Lews Castle 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

Lews Castle College

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Summary

The financial statements for the year ended 31 July 2014 were approved by the College on 8 December 2014. In our independent auditor's report, we issued an unqualified opinion on the financial statements, the regularity of transactions, and on other prescribed matters. There were no matters to report by exception.

Finance

Financial performance

The College reported an operating surplus for the year to 31 July 2014 of £103,164 (2012/13: £78,000 deficit). The budgeted surplus set at the beginning of the year was £3,953. The main reason for the variance was higher than anticipated SFC and UHI grant income, offset by pension costs. Income increased to £6,581,677 (4.32% on 2012/13) due to modest increases in both SFC (2.16%) and UHI (6.75%) recurrent grant funding. Expenditure increased by only 1.43% to £6,478,514, including due to higher costs associated with the provision of nursery services.

The College's revenue budget for 2014/15 is effectively forecasting a breakeven position for the year.

Financial position

The College has a deficit balance on reserves of £3,092,215. Despite the 2013/14 operating surplus, the deficit has grown by £542,835. This is due to an increase in the pension liability of £787,000. As in previous years a significant deferred capital grants balance of £7,704,018 offsets this deficit, resulting in an overall net asset position at 31 July 2014.

In 2012 the College entered into an agreement with Comhairle nan Eilean Siar (the Comhairle). The Comhairle agreed to oversee and fund the construction of a pre-school nursery, An Cotan. Based on the agreement all the responsibilities associated with the running of the nursery would lie with the College once the nursery became operational. In 2013/14, the nursery was completed and the Comhairle transferred the asset to the College. The nursery has been valued at £314,200. It has been added to the balance sheet as an asset, with a corresponding credit being made to deferred capital grants. This is in line with the FE/HE SORP (2007).

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. There are no subsequent events requiring disclosure.

Governance

The College's Corporate Governance Statement confirms that the College has been fully compliant with 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 (FReM) will impact on the College's 2014/15 financial statements and related disclosures.

Conclusion

This report concludes the audit of Lews Castle 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

8 December 2014

Introduction

1. This report summarises the findings from our external audit of Lews Castle College in 2013/14.

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

   - Sector change and arms' length foundation.
   - Greenspace.
   - Pension Fund.
   - 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 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 College Principal.

5. We would like to thank the Principal 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.

8. In this section we summarise the issues arising from our audit of Lews Castle College's 2013/14 financial statements.

Overall conclusion

An unqualified audit opinion

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

   - An unqualified opinion on financial statements;
   - An unqualified audit opinion on the regularity of transactions; and
   - An unqualified audit 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

10. 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 Principal and the finance staff for their assistance and support during the course of the audit.

Qualitative aspects of accounting practices and financial reporting

11. During the course of our 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. The following observations have been made:

Qualitative aspect considered	Audit conclusion
The appropriateness of the accounting policies used.	We have reviewed the significant accounting policies 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 primarily over fixed asset carrying values, depreciation rates, pension liabilities and 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.	We did not identify any significant uncertainties or risks that should be included 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 Comhairle transferred the An Cotan nursery building to the College during 2013/14. The College has capitalised the asset. A deferred capital grant will be released over the asset's useful life. 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 noted 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 discussion on certain options but no disagreement during the course of the audit with regards to any accounting treatment or disclosure. There are no unadjusted differences to report on.
Difficulties encountered in the audit.	There were no significant difficulties encountered during the audit.

Audit adjustments

12. The audit identified some disclosure and presentational adjustments and we are pleased to report that these are reflected in the updated financial statements. The cumulative effect of these journals is to increase the College's balance sheet value by £314,200 and decrease its operating surplus by £6,000. Full details of these adjustments are given in the table below:

Adjusted differences

		Income & Expenditure		Balance sheet	
No	Narrative	DR £	CR £	DR £	CR £
1	Fixed assets – Buildings Deferred capital grants *Being the addition of the pre-school nursery building, An Cotan, to fixed assts.*			314,200	 314,200
2	Other Grants UHI Millennium Institute Recurrent grant Other UHI Millennium Institute grants *Being the reclassification of grant income*	56,787 21,450	 78,237		
3	Tuition fees and education contract income Other creditors *Being removal of income due to be paid over to a third party*	6,000			 6,000

Board representations

13. 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. There are no unadjusted differences arising from our audit work.

Review of accounting systems

14. 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 generally adequate and operating effectively. However, there were issues outstanding from our 2012/13 audit which still have to be addressed. These are all of a moderate-to-low risk rating. Please refer to the action plan for details.

Significant issues from the 2013/14 audit

15. The following audit risk areas were identified at the outset of our audit and were 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 ONS. Unlike most other Scottish colleges, Lews Castle College has retained a 31 July year end accounting date as a result of being part of the UHI network. 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 the issues arising. However, at time of writing, not all issues have been definitively resolved.

One new development arising from reclassification is the setting up of arms' length foundations. 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. Given Lews Castle College's financial position, this is arguably a less significant issue compared to certain other FE bodies in Scotland but is still an area which must be administered efficiently and effectively.

16. We have not identified any reportable issues for 2013/14, regarding the impact of incorporated FE colleges in Scotland becoming central government bodies. However, there are implications for 2014/15 due to the need to comply with the Financial Reporting Manual (FReM) and this is discussed further the in "Looking forward" section of the report.

17. 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, within the regionalisation context. Lews Castle College and its partners will continue to develop these arrangements. We will monitor the situation in future audits.

18. In relation to arms' length foundations, the College decided that its current financial position did not require a foundation transfer in 2013/14. This will be reviewed in 2014/15 but is likely to remain the case for the foreseeable future.

Greenspace

The College has held a 27% share in the voting rights of Greenspace Live Ltd in 2013/14, a company involved in low carbon building design. The company was only spun out of the College in 2011/12, and so it is at a crucial point as it looks to establish and maintain sustainable business performance.

Financial Reporting Standard 9: Associates and Joint Ventures (FRS 9) presumes that a 20% share of the voting rights in a company would provide the College with significant influence over that company. Where significant influence is held the company should be consolidated as an associate. In the 2012/13 financial statements, the College rebutted the presumption of significant influence as it does not actively participate in the operating and financial policies of Greenspace Live Limited or overly influence strategic issues such as determining the balance between dividend and reinvestment.

We reviewed the accounting treatment of Greenspace Live Limited in our 2012/13 audit and found that, particularly given the immaterial nature of the transactions, the treatment was reasonable. We will perform further audit work during our 2013/14 audit to ensure Greenspace continues to be accounted for appropriately.

19. The College has retained its minority stake holding in Greenspace Live Limited through the year and its background role in the management of the company has not significantly altered since our last detailed review in 2012/13. There have been no material transactions with Greenspace during the year, individually or in aggregate. The College's rebuttal of the assumption of significant influence remained valid throughout 2013/14. Coupled with the immaterial nature of the transactions of Greenspace compared to the College as a whole, the accounting treatment is deemed reasonable.

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.

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 £1.069m as at 31 July 2013, a decrease on the £1.201m equivalent position as at 31 July 2012.

20. The pension liability on the HCPF scheme, as assessed by Hymans Robertson, has increased in the year to £1,856,000. 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 reflective of the College's circumstances.

Management override and revenue recognition

Management are in a unique position to overriding 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 is misreporting 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.

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

21. We have performed sufficient testing to provide assurance on the completeness and occurrence of income recognised in the financial statements and we are satisfied that income is reasonably recognised in the financial statements. In addition, our audit work included a review of journal entries processed in the period and around the year end, and analysis of plans, budgets and activity against the information in the financial statements. We are satisfied that there are no indications of management override in the year giving rise to material misstatement.

Use of Resources

22. 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.

23. 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

Lews Castle College	2013/14 (£)	2012/13 (£)	Variance (£)
Income	6,581,677	6,308,939	272,738
Expenditure	6,478,514	6,386,898	91,616
(Deficit) / Surplus	103,163	(77,959)	181,123

The College has reported a surplus of £103,163 for the year

24. The budgeted surplus at the start of the year was £3,953. The principal reasons for the variance against budget are:

- Pension costs of £141,000 were not foreseeable with certainty, so not included in forecast budgets.
- SFC grant income was £316,327 higher than budget. This was partly due to the strategic conditional grant of £100,000 received from SFC to offset the claw back of £842,000 over five years.

Increase in income to £6,581,677 was the largest contributing factor to achievement of operating surplus

25. Income increased to £6,581,677 (4.32% on 2012/13) due to modest increases in both SFC (2.16%) and UHI (6.75%) recurrent grant funding. Expenditure increased by only 1.43% to £6,478,514 due in part to higher costs associated with the provision of nursery services. The increase in grant funding, coupled with the College's ability to control costs, resulted in the net surplus on operations.

Financial position

The College's net asset position has reduced to £4,611,803 as at 31 July 2014

26. The College has a deficit balance on reserves of £3,092,215. The deficit has grown by a net £542,835 since 2012/13, primarily due to the increased pension liability on the HCPF scheme. The deficit balance on reserves is offset by a balance of £7,704,018 deferred capital grants, resulting in a net asset position of £4,611,803.

A pre-school nursery, An Cotan, became a College asset during the year

27. In 2012 the College entered into an agreement with Comhairle nan Eilean Siar (the Comhairle). The Comhairle agreed to oversee and fund the construction of a pre-school nursery, An Cotan. Based on the agreement all the responsibilities associated with the running of the nursery would lie with the College once the nursery became operational.

28. In 2013/14, the nursery was completed and the Comhairle transferred the asset to the College. The nursery has been valued at £314,200. It has been added to the balance sheet as an asset, with a corresponding credit being made to deferred capital grants. This treatment was arrived at during the audit, after discussions with College management. The treatment within the final accounts is in line with the FE/HE SORP (2007).

Financial forecasts

Indicative funding has been confirmed for 2014/15 and an effective break even position is forecast

29. The College's revenue budget for 2014/15 forecasts a small surplus of just £166, effectively break even. The SFC has confirmed funding for 2014/15 that will be allocated on a regional basis through outcome agreements. Lews Castle College is part of the Highlands and Islands region, along with Argyll College, Inverness 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.

30. Income is forecast to increase to £5,271,920 (1.74%), including an increase in UHI HE grants of £100,000. In addition, nursery fees are expected to increase by £17,000 (11.1% compared to 2012/13) due to the operation of An Cotan throughout the year.

31. Forecast expenditure is set at £5,217,754 and represents an increase of 1.82% on 2013/14 budgets. In common with most other bodies, the College's cost pressures primarily relate to staff costs.

Going concern and subsequent events

32. 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.

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

- Reviewing bank facilities.
- Performing a review of 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.

- Consideration of post balance sheet events/transactions.

34. 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

35. The College's 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.

36. 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

The Governance Statement complies with good practice

37. The financial statements must include a statement covering the responsibilities of their 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 UK Corporate Governance Code (2010) and the Guide for College Board Members 2012.

38. The College's Statement of Corporate Governance and Internal control explains that the College was compliant with the principles of the 2010 UK Corporate Governance Code throughout the year. This is consistent with the requirements of SFC's 2013/14 Accounts Direction.

39. 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.

40. 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 established risk management systems in place

41. 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 reasonable risk management arrangements in place to monitor and help mitigate key strategic risks to the College.

Internal audit

42. 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 and complies with good 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

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

Prevention and detection of fraud and irregularity

44. 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.

45. 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. Nor did we did not identify any instances of concern with regard to the legality of transactions or events in the course of our audit work.

Standards of conduct

46. 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.

47. 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.

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

Looking forward

FE Colleges: Statement of Recommended Practice (SORP)

49. 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.

50. 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.

51. The FE/HE SORP Board, consisting of key stakeholders from Higher and Further Education bodies across the UK, accounting practitioners, as well as representatives from funding bodies, has developed a SORP which takes account of the key requirements of the new Financial Reporting Standards.

52. 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.

53. 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 institutions. However, comparative figures for 2014/15 are required, which in turn will require an opening balance sheet for 2014/15 to be prepared.

54. 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

55. For financial years beginning on or after 1 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 and restatements within their 2014/15 financial statements.

56. 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.

57. 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. This will now be subject to revaluation. This will require a change in the Lews Castle College accounting policy for 2014/15 accounts onwards.

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. These are the issues that we believe need to be brought to the attention of the College.

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.

There were no new recommendations arising in 2013/14 and three actions remain outstanding from 2012/13.

Grade	Definition	Recommendations	
		2013/14	2012/13
5	Very high risk exposure - Major concerns requiring immediate attention		
4	High risk exposure - Absence / failure of significant key controls		
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
1	Efficiency / housekeeping point		1

Action plan - follow up on outstanding action plan points

1.	Review of Journals
Observation	Journals are not always subject to review before being posted to the financial ledger. We have carried out detailed testing of journals during the year and have found no issues which we believe would lead to a material misstatement.
Risk and recommendation	Although the College has some mitigating controls in place, through a monthly reconciliation process and the review of Management Accounts, there remains a risk that inaccurate or inappropriate journals are posted. The College should consider whether the current controls can be strengthened further, given the resources available to the finance team. One potential improvement could be for an experienced member of the finance team to carry out a review of all significant journals posted on a monthly basis. Such a detective control could be effective so long as it did not constitute self-review. **Grade 3**
Management Response	A review of journal processes will be undertaken to identify suitable thresholds for monthly reviews and regular monthly reviews will be put in place. **Responsible officer:** Principal **Implementation date:** 31 January 2014
Audit observation in 2013/14	There are some controls (eg pre-posting review of the payroll journal, a monthly reconciliation process and review of Management Accounts) in place. However, there remains a risk that inaccurate or inappropriate journals are posted. We will discuss this issue further with management to agree a way forward which balances efficiency and effectiveness, taking account of resources and risks.

2.	**Greenspace Live Ltd Funding**
Observation	The College receives funding from Edinburgh Napier University for the ENERMAN project. This funding is subsequently forwarded to Greenspace Live Ltd, which conducts the project work.
Risk and recommendation	Whilst we have not identified any significant issues with the arrangements currently in place, the College should consider whether the overall funding agreement should be amended so that the agreement is between Edinburgh Napier University and Greenspace Live Ltd. This may be a more efficient way for the project to be conducted. **Grade 2**
Management Response	Review will be undertaken and more efficient process identified. **Responsible officer:** Principal **Implementation date:** 31 January 2014
Audit observation in 2013/14	The College received a total of £45,000 for the ENERMAN project in 2013/14 which was then transferred over to Greenspace. Funding agreement and procedures in place remain unaltered. **Further management comment:** The ENERMAN project came to an end during the year. The College will no longer receive funds on behalf of Greenspace for this project.

3.	Asset Verification
Observation	The College does not carry out a verification exercise.
Risk and recommendation	There is a risk that assets are scrapped or disposed without the knowledge of the finance team. The College should carry out a periodic review of the assets in the Fixed Asset Register to confirm whether they are still in use. This could be carried out in line with current asset controls, such as PAT testing, as well as any records maintained by the IT team. **Grade 1**
Management Response	Review will be undertaken. **Responsible officer:** Principal **Implementation date:** 30 August 2014
Audit observation in 2013/14	No asset verification exercise has been conducted in the year. We understand management are aware of the need to perform a clear-up exercise on the fixed asset register and will do so when staff resources allow. **Further management comment:** Review will be undertaken by April 2015.

Appendix 2: Respective responsibilities

Management responsibilities

58. 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.

59. 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

60. 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

61. 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

62. 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

63. 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

64. 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

65. 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

66. 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.

67. Our assessment of materiality for the financial statements was £140,000, 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.

68. 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%	70,000
Medium	65%	91,000
Low	85%	119,000

Confirmation of auditor independence

69. *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.

70. 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.

Appendix 3: Your audit team

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