 22 of the Public Finance and Accountability (Scotland) Act 2000 in 2015-16. The colleges reported on were:

- Glasgow Colleges' Regional Board
- Glasgow Clyde College
- Coatbridge College.

As a result of the governance failings a Good Governance Task Group was established by the Scottish Government to consider sector wide issues related to the governance of colleges and make recommendations for improvements. The key recommendations relating to the Council are:

- Better systems are put in place to ensure that all boards consistently get the basics right
- Good governance practice is better supported and facilitated
- External assurance is better used to respond more promptly to emerging issues
- More sanctions are considered so that a wider range of measures are available
- The governance health of the sector is further assessed

The report also acknowledged that a number of the actions were already in progress including the move to a risk based approach to monitoring colleges as outlined in the financial sustainability section.

## Regionalisation of Colleges

The Post-16 Education (Scotland) Act (the Act) resulted in significant restructuring of the college sector along regional lines. This resulted in a series of mergers to single regional colleges and three instances of multi college regions which now report into a regional strategic board. Three regional strategic boards have been established as follows:

- Glasgow Colleges' Regional Board
- University of Highlands and Islands Further Education Regional Board
- New College Lanarkshire Regional Board.

The University of Highlands and Islands is the only regional board to date which has had funding responsibility transferred. As noted in the governance of colleges section of the report the Glasgow Colleges' Regional Board was the subject of a report to the Scottish Parliament highlighting significant governance weaknesses. While the Council has noted good progress in this area with the appointment of a permanent chair in January 2016, a decision has been made not to award fundable body status until there is adequate evidence of effective operation of the Regional Board.

A further impact of the regionalisation of the college sector was a number of mergers of colleges. Over the period from 2011-12 to 2013-14 the number of colleges reduced from 41 to 25. The Council are currently involved in a 2-year post merger evaluation programme.

In autumn 2015 the Council began a round of post merger evaluations of colleges that merged in the academic year 2013-14.

The Council has aimed to conduct evaluations two years after the merger activity to allow time for changes to be implemented.

Two evaluations were completed and reported in January 2016 for Fife College and the West of Scotland College. A further six have been completed and are due for publication in June 2016.

The post merger evaluations look at the benefits that were outlined in the merger proposal and the progress in achieving those benefits. The post merger evaluation also considers the level of savings achieved through the merger process.

The Council considered both the Fife and West of Scotland mergers a success generating savings of £7.15 million and £8.10 million respectively. The colleges were deemed to have successfully reduced duplication and competition, made better use of resources, increased focus on delivery and developed a stronger regional engagement. However, at Fife the post merger evaluation did identify a need to improve outcomes for students. The Council has received sufficient assurance that progress is underway in this area.

To date there has not been a sector wide review of the success of the regionalisation programme or the associated savings to the sector overall. There is an opportunity through the post merger evaluations to collate a sector wide picture and share good practice to drive improvement across the sector.

[See action plan point 6](#)

## Arm's Length Foundations (ALFs)

As reported in 2014-15 the Scottish Government budget regulations limit incorporated colleges ability to carry cash reserves. In order to mitigate the impact the Scottish Government approved the transfer of cash backed reserves to either a sector wide foundation trust or a local foundation trust as appropriate.

The Audit and Compliance Committee received an update of the financial position in the 2014-15 financial statements of the ALFs which reflected a reduction in the balances held from £99.0 million to £82.3 million. In 2014-15 a total of £24 million was provided to colleges from the ALFs through grants and a further £6.9 million was donated from colleges to the ALFs. The balance was projected to have reduced further to £63.2m in March 2016.

A key requirement of the ALFs is that they are independent bodies with no indication of control or significant influence by the colleges or the Council. As such there is a limited role the Council can play with regard to the ALFs. The Council has agreed to monitor the level of funds and provide the Audit and Compliance Committee annual updates on the financial position of the ALFs. The Audit and Compliance Committee have noted that this continues to be an area of public interest and have noted risks around the safeguarding of funds and maintaining the independence of the ALFs.

The Council has noted there are mitigating factors through the charities regulations and the supervisory powers of the Office of the Scottish Charities Regulator. This provides some assurance over the safeguarding of funds and the governance arrangements of the ALFs.

## Risk Management

The Audit and Compliance Committee is responsible for monitoring the management of risk at the Council. The Committee reviews the risk management framework put in place by the Senior Management Team and considers the risk register as a standing item on the agenda.

The Council undertook a review of risk management in early 2015-16 and presented a Risk Management Strategy in June 2015 to the Audit and Compliance Committee. In creating the strategy the Council considered

- the requirements of the SPFM
- Scottish Government guidance on risk management
- HM Treasury guidance on the Management of Risk

The Council's risk management framework outlines five key steps:



Source: Scottish Funding Council Risk Management Strategy

The risk management approach outlined seeks to identify and escalate new risks to management as appropriate. There is a formal monitoring framework through the Senior Management Team and the Audit and Compliance Committee.

Key areas of continuing high risk on the risk register are:

- governance in the college sector
- college sector student numbers and performance indicators
- European Social Funding applications are not approved
- insufficient internal capacity at the Council.

One of the key actions in the risk management strategy was for the Council to consider risk maturity modelling. This is currently in development and the Council are considering how best to implement an improvement plan for risk management.

We have assessed that the Council's risk management arrangements are adequate and note that this is an area where the Council has invested time and effort to develop in line with best practice.

## Internal Audit

The Council's internal audit function is provided by Scott Moncrieff an independent external firm of accountants. Internal audit provide an annual report to the Audit and Compliance Committee and as part of this report confirm their compliance with the Public Sector Internal Audit Standards.

In 2015-16, they issued the following opinion:

*"In our opinion the Scottish Funding Council has a framework of controls in place that provides reasonable assurance regarding the effective and efficient achievement of the organisation's objectives and the management of key risks, subject to implementation of the improvements noted below.*

*Our investigation into HE Funding identified core process weaknesses within the organisation which required improvements to key processes, structures and governance arrangements for the allocation of funding to HE institutions. The weaknesses related to annual budget setting, budget / treasury management, communication, governance and transparency and the clarity of reporting. Management have implemented a range of actions to address these issues, including the establishment of a Finance Committee."*

As set out in our audit plan we have reviewed the work of internal audit to inform our audit approach. However we did not place reliance on any internal audit work undertaken in 2015-16.

Internal audit completed work in line with their plan for 2015-16 and have provided detailed reports to the Audit and Compliance Committee.

In 2016-17, the internal auditors will focus on areas of risk, including:

- Financial controls self assessment
- Grant funding distribution
- Internal communications
- Further education reporting and sustainability.



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## Prevention and detection of fraud and irregularity

The integrity of public funds is a key concern for the organisation and for auditors. As external auditors, we are required to consider the arrangements made by management for the prevention and detection of fraud and irregularities.

The Council's fraud prevention/whistleblowing policy was reviewed during 2015-16 as part of a new annual process on the reporting of fraud and whistleblowing. No significant changes were made to the policy, however a decision was made in year to publish both the fraud and whistleblowing policies on the Council's website in addition to the intranet to improve transparency.

Our enquiries of management and the Council's internal auditors found that there were no internal frauds during 2015-16.

From our work in 2015-16 we have concluded that the Council has effective arrangements in place for the prevention and detection of fraud.

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## Arrangements for maintaining Standards of Conduct and detection of corruption.

In line with the Ethical Standards in Public Life etc (Scotland) Act 2000, the Council has established a Code of Conduct for Board Members, which was approved by Scottish Ministers. A register of interests is available for each Board member on the Council's website, and declarations of interest are made at each Council meeting.

In accordance with the Code of Audit Practice we have reviewed the arrangements in place for the prevention and detection of corruption and concluded that the Council has appropriate arrangements in place. We are not aware of any specific issues that we need to record in this report.



# 4. Best Value and Performance



# Best value

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## Demonstrating Best Value

All public sector Accountable Officers have a duty to secure Best Value in public services as set out by the SPFM. The Council has a range of mechanisms for securing Best Value in its operations and these are considered to be part of business as usual and embedded in governance arrangements.

The Council undertake a Best Value self-assessment exercise programme which is on a triennial basis. The last assessment took place in August 2013 and evaluated the Council across the 7 themes and 75 characteristics of the Scottish Government. At this stage the Council had 69% of indicators being well developed and 31% being under development.

In March 2016 the Audit and Compliance Committee considered a paper summarising some of the main methods and activities undertaken in 2015-16 to secure Best Value. This report highlighted activities across the 7 themes and highlighted new actions such as:

- Development of better partnership working in the context of strategic priorities
- The continued development of the performance management framework
- The introduction of the Scottish Government 3 Step Improvement Framework.

A further self assessment is due in 2016-17 and we feel that this would be the right time to reflect on the number of changes at the Council and their impact on delivering Best Value.

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## Outcome agreements

Outcome agreements are a key tool in driving continuous improvement in the college and university sectors. In line with prior years, monitoring the Outcome Agreements is conducted through two main channels:

- self evaluation by institutions
- on-going monitoring by outcome managers

The self evaluation data is used by the Council to assess the institutions level of compliance against the targets set out in the Outcome Agreements. The Council uses this information to publish a report for each of the college and university sectors summarising progress against key outcomes. The *Universities and Colleges- Progress and Ambitions* report published in March 2016 split the report into the four strategic areas set out in Scotland's Economic Strategy and highlighted no specific areas of concern and a general upward trend in articulation, student retention, widening access and the proportion of learners gaining recognised qualifications.

The Council had noted in previous years that the standard of the outcome agreements was below the target level, but it was noted that there was continuing improvement in this area and quality reviews undertaken by the Council were assisting in this area. The quality reviews were to be taken into consideration when writing revised guidance.

The academic year 2017-18 will be the first in the new three year cycle of outcome agreements and the Council plan to issue revised guidance which takes into account the learning from the first 3 years of using Outcome Agreements and revisions to the Council's Strategic Plan.

There will be challenges in continuing the upward trends against a back drop of cost pressures. The Council should ensure their guidance encourages colleges and universities to focus on their long term ambitions when setting targets and that short term constraints do not curb ambition.

[See action plan point 7](#)

# Performance

## Strategic Planning and Performance Management

The Council approved a revised Strategic Plan in November 2015. The Council reflected on the Scotland's Economic Strategy Published in March 2015 by the Scottish Government which sets out four key priorities of: Investment, Innovation, Inclusive Growth and Internationalisation.

The Council has demonstrated in their Strategic Plan how their ambitions for "Scotland to be the best place in the world to learn, to educate, to research and to innovate by 2025" links to the four priorities outlined by the Scottish Government.

The Strategic Plan focuses on three outcomes:

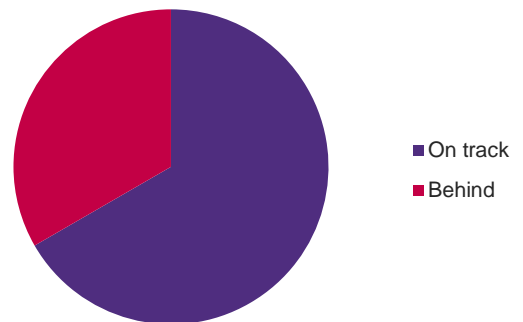
- High quality teaching and learning
- World leading research
- Greater innovation in the economy

Aligned to each of the outcomes is a programme for change which is split into key themes and associated strategic actions.

In conjunction with the development of the strategic plan the Council took the opportunity to review their performance management arrangements. The Council has provided feedback across the year which has been reflected in minor changes in content and presentation of performance reports.

The Council has considered best practice when creating their performance reports and engaged with their internal auditor to facilitate a session on good practice. It was noted that the report to the March Council was still a work in progress but was close to being finalised.

The performance management framework rates indicators across six categories on a scale from Far Ahead to Far Behind. Currently all indicators are either on track or behind.



Source: Scottish Funding Council performance report to March 2016 Board

One third of the overall outcomes were showing as behind target in year. The outcomes in this category were:

- Effective use of resources: the issues highlighted were the re-profiling issues identified in the Higher Education funding and the attainment of European Social Funds in relation to the Developing Scotland's Workforce grant. This grant relies on an additional 22,122 credits being provided and there are some concerns over the colleges ability to meet the core target.
- High performing colleges and universities: the key issues identified were the governance issues at a range of colleges as reported to the Scottish Parliament Audit Committee, meeting activity targets and financial sustainability of higher risk institutions.

The Council has created action plans for the issues identified and in a number of areas have already taken action. There is continued monitoring through the Council and the Senior Management Team.

# Appendices

Contents	Page
Appendix A – Action Plan	30
Appendix B – Follow-up of prior year actions	32
Appendix C – Fees, non audit services and independence	33
Appendix D – Draft Independent Auditors Report	34
Appendix E – Letter of Representation	36



# Appendix A- Action Plan

	Issue and Risk	Priority	Recommendation
1.	<p><b>Over-commitment of funding in the Higher Education Sector</b></p> <p>The Council reported that a net over commitment of £10 million was made in the Higher Education funding allocation for the academic year 2015-16. Internal audit reviewed the control environment for allocations and the events leading up to the over commitment and made a series of high priority recommendations. The Council has put in place the most significant actions with only a small number of lower priority areas still to be completed at the time of reporting.</p> <p><b>Risk</b></p> <p>There is a risk that the recommendations from internal audit are not adequately implemented.</p>	Low	A series of improved controls have been identified and a significant proportion have been addressed prior to the year end. The Council should ensure that the remaining, lower priority, items are completed during 2016-17.
2.	<p><b>Effectiveness of Committees</b></p> <p>The Finance Committee was established in 2015-16 to facilitate improved scrutiny of the financial position of the Council and grant allocation to institutions. To date there has been no assessment of the effectiveness of the committee or the role the committee plays.</p> <p><b>Risk</b></p> <p>There is a risk that the Finance Committee does not lead to more effective scrutiny of the financial management at the Council.</p>	Low	The Committee has been in operation for 9 months. Looking forward we recommend that the Finance Committee conducts a self assessment on an annual basis to ensure effective scrutiny.
3.	<p><b>Long term financial planning</b></p> <p>The Council are currently operating under the 3 year Corporate Plan covering the period 2015-18. Currently financial projections cover up to 31 March 2017. The Council has considered the financial position from 2016-17 onwards, due to uncertainties surrounding grant settlements there is no formalised medium to long term financial plan.</p> <p><b>Risk</b></p> <p>There is a risk that monies are not used to create long term benefits and are used to manage immediate pressures.</p>	Medium	The Council should consider their approach to longer term financial planning in conjunction with the spending review to identify if there is scope for improvement in line with best practice.
4.	<p><b>Effectiveness of the college merger programme</b></p> <p>To date there has not been a sector wide review of the regionalisation programme and savings associated with mergers.</p> <p><b>Risk</b></p> <p>There is a risk that the savings target for mergers will not be made and that learning across the sector is not utilised.</p>	Medium	The Council has an opportunity to collate a sector wide picture of the merger programme which could be used to drive good practice.

	Issue and Risk	Priority	Recommendation
5	<p><b>Review of the financial memorandum with the Scottish Government</b></p> <p>The current financial memorandum between the Council and the Scottish Government was prepared in 2006. There has been a great deal of change across the further education and higher education sectors since 2006. The Council is currently reviewing the governance documents with the Scottish Government with the process being close to completion.</p> <p><b>Risk</b></p> <p>The current financial memorandum does not adequately define the responsibilities of the Council.</p>	Medium	The Council should look to ensure the engagement with the Scottish Government is concluded in a timely basis to help in clarifying its role going forward.
6	<p><b>Workforce planning</b></p> <p>The Council do not currently have a workforce plan due to the small number of employees, however, as staff costs are a significant proportion of the running costs, there should be some assessment of any impact of changes in the workforce on the budget.</p> <p><b>Risk</b></p> <p>The workforce implications are not considered when budgeting.</p>	Low	The Council should consider their approach to workforce planning and consider as part of the financial budgeting process.
7	<p><b>Driving improvements through outcomes</b></p> <p>There will be challenges in maintaining upward trends in the delivery of college and university outcomes against a backdrop of increasing cost pressures.</p> <p><b>Risk</b></p> <p>Colleges and universities focus on tackling short term challenges rather than the delivery of longer term ambitions.</p>	Medium	The Council should ensure that any new guidance encourages universities and colleges to focus on the long term outcome targets rather than short term challenges.

# Appendix B - Follow-up of prior year actions

Set out below is our follow-up of the recommendations we made as part of our report on the 2014-15 audit

Recommendation	Priority	Action taken
1 Going forward data security should be included as a positive future confirmation.	Low	<b>Implemented:</b> This has been included in the Governance Statement in the 2015-16 financial statements.
2 The Council should ensure it has robust processes to provide assurance over the governance arrangements at all institutions.	High	<b>In progress:</b> The Council has endorsed a Code of Good Governance for both college and university sectors and have updated their processes for monitoring governance at institutions. The Good Governance Task Group made a number of recommendations relating to the Council which are currently being implemented.
3 The Council should take action to ensure there is adequate capacity within the senior team.	Medium	<b>Implemented:</b> the Council has restructured in year so that the Senior Management Team has adequate capacity to deliver the strategic aims of the Council.
4 The Council should ensure there is a robust handover process and training for the incoming Director of Finance and Corporate Resources.	Medium	<b>Implemented:</b> the new Director of Finance has been in position since September 2015. There was a transition period which allowed the current Director of Finance to shadow the outgoing Director of Finance and Corporate Resources.
5 That the Council should create a robust financial plan covering a 3-5 year period in line with the revised strategy.	Medium	<b>Not started:</b> it has been reported in year that due to uncertainty the financial planning was restricted to 2016-17. We have recommended in year that an approach to longer term financial planning is considered.
6 The Council should ensure it considers the Audit Scotland recommendations and develops an action plan to address all the identified risks.	Medium	<b>In progress:</b> The Audit Scotland report was considered by the Audit and Compliance Committee and the actions noted.



# Appendix C- Fees, non audit services and independence

We confirm below our final fees charged for the audit and confirm there were no fees for the provision of non audit services.

## Fees

	Per Audit plan £	Actual fees £
Council Audit (including EMA certification)	67,000	67,000
<b>Total audit fees</b>	<b>67,000</b>	<b>67,000</b>

## Fees for other services

Service	Fees £
None	Nil

## Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Auditing Practices Board's Ethical Standards.



# Appendix D - Draft Independent Auditor's Report

## **Independent auditor's report to the members of the Scottish Further and Higher Education Council, the Auditor General for Scotland and the Scottish Parliament**

We have audited the financial statements of the Scottish Further and Higher Education Council (the Council) for the year ended 31 March 2016 under the Further and Higher Education (Scotland) Act 2005. The financial statements comprise Statement of Financial Position, the Statement of Comprehensive Net Expenditure, the Statement of Cash Flows, the Statement of Changes in Taxpayers' Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the 2015-16 Government Financial Reporting Manual (the 2015-16 FReM).

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Auditor General for Scotland, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

### **Respective responsibilities of Accountable Officer and auditor**

As explained more fully in the Statement of the Accountable Officer's Responsibilities the Accountable Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and is also responsible for ensuring the regularity of expenditure and income. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Auditor General for Scotland. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors. We are also responsible for giving an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the body's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Accountable Officer; and the overall presentation of the financial statements. It also involves obtaining evidence about the regularity of expenditure and income. In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements, irregularities, or inconsistencies we consider the implications for our report.

### **Opinion on financial statements**

In our opinion the financial statements:

- give a true and fair view in accordance with the Further and Higher Education (Scotland) Act 2005 and directions made thereunder by the Scottish Ministers of the state of the body's affairs as at 31 March 2016 and of its net operating cost for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2015-16 FReM; and
- have been prepared in accordance with the requirements of the Further and Higher Education (Scotland) Act 2005 and directions made thereunder by the Scottish Ministers.

### **Opinion on regularity**

In our opinion in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

### **Opinion on other prescribed matters**

In our opinion:

- the part of the Remuneration and Staff Report to be audited has been properly prepared in accordance with the Further and Higher Education (Scotland) Act 2005 and directions made thereunder by the Scottish Ministers; and
- the information given in the Performance Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

### **Matters on which we are required to report by exception**

We are required to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the Remuneration and Staff Report to be audited are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- the Governance Statement does not comply with guidance from the Scottish Ministers.

We have nothing to report in respect of these matters.

Robin Baker, (for and on behalf of Grant Thornton UK LLP)

7 Exchange Crescent

Edinburgh

EH3 8AN

June 2016

# Appendix E - Letter of Representation

Grant Thornton UK LLP  
7 Exchange Crescent  
Edinburgh  
EH3 8AN

Date- Same date as accounts

Dear Sirs

**The Scottish Further and Higher Education Funding Council  
Financial Statements for the Year Ended 31 March 2016**

This representation letter is provided in connection with the audit of the financial statements of the Scottish Further and Higher Education Funding Council (the Council) for the year ended 31 March 2016 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the Public Finance and Accountability (Scotland) Act 2000, the Further and Higher Education (Scotland) Act 2005, the Government Financial Reporting Manual (the FReM) and the Scottish Public Finance Manual (SPFM).

We confirm that to the best of our knowledge and belief having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

**Financial Statements**

- i. We have fulfilled our responsibilities, as set out in the Further and Higher Education (Scotland) Act 2005 for the preparation of the financial statements in accordance with the Public Finance and Accountability (Scotland) Act 2000, the FReM and International Financial Reporting Standards. In particular the financial statements give a true and fair view of the Council's state of affairs in accordance therewith.
- ii. We have complied with the requirements of all statutory directions affecting the Council and these matters have been appropriately reflected and disclosed in the financial statements.
- iii. We acknowledge our responsibility for the design and implementation of internal control to prevent and detect error and fraud.
- iv. We are satisfied that the material judgments used in the preparation of financial statements are soundly based, in accordance with International Financial Reporting Standards and the FReM, and adequately disclosed in the financial statements. There are no other material judgments that need to be disclosed.
- v. Except as disclosed in the financial statements:
  - a. there are no unrecorded liabilities, actual or contingent
  - b. none of the assets of the Council has been assigned, pledged or mortgaged
  - c. there are no material prior year changes or credits, nor exceptional or non-recurring items requiring separate disclosure.

- vi. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of the FReM and International Financial Reporting Standards.
- vii. All events subsequent to the date of the financial statements and for which the FReM and International Financial Reporting Standards requires adjustment or disclosure have been adjusted or disclosed.
- viii. Actual or possible litigation and claims have been accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards and the FReM.
- ix. We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

#### **Information Provided**

- x. We have provided you with:
  - a. access to all information of which I am aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - b. additional information that you have requested from us for the purpose of your audit; and
  - c. unrestricted access to persons within the entity from whom you determine it necessary to obtain audit evidence.
- xi. We have confirmed there were no deficiencies in internal control of which management is aware
- xii. All transactions have been recorded in the accounting records and are reflected in the financial statements.
- xiii. We have considered the risk that the financial statements may be materially misstated as a result of fraud and am not aware of any such fraud or misstatement.
- xiv. We are not aware of any fraud or suspected fraud affecting the entity involving:
  - a. management;
  - b. employees who have significant roles in internal control; or
  - c. others where the fraud could have a material effect on the financial statements.
- xv. We have confirmed we have no knowledge of any allegations of fraud, or suspected fraud, affecting the Council's financial statements communicated by employees, former employees, regulators or others.
- xvi. We have confirmed to you there are no known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

- xvii. We have disclosed to you the identity of all of the Council's related parties and all the related party relationships and transactions of which we are aware.
- xviii. We have disclosed to you all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements

#### **Annual Report**

- xix. The disclosures within the Annual Report fairly reflect our understanding of the Council's financial and operating performance over the period covered by the financial statements.

#### **Annual Governance Statement**

- xx. We are satisfied that the Annual Governance Statement (AGS) fairly reflects the Council's risk assurance framework and we confirm that we are not aware of any significant risks that are not disclosed within the AGS.

#### **Approval**

The approval of this letter of representation was minuted by the Council's Board at its meeting on **10 June 2016**.

Yours faithfully

<Name and title>

Date:

Signed on behalf of the Board



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