Annual Audit Report

to the Board of Governors and the Auditor General for Scotland
West Lothian College
Year ending 31 July 2018

MAZARS

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This report has been prepared in accordance with our responsibilities as appointed auditors as set out in Audit Scotland's Code of Audit Practice. Reports and letters prepared by the auditor and addressed to West Lothian College are prepared for the sole use of West Lothian College and we take no responsibility to any member or officer in their individual capacity or to any third party.

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West Lothian College
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29 November 2018

Dear Members

Annual Audit Report – Year ended 31 July 2018

We are pleased to present our Annual Audit Report for the year ended 31 July 2018. The purpose of this document is to summarise our audit conclusions.

The scope of our work, including identified significant audit risks and other areas of management judgement, was outlined in our Audit Strategy Memorandum which we presented on 7 June 2018. We have reviewed our Audit Strategy Memorandum and concluded that the original significant audit risks and other areas of management judgement remain appropriate. We would like to express our thanks for the assistance of your team during our audit.

If you would like to discuss any matters in more detail then please do not hesitate to contact me on 07387 242 052.

Yours faithfully

Lucy Nutley
Mazars LLP

1. EXECUTIVE SUMMARY

Purpose of this report and principal conclusions

This Annual Audit Report sets out the findings from our audit of West Lothian College ('the College') for the year ended 31 July 2018, and forms the basis for discussion at the Audit Committee meeting on 29 November 2018.

Our responsibilities are defined by the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice ('the Code') issued by Audit Scotland. Subject to the satisfactory completion of the outstanding work, at the time of issuing this report we have the following conclusions:

Opinion on the financial statements	We have issued an unqualified opinion, without modification, on the financial statements on 14 December 2018.
Opinion on regularity	We have issued an unqualified regularity opinion on 14 December 2018, meaning that in our opinion, in all material respects the expenditure and income recognised in the financial statements have been applied for the purposes intended.
Opinion on other requirements	We have issued an unqualified opinion on the matters prescribed by the Auditor General for Scotland on 14 December 2018. Namely that the remuneration and staff report, performance report and governance statement have been properly prepared in accordance with the relevant legislation
Wider scope work	We have concluded as follows against the wider scope dimensions for smaller bodies: • The College has effective arrangements, including budgetary control, that help the Board members scrutinise finances; and • The College has governance arrangements in place that provide appropriate scrutiny of decisions made by the Board and are reflected in their governance statement

Misstatements and internal control recommendations

Section 3 outlines the misstatement noted as part of our audit.

As part of our audit we have considered the internal controls in place that are relevant to the preparation of the financial statements. We do this to design audit procedures that allow us to express an opinion on the financial statements; this does not extend to expressing an opinion on the effectiveness of internal control or to identify any significant deficiencies in their design or operation.

We have identified no recommendations for the improvement of internal controls at the College during our audit. In addition, there were no recommendations from the prior year which required to be followed up.

1. EXECUTIVE SUMMARY (CONTINUED)

Status of our audit work

We have completed our work on the financial statements and wider scope work for the year ended 31 July 2018.

Our audit approach

We provided details of our intended audit approach in our Audit Strategy Memorandum in June 2018. We have not made any changes to our audit approach since we presented our Audit Strategy Memorandum to the Audit Committee.

1. EXECUTIVE SUMMARY (CONTINUED)

Materiality

Materiality is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole. Misstatements in financial statements are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

We set materiality at the planning stage of the audit at £339k using a benchmark of 2% of gross expenditure. Our final assessment of materiality, based on the final financial statements and qualitative factors is £376k, using the same benchmark.

Threshold	Initial threshold £'000	Final threshold £'000
Overall materiality	339	376
Performance materiality	272	300
Trivial threshold for errors to be reported to the Audit Committee	10	11

The assessment of what is material is a matter of professional judgement and is affected by our perception of the financial information needs of the users of the financial statements. In making our assessment we assume that users:

- have a reasonable knowledge of business, economic activities and accounts;
- have a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- will make reasonable economic decisions on the basis of the information in the financial statements.

We consider materiality whilst planning and performing our audit based on quantitative and qualitative factors

Performance Materiality

Our audit testing is based on a level of performance materiality, which is a percentage of overall materiality, but also dependent on the level of inherent risk assessed on the area being tested. It is lower than overall materiality as it helps to reduce the risk that the total of the uncorrected or undetected misstatements does not exceed materiality for the financial statements as a whole. It is based on between 50 – 80% of overall materiality depending on the risk level. Our initial assessment of performance materiality is based on low inherent risk, meaning that we have applied 80% of overall materiality as performance materiality.

Misstatements

We aggregate misstatements identified during the audit that are other than clearly trivial. We set a level of triviality for individual errors identified (a reporting threshold) for reporting to the Audit Committee that is consistent with the level of triviality that we consider would not need to be accumulated because we expect that the accumulation of such amounts would not have a material effect on the financial statements. This level was set at 3% of materiality.

2. AUDIT OF THE FINANCIAL STATEMENTS

Set out below are the significant findings from our audit. These findings include:

- our audit conclusions regarding significant risks and key areas of management judgement outlined in the Audit Strategy Memorandum;
- our comments in respect of the accounting policies and disclosures that you have adopted in the financial statements. On page 12 we have concluded whether the financial statements have been prepared in accordance with the financial reporting framework and commented on any significant accounting policy changes that have been made during the year; and
- any significant difficulties we experienced during the audit.

Significant risks and key areas of management judgement
As part of our planning procedures we considered the risks of material misstatement in the College's financial statements that required special audit consideration. Although we report identified significant risks at the planning stage of the audit in our Audit Strategy Memorandum, our risk assessment is a continuous process and we regularly consider whether new significant risks have arisen and how we intend to respond to these risks. No new risks have been identified since we issued our Audit Strategy Memorandum.

Management override of controls

Description of the risk

In all entities, management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.

How we addressed this risk

We addressed this risk through performing audit work over:

- Accounting estimates impacting on amounts included in the financial statements;
- Consideration of identified significant transactions outside the normal course of business; and
- Journals recorded in the general ledger and other adjustments made in preparation of the financial statements.

Audit conclusion

Satisfactory assurance has been gained over the presumed risk of management override. We have no matters to report.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Revenue recognition

Description of the risk

There is a presumption under International Standards on Auditing that there is a significant risk of fraud and error in the timing of revenue recognition leading to the material misstatement of revenue overall. This is because revenue is an area of particular focus by all users of financial statements and can be subject to judgements as to when income for services should be recognised.

This risk only applies to the non-grant income generated by the College. The risk has been rebutted in relation to grant income received by the College, given the highly regulated nature of this income.

How we addressed this risk

We addressed this risk through performing work over:

- The design and implementation of controls management has in place to ensure income is recognised in the correct period;
- Cash receipts around the year end and to ensure they have been recognised in the right year; and
- The judgements made by management in determining when income for the services is recognised.

Audit conclusion

Satisfactory assurance has been gained over the presumed risk of revenue recognition. We have no matters to report.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Key areas of management judgement

Key areas of management judgement include accounting estimates which are material but are not considered to give rise to a significant risk of material misstatement. These areas of management judgement represent other areas of audit emphasis.

Valuation of pension liabilities

Description of the management judgement

The College makes contributions to two pension schemes – the Scottish Teachers Superannuation Scheme (STSS) and the Lothian Pension Fund (LPF). While both are defined benefit schemes, it is not possible to identify the College's share of the underlying assets and liabilities in the STSS and it is therefore accounted for as a defined contribution scheme.

The College's share of the LPF's underlying assets and liabilities is identifiable and a net liability is recognised in the accounts.

Given the scale of the liability recognised in the accounts, a misstatement in the reported position could be material to the financial statements.

How our audit addressed this area of management judgement

We considered the College's arrangements, including the existence of any relevant controls, for making estimates in relation to pension entries within the financial statements.

We also considered the reasonableness of the actuary's assumptions used in providing the College with information in the financial statements through the use of our internal experts.

Audit conclusion

Our audit work has provided satisfactory assurance over the valuation of the pension liability reported in the accounts and the actuarial assumptions used to calculate the liability. We have no matters to report.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Valuation of land and buildings

Description of the management judgement

The College holds a significant level of land and buildings – reporting a net book value of £17.8m as at 31 July 2017.

In line with the requirements of the Government Financial Reporting Manual, the College has adopted a formal revaluation policy of an external valuation every five years, with a desktop, interim valuation performed during the five year period. The interim valuation was performed as at 31 July 2017, so there is no revaluation in the current year.

The College policy meets the requirement of the FE SORP that assets are valued sufficiently regularly so that the carrying value of the asset is not materially different from its fair value.

The College is also required to assess on an annual basis whether there are indicators of impairment to assets at the reporting date.

Given the significance of the value of fixed assets held, a misstatement in the valuation could be material to the financial statements.

How our audit addressed this area of management judgement

We undertook a range of substantive procedures including:

- Review of management's assessment as to whether the value still reflects the prior year valuation;
- Review of the reconciliation between the College's asset register and general ledger; and
- Considered the College's impairment review process for land and buildings.

Audit conclusion

Our audit work has provided satisfactory assurance over the valuation of the land and buildings. We have no matters to report.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Financial Performance

The College is required to report financial performance under the HE/FE SORP, resulting in the reported surplus/deficit of £1,712k in the Statement of Comprehensive Income. However, as a central government body, the College is also required under the Accounts Direction from the Scottish Funding Council to report financial performance as an 'adjusted operating position'. We set out these required positions below.

	2017/18 £'000	2016/17 £'000
Operating income	17,837	18,618
Staff costs	11,922	10,933
Operating expenditure	6,854	7,962
Operating Deficit for the year (FE/HE SORP basis)	(939)	(277)

The decrease in income of £781k mainly relates to a reduction in the release of SFC deferred grants during the year compared to the prior year, while other income sources generally showed increases. The overall accounting deficit has increased by £662k as a result of the decreased income.

Staff cost increases have been primarily driven by the outcome of national bargaining. The percentage increase is reflective of the sector as a whole. Overall expenditure has decreased due to the impairment of asset values in the prior year, which has subsequently reduced the annual depreciation charge on some assets. The remaining expenditure is reasonably consistent with the prior year aside from premises expenses where £578k was spent on window repairs during the current year. This expenditure was offset by a grant received from the SFC.

All other expenditure is reasonably consistent with the prior year.

While showing an accounting deficit, we highlight that:

- The College met its student credit target confirming the level of funding in the financial statements;
- The College achieved its financial targets in line with its plan; and
- There were no significant changes to the reported position during the year.

Adjusted operating position

The table above sets out the financial position in accordance with the SORP requirements. The table below reflects the 'adjusted operating position' as required by the Accounts Direction set by the SFC. The adjusted operating position removes more volatile accounting entries, such as the valuation of pensions and those that do not have an immediate cash impact on the College. Full details of the adjustments included are shown on page 13 in the accounts.

	2017/18 £'000	2016/17 £'000
Deficit before other gains and losses	(939)	(277)
Add back:		
- Depreciation (net of deferred capital grant release)	343	199
- Non-cash pension adjustments for the Lothian Pension Fund	848	645
Deduct:		
- CBP allocated to loan repayments	158	158
- CBP allocated to Early Retirement payments	32	-
- Balance of payments to ERP	63	107
Adjusted operating (deficit/)/surplus	(1)	302

The College's position has more or less achieved a break even adjusted operating position in the current year. This is encouraging as the deficit before other gains and losses was significantly higher than in the previous year. The College is operating sustainably within its funding allocation.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Qualitative aspects of the entity's accounting practices

We have reviewed the College's accounting policies and disclosures and concluded they comply with the requirements of the 2015 Statement of Recommended Practice: Accounting for Further and Higher Education and the Government Financial Reporting Manual 2017/18 , appropriately tailored to the College's circumstances.

Our audit fieldwork commenced on 1 October 2018, with the first draft of the annual report and accounts being received from the Finance Manager on 2 October 2018 which was later than anticipated. The draft annual report and accounts were of an acceptable quality, although several further versions were issued due to financial and disclosure adjustments being made.

Producing quality supporting working papers is a crucial part of compiling financial statements that are complete and materially accurate. They also support the delivery of an efficient audit. Working papers provided for audit were good and staff were responsive to our requests during the audit.

Significant difficulties during the audit

During the course of the audit we did not encounter any significant difficulties and we have had the full co-operation of management.

3. SUMMARY OF MISSTATEMENTS (CONTINUED)

There were no unadjusted misstatements identified during the course of the audit above the trivial threshold of £11k.

The table below outlines the misstatements that have been adjusted by management during the course of the audit.

Adjusted misstatements 2017/18

		Statement of Comprehensive Income		Balance Sheet	
		Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
1	Dr: Bad debt provision			14	
	Cr: Expenditure		14		
	Being release of bad debt provision for debt repaid post year end.				
2	Dr: Employer suspense account			19	
	Cr: Expenditure		19		
	Release of funds in suspense account that have been fully reconciled.				
3	Dr: Debtors			2	
	Cr: Income		2		
	Being monies received from CITB not processed to income.				
4	Dr: Prepayments			14	
	Cr: Expenditure		14		
	Being correction of 2018/19 expenditure incorrectly processed in 2017/18.				

The total effect of the adjustments above were to decrease expenditure (and therefore decrease the accounting deficit) by £47k.

Disclosure amendments 2017/18

The audit review process suggested amendments to the Corporate Governance Statement to ensure this is in line with the Accounts Direction issued by the Scottish Funding Council.

A number of other minor presentational amendments were made following review of the draft Annual Report and Accounts and discussion with management.

4. WIDER SCOPE

Our approach to wider scope work

The Code requires us to conclude and make a judgement on the four dimensions of wider scope work. These are:

- financial sustainability;
- financial management;
- governance and transparency; and
- value for money.

In recognition that audit work should be risk based and proportionate to the nature and size of the audited body, the Code allows auditors to determine whether application of the full wider scope work is appropriate in smaller bodies. At the planning stage, we considered that the audit of West Lothian College should be carried out under the small body provisions of the Code. We have reached this conclusion through our assessment of:

- the relative size of the College;
- the relative simplicity of the College's functions;
- the College's risk profile; and
- the results of our full review of wider scope dimensions in 2016/17 that did not indicate any areas of higher risk.

In line with the Code requirements, our work has therefore focused on financial sustainability and the governance statement.

4. WIDER SCOPE
FINANCIAL SUSTAINABILITY

Dimension

Financial sustainability extends the going concern assumption from the financial statements, looking forward two to five years, reviewing and assessing arrangements for financial planning and affordable and sustainable service delivery in this timescale.

Our conclusion

West Lothian College has adequate financial planning arrangements in place.

Financial Planning

A review of the minutes of the Finance Committee and onwards to the Board demonstrated effective challenge of the financial position by members throughout the year.

In its annual review of the FE sector, Audit Scotland's 'Scotland's Colleges 2018' noted that the Scottish Funding Council (SFC) now requires colleges to prepare six-year financial forecasts, with the current forecasts running from 2016-17 to 2021-22. The SFC has been working with sector representatives to develop a set of common assumptions that colleges should use for longer-term financial forecasting. These assumptions are used to produce a financial forecast return (FFR) which is submitted to the SFC annually.

The College has a 6 year plan (which runs from 2017/18 to 2022/23), which is in line with the SFC requirements. There are inherent uncertainties around SFC funding for the College and student support funds, which provide difficulties in forecasting accurately.

The College's forecast as presented to, and approved by the Board is as follows:

	Forecast 2018/19 £000	Forecast 2019/20 £000	Forecast 2020/21 £000	Forecast 2021/22 £000	Forecast 2022/23 £000
Total income	18,513	19,268	20,004	20,097	20,078
Staff costs	13,468	14,045	14,742	14,939	14,951
Total expenditure	5,897	6,075	6,114	6,010	5,979
Deficit before other gains & losses	**(852)**	**(852)**	**(852)**	**(852)**	**(852)**
Add back:					
- Depreciation (net of deferred capital grant release)	325	325	325	325	325
- Non-cash pension adjustments for the LPF	813	813	813	813	813
Deduct:					
- CBP allocated to loan repayments and other capital items	258	258	258	258	258
Underlying operating result	**28**	**28**	**28**	**28**	**28**

The figures above are based on the following:

- Income assumptions provided by the SFC with additional credits and grants assumed in 2020/21 onwards with additional lecturing costs incorporated as appropriate;
- A largely flat income level for other/alternative income levels – but incorporates as element of growth the College consider achievable. The College has recently been notified that the re-tender for the training contract with Children's Hearings Scotland has been successful which will provide additional income (and costs) for 3 years;
- Increase in operational expenditure over the 6 years from £18.8m to £19.8m; and
- Salaries increasing slightly from being 67% to being 72% of total expenditure.

4. WIDER SCOPE
FINANCIAL SUSTAINABILITY (CONTINUED)

The forecast on the previous page was submitted to the SFC as their FFR. However, on request from the SFC, a further FFR has now been developed, with the following differences:

- The additional credits and grants assumed in 2020/21 onwards with additional lecturing costs incorporated as appropriate have been removed from the forecast; and
- The SFC had advised that adjustments in relation to the pension should be removed, so the non-cash balances are not added back in the calculation.

	Forecast 2018/19 £000	Forecast 2019/20 £000	Forecast 2020/21 £000	Forecast 2021/22 £000	Forecast 2022/23 £000
Underlying operating result (including growth – Scenario 1)	28	28	28	28	28
Underlying operating result (excluding growth – Scenario 2)	(4)	(4)	(95)	(135)	(278)
Decrease in underlying operating result	**(32)**	**(32)**	**(123)**	**(147)**	**(306)**

We understand that the Board, with the new Principal, are reviewing the projected outcomes of the forecast and are considering efficiency savings that can be implemented to mitigate the funding gap identified.

We consider that financial planning is appropriately managed by the College, and that scrutiny and discussion over future financial plans are built into the various committee and Board meetings.

Asset Management and Estates Strategy

An Estates Strategy 2015-2025 is in place. It was introduced to complement the College strategic and operational plans. The key aim of the Estate Strategy is to ensure maintenance of high quality fit for purpose facilities, minimum environmental impact and operational sustainability. The Board of Governors, through the Finance & General Purposes Committee monitors the strategy, and it is reviewed every 3 years in conjunction with the Corporate Plan.

During the year, Gardiner & Theobald were appointed by the Scottish Funding Council in January 2017 to provide a summary of the conditions of the estates within the Scottish Further Education sector, being the first independent review of the college estate in Scotland for 10 years.

The West Lothian College survey showed an estimate of £2 million of costs over the 5 year period from 2017-18 to 2022-23, with only £17k being identified as urgent. The report states that expenditure of this level is to be expected with buildings approaching 20 years old. The work marked as urgent has already been completed, and the remaining works are currently being planned.

We consider that appropriate attention is given to the estate and assets, and that their maintenance is factored into long term plans and discussions.

4. WIDER SCOPE
GOVERNANCE STATEMENT

Dimension
Governance and transparency covers the effectiveness of scrutiny and governance arrangements, leadership and decision making and transparent reporting of financial and performance information.

Our conclusion
West Lothian College has governance arrangements in place that provide appropriate scrutiny of decisions made by the Board, these are reflected in the governance statement

Governance arrangements

Our work in this area has considered the overall governance arrangements in place at the College, reviewed the financial and performance reporting to the Board of Governors, and reviewed the minutes of committees to inform our assessment of the appropriateness of the governance structure. We have also attended Audit Committees during the year.

Subsequent to the year end, the Principal of the College resigned on 3 August 2018 and a new Principal, Jackie Galbraith took up post on 6 August 2018. The new Principal will be approving and signing the Performance Report and she has received full assurances over the Governance arrangements in place at the College from the Senior Team for the year ended 31 July 2018. This has been appropriately disclosed in the Governance Statement.

During 2017/18, the Board consisted of 18 members, 8 female (including the Principal) and 10 male. The Board continues to work towards a gender balance that meets with the objective of the Gender Representation on Public Boards (Scotland) Bill which was introduced by the Scottish Parliament in June 2017 with an implementation date of 2022.

The key committees comprise, and are chaired by former Board members, with each also containing the Principal, with the exception of the Audit Committee. However, we note that the Principal attended the Audit Committee on a regular basis. The new Principal has continued these arrangements. In addition, the Chair of the Board is also not permitted to be a member of the Audit Committee. Appropriate College officers attend committees and present reports as required.

The Board and each of the various the committees (including the Audit Committee) meet 4 times a year. Minutes of these meetings are published to the College's website in a timeous fashion following the meetings, showing transparency. Committee papers are detailed and provide a good overview of the content of the meetings.

Governance Statement
As part of our audit we have read the governance statement included in the annual report. The governance statement sets out the corporate governance framework in place throughout the reporting year, the internal controls in operation, the work of internal audit and the overall efficiency and effectiveness of the governance framework.

The governance statement confirms the college's compliance with the 2016 Code of Good Governance for Scotland's Colleges.

We are required to read and provide an opinion on the governance statement. In our opinion, the information contained within is consistent with the financial statements. We also consider that the governance statement has been prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and further directions made by the Scottish Funding Council.

Internal audit
An effective internal audit service is an important element of any organisation's governance arrangements. Internal audit provide the College with independent assurance on internal control and corporate governance processes. The internal audit function at the College is provided by Scott Moncrieff. Internal audit have attended Audit Committees throughout the year and have produced a number of reports to support the overall Head of Internal Audit Opinion.

5. OUR FEES

Fees for work as the College's appointed auditor

We reported out proposed fees for the delivery of our work in our Audit Strategy Memorandum, presented to the Audit Committee in June 2018. Having substantially completed our work for the 2017/18 financial year, we can confirm that our final fees are as follows:

Area of work	Proposed fee 2017/18	Final fee 2017/18
Auditor remuneration	£12,880	£12,880
Pooled costs	£830	£830
Contribution to Audit Scotland costs	£720	£720
Total Fee	£14,430	£14,430

We confirm that these fees are in line with the scale fee set by Audit Scotland. We also confirm that we have not undertaken any non-audit services for the College in the year.

APPENDIX A
INDEPENDENCE

As part of our ongoing risk assessment we monitor our relationships with you to identify any new actual or perceived threats to our independence within the regulatory or professional requirements governing us as your auditors.

We can confirm that no new threats to independence have been identified since issuing the Audit Strategy Memorandum and therefore we remain independent.