North Highland 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 North Highland 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

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 North Highland 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 Audit and Risk Committee. 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 and Risk Committee on 23 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	£250,000
Tolerable Error is our materiality applied at an individual account balance – no change	£185,000
Reporting threshold, set in line with the requirements of the Code – no change	£12,500

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

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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 identified in our Annual Audit Plan.

Management provided completed draft financial statements, including the Performance Report, Accountability Report and Remuneration and Staff Report on 24 September, in line with timing of the onsite audit work. We made a number of suggestions to enhance the presentation and readability, and to ensure compliance with disclosure requirements. In particular, the financial statements required a number of updates to ensure compliance with the new requirements as outlined in the SFC’s 2017/18 Accounts Direction. Management responded positively to audit comments and addressed all material matters in the finalised version of the financial statements.

We have identified seven audit differences arising from our audit work, all of which have been adjusted by management. The impact of the adjusted differences was to increase the deficit by £163,000. All audit adjustments are outlined in Appendix E. There were no unadjusted audit differences.

Executive summary – key messages

Wider scope audit – key messages

We set out below our key messages in respect of the dimensions we consider for the College based on our scope of work outlined in our Annual Audit Plan, 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 College is currently forecasting significant accounting and underlying deficits through the five year period to 2023. These forecasts show negative cash from around the mid-point of the 2019/20 financial year. The College had net current liabilities of £400,000 at 31 July 2018 and relies on waivers from the bank to avoid loan covenants being breached. ▶ Management is aware of the financial position and sighted on the need to make savings. A number of previous efforts to address savings through structural change to the College governance arrangements have not yet delivered results. Formal plans to address savings within the College are being developed in 2018/19. ▶ Given the immediacy and scale of the projected savings required, this a significant area of risk to the ongoing financial sustainability of the College. Management has commenced an exercise to review the efficiency of curriculum delivery models for both further and higher education courses. This is due to be completed during 2018/19 and management will use the results to create a deficit action plan to address short term and longer term savings requirements from 2019.	Red
Governance and transparency	▶ While the College has a number of the key requirements in place for good governance and transparency it identified within the Governance Statement one area of non-compliance with the Scottish Code of Good Governance. ▶ A number of areas from the Board's 2016/17 self-effectiveness review have yet to be fully implemented. These include fundamental review of the committee structure, performance appraisal of Board members and improvement of performance management arrangements.	Amber

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 provided completed draft financial statements, including the Performance Report, Accountability Report and Remuneration and Staff Report on 24 September, in line with the timing of the onsite audit work. The draft financial statements provided by management were comparable in quality with the prior year. We made a number of suggestions to enhance the presentation and readability, and to ensure compliance with disclosure requirements. In particular, the financial statements required a number of updates to ensure compliance with the new requirements as outlined in the SFC's 2017/18 Accounts Direction. Management responded positively to audit comments and addressed all material matters the finalised version of the financial statements.

While the financial statements are materially compliant with the requirements outlined in the SFC 2017/18 Accounts Direction, FE SORP and FRS 102, the readability and usefulness to the reader should be an ongoing area of focus and improvement in future years.

Audit differences

We identified seven audit differences arising from our audit work, all of which have been adjusted by management. The impact of the adjusted differences was to increase the deficit by £163,000. All audit adjustments are outlined in Appendix E.

There were no unadjusted audit differences.

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, Arm's Length Foundations (ALF) were set up in order that any reserves were not required to be returned to the Scottish Government. The College transferred assets to a regional foundation. During 2017/18 the assets initially donated by the College were transferred to the Scottish Colleges Foundation, and at 31 July 2018 this ALF had approximately £1.2 million that was initially transferred from the College in its funds.

The governance arrangements between colleges and ALFs across the sector is an area of increased focus in 2017/18, in particular around the independence of the ALF and influence colleges can extend over their operations. We have re-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 which is independent of the College; no trustees are appointed by 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 of the College

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 and provided commentary to management around enhancing the layout and structure of the information, including the requirement to include committee attendance. See further commentary within governance and transparency section of wider scope. We are satisfied that the information within the Accountability Report is consistent with the financial statements and has been materially 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 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 transaction incurred before 31 July but deferred into 2018/19
- 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

What are our conclusions?

Our testing has not identified any material misstatements relating to revenue and expenditure recognition. We did not identify any areas of significant estimation or judgement as part of our audit work in these areas.

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 and Risk 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 our attention to 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 £17.4 million, and was last subject to a full revaluation at 31 July 2018, with an interim revaluation due again in 2020.

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 considered the value of the College estate as at 31 July 2018, in particular in respect of the indexation applied to the College estate for the year following the revaluation in 2016/17.
- We discussed with management the plans for the College estate, in particular around plans for Wick College and Ross House, and considered the accounting implications of the current use of the assets and plans to dispose of the buildings
- We reviewed the College's backlog maintenance plans, including consideration of possible indicators of impairment of the existing estate, and whether backlog maintenance expenditure in the year had been correctly accounted for as capital or revenue expenditure
- We agreed the PPE 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

What are our conclusions?

Management initially applied indexation of 1.5% to the value of the estate assets based on its own best estimate. Following consultation with external valuers and our own independent valuation team we confirmed this was lower than expected based on the DRC valuation approach for the fixed assets. The indexation was adjusted to 2.5% annually, resulting in an increase in the yearend fixed asset valuation of £173,000.

In respect of Wick College and Ross House, as management is actively marketing these properties and intends to sell them within the next year, these assets are required to be disclosed as assets held for sale within current assets. Based on the offers received to date on Ross House we are comfortable with the carrying value of the asset at the balance sheet date, however based on expectations of the sale value for Wick College it was determined the value should be impaired down to an expected recoverable value.

The adjustments noted are outlined in Appendix E. Our testing has not identified any other material misstatements relating to property, plant and equipment.

Based on the conclusions and adjustments from our audit work, in our view the valuation of the College estate is an area which requires increased focus from management. In particular management should consider the accounting requirements throughout the year in advance of preparation of the year end financial statements.

Recommendation one

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 £0.7 million (2016/17: £0.7 million). As at 31 July 2018, the College's share of the pension scheme net liability is £3.3 million (2016/17: £8 million).

The information disclosed is based on the FRS 102 report issued to the College by the actuary appointed by the Highland 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 in 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 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

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.	
Red	▶ The College is currently forecasting significant accounting and underlying deficits through the five year period to 2023. These forecasts show negative cash from around the mid-point of the 2019/20 financial year. The College had net current liabilities of £400,000 at 31 July 2018 and relies on waivers from the bank to avoid loan covenants being breached. ▶ Management is aware of the financial position and sighted on the need to make savings. A number of previous efforts to address savings through structural change to the College governance arrangements have not yet delivered results. Formal plans to address savings within the College are being developed in 2018/19. ▶ Given the immediacy and scale of the projected savings required, this a significant area of risk to the ongoing financial sustainability of the College. Management has commenced an exercise to review the efficiency of curriculum delivery models for both further and higher education courses. This is due to be completed during 2018/19 and management will use the results to create a deficit action plan to address short term and longer term savings requirements from 2019.

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 colleges' 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 SFC'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. 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 and recent financial context

In our 2017 Annual Audit Report we noted that management was sighted on the challenges around financial sustainability and was taking steps to address future funding gaps. Last year the College forecast £1.1 million deficit over a five year period, and noted that the College would face challenges delivering savings under its current operating model. However it had demonstrated a track record of delivering a number of significant savings in recent years, and had historically outperformed its budgets through in year management of resources and prudent budgeting forecasts. The College has reported an accounting deficit of £0.8 million for 2017/18 (2016/17: £0.5 million deficit). Following an actuarial gain of £6 million and an unrealised gain on the revaluation of property, plant and equipment of £0.3 million, the College reported total comprehensive income of £5.5 million. (2016/17: £3 million).

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

2017/18 College financial position (continued)

The 2017/18 budget was approved in the summer of 2017. The College budgeted for an underlying operating deficit of £290,000, excluding accounting transactions for FRS 102 pension adjustments and property valuations. 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. We reviewed the movements against our understanding from our audit work, together with our review of the budget obtained as part of the 2016/17 audit. We consider the movements to be reasonable given the timing of variances crystallising and not indicative of underlying inaccuracies in the College's budget process.

The College's underlying operating position in 2017/18 showed a surplus of approximately £110,000 after removal of costs in relation to non-cash transactions for fixed assets and pensions. This continues the College's trend of outperforming its budget performance in the year, being an improved position of £400,000 from budget to actual.

Medium term financial strategy and plan

The College has prepared its five-year financial forecasts from 2018 to 2023 and submitted these to the SFC. We have outlined below the forecast position through to 2023.

Year	18/19 £000's	19/20 £000's	20/21 £000's	21/22 £000's	22/23 £000's	Total
Accounting surplus / (deficit)	(554)	(1,250)	(1,463)	(1,684)	(1,872)	(6,823)
Underlying surplus / (deficit)	(218)	(367)	(580)	(801)	(989)	(2,955)
Forecast cash position at yearend – no remoteness funding	125	(304)	(949)	(1,818)	(2,878)	(2,878)
Underlying surplus / (deficit) with remoteness funding	(218)	(171)	(384)	(605)	(793)	(2,171)
Forecast cash position at yearend – remoteness funding included	125	(108)	(557)	(1,230)	(2,094)	(2,094)

Source: North Highland College

The five year forecasts show accounting and underlying deficits throughout the five year period. Overall the College is forecasting an underlying deficit of approximately £2.9 million to 2022/23, or £2.2 million with additional remoteness funding which the College anticipates, but is not year formally confirmed. Forecasts show negative cash from 2019/20 financial year under these forecasts. The increase in forecast deficit from the previous year is largely due to upwards revisions in forecast staff costs (1.5% salary increases forecast in 2017 to 2% in 2018 forecasts) and downwards revisions to funding following the latest projections from the regional strategic body. Meanwhile efforts to address savings requirements through changes to the College's structural arrangements have not developed in the year. Management has noted in its preparation of these forecasts a number of assumptions that could have a significant impact on the future financial position:

- Future SFC income is based on current instructions provided from the regional strategic body, including the forecast reductions in funding (and the College's associated share of this reduction) from 2021/22. This is subject to confirmation on an annual basis from the SFC, in particular in respect of additional remoteness funding from 2019/20
- In respect of the College estate, capital funding for backlog maintenance is included for 2018/19 only, totalling £737,000, in line with SFC guidance. However the College has not forecast any additional funding from its own resources from 2019/20 onwards, and in total an additional £2.7 million of estate improvements have been identified in addition to the funded amount. The College has also not included cash receipts that could be received from the sale of Ross House and Wick College, which are both being actively marketed for sale and are valued on the College balance sheet at £500,000
- Cost of living increases through the period remain at approximately 2%. This is subject to variance as pay awards are finalised. The College has assumed no additional funding from the SFC for pay increases after 2019/20.

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

Assessment of the College’s Financial Forecast Return

We have reviewed the College’s FFR, together with the underlying assumptions underpinning the return. The forecast is based on management’s best estimates over the five year period, recognising there are a number of significant sensitivities in forecasts. The forecast figures show an increasingly acute financial position, and without action to address forecast funding gaps the College may require financial support by the end of the 2019/20 financial year based on the projected cash position. This position would be exacerbated by any further negative movements in the sensitivities, such as staff costs increasing beyond the levels assumed, but could also be alleviated by other sensitivities such as the College retaining capital receipts or additional funding for remoteness. The College had net current liabilities of £400,000 at 31 July 2018 and relies on waivers from its bank to avoid loan covenants being breached (the loan value at 31 July 2018 was £1.3 million). There is an additional risk of the loan being called should the College have difficulty in making repayments.

In our view management is sighted on the scale of the financial challenges facing the College, as it has been in previous years. Given the immediacy and scale of the projected savings required, this a significant area of risk to the ongoing financial sustainability of the College. Management has commenced an exercise to review the efficiency of curriculum delivery models for both further and higher education courses. This is due to be completed during 2018/19 and management will use the results to create a deficit action plan to address short term and longer term savings requirements from 2019.

Recommendation two

During 2017/18 management refreshed its strategic vision for the College, which was approved by the Board. Currently the College’s strategic and operational plans are not aligned to financial plans, for example through the costing of strategic objectives and reconciliation of forecast expenditure to future funding. Given the financial savings that are required, it is particularly important that management take steps to identify and consider the impact of financial decisions on operations, and visa versa. It is important that financial and strategic decisions are taken in alignment and that this alignment is demonstrated to those charged with governance.

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 medium term financial plans that it does not assume any future income through EU grant funding from 2018/19.

Outcomes from the Audit Scotland Overview Report

Audit Scotland published its overview report for the sector in June 2018. This included comparative data across all colleges and analysis of a number of key developments in the sector. The report noted the significant financial challenges, and current position of net liabilities, facing the College.

3.2 Governance and transparency

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.	
Amber	▶ While the College has a number of the key requirements in place for good governance and transparency it identified within the Governance Statement one area of non-compliance with the Scottish Code of Good Governance. ▶ A number of areas from the Board's 2016/17 self-effectiveness review have yet to be fully implemented. These include fundamental review of the committee structure, performance appraisal of Board members and improvement of performance management arrangements.

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

We consider whether:

- Is the governance framework sound and arrangements 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

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 a number of the key requirements for good governance and transparency. We have reviewed Board minutes and papers and found these to set out 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 and information, including financial performance is generally clear and concise.

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. We have reviewed the draft internal audit annual report for 2017/18. Internal audit's opinion for the year was based on its agreed audit plan for 2017/18, as approved by the Audit and Risk Committee. For 2017/18 the Internal Auditor's annual statement of assurance notes that it is "of the opinion that for the areas reviewed during the year at North Highland College there is reasonable assurance that effective risk management, control and governance processes are in place to manage the achievement of its objectives".

Board effectiveness review

In our 2016/17 Annual Audit Report we noted that as part of the Board's self-effectiveness review that improvements were required to performance measurement, in particular around aligning performance reporting to the College's strategic aims. Overall we noted a number of recommendations from the review remained outstanding. As part of our 2017/18 audit, we reviewed the updated action plan provided by management and noted that, while the majority of actions have been addressed, a number of the more complex and fundamental actions are still to be addressed. Those outstanding include review of the committee structure, performance appraisal of Board members and performance management arrangements. There has been significant turnover of the Board membership in the year which has impacted delivery and progress on a number of these requirements. However, it is important these more fundamental issues are addressed in a timely manner to ensure a fully robust governance framework.

Recommendation four

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

Governance Statement

We reviewed the College's Governance Statement 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.

Management's initial assessment of compliance with the Code of Good Governance noted full compliance. As part of updating the financial statements management performed a high level assessment of compliance with the Code against the checklist provided by the regional strategic body. The updated financial statements noted one area of non-compliance with expected full compliance by the end of November 2019.

We made a number of recommendations to enhance the presentation and disclosures in the Governance Statement to ensure it complied with the core requirements of the 2017/18 SFC Accounts Direction. In our view, while the Governance Statement reflects management's view of governance compliance for 2017/18 in line with its own self-assessment, and our audit work has not identified any further areas of non-compliance, a more detailed assessment would be beneficial going forward. All matters raised in our review of the Governance Statements have been addressed by management in the most up to date financial statements.

Recommendation five

Risk management

The College's approach to risk management is set out within the risk management policy. This was formally approved by the College Board September 2018. There is routine reporting of the College's risk register to the senior management team. The Audit and Risk Committee reviews the risk register on a routine basis and the Board considers the risk register as part of its agenda.

Enquiries of those charged with governance

During 2017/18 we formally wrote to the chair of the Audit and Risk 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 and Risk Committee against our wider understanding of the College and other inquiries made through the year. No significant matters were noted. This was in line with our understanding from corroborating procedures through the audit.

Severance payments

All payments made to staff under exit agreements, either voluntary of compulsory, must be subject to appropriate approval in line with the requirements of the SFC. During 2017/18 no employees left the College under severance agreements.

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 and when deemed necessary.

Appendices

A – Code of Audit Practice: responsibilities

B – Independence and audit quality

C – Required communications

D – Action plan

E – Summary of audit differences

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).

<table>
<tr><th colspan="2">Responsibilities of audited bodies</th></tr>
<tr><td>Corporate governance</td><td>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.</td></tr>
<tr><td>Financial statements and related reports</td><td>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.</td></tr>
<tr><td>Standards of conduct / prevention and detection of fraud and error</td><td>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.</td></tr>
<tr><td>Financial position</td><td>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.</td></tr>
<tr><td>Best Value</td><td>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.</td></tr>
</table>

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	***£13,230***	*£14,110*
Pooled costs	**£790**	£760
Contribution to Audit Scotland costs	**£680**	£690
Total fee	**£14,700**	£15,560

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 & Risk 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 & Risk 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 & Risk 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 & Risk 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 & Risk 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	**College estate valuation processes** Based on the conclusions and adjustments from our audit work, in our view the valuation of the College estate is an area which requires increased focus from management, in particular around the accounting requirements throughout the year in advance of preparation of the yearend financial statements.	Management should ensure appropriate processes are in place to consider and review the College estate, both throughout the year and in advance of the preparation of the financial statements. *Grade two*	**Agreed.** The Director of Finance and Estates consulted the College's external valuer previously engaged in valuation exercises however responses were delayed, therefore management used a best estimate to ensure timely completion of the accounts. Management will engage with the valuer earlier in future years and will consider the accounting valuations for any assets for sale in advance of the yearend.
2	**Forecast financial position** In our view management is sighted on the scale of the financial challenges facing the College, as it has been in previous years. Given the immediacy and scale of the projected savings required, this a significant area of risk to the ongoing financial sustainability of the College. Management has commenced an exercise to review the efficiency of curriculum delivery models for both Further and Higher education courses. This is due to be completed during 2018/19 and management will use the results to create a deficit action plan to address short term and longer term savings requirements from the 2019 financial year onwards. .	Management should complete the review of the curriculum delivery model as a priority, and consider the potential impact of the review against its required forecast financial savings, reporting as appropriate to its RSB and the SFC once robust revised forecasts can be made. *Grade one*	Agreed. The exercise will be completed in 2018/19 as a priority and considered by management and the Board accordingly.

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**
3	**Financial and operational planning alignment** During 2017/18 year management refreshed its strategic vision for the College, which was approved by the Board. Currently the College's strategic and operational plans are not aligned to financial plans, for example through the costing of strategic objectives and reconciliation of forecast expenditure to future funding.	Given the financial savings that may be required, it is particularly important that management take steps to identify and consider the impact of financial decisions on operations, and visa versa. It is important that financial and strategic decisions are taken in alignment and that this alignment is demonstrated to those charged with governance. *Grade one*	Agreed. A significant sensitivity in future planning is how long colleges are required to fund inflation pay rises with no SFC funded support. Management recognises the significant challenge in achieving the savings required by the year 2022/23 from the current annual spend, within the current governance framework and without impact on FE and HE targets. Once management has confirmed the savings required with the RSB and SFC it will provide a summary of options for the Board on the financial savings options and the likely strategic and operational impact.

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**
4	**Board effectiveness review** We have reviewed the updated action plan provided by management and noted that, while the majority of actions have been addressed, a number of the more complex and fundamental actions are still to be addressed. Those outstanding include fundamental review of the committee structure, performance appraisal of Board members and performance management arrangements as noted above.	We note there has been significant turnover of the Board membership in the year which has impacted delivery and progress on a number of these requirements. However, it is important these more fundamental issues are addressed in a timely manner to ensure a fully robust governance framework. *Grade one*	Agreed. In 2019, the Board will continue to review progress on the action plan and update / revise in the context of this recommendation. A Board self-effectiveness review will be carried out before the end of the academic year 2018/19 to identify areas of risk that members feel the Board may have. Longer serving members will be given appraisals regarding performance, and actions for the future. New members will also be given appraisals once they have settled into their new roles and have attended a few meetings. Both of these actions will be complete by June 2019.
5	**Governance compliance – self assessment** In our view, while the governance statement reflects management's view of compliance for 2017/18 in line with its own self-assessment, and our audit work has not identified any further areas of non-compliance, a more detailed assessment would be beneficial going forward.	Management should ensure a full, detailed review of compliance with the Code is completed at the earliest opportunity. *Grade two*	Agreed. A more detailed review of governance compliance will be carried out by the Board Secretary and Senior Management by April 2019 using the UHI provided framework.

This appendix sets out the significant adjustments processed in the financial statements prior to their finalisation. No unadjusted audit differences were identified.

1. Indexation of Fixed Assets	Income and Expenditure impact / £	Balance sheet impact / £
Dr Land and Buildings		173,000
Cr Revaluation Reserve		(173,000)
2. Re-classify Assets held for Sale as Current Assets		
Dr Current Assets – Assets held for Sale		537,000
Cr Land and Buildings		(537,000)
3. Impair Wick College		
Dr Revaluation Reserve		10,000
Dr Impairment	180,000	
Cr Land and Buildings		(190,000)
4. Credit Balance within Debtors		
Dr Debtors		33,311
Cr Creditors		(33,311)
5. Debit Balance within Creditors		
Dr Debtors		17,390
Cr Creditors		(17,390)
6. Backlog Maintenance netted off against Provisions		
Dr Debtors		81,981
Cr Provisions		(81,981)
7. Holiday Pay Accrual		
Dr Accrual		17,000
Cr Staff Costs	(17,000)	
Total	**163,000**	**(163,000)**

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