



HENDERSON LOGGIE
Chartered Accountants

North Highland College UHI

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

External Audit Report No: 2014/02

Draft Issued: 5 November 2014

2nd Draft Issued: 7 November 2014

3rd Draft Issued: 27 November 2014

Final Issued: 12 December 2014



Contents

| | Page |
|---|----------------|
| 1. Executive Summary | 1 - 2 |
| 2. Introduction | 3 - 4 |
| 3. Financial Statements | 5 - 10 |
| 4. Corporate Governance | 11 - 12 |
| 5. Performance | 13 |
| 6. Outlook | 14 - 15 |
| Appendix I – Audited Bodies’ Responsibilities | 16 - 17 |
| Appendix II – Follow-up of 2011/12 Annual Audit Report Recommendations | 18 |

Notice: About this report

This report has been prepared in accordance with our responsibilities under International Standards on Auditing (ISAs) and those set out within Audit Scotland’s Code of Audit Practice (‘the Code’) and Statement of Responsibilities of Auditors and Audited Bodies.

This report is for the benefit of only North Highland College UHI and is made available to Audit Scotland (together with the beneficiaries), and has been released to the beneficiaries on the basis that it shall not be copied, referred to or disclosed, in whole or in part, without prior written consent.

Nothing in this report constitutes a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against Henderson Loggie CA (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law Henderson Loggie CA does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.



Executive Summary

Financial Statements

- On 12 December 2014 we issued an audit report with an unqualified opinion on the financial statements of the College for the year ended 31 July 2014 and on the regularity of the financial transactions reflected in those financial statements.
- The annual financial statements of the College comply with the Accounts Direction issued by the Scottish Funding Council (SFC) and the Statement of Recommended Practice (SORP) on Accounting for Further and Higher Education.
- There were a small number of audit and accounting adjustments made to the financial statements which had the impact of decreasing the deficit by £0.176 million. It was agreed not to amend the financial statements for a further seven potential adjustments on the grounds that the overall impact of these on the financial statements is not material.
- A small number of minor disclosure and clarification adjustments were also made to the financial statements to ensure compliance with the SORP and Accounts Direction and improve the overall presentation of the financial statements.
- The College's position is a deficit for the year of £1.223 million (2012/13 – deficit £0.306 million), and an Income and Expenditure Account balance of £0.841 million at 31 July 2014 (31/07/13 - £1.703 million). The results for the year are impacted by a transfer to the North Highland College Foundation of £1.300 million.

Corporate Governance

- The College's Corporate Governance Statement confirms that the College complies with all of the provisions of the 2010 UK Corporate Governance Code in so far as they apply to the further education sector, and it has complied throughout the year ended 31 July 2014.
- No material weaknesses in the accounting and internal control systems were identified during the 2013/14 financial statements audit which would adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.
- We did not identify any matters of concern relating to the College's corporate governance arrangements regarding the prevention and detection of fraud, or standards of conduct and the prevention and detection of corruption.
- The College has an on-going process for identifying, evaluating and managing its significant risks.

Performance

- The College management and committee structure clearly includes robust mechanisms to monitor and manage financial and non-financial performance. This appears to work well in practice.
- In relation to Shared Services, UHI Academic Partners continue to consider the potential for optimising efficiencies and achieving best practice across the Partnership including the development of shared Learning and Information Services (LIS).



Executive Summary

Outlook

- The order assigning the College to the University of the Highlands and Islands (UHI) as the Regional Strategic Body for the Highlands and Islands came into effect on 1 August 2014.
- UHI has established a Further Education Committee of Court (the Further Educational Regional Board) to carry out its functions as a Regional Strategic Body.
- The reclassification of incorporated colleges in Scotland as Central Government bodies from 1 April 2014 has a number of implications for budgeting, reporting and accounting practices. The position in the Highlands and Islands region is further complicated by the fact that the UHI itself and a number of its other Academic Partner colleges are not caught by the reclassification. The main practical impact of this change is that colleges are required to undertake monthly cash forecasts and report these to the SFC to ensure that they only draw down sufficient funding to meet forecast expenditure. The format of financial statements will also have to change from 2014/15 as Central Government bodies use the Government Financial Reporting Manual ('the FReM').
- The classification of incorporated colleges as Central Government bodies also limits the future use of surpluses and cash reserves. Taking SFC advice, and in line with other colleges in the sector, in order to protect existing cash reserves the College established an Arms-Length Foundation during 2013/14 and £1.300 million was transferred to the Foundation in March 2014. The Foundation is overseen by an independent Board of Trustees (following a number of new appointments to the Board in October 2014) and the College will be required to apply to the Foundation each time a funding need is identified.
- Incorporated colleges and Regional Boards are required to comply with the requirements of the Scottish Public Finance Manual (SPFM), except where directed by SFC's Accountable Officer.
- A new Financial Memorandum with colleges was issued by the SFC in December 2014 following a period of consultation. This sets out the formal relationship between the SFC and fundable bodies in the college sector, and the requirements with which fundable bodies are expected to comply in return for payment of grant by the SFC. In the Highlands and Islands region the UHI will sign the Financial Memorandum with the SFC, as the Regional Strategic Body, and will in turn require its assigned colleges to sign up to a Financial Memorandum with it.
- Three new accounting standards (Financial Reporting Standard (FRS) 100, 101 and 102) come into force for accounting periods commencing on or after 1 January 2015 which means that 2015/16 will be the first reporting year. However, comparative figures for 2014/15 will be required. In addition, a new Education SORP has been developed following the publication of the new FRSs, which will also be effective from 2015/16.



Introduction

Background

1. 2013/14 was the third year of our five year appointment as external auditors of North Highland College UHI ('the College'). This report summarises our opinion and conclusions and highlights significant issues arising from our work. It covers the communication of findings from the audit required by International Standard on Auditing (ISA) (UK and Ireland) 260: Communication of Audit Matters with Those Charged with Governance.
2. The audit framework is outlined in our Strategic Planning Memorandum and 2013/14 Annual Audit Plan issued on 30 May 2014 and considered by the Audit Committee on 4 June 2014. The scope of the audit was to:
 - provide an opinion on, to the extent required by the relevant authorities, the financial statements and the regularity of transactions in accordance with the standards and guidance issued by the Financial Reporting Council;
 - review and report on the College's corporate governance arrangements in relation to systems of internal control, the prevention and detection of fraud and irregularity, standards of conduct, and prevention and detection of corruption; and the College's financial position; and
 - review and report on the College's arrangements to manage its performance, as they relate to the economy, efficiency and effectiveness in the use of resources.
3. Our audit approach focused on the identification of the significant risk areas facing the College and the significant classes of transactions, estimates, other account balances and disclosures impacting upon the financial statements. These include:
 - compliance with legislation and financial regulations
 - fixed assets transactions, including consideration of any impairment; the estates development strategy implementation; on-going estate improvements and maintenance; and compliance with relevant financial reporting standards
 - recoverability of debtors
 - recognition of funding provided for specific purposes and the regularity of corresponding expenditure
 - compliance with FRS 17 – Retirement Benefits and provision for pension liabilities for early retirals
 - compliance with the SORP on Accounting for Further and Higher Education.



Introduction

Basis of Information

4. External auditors do not act as a substitute for the College's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.
5. To a certain extent the content of this report comprises general information that has been provided by, or is based on discussions with, management and staff of the College. Except to the extent necessary for the purposes of the audit, this information has not been independently verified. The contents of this report should not be taken as reflecting the views of Henderson Loggie CA except where explicitly stated as being so.
6. As our audit is designed primarily to enable us to form an opinion on the financial statements taken as a whole, our report cannot be expected to include all the possible comments and recommendations that a more extensive special examination would bring to light.

Acknowledgement

7. Our audit has brought us in contact with a range of College staff. We wish to place on record our appreciation of the co-operation and assistance extended to us by staff in the discharge of our responsibilities.



Financial Statements

Audit Opinion

8. On 12 December 2014 we issued an audit report with an unqualified opinion on the financial statements of the College for the year to 31 July 2014 and on the regularity of the financial transactions reflected in those financial statements.
9. We are required to undertake audit work from the Balance Sheet date up to the date of signing the financial statements and this was undertaken in the period up to 12 December 2014. No post balance sheet events were identified that required adjustment to be made to the financial statements or additional disclosure in a note thereto.

Audit Completion

10. An important measure of proper financial control and accountability is the timely closure and publication of audited financial statements. Table 1 summarises the three key elements of the audit process.

Table 1: Key elements of the audit process

Completeness of draft financial statements

A set of draft financial statements was received in advance of the final audit visit. These were of a high standard and required minimal presentational changes as part of the audit process.

Quality of supporting working papers

A full set of supporting working papers was provided from the outset of the audit and were of a suitably high standard.

Response to audit queries

We are pleased to note that all audit queries were dealt with in a timely manner.

Corporate Governance Statement

11. Colleges are required to include a statement on their corporate governance arrangements within their annual financial statements. The statement describes the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management.
12. We are required to review the statement to assess whether the description of the process adopted in reviewing the effectiveness of the system of internal control appropriately reflects the process and report where statements are not consistent with our knowledge of the body and report if the statement does not comply with SFC requirements. We are not required to provide an opinion on the College's systems of internal controls.
13. The College's corporate governance statement for 2013/14 states the College complies with all of the provisions of the UK Corporate Governance Code in so far as they apply to the further education sector, and it has complied throughout the year ended 31 July 2014.
14. Our audit opinion on the statement is covered by our auditor's report and is unqualified in this respect.



Financial Statements

Audit and Accounting Adjustments and Confirmation

15. In Table 2 we draw attention to the adjustments identified during the course of the audit. The effect of adjusting for these items was to reduce the deficit for the year by £0.176 million.

Table 2: Audit adjustments – impact on the financial statements

| Description | I&E | I&E | B/Sheet | B/Sheet |
|--|------------|------------|------------|------------|
| | DR | CR | DR | CR |
| | £000 | £000 | £000 | £000 |
| 1 Accruals and deferred income Transfer to Foundation <i>Being reversal of 'provision' for future transfer to the North Highland College Foundation. This did not meet the conditions for recognising a provision under FRS 12 i.e. no present obligation (legal or constructive) as a result of a past event.</i> | | 448 | 448 | |
| 2 Other operating income Accruals and deferred income <i>Being transfer of unused SFC capital grants to deferred income following confirmation from the SFC that these can be carried forward to 2014/15. Originally released to I&E A/C for transfer to the Foundation.</i> | 383 | | | 383 |
| 3 Early retirement provision Other operating expenses <i>Being reduction in early retirement provision required after correction to net interest rate used in calculation.</i> | | 111 | 111 | |
| 4 Revaluation reserve Income and expenditure reserve <i>Being additional release of revaluation reserve.</i> | | | 10 | 10 |
| 5 Other operating expenses SFC grants <i>Being HE Childcare income and expenditure moved to I&E A/C in accordance with SFC guidance.</i> | 16 | 16 | | |
| Total | 399 | 575 | 569 | 393 |
| Net impact on Income and Expenditure Account deficit | | 176 | | |

16. A small number of disclosure and clarification adjustments were made to the financial statements to ensure SORP and Accounts Direction compliance and improve the overall presentation of the financial statements.



Financial Statements

Audit and Accounting Adjustments and Confirmation (Continued)

17. A number of potential audit adjustments were identified which management decided not to adjust. These have been listed in Table 3 below and the total of these items is below our materiality level of £0.138 million. The effect of adjusting for these items would be to increase the deficit for the year by £0.005 million.

Table 3: Unadjusted audit differences – impact on the financial statements

| Description | I&E | I&E | B/Sheet | B/Sheet |
|---|-----------|-----------|-----------|-----------|
| | DR | CR | DR | CR |
| | £000 | £000 | £000 | £000 |
| 1 Trade debtors | | | 5 | |
| Trade creditors | | | | 5 |
| <i>Being reallocation of credit balances on the year-end sales ledger.</i> | | | | |
| 2 Trade debtors | | | 4 | |
| Trade creditors | | | | 4 |
| <i>Being reallocation of debit balances on the year-end purchase ledger.</i> | | | | |
| 3 Accruals and deferred income | | | 15 | |
| Trade debtors | | | | 15 |
| <i>Being reallocation of bad debt provision against trade debtors.</i> | | | | |
| 4 Other operating expenses | 4 | | | |
| Bank | | | | 4 |
| <i>Being retranslation of foreign currency bank account.</i> | | | | |
| 5 Other operating expenses | 1 | | | |
| Trade creditors | | | | 1 |
| <i>Being late invoice identified from supplier statement reconciliations</i> | | | | |
| 6 Trade creditors | | | 10 | |
| VAT liability | | | | 10 |
| <i>Being reallocation of VAT from trade creditors.</i> | | | | |
| 7 Other operating expenses | 41 | | | |
| Staff costs | | 41 | | |
| <i>Being reclassification of redundancy and pension costs accounts incorrectly coded to other operating expenses.</i> | | | | |
| Total | 46 | 41 | 34 | 39 |
| Net impact on Income and Expenditure Account deficit | 5 | | | |



Financial Statements

Audit and Accounting Adjustments and Confirmation (Continued)

Confirmations and Representations

18. We confirm that as at the date of this report, in our professional judgement, Henderson Loggie CA was independent within the meaning of regulatory and professional requirements and the objectivity of audit staff was not impaired.
19. In accordance with auditing standards, we obtained representations from the College on material issues.

Financial Position

20. SFC circular SFC/31/2009, issued on 16 October 2009, defines a sustainable college as one which 'continually develops the quality of its learning activities to meet the changing needs of its customers, society and the economy, controls its costs, and year on year secures sufficient income to resource its planned activities and enable a level of current and future investment necessary to maintain its assets.'
21. One impact of the ONS decision to reclassify incorporated colleges as Central Government bodies from 1 April 2014 was that college year-ends changed to 31 March, however the Scottish Government secured a concession from HM Treasury to allow UHI incorporated colleges to retain 31 July for accounting purposes only. Subsequent discussion between HM Treasury, the Scottish Government and the SFC concluded with the Cabinet Secretary for Education accepting the Chief Secretary to the Treasury's offer of derogation to all colleges to change their year-end from 31 March to 31 July. This offer was subject to colleges meeting HM Treasury budgeting and reporting requirements.
22. Table 4 provides a summary of the College's planned and actual financial results, based on the audited financial statements and the College budgets.

Table 4: Comparison of planned and actual financial results

| | 2012/13 Actual £000 | 2013/14 Planned £000 | 2013/14 Actual £000 | 2014/15 Planned £000 |
|--|---------------------------|----------------------------|---------------------------|----------------------------|
| Financial outturn Surplus/(deficit) | (306) | 0 | (1,223) | 0 |
| Income and expenditure reserves | 1,703 | 1,703 | 841 | 841 |
| Cash balances | 2,373 | 537 | 1,239 | 584 |

Source: Audited financial statements and College budgets

23. Overall, College income in 2013/14 has increased by £0.324 million (2.5%) over 2012/13 to £13,483 million. There was an increase of £0.240 million (216.2%) in SFC Estates grants treated as revenue this year to £0.351 million. Other grant income has decreased by £0.728 million (26.9%) on 2012/13 to £1.976 million largely as a result of a major EU project finishing in autumn 2013. Other operating income has increased by £0.386 million (51.1%) over 2012/13 to £1.142 million. This mainly relates to an increase in consultancy work at the Environmental Research Institute. The College's expenditure has increased by £1.241 million (9.2%) over 2012/13 to £14.706 million. This mainly relates to the transfer of £1.300 million to the North Highland College Foundation.



Financial Statements

Financial Position (Continued)

Loan Covenants

24. The transfer to the Foundation means that the College is technically in breach of financial covenants with the Bank of Scotland. The bank recognises why the transfer is required and has agreed to take this into consideration and adjust the transfer when calculating the minimum Income and Expenditure reserve and annual surplus / deficit.

Going Concern

25. The financial environment for 2013/14 continued to be challenging and College staff have again worked hard to achieve the financial results for this year. Financial challenges will continue for the foreseeable future but the College has budget setting and monitoring arrangements in place that should aid sustainability in future.
26. From our review of the results for the year and other available information we are satisfied that going concern is not an issue for the 2013/14 financial statements and the budget for 2014/15 shows a break-even position after a transfer of £0.109 million to the Foundation.

2013/14 FTEs / SUMs outturn

27. The College's outturn against its 2013/14 FTEs / WSUMs targets is shown in Table 5.

Table 5: 2013/14 FTE / SUMs outturn

| | HE 2013/14 | HE 2012/13 | FE 2013/14 | FE 2012/13 |
|-----------------------|---------------|---------------|---------------|---------------|
| FTE / WSUMS target | 425 | 475 | 26,826 | 25,217 |
| FTE / WSUMS actual | 390 | 388 | 28,378 | 26,228 |
| Excess / (deficit) | (35) | (87) | 1,552 | 1,011 |

Source: College records / audited SUMs returns

28. The audit of the SUMs return for 2013/14 was carried out by Wylie and Bisset LLP who concluded that the student data returns have been compiled in accordance with all relevant guidance, that adequate procedures are in place to ensure the accurate collection and recording of data; and, on the basis of testing, reasonable assurance can be taken that the FES return contained no material mis-statement.

FRS 17 Retirement Benefits

29. In 2013/14 the College accounted for its participation in the local government pension scheme as a defined benefit scheme. This is consistent with the accounting treatment adopted in previous years.

Capital Income and Expenditure

30. During 2013/14 the main capital project undertaken by the College was the biomass extension which now heats the whole Thurso Campus. The cost of this work was approximately £0.288 million, which was financed using SFC capital grants.



Financial Statements

Financial Position (Continued)

Arms-Length Foundation

31. An arms-length foundation was set up in during the year into which the College has transferred £1.300 million by way of a donation in March 2014 and intends to transfer any future surpluses. The objects of the North Highland College Foundation are *'to advance and promote further education, higher education and / or research in North Highland by the support of The North Highland College, or any successor bodies thereto; and to promote such similar charitable purposes in such proportions and manner as the directors will think fit'*. The main reason for setting up the Foundation is that the Central Government budget mechanisms mean that the ability to use College reserves and surpluses in future periods is restricted. The College will need to apply to the Foundation to access the money held there.
32. To ensure that the Foundation is not consolidated into the College's financial results, thereby most likely losing the ability to spend the money, it requires to be independent of the College. During 2013/14 we have had discussions with College management and the Chair of the Board of Management in relation to the Foundation, including with regard to the composition of the Board of Trustees and the steps needed to maintain the Foundation at arms-length. At the point that it was created the Foundation's Board comprised only College Board members which we considered would give the College control over the Foundation and thereby require consolidation. As a result the College and Foundation have sought further Board members for the Foundation and five independent members were recruited in October 2014, prior to any funds being allocated from the Foundation to the College. At 31 October 2014 the appointment of these additional members was in the course of being formalised. We have therefore concluded that the Foundation is at arms-length from the College and does not require to be consolidated at 31 July 2014. We will review the ongoing operation of the Foundation annually to consider if it remains at arms-length or is under the control of the College in terms of the requirements of Financial Reporting Standard 2 Accounting for Subsidiary Undertakings.



Corporate Governance

Corporate Governance

33. The College is responsible for ensuring that governance arrangements follow the three fundamental principles of openness, integrity and accountability and that arrangements are in place to ensure the proper conduct of its affairs. Mechanisms to monitor the adequacy and effectiveness of these arrangements should also be in place.
34. Our responsibility, as noted in the Code of Audit Practice, is to review and report on audited bodies' corporate governance arrangements as they relate to:
- Bodies' reviews of corporate governance and systems of internal control, including reporting arrangements
 - The prevention and detection of fraud and irregularity
 - Standards of conduct and arrangements for the prevention and detection of corruption
 - The financial position of audited bodies
35. Comments on the financial position and the College's Corporate Governance Statement are covered in the Financial Statement section of this report. The Corporate Governance Statement does not identify any significant areas for improvement.
36. We have considered the College's governance arrangements through formal review of documents and procedures and informal observation of the operation of committee arrangements and the relationships between Board members and staff. In particular we have considered the arrangements for risk management and reporting to committees. We did not identify any areas of concern regarding the College governance arrangements.
37. The Post-16 Education (Scotland) Act 2013 includes provisions in relation to the identification of principles of good governance practice for the college sector. In anticipation of them coming into effect, the SFC invited the Regional Leads to convene a Steering Group to develop a draft 'Code of Good Governance for Scotland's Colleges'. The first stage of consultation took place in December 2013 when stakeholders were invited to provide comments on what should be included in the new Code, for consideration by the Steering Group. On 24 April 2014 the second stage of consultation commenced, with comments invited from all interested parties by 2 June 2014. A final version of the Code was published in December 2014.
38. The Steering Group has taken a very deliberate decision to keep the Code focussed on the principles of good governance and not include practical guidance on best practice. In so doing, the aim is to achieve a more concise, accessible and unambiguous document that sets out clearly what is required of colleges. The Code sets out the principles of good governance across five main areas: Leadership and Strategy; Quality of the Student Experience; Accountability; Effectiveness; and Relationships and Collaboration. Colleges will be expected to comply with the new Code as condition of grant from the SFC or their regional strategic body.

Systems of Internal Control

Control environment

39. No material weaknesses in the accounting and internal control systems were identified during the 2013/14 financial statements audit which would adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.
40. Following our interim visit in July 2014, and the subsequent testing we performed during the year-end audit to update our findings, we concluded that the key controls for the main financial systems tested were in place and operating as expected. No weaknesses or issues were found that would impact adversely on the financial statements or our year-end audit.



Corporate Governance

Systems of Internal Control (Continued)

Internal Audit

41. Audit Scotland's Code of Audit Practice directs us to maintain effective co-ordination with internal audit and place the maximum possible reliance on their work. Wylie and Bisset LLP provided internal audit services to the College in 2013/14. We have reviewed the scope and extent of work performed by internal audit during the year and considered the impact of their findings and conclusions on our work, where appropriate. We have also considered the adequacy of the provision and are content that the audit service is of good quality.
42. The annual internal audit report issued in July 2014 did not identify any issues that affect our audit conclusions although a 'weak' conclusion was made on the IT review. This was primarily as a result of UHI-wide issues that the College cannot resolve itself. Previous years' reports have highlighted weaknesses in relation to the lack of a comprehensive asset inventory and documented schedules of cyclical and planned maintenance. Significant progress was noted in resolving these issues.

Risk Management

43. Risk management is important for the development and on-going review of systems of internal control.
44. The College has a Risk Management Policy and Strategy and risk management procedures are in place that are actively monitored and reported on. This includes an on-going process for identifying, evaluating and managing its significant risks.
45. Risk management is seen as a Board matter, with the key strategic risks being identified and reported to the Board. We noted that there are clear links drawn between the key risks in the Strategic Risk Register and the College's Strategic Plan.

Fraud and irregularity, standards and conduct, and prevention and detection of corruption

46. During 2013/14 we had regard to ISA 240: The Auditor's Responsibility to Consider Fraud in the Audit of Financial Statements.
47. The College has appropriate arrangements in place to deter fraud and irregularity, including current versions of its Financial Regulations and a Governance Manual including Standing Orders and a Fraud & Corruption Policy. These documents are reviewed and updated regularly. The last full review was during 2011 and both documents were approved by the Board in October 2011.
48. No frauds were identified during 2013/14 or in the period since 31 July 2014 to the date of this report.
49. The College has in place the following procedures / policies in relation to standards of conduct and prevention and detection of corruption. These are incorporated in the Governance Manual and are reviewed and updated regularly:
 - Code of Conduct for Board Members
 - Register of Board Members' and Senior Staff Interests
 - Fraud & Corruption Policy
 - Public Interest Disclosure (Whistleblowing) Policy and Procedures
 - Anti-bribery policy.
50. The arrangements for maintaining standards of conduct and the prevention and detection of corruption are considered to be appropriate.



Performance

Performance Audit

Introduction

51. The terms of appointment from Audit Scotland include a requirement for a proportion of our audit time to be spent on performance audit work. Performance audit work covers a variety of areas, both financial and non-financial, including both Audit Scotland centrally directed studies and locally determined studies based on agreement between each organisation and their auditors.
52. No mandatory performance audit studies were identified by Audit Scotland for the College during 2013/14 although Audit Scotland has requested auditors to provide information in a data set for use in a sector report. In particular it has requested information about voluntary severance schemes and payments. The College did not make any payments under a voluntary severance scheme during 2013/14 although there were a small number of redundancy payments made, totalling £0.030 million, as a result of reductions required to staff numbers in areas of the College where there has been a decrease in funding.

College performance arrangements

53. Audit Scotland reports are considered by management upon receipt and thereafter brought to the attention of the Board committee responsible, if appropriate.
54. Arrangements for financial and non-financial management are well established in the College, through the operation of the Senior Management Team and the Board and its various Committees. The Governance Manual clearly records the management responsibilities of the Board and each Committee, and how these interact with each other. Discussion with managers and our review of meeting papers and minutes confirms these responsibilities appear to be undertaken in an appropriate manner.

Education Scotland Review

55. We are required by Audit Scotland's Code of Audit Practice to contribute to the 'whole organisation' approach to inspection through co-ordination amongst auditors, inspectors and other scrutiny bodies. We therefore place reliance on the reported results of the work of statutory inspectorates in relation to corporate or service performance.
56. Education Scotland published a report on the education provision of the College in its annual engagement review issued in May 2014. The report noted a range of initiatives providing further progress in addressing the two main action points raised by Education Scotland following its full review of the College in February 2012. The College has identified further work to investigate changes to its procedures to more accurately reflect learner success and support trend analysis and benchmarking improvement. The College submitted several examples of excellence during the review and these will be considered at a future visit.



Outlook

2014/15 and beyond

Post-16 Education (Scotland) Act 2013

57. The Post-16 Education (Scotland) Act 2013 makes provision: about the support for, and the governance of, further and higher education institutions, including provision for the regionalisation of colleges; for reviews of how further and higher education is provided; for sharing information about young people's involvement in education and training; and for connected purposes. The Bill for this Act of the Scottish Parliament was passed by the Parliament on 26 June 2013 and received Royal Assent on 7 August 2013.
58. Under the Act, the University of the Highlands and Islands (UHI) is the Regional Strategic Body for the Highlands and Islands. The Assigned Colleges (University of the Highlands and Islands) Order 2014 came into force on 1 August 2014. The order assigns the Board of Management of The North Highland College to UHI.
59. UHI has established a Further Education Committee of Court (the Further Educational Regional Board) to carry out its functions as a Regional Strategic Body.

Regional Outcome Agreement

60. A Regional Outcome Agreement with the SFC has been finalised and the regional allocation of funding agreed for 2014/15.
61. The College's allocations for academic year 2014/15 are teaching grant of £6.020 million and remoteness funding of £0.400 million (both unchanged from 2013/14). The College's WSUMs target also remains unchanged from 2013/14 at 26,826 (17,491 to be delivered by North Highland College and 9,335 to be delivered by Argyll College).
62. The level of recurrent grant budgeted from UHI for the 2014/15 academic year is £1.426 million (2013/14 – £1.366 million).
63. In September 2014 the Director of Finance presented a draft budget for 2014/15 to the Board of Management for approval. This showed a break-even position after a transfer of £0.109 million to the North Highland College Foundation.

ONS Reclassification

64. The reclassification of incorporated colleges in Scotland as Central Government bodies from 1 April 2014 has a number of implications for budgeting, reporting and accounting practices and issues for consideration which the SFC has addressed through a series of Reclassification Communications and ONS Project Board Updates. The position in the Highlands and Islands region is further complicated by the fact that the UHI itself and a number of its other Academic Partner colleges are not caught by the reclassification.
65. The main practical impact of this change is that colleges are required to undertake monthly cash forecasts and report these to the SFC to ensure that they only draw down sufficient funding to meet forecast expenditure. The format of financial statements will also have to change from 2014/15 as Central Government bodies use the Government Financial Reporting Manual ('the FReM').



Outlook

2014/15 and beyond (Continued)

66. The Resource Return at 31 March will be used for Government accounting purposes. If required this can be amended before the end of September each year. From 2015/16 Whole of Government Accounts returns will also be required.

67. Incorporated colleges and Regional Boards are also required to comply with the requirements of the Scottish Public Finance Manual (SPFM), except where directed by SFC's Accountable Officer.

SFC Financial Memorandum with Colleges

68. A new Financial Memorandum with colleges was issued by the SFC in December 2014 following a period of consultation. This sets out the formal relationship between the SFC and fundable bodies in the college sector, and the requirements with which fundable bodies are expected to comply in return for payment of grant by the SFC. In the Highlands and Islands region the UHI will sign the Financial Memorandum with the SFC, as the Regional Strategic Body, and will in turn require its assigned colleges to sign up to a Financial Memorandum with it.

69. The Financial Memorandum shows a significant number of changes from the existing version, reflecting all the recent governance changes in the sector and the reclassification of incorporated colleges in Scotland as Central Government bodies.

FRS 102 'The Financial Reporting Standard' and new Education SORP

70. The Financial Reporting Council has been implementing a convergence programme aligning UK Generally Accepted Accounting Practice (GAAP) to International Financial Reporting Standards (IFRS) and published three new FRSs (FRS 100, 101 and 102) with the substantive FRS 102 'The Financial Reporting Standard' representing the final step towards IFRS convergence. These three new FRS' become the new UK GAAP, which is fully IFRS-based. The new accounting standards come into force for accounting periods commencing on or after 1 January 2015 which means that 2015/16 will be the first reporting year. However, comparative figures for 2014/15 will be required.

71. In addition, a new Education SORP has been developed following the publication of the new FRSs and this received final approval from the FRC on 26 March 2014 following an extensive consultation process. This will also be effective from 2015/16. The new SORP was formally published in May 2014 and is available on www.fehesorp.ac.uk.



Appendix I

Audited Bodies' Responsibilities

Extracts from the Audit Scotland Code of Audit Practice

The Scottish ministers, elected members, governing bodies, boards, accountable officers, managers and officials have primary responsibility for ensuring that public business is conducted in accordance with the law and proper standards, and that public money is handled with integrity and spent appropriately. Public bodies and those responsible for conducting their affairs must discharge this accountability by establishing and maintaining proper governance arrangements and effective stewardship of the resources at their disposal.

Financial statements

Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources. Audited bodies are responsible for:

- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority
- maintaining proper accounting records
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice)
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.

Many audited bodies publish other information, such as an annual report, alongside the financial statements.

Audited bodies should prepare financial statements in accordance with statutory timescales or in good time to allow audits to be completed by any dates specified by sponsoring directorates or other bodies (eg, the relevant Scottish Government Health Directorate for NHS bodies). Financial statements should be prepared in accordance with all relevant regulatory requirements and be supported by accounting records and working papers prepared to an acceptable professional standard.

Corporate governance arrangements

The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer

Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements.

Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

Systems of internal control

Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls.

They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.

Rigorous self-evaluation should be a central part of audited bodies' performance management to support continuous improvement.



Appendix I

Audited Bodies' Responsibilities

Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity.

This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions
- developing and implementing strategies to prevent and detect fraud and other irregularity
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity
- participating, when required, in data matching exercises carried out by Audit Scotland.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers
- promoting appropriate values and standards
- developing, promoting and monitoring compliance with standing orders and financial instructions

Financial position of audited bodies

Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified
- compliance with any statutory financial requirements and achievement of financial targets
- balances and reserves, including strategies about levels and future use
- the impact of planned future policies and foreseeable developments on their financial position.

Best Value

The Scottish Public Finance Manual explains that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure Best Value. Best Value is defined as the continuous improvement in the performance of functions. This includes having regard to the concepts of economy, efficiency and effectiveness and the need to meet equal opportunity requirements, and contributing to the achievement of sustainable development.

Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.



Appendix II

Follow-up of remaining 2011/12 Annual Audit Report Recommendations

| Recommendation | Grade | Management Comments | Agreed Y/N | Responsible Officer For Action | Agreed Completion Date | Update |
|--|-------|---|------------|--------------------------------|------------------------|---|
| <p>Capital Income and Expenditure</p> <p>R2 Plans to obtain information from the College's professional advisors, to identify major components within the new buildings with substantially different useful economic lives should be taken forward with a view to accounting separately for depreciation purposes for each component and depreciating each over its individual useful economic life.</p> <p>Further auditor comment 2013/14 Componentisation is a requirement of the current SORP and is also included in the new SORP applicable from 2015/16. Future guidance on implementation of the new SORP and the application of the FreM should be considered in due course and full componentisation reconsidered at that time.</p> | Low | External Project Manager recently provided a breakdown for both ETEC and CFEE regarding cost analysis and components of projects. This has been collated for the Valuer – this will help to form part of work for fixed assets for year ended 31 July 13. | Y | Director of Finance | 31 July 13 | <p>Progress at Nov. 2013 A breakdown for both ETEC and CFEE, regarding cost analysis and components of projects, has been provided by the Valuer which the College has used to componentise fixed assets and depreciate accordingly.</p> <p>Recommendation 2012/13 – this should be considered for the other College buildings in future years.</p> <p>Management comment – this recommendation was discussed at the November 2013 Audit Committee meeting and the Director of Finance undertook to further investigate the componentisation of the other College buildings.</p> <p>Progress at Nov. 2014 No further componentisation of College buildings was applied for 2013/14.</p> <p>Management comment – after further consideration and consultation on this issue during 2013/14 the Director of Finance made the decision not to apply componentisation retrospectively. However efforts will be made to ensure that the College complies with any changes in accounting standards and legislation that may mean retrospective componentisation work has to be done.</p> |