Inverness College Annual Audit Report

Year ended 31 July 2018

18 December 2018

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 Trustees 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 Diane McGiffen, 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.

1. Executive Summary

Executive Summary – purpose and scope

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 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 joint Audit and Finance and General Purposes committees. After consideration by the College, this report is provided to Audit Scotland and published on their 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.

A key objective of our audit reporting is to add value by supporting the improvement of the use of public money. We aim to achieve this through sharing our insights from our audit work, our observations around where the College employs best practice and where processes can be improved. We use these insights to form our audit recommendations to support the College in improving its practices around financial management and control, as well as around key aspects of the wider scope dimensions of audit. These are highlighted throughout the report together with our judgements and conclusions regarding arrangements.

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 2018. We summarise these responsibilities in Appendix A.

Our Annual Audit Plan set out an overview of our audit scope and approach for the audit of the 2017/18 financial statements. We carried out our audit in accordance with the plan. We applied the materiality levels below to our audit, as outlined in our audit plan and based on our consideration of the key risks and issues facing the College and its financial statements. We reassessed materiality on receipt of the draft financial statements and at the conclusion of our audit work, and concluded the levels identified during our planning work remained appropriate.

- Materiality for our audit – no change to that reported in our Annual Audit Plan — £400,000
- Tolerable Error is our materiality applied at an individual account balance – no change — £200,000
- Reporting threshold, set in line with the requirements of the Code – no change — £20,000

Financial statement audit

We are responsible for conducting an audit of the financial statements of the College. We provide an opinion on the financial statements as to whether:

- they give a true and fair view in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council of the state of affairs of the College as at 31 July 2018 and its deficit for the year then ended;
- they have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder issued 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).

We also review and report on other information prepared and published by the College along with its financial statements.

Wider scope audit

Our responsibilities extend beyond the audit of the financial statements. The Code requires auditors to provide judgements and conclusions on the dimensions of wider scope public audit that are relevant for each body. As outlined in our audit plan, the College qualifies as a "smaller body" in line with Audit Scotland guidance, therefore our wider scope work covers the arrangements in respect of financial sustainability and governance and transparency.

Key contacts

Stephen Reid, Partner
sreid2@uk.ey.com

Alison Martin, Senior Manager
amartin1@uk.ey.com

Ernst & Young LLP, Atria One, 144 Morrison Street, Edinburgh EH3 8EX

Independence

We confirm that we have undertaken client and engagement continuance procedures, included in which is our assessment of our continuing assessment of our independence to act as your external auditor.

Financial statements audit

We have issued an unqualified audit opinion on the College's financial statements. We have concluded satisfactorily in respect of each of the significant risks and audit focus areas in our Annual Audit Plan.

Management were unable to provide draft financial statements, including the Performance Report, Accountability Report and Remuneration and Staff Report in line with the agreed timetable. Delivery against the agreed timetable was impacted by a number of unforeseen finance team absences. We have agreed with management that, in line with good practice for the year end financial statements preparation and audit process, full draft financial statements will be provided before the start of the onsite audit work going forward. We made a number of minor suggestions for amendments to the draft financial statements to enhance their presentation and readability, and to ensure compliance with disclosure requirements.

We identified seven audit differences arising from our audit work, including two differences relating to yearend estimates where additional information became available subsequent to management's initial preparation of the financial statements. There were no unadjusted audit differences.

Wider scope audit – key messages

We set out below our key messages in respect of each of the dimensions of public sector audit, along with our overall assessment of each of these in terms of red / amber / green. Our assessment is built on our consideration of the risks facing the College, the extent to which these are mitigated by the College's processes and controls, and our assessment of management's process in implementing recommendations from the 2016/17 audit, where appropriate.

Financial sustainability	▸ The financial environment in which the College operates continues to be challenging, with significant uncertainty going forward around both key income and expenditure sources, in particular around future increases to staff costs through national bargaining and future SFC funding. ▸ The College has identified a significant underlying deficit in its latest forecast through the next five years. While management is sighted on this and has initiated a number of actions to address it, there is still significant work to be done. ▸ Management is aware of the need to develop a more robust medium term financial plan which is aligned to the College's future strategic objectives and quantifies how it will address future underlying deficits.	**Amber**
Governance & transparency	▸ The College has in place a number of the key requirements for good governance and transparency. The College has noted full compliance with the Scottish Code of Good Governance. ▸ 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.	**Green**

2. 2017/18 financial statements audit

2. Summary of 2017/18 audit opinion

The detailed form and content of our audit report, and the requirements underpinning the report, are set out in guidance issued by Audit Scotland. This covers our reporting requirements in accordance with International Standards on Auditing (UK), plus those matters prescribed by the Code.

Element of Audit opinion	Nature of opinion and basis for that
Opinion on financial statements	**Unqualified opinion**
▶ Truth and fairness of the state of affairs of the College at 31 July 2018 and of the deficit for the year then ended ▶ Preparation of the financial statements in accordance with the relevant financial reporting framework	▶ Performance of audit procedures to respond to our assessed risk of misstatement, including significant risks ▶ Accounting policies are appropriate and estimates are reasonable ▶ Completion of financial statement disclosure checklists / consideration of relevant guidance issued by Audit Scotland
Conclusions relating to the going concern basis of accounting	**No matters to report**
▶ The use of the going concern basis of accounting used in the preparation of the financial statements is not appropriate	▶ Supported by our core financial statements audit work, supplemented by our wider scope audit procedures in respect of financial sustainability
Other information in the financial statements	**No matters to report**
▶ We are required to consider whether the other information in the financial statements is materially inconsistent with the annual accounts or our knowledge obtained in the audit	▶ Review of committee minutes and papers / discussions with management / understanding of the business
Opinions on matters prescribed by Audit Scotland	**Unqualified opinions**
▶ The audited part of the Remuneration and Staff Report has been properly prepared in accordance with applicable regulations ▶ Information in the Accountability Report / Annual Governance Statement is consistent with the financial statements, and prepared in accordance with the relevant guidance	▶ We agreed the form of the report to the regulations and agreed the disclosures to underlying accounting records and supporting schedules ▶ We reviewed the content of the narrative statements to the information known to us in the audit, and against the requirements of the guidance
Matters on which we are required to report by exception	**No matters to report by exception**
▶ Whether adequate accounting records have been kept ▶ Whether financial statements and the audited part of the Remuneration and Staff Report are not in agreement with the accounting records ▶ Whether we have not received the information we require for our audit	▶ We were provided with all the information we required ▶ We have been able to agree information to the accounting records

The annual financial statements enables the College to demonstrate its accountability for the resources at its disposal, and its overall performance in the application of those resources during the year. They also enable the College to demonstrate openness and transparency in its governance and remuneration arrangements.

Financial Statement preparation 2017/18

Compliance with requirements

As part of our oversight of the College'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 Further and Higher Education (Scotland) Act 1992 and directions made thereunder issued 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).

Presentation and quality of financial statements

Management were unable to provide draft financial statements, including the Performance Report, Accountability Report and Remuneration and Staff Report in line with the agreed timetable. Delivery against the agreed timetable was impacted by a number of unforeseen finance team absences. We have agreed with management that, in line with good practice for the year end financial statements preparation and audit process, full draft financial statements will be provided before the start of the onsite audit work going forward.

The draft financial statements provided by management were of a reasonable quality, in line with the standard provided during 2016/17. Updates were made by management to reflect the new requirements of the SFC 2017/18 Accounts Direction. We made a number of minor proposals for amendments to enhance the presentation and readability, and to ensure fuller compliance with disclosure requirements.

Management responded positively to audit comments and addressed all matters in the final version of the financial statements. The readability and usefulness to the reader of the financial statements should continue to be an area of focus for management.

Audit differences

We identified seven audit differences arising from our audit work, including two differences relating to yearend estimates where additional information became available subsequent to management's initial preparation of the financial statements. These have been adjusted by management and are outlined in more detail in Appendix E. There were no unadjusted audit differences.

Quality of supporting working papers

Throughout the course of our audit we identified a number of areas where supporting documentation could be improved or where balances in the financial statements had no supporting documentation. Mainly this reflected a number of limitations with the College's current finance system. In our view management has made improvements in its processes following the appointment of the new finance manager, however further improvements are required, in particular in relation to the analysis of yearend debtors and creditors, as well as more general SAM and SIT system processes.

Management recognises the need for ongoing improvement, and a restructuring of the finance team is being implemented. A significant factor in any restructure will be the development of the underlying finance systems the College uses. The UHI finance system upgrade project continues to be significantly behind timetable. There has been numerous delays, with several "go live dates" being missed largely due to under estimations by the supplier of the original scope of work and insufficient third party resources to complete the system design. The system configuration is 80-85% complete and management anticipates the system will be operational by 1 August 2019. Management should ensure any restructuring takes place in alignment with completion of the new system to ensure the future finance team model is best placed to implement the new system and fully benefit from all improvements enabled through it.

Recommendation one

The annual financial statements enables the College to demonstrate its accountability for the resources at its disposal, and its overall performance in the application of those resources during the year. They also enable the College to demonstrate openness and transparency in its governance and remuneration arrangements.

Financial Statement preparation 2017/18: Other areas

Arms Length Foundation (ALF)

As a result of the reclassification of Scotland's Colleges from 1 April 2014, an Arm's Length Foundation (ALF) was set up in order that any reserves were not returned to the Scottish Government, in the case of Inverness College the Scottish Colleges Foundation was used to transfer reserves through a donation. A total of £3.3 million was transferred to the Foundation by the College since it was established. At 31 July 2018 approximately £2,562,000 remained in the ALF to be awarded at the ALF's discretion to meet its charitable objectives.

We have assessed the independence of the ALF for the year ended 31 July 2018 to consider the requirement for consolidation of the ALF into the College's financial statements. We have concluded that the ALF is independent of the College based on a number of factors:

- There is a board of trustees of the ALF which is independent of the College
- All applications for funding from the ALF are reviewed thoroughly against the ALF's charitable objectives
- Day to day management of the ALF is not delegated to, and does not involve management at the College

Should it be determined that the College has significant influence or control of the ALF, management would need to consider the accounting implications for the College, and potentially consolidate the ALF or account for it as an associate on an equity basis. This should be an area of ongoing review on an annual basis as part of the yearend financial statements preparation process.

2. 2017/18 financial statements audit

The annual financial statements enables the College to demonstrate its accountability for the resources at its disposal, and its overall performance in the application of those resources during the year. They also enable the College to demonstrate openness and transparency in its governance and remuneration arrangements.

Opinions on matters prescribed by the Audit Scotland
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. 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 within 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 Governance Statement and express an opinion on whether it is consistent with the financial statements and that it has been prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council. We have reviewed the Governance Statement. See further commentary within governance and transparency section of wider scope. We are satisfied that the information with the Accountability Report is consistent with the financial statements and has been prepared in accordance with applicable requirements.
Remuneration and Staff Report: 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 are satisfied that the 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 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.

2. Significant audit risks

Significant risk - risk of fraud in income and expenditure recognition: ISA (UK) 240 requires us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk. In the public sector, we extend that to consider the risk of material misstatements by manipulation of expenditure.

Our overall approach

As set out in our Annual Audit Plan, given the nature of funding to the College from the Scottish Funding Council (SFC), we rebutted the assumed fraud risk in respect of this income stream. However we recognised 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 recognised the same risk around incorrect recognition of non-pay expenditure in line with Practice Note 10.

What did we do in response to the significant risk?

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 an analytical review of the key movements in the year 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
  - For other income and expenditure, we performed an analytical review of movements and selected key item and representative samples for testing, and obtained the third party evidence along with confirmation of the balance being received / receivable by the College
- We performed focused additional testing around income and expenditure transactions posted nearer to the year end to gain comfort that any material items are recorded in the correct accounting period. In particular we focused on material income transactions incurred after 31 July, but included in the 2017/18 financial ledger, and material expenditure transactions incurred before 31 July but deferred into the 2018/19 financial ledger
- We reviewed and tested a sample of debtor balances at the year end, including any 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
- We tested an extended sample of year end income and expenditure accruals held on the balance sheet at 31 July. We obtained evidence to support management's conclusion that balances related to transactions in respect of the financial year in question
- Where we found audit differences (outlined at Appendix E), we performed additional testing to ensure errors were one off and did not indicate further related differences

What are our conclusions?

Our testing identified a number of misstatements relating to revenue and expenditure recognition, which management corrected in the finalised financial statements. These misstatements were above our reporting threshold for differences but not material to the financial statements. We did not identify any further adjustments through supplementary testing. Given the nature of the audit differences noted, with many having the impact of increasing income for the year, we are comfortable these did not represent attempts to manipulate the College's financial position but rather are reflective of deficiencies in reporting and financial statement preparation processes due to unforeseen staff absences. We did not identify any areas of significant estimation or judgement as part of our audit work in these areas.

2. Significant audit risks (cont.)

EY

Significant risk – management override: As identified in ISA 240, management is in a unique position to perpetrate fraud in its financial reporting because of its ability to manipulate accounting records directly or indirectly by overriding controls that otherwise appear to be operating effectively.

We respond to this risk on every engagement	
Audit procedures performed	**What did we find?**
We gave consideration to the risk of fraud, inquiring of management about their assessment of the risks of fraud and the controls put in place to address those risks. We also updated and developed our understanding of the oversight of those charged with governance over management's processes over fraud.	We have not identified any material weaknesses in controls or evidence of material management override. As part of the audit process we wrote to the chair of the Audit Committee to make inquiries around both the governance arrangements at the College and any instances or possible non-compliance identified in the year. Those charged with governance identified through their response no instances of non-compliance. They also did not draw to out attention any significant matters or material weaknesses or concerns in respect of the College's governance arrangements.
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 outside the normal course of business.
Consistency and application of accounting policies / overall presentation of financial information	We consider the accounting policies adopted by the College to be appropriate. There are no significant accounting practices which materially depart from what is acceptable under FRS 102 or the SORP.
What are our conclusions?	
We are have not identified any material weaknesses in the design and implementation of controls around journal processing. We did not identify any instances of evidence of management override of controls. There was no disagreement during the course of the audit over any accounting treatment or disclosure. We encountered no significant difficulties in the audit through our interaction with management.	

2. Other inherent risks

Valuation of property, plant and equipment: Our overall approach

The value of property, plant and equipment ("PPE") represents a significant balance on the College's balance sheet and is subject to valuation changes, depreciation charges and possible impairment. The total value of the College estate at 31 July 2018 was £50.9 million. The last formal valuation of the new campus was undertaken on 1 August 2015 (in the process of conversion from old UK GAAP to FRS 102), and will be due again in the 2018/19 financial year. Management has performed an interim desktop valuation of the former Longman campus building in the year.

As set out in our Annual Audit Plan, given that a number of assumptions are used in valuing property, plant and equipment, we assigned a higher inherent risk to the valuation of PPE at 31 July 2018.

What did we do in response to the risk?

We undertook the following procedures as part of our audit:

- We reviewed the desktop valuation report prepared by the external valuer for the former College building on Longman Road and considered any accounting implications. As part of this we challenged the assumptions used by the valuer to ensure they are appropriate and consistent with our expectations and understanding of the estate
- We reviewed the College's backlog maintenance plans, including consideration of identified maintenance as a possible indicator of impairment within the estate, and whether backlog maintenance expenditure in the year had been correctly accounted for as capital or revenue expenditure
- We agreed the balances disclosed in the financial statements to underlying accounting records, in particular the College's fixed asset register
- We tested a sample of additions and disposals in the year, considering the appropriateness of capitalisation in line with the College's accounting policies and to ensure the correspondingly replaced assets had been appropriately disposed
- We considered any material capital grant income to supporting documentation and consideration of the appropriateness of recognition against the terms of any grant conditions, the College's own accounting policies and the applicable accounting standards
- We have recalculated the depreciation charge for the year on the assets by assets basis

What are our conclusions?

The Longman Inverness Campus building valuation identified a market value of £2.5 million on the basis of the clear ground, i.e. after the demolition of the campus building. Demolition costs, that will be fully funded by the SFC, are currently forecast to be £1.3 million, with a net book value as of 31 July 2018 of £1.2 million. No adjustments to the carrying value was therefore made on the basis that current net book value is materially in line with market value after deducting the costs of demolition.

Our depreciation testing has identified that a full year's depreciation is charged for assets obtained / transferred to fixed assets at any point in the year. Management has agreed to make appropriate amendments to the accounting policy note to reflect these arrangements.

Our testing has not identified any material misstatements relating to property, plant and equipment. We concluded that management has appropriately valued the estate based on the requirements of the FReM and did not identify any indicators of impairments at the yearend, which is in line with our expectations given the recent build of the new campus.

2. Other inherent risks

Capital financing arrangements: Our overall approach

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 2018 the present value of future lease payments are reported as £36.8 million (2016/17: £37.4 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.

What did we do in response to the risk?

In response to the inherent risk we performed the following audit procedures:

- Reviewed the capital funding transactions, including SFC capital grants, against the requirements of FRS 102 and the 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
- Performed test of details over the transactions posted in the financial year, agreeing to supporting documentation from third parties
- Utilised our internal specialists to consider the accounting treatment, including review of the key assumptions driving the model, and disclosures against the requirements of the SORP and FRS 102.
- Agreeing disclosures made in the financial statements to the College`s NPD model.

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. In 2016/17 we made a recommendation for management to review the model and accounting treatment to ensure it continues to meet the requirements of FRS 102. This has yet to be implemented.

While we are satisfied that the NPD model and subsequent recognition within the financial statements is materially consistent with our expectations, we have outlined a recommendation below in respect of future arrangements.

What are our conclusions?

We are satisfied that the NPD liability and associated accounting treatment and disclosure is free from material misstatement for the year ended 31 July 2018. Management should ensure it reviews the accounting model annually to consider the assumptions contained, whether these remain appropriate, and in particular whether the model should incorporate contingent rent within the calculation in the future.

Recommendation two

Accounting for retirement benefits: Our overall approach

In line with accounting standards, the College recognises the cost of retirement benefits provided to its staff in the reported cost of service when they are earned by the employee and not when the pension benefits are actually paid.

The College's employees belong to two principal pension schemes, the Scottish Teachers Superannuation Scheme (STSS) and the Highland Pension Scheme (LGPS). The present value of Unfunded Obligations in relation to early retirements agreed in previous years is £2 million (2016/17: £2.2 million). As at 31 July 2018, the College's share of the pension scheme net liability is £4.3 million (2016/17: £10.3 million).

The information disclosed is based on the FRS 102 report issued to the College by the actuary appointed by the Highland Council Pension Fund. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.

What did we do in response to the risk?

As a result of the thematic review performed by the Financial Reporting Council, there has been an increase in focus on accounting for retirement benefits and, as such, auditors have additional requirements to address in completing and concluding on the valuation of these balances. We undertook the following procedures as part of our audit:

- Obtained the actuarial report at the year end date for the scheme and utilised our in-house experts to assess both the robustness of the methodology used to derive the key actuarial assumptions, and the reasonableness and consistency of the assumptions underpinning such reports
- We wrote to the actuaries of the pension scheme to confirm their independence and expertise to ensure this was appropriate and sufficient for the purposes of preparing their FRS 102 report
- We wrote to the auditor of the Pension Fund to gain assurance over the completeness, existence and valuation of the Fund's assets at 31 March 2018, as well as the processes and controls to ensure accurate information is obtained in respect of the College's share of fund assets
- We performed additional testing on the College's share of the Fund pension assets at 31 July, performing roll forward procedures on its share of assets from 31 March to the College balance sheet date
- We reviewed the calculation of the College's valuation of future early retirement liabilities at 31 July and completed integrity testing over the inputs into the calculation

What are our conclusions?

We concluded that we were able to rely on the work of management's specialists – the pension fund actuaries – and were satisfied that the actuarial assumptions used in the preparation of the FRS 102 report were appropriate. These include the assumptions directed to be used by management (such as assumptions over future salary cost increases).

We obtained relevant assurances from the pension fund auditor to support our conclusions.

Our testing has not identified any material misstatements relating to future early retirement liabilities.

3. Wider scope audit

3.1 Financial sustainability

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

Amber	▶ The financial environment in which the College operates continues to be challenging, with significant uncertainty going forward around both key income and expenditure sources, in particular around future increases to staff costs through national bargaining and future SFC funding. ▶ The College has identified a significant underlying deficit in its latest forecast through the next five years. While management is sighted on this and has initiated a number of actions to address it, there is still significant work to be done. ▶ Management is aware of the need to develop a more robust medium term financial plan which is aligned to the College's future strategic objectives and which quantifies how it will address future underlying deficits.

Elements of financial sustainability, and our assessment of the College's arrangements

We consider whether:

- The College's revenue and capital outturn for 2017/18 was in line with the approved budgets, with material changes to budgets identified and reported?
- The College has a medium term financial strategy and plan which takes into account risks and uncertainties?
- The College has arrangements to address any identified funding gaps?

The context for financial sustainability

In June 2018, Audit Scotland published their report *Scotland's Colleges 2018*. This report provided an overview of the college sector in Scotland and provided an update on college finances across the sector. The report highlighted that while the college sector's underlying financial position improved in 2016-17, several colleges face significant financial challenges. Scotland's 20 incorporated colleges reported an overall underlying financial surplus for 2016-17 of £0.3 million. This compares to an underlying deficit of £8 million in 2015-16. Across the sector, the cash held by colleges increased by 13 per cent in 2016-17 and the net value of their assets, such as land and property, compared against financial liabilities, such as pension costs, grew by 10%. However, these sector-wide increases mask significant variations between colleges.

The report noted that several factors pose a risk to the sector's financial sustainability, including: the future impact of national bargaining for support staff; uncertainties around long-term funding of improved employment terms; the cost of maintaining buildings and land; and the potential impact of leaving the European Union.

The Scottish Funding Council's 2017 estates condition survey indicates that college buildings require urgent and significant investment. The survey estimates a backlog of repairs and maintenance over the next five years of up to £360 million. These figures exclude the six campuses that have been financed in recent years through public-private partnerships, with Inverness College being one of these. The SFC is providing £27 million of capital funding to colleges in 2018/19 to cover the very high priority needs identified in the condition survey.

2017/18 College financial position

The 2017/18 College budget was approved by the Board in June 2017. The College budgeted for a break even underlying position before the accounting for deferred capital grants and net depreciation charge. The budget recognised significant uncertainties around the Scottish Government's funding of national pay bargaining and the potential impact this could have on the College's cost base. The College has reported an actual accounting deficit of £1.4 million for the year (2016/17: £350,000 surplus). Following actuarial gains of £7.2 million, the College reported total comprehensive income of £5.7 million (2016/17: £2,400 surplus).

Elements of financial sustainability, and our assessment of the College's arrangements (cont.)

2017/18 College financial position (continued)

The College has reported an underlying surplus in the year of £365,000 against a break even budget. As part of the submission of its financial forecast return ("FFR") for 2018/19, management outlined the key movements in the year between the College's 2017/18 budget and actual position. It noted a number of movements in both income and expenditure throughout the year against budget. We have reviewed the movements against our understanding of the College's financial position from our year end audit work, and our review of the budget from the prior year audit work. We considered the variance between actual and budgeted financial performance to be reasonable given the timing of variances crystallising throughout the year. We do not consider the variances indicative of underlying inaccuracies in the College's budget process.

Medium term financial strategy and plan

The College's forecast underlying financial position through to 2023, outlined in its FFR, continues to deteriorate year on year, forecasting a cumulative £4.6 million underlying deficit over the next five years. £3.5 million of this deficit relates to planned payments for the NPD arrangement, with a £1.1 million deficit forecast after accounting for this. We have outlined the forecast position through to 2023 below:

Year	18/19 £000's	19/20 £000's	20/21 £000's	21/22 £000's	22/23 £000's	Total £000's
Accounting surplus / (deficit)	(718)	(1,069)	(780)	(1,310)	(1,599)	(5,476)
Underlying surplus / (deficit)	(257)	(627)	(567)	(1,284)	(1,895)	(4,630)
Impact of NPD payments	580	639	702	771	846	3,538
Revised underlying surplus / (deficit)	323	12	135	(513)	(1,049)	(1,092)

Source: Inverness College

In preparing this forecast, management has noted a number of significant assumptions that could be subject to significant sensitivity over the course of the five year period:

- Forecast SFC income is in line with the latest correspondence and guidance shared by UHI in its role as the regional strategic body. However this is not confirmed by the SFC beyond 2018/19 and as the largest source of income is a significant source of uncertainty in future forecasts
- Assumption that staff costs will increase by 3% year on year in the last three years of the forecast period, compared to the 2% forecast assumption proposed by the SFC
- Assumption that tuition fee income and commercial income, and other operating expenditure, increase in line with inflation over the period of the FFR.

Assessment of the College's Financial Forecast Return

We have reviewed the College's FFR submitted to the SFC for 2018/19 through 2022/23, as well as the underlying assumptions underpinning the return. The forecast submitted is based on robust management workings for the forecast period and represent management's best estimate of the future position for the five years from 1 August 2018.

Elements of financial sustainability, and our assessment of the College's arrangements (cont.)

The College's approach to addressing funding gaps going forward

As outlined, the College is currently forecasting a significant underlying deficit across the five year period through 2022/23. Good practice in respect of ensuring financial sustainability for the College would dictate that management has identified how it intends to address this gap across the five year period, in the form of a medium term financial plan. This would be aligned to both the FFR and the College's own strategic vision and operational plans to ensure that it is both achievable and that the College's strategy is not impacted by any proposed savings.

Management is aware of the financial shortfalls being forecast and is in the process of developing a finance strategy through to 2023. This has been initially reviewed by the Board and is being updated to reflect feedback, including the incorporation of scenario planning into the strategy. This will be further updated at scheduled Board away days and management aims to finalise the revised strategy early in 2019. The strategy includes, among other objectives, aims to increase income from fee paying students and achieve efficiencies through better working with UHI. While the development of this strategy is a good start to more robust financial forecasting and management, it is still to be aligned to the College's strategic vision and a medium term financial plan that reconciles to the FFR.

It is important that management finalises this process as a priority with a view to identifying the savings required to address the forecast underlying deficit. This needs to be communicated with the College's regional strategic body, along with any forecast unresolved deficits, in a timely manner, and not just through the annual FFR process.

Recommendation three

Focus on EU withdrawal

Withdrawing from the European Union will have implications for the college sector. In October 2018 Audit Scotland published a paper setting out the key issues for the public sector. The issues were identified around the three themes of people, finances and rules and regulations.

The risks and opportunities presented by EU withdrawal will vary markedly between organisations. Some parts of the public sector are already experiencing an impact. Audit Scotland expects all public bodies to be assessing the potential impact of EU withdrawal on their organisation, and identifying any specific risks and how they will respond to them.

Discussions with management and review of Board papers has confirmed that the College is sighted on Brexit as likely to have an impact on both the Further Education and wider College sector, while recognising uncertainty as to the detail behind those risks. We have confirmed as part of our review of the College's FFR that it does not assume any future income through EU grant funding from 2019/20.

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.	
Green	▸ The College has in place a number of the key requirements for good governance and transparency. The College has noted full compliance with the Scottish Code of Good Governance. ▸ 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.

Elements of governance and transparency, and our assessment of the College's arrangements

We consider whether:

- Is the governance framework is sound and arrangements are operating effectively?
- Is there effective scrutiny, challenge and transparency on decision making?
- Is the Governance Statement complete and does it reflect key findings from audit, scrutiny and inspection?

Governance and transparency

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, and the appropriateness of the related disclosures made in the financial statements around governance and transparency.

The Board is 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.

The College has in place a number of the key requirements for good governance and transparency. 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. 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.

The College has a robust approach for keeping policies and procedures up to date, including arrangements for identifying procedures that require to be updated. Through our review of policies we identified that the *Staff Recruitment and Selection* policy is currently overdue for review and updating. However, we were provided with evidence that this was a one off delay and action was already underway to address the matter.

Risk management

The College's approach to risk management is set out within the risk management policy. This was last reviewed and updated in March 2018. The College's risk register is considered by the senior management team on a routine basis and reviewed by the Audit Committee at each meeting, and periodically by the Board, as appropriate.

Audit Scotland national reports

It is important that the College has embedded arrangements to ensure that consideration is appropriately given to national reports published by Audit Scotland. This should include ensuring that management has evaluated the implications for the College and that the reports and assessment are shared with the Board. Discussions with management highlighted that national reports are reviewed by management and the impact on the College is considered. These are taken to the Board as appropriate.

Elements of governance and transparency, and our assessment of the College's arrangements (cont.)

Internal audit

The College's internal audit service provides an important source of assurance to inform management and the Board's assessment of the College's governance arrangements. Internal audit's opinion for the year was based on its agreed audit plan, as approved by the Audit Committee. For 2017/18 the Internal Auditor's annual statement of assurance concluded:

"With the exception of our review on Data Protection, whereby we concluded that further work is required to ensure robust processes, the risk management activities and controls in the areas which we examined were found to be suitably designed to achieve the specific risk management, control and governance arrangements. We also note that the necessary control improvements required from our review on Data Protection have been implemented by management at the time of this report.

Based on our verification reviews and sample testing (and with the exceptions noted above), the risk management, control and governance arrangements were operating with sufficient effectiveness to provide reasonable, but not absolute assurance that the related risk management, control and governance objectives were achieved for the period under review".

Part of internal audit's work in the year was the review of the implementation of outstanding recommendations. As at October 2018, 14 of these recommendations had been fully implemented, 6 had been partially implemented, and one recommendation was not implemented by management. Internal Audit conclude that "on the basis of follow up work and additional commentary provided by management on planned implementation actions we can take reasonable assurance that management's resolve to implement previously agreed recommendations is sound".

Governance Statement

We reviewed the Governance Statement within the financial statements against the requirements outlined in the SFC's 2017/18 Accounts Direction. This includes the requirement to conclude on the College's compliance with the Scottish Code of Good Governance, or to explain any areas of non-compliance along with mitigating actions and plans to address. We also considered management's arrangements for its own self-assessment of compliance with the Code. Management chose not to complete the checklist of compliance provided by the regional strategic body in the year, noting that it had completed this exercise when the Scottish Code of Good Governance was implemented in 2016, with areas of non-compliance identified being addressed since that period.

The College financial statements noted full compliance with the Code of Good Governance. Through our review of the governance arrangements in the year we have not identified any areas of non-compliance.

Enquiries of those charged with governance

During 2017/18 we formally wrote to the chair of the Audit Committee to make inquiries around the College's governance arrangements, including consideration by those charged with governance in respect of compliance with laws and regulations; identification of fraud, error and breaches of internal control; and material litigation and claims. We considered the response received from the chair of the Audit Committee on 21 September against our wider understanding of the College and other inquiries made through the year. No significant matters were noted that would have an impact on the financial statements in 2017/18.

Severance payments

All severance payments made by the College to employees are required to be formally approved by both management and an appropriate governance body (usually the Remuneration Committee), and calculated in line with a robust process. As part of our audit we consider the process for any payments made in the year. There were no severance payments made during the 2017/18 (2016/17: nil).

Appendices

A – Code of Audit Practice: responsibilities

B – Independence and audit quality

C – Required communications

D – Action plan

E – Summary of audit differences

A - Code of Audit Practice: responsibilities

In our Annual Audit Plan, we provided a summary of the responsibilities on audited bodies falling within the public sector audit framework, as set out in the Code of Audit Practice (the Code).

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 and risk-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.

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

The FRC Ethical Standard requires that we provide details of all relationships between Ernst & Young (EY), its directors and senior management and affiliates, and you, including all services provided by us and our network to you, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our integrity or objectivity, including those that could compromise independence and the related safeguards that are in place and why they address the threats.

There are no relationships from 1 August 2017 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.

Confirmations

We confirm that there are no changes in our assessment of independence since our confirmation in our Annual Audit Plan, dated May 2018.

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 management and members of the Board consider the facts known collectively to you and come to a view.

Audit fees – payable in the respect of the year ended 31 July 2018

Component of fee:	2017/18	2016/17
Auditor Remuneration – expected fee	**£14,370**	£14,230
Pooled Costs	**£920**	£890
Contribution to Audit Scotland costs	**£800**	£810
Total fee	**£16,090**	£15,930

Audit Quality
International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances. The EY 2018 UK Transparency Report can be accessed on our website at www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018. This material is published to provide a timely and relevant source of information about EY in general, and our audit business in particular. The disclosures are extensive. For example, they explain our outlook and how we are structured and governed, including the role of our Independent Non-Executives and how we apply the requirements of the UK's Audit Firm Governance Code. We refer to the quality of our audits and our commitment to recruiting, developing and diversifying our people and talent pool. We also explain how we manage our risks and remain innovative and technologically advanced in what we do and how we do it. Maintaining high audit quality across all of our engagements is of paramount importance to us. Our transformational Audit Quality Programme continues and is a part of the global EY Sustainable Audit Quality Programme (SAQ). Our Audit Quality Board (AQB) continues to oversee all matters relating to audit quality and sets the agenda for the Audit Quality programme. The AQB meets monthly and also holds an annual strategy session. The AQB reports to the EY UK Board. The AQB receives regular updates on regulatory matters, results of internal and external reviews, results of root cause analysis, resourcing, the SAQ programme and pursuit approvals, as well as a comprehensive dashboard on quality measures. Our Audit Quality Support Team (AQST), which started within the SAQ programme, reviews 40 to 50 audits each audit cycle providing challenge and guidance to the engagement teams. These are in-depth reviews carried out by experienced auditors independent of the audit team. AQST reviews enhance the quality of both the audit under review and other audits on which team members apply the lessons learned. The AQST has now become a business-as-usual function.
Audit Scotland – Audit Quality Framework / Annual Audit Quality Report
Audit Scotland's Appointments and Assurance Team are responsible for applying the new Audit Quality Framework across all financial audits and performance and Best Value audits. This covers the quality of audit work undertaken by Audit Scotland staff and appointed firms. The team are independent of audit delivery and provide assurance on audit quality to the Auditor General and the Accounts Commission. We support Audit Scotland in their commitment to reporting on audit quality through responding to requests for information and providing the results of internal quality reviews undertaken in respect of relevant public sector audits in Scotland. The most recent audit quality report which covers our work at the College since appointment can be found at: www.audit-scotland.gov.uk/uploads/docs/report/2018/as_audit_quality_1718.pdf.

Required communication	Our reporting to you
Terms of engagement / Our responsibilities Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties. Our responsibilities are as set out in our engagement letter.	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, any limitations and the significant risks identified.	Annual Audit Plan – May 2018
Significant findings from the audit ▸ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▸ Significant difficulties, if any, encountered during the audit ▸ Significant matters, if any, arising from the audit that were discussed with management ▸ Written representations that we are seeking ▸ Expected modifications to the audit report ▸ Other matters if any, significant to the oversight of the financial reporting process	This Annual Audit Report We request written representation from you in respect of key matters arising during the course of our audit, and in accordance with auditing standards. A copy of this letter is provided for your consideration and signature at the time of approval of the financial statements.
Going concern Events or conditions identified that may cast significant doubt on the College'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.
Misstatements ▸ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation ▸ The effect of uncorrected misstatements related to prior periods ▸ A request that any uncorrected misstatement be corrected ▸ Corrected misstatements that are significant ▸ Material misstatements corrected by management	This Annual Audit Report
Fraud ▸ Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the College ▸ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ▸ A discussion of any other matters related to fraud, relevant to the Audit Committee	This Annual Audit Report
Consideration of laws and regulations ▸ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ▸ Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of	This Annual Audit Report We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations.

Required communication	Reference
Related parties Significant matters arising during the audit in connection with the College's related parties including, when applicable: ▸ Non-disclosure by management ▸ Inappropriate authorisation and approval of transactions ▸ Disagreement over disclosures ▸ Non-compliance with laws and regulations ▸ Difficulty in identifying the party that ultimately controls the College	No significant matters have been identified.
Independence Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of 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 about the general policies and process within the firm to maintain objectivity and independence	Annual Audit Plan This Annual Audit Report – Appendix B
Internal controls Significant deficiencies in internal controls identified during the audit	This Annual Audit Report – no significant deficiencies reported
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.
Material inconsistencies Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	This Annual Audit Report

D – 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 College 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 / or risk**	**Recommendation / grading**	**Management response / Implementation timeframe**
1	**Financial process improvements** Throughout the course of our audit, we identified a number of areas where supporting documentation could be improved or where balances in the financial statements had no supporting documentation. While progress has been made, further improvements are required to financial processes, in particular in relation to the analysis of yearend debtors and creditors, as well as more general SAM and SIT system processes.	Management recognises the need for ongoing improvement, and a restructuring of the finance team is being implemented to provide support in these areas. *Grade 2*	Recruitment to the vacant posts within the revised structure is underway. In addition, support is being provided by the UHI Business Improvement team to identify potential process changes. Timescale – end of March 2019 for all posts to be filled.
2	**Non-Profit Distribution model** 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.	In the prior year, we made a recommendation to management to review the model and accounting treatment to ensure it continues to meet the requirements of FRS 102. This has not yet been implemented. *Grade 2*	Due to limited availability it was not possible to complete this during 2017/18. Timescale - end of July 2019.
3	**Medium term financial plan** The College is currently forecasting a significant underlying deficit across the five year period through 2022/23. Good practice in respect of ensuring financial sustainability for the College would dictate that management has identified how it intends to address this gap across the five year period, in the form of a medium term financial plan.	Management is aware of the financial shortfalls being forecast and is in the process of developing a finance strategy through to 2023. This has been initially reviewed by the Board and is being updated to reflect feedback, including the incorporation of scenario planning into the strategy. This will be further updated at scheduled Board away days and management aims to finalise the revised strategy early in 2019. *Grade 1*	The Senior Management Team are working to prepare a detailed financial plan to support a new Finance Strategy. This process has commenced with a view to completion in March 2019. Timescale - end of March 2019.

E. 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. All differences identified through the audit process were adjusted by management in the final financial statements.

Summary of audit differences – adjusted differences			
No.	**Account**	**Income and Expenditure impact / £**	**Balance sheet impact / £**
1	**Being Deferred Income release omitted in error**		
	Dr Balance sheet – Deferred income		20,129
	Cr CIES – Other Income	(20,129)	
2	***Being adjustment to recognise accrued income in respect of cash received from UHI in relation to Modern Apprenticeship***		
	Dr Balance Sheet – Accrued Income		27,080
	Cr CIES – Modern Apprentices	(27,080)	
3	**Being adjustment of over-provision for bad debt**		
	Dr Balance Sheet –Bad Debt Provision		128,557
	Cr CIES – Bad Debt provision	(128,557)	
4	**Being partially release of potential ESF clawback provision**		
	Dr Balance Sheet – Other Provision		43,811
	Cr CIES – Provision Release	(43,811)	
5	**Being an adjustment of cash receipt from UHI incorrectly posted to Accounts Receivables**		
	Dr Balance Sheet – Accounts Receivables		68,464
	Cr Balance Sheet – SITS Control account		(26,762)
	Cr CIES – Short Course Income	(41,702)	
6	**Being an accrual for support staff pay-rise agreed deal**		
	Dr CIES – Admin Basic Pay	34,220	
	Dr CIES – Admin National Insurance Contributions	4,722	
	Dr CIES – Admin Superannuation	5,574	
	Cr Balance Sheet - Accruals and Deferred Income		(44,517)
7	**Being an accrual for academic staff pay-rise**		
	Dr CIES – Lecturers basic pay	41,969	
	Dr CIES – Lecturers National Insurance Contributions	4,642	
	Dr CIES – Lecturers Superannuation	7,730	
	Dr CIES – Temporary Staff Returns	4,049	
	Cr Balance Sheet – Accruals and Deferred Income		(58,390)
	Total	**(158,372)**	**(158,372)**

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Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

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