University of the Highlands and Islands

Moray College

Report on 2015/16 Audit

Prepared for the Board of Management of Moray College UHI and

the Auditor General for Scotland

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Anne MacDonald is the engagement lead for the audit of Moray College UHI for the period 2011/12 to 2015/16.

This report has been prepared for the use of Moray College UHI and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the Board of Management. The information in it may be used by the Auditor General in support of her wider responsibilities, including reporting to the Scottish Parliament.

Contents

Key messages

Audit of financial statements	• The independent auditor's report provides an unqualified opinion for the 2015/16 financial statements of Moray College UHI.
Financial Position	• During the year the college needed to urgently draw down additional funding of £597k over the level anticipated in its monthly cash flow to meet operational requirements. The current financial position is not sustainable and is being addressed through the development of a recovery plan. • The deficit for the year was £876k. Excluding non-cash items such as net depreciation, the deficit was £158k.
Governance & accountability	• Management accounting processes continue to be developed, otherwise the college had a good standard of internal controls operating during the year. • The Board's internal audit service complies with Public Sector Internal Audit Standards. • The college's action plan in respect of the 2014 code of good governance for Scotland's colleges has been progressed. Now that a new board has been appointed, the remaining actions related to the operation of the board should be implemented.
Performance	• Through the performance and accountability reports within the financial statements, the college has made improvements to its public performance reporting. • The college has made some progress against the national recommendations contained in Audit Scotland's report 'Scotland's Colleges 2016'. There is scope to develop financial and workforce planning.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Moray College UHI.
2. The management of Moray College UHI is responsible for:
   - preparing financial statements which give a true and fair view, in accordance with the relevant financial reporting framework
   - ensuring the regularity of transactions, by putting in place systems of internal control
   - maintaining proper accounting records
   - publishing with their financial statements an annual governance statement and a remuneration report.
3. Our responsibility, as the external auditor, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements. This does not relieve management of their responsibility for the preparation of financial statements.
5. Appendix I highlights significant audit risks and our corresponding audit work. Appendix II is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit.
6. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that the college understands its risks and has arrangements in place to manage them. The Audit Committee should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.
7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

Our audit appointment

9. Audit Scotland is responsible for public sector audit in Scotland with audit appointments generally covering a five year cycle. The financial year 2015/16 is the final year of the current cycle. From 2016/17, the auditor of Moray College UHI will be Ernst and Young. In accordance with agreed protocols and International Standards on Auditing we will be liaising with the incoming auditors as part of this transition.

Audit of the 2015/16 financial statements

Audit opinions

Financial Statements	• We have concluded our audit and provided an unqualified audit opinion that the 2015/16 financial statements of Moray College UHI give a true and fair view of the state of the college's affairs and of its income and expenditure for the year. • We confirm that the financial statements have been properly prepared in accordance with the 2015 Statement of Recommended Practice: Accounting for Further and Higher Education (the 2015 SORP), the 2015/16 Government Financial Reporting Manual (FReM) and the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions.
Going Concern	• The financial statements of the college have been prepared on a going concern basis. We have examined the college's financial plans for the next 12 months and discussed the financial position with the Principal and interim Director of Finance. The current financial position is not sustainable and work is required to achieve financial balance. The University of the Highlands and Islands (UHI) as the Regional Strategic Body is working closely with its partner colleges including Moray to find solutions. On this basis, it is appropriate, in our opinion, for the college to continue to be considered as a going concern.
Regularity	• In our opinion, in all material respects, the expenditure and income in the financial statements was incurred or applied in accordance with any applicable enactments and guidance.

Other prescribed matters	• We review and report on other information published with the financial statements notably the Performance Report and Accountability Report which includes a Governance Statement and a Remuneration and Staff Report. • Information on the college's performance in the Performance Report and in the Accountability Report in respect of the governance statement was considered to be limited on receipt of the draft accounts for audit. The governance statement has been strengthened and further narrative included to explain how the college has performed during the year. • The part of the Remuneration and Staff Report to be audited has been prepared in accordance with FReM and directions by Scottish Ministers. The arrangements for the preparation of the report and the supporting evidence and audit trails need to be strengthened. • While the above reports are consistent with the financial statements, improvements have been recommended at appendix II.

Submission of financial statements for audit

10. We received the unaudited financial statements on 27 September 2016, in accordance with an agreed timetable. With the exception of the figures for pension scheme liabilities and financial instruments, we also received a full set of working papers at that time. The working papers were of a good standard and staff provided good support to the audit team which enabled us to largely complete our on-site fieldwork on 12 October 2016.

11. The accounting and disclosure requirements of FRS 102 applied for the first time in 2015/16 and were introduced through the revised statement of recommended practice (SORP) issued in 2014 by the FE/HE SORP Board. The transitional arrangements included:
    - significant change to the organisation of the financial statements, with the former Statement of Historical Cost Surpluses and Deficits and the Statement of Total Recognised Gains and Losses replaced by the Statement of Changes in Reserves
    - the need to revise accounting policies and where necessary, restate the comparative figures by making prior year adjustments. The balance sheet for 2014/15 and the closing reserves for 2013/14 were therefore revised where appropriate. The impact of these changes on the financial statements has been explained in the accounting policies supported by Note 36 to the financial statements
    - the method of accounting for the local government pension scheme was changed. For the first time, it was treated as a defined benefit scheme
    - re-classification of deferred capital grants; they are now shown as items of deferred income within creditors.

12. There were also significant changes to the other information contained within the accounts. The Accounts Direction required the inclusion of performance and accountability reports in accordance with FReM which replace the former Operating and Financial Review by the Board of Management and the Statement of Corporate Governance and Internal Control. These reports should contain a range of information including a summary of the college's performance against strategic objectives, a governance statement and a remuneration and staff report.

Overview of the scope of the audit of the financial statements

13. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Audit Committee on 24 May 2016.

14. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken any non-audit related services. The 2015/16 agreed fee for the audit was £19,200 and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

15. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance.

16. Appendix I sets out the audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

17. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

18. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, an item contrary to law).

19. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

20. We summarised our approach to materiality in our 2015/16 Annual Audit Plan. Based on our knowledge and understanding of Moray College UHI, we set planning materiality at 1% of gross expenditure. On receipt of the financial statements, we reviewed our materiality levels and concluded that no major change was required to our approach. Materiality was therefore set at £125,000.

21. We also set a lower level, known as performance materiality, when defining our audit procedures. This is determined to ensure that uncorrected and undetected audit differences do not exceed our materiality level. Performance materiality was set at £38,000 (i.e. 30% of materiality) to reduce to an acceptable level the probability of uncorrected and undetected audit differences exceeding our materiality level. We report all misstatements greater than £6,000.

22. Whilst we request that all errors be corrected, the final decision on this matter rests with those charged with governance taking into account advice from officers.

23. A number of misstatements and presentational adjustments were identified in the financial statements in the course of the audit. These arose mainly from changes of accounting policy due to the transition to the 2015 SORP and the inclusion of defined benefit pension liabilities on the balance sheet.

24. Pension scheme revaluation adjustments increased the deficit for the year by £2.5m to £3.4m. There was also a prior year adjustment which caused the deficit for the prior year to increase by £462k. However, there was also recognition of a provision for future pension costs which had a cumulative impact on the general fund at 31 July 2014 of £3.4m.

25. In addition, it was agreed not to adjust the accounts for two amounts totalling approximately £25k as the overall impact on the financial statements was not material.

Significant findings from the audit

26. International Standard on Auditing 260 (ISA 260) requires us to communicate to you significant findings from the audit as detailed below:

- the auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and disclosures
- significant difficulties encountered during the audit
- significant matters arising from the audit that were discussed, or subject to correspondence with management
- written representations requested by the auditor
- other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

27. The following table details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

Table 1: Significant findings from the audit

Significant findings from the audit in accordance with ISA260
1. Remuneration report In accordance with FReM, a remuneration report disclosing pay and pension information for the college's management team was required. In addition to salary and pension benefit information, there is a requirement to provide accrued pension information and cash equivalent transfer values (CETVs). The remuneration report correctly disclosed salary information but details of the pension interests, accrued pension benefits and CETVs were not disclosed. In two of the seven cases included in the remuneration report, consent had not been provided because the individuals concerned believed their data was not correct. Information provided by the Scottish Public Pensions Agency (SPPA) is generally based on service at the previous 31 March and with this time delay, staff concerned felt that the acting up allowances earned over the last 2 -3 years would not be properly represented in the calculations. On the basis that the required disclosures had not been made, the likelihood of a qualified audit opinion in respect of the remuneration report was discussed with the Principal. This led to further discussion on options for resolution. **Resolution** Having reflected on the requirements of FReM, we proposed that sufficient disclosures could be made for the two non-consenting cases through calculations based on salary only using an online calculator which SPPA provide to help employers meet their requirements in respect of routine pay and pension disclosures. In addition, we sought the inclusion of a footnote to the remuneration report outlining the approach taken. Consent had largely already been obtained for the other cases and so the information would be collated to enable the disclosures to be calculated. As at 29/11/2016, the date the audit committee considered our report, a final response was awaited on this matter. The figures and supporting evidence were duly received which enabled us to issue an unqualified opinion. One of the risks identified in our 2015/16 annual audit plan (Appendix 1, page 24) was the risk that the remuneration report would not be prepared in accordance with requirements if there was insufficient planning at an early enough stage for the preparation of the report. This proved to be the case and consequently, we have included an action for improvement to ensure the arrangements for the preparation of the report and supporting evidence are built into the timetable for the financial statements. ***Refer Action Plan, number 1***

Significant findings from the audit in accordance with ISA260

2. Pension costs

In the past, the college accounted for pension contributions to the Local Government Pension Scheme as if it were a defined contribution scheme. This meant that the liability to pay for future pensions of current staff was not recognised on the balance sheet as required by FRS 17. Historically, the actuary only identified the assets and liabilities for the north east Scotland colleges on an aggregate basis which meant the colleges received a pooled valuation and shared a common contribution rate. From 2015/16, the new SORP requires the college to bring the estimated liability based on an actuarial valuation onto the balance sheet and to restate prior year figures.

The long term obligation of early retirees, which is not funded by the pension scheme, had previously been reflected as a provision in the balance sheet based on valuation guidance provided by the Scottish Funding Council. With the implementation of the SORP, the provision needed to be amended to remove Local Government retirees and avoid double counting. This affected both the current and previous year figures.

The actuary estimates the liability using a range of assumptions to which a discount factor is applied to determine the current value. The discount factor applied in 2016 was 2.5% (2015 3.8%).

Resolution

In order to reflect the pension liability on the balance sheet, the restated provision figure for the previous year increased by £4m (increasing from £3m to £7m). The provision increased by a further £3m in 2015/16 and this was largely due to a fall in the discount rate. This fall represents the downturn experienced in the financial markets in the summer following the referendum result for the UK to exit the European Union. In accordance with ISA 620, we place reliance on the work of an expert when considering the findings and conclusions of the actuary.

We are satisfied with the accounting treatment and amounts reflected in the audited accounts in respect of pension liabilities following implementation of the 2015 SORP.

Significant findings from the audit in accordance with ISA260

3. Deferred grants

Note 36 to the financial statements sets out the impact on the college's prior year balances after implementing the 2015 SORP. On restatement, net assets has reduced from £22m to £9m. This is largely represented by the pension liability of £4m mentioned above and £8m in respect of deferred capital grants. Previously, deferred grants were shown separately before reserves on the face of the Balance Sheet but are now included within creditors.

Resolution

We are satisfied that the accounting treatment in the audited accounts meets the requirements of the 2015 SORP/FReM.

4. Completeness of expenditure

When financial pressures are experienced, there is an increased risk that expenditure may be understated or income overstated in order to present a more favourable financial result for the year. While net current liabilities have increased from £0.975m to £1.157m, Note 14 shows that trade creditors have fallen by £299k and accruals by £46k. This position reflects our wider knowledge that there was a restriction on spending in the summer.

Resolution

Having examined a sample of supplier statements and reviewed payments in 2016/17 to 31 October 2016, we are satisfied that creditors are not materially understated.

5. Nairn Centre – termination of a lease

With effect from 31 October 2016, the college opted not to renew its lease of the Nairn Centre. On conclusion of a lease, dilapidation costs may arise which should be provided for when it becomes known a liability will arise. We have taken assurances from the Estates Manager that no dilapidation costs are anticipated in respect of this property.

Resolution

We have taken management assurances on this matter by including a reference in our letter of management representation.

Financial management and sustainability

2015/16 financial position

28. Moray College UHI is largely funded by grants from the Scottish Funding Council which are allocated by the UHI Regional Strategic Body. There is also income from course fees, which amounts to around 16.5% of total income. The college is required to break even against resource limits at 31 March as set by the Scottish Government. For the year to 31 March 2016, the outturn was as follows:

Revised Resource Budget 2015/16 (Year to 31 March 2016)	Budget (£000)	Actual Outturn (£000)	Over / (under) Spend (£000)
Cash Departmental Expenditure Limit (DEL)	(27)	555	582
Non-Cash	192	355	163
Total Revenue	**165**	**910**	**745**
Capital	0	(2)	(2)
Total	**165**	**908**	**743**

29. While advance funding was requested in summer 2015, it was anticipated that this would even out over the year and the acting principal expected financial targets to be met at 31 March 2016. In reality, this was not the case and an overspend of £582k was incurred.

30. As in the previous year, colleges received cash funding in respect of depreciation which is a non-cash item. The cash (£264k) was however required to be spent by 31 Mach which put the college into an accounting deficit position once net depreciation was taken into account. Excluding depreciation, the overspend amounted to £318k.

31. The financial statements for the year to 31 July 2016 show gross operating costs of £12.96m and gross income of £12.08m. The deficit before pension remeasurements was £0.88m. This included non-cash pension costs (£0.27m) and depreciation (£0.45m). Adjusting for these non-cash items, the deficit before pension remeasurements amounted to £158k (2015 deficit of £347k).

32. Compared with the previous year, financial performance improved, due mainly to tighter control of non-pay operating costs. These fell by £0.70m. Staff costs however rose by £0.51m due to a pay-rise of between 1% and 2.5% which applied to all staff and was backdated to 1 April 2015.

33. The Balance Sheet at 31 March 2016 shows net assets of £5.2m compared to a net assets position of £8.6m in 2014/15. The decline in the position is largely attributable to implementation of pension accounting which brought pension liabilities, based on an actuarial valuation, onto the balance sheet for the first time as explained in Table 1 (item 2) on page 12.

Financial Planning

34. The latest financial plan covered the period 2011 to 2015. The college is currently preparing a financial plan for the period to 2020. The last plan anticipated the decline in defence spending due to the closure of RAF Kinloss and the tightening fiscal environment. It identified the pressures building on staff costs and the need to diversify sources of income.

35. The college is currently faced with a level of staff costs which appear unsustainable and, at 73%, are higher than the average for Scotland's colleges which is 63% of gross expenditure. However, many other colleges have undertaken some form of restructuring since the introduction of reclassification and this has not been the case in Moray.

36. The 2016/17 resource budget shows staff costs at 78% of expenditure and a deficit of £0.18m was anticipated at 30 June 2016. Since this is achievable only with further reductions in non-pay expenditure, it is questionable if more can be saved without impacting on the learning experience.

Financial management

37. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:

- the officer responsible for finance has sufficient status to be able to deliver good financial management
- standing financial instructions and standing orders are comprehensive, current and promoted within the body
- reports monitoring performance against budgets are accurate and provided regularly to budget holders
- monitoring reports do not just contain financial data but are linked to information about performance
- committee members provide a good level of challenge and question significant variances.

38. The Director of Finance retired on 31 July 2016 following a period of long term absence. After the appointment of a new principal, an interim Director of Finance was brought in for a limited period to develop a financial forecast and plan for the next 4- 5 years. Financial management is provided mainly within the accounts team, led by an Assistant Accountant. The team is competent and professional but more capacity is needed, separate from operational financial duties, to ensure strategic financial plans are soundly developed and where difficult decisions are required, that all the options are presented for consideration.

Refer Action Plan, number 2

39. Senior management receive monthly management accounts in advance of consideration by the Finance and General Purposes Committee and the Board. In our 2014/15 report, we commented that the management accounts did not contain sufficient signposting and commentary to alert board members to emerging issues. We recommended sufficient commentary be added for the lay reader to understand the financial position and to provide an early alert if that is required.

40. While prompt improvement action was taken by staff and detailed commentaries have been provided for actual figures against budget since December 2015, there is more work to do. Despite the restriction on non-pay spending, forecast outturn figures for the year changed dramatically between January and April 2016, moving from a surplus of £145k to a deficit of £499k. Management accounts analysed the areas of overspend but did not provide explanations for variances between budgets and forecasts or indicate why the issues were not identified and flagged earlier so alternative action could have been considered. Board and committee minutes confirmed that members welcomed the additional narrative and providence of discussion, but they did not evidence committee's decisions or agreed actions.

41. Internal audit undertook a follow up review of budgetary control procedures and reported in May 2016 that more time was required to ensure changes made were properly embedded and operating correctly. There were also comments about the absence of audit trails to support some budget and forecast figures included in management accounts.

42. While important improvements have been made during the year, the arrangements are not yet effective. The unexpected fluctuation in the 2015/16 figures casts doubt on the robustness of budgets and without a clear audit trail to the assumptions, it is difficult to reliably forecast final figures. There needs to be clearer evidence of the decisions taken by committee to address the financial challenges set out in the management accounts.

Refer Action Plan, number 3

Financial sustainability

43. Financial sustainability considers whether the college has the financial resources to meet current and future operational needs. Since coming into post in March 2016, the Principal has undertaken a thorough review of the college's activities and its associated income and expenditure streams and understands that changes are required to achieve financial balance.

44. In June 2016, the college requested a cash advance from UHI amounting to £697k (representing 6% of income) to meet immediate commitments. While the majority of this amount was included within year end creditors in the financial statements, the amount was deducted from the first funding payment made by UHI in the new academic year. We commented in our report on the 2014/15 audit following a similar situation that required an advance of £538k.

45. Other colleges within the UHI partnership are experiencing financial difficulties and as a group, the UHI Further Education Regional Board (FERB) need to identify solutions to create financial balance for the strategic regional body. Work undertaken during the year included a review of regional arrangements for FE/HE funding and from 2017/18, there may be a change in the basis for allocating funding. While the Principal anticipates some benefit for Moray, reliance on the expectation of additional income is a high risk strategy when there may be no guarantee of receipt. I recognise that there were additional challenges in the year with the implementation of national pay bargaining and had it not been for the restriction put on college spending, the financial outturn could have been significantly worse. In my view, a fundamental change is required to deliver a sustainable balanced budget.

46. ISA 570 requires me to consider the appropriateness of the use of the going concern basis of accounting. Although it is rare that it would ever be appropriate to prepare financial statements for a public sector body other than on a going concern basis, the college displays a number of characteristics which have created increased financial uncertainty, for example:

- deficits reported on income and expenditure statements year to year
- there is a trend developing where the net current liability position reported in the college's balance sheet is increasing each year
- the decision to delay property repairs as a short term funding solution may require increased impairment in the future and consequently a deterioration in the value of assets
- failure to achieve financial targets against resource limits
- some difficulty has been experienced in meeting unexpected one-off claims, for example a VAT recovery and repayment of ERDF monies
- changing policy in the sector continues to adversely affect the operation of the college e.g. changes in funding allocation, national pay bargaining.

47. I have reflected on my responsibilities and options for reporting on the above matters. Having consulted auditing standards, I concluded that while going concern and financial sustainability are serious matters, they do not impact on my audit opinion as sufficient explanatory disclosures have been made within the Performance and Accountability Reports accompanying the accounts. However, Audit Scotland's Code of Audit Practice sets out my specific responsibilities to report on wider scope requirements including financial sustainability and confirms that this report, the Annual Audit Report, is the appropriate mechanism for doing so.

48. There are increasing financial challenges across the further education sector and the wider public sector, however the Regional Strategic Body has limited scope to provide more than short term financial support. The college needs to address the increased pressures it is facing and the most likely solution is a reduction in staffing.

49. While there are important financial challenges to be addressed, Moray College UHI is not unique in needing to find viable solutions to achieve financial sustainability. In considering going concern, auditing standards requires management to consider plans covering a period at least 12 months from the date the accounts are approved, in this case at least up to December 2017.

50. The interim Director has recently developed longer term financial forecasts which show financial balance by 2020. The 2016/17 budget currently shows a forecast deficit position and while the financial statements refer to a recovery plan, the content of that plan is currently a priority area of emerging business for the college and discussions are in progress between the college and the FERB with a view to putting a voluntary severance scheme in place in the next few weeks as a means of achieving financial balance.

Refer Action Plan, number 3

Governance and transparency

Corporate governance

51. The Board of Management is responsible for establishing arrangements to ensure that its business is conducted in accordance with the law and proper standards, that public money is safeguarded and for monitoring the adequacy and effectiveness of these arrangements.

52. The senior management team has experienced significant change in the last year. The previous Principal and Chief Executive left in March 2015 and a new Principal was appointed in March 2016. In the interim, Acting Principal arrangements were in place. An interim Director of Finance was brought in on a part time basis to assess the financial position within the college and offer strategic financial support to the management team.

53. In addition, as part of a national refresh of college boards of management, ten non-executive members of the board (from a total of 18) resigned while nine new appointments were made. Three members, including the Acting Chair, provide continuity during this period of transition between boards.

Governance and internal control systems

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

55. Through its accountable officer or equivalent, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs, including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

56. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:

- corporate governance and systems of internal control
- the prevention and detection of fraud and irregularity.

57. In general, it is a requirement of a college's funding that they sign a Financial Memorandum with the Scottish Funding Council. With regard to Moray College UHI, the current arrangement requires UHI to agree a Financial Memorandum with the Funding Council and in turn, UHI have an agreement with each of the partner colleges. Moray College UHI in common with other partners was in discussion with UHI for some time around the detail of the memorandum.

Discussions were concluded and the Financial Memorandum was finalised in December 2015.

Audit Committee

58. Scrutiny of the effectiveness of the internal control processes within Moray College UHI is undertaken by the Audit Committee. The terms of reference for the committee were updated during the year and now formally set out that the committee will provide assurance to the board on governance, internal control and risk management and will engage with financial reporting issues. This is new territory for the committee as it previously focused on matters of internal control with financial matters falling within the remit of the Finance and General Purposes Committee.

59. One of the standard conditions within the financial memorandum is that colleges are expected to comply with the principles of good governance as set out in the 2014 Code of Good Governance for Scotland's Colleges. Internal audit carried out a follow up review of the college's compliance with the Code in May 2016. The initial report included 28 recommendations and the follow up reported that 8 had been implemented, 13 partially implemented and 7 with little or no progress. At November 2016, the actions still to be addressed relate to the operation of the board e.g. induction and ongoing training, the work of committee chairs and evaluation of the board. Now that a new board has been appointed, plans are in place to address the outstanding matters.

Refer Action Plan, number 4

Internal control

60. The auditor evaluates significant financial systems and associated internal controls for the purpose of giving an opinion on the financial statements and as part of the review of the adequacy of governance arrangements. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.

61. Internal audit provides the Audit Committee and Board with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work.

62. As part of our risk assessment and planning process, we assessed Henderson Loggie, Moray College's internal auditors, and concluded that they operate in accordance with the Public Sector Internal Audit Standards (PSIAS). This enabled us to place reliance on the work of internal audit, in terms of our wider code responsibilities.

63. The Accounts Direction requires the inclusion of an Accountability Report as part of the financial statements in 2015/16 for the first time. This includes a governance statement as well as a remuneration and staff report. Having considered the requirements of the Accounts Direction, we were satisfied that the 2015/16 governance statement included all the headings required by the Direction but that the risk management and internal control section

needed more detail on the assessment of their operation during the year and any ongoing review or action being taken in response to previous recommendations. The statement included in the audited accounts has been strengthened to reflect these matters. There is scope for the Audit Committee to have greater oversight of this statement and it will also inform the Audit Committee's annual report to the board.

Transparency

64. The Annual Report included within the financial statements provides a summary of the business strategy and future developments and information on the volume of applications processed together with performance against targets. Information is also provided on the operational activity throughout the year.

65. A range of other information, for example corporate and business plans and governance structures, are available for public review on the website. We also note that board papers are now routinely placed on the website.

66. Overall we concluded that Moray College UHI adequately complies with the principles of openness and transparency.

Arrangements for the prevention and detection of fraud

67. Moray College UHI is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We reviewed these arrangements and have concluded that there are effective arrangements for the prevention and detection of fraud.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

68. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. We consider whether bodies have adequate arrangements in place and have concluded that appropriate arrangements exist within Moray College UHI.

69. There were no instances of fraud or corruption reported by Moray College UHI in 2015/16.

Performance

70. As outlined earlier, the Accounts Direction requires a Performance Report as part of the financial statements in 2015/16 for the first time. The Accounts Direction states that the performance analysis should set out how the college measures performance and provide a detailed analysis and explanation on the development and performance of the entity.

71. A detailed performance report has been included with the financial statements. It sets out the college's strategic aims and priorities, identifies the key issues and risks and provides a detailed narrative on the performance processes in place.

72. Within the performance analysis, student recruitment, retention and attainment are monitored and comparisons reported for the current and previous year. This could be developed to include comparison against targets and more detailed trend analysis could be collated and reported for a period covering say 5-10 years.

73. Within the detailed narrative on the processes in place at the college, examples are provided of different activities undertaken to support improvement e.g. benchmarking, surveys and quality arrangements. There is scope to review data collected to select key facts and figures for inclusion in the performance report as more quantitative evidence of the college's performance.

74. Overall, there is scope to further consider the board's key performance indicators and targets and their measurement. A new strategic plan has recently been developed. Its delivery and success should be measurable and progress reported as part of the college's performance reporting arrangements.

Refer Action Plan, number 5

Performance audit reports

75. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Each year the programme includes an annual overview of Scotland's colleges. The latest report was published in August 2016 and concluded that colleges are still adjusting to substantial (reform) changes that affect how they operate.

76. The report also highlighted that the financial health of the sector is relatively stable although the analysis provided in the report indicated four colleges (including Moray) with underlying financial challenges. The report went on to say that colleges do not have long-term financial plans which would help them prepare for and address further financial pressures, such as national collective bargaining, estate maintenance and student support funding. It was also recognised that the Scottish Government's current approach to funding colleges for depreciation was complex and created a degree of uncertainty for colleges.

77. The College Good Governance Task Group's recommendation should mitigate the risk of significant governance failures. While the Scottish Funding Council undertakes a range of monitoring and engagement within the college sector, this has not always resulted in timely and effective resolution of problems and issues.

78. The report recommended that colleges should:

- develop long-term (a minimum of five years) financial strategies. These should be underpinned by medium-term(between three and five years) financial plans that link to workforce plans and take account of significant financial pressures
- implement a more systematic approach to workforce planning to ensure that they have the appropriate resources and skills to achieve their strategic goals
- make agendas, supporting papers and minutes (subject to confidentiality issues) for board and committee meetings publicly available within appropriate timeframes.

79. Moray College UHI has made progress against these national recommendations and should continue to work towards full implementation.

Appendix I: Significant audit risks

The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
2015 SORP The new SORP brings college accounts into line with International Financial Reporting Standards (IFRS). There will be changes in the primary statements and a restatement of prior year figures including an opening balance sheet at 1 August 2014. There is a risk that the new requirements are not met. Key areas that may involve restatement are the treatment of pensions and deferred capital grants. There will also be significant changes to accounting policies and disclosure of fixed assets, pensions and financial instruments.	• Early planning meeting with Principal to confirm expectations from new financial reporting requirements • Liaison with Assistant Accountant to ensure requirements are communicated • Topic by topic review of what needs to be considered, taking into account guidance from the Scottish Funding Council, Technical Services Unit checklists, and what is appropriate for the college.	• There was regular contact with the finance team during the year • Draft accounts were subject to a review cycle and contained substantial elements of revision to accord with the new SORP • The agreed timetable for delivery of draft annual accounts was met.

Audit Risk	Assurance procedure	Results and conclusions
Remuneration Report With 2014/15 the first year a remuneration report was required to be included in the college's accounts, there were a number of iterations before the information was complete. While the second year should be more straightforward, if planning is not conducted at an early stage, a risk remains that the remuneration report will not be prepared in accordance with this year's Scottish Funding Council guidance and may require significant changes during the audit process.	• Early planning meeting with Principal to confirm expectations • Timely liaison with management team and board members to ensure appropriate consents are obtained • Timely liaison with actuaries to provide figures.	• Salary figures were provided within the first draft accounts provided for audit • The actuaries provided figures for pensions which were circulated among management • The Principal advised the board in good time to advise them of the intent to publish pension figure but there was initial general reluctance to publish the information. • Following further discussion, agreement was reached on the approach to be adopted and sufficient information was duly obtained and audited.
Pension fund accounting The 2015 SORP makes it mandatory to show potential future pension fund liabilities on the balance sheet. The college should hold early discussions with the North East Scotland Pension Fund to ensure that appropriate disclosures can be made. There is a risk of qualification if the college fails to comply with accounting standards.	• Early planning meeting with Principal to confirm expectations for pension fund accounting • Timely liaison with the local government pension scheme (LGPS) to provide the position at 31 July 2016, the position at 31 July 2015 for the comparatives, and an opening position at 31 July 2014, in accordance with the FRS 102 / SORP disclosure requirements.	• Regular contact with finance department • Review of FRS 102 calculations provided by the actuary of the LGPS • The prior year adjustment and disclosure treatment on the balance sheet were correctly completed.

Audit Risk	Assurance procedure	Results and conclusions
Income Grant income sources are complex, with awards from the Scottish Funding Council and the regional board. There is a risk that total grant income for the year cannot be reconciled to award letters, leading to uncertainty over the correct amount of income to show. There are also a number of other sources of income, relating to tuition and trading activities. The extent and complexity of income means there is an inherent risk of misstatement in accordance with ISA240.	• Award letters issued by the Scottish Funding Council and the UHI Regional Strategic Body state the totals for annual capital and revenue grants and funding awards • Internal audit reviews which assist in providing an opinion on governance arrangements • There are a range of policies and procedures in place to prevent and detect fraud including standing orders and financial regulations • Arrangements for clearing sales ledger control and trading accounts.	• We agreed grant income to funding award documents • We performed analytical procedures on non-grant receipts and concluded that they were fairly stated • We substantively audited debtors and concluded that they were not over-stated.

Audit Risk	Assurance procedure	Results and conclusions
Management override of controls As stated in ISA240, management in all entities is in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.	• Internal audit reviews which assist in providing an opinion on governance arrangements • Regular reconciliations of bank accounts and sub-ledger control accounts with the main ledger • Regular print-out and review of debtor and creditor balances.	• Internal audit reported good progress in addressing previous recommendations • We confirmed a sample of purchase ledger balances with suppliers • We reviewed journal entries and accounting estimates for bias • We reviewed the use of control accounts, suspense accounts and deferred income accounts and found no evidence of management override or bias.

Audit Risk	Assurance procedure	Results and conclusions
Wider dimension issues and risks		
Budget savings and financial pressures The college has identified funding shortfalls in respect of 2016/17 and beyond. There is a risk that the necessary efficiencies are not secured to meet the estimated shortfall in the longer term. This could undermine the assumption of going concern and lead to inadequate disclosures in the accounts.	• Management Accounts and cash forecasts • Reports to the Board of Management • Compliance with the Code of Good Governance • Provision of financial information to the Regional Board and compliance with the Financial Memorandum.	• Meetings were held with the Principal and interim Director of Finance to discuss action taken to address the college's financial position • Quarterly funding returns for 2015/16 and the first quarter of 2016/17 were reviewed • FERB minutes were reviewed and discussions were held with UHI's Chief Operating Officer • A high level review of recently prepared 4-year forecasts was undertaken • We concluded that the college should be considered a going concern but that the current financial position is not sustainable and fundamental action is required.
Governance A condition of the Financial Memorandum with the Scottish Funding Council is the college's on-going compliance with the Code of Good Governance for Scotland's Colleges. There is a risk that if the Code is breached, grant conditions and the requirements of funders will not be met.	• Governance Steering Group • Updated Governance Manual • Assurances provided by the work of internal audit.	• Internal audit carried out a review in 2015 which was followed up in 2016. While progress was initially slow, the main matters to be addressed relate to the operation and evaluation of the board. Plans are in place for the new board to implement these matters.

Appendix II: Action plan

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1	27 (Table 1, item 1)	**Remuneration Report** The Remuneration Report in the unaudited financial statements did not meet the requirements of FReM in respect of pension benefits and accrued pension rights. ***Risk:*** *There is a risk the remuneration report is not prepared in accordance with requirements leading to significant changes during the audit process or an unqualified audit opinion.* **Recommendation:** Sufficient time should be built into the timetable to gather the necessary information to calculate the figures for inclusion in the remuneration report and provide the supporting audit trails.	Plans will be put in place to ensure the information is available at an early stage enabling the remuneration report to be complete when the 2016/17 unaudited accounts are available.	Principal/Director of Finance Summer 2017

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
2	38	**Senior finance expertise** There is currently an interim director of finance supporting the college senior management team. Arrangements need to be put in place for a longer term solution to ensure there is sufficient capacity at a strategic level to steer the board through the current financial difficulties. ***Risk:*** *Board members and senior management are not sufficiently supported when difficult financial decisions need to be made.* **Recommendation**: Discussions should be held with other academic partners within UHI to source a solution, for example a shared arrangement.	The Board Chairs' meeting of 28 October 2016 approved a proposal to proceed with the recruitment of a new Finance Director for the college. The APUC process was then used to undertake a mini-competition to select a search consultant to use for this process. The successful company, Aspen People, have now been informed and the initial contract meeting is scheduled for 30 November. It is anticipated that an appointment to the post will be made in January 2017.	Head of HR Final interviews January 2017

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
3	39-50	**Recovery plan and financial information** Improvements are needed to ensure there is a supporting audit trail for the assumptions behind the budget. Management accounts identified movements between budgets and forecasts but did not provide sufficient early alert or explanation of the extent of overspends. While 4-year forecasts have recently been prepared, at the stage of audit fieldwork, the 2016/17 budget was projecting a deficit. ***Risk****: The current financial position is not sustainable* **Recommendation**: More work is needed to develop robust budgeting and forecasting processes which provide the opportunity for early warnings in management accounts as well as analysis of actual spend. Thereafter, reporting processes need to be strengthened to ensure that the college can demonstrate its delivery of the improved financial position set out in recently developed 4-year forecasts.	The 2016/17 budget has been re-forecast from the original Financial Forecast Return (FFR) following recent meetings with budget holders. The forecast deficit has been reduced from £967k to £641k. The workforce planning 'staffing model' has been amended following review and reduction of teaching staff requirements post student enrolment in October 2016 and review of all 'natural churn' vacancies on the support staff side. Income figures have been revised following the November census date for funded student enrolment and following budget meetings with budget holders for all other income lines. An audit trail exists for all budget and forecast figures, and the college Finance and General Purposes Committee has challenged and reviewed all income forecasts. Both the Chair and the Accountable Officer of the Regional Board have recently confirmed that there will be no in-year restoration of any under-funding of the college and so the college Board is now able to proceed with decisions on the implementation of other steps to bring expenditure in line with income.	Principal/Director of Finance. Review implementation at 31 July 2017

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
4	59	**Code of Good Governance Action Plan** Several actions linked with the operation of the board, chair and committee chairs from the 2014 code of good governance action plan should be implemented. ***Risk:*** *As compliance with the code is a requirement of the financial memorandum, there is a risk there could be an impact on funding. (It should also be noted that the Code was refreshed and updated with effect from August 2016.)* **Recommendation:** Now that the new board is in place, these matters should form part of the board's early business.	Further progress on the outstanding actions has been made since the appointment of the new Board. These are to be brought to completion by March 2017	Clerk to Governing Body March 2017

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
5	70-74	**Performance** The Performance Report includes a detailed narrative on the college's performance monitoring arrangements. Student activity numbers have been provided but largely focus on a comparison of the current year's figures against the previous year. There is scope to review data collected and identify more quantitative information to demonstrate the college's performance against plans, targets, and benchmarks for the year or progress achieved in priority areas identified for improvement. ***Risk:*** *The information may not fully meet the expectations of the Accounts Direction.* **Recommendation**: There is scope to increase the level of performance information included in the report, for example the board's key performance indicators, their measurement and reporting against corporate targets and adopt more sophisticated trend analysis.	The college's Board has regularly monitored the key performance indicators and trend analysis of student enrolment, early student retention, and student attainment, as evidenced by the successful achievement of the college's Action Plan following its 2013 External Review. Following the Board's approval of the new Strategic Plan in July 2016 it was intended to review key performance indicators and monitoring processes early in 2016/17, once Education Scotland had finalised the new Quality arrangements for colleges. The groundwork for this was discussed during a visit of the college's designated HMI in August 2016. First discussions with Education Scotland on the new, and hopefully finalised, arrangements will be held with the college's newly-designated HMI and the Scottish Funding Council's lead on the UHI Regional Outcome Agreement (ROA) on 7 December 2016.	Assistant Principal (Learning and Teaching) October 2017