Scott-Moncrieff
business advisers and accountants

Inverness College

Annual report on the 2014/15 audit to the Board of Management and the Auditor General for Scotland

December 2015

Contents

Summary

Financial Statements

The financial statements for the year ended 31 July 2015 were approved by the Board on 17 December 2015. In our independent auditor's report we provided an unqualified opinion on the financial statements, the regularity of transactions, and on the consistency of the operating and financial review and the financial statements. We are also satisfied that there are no matters which we are required to report by exception.

In our independent auditor's report we provided a qualified opinion on the remuneration report. The Government Financial Reporting Manual requires pension disclosures for each senior official who has served during the year. The College has not included these disclosures in full. Except for this matter, the remuneration report has been properly prepared.

The financial statements and supporting schedules prepared by the College were of a good standard. We would like to thank all management and staff at the College for their co-operation and assistance.

Financial management

We found that the College has effective arrangements in place for financial management and the use of resources.

Overall, the College has seen a reduction in income of £0.466million compared to last year. Over the same period expenditure has reduced by £1.498million.

The College managed its finances well during the financial year and has good budget management controls in place.

Financial sustainability

The College continues to report a deficit balance on reserves. In 2014/15 the deficit increased by £0.124million due to the operating deficit being only partially offset by the actuarial gain recognised on the pension liability. The deficit balance on reserves is offset by a balance of £12.034million of deferred capital grants, leaving net assets of £6.763million.

- **An unqualified opinion on:**
  - **the financial statements**
  - **regularity**
  - **the consistency of the OFR and the financial statements.**
- **A qualified audit opinion on the remuneration report due to incomplete disclosure of pension information.**
- **The College has effective arrangements in place for financial management and the use of resources.**
- **The College has appropriate governance arrangements in place.**
- **College has proper arrangements in place to promote and secure value for money.**

Funding has been confirmed for the coming year through the Highlands and Islands Regional Further and Higher Outcome Agreements 2015/16.
The College has adequate planning arrangements in place and the approved revenue budget forecasts a break even position for 2015/16.

Whilst the financial outlook for the College, and the further education sector more generally, continues to be challenging, the College remains financially resilient and in good financial health.

Governance and transparency

In our opinion, the College's corporate governance arrangements as they relate to standards of conduct and the prevention and detection of bribery and corruption are adequate and appropriate.

We have reviewed the statement of corporate governance and internal control and can confirm that this is in line with the Scottish Funding Council'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.

Performance

The College monitors a range of Key Performance Indicators (KPIs) as part of its performance management arrangements and reports that it exceeded student activity targets during the financial year.

The College has to promote and secure value for money in its operations and has confirmed that it has appropriate arrangements in place to do so.

Conclusion

This report concludes the audit of Inverness College for the year to 31 July 2015. 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 2015

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Introduction

Introduction

1. This report summarises the findings from our 2014/15 audit of Inverness College. The scope of the 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 2014/15:

   - 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. The main elements of our work in 2014/15 have been:

   - An audit of the financial statements, including a review of the College's statement of corporate governance and internal control and the remuneration report;
   - A review of governance arrangements, internal controls and financial systems; and
   - Completion of a minimum dataset of information that is submitted to Audit Scotland.

4. As part of our audit, we have made use of the work of the College's internal audit service and Audit Scotland.

5. 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).

6. The College is responsible for preparing its financial statements that show a true and fair view and for implementing appropriate internal control systems.

7. This report contains an action plan with a specific recommendation, responsible officer and date for implementation. Senior management should assess this recommendation and consider the wider implications before deciding appropriate actions. The recommendation has been given a grading to help the College assess the significance and prioritise the actions required.

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

9. This report is addressed to both Inverness College and the Auditor General for Scotland and will be published on Audit Scotland's website.

10. We would like to thank all members of the College's management and staff who have been involved in our work for their co-operation and assistance during our audit work.

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Financial statements

Financial statements

11. 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 3.

Overall conclusion

An unqualified audit opinion on the financial statements and regularity

12. The financial statements for the year ended 31 July 2015 were approved by the Board on 17 December 2015. In our independent auditor's report we provided:

- an unqualified opinion on the financial statements;
- an unqualified opinion on regularity; and
- an unqualified opinion on the consistency of the Operating and Financial Review (OFR) and the financial statements.

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

A qualified audit opinion on the remuneration report

14. In our independent auditor's report we provided a qualified opinion on the remuneration report. This was due to the College not being able to report the required pension disclosures for each senior official who has served during the year. Except for this matter, in our opinion, the part of the Remuneration Report to be audited has been properly prepared. This matter is explained further in *our assessment of risks of material misstatement* below.

Our assessment of risks of material misstatement

15. The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the audit team. Our audit procedures relating to these matters were designed in the context of our audit of the annual report and accounts as a whole, and not to express an opinion on individual accounts or disclosures.

1. Sector change and arms' length foundation

Incorporated further education (FE) colleges in Scotland became central government bodies from 1 April 2014, after reclassification by the Office for National Statistics (ONS). A key issue 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 2013/14, Inverness College donated £2.7m of cumulated reserves into a new national foundation.

We will consider how the College has managed the implications of reclassification. We will review how the College has interacted with the arms' length foundation, including ensuring that the transactions have been appropriately administered, accounted for and disclosed. We will also consider regionalisation and how this has impacted and may continue to affect Inverness College.

Summarised from 2014/15 External Audit Plan

16. 2014/15 is the first year that incorporated colleges have been required to comply with the Government Financial Reporting Manual 2014-15 (FReM), where applicable. Whilst no changes have been required in accounting treatment for Inverness College, application of the FReM has resulted in additional disclosures within the 2014/15 financial statements. The most significant change has been the inclusion of a Remuneration Report.

17. We have reviewed the additional disclosures made in 2014/15 and have found that the College has complied with the FReM in all areas but one. The College has not been able to obtain the level of information needed to make the all of the remuneration disclosures required by the FReM. It is our understanding that other colleges in Scotland have also had difficulty in obtaining the required information in sufficient time for the 2014/15 financial statements.

18. In particular, compliance with the FReM requires the following pension disclosures for each senior official who has served during the year:

- the real increase during 2014/15 in the pension and, if applicable, related lump sum at age 60 in bands of £2,500
- the value at 31 July 2015 of the accrued pension and, if applicable, related lump sum at age 60 in bands of £5,000
- the value of the cash equivalent transfer value (CETV) at 1 August 2014 and 31 July 2015 to the nearest £1,000
- the real increase in the CETV funded by the employer during 2014/15 disclosed to the nearest £1,000.

19. As the College has not made the required disclosures in full, we have given a qualified opinion over this aspect of the remuneration report.

20. We have reviewed the College's transactions with the ALF and found that they have been appropriately administered, accounted for and disclosed. As in the prior year, the College opted to donate funds to the Scottish Colleges Foundation, an umbrella foundation open to all colleges in Scotland. Due to the required timing of the donation, and given the best information available, the Board approved a range of £0.4million to £0.7million for the donation in March 2015. £0.6million was donated to the ALF before 31 March 2015.

2. Estates developments

The College continues to move forward with the new campus at Beechwood. The College is using the new Non-Profit Distributing (NPD) funding model, in collaboration with the Scottish Futures Trust (SFT), for the £51million of capital construction costs. The other £11million 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. This has involved a substantial write down of the assets in 2012/13 and 2013/14.

We have had ongoing discussions with the Director of Corporate Services on this area, informed by some accounting guidance provided to the College by the SFC. However, this high level guidance needs to be further explored, to ensure the specific and technical complex accounting requirements are fully adhered to.

Summarised from 2014/15 External Audit Plan

21. Practical completion on the new campus at Beechwood was achieved on 7 August 2015, in time for the start of the 2015/16 academic year. Under the NPD model, the College will repay £51million capital construction costs over a 25 year period, via a unitary charge, once the buildings are in use. We have considered the accounting treatment adopted and have found that, under the extant accounting standards and the Statement of Recommended Practice: Accounting for Further and Higher Education 2007 ('the SORP') the College has accounted for the development appropriately in 2014/15. In line with expectations, the NPD asset will be recognised for the first time on the College's balance sheet in the 2015/16 financial statements.

22. From 2015/16 the College will require an accounting model to calculate the required accounting entries for the new campus. The model may be technically complex and there is a lack of clear, comprehensive guidance available to date on the exact treatment to be adopted. The College will also need to undertake a valuation of the new campus upon recognition. In our experience, it is not uncommon for there to be impairment upon recognition of this type of asset.

23. There remains significant uncertainty over the accounting treatment going forward and the implications for the assets currently recognised by the College. The College will need to consider the impact of the NPD asset, its subsequent valuation, any related impairments and the required accounting model in detail to ensure that the correct treatment is adopted. Consideration should be carried out in consultation with the SFT, SFC and EY, the College's project advisors. We will continue to work with management to ensure the development is appropriately treated and to highlight potential implications for accounting in 2015/16.

Management action plan point 1

24. During the year, and in line with the project plan, the College also directly incurred capital expenditure of £1.984million related to the new campus and ££0.361million on equipment for use in the new campus. The full cost of these additions was funded from SFC capital grant. We have reviewed the College's treatment of its estates developments in 2014/15 and have found them to be reasonable under the extant accounting standards and the SORP.

3. 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 £6.632m as at 31 July 2014, a significant increase on the £4.012m equivalent position as at 31 July 2013.

We will review 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 actuaries' valuation. We will also confirm that the actuarial assumptions underpinning the valuation are reasonable and reflective of the College's circumstances.

Summarised from 2014/15 External Audit Plan

25. The pension liability on the HCPF, as assessed by Hymans Robertson, has increased in the year to £7.053million. 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.

4. Management override and revenue recognition

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 varies from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, there is presumed to be a risk of material misstatement due to fraud under ISA 240 - *The auditor's responsibilities relating to fraud in an audit of financial statements*.

4. Management override and revenue recognition (continued)

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.

Summarised from 2014/15 External Audit Plan

26. 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.

Financial statements preparation

27. We received draft financial statements and supporting papers of a good standard. However, information relevant to the audit was not always available on a timely basis. This appears to have been due, at least in part, to the logistical impact of the move to the new campus. As a result, the 2014/15 audit was not as efficient as in previous years.

28. We remain grateful to the Director of Corporate Services and the finance staff for their assistance and support during the course of the audit.

Audit differences

29. There were no material adjustments to the draft financial statements. We identified some minor disclosure and presentational adjustments during our audit, which have been reflected in the final set of accounts.

Board representations

30. 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 five unadjusted differences during our audit work. These unadjusted items are included in our representation letter and shown in Appendix 4.

Regularity

31. We did not identify any instances of concern regarding the legality of transactions or events.

32. We have planned and performed our audit recognising that non-compliance with statute or regulations may materially impact on the financial statements. Our audit procedures included the following:

- reviewing minutes of relevant meetings
- enquiring of senior management and the College's solicitors the position in relation to litigation, claims and assessments
- performing detailed testing of transactions and balances.

Corporate Governance

33. The financial statements must include a statement covering the responsibilities of the governing body in relation to corporate governance. The statement must indicate how the College has complied with good practice in this area, including the 2014 Code of Good Governance for Scotland's Colleges ('Good Governance Code 2014').

34. The College's statement of corporate governance and internal control states the College was compliant with the principles of the Good Governance Code 2014. We reviewed the 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
- assessing whether disclosures in the statement are consistent with our knowledge of the College.

35. 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.

Going concern and subsequent events

36. 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.

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

- reviewing bank facilities
- reviewing budget and cash flow projections
- reviewing minutes of post balance sheet board meetings.
- enquiries of senior management and the College's solicitors
- consideration of future SFC and University of the Highlands and Islands (UHI) funding
- performing sample testing of post balance sheet transactions.

38. 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.

Qualitative aspects of accounting practices and financial reporting

39. 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 by 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 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.	We are satisfied with the appropriateness of the accounting estimates and judgements used in the preparation of the financial statements.
The potential effect on the financial statements of any uncertainties, including significant risks and disclosures such as pending litigation that are required to be disclosed.	We did not identify any uncertainties, including any significant risk or required disclosures that should be included in the financial statements.
The extent to which the financial statements have been affected by unusual transactions and the extent that these transactions are separately disclosed in the financial statements.	From the testing performed, we identified no unusual transactions in the period.

Qualitative aspect considered	Audit conclusion
Apparent misstatements in the OFR or material inconsistencies with the financial statements.	There are no misstatement or material inconsistencies with the financial statements in the OFR.
Any significant financial statement disclosures to bring to your attention.	There is no significant financial statement disclosures that we consider should be brought to your attention. All disclosures made are required by relevant legislation and applicable accounting standards.
Disagreement over any accounting treatment or financial statement disclosure.	There was no material disagreement during the course of the audit over any accounting treatment or disclosure.
Difficulties encountered in the audit.	The 2014/15 audit was not as efficient as previous years. Information relevant to the audit was not always available on a timely basis. This appears to have been due, at least in part, to the impact of the move to the new campus.

Looking forward

Readiness for FRS 102

40. Colleges are currently required to follow 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.

41. With effect from the year ending 31 July 2016, the College will be required to present its financial statements under FRS 102 (new UK GAAP), in line with all further education entities, reporting under the new Statement of Recommended Practice: Accounting for Further and Higher Education (the SORP 2015). FRS 102 is a single set of accounting standards developed by the Financial Reporting Council (FRC) and replaces current UK GAAP.

42. The SORP represents a significant change in financial reporting across the college sector. This includes changes in disclosure and terminology within the accounts. There are also some fundamental changes to accounting treatment e.g. income recognition, treatment of capital grants, and accounting for employee benefits.

43. For Inverness College the transition date is 1 August 2014 with the first FRS 102 compliant accounts being prepared for year ended 31 July 2016. The comparative figures for the period ended 31 July 2015 will also require to be restated as part of the transition process.

44. The College should not underestimate the level of work that will be required to ensure that the draft 2015/16 accounts, including any restatements required on transition, are compliant with the SORP 2015.

3

Financial management

Financial management

45. It is the College's responsibility to conduct its financial affairs in a proper manner. Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

Overall conclusion

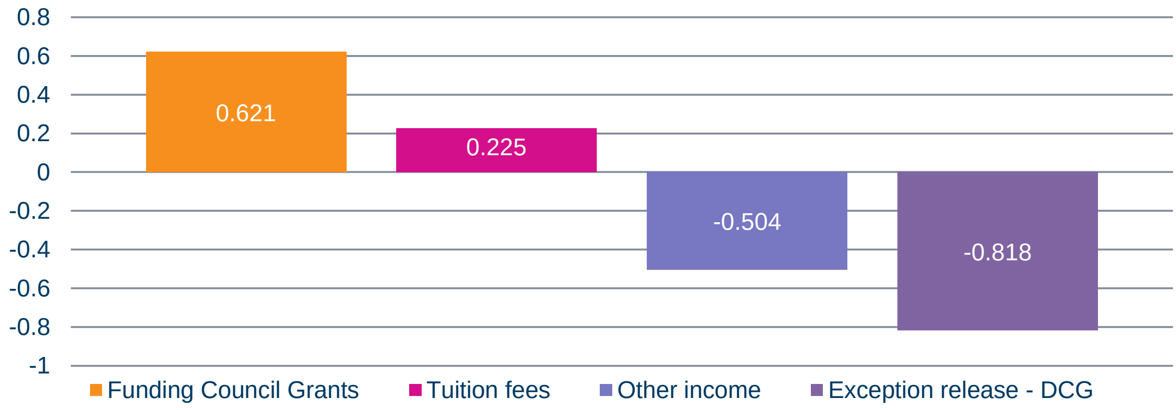
46. We found that the College has effective arrangements in place for financial management and the use of resources. Our conclusion has been based on a review of the College's financial performance and financial position. Each of these elements is discussed in more detail below.

Financial performance

Inverness College	2014/15 (£million)	2013/14 (£million)	Variance (£million)
Income	17.685	18.151	-0.466
Expenditure	17.959	19.457	-1.498
(Deficit) / Surplus	-0.274	-1.306	1.032

47. Overall the College has seen a reduction in income of £0.466million compared to last year. Over the same period expenditure has reduced by £1.498million.

Year on year increases / (decreases) on major income streams (£million)



Income has reduced by £0.466million

48. The College has seen an increase in income of £0.621million (5%) from SFC grants, from £12.417million in 2013/14 to £13.039million in 2014/15. This has been due to:

- Increases in SFC recurrent grant (£0.567million), UHI recurrent grant (£0.238million), Other UHI grants (£0.236million) and the release from deferred capital grants (£0.118million).
- Reductions of childcare funding (£0.222million) and other SFC grants (£0.316million).

49. Income from tuition fees and educational contracts has risen by £0.225million to £3.241million in 2014/15. This has been principally due to improvements in achievement in the year being reflected in employability funding.

50. Other income has fallen by £0.504million to £1.373million in the year. This was due to a number of non-recurring project grants being received in 2013/14 for which there is no current year comparator.

51. In the prior year the college recognised an exceptional release from deferred capital grants of £0.818million in relation to the impairment of the sites at Longman Road and Midmills.

Expenditure has fallen by 7.7% to £17.959million

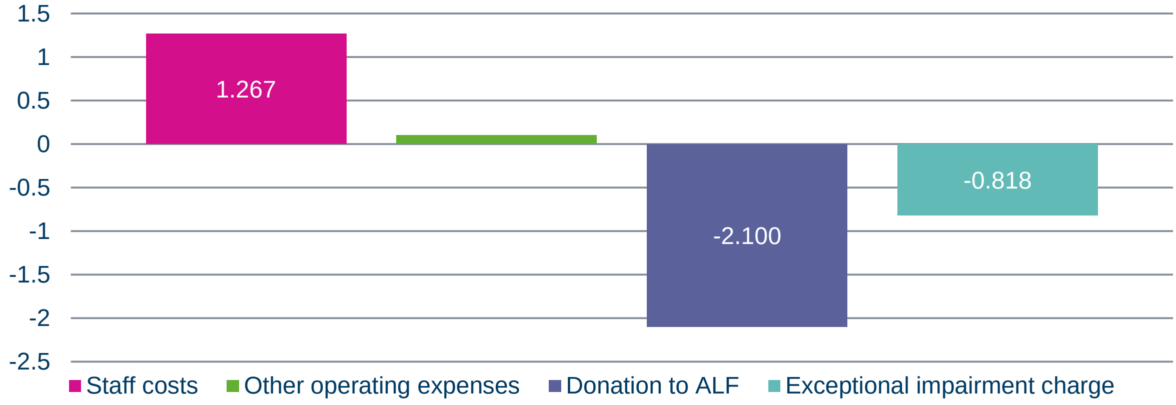
52. Overall the College's has seen a reduction in expenditure of £1.498million. This is principally due to:

- There being no current year comparator for the exceptional impairment charge recognised in 2013/14 in relation to the Longman Road and Midmills sites.
- The £0.6million donation made to the ALF in 2014/15 is significantly lower than that in 2013/14 (£2.7million).

53. The decreases in costs noted above are somewhat offset by increases in staff costs, which have risen by £1.267million to £12.677million in 2014/15 due to:

- £0.598million costs resulting from the increase in the value of the pension liability (this is £0.259million higher than the comparative cost in the prior year).
- Incremental increases in wages and salaries alongside increased staffing levels (the college had 23 additional full time equivalent staff in 2014/15).

Year on year increases / (decreases) on major expenditure streams (£million)



Financial position

The College has increased its healthy net asset position due to substantial deferred capital grants

54. The College continues to have a deficit balance on reserves. In 2014/15 the deficit increased by £0.124million due to the operating deficit being only partially offset by the actuarial gain recognised in relation to the pension liability (£0.151million). However, the deficit balance on reserves is offset by a balance of £12.034million of deferred capital grants, leaving net assets of £6.763million.

55. As at 31 July 2015 the College had a significant cash balance of £4.794million. This was £2.780million (147%) higher than the balance held as at 31 July 2014.

56. There has been a large reduction in the debtors balance at year end, from £3.280million in 2013/14 to £0.494million in 2014/15. This is due to the prior year balance including a significant level of accrued income in respect of 2013/14 SFC funding which had not been drawn down by 31 July 2014.

57. Overall the College's creditor balances have remained broadly consistent year on year, increasing by just 1.5% to £3.524million. Provisions have decreased from £2.911million to £2.626million due to the College no longer needing some provisions for funding claw back that were recognised in previous years.

58. We comment within *our assessment of risks of material misstatement* above on asset additions of £2.603million in the year and the increase in the actuarial valuation of the pension liability to £7.053million.

4

Financial sustainability

Financial sustainability

59. Financial sustainability looks forward to the medium and longer term to consider whether the College is planning effectively to continue to deliver its services or the way in which they should be delivered.

Overall conclusion

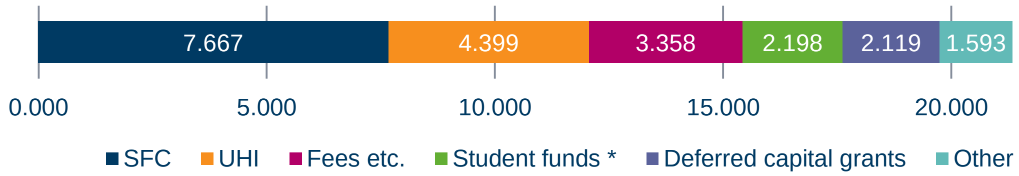
60. The College has good budget management controls in place. Whilst the financial outlook for the College, and the further education sector more generally, continues to be challenging, the College remains financially resilient and in good financial health.

UHI is the regional lead

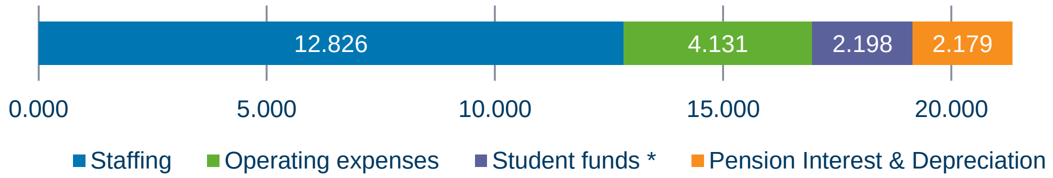
61. Inverness College is part of the Highlands and Islands region, along with Argyll College, Lews Castle College, Moray College, North Highland College, Orkney College, Perth College, Shetland College and West Highland College.

62. UHI is the regional lead and the Further Education Regional Board is a sub-committee of UHI Court. This makes the UHI region unique amongst colleges in Scotland, in terms of structure, governance and (to an extent) operations and practicalities.

Income of £21.335million is forecast for 2015/16



£21.335million expenditure is forecast for 2015/16



** Student funds income and expenditure includes funds accounted for on an agency basis not recognised in the financial statements*

Financial forecasts

Funding has been confirmed for 2015/16 and a break even position has been forecast

63. The College's revenue budget, as reported to the Finance and General Purposes Committee in June 2015, forecast a break even position for 2015/16.

64. Funding has been confirmed for the coming year through the Highlands and Islands Regional Further and Higher Outcome Agreements 2015/16. As requested by the SFC, the 2015/16 outcome agreement was a refresh of the three year 2014/17 outcome agreement reached in 2014.

65. The College's forecast position reflects income and expenditure of £21.335million for 2015/16, the major elements of which are shown above.

There is no rise in the FE activity target for 2015/16

66. The College's FE funding allocation is based on achieving 28,569 credits under the SFC's new simplified approach to funding. On a like-for-like basis this equals 40,301 weighted SUMS, the same as the 2014/15 target which the College has managed to exceed. The College also has a higher education (HE) activity target of 1,450 full time equivalents (FTE), 8% higher than the FTE achieved in 2014/15.

Capital plans

67. The new campus at Beechwood is the College's most significant capital development and is discussed within *our assessment of risks of material misstatement*. The College also plans £0.255million further additions in 2015/16:

ICT equipment	General equipment	New campus
£0.12million	£0.098million	£0.037million

Financial capacity in public bodies

68. The Accounts Commission and Auditor General for Scotland are interested in the impact that reductions in staff numbers are having on back-office functions and specifically finance. As part of the 2014/15 audit we have collected baseline information on the finance function at the College. This information will be submitted to Audit Scotland who will be assessing the findings across a number of public sector organisations, to identify any common or emerging issues.

Budgetary control

69. Internal audit carried out a review of the College's budget setting and monitoring processes during 2014/15. Internal audit concluded that:

- there was a robust process for setting budgets, including internal challenge of key assumptions
- budgets were controlled in accordance with the Financial Regulations and Procedures
- information was available to management throughout the College which was up-to-date and in a format that could be easily understood
- budget holders had the necessary skills for managing budgets
- budget variations were reported and acted upon
- senior management and the Board of Management regularly reviewed the College's overall financial position.

5

Governance and transparency

Governance and transparency

70. Governance and transparency is concerned with the adequacy of governance arrangements, leadership and decision making, and transparent reporting of financial and performance information. The College is responsible for ensuring the proper conduct of its affairs including compliance with relevant guidance, the legality of activities and transactions and for monitoring the adequacy and effectiveness of these arrangements.

Overall conclusion

71. The College has appropriate governance arrangements in place. Our audit work has included reviewing corporate governance arrangements as they relate to:

- systems of internal control
- risk management
- internal audit
- the prevention and detection of fraud and other irregularities
- standards of conduct and arrangements for the prevention and detection of corruption.

Governance arrangements

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

72. During 2014/15 five members of the Board of Management left their post: two independent members, the support staff representative, the teaching staff representative and the student representative. Shortly after the year end four new members were appointed to the Board of Management, including support staff, teaching staff and student representatives, bringing the membership to sixteen.

Corporate governance arrangements are appropriate

73. In the previous year the Board agreed to formalise the appointment of the vice chair and a senior independent director. 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.

74. The Board conducts a self- evaluation exercise annually, facilitated by the Depute Principal. Evaluations were also conducted by each standing committee and on each of the Board and Committee chairs during 2014/15. The outputs from these assessments inform an action plan for improvements.

75. The College's statement of corporate governance and internal control confirms that the College has applied the principles of the 2014 Code of Good Corporate Governance for Scotland's Colleges.

Systems of internal control

76. 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.

Risk management

77. 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.

Internal audit

78. The internal audit service is a key component of the College's internal control framework. 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 2014/15 and we have considered their findings within our audit process.

79. Henderson Loggie concluded in the internal audit annual report that the College has adequate and effective arrangements for risk management, control and governance.

Prevention and detection of fraud and irregularity

80. 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.

81. 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

82. In our opinion the College's arrangements in relation to standards of conduct and the prevention and detection of bribery and corruption are adequate and in line with our expectations. Our conclusion has been informed by a review of the arrangements for adopting and reviewing standing orders, financial instructions and schemes of delegation and complying with national and local Codes of Conduct.

83. The statement of corporate governance and internal control confirms that the College has applied the principles of the Good Governance Code 2014. This includes compliance with the SFC financial memorandum and the relevant aspects of the Scottish Public Finance Manual.

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Value for money

Value for money

84. Value for money is achieved though the optimal use of resources to achieve the intended outcomes. The College had a duty to apply its resources economically, efficiently and effectively.

Overall conclusion

85. The College has confirmed that proper arrangements are in place to promote and secure value for money.

Arrangements are in place to promote and secure value for money

86. The Financial Memorandum between the College and the Scottish Funding Council (SFC), states the College must:

- have a strategy for reviewing systematically management's arrangements for securing value for money
- obtain a comprehensive appraisal of management's arrangements for achieving value for money as part of its internal audit arrangements.

87. The Board of Management has delegated the responsibility for reviewing and monitoring the arrangements in place to achieve value for money to the Audit committee.

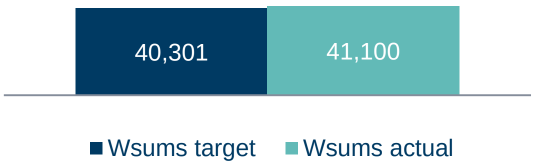
88. The statement of corporate governance and internal control confirms that the College has applied the principles of the Good Governance Code 2014. Compliance with the Good Governance Code 2014 includes ensuring that funds are used as economically, efficiently and effectively as possible.

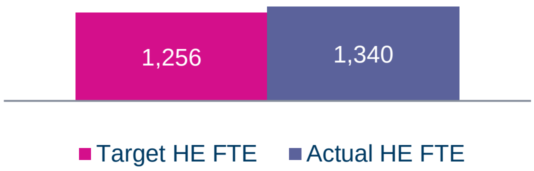
Internal audit opinion on value for money

89. Henderson Loggie concluded in the internal audit annual report that the College has proper arrangements in place to promote and secure value for money.

Performance

90. The College achieved its targets for weighted SUMS and HE FTEs in 2014/15.





91. The College reports student retention and attainment as part of its performance monitoring arrangements. The table below shows that there has been a small increase in completion rates of Full time FE, Full time HE and part time HE students compared to last year. There was however a small decrease in the completion rates of FE part time students.

KPIs	2014/15		2013/14		Trend	
	Further withdrawal	Completed	Further withdrawal	Completed	Further withdrawal	Completed
FE Full time	18%	63%	15%	60%	3%	3%
FE Part time	8%	73%	6%	75%	2%	-2%
HE Full time	8%	74%	8%	70%	0%	4%
HE Part time	3%	58%	3%	57%	0%	1%

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Appendices

Appendix 1: Management action plan

This action plan details the significant control weakness and opportunity for improvement that we have identified from our audit work during 2014/15. The action plan details the officer responsible for implementing the recommendation and an implementation date. The Board should assess the recommendation for wider implications before approving the action plan.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work, and may not be all that exist. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements. Communication in this report of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control

Grading

The grading structure for our recommendations is as follows:

Grade	Explanation
Grade 5	Very high risk exposure - Major concerns requiring Board attention.
Grade 4	High risk exposure - Material observations requiring senior management attention.
Grade 3	Moderate risk exposure - Significant observations requiring management attention.
Grade 2	Limited risk exposure - Minor observations requiring management attention
Grade 1	Efficiency / housekeeping point.

We identified no new recommendations for management action this year. One prior year management action remains outstanding from 2011/12.

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**
Audit observation in 2014/15	We have reviewed the College's treatment of its estates developments in 2014/15 and have found it to be reasonable. We will continue to work with management to ensure the estates developments are appropriately treated and to highlight potential implications for accounting treatments in 2015/16.
Management Response	Agreed **Responsible officer:** Director of Corporate Services **Implementation date:** by end July 2016

Appendix 2: Scope of the audit

An overview of the scope of our audit

The external audit strategy and plan explained that we follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the College. This ensures that our audit focuses on the areas of highest risk. Planning is a continuous process and our audit plan is subject to review during the course of the audit to take account of developments that arise.

At the planning stage we identified the significant risks that had the greatest effect on our audit. Audit procedures were then designed to mitigate these risks. No additional significant risks were identified after the planning stage during our audit work this year.

The significant risks that had the greatest effect on our audit, our response to those risks and our findings from the work performed are set out within *our assessment of risks of material misstatement* in this report. The audit response to each significant risk was designed in the context of the financial statements as a whole and, consequently, where we set out findings we do not express any opinion on these individual risks.

Our standard audit approach is based on performing a review of the significant accounting systems in place, substantive tests and detailed analytical review. Tailored audit procedures, including those designed to address significant risks, were completed by the audit fieldwork team and the results were reviewed by the audit manager and audit partner. In performing our work we have applied the concept of materiality.

Overall materiality

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.

Our initial assessment of materiality for the financial statements, as presented in the external audit strategy and plan, was £350,000, which has remained appropriate throughout the audit. Our assessment of materiality was set with reference to a range of benchmarks and reflects our assessment of the College as relatively low risk. We consider income and gross assets to be the principal considerations for the users of the accounts when assessing the performance of the College.

Performance materiality

At the planning stage we set a performance (testing) materiality for each area of work that was based on a risk assessment for the area. We performed audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we performed a greater level of testing on the areas deemed to be of significant risk of material misstatement.

We set performance materiality as a percentage of overall materiality. Our final assessment of performance materiality was lower than that reported in our external audit plan:

Area risk assessment	Weighting at planning	Weighting at final audit
High	50% / £175,000	40% / £140,000
Medium	60% / £210,000	55% / £192,500
Low	75% / 262,500	70% / 245,000

Reporting

We have reported all misstatements identified through our audit that fell into one of the following categories:

- Material corrected misstatements, i.e. all corrected misstatements over £350,000.
- Uncorrected misstatements with a value in excess of 2.5% of overall materiality, i.e. over £8,750.
- Other misstatements below 2.5% of overall materiality that we believe warrant reporting on qualitative grounds.

Appendix 3: Respective responsibilities

Management responsibilities

Within the terms and conditions of the financial memorandum between the 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.

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

Public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance not only on the financial statements and associated documents such as the governance statement, but also providing a view, where appropriate, on matters such as propriety, performance and the use of resources.

Our responsibilities, as independent auditors, are established by the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice approved by the Auditor General for Scotland, and guided by the auditing profession's ethical guidance. Specifically in relation to the financial statements, we are required to audit them in accordance with ISAs and to give: 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

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 SFC of the state of the body's affairs as at 31 July 2015 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, the Charities and Trustee Investment (Scotland) Act 2005, and regulation 14 of The Charities Accounts (Scotland) Regulations 2006.

Opinion on regularity

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

We express an opinion on whether:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Ministers; and
- the information given in the Operating and Financial Review for the financial period for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We are 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.

Confirmation of auditor independence

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.

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 facilitated a risk workshop for the College during 2015. The risk workshop was facilitated by staff who had no involvement in the audit of the financial statements.

Appendix 4: Unadjusted differences

Board representations

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 five unadjusted differences during our audit work. These five 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 financial statements. 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	Fixed assets – accumulated depreciation			153,356	
	Expenditure – depreciation		153,356		
	Being the restatement of depreciation charges				
2	Expenditure – premises	101,234			
	Creditors – accruals				101,234
	Being the recognition of accruals for 2014/15 expenditure				
3	Expenditure – staff costs	97,801			
	Creditors – accruals				97,801
	Being the recognition of the accrual for untaken annual leave				
4	Creditors – trade creditors			27,685	
	Creditors – other tax and social security				27,685
	Being the adjustment of trade creditors				
5	Pension liability			9,000	
	Provisions – other				9,000
	Being the adjustment of unfunded pension liabilities				
	Aggregate impact on the I&E	**45,679**			

Scott-Moncrieff
business advisers and accountants