Inverness College

Annual External Audit Report to the Board of Management and the Auditor General for Scotland

2013/14

December 2014

Scott-Moncrieff
business advisers and accountants

Inverness College

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

Summary

The financial statements for the year ended 31 July 2014 were approved by the College on 17 December 2014. Within our independent auditor's report, we gave an unqualified opinion on the financial statements, the regularity of transactions, and on other prescribed matters. We are also satisfied that there are no matters which we are required to report by exception.

Finance

Financial performance

The College reported an operating deficit for the year to 31 July 2014 of £1,305,339. The budgeted surplus set at the beginning of the year was £100,000. The budget was set at a time of significant uncertainty in the sector. In line with other colleges, the initial budget set did not reflect the £2,700,000 payment that the College subsequently made to the Scottish Colleges Foundation. In the absence of this one-off transfer, the College would have reported a surplus of £1,394,661 for the year.

Overall, income has increased to £18,151,411 in 2013/14, principally due to increases in the UHI recurrent grant and in other funding council grants. The increase was partially offset by a reduction in the SFC recurrent grant. There have also been increases in the income from tuition fees and educational contracts.

Expenditure was £19,456,750 in 2013/14, an increase of £3,392,004 on the prior year. This variance was principally due to the £2,700,000 payment that the College made to the Scottish Colleges Foundation, an umbrella foundation open to all colleges in Scotland. An increase in staff costs was also recognised in 2013/14, due to slightly higher staff numbers and the impact of a 1.5% wage increase.

The College's revenue budget for 2014/15 forecasts a break even position.

Financial position

The College has a deficit balance on reserves of £5,147,267. The deficit has grown by £3,567,339 since 2012/13, due to the operating deficit recognised in the year and an increase in the pension liability. The deficit balance on reserves is offset by significant deferred capital grants, leaving net assets of £4,688,909.

The College has continued to progress plans to relocate to new campuses at Beechwood and Balloch. The construction is expected to be completed by May 2015, which will allow the new campus to be available in good time for the start of the 2015/16 academic year. The College expects that the new campus will be recognised in the 2015/16 financial statements.

Once the new campus is operational, the College plans to dispose of the existing sites at Longman Road and Midmills. In line with the treatment previously adopted, the College has recognised an exceptional impairment charge during 2013/14. The charge, totalling £817,858, brings the existing sites at Longman Road and Midmills in line with the expected market value, as assessed by the College's advisers Graham & Sibbald.

Going concern and subsequent events

The Board of Management considers that the College has adequate resources to continue its business activities for the foreseeable future. In our opinion the going concern assumption is appropriate.

Governance

The College's Corporate Governance Statement confirms that the College has been fully compliant the principles of the UK Corporate Governance Code (2010 version), in so far as they apply to educational institutions, during 2013/14. We have reviewed the College's statement and can confirm that this is in line with the SFC's guidance and is consistent with our understanding of the College's governance arrangements based on the information gathered as part of our normal audit work.

Looking forward

From 2015/16 a new Statement of Recommended Practice (SORP): *Accounting for further and higher education* will align UK Generally Accepted Accounting Practice with International Accounting Standards. Preparation for the transition to the new SORP will need to commence in 2014/15. In addition, the application of the Government Financial Reporting Manual will mean that the College will have to provide additional disclosures within its 2014/15 financial statements.

Conclusion

This report concludes the audit of Inverness College for the year to 31 July 2014. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards

Scott-Moncrieff

December 2014

Introduction

1. This report summarises the findings from our external audit of Inverness College in 2013/14. The scope of our audit was set out in our External Audit Strategy and Plan which was presented to the Audit Committee at the outset of the audit.

2. The External Audit Strategy and Plan summarised four key audit issues for 2013/14:

   - Sector change and arms' length foundation.
   - Estates developments.
   - Pension Fund liabilities.
   - Management override and revenue recognition.

   This report includes our findings in relation to these key audit issues.

3. Our procedures are carried out solely for the purpose of our audit so that we can form and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) (ISAs). Our audit does not necessarily disclose every weakness and for this reason the matters referred to may not be the only shortcomings which exist.

4. The report has been discussed and agreed with the Director of Corporate Services.

5. We would like to thank the Director of Corporate Services and his staff for their kind co-operation and assistance during our audit.

6. The report is also addressed to the Auditor General for Scotland and will be published on Audit Scotland's website, www.audit-scotland.gov.uk.

Financial Statements

Introduction

7. The College's annual financial statements are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources. The respective responsibilities of the College and the auditor in relation to the financial statements are outlined in Appendix 2.

Overall conclusion

An unqualified audit opinion

8. The financial statements for the year ended 31 July 2014 were approved by the College on 17 December 2014. Our independent auditor's report provided:

- an unqualified opinion on the financial statements;
- an unqualified opinion on the regularity of transactions; and
- an unqualified opinion on other prescribed matters.

We are also satisfied that there are no matters which we are required to report by exception.

Financial statements preparation

9. We received draft annual accounts and supporting papers of a good standard, in line with our agreed audit timetable. We are pleased to report that the audit process ran smoothly, and we are grateful to the Director of Corporate Services and the finance staff for their assistance and support during the course of the audit.

Qualitative aspects of accounting practices and financial reporting

10. During the audit, we consider the qualitative aspects of the financial reporting process, including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided in the financial statements. We made the following observations:

Qualitative aspect considered	Audit conclusion
The appropriateness of the accounting policies used.	We reviewed the significant accounting policies, which are disclosed in the financial statements, and we consider these to be appropriate to the College.
The timing of the transactions and the period in which they are recorded.	We did not identify any significant transactions where we had concerns over the timing or the period in which they were recognised.
The appropriateness of the accounting estimates and judgements used.	The accounting estimates and judgements used by management in preparing the financial statements are considered appropriate. Estimates and judgements have been adopted over fixed asset valuations, depreciation rates, pension liabilities and the valuation of provisions. Where available, the College has utilised the work of independent experts or industry practice to support the estimate applied.
The potential effect on the financial statements of any uncertainties including significant risks and disclosures such as pending litigation.	All significant risks and uncertainties have been appropriately reflected in the financial statements.
The extent to which the financial statements have been affected by unusual transactions during the period and the extent that these transactions are separately disclosed in the financial statements.	The College has recognised an exceptional impairment charge in the year on its Midmills and Longman Road Sites. This charge has been offset by a release from deferred capital grants. From the testing performed, we have concluded that these transactions have been appropriately accounted for in the financial statements. We did not identify any other significant unusual transactions in the year.
Apparent misstatements in the Operating and Financial Review and inconsistencies with the financial statements.	There are no misstatements or material inconsistencies between the financial statements and the Operating and Financial Review.
Any significant financial statement disclosures to bring to your attention.	The significant financial statement disclosures that we consider should be brought to your attention are described below under the heading “Significant issues from the 2013/14 financial statements”.
Disagreement over any accounting treatment or financial statement disclosure.	There was no disagreement during the course of the audit with regards to any accounting treatment or disclosure. We identified four immaterial adjustments which have not been reflected in the financial statements. The aggregate impact of these adjustments would be to increase the College’s deficit by £9,319. A list of the unadjusted differences is appended to our letter of representation.
Difficulties encountered in the audit.	There were no significant difficulties encountered during the audit.

Audit adjustments

11. The audit identified some disclosure and presentational adjustments and we are pleased to report that these are reflected in the updated financial statements. A small number of adjustments were also identified during the audit. The effect of these journals is detailed below:

Adjusted differences		Income & Expenditure		Balance sheet	
No	**Narrative**	**DR £**	**CR £**	**DR £**	**CR £**
1	Debtors			85,190	
	Creditors				85,190
	Being the grossing up of trade creditors & trade debtors				
2	Accruals			322,140	
	Provisions				322,140
	Being the reclassification of accruals as provisions				
3	Fixed assets accumulated depreciation			389,574	
	Fixed assets cost				389,574
	Being the stripping out of accumulated depreciation on revalued assets				
	Net impact on the deficit reported in the Income and Expenditure Account				**0**

Board representations

12. We have requested that a signed representation letter, covering a number of issues, be presented to us at the date of signing the financial statements. We identified four unadjusted differences during our audit work. These four differences are not considered to be material to the financial statements, either individually or in aggregate. Through discussion with the Director of Corporate Services the decision was taken not to adjust the annual accounts. These unadjusted items are included in our representation letter and shown in the table below.

Unadjusted differences		Income & Expenditure		Balance sheet	
No	**Narrative**	**DR £**	**CR £**	**DR £**	**CR £**
1	Depreciation charge		18,123		
	Tangible fixed asset additions			18,123	
	Being the adjustment to reflect a pro-rated depreciation charge on additions				

Unadjusted differences (continued)		Income & Expenditure		Balance sheet	
No	Narrative	DR £	CR £	DR £	CR £
2	Prepayments			15,292	
	Expenditure		15,292		
	Being the recognition of prepayments originally charged as expenditure				
3	VAT Debtor			3,867	
	Fixed assets				3,867
	Being the recognition of recoverable VAT on additions				
4	Exceptional impairment charge	42,734			
	Fixed assets			95,000	
	Revaluation Reserve				137,734
	Being the adjustment of asset values in line with the professional revaluation				
	Potential increase in the deficit reported in the Income and Expenditure Account				**9,319**

Review of accounting systems

13. During our audit work we have considered the College's accounting systems and internal controls. We have found the College's systems of internal financial control to be adequate and operating effectively. Please refer to the action plan for details of control improvements identified during audit fieldwork.

Significant issues from the 2013/14 audit

14. As noted in our audit plan, presented to the Audit Committee at the outset of our audit, the following audit risk areas were identified and were therefore considered in detail during our audit fieldwork.

Sector change and arms' length foundation

Incorporated FE colleges in Scotland became central government bodies from 1 April 2014, after reclassification by the Office for National Statistics (ONS). Unlike most other Scottish colleges, Inverness College has retained a 31 July year end accounting date as a result of being part of the University of the Highlands and Islands UHI network (UHI). However, it will have to take cognisance of other potential implications of reclassification. There has been and continues to be guidance from a range of stakeholders such as the Scottish Funding Council on this, and clarification of some of the issues arising.

Sector change and arms' length foundation (continued)

One new development arising from reclassification is the setting up of arms' length foundations (ALFs). This is in response to tightening financial operating requirements; as central government bodies, colleges should deliver at least a breakeven position each year and there are no guarantees that they can retain in-year surpluses for future periods in the way they have enjoyed to date. In 2013/14, Inverness College transferred some £2,700,000 of cumulated reserves into a new national foundation and plans to apply for funding from the foundation in future to support College activities.

Noted in the 2013/14 External Audit Plan

15. The College has opted to transfer monies in to the Scottish Colleges Foundation, an umbrella foundation open to all colleges in Scotland. The articles of association of the ALF require that it sets up sub-funds for each college that participates. Each of these sub-funds is established and operated as a restricted fund that must only be applied for the benefit of the relevant college. However, in order to comply with Scottish Government budget constraints, transfers into the fund have to be made by 31 March each year.

16. At March 2014 the College's forecast outturn position was a surplus of £300,000 and it held £2,432,000 accumulated reserves. As a result, the board approved a payment of £2,700,000 to the ALF which was made before 31 March 2014.

17. In July 2014 the College made its first request for grant funding from the ALF. The trustees approved payments totalling £150,233 in respect of the College's Customer Service Excellence and IIP Gold Project, and equipment. In line with the agreed terms, £111,833 was received by the College during the 2013/14financial year. The remaining balance is due to be received in the 2014/15 financial year.

18. We have reviewed the College's transactions with the arms' length foundation and found that they have been appropriately administered, accounted for and disclosed.

19. The College has been working with UHI partners on the role of the FE Regional Board within the UHI governance structure. The Assigned Colleges (University of the Highlands and Islands) Order 2014 made by Scottish Ministers takes cognisance of the unique structure of UHI, against the regionalisation context. Inverness College and its partners will continue to develop these arrangements. We will monitor the situation in future audits.

Estates developments

The College continues to move forward with plans to relocate to new campuses at Beechwood and Balloch. The College is using the new Non-Profit Distributing (NPD) funding model, in collaboration with the Scottish Futures Trust, for the £51m of capital construction costs. The other £11m of costs associated with the project are being provided through a mix of College and SFC funding. This mechanism for funding estates development is new, technically complex and there is a lack of detailed guidance currently available on the specific accounting implications.

The estates development is part of a strategy which will involve disposal of the existing sites at Longman Road and Midmills. It was previously highlighted that this would have significant implications on accounting for the existing estate. There was a substantial write down of the assets in 2012/13 (to around the expected net recoverable amount) from a carrying value of £18.8m as at 31 July 2012, offset largely by using the College's revaluation reserve.

Noted in the 2013/14 External Audit Plan

20. The College has progressed plans to relocate to new campuses at Beechwood and Balloch. In June 2014, the project manager reported that progress was six weeks behind the critical path of the programme. However, it is still expected that the contract completion date of May 2015 will be achieved. If this is the case, the new campus will be available in good time for the start of the 2015/16 academic year. The College expects that the new campus will be first recognised in the 2015/16 financial statements.

21. Once the new campus is operational, the College plans to dispose of the existing sites at Longman Road and Midmills. In line with the treatment previously adopted, the College has recognised an exceptional impairment charge during 2013/14. The charge, totalling £817,858, brings the existing sites at Longman Road and Midmills in line with the expected market value, as assessed by the College's advisers Graham & Sibbald. The impairment charge has been recognised in the Income and Expenditure account and has been wholly off-set by a release from deferred SFC grants. This approach was agreed in advance with the SFC.

22. During the year some additional costs were identified for the new campus. The most significant of these was an additional cost of £259,344 in respect of further training kitchen facilities. In total the Board approved additional capital investments of £468,205 for the new campus during the year, the cost of which is planned to be met from the 2014/15 SFC capital grant, 2013/14 SFC capital grant brought forward and funds held by the Scottish Colleges Foundation.

23. Internal audit carried out a review during the year: *New Campus Capital Project and IT Systems Development / Implementation 2013/14*. The scope was to review and test the policies and procedures in place within the College for the planning, control and monitoring of the new campus project. Internal Audit reported that they obtained reasonable assurance that controls in place over the new campus project are in line with SFC and other good practice guidance, although some weaknesses were present. The College has agreed to implement the two significant recommendations raised from the review:

- That the meeting agendas for the weekly liaison and monthly progress meetings include a review of the risk register as a standing item.
- That all significant items, including those not included within the original project specifications but subsequently agreed prior to the contract award, are specifically detailed within the terms of future contracts.

24. The College made asset additions of £724,229 in the year. £520,191 of the total related to pay costs, professional fees and consultancy costs directly attributable to the new campus, which were accounted for as assets under construction. A further £181,878 was invested in equipment during the year, and improvements totalling £22,160 were made to the College's buildings.

25. We have reviewed the College's treatment of the revaluation and its estates developments and have found them to be reasonable and appropriate.

Pension fund

The College's employees belong to two principal defined benefit pension schemes; the Scottish Teachers' Superannuation Scheme (STSS) for teaching staff and the Highland Council Pension Fund (HCPF) for the non-teaching staff.

Pension fund (continued)

The STSS is a multi-employer, notionally funded scheme and the College is unable to identify its share of the underlying assets and liabilities of the scheme. In line with Financial Reporting Standard 17 – *Retirement Benefits* (FRS 17), the College does not recognise any asset or liability relating to the STSS and the scheme is effectively accounted for as if it was a defined contribution scheme.

The HCPF is also a multi-employer scheme but the College can identify its share of underlying assets and liabilities and has therefore recognised a net liability in its balance sheet. The College reported a liability of £4,012,000 as at 31 July 2013, a decrease on the £4,438,000 equivalent position as at 31 July 2012.

Noted in the 2013/14 External Audit Plan

26. The pension liability on the HCPF, as assessed by Hymans Robertson, has increased in the year to £6,632,000. We have reviewed the College's accounting for the pension liability and confirm that it complies with the requirements of FRS 17 and that the disclosure is consistent with the actuarial valuation. We have also confirmed that the actuarial assumptions underpinning the valuation are reasonable and reflect the College's circumstances.

Management override and revenue recognition

Management override and revenue recognition are presumed risks under ISAs and will be tested as part of our audit work.

Management are in a unique position to override controls that otherwise may appear to be operating effectively, potentially facilitating fraud. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and therefore a significant risk. (ISA 240: *The auditor's responsibilities relating to fraud in an audit of financial statements*).

There is also a risk that the College may misreport its income through an inaccurate or inappropriate approach to revenue recognition. However, this is generally of much lower risk in public sector bodies than in commercial entities.

Noted in the 2013/14 External Audit Plan

27. We have performed sufficient testing to provide assurance on the completeness and occurrence of income and we are satisfied that income is correctly stated in the financial statements. Additionally, our audit work included a review of journal entries processed in the period and around the year end. We are satisfied that there are no indications of management override in the year.

Use of Resources

28. It is the College's responsibility to conduct its financial affairs in a proper manner. We are responsible for auditing the financial statements and considering the College's governance arrangements in relation its financial position.

29. This section of the report summarises our findings in relation to the College's financial performance for the year and its position as at 31 July 2014.

Financial performance

Inverness College	2013/14 (£)	2012/13 (£)	Variance (£)
Income	18,151,411	16,496,149	1,655,262
Expenditure	19,456,750	16,064,746	3,392,004
(Deficit) / Surplus	(1,305,339)	431,403	1,736,742

The College has reported a deficit of £1,305,339 for the year

30. The College has reported an operating deficit for the year to 31 July 2014 of £1,305,339. The budgeted surplus set at the outset of the year was £100,000. The principal reasons for the £1,405,339 variance against budget are:

- The £2,700,000 payment made to the Scottish Colleges Foundation, discussed in paragraph 15, was not included in the budget set. This was due to the uncertainties the sector faced as a result of ONS reclassification. In the absence of this one-off transfer, the College would have reported a surplus of £1,394,661 for the year.
- The budgeted charge for depreciation and pensions costs, based on historical precedent, was £240,000 higher than the charge actually required in 2013/14.
- 'Other income' and income from 'other specific SFC grants' were higher than budget. The reasons for these are discussed in paragraphs 31 and 32 below.

Income has increased to £18,151,411 in 2013/14

31. The College has seen an increase of £718,516 (6.1%) in income from SFC grants from £11,698,866 in 2012/13 to £12,417,382 in 2013/14. This has been principally due to increases of £443,613 (11.7%) in the UHI recurrent grant and increases of £339,964 (54.1%) in other funding council grants being only partially offset by a reduction of £200,487 (2.7%) in the SFC recurrent grant. The increase in other funding council grants partially reflects the writing out of provisions raised in prior years that were not subsequently required.

32. The College has seen an increase of £394,241 (15%) in income from tuition fees and educational contracts, primarily due to additional HE and FE fees from UK students. There has also been an increase of £552,167 (41.7%) in other income, principally due to the utilisation of income deferred in previous years.

Expenditure has risen to £19,456,750

33. Expenditure was £19,456,750 in 2013/14, an increase of £3,392,004 (21.1%) on the prior year. This variance was principally due to the £2,700,000 payment that the College made to the Scottish Colleges Foundation, which we have discussed in paragraph 15. Additional staff costs of £777,033 (7.3%) have been recognised in 2013/14, due to slightly higher staff numbers and the impact of a 1.5% wage increase. Other operating expenses rose by £341,301 (8.8%) due to additional administration and premises costs in the year. Depreciation has fallen significantly (67.4%) from £694,935 in 2012/13 to £226,578 in 2013/14 as a result of the impairment of the Longman and Midmills sites in the previous year. See paragraph 20 above for more information on the College's estates strategy.

Financial position

The College has maintained a net asset position due to substantial deferred capital grants

34. The College has a deficit balance on reserves of £5,147,267. The deficit has grown by £3,567,339 since 2012/13, due to the operating deficit recognised in the year and the increased pension liability reflected in the 2013/14 actuarial valuation of the College's share of the HCPF. The deficit balance on reserves is offset by a balance of £9,836,176 deferred capital grants, leaving net assets of £4,688,909.

35. As at 31 July 2014 the College had a cash balance of £2,013,979. This was £3,805,764 (65.4%) lower than the balance held as at 31 July 2013. This reduction is principally due to the £2,700,000 payment that the College made to the Scottish Colleges Foundation. The reduced balance also reflects one of the impacts of the ONS reclassification: that the SFC is responsible for distributing cash to the sector on the basis of need. This policy has been the main reason for an increase of £3,045,292 in Debtors as the College has recognised a significant level of accrued income in respect of 2013/14 SFC funding which had not been drawn down by 31 July 2014.

36. The College's creditor balance has increased by £400,445 (13%) to £3, 470,050 as at 31 July 2014. This is principally due to £314,415 of SFC capital grant funding being carried forward as deferred income to be used in 2014/15.

Financial forecasts

Funding has been confirmed for 2014/15 and a break even position has been forecast

37. The College's revenue budget, as reported to the Finance and General Purposes Committee in June 2014, forecast a break even position for 2014/15. The SFC has confirmed funding for 2014/15 that will be allocated on a regional basis through outcome agreements. Inverness College is part of the Highlands and Islands region, along with Argyll College, Lews Castle College, Moray College, North Highland College, Orkney College, Perth College, Shetland College and West Highland College. This arrangement will include UHI and the Regional Board, which operates as a sub-committee within UHI.

38. The College recognises that the sector currently faces substantial challenges with wider changes, including the ongoing impact of ONS reclassification, leading to a degree of unpredictability. The income budget is £169,000 (0.9%) higher than that set for 2013/14. This reflects SFC recurrent funding remaining consistent year on year and marginal increases in UHI grants (1.9%) being offset by reductions in income from training contracts (-5.7%). Expenditure is expected to increase by £269,000 (1.5%) compared to the 2013/14 budget. This is principally due to additional staffing costs (1.8).

39. The budget for 2014/15 was based on the most reliable information available at the time. As a result it reflects, amongst other things, that the SFC had only given indicative funding allocations for the 2014/15 recurrent grant, and that UHI HE grant had not yet been finalised and approved. The 2014/15 budget was presented along with a risk assessment showing the estimated impact of the key financial risks facing the College. The net risk associated with these factors equates to additional costs of £660,000, as shown below.

Key financial risks facing Inverness College in 2014/15

Description	Risk	Potential negative impact (£)	Potential positive impact (£)
UHI HE Grant Income	High	200,000	0
FE Grant Income	High	200,000	0
HE Fees & Charges	Medium	50,000	50,000
FE Fees & Charges	Medium	50,000	50,000
Contracts & other income	Medium	160,000	50,000
Staff costs	Medium	100,000	50,000
Property Costs	Medium	120,000	20,000
Total		**880,000**	**220,000**

Source: Revenue Budget 2014/15, Finance & General Purposes Committee, June 2014

Going concern and subsequent events

40. ISA 570: *Going Concern* requires us to consider the appropriateness of the use of the going concern assumption in the preparation of the financial statements, and to consider whether there are material uncertainties about the College's ability to continue as a going concern which need to be disclosed in the financial statements.

41. In order to gain assurance on these matters our work has included:

- Reviewing bank facilities.
- Reviewing budgets and cash flow projections covering a period of 12 months from the expected signing of the audit report, together with post year end management accounts.
- Reviewing minutes of post balance sheet board meetings.
- Enquiring of senior management and the College's solicitors concerning litigation, claims and assessments.
- Consideration of future SFC and UHI funding.
- Performing sample testing of post balance sheet transactions.

42. The Board of Management considers that the College has adequate resources to continue its business activities for the foreseeable future. In our opinion the going concern assumption is appropriate.

Governance

43. The College is responsible for ensuring that it has adequate governance arrangements in place. It is our responsibility to review and report on these arrangements as they relate to:

- the College's review of its systems of internal control, including reporting arrangements;
- the prevention and detection of fraud and other irregularities;
- standards of conduct and arrangements for the prevention and detection of corruption; and
- the College's financial position.

44. The "Finance and Use of Resources" section of this report gives our conclusion over the corporate governance arrangements in relation to the College's financial position. This "Governance" section includes our comments on other aspects of the College's arrangements.

Corporate Governance

New members were appointed to the Board of Management during the year

45. In March 2014, following a recruitment exercise, the Board approved the appointment of three new non-executive members, as well as one co-opted board member. In addition, during 2013/14, the College appointed a new Depute Principal, a new Director of Business Development and a new Campus Project Director.

Corporate governance arrangements are appropriate

46. In June 2014, following a review of governance arrangements by internal audit, the Board agreed to formalise the appointment of the vice chair and a senior independent director, in line with the requirements of the UK Corporate Governance Code. The Board also amended the membership of the Audit Committee and the Finance and General Purposes Committee to ensure that the Audit Committee had a member with recent and relevant financial experience and skill.

47. The Board conducted a self- evaluation exercise during the year, which was facilitated by the Depute Principal. Self-evaluations were also conducted by each standing committee and by each of the Board and Committee chairs. The outputs from each assessment have informed an action plan that has been approved by the Board.

The Governance Statement complies with good practice

48. The financial statements must include a statement covering the responsibilities of the governing body in relation to corporate governance. The statement is required to indicate how the college has complied with good practice in this area, including the, the UK Corporate Governance Code (2010 version) and the Guide for College Board Members 2012.

49. The College's Statement of Corporate Governance and Internal control explains that the College was compliant with the principles of the UK Corporate Governance Code (2010 version), in so far as they apply to educational institutions throughout the year. This is consistent with the requirements outlined in the 2013/14 Accounts Direction, released by the SFC.

50. We reviewed the Corporate Governance Statement by:

- checking the statement against SFC and Audit Scotland guidance;
- considering the adequacy of the process put in place by the Principal and Board of Management to obtain assurances on systems of internal control; and
- assessing whether disclosures in the statement are consistent with our knowledge of the College.

51. We are satisfied that the statement is consistent with SFC and Audit Scotland guidance and that the contents are not inconsistent with information gathered during the course of our normal audit work.

Risk management

The College has risk management systems in place

52. Risk management is important to the establishment and regular review of systems of internal control. The College's financial statements outline the principal risks and uncertainties of the College and the College's response. We have found that the College has adequate risk management arrangements in place to monitor and help mitigate key strategic risks to the College.

Internal audit

53. The internal audit service is a key component of the College's internal control framework. We have reviewed the College's arrangements to ensure that the work of internal audit is sufficient in quality and volume and complies with best practice. Our review was performed in accordance with the Code of Audit Practice and ISA 610: *Considering the work of internal audit*.

Considering the work of internal audit

54. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the College's total audit resource. Henderson Loggie provided the internal audit service in 2013/14 and we have considered their findings within our audit process. Henderson Loggie has concluded in their annual report that the College operated adequate and effective internal control systems in the year. We are grateful to Henderson Loggie for their assistance during the course of our audit work.

Prevention and detection of fraud and irregularity

55. The Board of Management is responsible for preventing and detecting fraud and other irregularities. We are not required to search specifically for such matters and our audit should not be relied upon to disclose them. However, our audit was planned and conducted so as to give a reasonable expectation of detecting any material misstatements in the financial statements resulting from improprieties or breach of regulations.

56. Our work has included a consideration of the College's arrangements for the prevention and detection of fraud and irregularity. We are pleased to report that we did not identify any issues of concern in relation to fraud and irregularity.

Standards of conduct

57. We have considered the arrangements made by management in relation to standards of conduct and prevention and detection of corruption. Our work in this area included a review of the arrangements for adopting and reviewing standing orders, financial instructions, registers of interest and schemes of delegation and complying with national and local Codes of Conduct. We have also considered arrangements in place for ordering and procurement and disposal of assets.

58. In February 2014 the Scottish Government published an updated model code of conduct for members of devolved public bodies. In June 2014 the Board agreed to adopt and implement the revised code of conduct.

59. We have found the College's arrangements to maintain appropriate standards of conduct to be satisfactory.

Looking forward

FE College Statement of Recommended Practice (SORP)

60. Colleges are currently required to follow the Statement of Recommended Practice: Accounting for Further and Higher Education 2007 ('the SORP'). The SORP reflects UK Generally Accepted Accounting Practice (UK GAAP) and aims to combine the requirements of further and higher education institutions and key stakeholders into recommended accounting practice.

61. Over the last ten years, the Financial Reporting Council has been working on a conversion programme to base all financial reporting in the UK on International Financial Reporting Standards (IFRS). As a result of this conversion programme the Financial Reporting Council has adopted into UK GAAP, Financial Reporting Standards 100, 101 and 102 for financial years beginning on or after 1 January 2015. These three standards effectively become the new IFRS-based UK GAAP.

62. The FE/HE SORP Board, consisting of key stakeholders from Higher and Further Education across the UK, has developed a SORP which takes account of the key requirements of the new Financial Reporting Standards.

63. The SORP represents a significant change in financial reporting across the College sector. This includes changes in disclosure and terminology within the accounts including the names of the primary financial statements. There are also some fundamental changes to accounting practice.

64. The new accounting standards come into force for financial years commencing on or after 1 January 2015, which means 2015/16 will be the first reporting year for colleges. However, comparative figures for 2014/15 are required, which in turn will require an opening balance sheet as at 1 August 2014 to be prepared.

65. In September 2014 the Scottish Funding Council released *Reclassification of Incorporated Colleges Communication Number 15* which outlines a number of major changes to the way financial performance, assets and liabilities are to be presented in colleges' financial statements from 2015/16.

Government Financial Reporting Manual

66. For financial years beginning on or after 01 April 2014, all colleges have to comply with the Government Financial Reporting Manual (FReM). Application of the FReM will mean that colleges will have to provide additional disclosures within their 2014/15 financial statements.

67. The SFC has advised that the immediate workload to comply with the FReM is not significant. The most significant changes required will be to the 2014/15 Operating and Financial Review which will need to incorporate a Remuneration Report, estates information, and some resource outturn information that has not previously been required.

68. A study commissioned by the SFC found that no changes would be required in accounting treatment under the FReM, with the exception of the treatment of property and land held at historic cost. Inverness College does not hold property or land at historic cost.

Appendix 1: Management action plan

Our annual report action plan details the control weaknesses and opportunities for improvement that we have identified during our audit.

The action plan details the officers responsible for implementing the recommendations and implementation dates. The College should assess these recommendations for their wider implications before approving the action plan. Following submission of this report to the Audit Committee, we will send a copy to the Auditor General.

The weaknesses identified are only those which have come to our attention during our normal audit work, and may not be all that exist. Communication of the matters arising from the audit of the financial statements does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

We identified no recommendations for management action this year. Two prior year management actions remain outstanding from 2011/12.

Grade	Definition	Recommendations		
		2013/14	2012/13	2011/12
5	Very high risk exposure - Major concerns requiring immediate attention			
4	High risk exposure - Absence / failure of significant key controls			1
3	Moderate risk exposure - Not all key control procedures are working effectively			1
2	Limited risk exposure - Minor control procedures are not in place / not working effectively			
1	Efficiency / housekeeping point			

Follow up on outstanding action plan points

1.	Accounting for the new campus
Observation	The financing and operating model for the new campus development is new and potentially technically complex and there is a lack of guidance available on the accounting implications of the model. There remains significant uncertainty over the accounting treatment of the project going forward and the implications this may have on the assets currently recognised by the College.
Risk and recommendation	There is a risk that that the model will have a considerable impact on the College's financial statements in the coming years which has not yet been fully considered, primarily due to the lack of guidance available on the accounting implications of the model. The College will need to consider the impact of the model in detail to ensure that the correct accounting treatment is adopted going forward. This should be carried out in consultation with the SFT, the SFC and the College's advisors on the project Ernst & Young. **Grade 4**
Management Response	Agreed **Responsible officer:** Director of Corporate Services **Implementation date:** by end July 2013
Audit observation in 2012/13	We have reviewed the College's treatment of its estates developments in 2012/13 and have found them to be reasonable and appropriate. We will continue to work with management to ensure the estates developments are appropriately treated and to highlight potential implications for future years of the College's estates development plans.
Audit observation in 2013/14	We have reviewed the College's treatment of its estates developments in 2013/14 and have found them to be reasonable and appropriate. We will continue to work with management to ensure the estates developments are appropriately treated and to highlight potential implications for future years of the College's estates development plans.

2.	Provisions for potential claw back of funding
Observation	The College has made immaterial provisions for potential claw back in three different funding streams. Some of these provisions have remained consistent over recent years. At present there is some uncertainty over the value the potential claw backs and the certainty that they will be required. The College should only recognise provisions for claw back where there is an obligation to transfer economic benefits as a result of past transactions or events
Risk and recommendation	Due to the uncertainty surrounding these provisions there is a risk that there is an immaterial misstatement in the College's financial statements. We endorse the Director of Corporate Services plan to investigate these matters in the coming year to ensure clarity is achieved over any obligation. **Grade 3**
Management Response	Agreed **Responsible officer:** Director of Corporate Services **Implementation date:** by end July 2013
Audit observation in 2012/13	There remain some provisions for potential claw back where there is some uncertainty over the value the potential claw backs and the certainty that they will be required.
Audit observation in 2013/14	The College has continued to investigate the balances held and there has been some reduction year on year. Provisions of around £650,000 for potential claw back remain where there is still some uncertainty over the value the potential claw backs and the certainty that they will be required.

Appendix 2: Respective responsibilities

Management responsibilities

69. Within the terms and conditions of the financial memorandum between the Scottish Funding Council (SFC) and the Board of Management of the College, the Board, through the Principal, is required to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the College and the surplus or deficit for that year. In preparing the financial statements the Board is required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare financial statements on the going concern basis unless it is inappropriate to assume that the College will continue in operation.

70. The Board is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the College and enable it to ensure that the financial statements comply with the Further and Higher Education (Scotland) Act 2005, together with the Financial Memorandum issued thereunder, and are presented in accordance with the Accounts Direction issued by the SFC.

Auditor responsibilities

71. Our Independent Auditor's Report, included within the financial statements, gives three opinions: an opinion on the financial statements, an opinion on regularity and an opinion on other prescribed matters. We are also required to report certain matters by exception. Each of these responsibilities is described below.

Opinion on financial statement

72. We audit the financial statements and give an opinion on whether they:

- give a true and fair view in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council of the state of the body's affairs as at 31 March 2014 and of its deficit for the period then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council, the Charities and Trustee Investment (Scotland) Act 2005, and regulation 14 of The Charities Accounts (Scotland) Regulations 2006.

Opinion on regularity

73. We confirm whether, 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

74. We express an opinion on whether the information in the Operating and Financial Review is consistent with the financial statements.

Matters on which we are required to report by exception

75. We are also required to report if, in our opinion:

- proper accounting records have not been kept; or
- the financial statements 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 Statement of Corporate Governance and Internal Control does not comply with SFC requirements.

Reporting thresholds

76. We report the following misstatements identified through our audit to you:

- all material corrected misstatements;
- uncorrected misstatements with a value in excess of 1% of the overall materiality figure; and
- other misstatements below the 1% threshold that we believe warranted reporting on qualitative grounds.

Materiality

77. Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement and involves considering both the amount and the nature of the misstatement.

78. Our assessment of materiality for the financial statements was £340,000, which has remained appropriate throughout the audit. Our assessment of materiality was set with reference to a range of benchmarks (including total income, the deficit on continuing operations after depreciation of assets at valuation and before tax, gross assets and net assets. We consider these to be the principal considerations for the users of the accounts when assessing the financial performance of the College.

79. Our External Audit Strategy and Plan outlines the significant risks that were identified at the planning stage of the audit. We have designed procedures to mitigate the risk of material misstatement. Our audit approach is based on performing a review of the significant accounting systems in place, substantive tests and detailed analytical review. We set a performance (testing) materiality for each area of work which is based on a risk assessment for the area. This meant that we performed a greater level of testing on the areas deemed to be of significant risk of material misstatement.

Calculation of performance materiality (£)

Area risk assessment	Weighting	Performance materiality (£)
High	50%	170,000
Medium	65%	221,000
Low	85%	289,000

Confirmation of auditor independence

80. *Ethical Standard 1: Integrity, objectivity and independence*, issued by the Auditing Practices Board (APB), requires that external auditors ensure that the Audit Committee is appropriately informed on a timely basis of all significant facts and matters that bear upon the auditors' objectivity and independence.

81. We confirm that we have complied with APB Ethical Standards throughout our audit and that, in our professional judgement, we have remained independent and our objectivity has not been compromised in any way. In particular:

- There are and have been no relationships between Scott-Moncrieff and the Board of Management or senior management that may reasonably be thought to bear on our objectivity and independence.
- In addition to the audit of the financial statements, Scott-Moncrieff has facilitated a risk workshop for the College. The risk workshop was facilitated by staff who had no involvement in the audit of the financial statements.

Appendix 3: Your audit team

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