Scott-Moncrieff
business advisers and accountants

Lews Castle College

Annual report on the 2015/16 audit
to the Board of Management and the Auditor General for Scotland

December 2016

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Executive Summary

Financial Statements

The financial statements for the year ended 31 July 2016 were due to be approved by the Board on 13 December 2016.

We reported unqualified audit opinions on the financial statements, regularity and on other prescribed matters. There were no matters which we were required to report by exception.

Financial management

The College has adequate arrangements in place for financial management and the use of resources. A deficit of £274,000 was reported for the year to 31 July 2016. We found the College's systems of internal financial control to be adequate and operating effectively.

Financial sustainability

The College's 2016/17 revenue budget projects a broadly break even position. There are adequate short term financial planning arrangements in place. However, the College continues to face significant challenges to its financial sustainability as it is not achieving student activity targets.

The College reports that amended credits allocations may be in place from 2017/18. Early indications are that the 2017/18 target for Lews Castle College may reduce by up to 1,000 credits which would equate to an estimated £100,000 reduction in funding.

We note that the College has not yet developed a long term financial strategy and, in the context of the College's current financial position, this should be regarded as a priority.

Governance and transparency

Delays in board appointments significantly impacted on governance arrangements during 2015/16. Seven independent members left during the year, including the Chair. The College has lost a great deal of experience from its board during 2015/16 and to date a full induction process has not been completed for the members who joined the board in 2015/16, or those existing members with new responsibilities.

- **An unqualified opinion on:**
  - **the financial statements;**
  - **the regularity of transactions; and**
  - **other prescribed matters.**
- **A deficit of £274,000 for the year.**
- **Adequate arrangements for financial management and use of resources.**
- **A break even position forecast for 2016/17**
- **Significant challenge to financial sustainability due to ongoing underachievement against activity targets**
- **Delays in board appointments significantly impacted on governance arrangements during 2015/16**

The Board's standing committees did not meet between December 2015 and October 2016. During that period all committee business, other than that of the audit committee, had to be considered by the Board in full at its meetings in March, June and September 2016.

The College's governance statement is considered consistent with the Scottish Funding Council's guidance and our understanding of the College.

Value for money

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

Conclusion

This report concludes the audit of Lews Castle College for the year to 31 July 2016. 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.

This report has been discussed and agreed with the Principal and the Finance Manager and we would like to thank all management and staff for their co-operation and assistance during our audit.

Scott-Moncrieff
December 2016

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Introduction

Introduction

1. This report summarises the findings from our 2015/16 audit of Lews Castle College. The scope of the audit was set out in our external audit plan which was presented to the Audit Committee at the outset of the audit.

2. The external audit strategy and plan summarised five key audit issues for 2015/16:

   - FRS102 restatement;
   - Group accounting;
   - Revenue recognition;
   - Management override; and
   - Financial sustainability.

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

3. The main elements of our work in 2015/16 have been:

   - An audit of the financial statements, including a review of the College's governance statement and the remuneration and staff 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 taken cognisance 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 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 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.

12. In this section we summarise the findings from our audit of the 2015/16 financial statements.

Overall conclusion

An unqualified audit opinion on the financial statements and regularity

13. The financial statements for the year ended 31 July 2016 were approved by the Board on 13 December 2016. We reported within our independent auditor's report:

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

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

14. Our audit opinion was based on the approval of the financial statements and signing of a letter of representation. Within the letter, the College confirmed that there were no subsequent events that require amendment to the financial statements.

Our assessment of risks of material misstatement

15. These assessed risks of material misstatement 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 as a whole, and not to express an opinion on individual accounts or disclosures. Four significant risks are outlined below with one further significant risk outlined in section 4 of this report: *Financial sustainability*.

1. FRS102 restatement

In March 2013, the Financial Reporting Council (FRC) issued FRS102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland". FRS102 is a single set of accounting standards that replaces UK GAAP. A new FE/HE SORP has also been developed, published in March 2014, which supplements FRS102 and sets out specific requirements and guidance for the HE/FE sector.

FE establishments are required to adopt the new SORP for accounting periods starting on or after 1 January 2015, with the comparative balance sheet and opening comparatives requiring restatement.

The transition to FRS102 brings with it potentially significant implications to the financial statements of bodies adopting the standard, although not all will be directly relevant to the College.

Summarised from 2015/16 External Audit Plan

16. The College had not completed the FRS102 restatement exercise at the outset of audit fieldwork. We reviewed the adjustments subsequently recognised by the College during the audit process to ensure that transactions and balances have been appropriately restated. We consider the exercise undertaken has materially addressed all requirements of FRS102 and the new SORP.

17. All material transitional adjustments have been subject to audit testing and no issues were identified with the College's final workings. We will have also ensured that disclosures, including stated accounting policies, as included within the 2015/16 financial statements are transparent and are in accordance with FRS102 and new SORP requirements.

2. Group accounting

The College has historically held a 27% share in the voting rights of Greenspace Live Ltd ('Greenspace'). FRS 102 (section 14: Investments in Associates) presumes that a 20% share of the voting rights in a company would provide the College with significant influence over that company, unless it can be clearly demonstrated that this is not the case. Where significant influence is held the company should be consolidated as an associate.

Summarised from 2015/16 External Audit Plan

18. The College has retained its stake holding in Greenspace. As in 2014/15, 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 2015/16. The impact of consolidation the College's net asset position was estimated at £45,000. We reviewed the College's approach to potential consolidation and found the accounting treatment adopted to be reasonable, in particular as the potential consolidation adjustments required would be immaterial to the College's financial statements as a whole.

3. Revenue recognition

Under ISA 240, "*The auditor's responsibilities relating to fraud in an audit of financial statements*" there is a presumed risk of fraud in relation to revenue recognition. The presumption is that the College could adopt accounting policies or recognise income and expenditure transactions in such a way as to lead to a material misstatement in the reported revenue position

Summarised from 2015/16 External Audit Plan

19. We did not identify any evidence of fraud in relation to revenue recognition from the testing performed throughout our audit work. We have evaluated each material revenue stream, considered the College's revenue recognition policy and carried out testing to ensure this is appropriate and has been applied. We performed detailed testing of each material income stream. .

4. Management Override

In any organisation, there is a risk that management have the ability to process transactions or make adjustments to the financial records outside of the normal financial control processes. Such transactions could lead to a material misstatement in the financial statements. We treat this as a presumed risk area in accordance with ISA 240.

Summarised from 2015/16 External Audit Plan

20. We did not identify any evidence of management override through our audit testing. We reviewed the accounting records and did not identify any significant transactions outside the normal financial control processes. We performed a detailed review of the journals raised and posted throughout the year and at the year-end to identify any unusual transactions or activity. We also reviewed the controls in place over the journal process for any potential weaknesses that could give rise to management override.

Financial statements preparation

21. We did not receive a complete set of draft accounts in line with the agreed timeframe and information relevant to the audit was not always available on a timely basis. As a result, there was a negative impact on the efficiency of the 2015/16 audit. We remain grateful to the College's staff for their assistance and support during the course of the audit.

Management action plan point 3

Audit differences

22. We identified a number of immaterial disclosure and presentational adjustments during our audit which have been reflected in the final set of financial statements. In addition, the following adjustments were made through the audit process which we consider to be material:

- The draft annual report did not take into account the changes required by the 2015/16 Accounts Direction to present a performance report and an accountability report.
- The draft financial statements did not include the required FRS102 transitional adjustments to the prior year figures.

Board representations

23. 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.

Regularity

24. We did not identify any instance of concern regarding the legality of transactions or events. We planned and performed our audit recognising that non-compliance with statute or regulations may materially impact on the financial statements. Our procedures included:

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

Going concern & subsequent events

25. Auditing standards require 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.

26. The term "subsequent events" is used to refer to events occurring between the year-end date of the financial statements and the date of the auditor's report. International Standard on Auditing (UK & Ireland) 560: "Subsequent events" requires us to assess all such matters before signing our audit report.

27. 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 funding; and
- performing sample testing of post balance sheet transactions.

28. 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. We did not identify any subsequent events which require amendments or disclosures to be made in the financial statements.

Corporate Governance

The governance statement discloses that delays in board appointments impacted on the committee cycle

29. 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').

30. The College's governance statement describes how the College has applied the principles in the Good Governance Code 2014. The statement discloses that, due to delays in board member appointments, the audit committee did not meet between January 2016 and October 2016. The delays in appointment also meant that the Board, at its meetings in March, June and September 2016, had to directly consider all items that would normally have been delegated to sub-committees.

31. 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.

Qualitative aspects of reporting

32. 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. Our conclusions are summarised below:

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 which were not adequately disclosed in the financial statement.
Apparent misstatements in the performance report or material inconsistencies with the financial statements.	The performance report contains no material misstatements or inconsistencies with the financial statements.
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.
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.

Qualitative aspect considered	Audit conclusion
Difficulties encountered in the audit.	The audit overall has been completed in line with the agreed timetable. However, we do note that the College had not completed the FRS102 exercise, or stated the draft annual report in line with the requirements of the Accounts Direction at the outset of our work. This had a negative impact on the efficiency of the audit.

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Financial management

Financial management

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

Overall conclusion

34. 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.

35. However, the College is currently not meeting student activity targets and this presents a significant risk to the College's future financial performance.

Financial performance

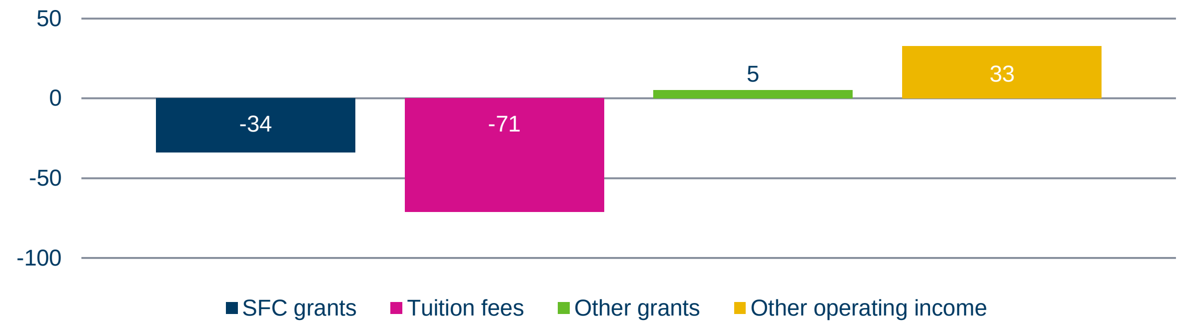
36. The College reported a deficit of £274,000 for the year to 31 July 2016 in the financial statements. However, the performance report reflects a net outturn position of break even on a cash basis.

College's assessment of the reported deficit	
Underlying net position	£0
Non-cash pension provision adjustments.	(£231,000)
SFC strategic grant	£100,000
Unbudgeted depreciation charge	(£143,000)
Reported deficit	**(£274,000)**

37. The College's assessed underlying position strips out:

- non-cash adjustments to provisions;
- additional strategic grant received, as commented on in paragraph 43 below; and
- unbudgeted depreciation charges required in 2015/16 as a result of required change in accounting policy to revalue fixed assets in 2014/15. The 2015/16 budget was agreed before the policy had been applied and further commentary is provided on this in paragraph 56.

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



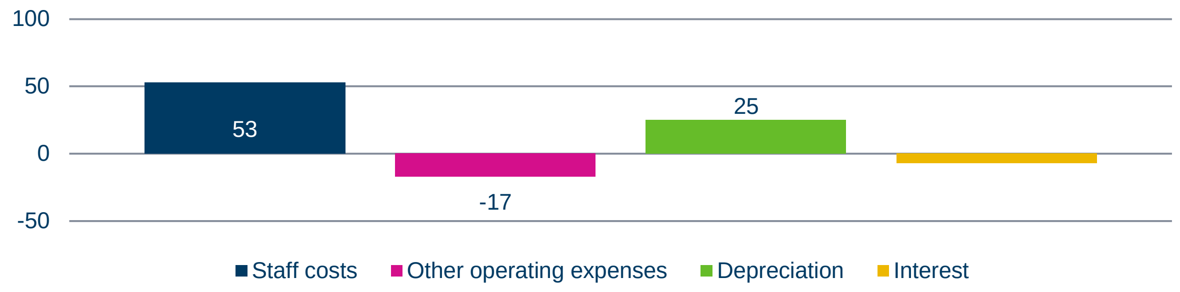
Income has reduced by £68,000

38. As shown above, the College has seen only a small decrease in income overall of £67,000 (1.2%), to £5,741,000, in 2015/16. This has been principally due to reduced tuition fees being received compared to 2014/15.

Expenditure has increased by £133,000

39. The College has also seen an increase in expenditure of £54,000 due to minor uplifts in staff costs and depreciation charges.

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



Financial position

The College has maintained a net asset position as a result of the revaluation reserve

40. The College has an overall balance on reserves of £969,000. That position is principally due to a revaluation reserve balance of £4,887,000 being in large part offset by a deficit on the income and expenditure reserve of £3,918,000.

41. The deficit on the income and expenditure reserve is largely due to the accounting entries required in relation to the College's actuarially assessed liability to the Highland Council Pension Fund which has been estimated at £2,610,000 as at 31 July 2016. However, the pension liability does not account for the whole deficit and, discounting any movements due to pensions accounting, the underlying deficit on the income and expenditure reserve increased by £184,000 in 2015/16.

The College has now repaid the claw back of funding received between 2007 and 2009

42. From 2013/14 the College 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.

43. 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 under that agreement took place in 2015/16.

Systems of internal control

44. 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.

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Financial sustainability

Financial sustainability

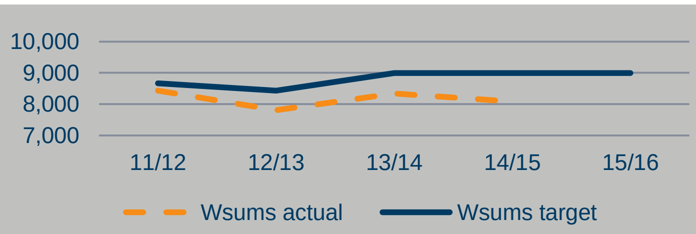
45. Financial sustainability looks forward to the medium and longer term to consider whether the College is planning effectively to continue to deliver its services or the way in which they should be delivered.

Significant audit risk

46. In addition to the risks of material misstatement identified in section 2 we also considered there to be a significant audit risk in relation to the College's financial sustainability:

5. Financial sustainability

The College has found it difficult to achieve activity targets in recent years. The graph opposite shows that the College did not achieved the targeted Wsums during 2014/15, or in the three preceding periods. The target activity for 2015/16 has not reduced and will be challenging to achieve.



As the financial outlook for the sector continues to be challenging, it is increasingly likely that underachievement against 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.

Summarised from 2015/16 External Audit Plan

Overall conclusion

47. There are adequate short term financial planning arrangements in place. However, the College continues to face significant challenges to its financial sustainability.

The College has not achieved activity targets and there is a continued risk to financial sustainability

48. In recent years the College has not been able to achieve its student activity targets. From 2015/16 student activity has been measured in credits. However, the College has continued to find activity targets unachievable and it delivered 5,131 credits against a target of 6,376 for 2015/16 (81%). The Credits target for 2016/17 remains at 6,376.

49. There is a clear potential for claw back of SFC funding when performance against activity targets is poor. In the College's case, actual claw back would be dependent on the wider Highlands and Islands regional performance and the approach to be taken to this matter by the regional group, the University of the Highlands (UHI).

50. The College reports that overall the region has comfortably achieved the credits target set for 2015/16 and that UHI has confirmed there will be no claw back of 2015/16 SFC funding.

51. In 2014/15 we reported that the College had 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 the challenges it faces over student activity.

52. As part of that work the College reports that it has worked with its regional partners to assess the allocation of credits targets within the group. In October 2016 a seminar was held with the regional partners and the SFC to progress the amendments to the credits allocations within the region.

53. The College reports that an amended allocation process may be concluded by February 2017 with new allocations potentially in place from 2017/18.

54. Early indications are that the 2017/18 credit target for Lews Castle College may reduce by up to 1,000 credits which would equate to an estimated £100,000 reduction in funding. Given the current year's performance we consider this matter should continue to be a very high priority for the College.

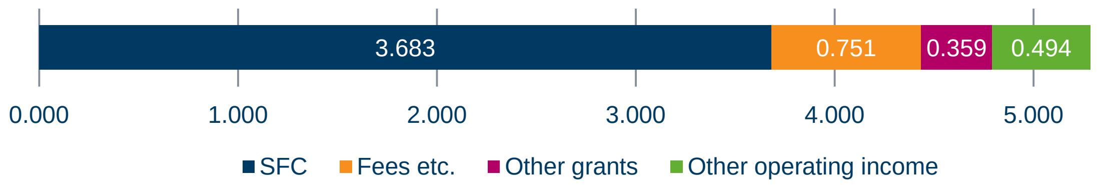
Management action plan point 4

Financial forecasts

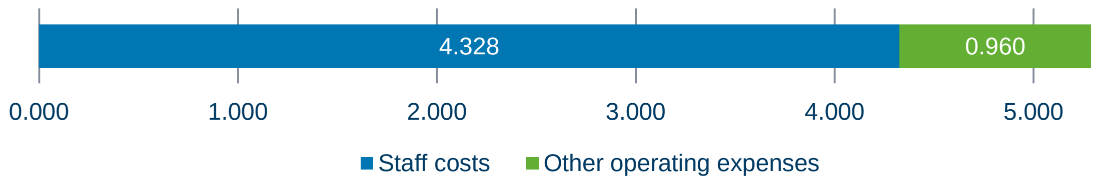
A break even position forecast for 2016/17

55. The College's 2016/17 revenue budget was approved by the Board of Management in June 2016. The budget projects a small surplus (£620).

Income of £5.24million is forecast for 2016/17 with £0.048million funding expected from depreciation allocations



£5.288million expenditure is forecast for 2016/17



56. The College's projected surplus is dependent on confirmation that £48,000 additional funding will be agreed by the SFC to be funded from depreciation allocations.

57. Within the FE sector it is recognised that the funding of non-cash depreciation charges can result in technical deficits within College's financial statements. We do not consider the potential application of such depreciation allocations in this way to be indicative of underlying financial sustainability concerns in and of themselves.

Financial planning

Long term financial strategies

58. In August 2016 Audit Scotland published the national report *Scotland's Colleges 2016*. The report recommends that colleges should prepare long term financial strategies (a minimum five years). The report also suggests the strategy should be supported by medium term financial plans and workforce plans.

59. To date the College has not developed a long term financial strategy as outlined in the national report and it does not currently have formal, documented workforce plans in place. Given the significant difficulty the College faces in guaranteeing financial sustainability in the face of challenging activity targets we consider the development of such long term plans to be of particular importance to Lews Castle College.

Management action plan point 1

5

Governance and transparency

Governance and transparency

60. 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

61. Delays in board member appointments during 2015/16 significantly impacted on the College's governance arrangements and the planned committee cycle.

62. Our audit work has included reviewing corporate governance arrangements as they relate to:

- 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.

Delays in board appointments significantly impacted on governance arrangements during 2015/16

63. The College reports that during 2015/16 all independent board members went through a formal recruitment process. This resulted in significant movement in board members with seven independent members leaving during the year, including the Chair. Additionally one further independent member left the board after the year end.

64. 2015/16 was the first year that the College's board members were formally appointed by The University of the Highlands and Islands in its role as regional strategic body. However, the recruitment process was not carried out efficiently leading to delays in appointments.

65. Four members came to the end of their terms in February 2016. Two retired from the board and two were reappointed. Despite the application process for the initial group of appointments ending in February 2016, the three new members selected were not appointed until June 2016.

66. A further five independent members, including the Board Chair, came to the end of their terms in July 2016. Two were reappointed and two further new members were appointed in September 2016. A new Chair was also appointed in September 2016.

67. The College has lost a great deal of experience from its board during 2015/16. The Chair is now the only independent member with more than two years' experience on the Board of Management. To date a full induction process has not been completed for the members who joined the board in 2015/16, or those existing members with new responsibilities.

68. The substantial change in board membership during the year had a significant impact on the College's governance arrangements and the planned committee cycle. As disclosed in the governance statement, the audit committee did not meet between December 2015 and October 2016. The Board's other standing committees did not meet during that period either and all committee business had to be considered by the Board in full at its meetings in March, June and September 2016.

69. There is a significant risk that the Board of Management cannot give the appropriate full consideration to all relevant matters where the committee cycle is not maintained. Additionally, while the introduction of new members will bring a range of opportunities to the Board and the College, it is crucial that new members, and those with new responsibilities, receive the proper induction, training and ongoing support to allow them to effectively fulfil their roles.

Management action plan point 2

Risk management

70. Risk management is important to the establishment and regular review of systems of internal control. The College's annual report outlines 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, notwithstanding the challenges faced in the 2015/16 committee cycle.

Internal audit

71. 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.

72. Wylie & Bisset provided the internal audit service in 2015/16 and we have considered their findings within our audit process.

73. Wylie & Bisset concluded in the internal audit annual report that they could provide reasonable assurance that there were no major weaknesses in the College's risk management, control and governance processes.

Prevention and detection of fraud and irregularity

74. 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.

75. 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

76. 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.

6

Value for money

Value for money

77. 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

78. 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

79. 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.

80. The corporate governance report confirms that the Board of Management has taken reasonable steps to secure the economical, efficient and effective management of the College's resources and expenditure.

Internal audit opinion on value for money

81. Within the internal audit annual report Wylie & Bisset confirmed that in forming their overall opinion they carried out a review of the College's procedures in place to promote and secure value for money. Wylie & Bisset concluded overall that they could provide reasonable assurance that there were no major weaknesses in the College's risk management, control and governance processes.

Performance

82. As discussed in section 4: *Financial sustainability*, the College has continued to find activity targets unachievable. It delivered 5,131 Credits in 2015/16 against a target of 6,376 (81%).

Key performance indicators

83. 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 reflects a selection of the key performance indicators reported in 2015/16. It shows that despite challenges in achieving student activity targets in the form of Credits, there has been an increase in the student enrolments during 2015/16 with only marginal movements report against retention and outcomes.

KPI	Description	2015/16	2014/15	Trend
Student numbers	Measures students enrolled after census date	1,959	1,561	398
Overall early retention	Measures student retention before cut-off date	98.24%	98.15%	0.09%
Overall retention	Measures student retention	94.15%	94.65%	(0.5%)
Student outcome FE	Measures FE student success	94.15%	94.65%	(0.5%)

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Appendices

Appendix 1: Management action plan

Our action plan details the control weaknesses and opportunities for improvement that we have identified during the course of our audit. The action plan details the officer responsible for implementing each recommendation and an implementation date. The College should assess each 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 annual report and accounts 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.

Action plan grading structure

To assist the College in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated.

The grading structure for our recommendations is as follows:

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

Recommendations raised in 2015/16

1	Long term financial planning
Observation	In August 2016 Audit Scotland published the national report Scotland's Colleges 2016. The report recommends that colleges should prepare long term financial strategies (a minimum five years). The report suggests the strategy should be supported by medium term financial plans and workforce plans. To date the College has not developed a long term financial strategy as outlined in the national report and it does not currently have formal, documented workforce plans in place.
Risk and recommendation	The College may not be able to demonstrate that it is taking a strategic approach to financial planning, in line with best practice. The College may not be able to adequately prepare for and address further financial pressures on income (from challenging activity targets) or expenditure (such as national collective bargaining, estate maintenance and student support funding). Given the significant difficulty the College faces in guaranteeing financial sustainability in the face of challenging activity targets we consider the development of such long term plans to be of particular importance to Lews Castle College. **Grade 4**
Management response	A key element in future financial and workforce planning is the context in which the College will operate in future. There has been significant doubt about the direction of travel for the UHI partnership with the University favouring the merger of all Academic Partner Colleges into the University. In November 2016, following the intervention of the Deputy First Minister, UHI and its partners have come to agreement on the future direction of the partnership that does not involve the merger of individual Colleges into the University. The proposals involve significant changes in the management and leadership of the University to more closely involve Colleges in that leadership. One of the early priorities is to develop a transformation plan that will lead to the development of a more efficient and financially stable partnership. The College will develop its own plans within this overall UHI context. **Responsible officer:** Principal **Completion Date:** Initial Plan by September 2017

2	Board member changes
Observation	Delays in board appointments significantly impacted on governance arrangements during 2015/16. Seven independent members left during the year, including the Chair. The College has lost a great deal of experience from its board during 2015/16 and to date a full induction process has not been completed for the members who joined the board in 2015/16, or those existing members with new responsibilities. The substantial change in board membership during the year had a significant impact on the College's governance arrangements and the planned committee cycle. As disclosed in the governance statement, the Board's standing committees did not meet between December 2015 and October 2016. During that period all committee business had to be consider**ed** by the Board in full at its meetings in March, June and September 2016.
Risk and recommendation	There is a significant risk that the Board of Management cannot give the appropriate full consideration to all relevant matters where the committee cycle is not maintained. Additionally, without a full induction process, new members and those with new roles, may not be aware of their responsibilities as members of the Board of Management and may not be able to effectively discharge those responsibilities. It is crucial that new members, and those with members new responsibilities, receive the proper induction, training and ongoing support to allow them to effectively fulfil their roles. The College should develop a planned approach to board member appointments to ensure that future appointment processes are carried out on a timely basis and do not negatively impact on the College's governance arrangements and the committee cycle. **Grade 4**
Management response	Agree that the induction of Board members is critical and that this will be prioritised. A formal process of induction is being developed by UHI, as Regional Strategic Body, in conjunction with the Colleges Development Network. The majority of Boards in the Highlands and Islands have a high proportion of new members and the context in which Boards now operate in the Region has changed significantly. The Board Chair attended an induction meeting for new Chairs on 22 November 2016 and the information provided at this meeting provides the framework for the cascading of information to other Board members and outlining the further steps in the induction process. The College still faces a challenge in that the induction meetings for Board members are held on the mainland and there is a requirement at the moment to attend in person. The costs of this are currently prohibitive for the College and we are seeking ways of mitigating these costs **Responsible officer:** Board Chair/Secretary to the Board **Completion Date:** March 2017

Follow up on recommendations raised in 2014/15

3	Audit efficiency
2014/15 Observation	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. The audit process was markedly less efficient than in previous years.
2014/15 Risk and recommendation	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. 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. 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. **Grade 3**
2015/16 update	We did not receive a complete set of draft accounts in line with the agreed timeframe and information relevant to the audit was not always available on a timely basis. As a result, there was a negative impact on the efficiency of the 2015/16 audit. the following adjustments were made through the audit process which we consider to be material: • The draft annual report did not take into account the changes required by the 2015/16 Accounts Direction to present a performance report and an accountability report. • The draft financial statements did not include the required FRS102 transitional adjustments to the prior year figures.
Management Response	The changes resulting from FRS102 have caused difficulties with the finalising of the accounts. The process to collate the accounting information was however improved on the previous year and now that the Finance team is back up to strength they are well placed to ensure that the process will continue to show improvement. The process will be reviewed to ensure that all necessary preparatory work is concluded in good time for the production of future annual accounts. **Responsible officer**: Finance Manager **Implementation date**: March 2017

4	Student activity targets
2014/15 Observation	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. 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.
2014/15 Risk and recommendation	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. 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. **Grade 4**
2015/16 update	The College has continued to find activity targets to be unachievable and delivered 5,131 Credits against a target of 6,376 credits for 2015/16 (81%). There is a clear potential for claw back of SFC funding when performance against activity targets is poor. However, the College reports that UHI has confirmed there will be no claw back of 2015/16 SFC funding. The College has worked with its regional partners to assess the allocation of credits targets within the group. An amended allocation process may be concluded by February 2017 with new allocations potentially in place from 2017/18. Early indications are that the 2017/18 credit target for Lews Castle College may reduce by up to 1,000 credits. Given the current year's performance we consider this matter should continue to be a very high priority for the College.
Management Response	This has been a high priority for the College and will remain so. The Principal continues to be directly involved in regional activity to develop a new and detailed framework for the allocation of student activity and the consequent funding. College managers are also developing the detail of the curriculum strategy to ensure that student recruitment is maximised and that available resources are utilised efficiently. **Responsible officer**: Principal **Implementation date**: March 2017

Appendix 2: Scope of the audit

An overview of the scope of our audit

Our procedures are carried out solely for the purpose of our audit so that we can form and express an opinion on the financial statements in accordance with applicable law and ISAs.

Our external audit 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 section two and section four of 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.

Our application of 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 plan, was £125,000. We revised materiality for the financial statements at the final accounts audit to £100,000.

Our assessment of materiality was set with reference to a range of benchmarks. We consider the application of income to be the principal considerations for the users of the accounts when assessing the performance of the College.

Performance materiality

We set a performance materiality for each area of work which was based on a risk assessment for the area and percentage application of overall materiality. We have performed audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we perform a greater level of testing on the areas deemed to be of significant risk of material misstatement.

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	40% £50,000	40% £40,000
Medium	60% £75,000	55% £55,000
Low	70% £87,500	70% £70,000

Reporting

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

- All material corrected misstatements.
- Uncorrected misstatements above £4,000.
- Other misstatements below £4,000 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 college's affairs as at 31 July 2016 and of its surplus for the period then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the SFC, the Charities and Trustee Investment (Scotland) Act 2005, and regulation 14 of The Charities Accounts (Scotland) Regulations 2006 (as amended).

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 Performance Report 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 and the part of the Remuneration and Staff Report to be audited 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 corporate governance report 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.
- Scott-Moncrieff has not provided any consultancy or non-audit services to the Board of Management.

Audit fee

The fee for the external audit proposed at the outset, and reported in our external audit plan, was £19,400. However, we did not receive a complete set of draft accounts in line with the agreed timeframe and information relevant to the audit was not always available on a timely basis. As a result we agreed uplift in the audit fee of £1,200 with the College resulting in a final audit fee of £20,600.

Scott-Moncrieff
business advisers and accountants