



**Scott-Moncrieff**  
business advisers and accountants

# Lews Castle College

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

**December 2015**

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# Summary

## Financial Statements

The financial statements for the year ended 31 July 2015 were approved by the Board on 15 December 2015. In our independent auditor's report we provided an unqualified opinion on:

- the financial statements;
- regularity; and
- other prescribed matters.

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

The audit process in 2014/15 was markedly less efficient than in previous years. Two material adjustments were raised through the audit process:

- A prior year adjustment in relation to the change in accounting policy for land and buildings.
- The disclosure of the remuneration report.

## 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 £526,000 compared to last year. Over the same period expenditure has reduced by £334,000, so cost management remains a priority area for the College.

## Financial sustainability

The deficit on the general reserve decreased by £113,000 in 2014/15. At 31 July 2015 the College had reserves of £1,711,000 supported by £7,881,000 deferred capital grants, giving net assets of £9,592,000.

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 forecasts a small surplus in 2015/16.

- **Unqualified audit opinion.**
- **Two material adjustments were raised through the audit process.**
- **The College has adequate financial management arrangements in place.**
- **The College has appropriate governance arrangements in place.**
- **College has proper arrangements in place to promote and secure value for money.**

## Governance and transparency

The College's corporate governance arrangements 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.

## Value for money

The College has proper arrangements in place to promote and secure value for money.

The College monitors a range of Key Performance Indicators (KPIs) as part of its performance management arrangements and reported improvements in student retention and attainment during 2014/15.

## Conclusion

This report concludes the audit of Lews Castle 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 Lews Castle College ('the 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, regionalisation and arms' length foundation;
  - Group accounting;
  - Pension fund liabilities; and
  - 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 four specific recommendations, responsible officers and dates for implementation. Senior management should assess these recommendations and consider the wider implications before deciding appropriate actions. The recommendations have 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 Lews Castle 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 15 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 other prescribed matters.

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

### Our assessment of risks of material misstatement

14. 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, regionalisation 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 (to 31 March) and there are no guarantees that they can retain in-year surpluses for future periods in the way they have enjoyed to date. The College decided that its financial position did not require a foundation transfer in 2013/14. This will be reviewed throughout 2014/15 but is likely to remain the case for the foreseeable future.

We will consider as part of our final audit visit 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 the College.

*Summarised from 2014/15 External Audit Plan*



15. 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. Application of the FReM has resulted in additional disclosures within the 2014/15 financial statements, the most significant of which has been the inclusion of a Remuneration Report. Application of the FReM has also led the College to change accounting policy in relation to land and buildings.
16. In previous year's the College held land and buildings at historic cost less depreciation. The college changed this accounting policy in 2014/15 to hold land and buildings at their current value, as estimated through periodic valuations. As the resulting increase in asset value was material the change in accounting policy has been accounted for as a prior year adjustment to the financial statements, in line with *Financial Reporting Standard 3 - Reporting financial performance (FRS3)*.

17. The prior year adjustment has resulted in:
- A reduction in the depreciation charge recognised in 2013/14 of £263,000.
  - A reduction in the release from deferred capital grants recognised in income during 2013/14 of £382,000.
  - A cumulative gain in valuation of tangible fixed assets as at 31 July 2014 of £4,459,000.
18. We have reviewed the additional disclosures and the change to accounting policy in 2014/15 and have found that the College has complied with the requirements of the FReM. We have reviewed the prior year adjustment processed by the College and found that it has been accounted for in line with the *Statement of Recommended Practice: Accounting for further and higher education* (SORP) and the underlying FRS.
19. As with 2014/15, given the College's financial position, no donation to the ALF was made in the year.

## 2. Group accounting

The College has held a 27% share in the voting rights of Greenspace Live Ltd ('Greenspace') in the last few years. *Financial Reporting Standard 9: Associates and Joint Ventures* presumes that a 20% share of the voting rights in a company would provide the College with significant influence over that company. Where significant influence is held the company should be consolidated as an associate.

In the 2013/14 financial statements, the College rebutted the presumption of significant influence as it does not actively participate in the operating and financial policies of Greenspace or overly influence strategic issues such as determining the balance between dividend and reinvestment.

*Summarised from 2014/15 External Audit Plan*



20. The College has retained its stake holding in Greenspace. As in 2013/14, the College has rebutted the presumption of significant influence as it does not actively participate in the operating and financial policies of Greenspace or influence strategic issues. As a result, Greenspace has not been consolidated in to the group accounts in 2014/15. We reviewed the College's rationale and found the accounting treatment adopted is reasonable.

## 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 *FRS 17 – Retirement Benefits*, 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.

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*





21. The pension liability on the HCPF, as assessed by Hymans Robertson, has increased in the year to £1,951,000. We have reviewed the College's accounting for the pension liability and confirm that it complies with the requirements of FRS 17 and that the disclosure is consistent with the actuarial valuation. We have also confirmed that the actuarial assumptions underpinning the valuation are reasonable and reflect the College's circumstances.

#### 4. Management override and revenue recognition (continued)

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*. 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*



22. 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.

#### Other matters identified

##### Review of nursery and catering provision

23. The College provides catering and nursery facilities on campus. It is currently assumed that catering facilities are used exclusively by staff and students. Nursery facilities are provided for students however can be available to the general public when capacity allows.
24. As a registered charity, we consider it good practice for the College to review any non-teaching operations periodically to ensure that the most appropriate governance and accounting arrangements remain in place.

**Management action plan point 1**

##### Financial statements preparation

25. We received draft financial statements in line with our agreed audit timetable. However, information relevant to the audit was not always complete or available on a timely basis, and substantial changes to the draft accounts were required throughout the audit. In particular, a complete Trial Balance was not available until very late in the process. As a result the audit was markedly less efficient than previous years.

**Management action plan point 2**

26. We remain grateful to the Principal, the Finance Manager and the finance staff for their assistance and support during the course of the audit.

#### Audit differences

27. There were two material adjustments to the draft financial statements through the audit process. These were:
- The recognition of a prior year adjustment in relation to the change in accounting policy for land and buildings described in paragraph 15 above.
  - The disclosure of the remuneration report, as required by the FReM, described in paragraph 16 above.
28. The majority of the figures disclosed within the remuneration report fall below the assessed level of overall materiality (£130,000). However, we consider the addition of the remuneration report as a whole during the audit to warrant reporting to you as a material adjustment on qualitative grounds.
29. We also identified some minor disclosure and presentational adjustments during our audit, which have been reflected in the final 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 two 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

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.
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 and substantial changes to the draft accounts were required throughout the audit process.

## Looking forward

### Readiness for FRS 102

39. 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.
40. 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.
41. 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.
42. For Lews Castle 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.
43. 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.

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# **Financial management**

# Financial management

44. 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

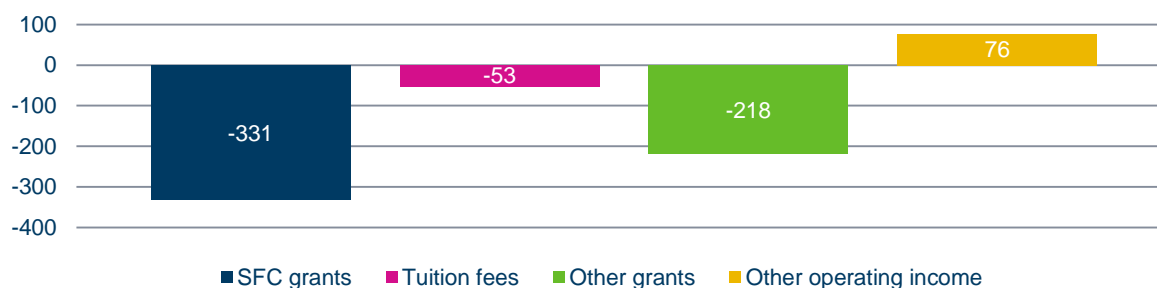
45. We found that the College has adequate arrangements in place for financial management and the use of resources. Our conclusion has been based on a review of the College's financial performance and financial position. Each of these elements is discussed in more detail below.

## Financial performance

Lews Castle College	2014/15 (£000s)	2013/14 (£000s)	Variance (£000s)
Income	5,674	6,200	(526)
Expenditure	5,882	6,216	(334)
Surplus / (Deficit)	(208)	(16)	(192)

46. Overall the College has seen a reduction in income of £526,000 compared to last year. Over the same period expenditure has reduced by £334,000.

### Year on year increases / (decreases) on major income streams (£000s)



### Income has reduced by £526,000

47. The College has seen a decrease in SFC income of £331,000 (8%), to £3,809,000 in 2014/15. This has been due to:
- £28,000 increase in SFC recurrent grant.
  - Reductions of UHI recurrent grant (£88,000), childcare funding (£29,000) release of deferred capital grants (£47,000) and other SFC & UHI grants (£195,000).
48. Income from tuition fees and educational contracts has reduced by £53,000 to £694,000 in 2014/15. This has been principally due to a £41,000 reduction in income from educational contracts.
49. Other grant income has fallen by £218,000 to £654,000 in the year. This was principally due to a number of non-recurring project grants

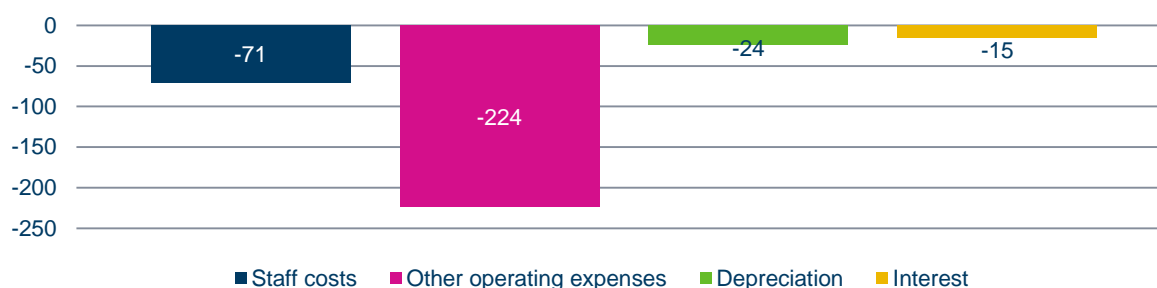
being received in 2013/14 for which there is no current year comparator.

50. Other operating income has increased by £76,000 to £517,000. This is principally due to the allocation of sundry immaterial income streams to this note in 2014/15.

### Expenditure has fallen by 5% to £5,882,000

51. As shown on page 13, the College has seen an overall reduction in expenditure of £334,000.
- There has been a decrease of £224,000 in other costs. This is broadly in line with the reduction in activity reflected through the fall in other grant income.
  - There has been a reduction of £71,000 in staff costs principally due to reduced staffing in the year (there were 4 less full time equivalent staff in 2014/15).

### Year on year decreases on major expenditure streams (£000s)



## Financial position

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

52. The College continues to have a deficit balance on the general reserve. In 2014/15 the negative balance on the reserve decreased by £113,000, from £1,236,000 to £1,123,000.

53. The reduction in the general reserve deficit balance was due to the operating deficit (£208,000) being offset by the transfer from the pension reserve in respect of FRS 17 costs (£189,000) and the transfer from the revaluation reserve in respect of depreciation charged on revalued amounts (£132,000).

54. Due to the revaluation reserve balance of £4,785,000, the College has an overall net asset position on reserves in 2014/15 of £1,711,000. In previous years, before the College adopted the policy of revaluation, described in paragraph 16, the College had a net liability on reserves.

55. The net asset position on reserves is further supported by a balance of £7,881,000 of deferred capital grants, giving net assets as at 31 July 2015 of £9,592,000.

### There has been an increase in the value of tangible fixed assets

56. The value of tangible fixed assets has increased by £213,000 to £12,640,000 compared to the prior year restated balance of £12,427,000 (see paragraph 17 for discussion of the prior year adjustment).

57. The increase in tangible fixed assets has been due to the depreciation charge in the year of £425,000 being offset by:

- Asset additions of £60,000.
- The impact of the revaluation of land and buildings as at 31 July 2015 (£576,000).

58. Debtors have reduced from £401,000 in 2013/14 to £232,000 in 2014/15. This is because the prior year balance included accrued income in relation to non-recurring projects for which there is no current year comparator.

59. Non-current liabilities have reduced from £168,000 in 2013/14 to nil in 2014/15. The non-current liability recognised in 2013/14 reflected a liability to repay the SFC an element of funding received between 2007 and 2009. This was a result of the College over claiming against weighted standard units of measurement (Wsums) targets during that period.

60. The College entered in to an agreement with the SFC to repay the over claimed amounts over five years (supported by a conditional strategic grant from the SFC totalling £500,000 over the same five year period). The final repayment will take place in 2015/16 and as such the related liabilities are recognised as current liabilities.



# Financial sustainability



# Financial sustainability

61. 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.

## UHI is the regional lead

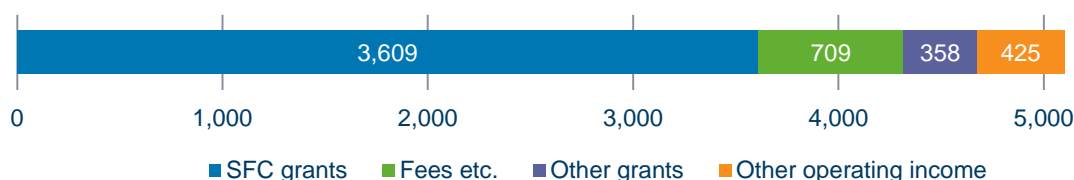
63. Lews Castle College is part of the Highlands and Islands region, along with Inverness, Argyll, Moray, North Highland, Orkney, Perth, Shetland and West Highland colleges.

## Overall conclusion

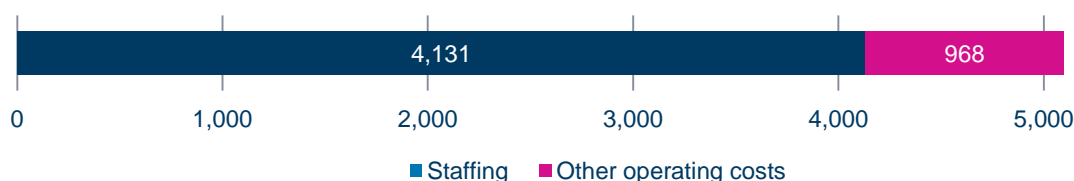
62. The College has adequate planning arrangements in place and is fully aware that the financial outlook, and that of the further education sector more generally, continues to be challenging.

64. 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.

### Major income streams expected in 2015/16 (£000s)



### Major expenditure streams expected in 2015/16 (£000s)



## Financial forecasts

### Funding has been confirmed for 2015/16 and a small surplus has been forecast

65. The 2015/16 revenue budget, as approved by the board of Management in June 2015, forecasts a £2,542 surplus (0.05% of income).

66. The College's forecast position for 2015/16 reflects income £5,101,452 and expenditure of £5,098,910, the major elements of which are shown above.

67. 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 agreement.

## Challenging activity targets

68. In paragraph 86 we reflect that the College has found it difficult to achieve activity targets. As the financial outlook for the sector continues to be challenging, it is increasingly likely that underachievement of activity targets may result in claw back of funding and / or reductions in future funding settlements. As SFC funding accounts for around two thirds of the College's total income, any reduction or claw back could have a significantly detrimental effect on the College's financial sustainability.

## Budgetary control

69. Internal audit carried out a review of the College's budgetary and financial controls during 2014/15 and concluded arrangements were satisfactory with no major weaknesses identified.

## Financial capacity in public bodies

70. 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 collected baseline data 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.

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# Governance and transparency

# Governance and transparency

71. 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

72. 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; and
- standards of conduct and arrangements for the prevention and detection of corruption.

73. 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 ('2014 Code'). Application of the 2014 Code requires compliance with the SFC financial memorandum and the relevant aspects of the Scottish Public Finance Manual.

## Risk management

74. 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.

## Systems of internal control

75. 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.

## Internal audit

76. 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. Wylie & Bisset provided the internal audit service in 2014/15 and we have considered their findings within our audit process.

77. Wylie & Bisset 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

78. 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.

79. 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

80. In our opinion the College's arrangements in relation to standards of conduct and the prevention and detection of bribery and corruption are adequate. 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.

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# Value for money

# Value for money

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

## Overall conclusion

82. 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

83. 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; and
  - obtain a comprehensive appraisal of management's arrangements for achieving value for money as part of its internal audit arrangements.
84. 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.

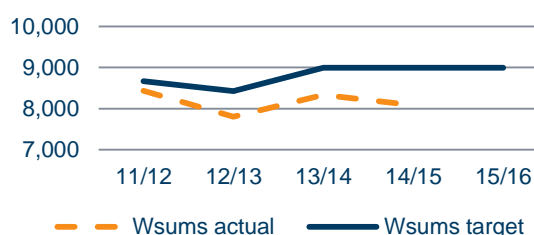
### Internal audit opinion on value for money

85. Wylie & Bisset concluded in the internal audit annual report that the College has proper arrangements in place to promote and secure value for money.

## Performance

86. The College has found it difficult to achieve its activity targets in recent years. The graph below shows that the College has not achieved the targeted Wsums agreed at the outset this year, or in the three preceding periods. The target activity for 2015/16 has not reduced and will be challenging to achieve.

Performance against Wsums targets 2011-2016



Source: Annual accounts 2010/11 - 2014/15

87. The College is aware of the significant challenge it faces in achieving its Wsums target for 2015/16. The College has begun dialogue and analysis internally, and with local partners, in order to fully understand the underlying issues it faces with a view to informing an appropriate response to this matter.

### Management action plan point 3

### Key performance indicators

88. The College reports student recruitment, retention and attainment measures, alongside a number of other measures, as part of its performance monitoring arrangements. The table below shows, using a selection of the key performance indicators reported in 2014/15, that while there has been a small reduction in student recruitment compared to 2013/14 there have been improvements in student retention and attainment.

KPI	Description	2014/15	2013/14	Trend
Student numbers	Measures students enrolled after census date	1,561	1,640	(106)
Overall early retention	Measures student retention before cut-off date	98%	96%	3%
Overall retention	Measures student retention	94%	87%	7%
Student outcome FE	Measures FE student success	94%	84%	10%



# 7

# Appendices

# Appendix 1: Management action plan

This action plan details the significant control weaknesses and opportunities 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 three new recommendations for management action this year. One prior year management action remains outstanding from 2013/14.



## Recommendations raised in 2014/15

1.	Review of non-teaching operations
<b>Observation</b>	<p>The College provides catering and nursery facilities on campus. It is currently assumed that catering facilities are used exclusively by staff and students. Nursery facilities are provided for students however can be available to the general public when capacity allows.</p> <p>The College has not formally reviewed its non-teaching operations in recent years.</p>
<b>Risk and recommendation</b>	<p>There is a risk that loss making non-teaching operations may be subsidised by the College, to the detriment of the College's overall financial sustainability. There is also a risk that profit making non-teaching activities could be considered trading activities and fall outside of the Colleges charitable objectives.</p> <p>As a registered charity, we consider it good practice for the College to review any non-teaching operations periodically to ensure that the most appropriate governance and accounting arrangements remain in place.</p> <p><b>Grade 3</b></p>
<b>Management Response</b>	<p>The College will review the financial aspects of its catering and nursery arrangements prior to agreeing the budget for 2016/17.</p> <p><b>Responsible officer:</b> Principal</p> <p><b>Implementation date:</b> 31 May 2016</p>
2.	Audit efficiency
<b>Observation</b>	<p>We received draft financial statements in line with our agreed timetable. However, information relevant to the audit was not always complete or available on a timely basis and substantial changes to the draft accounts were required throughout the audit process.</p> <p>The audit process was markedly less efficient than in previous years</p>
<b>Risk and recommendation</b>	<p>The agreed audit fee is based upon the assumption that all of the required information for the audit is available within the agreed timetable. If the information is not available within the timetable we may need to charge additional fees for the time spent by our staff.</p> <p>If the College's draft financial statements, supporting information and working papers are not of a high standard, and available within the agreed timetable, we may be unable to provide an opinion on the financial statements.</p> <p>Effective planning should take place in advance of the 2015/16 audit to ensure that the draft accounts are complete, comprehensive, supported by the appropriate working papers and available within the agreed timetable</p> <p><b>Grade 3</b></p>
<b>Management Response</b>	<p>The process for preparing the accounts for audit will be revised to ensure that all information is available at the start of the audit.</p> <p><b>Responsible officer:</b> Finance Manager</p> <p><b>Implementation date:</b> 31 July 2016</p>

## Recommendations raised in 2014/15 (continued)

3.	Student activity targets
<p><b>Observation</b></p>	<p>The College has not achieved the Wsums target set at the outset this year, or in the three preceding periods. The target activity for 2015/16 has not reduced and will be challenging to achieve.</p> <p>We recognise that the College is aware of the significant challenge it faces in achieving its Wsums target for 2015/16. The College has begun dialogue and analysis internally, and with local partners, in order to fully understand the underlying issues it faces with a view to informing an appropriate response to this matter.</p>
<p><b>Risk and recommendation</b></p>	<p>As the financial outlook for the further education sector continues to be challenging, it is increasingly likely that underachievement of activity targets may result in claw back of funding and reductions in future funding settlements. As SFC funding accounts for around two thirds of the College's total income, any reduction or claw back could have a significantly detrimental effect on the College's financial sustainability.</p> <p>We endorse the College's current partnership approach to investigating the underlying issues with a view to informing an appropriate response to this matter. As part of this process the College should ensure that the impact of any long term trends in student recruitment and activity is fully considered and reflected within its financial and operational plans.</p> <p><b>Grade 4</b></p>
<p><b>Management Response</b></p>	<p>Recruitment activity has been re-focused to increase the emphasis on part-time/short course recruitment. This should go some way to increasing recruitment in the second half of the academic year. The College is also working with Comhairle nan Eilean Siar to increase activity with schools. The outcome of these initiatives will be reviewed in January and February 2016. This review will take account of current year financial implications and also future implications for activity levels.</p> <p><b>Responsible officer:</b> Principal</p> <p><b>Implementation date:</b> 29 February 2016</p>

## Follow up on recommendations raised in 2013/14

1.	Review of journals
<b>Observation in 2013/14</b>	Journals are not always subject to review before being posted to the financial ledger. We have carried out detailed testing of journals during the year and have found no issues which we believe would lead to a material misstatement.
<b>Risk and Recommendation in 2013/14</b>	<p>Although the College has some mitigating controls in place, through a monthly reconciliation process and the review of Management Accounts, there remains a risk that inaccurate or inappropriate journals are posted.</p> <p>The College should consider whether the current controls can be strengthened further, given the resources available to the finance team. One potential improvement could be for an experienced member of the finance team to carry out a review of all significant journals posted on a monthly basis. Such a detective control could be effective so long as it did not constitute self-review.</p> <p><b>Grade 3</b></p>
<b>Audit observation in 2014/15</b>	<p>With the introduction of the new Finance Manager there are now some detective controls in place. However, the controls have not been in operation for the full period and evidence of the controls had not been consistently recorded.</p> <p>There remains a risk that inaccurate or inappropriate journals could be posted.</p>
<b>Management Response</b>	<p>Suitable detective controls will continue to be carried out in 2015/16 and evidence of these controls will be retained. All journals are reviewed by the Finance Manager on a monthly basis.</p> <p><b>Responsible officer:</b> Finance Manager</p> <p><b>Implementation date:</b> 31 July 2016</p>

# 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 £130,000, 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 for high risk areas was slightly lower than that reported in our external audit plan:

Area risk assessment	Weighting at planning	Weighting at final audit
High	40% / £52,000	40% / £52,000
Medium	55% / £71,500	55% / £71,500
Low	75% / £97,500	70% / £91,000

## 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 £130,000.
- Uncorrected misstatements with a value in excess of 3% of overall materiality, i.e. over £4,000.
- Other misstatements below the £4,000 threshold 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.

# 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 two unadjusted differences during our audit work. These differences are not considered to be material to the financial statements individually or in aggregate. Through discussion with the Principal and the Finance Manager the decision was taken not to adjust the financial statements. The unadjusted items are included in our representation letter and shown below.

Unadjusted differences		Income & Expenditure		Balance sheet	
No	Narrative	DR £	CR £	DR £	CR £
1	Expenditure – staff costs	73,000			
	Creditors – accruals				73,000
	<i>Being the recognition of the accrual for untaken annual leave</i>				
2	Expenditure – childcare	38,000			
	Income – childcare		38,000		
	<i>Being the recognition of childcare expenditure and funding</i>				
	<b>Aggregate impact on the I&amp;E</b>	<b>73,000</b>			



**Scott-Moncrieff**  
business advisers and accountants