Members of the Board of Management
The North Highland College
Ormlie Road
Thurso
Caithness
KX14 7EE

Auditor General
110 George Street
Edinburgh
EH2 4LH

4 December 2006

Dear Board of Management/Auditor General

Report on the audit for the year ended 31 July 2006

We have now completed our audit of the College's accounts for the year ended 31 July 2006.

As part of our responsibilities as external auditor to the College we are required to submit, at the conclusion of each year's audit, a final report addressed both to the members of the Board of Management and to the Auditor General.

This report aims to summarise all significant matters which have arisen during the course of the audit and which we feel are worthy of members' attention.

We have pleasure in attaching our final report on the College's audit for the year to 31 July 2006, which will be submitted to the Board of Management.

We should like to take this opportunity to thank the Principal and her staff for their assistance during the course of the audit.

Yours faithfully

Baker Tilly
Enc.

The North Highland College

Report to those Charged with Governance

Year ended 31 July 2006

Presented to the Audit Committee
On 4 December 2006

Index

Index

This report has been prepared for the sole use of The North Highland College and must not be disclosed to any third party, or quoted or referred to, with the exception of the Scottish Funding Council and Audit Scotland, without our written consent. No responsibility is assumed to any other person in respect of this report.

1. Executive Summary

Audit report

1. Our responsibilities and duties as auditor are summarised in Audit Scotland's Code of Audit Practice and are derived from the Public Finance and Accountability (Scotland) Act 2000. This report to the Board of Management and the Auditor General on the 2005/06 audit is a summary of audit activity for the year. The most significant issues identified by the audit are included in this section with more detail provided in the body of the report

2. We are pleased to record that there are no qualifications in our audit report on the College's 2005/06 accounts, as, in our opinion, the financial statements give a true and fair view of the College's financial position and the income and expenditure for the year; and funds received have been applied for their intended purpose.

Financial Performance

3. The income and expenditure account showed a surplus of £21k (2005 deficit restated £8k) on the year's operations, after the impact of the inclusion of the pension accounting entries required to comply with FRS17 for the first time this year. Prior to this adjustment the surplus for the year was £53k (2005 surplus £41k). The balance sheet has also been adjusted to reflect a prior year adjustment of £1.117m being the deficit on the scheme at 31 July 2004 which increased to £1.42m at 31 July 2005 and reduced back to £1.24m at 31 July 2006 due to an actuarial gain in the year. The pension liability under FRS17 is a long term liability which the College has to recognise as the Highland Council Pension Fund is able to allocate assets and liabilities in the scheme to individual employers. Some local government schemes cannot calculate the individual employer's share of assets and liabilities so those colleges in these schemes can only disclose the overall scheme deficit and are not required to recognise their liability for future pension provision in their balance sheet.

4. A number of minor disclosure adjustments in addition to the FRS17 adjustment were required to the accounts prepared for audit; however only the FRS17 adjustment affected the financial and net asset position of the College.

5. A more detailed analysis of financial performance is undertaken at Appendix D.

Issues Arising

6. In general there were no major unexpected issues identified. During our audit the following matters were discussed and resolved with the College:

- FRS17 – we discussed the disclosure requirements for the new FRS17 pension liability recognition, and the disclosure of the ongoing liability under SSAP24.

- Bad Debts – we discussed the adequacy of the bad debt provision, identifying that there was a general provision of £769 which is not permitted under FRS12 and in fact the specific provision was understated in respect of an old debt payable by UHI Millennium Institute which is not expected to be collected.

7. We did note that due to pressure of time in the Finance Department the quality of the supporting accounts file and the draft financial statements was not of the normal high standard as in previous years. This has resulted in additional time, amounting to a cost of £3,000, being spent by audit staff on the audit.

Corporate Governance

8. Audit work has confirmed that overall the College's corporate governance arrangements are satisfactory and initiatives to strengthen any areas where possible improvements have been identified by the College are continuing. In our opinion, the corporate governance statement included in the accounts complies with the requirements of the SFC and the information disclosed is not inconsistent with other information of which we are aware from our audit.

Internal Audit

9. External audit placed reliance on the work of internal audit in all areas on which they reported in 2005/06. Chiene & Tait's internal audit annual report 2005/06 concluded that, in their opinion management has substantial assurance that the internal controls and governance frameworks which it operates are sufficient to ensure the efficient and effective operation of the organisation and the strategic and operational risks to which the organisation is exposed are being managed.

Concluding Remarks

10. We are pleased to be able to formally conclude the audit of the College's 2005/06 accounts.

11. The key issues for action by the College arising from the audit are set out in an action plan at Section 8.

12. We would like to take this opportunity to convey our thanks to the Principal, Director of Finance and Information and other staff of the College with whom the audit team has had contact, for their courteous and helpful co-operation.

2. Introduction and coverage

1. This report summarises our key findings in connection with the audit of the financial statements of The North Highland College in respect of the year ended 31 July 2006.

2. The scope of our work has already been communicated to you via our Audit Plan document dated September 2006.

3. Our audit has been carried out in accordance with statutory responsibilities under the Public Finance and Accountability (Scotland) Act 2000, and in accordance with the statements of international auditing standards (UK and Ireland) ("IAS") issued by the Auditing Practices Board, and the wider responsibilities embodied in the *Code*. Under this *Code* auditors address and comment upon a number of objectives, together with complying with a number of obligations.

Financial statements

4. Provide an opinion on, to the extent required by the relevant authorities, the College's financial statements and the regularity of transactions in accordance with the standards and guidance issued by the Auditing Practices Board.

Corporate governance

5. Review and report on, to the extent required by relevant legislation and requirements of the *Code*, the College's corporate governance arrangements as they relate to the College's review of its systems of internal control; the prevention and detection of fraud and irregularity, standards of conduct, prevention and detection of corruption and its financial position.

Performance audit

6. Review and report on, to the extent required by relevant legislation and requirements of the *Code*, aspects of the College arrangements to manage its performance, as they relate to the economy, efficiency and effectiveness in the use of resources.

7. Audit Scotland has issued a document entitled *Statement of responsibilities of auditors and audited bodies* which accompanies the *Code*. This briefly summarises where the responsibilities of auditors begin and end and what is expected from the College. Your attention is drawn to this document.

8. We have planned our work with a view to ensuring:

    - minimum disruption to your staff and operations;
    - that reports submitted to you are constructive and clear, focusing on the issues that matter; and
    - that surprises are avoided and that good communications are maintained with you throughout the assignment.

9. A summary of adjusted and unadjusted misstatements identified during the audit has been prepared and is included in Section 11.

10. Appendix B sets out the additional services provided to the College in the year.

11. We consider that the audit approach adopted will provide the Audit Committee with the required confidence that a thorough and robust audit has been carried out.

3. Financial Statements and Related Matters

Introduction

1. The financial statements of the College are the means by which it accounts for its stewardship of the resources made available to it and its financial performance in the use of these resources. In accordance with the Further and Higher Education (Scotland) Act 1992 and the Accounts Direction issued by the Scottish Funding Council (SFC), it is the responsibility of the College to prepare financial statements, which give a true and fair view of the College's financial position and the income and expenditure for the year.

2. The Public Finance and Accountability (Scotland) Act 2000 requires that the auditor shall place on the abstract of accounts an audit report, which contains an opinion as to whether the College has fulfilled this responsibility. The format of the audit report directed by the Auditor General for Scotland clarifies the respective responsibilities of management and auditors in relation to the accounts and requires auditors to set out the basis on which they have formed their audit opinion.

Audit Report

3. We are pleased to record that there are no qualifications in our audit report on the College's 2005/06 accounts, as, in our opinion, the financial statements give a true and fair view of the College's financial position and the income and expenditure for the year; and funds received have been applied for their intended purpose.

Financial Performance

4. The income and expenditure account showed a surplus of £21k (2005 deficit restated £8k) on the year's operations, after the impact of the inclusion of the pension accounting entries required to comply with FRS17 for the first time this year. Prior to this adjustment the surplus for the year was £53k (2005 surplus £41k). The balance sheet has also been adjusted to reflect a prior year adjustment of £1.117m being the deficit on the scheme at 31 July 2004 which increased to £1.42m at 31 July 2005 and reduced back to £1.24m at 31 July 2006 due to an actuarial gain in the year. The pension liability under FRS17 is a long term liability which the College has to recognise as the Highland Council Pension Fund is able to allocate assets and liabilities in the scheme to individual employers. Some local government schemes cannot calculate the individual employer's share of assets and liabilities so those colleges in these schemes can only disclose the overall scheme deficit and are not required to recognise their liability for future pension provision in their balance sheet.

5. The surplus represents an improved position from the previous year's deficit of £8k after the FRS17 pension adjustment. The improved position is due to the fact that the College has managed to increase income whilst keeping tighter control on expenditure, hence increasing the surplus made.

6. A more detailed analysis of financial performance is undertaken at Appendix D.

7. In June 2006 the Scottish Funding Council (SFC) published a circular, which contained a series of performance indicators (PIs) assessing the financial performance of further education colleges for 2004/05. While it is accepted that there are some valid criticisms of the methods of identifying unit costs and the fact that each college has some specific geographically relevant factors that influence costs they are a useful indication of one basis on which external readers will assess the College.

8. The indicators show that in 2004/05 the College operated above the sector average in some areas and below in others as detailed below;

- Designated reserve plus income & expenditure reserve as a percentage of total income was 13.9% compared to the sector average of 7.0%.
- Days' cash to total expenditure of 27 compared to the sector average of 57.
- Interest cover of 4.4 compared to the sector average of 4.0.
- Operating surplus percentage of total income was 0.8% compared to the sector average of 1.8%;
- Historical cost surplus as a percentage of total income was 1.2% compared to the sector average of 3.1%;
- Current assets over current liabilities of 1.9 compared to the sector average of 1.3;

Submission of Accounts

9. The accounts were submitted for audit on 6 November 2006, in line with the agreed timetable. The accounts submitted for audit were not complete and information was still outstanding two weeks after the completion of audit fieldwork. The supporting working papers were also not as complete as in prior years. This appears to be due to pressure of other work on the Finance Team. However all information has now been received and queries arising from the audit have all been resolved. Key staff were readily available for consultation throughout the audit process, although the Director of Finance and Information had several other calls on his time.

Issues Arising

10. During the course of the audit a number of minor issues arose which were resolved in discussion with, or formally reported to the Director of Finance and Information. This practice is an established part of the audit process. The FRS17 adjustment referred to in paragraph 4 was a significant adjustment

processed after the audit fieldwork was complete. This is the first year the pension deficit had to be incorporated and considerable time had to be spent by the Finance Team in ensuring accounting entries and disclosure were correct. The remainder of this report draws to the attention of the Board of Management and the Auditor General any matters of particular significance or interest, which arose from the audit.

Matters brought forward from the 2004/05 audit report

11. During the course of the College's bursary fund audit it was noted that there were minor differences between the Student Education Award Processing (SEAP) System and the SUN financial ledgers. The College has now moved from the SEAP System to Tequois and regular reconciliations are undertaken between the two systems

12. A misappropriation of petty cash occurred at the College's Alness site. A review of procedures within Alness was undertaken and controls have been strengthened following the implementation of greater segregation of duties.

New matters arising in 2005/06

13. This is the first year that FRS 17 has impacted on the financial statements; therefore the disclosure and the impact on the financial statements were reviewed as part of the audit process, see paragraph 4. This has resulted in the balance sheet at 31 July 2006 including a pension deficit provision of £1.24m reducing the College's net asset position to £6.13m. The provision reflects the Colleges future obligation to meet employees pension liabilities as they fall due.

4. Corporate Governance

Introduction

1. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of an organisation. The College has a responsibility to put in place arrangements for the conduct of its affairs, ensure the legality of activities and transactions and to monitor the adequacy and effectiveness of these arrangements in practice.

2. As auditor we have a responsibility to report on the College's corporate governance arrangements.

System of Internal Council

General arrangements

3. A review and assessment of the College's corporate governance arrangements was carried out. This assessment included a review of the College's committee minutes and completion of a number of standard checklists. The checklists cover issues relating to systems of internal control, arrangements for the prevention and detection of fraud and corruption, standards of conduct, issues of legality and the College's financial position. This work confirms that overall the College's corporate governance arrangements are satisfactory and initiatives to strengthen any areas of improvements are continuing.

4. In our opinion, the corporate governance statement included in the accounts complies with the requirements of the SFC and the information disclosed is not inconsistent with other information we are aware of from our audit.

Financial Systems

5. It is the responsibility of management to maintain adequate financial systems and associated internal controls. The auditor evaluates the significant financial systems and the associated internal controls, both for the purpose of giving an opinion on the statement of accounts, and in order to report to the College on the adequacy of such systems and controls. Audit's work confirmed that overall the financial systems are adequate for the purpose of producing the financial statements. The most significant issues to be addressed are detailed at Section 8.

6. It is emphasised that the weaknesses identified are only those that have come to the attention of the auditor during the normal audit work in accordance with the Code of Audit Practice and, therefore, are not necessarily all the weaknesses which may exist.

Fraud and Corruption Arrangements

7. During 2005/06, no instances of fraud were identified by the College.

8. The College's arrangements for preventing, detecting and identifying fraud and corruption were assessed during the audit. This assessment included a review of the College's committee minutes and completion of a standard checklist. The work confirms that overall the College's fraud and corruption arrangements are adequate.

Review of Internal Audit

9. Internal audit is a key element of the internal control system set up by management. A strong internal audit function is necessary to ensure the continuing effectiveness of the internal control systems established. The College, therefore, needs to have in place a properly resourced internal audit service of good quality. To maximise the reliance that may be placed on internal audit and to avoid duplication of effort, the adequacy of internal audit is assessed each year.

10. Internal audit services are provided by Chiene & Tait. An assessment was made of the adequacy of the internal audit input and it was concluded that external audit can place formal reliance on the work of internal audit. Accordingly reliance was placed on the work of internal audit in all areas on which they reported in 2005/06.

11. Chiene & Tait's internal audit annual report 2005/06 concluded that, in their opinion management has substantial assurance that the internal controls and governance frameworks which it operates are sufficient to ensure the efficient and effective operation of the organisation and the strategic and operational risks to which the organisation is exposed are being managed.

5. Performance Audit

1. It is the College's responsibility to ensure that proper arrangements are in place to secure the economy, efficiency and effectiveness in the use of its resources. As part of the auditor's statutory responsibilities we are required to satisfy ourselves that the College has made appropriate arrangements to fulfil its responsibilities

2. Throughout our appointment, the Performance Audit Section of Audit Scotland will, from time to time, require auditors to undertake field work on topics which form part of Audit Scotland's VFM centrally directed studies programme. No such studies were included within the 2005/06 programme for the FE sector.

3. SFC indicators: as reported in section 3 of this report the SFC now publishes performance indicators (PIs) which assess the financial performance of further education colleges. Also, SFC now publishes student and staff performance indicators for further education colleges, which they use for benchmarking purposes. The College is to keep the inter-college comparisons produced by SFC under review, to identify areas where current practices could be reviewed to further improve performance, by sharing and discussing good practice with other Colleges.

6. Audit and accounting issues identified at planning stage

Key area of audit focus	Our approach	Resolution
The College has suffered a decrease in full time students over the past few years due to high levels of employment in the area and the loss of some students to UHI. This has resulted in the College not meeting its SUMs targets. A further decrease in SUMs could result in a reduction in the level of funding received from the SFC. In addition, the future decrease in European funding in the sector is likely to increase pressure on the College's income generating ability.	We will review the College's strategies to overcome this problem, including the development of research centres of excellence and growing HE delivery. This will include consideration of whether the proposed research centres will break even with regard to the level of income they are likely to generate. We will review also the College's plans to replace this income in the face of the future loss of this income.	The College has developed a three year strategic plan which we reviewed and is the basis for what the College intends to do to rectify the issue including the following: a) develop and sign partnership agreements with local consortiums; b) Identifying local skill shortages within specific local schools and develop "skills for work" programmes as appropriate.
The College's curriculum is considered to be in need of modernisation in line with trends throughout the sector, with focus given to developing a range of niche areas of study in order to increase the number of full time students applying to the College.	We will consider management's approach in this area in order to ensure that sufficient consideration has been given to both the risks and potential rewards associated with such a move.	It plans to broaden its curriculum by: a) the packaging of on-line learning material in subject areas such as Health, Hospitality and Land Based studies to suit the needs of school based learners. b) A partnership based approach, involving schools and local community groups, to provide access to conventional courses from subject areas not always available in the small school curriculum.

Key area of audit focus	Our approach	Resolution
The College's management team has been in place for a number of years. As such, succession planning is an issue for the College as it must be ensured that any changes at senior management level are made with minimal disruption to the College's operations. This should encompass a skills audit of management and give due consideration to the attributes required to drive forward the alternative strategies being considered by the College.	We will consider the profile of the College's management team and Committee membership to ensure that succession issues are being addressed satisfactorily and make recommendations where this is considered to be appropriate.	It was reported to the Board of Management on the 3rd May 2006 that the Board had lost three members and that there was now a need to advertise externally for new members. The Board must ensure that the skills base of the Board membership is enhanced through the new Board appointments.
The College contributes to the Highland Council local government pension scheme. The College's share of the scheme's assets and liabilities can be identified therefore recognition of the pension liability under FRS 17 is required in the 2005/06 financial statements.	Our standard audit procedures will be used to consider how the results of the valuation of the pension scheme are incorporated into the financial statements with disclosure of a prior year adjustment. This will include a review of the adequacy of the assumptions used in the valuation. We will also discuss with management the impact on future funding requirements of the pension scheme deficit.	FRS 17 requirements disclosed in full in the accounts. This resulted in a £32k reduction in the surplus for the year to 31 July 2006 and the inclusion of a prior year adjustment of £1.117m.
International Auditing Standards, which came into effect on 1 January 2005, require us to document more fully the key controls within the College's systems, and consideration of key business and operational risk and the organisations culture, in relation to formal management.	Discussion and documentation of key controls over completeness of income, accuracy of payroll costs and validity and accuracy of other costs together with walk through tests.	Internal control testing was carried out during the course of the audit and walkthrough testing performed on the controls in place and no major issues were noted.

7. Audit and accounting issues identified during the audit

Issue	Resolution
No significant audit or accounting issues were identified during the audit.	-

8. Internal control issues

Matters arising in this year's audit

We have set out below those areas of internal control weakness that we consider should be brought to the attention of the Audit Committee which arose as a result of our audit work. This does not constitute a comprehensive statement of all weaknesses that may exist in internal controls or of all improvements which may be made.

Fact and potential consequence	Recommendations	Management response	Timing of implementation and responsibility
Budgetary Controls There is no evidence that a review of the final input budget to the system is conducted. The budget is only input after approval by the Board of Management.	The policy should be updated to accurately reflect procedures.	The minor procedural point is accepted. However the College would stress that all financial performance is monitored against the agreed FFR budget.	Director of Finance January 2007
Receipt of Goods No delivery notes are kept for goods received therefore there is no evidence of check to purchase order.	Delivery notes should be maintained and signed off against purchase order.	The College does not have a central goods received point and relies upon the ordering sections to verify receipt of goods prior to payment. The College will consider a central receipt point to streamline the goods received process.	Senior Management Team April 2007

Fact and potential consequence	Recommendations	Management response	Timing of implementation and responsibility
Procedure Update The financial procedures state that the purchase order is marked to agree the delivery is correct. This is not what occurs, the invoice is signed by the service leader to confirm the delivery was correct.	The procedures should be updated to accurately reflect the controls currently in place.	Point accepted	Director of Finance January 2007
Invoices Received Invoices are not stamped or signed to confirm payment. There is therefore a risk of invoices being paid twice in error.	All invoices should be marked as paid when paid.	Point accepted	Director of Finance January 2007
Debtor Ageing The ageing of the debtors is incorrect due to it being produced by the Vision system and staff not yet being familiar with the system. It is important to have an accurate record of the ageing of debtors so that debts are pursued and collected on a timely basis.	We would recommend that all relevant staff are trained on the Vision system so that accurate reports are produced.	The point regarding further training is accepted. However, the introduction of Vision has greatly increased the functionality and efficiency of College financial reporting.	Director of Finance February 2007

Fact and potential consequence	Recommendations	Management response	Timing of implementation and responsibility
Debtor Provision The financial statements include a general bad debt provision of £729, although the general provision is immaterial this is not in line with FRS 12 and as such we have included a write-back within our potential audit adjustments. In addition the specific bad debt provision was understated by £5k in respect of a debtor due from UHI which is unlikely to be recoverable.	We would recommend that a specific bad debt provision is calculated in future.	Point accepted. The general provision reflected a temporary position which should have later been converted to a specific provision. However, due to other commitments this did not happen.	Director of Finance Ongoing
Statutory Accounts & Supporting Working Papers The pack provided when we commenced our audit fieldwork was not up to its normal high standard resulting in additional time being spent by the audit team following up and reviewing outstanding information. This has resulted in additional audit time amounting to approximately £3,000. We accept that some costs may have been due to changes in the audit team and have discounted our proposed additional fee accordingly.	While we are aware that these issues arose due to additional pressure on the Finance Team due to other demands on their time, in future it is recommended that the audit does not commence until the pack is completed.	The 2005-06 audit took place against exceptional circumstances. In particular the College Board is considering a number of significant projects. The option appraisal and affordability analysis work have required a significant time commitment from the Director of Finance in addition to his normal duties. The requirement to comply with FRS 17 for the first time was an additional burden.	Not applicable.

BAKER TILLY

9. Significant accounting policies

- **Pension Schemes**
  Retirement benefits to employees of the College are provided by the Scottish Teachers' Superannuation Scheme (STSS) and the Local Government Superannuation Scheme (LGSS). These are defined benefit schemes, which are externally funded and contracted out of the State Earnings Related Pension Scheme. Contributions to the STSS scheme are charged to the income and expenditure account so as to spread the cost of pensions over employees' working lives with the College in such a way that the pension cost is a substantially level percentage of current and future pensionable payroll. The contributions are determined by qualified actuaries on the basis of periodic valuations using the projected unit method. Any deficit on the STSS scheme is not quantified or reflected in the financial statements.
  Where enhanced pension payments are a liability of the College, provision is made for their capital cost in the year of retirement.
  The LGSS scheme is a defined benefit scheme and as noted earlier, the assets and liabilities relating to the College can be identified, it has therefore been incorporated in the financial statements in line with FRS17.

- **Tax**
  As a registered charity the College benefits by being broadly exempt from corporation tax on income it receives from tuition fees, interest and rents.

  The College is exempted from levying VAT on most of the services it provides to students. For this reason the College is generally unable to recover input VAT it suffers on goods and services purchased.

- **Land and Buildings**
  Land and buildings inherited from the local authority are stated in the balance sheet at a valuation less amounts written off by way of depreciation. They have been valued at depreciated replacement cost on an existing use basis, which is considered to be equivalent to open market value on an existing use basis. Freehold land is not depreciated.

  Land and buildings acquired since incorporation are included in the balance sheet at cost.

- **Income recognition**
  Income from grants, contracts and other services rendered are recognised in the income and expenditure account in proportion to the extent of completion of the contract or service concerned. All income from short-term deposits are credited to the income and expenditure account in the period in which it is earned. The main annual recurrent allocation from SFC, which is intended to meet recurrent costs, is credited direct to the income and expenditure account.

10. Uncertainties, risks, exposures, estimates and judgemental issues

Set out below are those matters that we have identified in respect of the above, during the course of our work, that we consider should be brought to the attention of the Audit Committee.

Key Issue	Audit Impact	Resolution
Depreciation The depreciation calculation applied by the College is based on an estimate of the expected useful life of each fixed asset owned by the College. Rates used are as follows: Building 10-60 years Plant & Equipment 3 years Computer Equipment 3 years Motor Vehicles 4 years	We consider whether the policy adopted by the College is realistic, and whether or not any material misstatement would apply if we were of the opinion that an alternative charge would be more appropriate. We also ask the Board to review these rates for reasonableness.	We reviewed the reasonableness of the depreciation policy, and have performed tests to determine the reasonableness of the actual charge based on the accounting policies adopted. We did not identify any material misstatements as a result of this testing.

11. Unadjusted/adjusted misstatements

A summary of the unadjusted/adjusted errors identified during the course of our work is set out below, analysed between errors of fact and differences in judgement.

College	Adjusted misstatements		Unadjusted Misstatements Factual		Unadjusted Misstatements Judgemental	
	Income& Expenditure effect Dr/(Cr) £	Balance Sheet effect Dr/(Cr) £	Income& Expenditure effect Dr/(Cr) £	Balance Sheet effect Dr/(Cr) £	Income& Expenditure effect Dr/(Cr) £	Balance Sheet effect Dr/(Cr) £
Over accrual of Burghfield Invoice - effect on P&L - effect on creditors	 - -	 - -	 (1,684) -	 - 1,684	 - -	 - -
Under accrual of ESF Claim - effect on Income - effect on Accrued Income(Debtors)	 - -	 - -	 (2,548) -	 - 2,548	 - -	 - -
Error in accrual of ARC Income - effect on Income - effect on Accrued Income (Debtors)	 - -	 - -	 7,941 -	 - (7,941)	 - -	 - -
UHI Debt due since 2001 - effect on income - effect on debtors	 - -	 - -	 5,000 -	 - (5,000)	 - -	 - -
Debtor provision not in line with FRS 12 - effect on debtors - effect on income and expenditure	 - -	 - -	 - (729)	 729 -	 - -	 - -

College	Adjusted misstatements		Unadjusted Misstatements Factual		Unadjusted Misstatements Judgemental	
Legal costs at year end not accrued						
- effect on creditors	-	-	-	(2,772)	-	-
- effect on income and expenditure	-	-	2,772	-	-	-
Exchange rate difference						
- effect on bank	-	-	-	(12)	-	-
- effect on income and expenditure	-	-	12	-	-	-
Mis disclosure of car w/o						
- effect on income and expenditure – dep	-	-	(5,100)	-	-	-
- effect on income & expenditure – loss on sale	-	-	5,100	-	-	-
VAT included in Trade Creditors						
- effect on trade creditors	-	-	-	11,211	-	
- effect on Other taxes	-	-	-	(11,211)	-	
Debit balances included in Trade Creditors						
- effect on Trade Debtors	-	-	-	1,804	-	-
- effect on Trade Creditors	-	-	-	(1,804)	-	-
Credit balances included in Trade Debtors						
- effect on Trade Creditors	-	-	-	(13,749)	-	-
- effect on Trade Debtors	-	-	-	13,749	-	-
Negative ESF Debtor Balance						
- effect on Accrued Income	-	-	-	190	-	-
- effect on Deferred Income	-	-	-	(190)	-	-
Total	-	-	10,764	(10,764)	-	-

12. Concluding Remarks

1. We are pleased to be able to formally conclude the audit of the College's 2005/06 accounts.

2. The key issues for action by the College arising from the audit are set out in the attached action plan.

3. We would like to take this opportunity to convey our thanks to the Principal, Director of Finance and Information, Finance and other staff with whom the audit team has had contact, for their courteous and helpful co-operation.

Baker Tilly

4 December 2006

Appendix A – Emerging issues

Emerging issues for the Sector

Procurement policy

Over the next two years the FE sector is tasked to deliver £78 million savings, which in simplistic terms represents approximately £200,000 per college. In order to achieve this all colleges will need to make significant changes in the way they manage procurement.

To achieve these savings the college will need to establish effective and consistent procedures and controls, and review its policy for procurement of goods and services to ensure that value for money is obtained on all contracts for goods and services and any areas where efficiencies and savings could be made. The college should review its purchasing strategy to consider whether savings could be achieved via:

- Price reduction
- Cost avoidance
- Added value
- Improvements to the purchasing process

VAT on new building works

Colleges recognise that if they construct a building predominately for the use of grant funded students (e.g. those under 19) the construction of the building will not be subject to VAT. The position becomes more problematic the greater the business use of the new building. Business use can come in many forms, such as sales of meals to non-students, vending machines, photocopying charges and hire of premises as well as any charges to students by way of fees, even if heavily subsidised by the LSC.

However greater opportunities are now available given the Court of Session judgement in Telford College that a further education college is a public body which provides non-business education, even to fee paying students. The college needs to determine whether it has paid VAT on the construction of new buildings, or parts of buildings in recent years. If so, retrospective claims can be made for VAT relief.

Land disposals

There is a risk that certain profits from the disposal of land could be taxable under section s776 of ICTA 1988. This section applies where land is developed with the sole or main object of realising a gain from disposing of land when developed. In particular when the disposal proceeds are contingent on development, e.g. the deal involves a fixed sum, plus overages depending on how many houses the developer builds. Any proceeds in respect of the contingent element will be liable to s776 tax.

ASB Convergence Plan

The ASB is pursing a programme of convergence between UK Accounting standards and IFRS by issuing new UK standards that are based on IFRS. As a result, over time, all UK entities will be preparing their financial statements in accordance with standards based on the same core set of IFRS. The ASB remain at consultation stage in respect of this convergence, which may not impact on organisations in the UK other than plc's and larger entities.

Draft Statement of Principles for Public Benefit Entities and the Charities SORP

It is possible that at some point in the future colleges will be required to comply with the Statement of Principles for Financial Reporting Proposed Interpretation for Public Benefit Entities (currently in draft) or the Charities SORP. The main impact of these two proposals would be the on recognition of deferred capital grants. Colleges currently recognise grants under SSAP 4, i.e. the grant is released to the income and expenditure account over the life of the assets acquired with the grant, whereas under the statement and the Charities SORP they would need to recognise all the income in the income and expenditure account on receipt

Members report

As best practice it is recommended that the college’s members report should also be changed to more closely resemble the trustees report in the Statement of Recommended Practice “Accounting and Reporting by Charities” (SORP 2005).

Financial Reporting Exposure Drafts ("FRED)

(a) *Proposed Amendment to FRS 17: Retirement Benefits*

On 31 May 2006, the ASB published an exposure draft setting out proposals to amend FRS 17 'Retirement Benefits' and to issue a new Reporting Statement 'Retirement Benefits – Disclosures'.

The amendment achieves convergence on disclosure requirements between IAS 19 and FRS 17 by replacing the disclosure requirements in FRS 17 with those of IAS 19.

The FRED proposes the amendment to FRS 17 should be effective for accounting periods ending on or after 31 December 2006.

(b) *FRED 36: Business Combinations*

FRED 36 sets out proposals for how the IFRS3 business Combinations could be implemented into UK accounting standards, and sets out consequential amendments to several UK accounting standards.

The amendments proposed will require all business combinations to be accounted for using the acquisition method. Merger accounting will not be permitted, which will impact on colleges accounting for mergers.

It should be noted that currently when the combination has the characteristics of an acquisition, for example a larger college acquiring the assets and liabilities of a smaller college in financial difficulty, then that combination should be accounted for as an acquisition. As there is no consideration for the acquisition a significant level of negative good will would arise when comparing cost (nil) to the fair value of assets acquired. In this situation the LSC have suggested a true and fair override over the treatment of negative goodwill.

Effective date: Periods commencing on or after 1 January 2007.

(c) *FRED 37 and 38: Intangible assets and impairment of assets*

Intangible assets comprise an increasing proportion of the assets of many entities, including colleges. The FRED reconsiders the definition of intangible assets. They are (FRS10 Goodwill and Intangible assets) currently recognised when they are capable of being separately disposed of, without disposing of a business of the undertaking. The new proposals change the identification criterion to include the fact that the asset is *separable*, i.e. is capable of being separated or divided from the entity and sold either individually or together with a related asset or liability.

The most significant changes arising as a result of this are likely to result from the potential capitalisation of both Computer Software and Development costs (e.g. website costs).

The exposure draft FRED 38 will require the recoverable amount of an intangible asset with an indefinite useful life to be measured annually, irrespective of whether there is any indication that it may be impaired.

Effective date: Periods commencing on or after 1 January 2007.

(d) FRED 39: Amendments to FRS12

The Exposure Draft no longer uses the term ‘provision’ but refers to ‘non-financial’ liabilities, and no longer applies the terms ‘contingent liabilities and assets’. A non-financial liability is a liability other than a financial liability, i.e. any financial liability that is not a contractual obligation that gives rise to a financial asset of one enterprise and a financial liability/equity instrument of another.

The Exposure Draft uses the term ‘contingency’ to refer to an uncertainty about the amount that will be required to settle the liability, rather than uncertainty as to whether the liability exists. It also distinguishes between conditional and unconditional obligations, whereby all unconditional obligations that meet the definition of a liability are considered for recognition.

The probability criterion is moved from recognition to measurement of the liability which will lead to more liabilities being recognised, e.g. if a college was being sued for damages of £5 million, with a 25% chance of losing the case, under the new proposals a non financial liability would be provided for of £1.25 million, rather than disclosure as a contingent liability under FRS12.

Effective date: Periods commencing on or after 1 January 2007.

Updated Combined Code on Corporate Governance

On 27 June 2006 the Financial Reporting Council (“FRC”) published an updated version of the Combined Code on Corporate Governance (“Combined Code”). The Listing Rules will not formally apply to the revised Combined Code until a consultation exercise, which is expected to start in September 2006, has been carried out by the Financial Services Authority. However, the FRC have indicated that in view of the limited nature of the changes and the strong support they had received, they would encourage listed companies and their investors to adopt the updated Combined Code on a voluntary basis for reporting years commencing on or after 1 November 2006.

The college currently applies the principles set out in the revised Combined Code on Corporate Governance issued by the London Stock Exchange in July 2003, and will be required to comply with the updated Combined Code. As best practice the college should consider adopting the updated Combined Code on a voluntary basis for the year ended 31 July 2007.

Financial Memorandum

A new Financial Memorandum is in place from January 2006, in order to reflect the current financial relationships between Colleges and the SFC, as well as the requirements on Government and the SFC and good practice that has emerged over the years.

Appendix B – Additional Services

Additional Services

Under the interim Audit Code of Practice we are required to report to the Audit Committee any services we performed for the College in addition to the external audit of the financial statements. In the year to 31 July 2006 we carried out the Student Support Funds audit. The total fees charged in relation to this service in the year to 31 July 2006 were £1,600 (excluding disbursements and VAT).

Appendix C – Letter of representation

THE NORTH HIGHLAND COLLEGE
ORMLIE ROAD
THURSO
CAITHNESS
KX14 7EE

Baker Tilly
23 Queen Street
Edinburgh
EH2 1JX

11 December 2006

Dear Sirs

AUDIT OF FINANCIAL STATEMENTS – YEAR ENDED 31 JULY 2006

We confirm, to the best of our knowledge and belief, and having made appropriate enquiries of other officials of the college, the following representations given to you in connection with your audit of the college's financial statements for the year ended 31 July 2006.

1. We acknowledge as governors our responsibility for the fair presentation of the financial statements in accordance with United Kingdom Generally Accepted Accounting practice. All the accounting records have been made available to you for the purpose of your audit and all transactions undertaken by the college have been properly reflected and recorded in the accounting records. All other records and related information and explanations, including minutes of all meetings of governors, committees of governors and management held between the beginning of the accounting period and the date of this letter, have been made available to you. We confirm that as far as we are aware, there is no relevant audit information of which the auditors are unaware.

2. We confirm that:

   a. We acknowledge responsibility for the design and implementation of internal control to prevent and detect fraud;

   b. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud;

   c. We have disclosed to you our knowledge of fraud and suspected fraud affecting the college involving:

      i. Management;
      ii. Employees who have significant roles in internal control; and
      iii. Others where the fraud could have a material effect on the financial statements;

   d. We have disclosed to you our knowledge of any allegations of fraud, or suspected fraud, affecting the college's financial statements communicated by employees, former employees, analysts, regulators or others.

3. We have not adjusted the following misstatements, which were drawn to our attention by the auditors, because they are immaterial to the overall disclosure of the financial statements.

	Value £	I & E Effect £
Being debit balances included in Creditors which should be in Debtors	1,804	-
Being VAT Liability included in Trade Creditors	11,212	-
Being Burghfield Consultancy over accrual of invoice	1,684	1,684
Being credit balances included in Debtors which should be in Creditors	13,749	-
Being negative ESF balance included in Accrued Income	190	
Being error in accrual of ARC income	7,941	(7,941)
Being under accrual of an ESF claim	2,548	2,548
Being UHI bad debt unprovided	5,000	(5,000)
Being provision not in line with FRS 12	729	729
Being over depreciation of asset	5,100	-
Being under accrual of legal fees	2,772	(2,772)
Exchange rate differences	12	(12)
Net Income and Expenditure Effect – decrease to surplus		**(10,764)**

4. We confirm that full disclosure is made in the financial statements of:-

   a. any arrangement, transaction or agreement to provide credit facilities (including loans, quasi-loans, or credit transactions) for senior post holders;

b. Transactions and balances with related parties (including members of the corporation and senior post holders) including:-

    i. the names of the transacting parties;
    ii. a description of the relationship between the parties;
    iii. a description of the transactions;
    iv. the amounts involved (even if nil);
    v. any other elements of the transactions necessary for an understanding of the financial statements;
    vi. the amounts due to or from related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and
    vii. amounts written off in the period in respect of debts due to or from related parties;

c. outstanding capital commitments contracted for at the balance sheet date;

d. all contingent liabilities including details of pending litigation and material claims against the college;

e. all guarantees or warranties or other financial commitments.

5. We have disclosed all events of which we are aware which involve possible non-compliance with those laws and regulations which provide a legal framework within which the college conducts its business and which are central to its ability to conduct that business. We have also notified you of the actual or contingent consequences which may arise from such non-compliance.

6. We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

   There have been no events (other than those already disclosed in the financial statements) since the balance sheet date, which necessitate revision of the figures included in the financial statements or inclusion of a note thereto. Should such further material events occur prior to your signature of the audit report we will advise you accordingly.

Fixed assets

7. Disposals - Buildings, plant and equipment, which have been disposed of, scrapped, or otherwise taken out of use, have been eliminated from the financial statements.

8. We confirm that all additions made to fixed assets in the year were additional assets required and not replacements of assets disposed of in the year. No disposals were made in the current year.

Internal Audit

9. To the best of our knowledge and belief all internal audit reports and reports from Chiene and Tait have been made available to you.

Partnerships and other relationships

10. To the best of our knowledge and belief we have made available to you details of all partnerships, franchises, joint ventures, subsidiary companies, associated companies and trusts that the college is associated with.

Income sources/initiatives

11. To the best of our knowledge and belief the college has complied with the terms and conditions attached to all income brought into the financial statements, including meeting non-financial targets and outcomes as required, and has provided you with details of all income sources.

12. The college has carried out appropriate procedures to ensure that it has not claimed double funding for blocks of provision or individual students.

European Structural Funds

13. To the best of our knowledge and belief we have made available to you details of any involvement in activity funded from European Structural Funds (ERDF and ESF and other as appropriate) and income received in respect of that activity and the college has complied with any terms and conditions attached to that income.

14. We have made available to you copies of any audit reports relating to claims for European Structural Funds.

15. Stock is stated in the financial statements at the lower of cost and net realisable value. There is no provision required for obsolete or damaged stock.

16. The following debtor balances are recoverable:
    - Stolt Sea Farm £9,512
    - Ross & Cromarty Enterprise Limited £3,821

17. The college has satisfactory title to all assets and there are no liens or encumbrances on the college's assets, except those disclosed in Note 20.

18. We confirm that we are acting within our charitable objects and primary purpose trading and that tax has been assumed as nil on this basis.

19. The financial statements are free of material misstatements, including omissions.

We confirm that the above representations are made on the basis of enquiries of management and staff with relevant knowledge and experience (and, where appropriate, of inspection of supporting documentation) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

The contents of this letter were considered and approved by the Board at its meeting on 11 December 2006.

Yours faithfully

Signed on behalf of the Board of Management of The North Highland College

Chairman ....…………………................

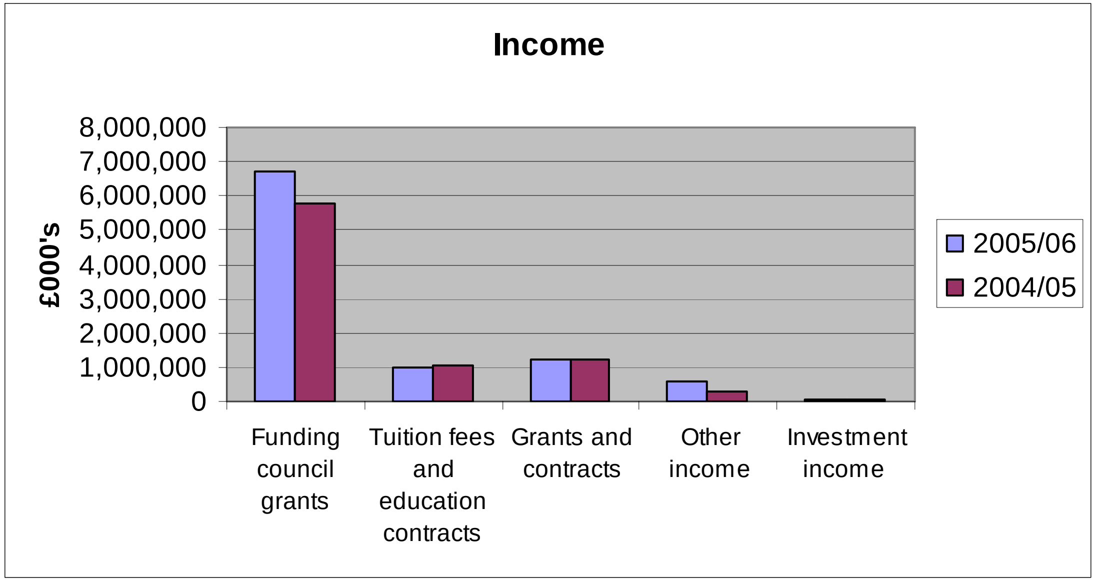
Principal ....……………..……………..

Date ……………………… **2006**

Appendix D – Analysis of Financial Performance

Detailed analysis of financial performance

Income



Source: Audited financial statements

Funding council grants

There has been an increase of £966k in the current year, primarily due to increases in SFC grant funding (£701k), and an increase in UHI Grants of 265K for 2005/06.

Tuition fees and education contracts

There is a decrease of £23k overall although tuition fees and charges have risen by £44k. The reduction has come about due to fewer education contracts won in the current year.

Other grants and contracts

Overall there has been a marginal decrease of £2k which is mainly due to the following:

- Decrease in European Funding of £14k;
- Increase in Other Funds of £70k mainly in relation to research grants;
- Decrease in Student allowances for LEC contracts £20k; and
- Decrease in the release of deferred capital grants of £38k.

Other Income

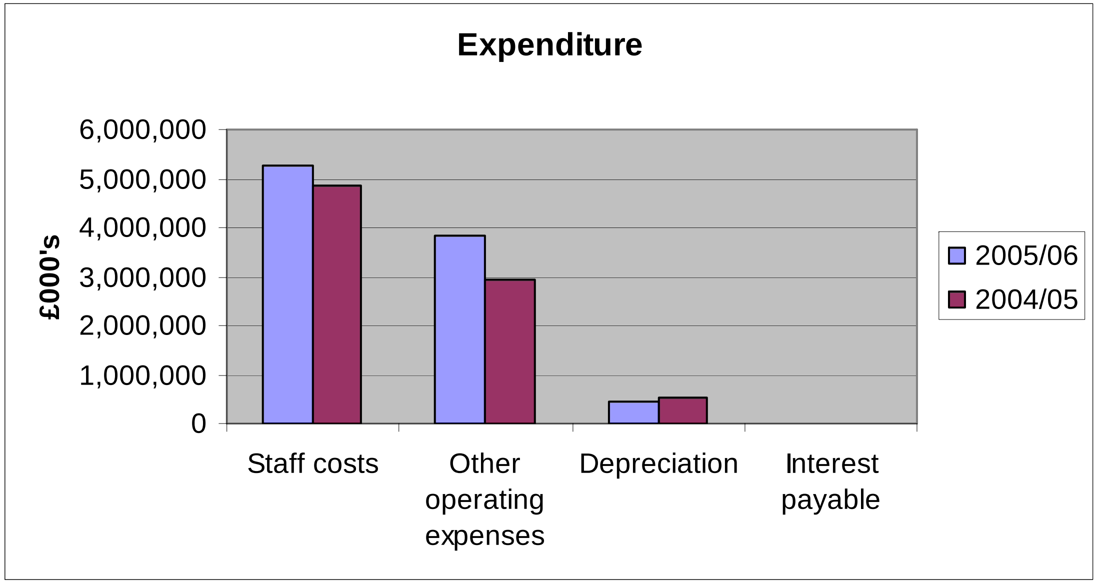
There is an increase of £280k mainly due to the following:

- Online income has risen by £107k which is income derived from the expertise the College has in making curriculum's available on line;
- Highland History Centre donations amounted to £104k in the current year, no such donations in the prior year;
- Catering and Residency including the training restaurant income has risen by £48k due to a new catering contract with the DERC Centre as well as providing a room in the Solar building for the local nursing home as a day centre; and
- Other immaterial movements explain the further £21k increase.

Investment income

There has been an increase of £28k from last year due to £15k net return on pension assets recognised this year under FRS17 and also better management of funds in the current year. Funds were transferred to deposit account on a timelier basis in the current year.

Expenditure



Source: Audited financial statements

Staff costs

Staff costs have risen by £424k in the year mainly due to an average pay increase of 3.5% and an increase in employees in the current year.

Other operating expenditure

Increase of £885k is in line with the increase in income. Increases have arisen primarily due to**:**

- An increase of £597k in operating costs relating to teaching activities;
- An increase of £183k in respect of premises costs; and
- An increase of £61k in administrative costs

Depreciation

Depreciation has decreased by £77k in the year due to more assets being fully depreciated in 2005/06.

Interest payable

Interest payable has decreased by £12k year on year, this is mainly due to the net return on pension assets being a charge of £11k in the year to 31 July 2005 where income of £15k was earned this year.

Balance Sheet

- The College's net asset value as originally reported in last years financial statements to 31 July 2005 has decreased from £7.471m to £6.125m in the year. The 2005 figures have been restated to incorporate the revised treatment of the LGSS pension scheme which resulted in the recognition of a prior year adjustment of £1.117m being the deficit on the pension scheme at 31 July 2004. The impact during the year of complying with FRS17 has been to reverse the original surplus of £41k for the year to 31 July 2005 to a deficit of £8k. Hence the net asset value of the restated balance sheet at 31 July 2005 was £6.121m. There has therefore been an overall increase in net assets on a like for like basis to £6.125m this year. This is partly due to a reduction in the pension deficit provision from £1.42m to £1.24m and to controls over general costs. It should be noted that the net current assets position has strengthened from £612k to £778k.

- The cash at bank held by the College has increased from £580k to £644k.

- Overall the Balance Sheet appears to show a reasonably stable position.