Inverness College

Year ended 31 July 2017
Annual Audit Report

21 December 2017

Building a better working world

Contents

About this report

This report has been prepared in accordance with Terms of Appointment Letter from Audit Scotland dated 31 May 2016 through which the Auditor General for Scotland has appointed us as external auditor of Inverness College (the College) for financial years 2016/17 to 2020/21. We undertake our audit in accordance with the Further and Higher Education (Scotland) Act 1992 and section 44(1)(c) of the Charities and Trustee Investment (Scotland) Act 2005 and our responsibilities as set out within Audit Scotland's Code of Audit Practice (the Code), issued on 26 May 2016.

This report is for the benefit of the College and is made available to the Auditor General and Audit Scotland (together the Recipients). This report has not been designed to be of benefit to anyone except the Recipients. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Recipients, even though we may have been aware that others might read this report.

Any party other than the Recipients that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Recipient's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, Ernst & Young LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Recipients.

Complaints

If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with Stephen Reid who is our partner responsible for services under appointment by Audit Scotland, telephone 0131 777 2839, email sreid2@uk.ey.com. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, or with how your complaint has been handled, you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN. Alternatively you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Executive summary

Purpose of this report

In accordance with section 21 of the Public Finance and Accountability (Scotland) Act 2000, the Auditor General for Scotland appointed EY as the external auditor of Inverness College (the College) for the five year period 2016/17 to 2020/21. We undertake our audit in accordance with the Code of Audit Practice (the Code), issued by Audit Scotland in May 2016; Auditing Standards and guidance issued by the Financial Reporting Council; relevant legislation; and other guidance issued by Audit Scotland.

This Annual Audit Report is designed to summarise our key findings and conclusions from our audit work. It is addressed to both the members of the College and the Auditor General for Scotland, and presented to both College management and those charged with governance, identified as being the Board and the College's Audit Committee. It will be published on Audit Scotland's website.

We draw your attention to the fact that our audit was not designed to identify all matters that may be relevant to the College. Our views on internal control and governance arrangements have been based solely on the audit procedures performed in respect of the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

Scope and responsibilities

The Code sets out the responsibilities of both the College and the auditor. We provided details of these in our Annual Audit Plan, which was presented to the Audit Committee on 29 May 2017. We summarise the responsibilities of the College in Appendix A.

Our Annual Audit Plan also provided you with an overview of how we intended to carry out our responsibilities as your auditor. We carried out our audit in accordance with this plan.

We planned our procedures using a materiality of £400,000 and a Tolerable Error of £200,000. We reassessed this using the actual year-end figures, to confirm that the materiality remained appropriate for the audit. No adjustment was made to materiality amounts communicated in our Annual Audit Plan. The threshold for reporting audit differences was increased to £19,000 from £10,000.

Audit opinion

We have issued an unqualified opinion that the financial statements:

- give a true and fair view in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council (SFC) of the state of the affairs of the College and Group as at 31 July 2017 and of its surplus for the year 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 Scottish Funding Council, the Charities and Trustee Investment (Scotland) Act 2005, and regulation 14 of The Charities Accounts (Scotland) Regulations 2006 (as amended).

Key contacts

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Acknowledgement

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.

Accounting and audit matters – our reporting on the College's financial statements

Preparation of financial statements

- The draft financial statements were presented for audit in line with agreed timescales. There were a number of presentational amendments required to ensure compliance with the requirements of the SORP and Accounts Direction.
- There was one adjusted audit difference to the draft financial statements. This related to the adjustment required to recognise the £1.9 million net sales proceeds arising from the disposal of the former campus which was subsequently paid to the Scottish Funding Council (SFC) as a repayment of capital grant funding rather than an in year expense. There was one unadjusted audit difference relating to an overstatement of accruals of £176,000. Management do not consider this misstatement to be material to the financial statements and we concur with this view.

Significant risks

- Our testing has not identified any material misstatements from revenue and expenditure recognition. Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the College's financial position based on manipulation of revenue or expenditure transactions.
- We have not identified any material weaknesses in the design and implementation of control arrangements tested as part of our audit, or evidence of material management override through inappropriate judgements being applied.

Other inherent risks

- We are satisfied that the NPD liability and associated accounting treatment and disclosure is free from material misstatement. We recommend that management review the current accounting model to consider the assumptions contained therein, whether these remain appropriate and in particular whether the model should incorporate contingent rent within the calculation.
- The College received net proceeds of £2.0 million from the sale of land on the former campus site at Midmills and Longman. In line with the original funding agreement for the new campus, this was paid to the SFC in the year. An audit adjustment was agreed with management to reflect this as a repayment of capital funds rather than in year costs.
- The Highland Council defined benefit pension scheme liabilities were estimated using actuarial assumptions which we consider to be reasonable. We have undertaken appropriate testing of underlying data to support the calculation of the liability.

Other matters and reporting requirements

- Our testing on opening balances was completed satisfactorily. We have no matters to bring to your attention in respect of our work on the qualitative aspects of the financial statements.
- In respect of our responsibility to report on the regularity of transactions, we have concluded that 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.
- In respect of our 'Opinions on other prescribed matters', which includes the Performance Report, the auditable part of the remuneration report and the Governance Statement we have concluded that our opinion is unqualified. We have not identified any other matters on which we are required to report by exception.

Wider scope audit dimensions – our judgements and conclusions on the College's arrangements

Financial management

- The College reported a surplus of £0.3 million for the year (2015/16: deficit of £1.5 million). Following losses on the disposal of fixed assets (£183,000) and actuarial losses (£164,000), the College reported total comprehensive income for the year of £2,407 (2015/16: Expenditure £2.99 million).
- The College's senior finance team went through significant change during the period. We have identified areas for action which reflect the need for the College to develop its financial monitoring arrangements to reflect the different financial performance targets from both annual outturn performance and annual resource limits.

Financial sustainability

- We have concluded that achieving financial sustainability continues to represent a significant challenge for the College. Medium-term financial planning is partly constrained by the requirement to deliver in year resource targets.
- The College's financial forecasts need to be updated to reflect the impact of the adjustments arising during the course of the audit. This includes revised forecast annual deferred capital grant income and the recognition of future disposal proceeds from the former campus. With funding levels beyond the next financial year uncertain, as well as inherent degree of uncertainty of future operating costs, it will be important that financial assumptions are kept under regular review.

Governance and transparency

- We have concluded that the College has generally established a sound basis to demonstrate good governance and transparency in its operational activity.

Value for money

- The College has undertaken its Evaluative Report and Enhancement Plan as part of its assessment against the sector wide quality measures. While we have identified opportunities to enhance future performance information included within the financial statements, we have no concerns over the College's underlying performance management arrangements.

Appendices

We have confirmed our independence to act as auditor of the College. Our planned auditor remuneration of £14,230 was agreed with management. Given the additional audit work and support to management required in respect of the audit of the more complex accounting treatments, we will discuss with the director of finance the final fee for the audit. Non-audit services of £1,200 were provided in respect of the College's EMA certification.

We have made four recommendations for action by management, one of which is at grade 1. All have been accepted by management.

1. Financial statements and accounting

1. Financial statements and accounting

The College's annual financial statements enables the Board to demonstrate accountability for its resources and its performance in the use of those resources during the year. They are prepared in accordance with applicable law and UK Generally Accepted Accounting Practice.

Audit opinion

In respect of the financial statements, we report on the truth and fairness in accordance with the requirements of the Further and Higher Education (Scotland) 1992 and directions made thereunder by the Scottish Funding Council, the Charities and Trustee Investment (Scotland) Act 2005, regulation 14 of the Charities Accounts (Scotland) Regulations 2006 (as amended), and United Kingdom Generally Accepted Accounting Practice, including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland.

The detailed form and content of our audit report, plus the requirements underpinning the report, are contained in the Audit Scotland guidance at http://www.audit-scotland.gov.uk/uploads/docs/um/tgn_2017-7_further_education.pdf (Appendix 1).

We have issued an unqualified opinion based on the satisfactory completion of our work.

Financial statements preparation

As part of our oversight of the Board's financial reporting process, we report on our consideration of the quality of working papers and supporting documentation prepared predominantly by the finance team to support the audit. The financial statements were prepared in accordance with the 2015 Statement of Recommended Practice for Further and Higher Education (SORP) alongside the Government Financial Reporting Manual (FReM) 2016/17.

During 2016/17 there has been significant change across the finance function with the former director of corporate services leaving the College in November 2016; the interim replacement left in January 2017. The College senior management team was restructured during the year with a director of finance role created. This was formally filled in July 2017 by the former finance manager.

While arrangements were put in place to ensure ongoing financial management remained sound, during our audit we found finance team resources to be significantly stretched. This impacted on the timeliness and quality of information provided to support the audit. In particular in relation to accruals and provisions relating to long-term outstanding projects we found limited documentation readily available to substantiate the provision. It is essential that management ensure that key areas of judgement in the financial statements are appropriately supported and documented. We have agreed with management they undertake a detailed review of these project balances and establish a robust and transparent basis on which to evaluate these to determine where and why deferral of income remains appropriate.

Action plan point 1

Materiality

We planned our procedures using a materiality of £400,000 and a Tolerable Error of £200,000. We reassessed this using the actual year-end figures, to confirm that materiality remained appropriate for the audit. No adjustment was made to materiality amounts communicated in our Annual Audit Plan. The threshold for reporting audit differences was increased from our planned threshold of £10,000 to £19,000 to better reflect the value of balances considered appropriate to report to management based on the year end financial results. We also identified areas where misstatement at a lower level than materiality might influence the reader of the financial statements and developed a specific audit strategy for them. They include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits - we applied a materiality of £1,000 based on the potential sensitivity of these disclosures.
- Related party transactions - we considered the nature of these disclosures individually.

Audit differences
The draft financial statements presented for audit in line with agreed timescales. There were a number of presentational amendments required to ensure compliance with the requirements of the SORP and Accounts Direction. There was one adjusted audit difference to the draft financial statements. This related to the adjustment required to recognise the £1.9 million net sales proceeds arising from the disposal of the former campus which was subsequently paid to the SFC as a repayment of capital grant funding rather than an in year expense. There was one unadjusted audit difference relating to an overstatement of accruals of £176,000. Management do not consider this misstatement to be material to the financial statements and we concur with this view. Details of these are included in Appendix F: summary of audit differences.

1. Financial statements and accounting

Our Audit Plan identified key areas of focus for our audit of the College's financial statements, including significant risks. This report sets out the results of our audit procedures plus relevant observations, including our views on areas which might be conservative, and where there may be potential risk and / or exposure.

Significant risk – risk of fraud in revenue recognition

What is the risk?

Under ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

We rebutted the presumed revenue recognition risk in relation to SFC core funding to the College. This was based on the fact that the funding is clearly allocated for delivery of activity within the financial year. Prior year College returns to the SFC have demonstrated that it has over-delivered on student credits (formerly SUMs) with no history of material clawback from the SFC. As there has been no history of issues or concerns raised through internal audit review of the College's data return for funding (FES) to the SFC, we considered the risk over potential clawback due to inaccurate data as low. However we recognise a revenue recognition risk for tuition income and other material income in respect of possible manipulation of cut-off around the financial year end. We also recognise the same risk around incorrect recognition of non-pay expenditure in line with Practice Note 10.

Results of audit procedures

We undertook the following procedures as part of our audit:

- Reviewed and tested revenue and expenditure recognition policies against the relevant accounting standards and the SORP.
- Reviewed and discussed with management any accounting estimates on revenue or expenditure recognition for evidence of bias.
- Developed a testing strategy in respect of material revenue and expenditure streams. For tuition fees and education contracts, we performed analytical review and substantive testing across a sample of contracts to ensure appropriate recognition. For SFC and other funding body grant income we reviewed all material grant funding recognised in the year for any indicators of either claw-back or that the terms and conditions of the financial memorandum have not been complied with in all material respects. In doing so, we considered the work of internal audit in respect of the College's FES return. We considered the conclusions of internal audit and their opinion on the return that there would be no potential reclaim of SFC funding paid to the College. For other income, we performed analytical review and substantive testing over a sample of transactions to gain assurance.
- We performed focused additional testing around transactions posted at the year end to gain comfort that key items are recorded in the correct accounting period. In particular we focused on any transactions incurred after 31 July, but included in the 2016/17 financial ledger.
- Reviewed and tested a sample of debtor balances at the year end, including material balances. We undertook an assessment of aged balances held on the balance sheet at year end including investigation of unusual items, such as those past payment due date.

There are no matters to raise with you as a result of the work performed.

Significant Risk, fraud in income and expenditure recognition – what have we concluded?

- Our testing has not identified any material misstatements from revenue and expenditure recognition. Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the College's financial position based on manipulation of revenue or expenditure transactions.

Significant risk – management override
What is the risk?
As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.
Results of audit procedures
Test the appropriateness of manual journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements We obtained a full list of journals posted to the general ledger during the year, and used our bespoke data analysers to identify any unusual journal types or amounts based on our identified risk areas for the audit. We then tested a sample of these journals, understood their purpose and agreed and corroborated them to supporting documentation. **Review accounting estimates for evidence of management bias, including management's retrospective consideration of prior year estimates** We identified and considered the appropriateness of key accounting estimates, including provisions, and their susceptibility to bias. Management has disclosed their consideration of the critical accounting judgements and key estimates in the financial statements. We have reviewed these and agree with the detail of the assessment performed. **Evaluate the business rationale for any significant unusual transactions** We did not identify any significant unusual transactions. We have not identified any material weaknesses in the design and implementation of control arrangements tested as part of our audit, or evidence of material management override through inappropriate judgements being applied.

Significant risk, Management override – what have we concluded?
• We have not identified any material weaknesses in the design and implementation of control arrangements tested as part of our audit, or evidence of material management override through inappropriate judgements being applied.

Other inherent risks
New campus financing
In July and August 2015, the College procured its new campus buildings at Balloch and Inverness using the Scottish Futures Trust's Non-Profit Distributing (NPD) model. Under the NPD arrangement, the College makes monthly service charge "unitary charge" payments which include the capital element of the loan funding together with interest, facilities management and building lifecycle costs. As at 31 July 2017 the present value of future lease payments are reported as £38 million. Given the material value of the NPD liability, together with the complexity of the associated accounting treatment, we considered this as an area of higher inherent risk.
Results of audit procedures
In response to the inherent risk we performed the following audit procedures: • Used our internal specialist to review the College's NPD accounting and disclosures against the requirements of the SORP and FRS 102, agreeing disclosures to the underlying contracts. • Reviewed the capital funding transactions, including SFC capital grants, against the requirements of FRS 102 and SORP. • Reviewed the College's recognition of assets held for disposal, including the valuation of these within the financial statements and the accounting treatment of disposals of the former campus during the year In 2012, the College received capital funding from the SFC to support upfront payments incurred as part of the new College NPD arrangement. The terms of the funding required future sale proceeds of the former campus to be paid to the SFC. In October 2016 and March 2017 management paid £0.726 million and £1.285 million respectively to the SFC, being the net sale proceeds less costs of disposal received in the year; recognised in the draft financial statements as a loss on disposal. The original upfront capital funding from the SFC was recognised within deferred capital grants. Under the terms of the original funding agreements with the SFC, an element of the funding represented a cash advance equivalent to future sales proceeds. In our opinion, the payment to SFC in the year was a repayment of the capital advance and therefore should be reflected as a reduction in deferred capital grants to reverse the original receipt. Management has agreed with our conclusions and have adjusted the financial statements accordingly. Details of the adjusted differences are included within Appendix F. The NPD model, and assumptions contained therein, does not factor in a contingent rent element which we would expect in such an arrangement. Furthermore, the model has the effect of smoothing lifecycle costs over the term of the agreement. Consequently, there is a risk future accounting recognition may not fully reflect the substance of the transaction in accordance with FRS 102. While we are satisfied that the NPD model and subsequent recognition within the financial statements was not materially inconsistent with our expectations, we recommend management review the model and accounting treatment to ensure it continues to meet the requirements of FRS 102. ***Action plan point 2***

Other inherent risk, valuation of property, plant and equipment – what have we concluded?
• We are satisfied that the NPD liability and associated accounting treatment and disclosure is free from material misstatement. We recommend that management review the current accounting model to consider the assumptions contained therein, whether these remain appropriate and in particular whether the model should incorporate contingent rent within the calculation. • The College received net proceeds of £2.0 million from the sale of land on the former campus site at Midmills and Longman. In line with the original funding agreement for the new campus, this was paid to the SFC in the year. An audit adjustment was agreed with management to reflect this as a repayment of capital funds rather than in year costs.

Other inherent risks
Valuation of pension liabilities
The College participates in two defined benefit pension schemes; the Highland Council Pension Scheme (HCPS), and the Scottish Teachers Superannuation Scheme (STSS). While both are defined benefit pension schemes, the College is unable to identify its share of the underlying assets and liabilities of the STSS scheme on a consistent and reasonable basis and therefore, the scheme is accounted for as if it were a defined contribution scheme. HCPS is accounted for as a defined benefit scheme. The net pension liabilities on the balance sheet as at 31 July 2017 arising from participation in the scheme were £10.3 million. In addition the College recognises a provision for future early retirement liabilities of £2.2 million.
Results of audit procedures
In response to the identified inherent risk we: • Obtained actuarial reports at the year end date for the HCPS scheme and considered the reasonableness and consistency of assumptions underpinning such reports, in light of guidance available ensuring compliance with funding agreements. • Utilised our in-house actuaries to assess the reasonableness of key assumptions such as discount rate, inflation and expected market return. • Performed substantive testing on the verification of the pension assets and audited the calculation of the College's valuation and disclosure in the financial statements. In respect of the HCPS, the College used an independent actuarial valuation to determine the value of net pension liabilities as at 31 July 2017 and associated movement in the year. Our in-house actuaries are satisfied with the reasonableness of the assumptions contained within the actuarial valuation. We are satisfied that the deferred benefit pension scheme liabilities have been appropriately reflected in the College's financial statements. In respect of the provision for future early retirement obligations, we reviewed the College's valuation of the provision as at 31 July 2017, including the reasonableness of management's assumptions and the accuracy of amounts calculated. The College followed the SFC's early retirement provision guidance and supporting model to determine the provision required at 31 July 2017. We are satisfied with the reasonableness of the assumptions applied and that the provision is free from material misstatement.

Other inherent risk, valuation of pension liabilities – what have we concluded?

- The Highland Council defined benefit pension scheme liabilities were estimated using actuarial assumptions which we consider to be reasonable. We have undertaken appropriate testing of underlying data to support the calculation of the liability.

Our Audit Plan identified other aspects of our work which arise either in accordance with International Standards on Auditing (UK) or in accordance with the Code. These are set out below.

Other audit matters

Opening balances

International Standard on Auditing (UK) 510: *Initial audit engagements – opening balances* requires auditors to obtain sufficient, appropriate audit evidence that opening balances do not contain misstatements that materially affect the financial statements. The standard also requires auditors to verify that appropriate accounting policies are reflected in the opening balances and that they have been consistently applied in the current period's financial statements.

In response, we have:

- Reviewed prior year financial statements, annual audit reports and other reports issued by the former external auditor and held discussions with the former external auditor in respect of previous significant audit issues, corporate governance and as part of our audit risk assessment.
- Substantively tested opening balances to ensure that they agree both to the prior year audited financial statements and closing trial balance.
- Undertaken a mix of testing on balances during 2016/17 which provides assurance on the judgements and estimates made as at 31 July 2016.

We have no matters to report upon completion of these procedures which have not been separately commented on within this report.

Opening balances / group financial statements – what have we concluded?

- We have obtained sufficient, appropriate audit evidence that opening balances do not contain misstatements that materially affect the financial statements.

1. Financial statements and accounting

In accordance with Audit Scotland requirements, our independent auditor's report also covers the key narrative statements such as the Performance Report, the Accountability Report and the Remuneration and Staff Report which the College is required to include within its Annual Report and Accounts.

Other reporting requirements

Performance Report

In accordance with the Code, we review the information contained within the Performance Report and confirm that this is consistent with the information reported within the financial statements. As a new responsibility in 2016/17, under the Code, Audit Scotland requires us to also express an opinion on whether the Performance Report has been prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.

We are satisfied that the information with the Performance Report is consistent with the financial statements and has been prepared in accordance with applicable requirements.

Accountability Report, including the Governance Statement

Audit Scotland requires us to read the information in the annual governance statement and express an opinion on whether Governance Statement is consistent with the financial statements and that report has been prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.

We are satisfied that the information with Governance Statement is consistent with the financial statements and has been prepared in accordance with applicable requirements.

Remuneration and staff reports

Auditors are required by the Code to audit the disclosures of remuneration and pension benefit, pay bands, and exit packages and express a separate opinion within their independent auditor's report on whether they have been properly prepared in accordance with the Regulations.

We provided recommendations to management to enhance the disclosure within the remuneration report including clarity around senior staff within the College and these have been reflected in the final draft accounts.

We are satisfied that auditable part of the remuneration and staff report has been properly prepared in accordance with regulations.

Regularity opinion

The Board is responsible for ensuring the regularity of expenditure and income. Auditors are responsible for expressing an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000. 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.

Other reporting requirements – what have we concluded?

- We reviewed the other information presented within the financial statements and provided management with comments to enhance the content, structure and presentation of these. These were amended by management.
- In respect of our 'Opinions on other prescribed matters', which includes the management commentary, the auditable part of the remuneration report, and the annual governance statement, our opinion is unqualified.
- We have not identified any other matters on which we are required to report by exception.

2. Wider scope audit

2. Wider scope audit

In accordance with the Code, we provide judgements and conclusions in respect of our work on the four audit dimensions of public sector audit: financial management; financial sustainability; governance and transparency; value for money.

Wider scope audit risks

The Code requires us to undertake work in respect of each of the four dimensions on an annual basis. The Code also sets out an expectation that 'significant' risks identified through our planning process that relate to the wider scope dimensions will be communicated with you. In undertaking our risk assessment in respect of the wider scope audit areas, we distinguish between the definition of 'significant risks' which apply to the audit of the financial statements, by referring to 'Wider Scope Audit Focus Areas'.

In our Annual Audit Plan we did not identify any areas of wider scope audit focus in the current year. We have however, undertaken routine work in respect of each of the audit dimensions, by considering the evidence available to us through various aspects of our work.

Financial management

The College reported a surplus of £0.35 million for the year (2015/16: deficit of £1.5 million). Following losses on the disposal of fixed assets (£183,000) and actuarial losses (£164,000), the College reported total comprehensive income for the year of £2,407 (2015/16: expenditure £2.99 million).

In respect of the final resource funding agreed by the SFC, the College reported an overspend of £0.1 million against its revenue resource limit (RDEL) of £9.96 million and an underspend of £2.2 million against its capital resource limit (CDEL) of £0.2 million. The overspend on RDEL was due to the loss on disposal of the former campus sites while the outturn on CDEL reflects the income received in respect of disposals.

Performance against budget

The College reported a net operating surplus of £0.35 million against an initial breakeven budget. This reflects the one-off release of deferred capital grants of £1.5 million to income relating to the former campus disposal in the year. This was offset through non-cash pension costs resulting from the defined benefit pension calculation. Additionally, there was an increase from the original budget in the level of NPD annual unitary charge costs recognised through expenditure, rather than capital repayment. This was due to the final agreed model being different to that assumed during the budget setting process.

The outturn position reflected the impact of FRS 102 defined benefit pension costs on operating expenditure during the period. While these are not included within budget forecasts, management incorporate these into 'financial risks' included within budget papers.

Capital expenditure and NPD payments

During 2016/17, the College had limited capital expenditure. At total of £401,000 was capitalised during the year, predominantly relating to equipment. Under the NPD arrangement, during 2016/17 the College made unitary payments of £5.1 million. In the early years of the NPD model, payments are profiled to initially repay interest with capital repayments weighted towards the end of the arrangement. The net NPD liability as at 31 July 2017 was £38 million.

Monitoring of expenditure

Financial performance is monitored through monthly management accounts comprising an income and expenditure account, cash flow statement and creditor and debtor reports. The reporting pack also includes an update on major capital projects. Financial performance is monitored by the Principal and senior management team. Performance is also monitored and scrutinised by the finance and general purposes committee.

We reviewed the financial information monitored by senior management, committees and the Board and we are satisfied that the information is sufficiently detailed, including explanation of material variances to provide meaningful information to allow scrutiny and challenge of performance.

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

Financial management (continued)

Colleges are classified as central government bodies and therefore are now required to operate within a resource limit which is measured annually at the end of March. Management provide a verbal update on the delivery of these targets to the finance, commercial and estates committee. However, we did not identify any formal monitoring and reporting against these targets throughout the year.

Monitoring performance against two distinct measures is a challenge. It will continue to be important that management ensure that the Board are aware of the impact of key decisions on both outturn financial performance as well as ability to meet resource limits. To aid this understanding there may be an opportunity to reconcile resource targets with outturn budgets.

Action plan point 3

Internal control and internal audit

It is the responsibility of the College to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility, as auditor, is to consider whether the College has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Our first year audit has been predominantly substantive in nature, and therefore we have not tested the operating effectiveness of key controls. Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control. We have not identified any such matters to report to you.

Henderson Loggie provided internal audit services for the College for the year. Within the 2017 annual report to the Board, internal audit concluded:

"In our opinion the College has adequate and effective arrangements for risk management, control and governance. Proper arrangements are in place to promote and secure Value for Money. This opinion has been arrived at taking into consideration the work we have undertaken during 2016/17 and in prior years since our first appointment in 2007/08."

We have considered the work performed by internal audit during the year and did not identify any material issues that would impact on our overall opinion on the financial statements or our consideration of the wider scope aspects.

Financial management - what have we concluded?

- The College reported a surplus of £0.35 million for the year (2015/16: deficit of £1.5 million). Following losses on the disposal of fixed assets (£183,000) and actuarial losses (£164,000), the College reported total comprehensive income for the year of £2,407 (2015/16: expenditure £2.99 million).
- The College has well established financial management arrangements, and we are satisfied that these are adequate for the management of its financial activities. We have identified the need for the College to develop its financial monitoring arrangements to reflect the different financial performance targets from both annual outturn performance and annual resource limits.

Financial sustainability is focused on the medium to longer term financial viability, and considers how effectively an audited body is planning to delivers its services over the medium term.

Financial sustainability

Financial sustainability interprets auditors' requirements under ISA 570 *Going concern* and looks forward to the medium (two to five years) and longer-term (longer than five years) to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Audit Scotland's sector report: Scotland's colleges 2016, highlighted that between 2011 and 2015/16 the Scottish Government funding to the sector reduced by 18 % in real terms. While the College's core funding has remained relatively stable in the current year of £30.8million (2016: £30.2 million) management recognise that savings will be required in future years with envisaged constraints on future public sector resources. This requires an ability to transform and deliver significant recurring efficiency savings, while at the same time ensuring that the impact on core delivery is minimised.

Financial performance

The College reported a surplus of £0.35 million for the year (2015/16: deficit of £1.4 million). Following losses on the disposal of fixed assets (£183,000) and actuarial losses (£164,000), the College reported total comprehensive income for the year of £2,407 (2015/16: expenditure £2.99 million). The outturn performance reflected unbudgeted items, including the release of deferred capital grants of £1.5 million following disposal of part of the former campus site as well as non-cash pension costs arising from the FRS 102 pension valuation. Furthermore, the NPD annual unitary charge costs recognised through expenditure were marginally higher than expected due to the final agreed model being different to that assumed during the budget setting process.

The 2017/18 budget was approved in June 2017. The College budgeted for a breakeven outturn position for the year. The budget recognises major uncertainties around funding of national bargaining and the potential impact this could have on operating costs.

An important part of ongoing financial assurance is regular updates to the Board on monitoring of expenditure against budget and the forecast outturn for the year. Financial performance is scrutinised by the senior management team, the finance, commercial and estates committee and the Board.

Financial planning

The College has prepared its five-year financial forecasts 2017 to 2022 and submitted these to the SFC. These forecast marginal deficits for the next five years. The forecasts, including those submitted in the Financial Forecast Return submitted to SFC were prepared on the basis of the Board's strategic plans and supporting aims and objectives.

Financial Forecast Return (FFR)

The College's latest FFR forecasts for academic years 2018/19 and beyond are based on the 2017/18 budget adjusted for known and estimated financial impacts. The College's financial forecast return to the SFC provides a five yearly projection. The current forecast identifies key assumptions underpinning these. Furthermore, the College's risk register identifies those critical financial risks to the medium to long-term sustainability of the College.

The key assumptions from review of the financial forecasts are:

- SFC core funding to increase by 5% cumulatively over the period, however this additional funding is offset by forecast reductions in other income, including funding from the arms length foundation.
- Staff costs to increase by 18% over the same period, predominantly reflecting the impact of pay increases including future increases from the national pay bargaining agreement.

Financial sustainability (continued)

The College's financial forecasts need to be updated to reflect the impact of the adjustments arising during the course of the audit. This includes revised forecast annual deferred capital grant income and the recognition of future disposal proceeds from the former campus. With funding levels beyond the next financial year uncertain, as well as inherent degree of uncertainty of future operating costs, it will be important that financial assumptions are kept under regular review, and appropriate sensitivity analysis around those assumptions is conducted and made available to the Board.

Financial sustainability – what have we concluded?

- We have concluded that achieving financial sustainability continues to represent a significant challenge for the College. Medium-term financial planning is partly constrained by the requirement to deliver in year resource targets.
- The College's financial forecasts need to be updated to reflect the impact of the adjustments arising during the course of the audit. This includes revised forecast annual deferred capital grant income and the recognition of future disposal proceeds from the former campus. With funding levels beyond the next financial year uncertain, as well as inherent degree of uncertainty of future operating costs, it will be important that financial assumptions are kept under regular review.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making, and transparent reporting of financial and performance information.

Governance and transparency

The Board and management of the College are responsible for establishing robust governance arrangements. This includes ensuring effective systems of internal control, including arrangements to safeguard public money, and compliance with applicable laws and regulations. While we have not identified any significant risks in relation to the College's governance arrangements through our audit planning, we consider the adequacy and effectiveness of the College's governance arrangements as part of our audit work.

Governance arrangements

The College has in place a number of the key requirements for good governance. We have reviewed Board minutes and papers and found these to set out clearly the matters considered and discussed. Standing Orders regulate how the business of the College is conducted. The Board has approved detailed terms of reference for its standing committees.

During March 2017, an external effectiveness review was undertaken followed by an internal Board evaluation. This review concluded that overall the Board was effective with a clear understanding of the risks and challenges facing the organisation. A number of areas for developing the governance arrangements were identified, and management has taken forward an action plan from the report findings to enhance governance arrangements.

Membership of the Board

During 2016/17 there was significant change in the membership of the Board with six new independent members being appointed as well as two observers, one staff member and one student member. The College has placed significant focus on induction of the new members as well as continued development of existing members. This programme has included financial and non-financial training.

Change in Principal and senior management team

In June 2017, the former Principal left the College. The new Principal took up post in September 2017. During 2016/17 there were also changes across the senior management team. The former director of corporate services left the organisation in November 2016 and the subsequent interim director left in January. A new director of finance was appointed in July 2017. In the interim period, arrangements were put in place to ensure continued leadership and oversight of the day-to-day running of the College with responsibilities shared across the senior management team.

Effective risk management

The risk management policy outlines the approach to risk management, the roles and responsibilities of the Board, the senior management team, and other key parties. It also outlines the key risk management processes and identifies the main reporting arrangements. During 2016/17 the Board adopted the strategic risk register template which is a consistent format across the UHI partnership. The Board has established arrangements to ensure risks are regularly reviewed and remain appropriate to the College.

Transparency

The College publicises Board and standing committee agendas, minutes and papers on their website on a timely basis and information, including financial performance is generally clear and concise.

Governance and transparency – what have we concluded?

- We have concluded that the College has generally established a sound basis to demonstrate good governance and transparency in its operational activity. 2016/17 represented a significant period of change in the membership of the Board and senior management.
- The independent board effectiveness review reported positively, with some areas for continued improvement identified.
- The College publicises Board and standing committee agendas, minutes and papers on their website on a timely basis and information, including financial performance is generally clear and concise.

Value for money is concerned with using resources effectively and continually improving services. This includes consideration of whether resources are being used effectively; services are improving and the College has appropriate arrangements to demonstrate Best Value.

Strategic planning

The College revised its strategic plan during the year covering a three year period 2017-2020. The plan is closely aligned to the UHI strategy and provides a framework to respond to the Highland Single Outcome Agreement and regional skills investment plan. The plan contains the following six key themes that the College will work towards over the period. These are focused on delivering opportunity and growth in the following areas:

- Student life: Including strengthening existing relationships between students, staff, employers and the wider community.
- Curriculum: Providing a progressive curriculum valued by students, employers and communities.
- Professional practice: targeting a positive culture to ensure staff operate to the highest standards of service, supporting delivery that exceeds expectations.
- Organisational development: Creating a supportive, collaborative and dynamic environment where students and staff are inspired to learn and develop.
- Research and innovation: To continue to support and grow an innovative and inspired postgraduate researcher community to help strengthen the impact and excellence of the College's research activity.
- Sustainability: Working collaboratively to ensure continued financial sustainability by developing income streams and promoting efficient and effective service delivery.

Evaluate Report and Enhancement Plan

As part of the Outcome Agreement between the College and the SFC, the College produces an Evaluative Report and Enhancement Plan (EREP). The EREP evaluates the provision and services offered by the College against the quality indicators identified in Education Scotland's 'How Good is our College?' (2016) quality framework. The assessment is predominantly self-assessment with oversight from a quality review group established during the year. This group comprised of the College's senior management team, key supporting staff, the College's outcome agreement manager and representation from Her Majesty's Inspectorate of Education. The group maintained an oversight of the process to embed the new quality framework and supported the preparation of the EREP.

The EREP identified a number of areas of good practice including the College's commitment to improvement and enhancing learner experience. The EREP has also identified a number of actions for the College to address to improve its arrangements. An enhancement plan is in place with key actions set for the next 12 months. These will be monitored through the 2017/18 EREP process and through the College's established quality review process including course committees and the senior management team.

Performance reporting

The College publishes its performance information annually on its website as well as including key measures within the financial statements and Board and committee papers published on the website. While there is a range of sources of performance information, including the College website, there is an opportunity to enhance the current performance information contained within the financial statements to provide more of a holistic overview of College performance in the delivery of its strategic objectives.

Action plan point 4

Value for Money – what have we concluded?

- The College has undertaken its Evaluative Report and Enhancement Plan as part of its assessment against the sector-wide quality measures. While we have identified opportunities to enhance future performance information included within the financial statements, based on the work performed, we have no matters to report over the Colleges underlying performance management arrangements.

Appendices

A. College responsibilities
B. Required communications with the Audit Committee
C. Auditor independence
D. Management representations
E. Action plan
F. Summary of audit differences

A. College’s responsibilities

The Code of Audit Practice summarises the responsibilities on all audited bodies falling within the public sector audit framework. We summarise these on this page.

Responsibilities of audited bodies	
Corporate governance	Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure 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 should involve those charged with governance (including audit committees or equivalent) in monitoring these arrangements.
Financial statements and related reports	Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for: • preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation. • maintaining accounting records and working papers that have been prepared to an acceptable professional standard and support their financial statements and related reports disclosures. • ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority. • maintaining proper accounting records. • preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body. Management, with the oversight of those charged with governance, should communicate clearly and concisely relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal Audit-management functions.
Standards of conduct / prevention and detection of fraud and error	Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.
Financial position	Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to: • such financial monitoring and reporting arrangements as may be specified • compliance with any statutory financial requirements and achievement of financial targets • balances and reserves, including strategies about levels and their future use • how they plan to deal with uncertainty in the medium and longer term • the impact of planned future policies and foreseeable developments on their financial position.
Best Value	The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.

B. Required communications

There are certain additional communications that we must provide to the Audit Committee, in accordance with ISA (UK) 260 and other auditing standards, which are set out below.

Required communication - what is reported?	Our reporting to you
Terms of engagement Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	Audit Scotland Terms of Appointment letter – audit to be undertaken in accordance with the Code of Audit Practice
Planning and audit approach Communication of the planned scope and timing of the audit, including any limitations.	Annual Audit Plan
Significant findings from the audit • Our view of the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Any significant difficulties encountered during the audit • Any significant matters arising from the audit that were discussed with management • Written representations we have requested • Expected modifications to the audit report • Any other matters significant to overseeing the financial reporting process • Findings and issues around the opening balance on initial audits	This Annual Audit Report.
Going concern Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: • Whether the events or conditions constitute a material uncertainty • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The adequacy of related disclosures in the financial statements	No conditions or events were identified, either individually or together to raise any doubt about the College's ability to continue for the 12 months from the date of our report.
Fraud • Asking the Audit Committee whether they have knowledge of any actual, suspected or alleged fraud affecting the College • Unless all those charged with governance are involved in managing the entity, any fraud identified or information obtained indicating that a fraud may exist involving: (a) management; (b) employees with significant roles in internal control; or (c) others where the fraud results in a material misstatement in the financial statements. ► A discussion of any other matters related to fraud, relevant to Audit Committee responsibility.	This Annual Audit Report.

Required communication - What is reported?	Our reporting to you
Misstatements • Uncorrected misstatements and their effect on our audit opinion • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Significant corrected misstatements, in writing	This Annual Audit Report.
Significant deficiencies in internal controls identified during the audit • Significant deficiencies in internal controls identified during the audit.	This Annual Audit Report No significant deficiencies were identified in the course of our audit which required immediate communication to the Audit Committee.
Related parties Significant matters arising during the audit in connection with the College's related parties including, where applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and/or regulations • Difficulty in identifying the party that ultimately controls the entity	We have no matters to report.
Subsequent events • Where appropriate, asking the Audit Committee whether any subsequent events have occurred that might affect the financial statements.	We have asked management and those charged with governance. We have no matters to report.
Other information • Where material inconsistencies are identified in other information included in the document containing the financial statements, but management refuses to make the revision.	We have no matters to report.
External confirmations • Management's refusal for us to request confirmations • We were unable to obtain relevant and reliable audit evidence from other procedures.	We have received all requested confirmations.
Consideration of laws and / or regulations • Audit findings of non-compliance where it is material and believed to be intentional. This communication is subject to compliance with legislation on "tipping off" • Asking the Audit Committee about possible instances of non-compliance with laws and/or regulations that may have a material effect on the financial statements, and known to the Audit ad Risk Governance Committee.	We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations.
Independence • Communication of all significant facts and matters that have a bearing on EY's objectivity and independence.	This Annual Audit Report – Appendix C

Professional ethical standards, and the Terms of our Appointment, require us to communicate all significant facts and matters that have a bearing on EY's objectivity and independence as auditor of the College.

What we are required to communicate?

Communicating key elements of the audit engagement partner's consideration of independence and objectivity such as:

- The principal threats
- Safeguards adopted and their effectiveness
- An overall assessment of threats and safeguards
- Information on the firm's general policies and processes for maintaining objectivity and independence
- Communications whenever significant judgments are made about threats to objectivity or independence and the appropriateness of safeguards.

Confirmations

We confirm that there are no changes in our assessment of independence since our confirmation in our Annual Audit Plan.

We complied with the Financial Reporting Council's Ethical Standards and the requirements of Audit Scotland's Terms of Appointment. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.

We consider that our independence in this context is a matter which you should review, as well as us. It is important that you and your Audit Committee consider the facts known to you and come to a view. If you would like to discuss any matters concerning our independence, we will be pleased to do this at the meeting of the College Audit Committee on 7 December 2017.

Summary of fees

As part of our reporting on our independence, we set out below a summary of the initially agreed fees for the year ended 31 July 2017. Given the additional audit work and support to management required in respect of the audit of the more complex accounting treatments, we will discuss with the director of finance the final fee for the audit

We confirm that we have not undertaken non-audit work outside the Code requirements.

Our planned audit fee was agreed with management and is disclosed in the table opposite.

Auditor remuneration	£14,230
Fixed costs *	£1,700
Non-audit fees **	£1,200
Total audit fees	£16,930

* Fixed costs, which are determined by Audit Scotland, comprise £890 pooled costs, £810 contribution to Audit Scotland's costs.

** We have agreed a separate fee of £1,200 (including VAT) for the audit of the College's Education Maintenance Allowance return.

ISA (UK) 580*: Written representations,* requires the auditor to obtain written representation that management, including those charged with governance, has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant, their fair presentation.

Ernst & Young LLP
Atria One
144 Morrison Street,
Edinburgh, EH3 8EB
[Date]

This letter of representations is provided in connection with your audit of the financial statements of Inverness College ("the College") for the year ended 31 July 2017. We recognise that obtaining representations from us concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the financial statements give a true and fair view of the College financial position as of 31 July 2017 and of its income and expenditure for the year then ended in accordance with applicable law and the Financial Reporting Standard 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland, and the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.

We understand that the purpose of your audit of our consolidated financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing (UK), which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose – all fraud, shortages, errors and other irregularities, should any exist.

Accordingly, we make the following representations, which are true to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

A. Financial Statements and Financial Records

1. We have fulfilled our responsibilities, under the relevant statutory authorities, for the preparation of the financial statements in accordance with applicable law and the Financial Reporting Standard 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland, and the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.
2. We acknowledge, as members of management of the College, our responsibility for the fair presentation of the financial statements. We believe the financial statements referred to above give a true and fair view of the financial position, financial performance (or results of operations) and cash flows of the College and its group in accordance with with applicable law and the Financial Reporting Standard 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland, and the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.
3. The significant accounting policies adopted in the preparation of the financial statements are appropriately described in the financial statements.
4. As members of management of the College, we believe that the College has a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with applicable law and the Financial Reporting Standard 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland, and the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.
5. We believe that the effects of any unadjusted audit differences, summarized in the accompanying schedule, accumulated by you during the current audit and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the (consolidated) financial statements taken as a whole.

B. Fraud

1. We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.
2. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
3. We have no knowledge of any fraud or suspected fraud involving management or other employees who have a significant role in the College's internal controls over financial reporting. In addition, we have no knowledge of any fraud or suspected fraud involving other employees in which the fraud could have a material effect on the financial statements. We have no knowledge of any allegations of financial improprieties, including fraud or suspected fraud, (regardless of the source or form and including without limitation, any allegations by "whistleblowers") which could result in a misstatement of the financial statements or otherwise affect the financial reporting of the College.

C. Compliance with Laws and Regulations

1. We have disclosed to you all identified or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements.

D. Information Provided and Completeness of Information and Transactions

1. We have provided you with:
   - Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
   - Additional information that you have requested from us for the purpose of the audit; and
   - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
2. All material transactions have been recorded in the accounting records and are reflected in the financial statements.
3. We have made available to you all minutes of the meetings of the Board of Management of the College and its relevant committees (or summaries of actions of recent meetings for which minutes have not yet been prepared) held through the year to the most recent meetings.
4. We confirm the completeness of information provided regarding the identification of related parties. We have disclosed to you the identity of the College's related parties and all related party relationships and transactions of which we are aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the period ended, as well as related balances due to or from such parties at the year end. These transactions have been appropriately accounted for and disclosed in the financial statements.
5. We believe that the significant assumptions we used in making accounting estimates, including those measured at fair value, are reasonable.
6. We have disclosed to you, and the College has complied with, all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

E. Liabilities and Contingencies

1. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the financial statements.
2. We have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.
3. We have recorded and/or disclosed, as appropriate, all liabilities related litigation and claims, both actual and contingent, and have disclosed in the financial statements all guarantees that we have given to third parties.
4. No other claims in connection with litigation have been or are expected to be received.

F. Subsequent Events

1. As disclosed in the financial statements, there have been no events subsequent to period end which require adjustment of or disclosure in the financial statements or notes thereto.

G. Going concern

1. We have not identified any material uncertainties that may cast significant doubt about the College's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

H. Other information

1. We acknowledge our responsibility for the preparation of the other information. The other information comprises the Remuneration Report, the Performance Report , the Annual Governance statement and the Statement of Responsibilities.
2. The disclosures within the Performance Report and Annual Governance Statement reflects our understanding of the financial and non-financial performance of the College over the reporting year, is consistent with the financial statements and has been prepared in accordance with Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council
3. The information given in the Annual Governance Statement for the financial year for which the financial statements are prepared reflects the College's governance framework, is consistent with the financial statements and that report has been prepared in accordance with the Accounts
4. The information contained in the auditable part of the Remuneration Report has been prepared in accordance with Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.

I. Regularity

1. We confirm that 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

Yours faithfully,

____

Principal

____

Chair of the Board of Management of the College

E. Action Plan

This action plan summarises specific recommendations included elsewhere within this Annual Audit Report. We have graded these findings according to our consideration of their priority for the Board or management to action.

Classification of recommendations		
Grade 1: Key risks and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently management needs to address and seek resolution urgently.	**Grade 2:** Risks or potential weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.	**Grade 3:** Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.

No.	Findings and risk	Our recommendation and grading	Management response
1	**Financial statement preparation** During the course of our audit we found finance team resources to be significantly stretched. This impacted on the timeliness and quality of information provided to support the audit. In particular, there was limited documentation readily available to support historic provisions and accruals recognised on the balance where the College had deferred recognising the income due to the possibility of potential clawback of funding or uncertainty over entitlement.	We recognise that management are actively looking to recruit appropriately skilled and experienced resource to the finance team. In light of the financial challenges facing the College it is key that sufficient resource is in place to ensure robust financial information is available to inform management decision making, and that accounting judgements and estimates are sufficiently documented. *Grade 1*	Agreed. Responsible Officer – Director of Finance. Comment – recruitment for a new Finance Manager is nearing completion. Once in post, a review of departmental resource requirements will be undertaken
2	**Non-Profit Distribution model** The NPD model contains a number of assumptions around future lifecycle costs as well as not incorporating any provision for contingent rent as expected under FRS 102. The current model has the effect of smoothing lifecycle costs over the term of the agreement rather than reflecting actual in year costs incurred. Consequently, there is a risk that future accounting treatment may not fully reflect the substance of the transaction in accordance with FRS 102.	While we do not consider the differences material in the current year, we recommend management review the model to ensure that it is sufficient to be applied on an ongoing basis to meet the requirements of the FRS 102 based SORP. *Grade 2*	Agreed. Responsible Officer – Director of Finance. Comment – The College will review, with involvement from Scottish Futures Trust and Scottish Funding Council, as deemed necessary.

No.	Findings and risk	Our recommendation and grading	Management response
3	**Financial monitoring** Colleges are classified as central government bodies and therefore are required to operate within resource limits which are measured annually at 31 March. It is important that to enable effective oversight and scrutiny of the College's financial performance against key financial targets internal reporting reflects both the financial accounting period (academic year) and the resource year.	Management should ensure that the Board are aware of the impact of key decisions that impact on both outturn financial performance as well as ability to meet resource limits. To aid this understanding there may be an opportunity to reconcile resource targets with outturn budgets. *Grade 2*	Agreed. Responsible Officer – Director of Finance. Comment – this will be taken into account when reviewing resource requirements.
4	**Performance reporting** While there is a range of sources of performance information, including the financial statements, and KPI information, there is an opportunity to enhance the current performance information contained within the financial statements to provide more of a holistic overview of the College's performance in the delivery of its strategic objectives	We recommend that management continue to develop the performance information included with the annual performance report to provide a greater insight into the overall performance of the College. *Grade 3*	Agreed. Responsible Officer – Director of Finance / Depute Principal. Comment – we will review the information included and seek to gain consistence with other UHI academic partner reporting.

F. Summary of audit differences

There were a number of adjustments processed to the unaudited financial statements as a result of our audit work. The impact of these is summarised below.

Summary of audit differences – adjusted differences			
No.	**Account**	**Comprehensive income and expenditure statement (Increase) / Decrease £000**	**Balance sheet (Decrease) / Increase £000**
1	***Being adjustment to recognise the payment of disposal proceeds through deferred capital grants rather than through other comprehensive expenditure***		
	CIES – Loss on disposal (payment to SFC)	(2,011)	
	Balance sheet – Deferred capital grants		2,011

F. Summary of audit differences continued

There were a number of audit differences arising through the course of our audit work. Management has considered that these individually and cumulatively did not have a material impact on the financial statements and therefore have not adjusted for these differences. We concur with managements opinion that these are not material.

Summary of audit differences – 2016/17 unadjusted differences			
No.	**Account**	**Comprehensive income and expenditure statement (Increase) / Decrease £000**	**Balance sheet (Decrease) / Increase £000**
1	***Being adjustment to release accruals where no liability / obligation remains at the balance sheet date***		
	Balance sheet – Accruals		176
	CIES – Investment / interest income	(176)	

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