Audit Strategy Memorandum

Ayrshire College

Year ending 31 July 2019

MAZARS

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MAZARS

Mazars LLP
100 Queen Street
Glasgow
G1 3DN

The Board of Management
Ayrshire College
Kilmarnock Campus
Hill Street
Kilmarnock
KA1 3HY

11 June 2019

Dear Members,

Audit Strategy Memorandum – Year ending 31 July 2019

We are pleased to present our Audit Strategy Memorandum for Ayrshire College for the year ending 31 July 2019.

The purpose of this document is to summarise our audit approach, highlight significant audit risks and areas of key judgements and provide you with the details of our audit team. As it is a fundamental requirement that an auditor is, and is seen to be, independent of its clients, Section 7 of this document also summarises our considerations and conclusions on our independence as auditors.

We consider two-way communication with you to be key to a successful audit and important in:

- reaching a mutual understanding of the scope of the audit and the responsibilities of each of us;
- sharing information to assist each of us to fulfil our respective responsibilities;
- providing you with constructive observations arising from the audit process; and
- ensuring that we, as external auditors, gain an understanding of your attitude and views in respect of the internal and external operational, financial, compliance and other risks facing Ayrshire College which may affect the audit, including the likelihood of those risks materialising and how they are monitored and managed.

This document, which has been prepared following our initial planning discussions with management, is the basis for discussion of our audit approach, and any questions or input you may have on our approach or role as auditor.

This document also contains specific appendices that outline our key communications with you during the course of the audit, and forthcoming accounting issues and other issues that may be of interest.

Client service is extremely important to us and we strive to continuously provide technical excellence with the highest level of service quality, together with continuous improvement to exceed your expectations so, if you have any concerns or comments about this document or audit approach, please do not hesitate to contact me.

Yours faithfully

Lucy Nutley

Mazars LLP

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1. ENGAGEMENT AND RESPONSIBILITIES SUMMARY

Overview of engagement

We are appointed by the Auditor General for Scotland to perform the external audit of Ayrshire College for the year to 31 July 2019. This is our third year of appointment.

Responsibilities

Our responsibilities, principally derived from the Code of Audit Practice ('the Code') issued by Audit Scotland, are outlined below.

Audit opinion	We are responsible for forming and expressing an opinion on the financial statements. The Audit Committee is responsible for the assessment of the College's ability to continue as a going concern. As auditors, we are required to consider the appropriateness of the use of the going concern assumption in the preparation of the financial statements and the adequacy of the disclosures made.
Regularity opinion	We are required to form and express an opinion on whether the College has, in all material respects, incurred expenditure and income in accordance with any applicable enactments and guidance issued by the Scottish Ministers.
Opinion on other matters	We are required to express an opinion on whether the audited part of the Remuneration and Staff Report, and the Governance Report have been properly prepared in line with relevant legislation and directions. We also express an opinion on whether the Performance Report is consistent with the audited financial statements.
Wider scope work	The Code requires us to conclude and make a judgement on the four dimensions of wider scope work. The four dimensions are Financial Sustainability, Financial Management, Governance and Transparency, and Value for Money.

Our audit does not relieve management or the Board of Management, as those charged with governance, of their responsibilities. The responsibility for safeguarding assets and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with both those charged with governance and management. In accordance with International Standards on Auditing (UK), we plan and perform our audit so as to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. However our audit should not be relied upon to identify all such misstatements.

As part of our audit procedures in relation to fraud we are required to enquire of those charged with governance as to their knowledge of instances of fraud, the risk of fraud and their views on management controls that mitigate the fraud risks.

2. YOUR AUDIT ENGAGEMENT TEAM

- **Lucy Nutley** – Director
- Lucy is the Engagement Lead for the audit and will be the key point of contact for the Audit Committee. She will have overall responsibility for delivering a high quality audit to the College. Lucy will be responsible for the opinions given on the financial statements and will liaise with the Vice Principal – Finance and ICT, Director of Finance and Student Funding and Head of Financial Services. She will attend Audit Committee meetings, and where appropriate, Board meetings.
- lucy.nutley@mazars.co.uk

- **Joanne Buchanan** – Senior Manager
- Joanne will manage and coordinate the audit and be the key point of contact for the Vice Principal – Finance and ICT, Director of Finance and Student Funding and Head of Financial Services, as well as liaising with Internal Audit. Joanne will oversee completion of audit work to a high standard and attend Audit Committees as appropriate.
- joanne.buchanan@mazars.co.uk

- **Suzie Graham** – Audit Assistant Manager
- Suzie will be responsible for leading the onsite work, reviewing the work of more junior members of the team and performing the audit work in more specialised areas.
- suzie.graham@mazars.co.uk

3. AUDIT SCOPE, APPROACH AND TIMELINE

Audit scope

Our audit approach is designed to provide an audit that complies with all professional requirements.

Our audit of the financial statements will be conducted in accordance with International Standards on Auditing (UK), relevant ethical and professional standards, our own audit approach and in accordance with the terms of our engagement. Our work is focused on those aspects of your business which we consider to have a higher risk of material misstatement, such as those affected by management judgement and estimation, application of new accounting standards, changes of accounting policy, changes to operations or areas which have been found to contain material errors in the past.

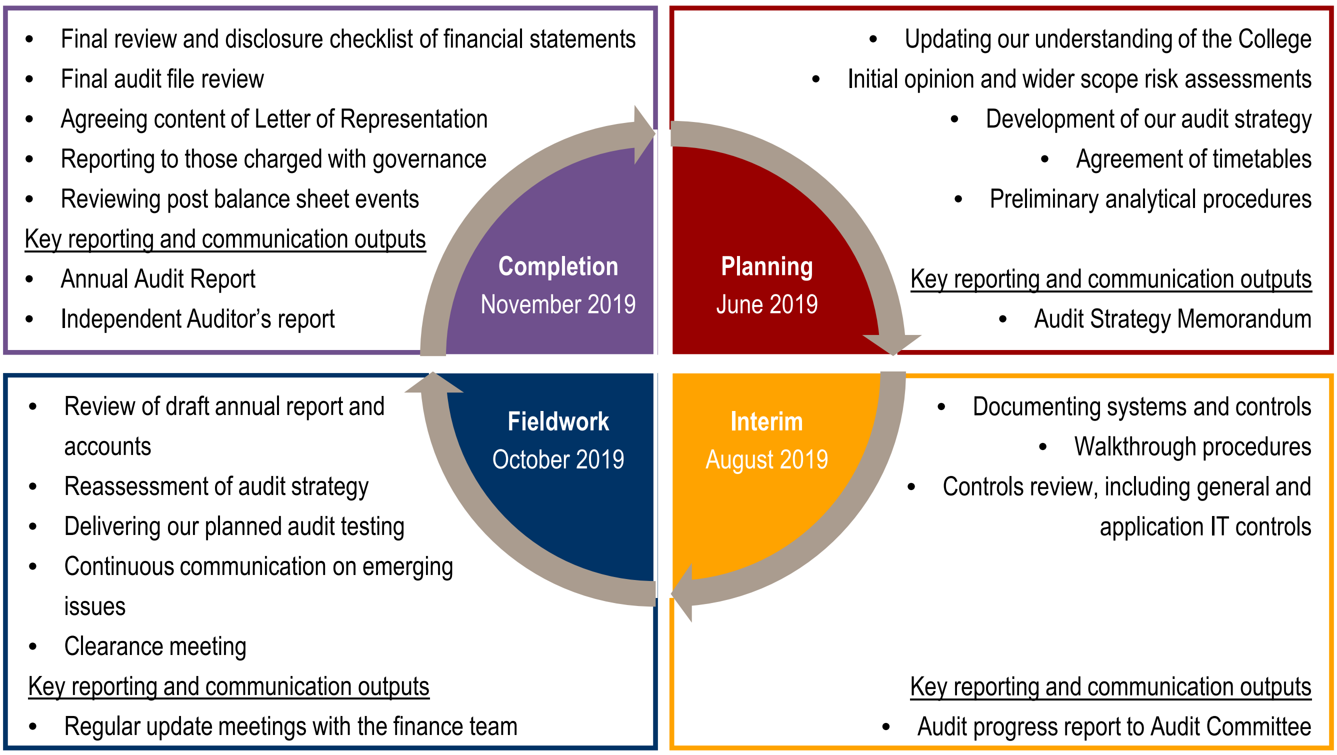
Audit approach

Our audit approach is a risk-based approach primarily driven by the risks we consider to result in a higher risk of material misstatement of the financial statements. Once we have completed our risk assessment, we develop our audit strategy and design audit procedures in response to this assessment.

If we conclude that appropriately designed controls are in place then we may plan to test and rely upon these controls. If we decide controls are not appropriately designed, or we decide it would be more efficient to do so, we may take a wholly substantive approach to our audit testing. Substantive procedures are audit procedures designed to detect material misstatements at the assertion level and comprise tests of details (of classes of transactions, account balances, and disclosures) and substantive analytical procedures. Irrespective of the assessed risks of material misstatement, which take into account our evaluation of the operating effectiveness of controls, we are required to design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

Our audit will be planned and performed so as to provide reasonable assurance that the financial statements are free from material misstatement and give a true and fair view. The concept of materiality and how we define a misstatement is explained in more detail in section 8.

The diagram below outlines the procedures we perform at the different stages of the audit.



3. AUDIT SCOPE, APPROACH AND TIMELINE (CONTINUED)

Reliance on internal audit

Where possible we will seek to utilise the work performed by internal audit to modify the nature, extent and timing of our audit procedures. We will meet with internal audit to discuss the progress and findings of their work prior to the commencement of our controls evaluation procedures.

Where we intend to rely on the work on internal audit, we will evaluate the work performed by your internal audit team and perform our own audit procedures to determine its adequacy for our audit.

Management's and our experts

Management makes use of experts in specific areas when preparing the College's financial statements. We also use experts to assist us to obtain sufficient appropriate audit evidence on specific items of account.

Items of account	Management's expert	Planned audit approach
Defined benefit pension liability and associated accounting entries and disclosures required by FRS 102.	Actuary – Hymans Robertson	We will consider the reasonableness of the actuarial assumptions made, referring to our in-house pension scheme experts.

4. SIGNIFICANT RISKS AND KEY JUDGEMENT AREAS

Following the risk assessment approach discussed in section 3 of this document, we have identified relevant risks to the audit of financial statements. The risks that we identify are categorised as significant, enhanced or standard, as defined below:

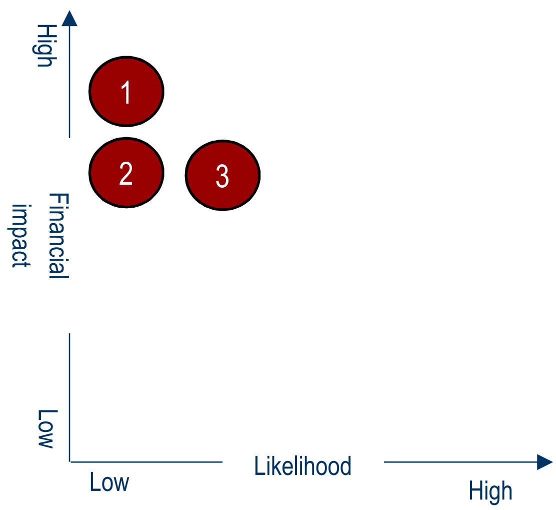
Significant risk — A significant risk is an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration. For any significant risk, the auditor shall obtain an understanding of the entity's controls, including control activities relevant to that risk.

Enhanced risk — An enhanced risk is an area of higher assessed risk of material misstatement ('RMM') at audit assertion level other than a significant risk. Enhanced risks incorporate but may not be limited to:

- key areas of management judgement, including accounting estimates which are material but are not considered to give rise to a significant risk of material misstatement; and
- other audit assertion risks arising from significant events or transactions that occurred during the period.

Standard risk — This is related to relatively routine, non-complex transactions that tend to be subject to systematic processing and require little management judgement. Although it is considered that there is a risk of material misstatement (RMM), there are no elevated or special factors related to the nature, the likely magnitude of the potential misstatements or the likelihood of the risk occurring.

The summary risk assessment, illustrated in the audit risk continuum below, highlights those risks which we deem to be significant and other enhanced risks. We have summarised our audit response to these risks on the next page.



Risk	
1	Management override of control
2	Revenue recognition
3	Expenditure recognition

4. SIGNIFICANT RISKS AND KEY JUDGEMENT AREAS (CONTINUED)

We provide more detail on the identified risks and our testing approach with respect to significant risks in the table below. An audit is a dynamic process, should we change our view of risk or approach to address the identified risks during the course of our audit, we will report this to the Audit Committee.

Significant risks

	Description of risk	Planned response
1	**Management override of controls** 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 there is a risk of material misstatement due to fraud on all audits.	We will address this risk through performing audit work over: • Accounting estimates impacting 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
2	**Revenue recognition** 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 users of financial statements and can be subject to judgements as to when grant income should be recognised and if clawback conditions apply to the funding. The risk above applies only to the non-grant income generated by the College. The risk has been rebutted in relation to the grant income received by the College, given the highly regulated nature of this income, and therefore the low inherent risk associated with it.	We will address this risk through performing audit 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 to ensure they have been recognised in the right year; • the judgements made by management in determining when non-grant income is recognised; and • for major non-grant income, obtaining counterparty confirmation.

4. SIGNIFICANT RISKS AND KEY JUDGEMENT AREAS (CONTINUED)

	Description of risk	Planned response
3	**Expenditure recognition** For public sector organisations, the same risk can apply to the recognition of non-payroll related expenditure and contractual obligations. The pressure to manage expenditure to ensure that budgeted outcomes are achieved increases the risk surrounding fraudulent reporting of expenditure.	We will address the risk through performing audit work over: • the design and implementation of controls management has in place; • testing of non-payroll expenditure around the year end to ensure transactions are recognised in the correct year; • testing material year end payables, accruals and provisions; and • reviewing judgements about whether the criteria for recognising provisions are satisfied.

Area of focus

Enhanced risks can arise from significant events occurring in relation to the period under review. The College has undertaken a voluntary severance scheme during FY18/19. The scheme is approved by the Scottish Funding Council and is due to close on 31 July 2019. This has been assessed as an area of audit focus due to the funding received from the Scottish Funding Council to undertake the scheme and the significant costs associated to ensure that the College can achieve the savings identified.

	Area of focus	Planned response
1	**Voluntary Severance Scheme** The SFC has agreed to provide the College with strategic funding in 2018/19 for a second voluntary severance scheme, as part of the College's Transition Plan. An initial strategic grant of £300k was awarded with a further £700k agreed, that will be used to fund severances in the period to 31 July 2019.	We will consider the procedures in place in relation to the operation of the voluntary severance scheme: • the severance pay amounts and how these have been calculated; • the communication of the voluntary severance scheme to those affected; • whether the funding received to fund the voluntary severance scheme has been utilised in accordance with the grant conditions; and • the accounting treatment of payments and disclosures made in the financial statements.

4. SIGNIFICANT RISKS AND KEY JUDGEMENT AREAS (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.

	Area of management judgement	Planned response
1	**Valuation of pension liabilities** The College makes contributions to two pension schemes – the Scottish Teachers Superannuation Scheme (STSS) and the Strathclyde Pension Fund (SPF). 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 SPF'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.	We will consider the College's arrangements, including the existence of any relevant controls, for making estimates in relation to pension entries within the financial statements. We will also consider 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.
2	**Valuation of land and buildings** The College holds land and buildings with a net book value of £113m as at 31 July 2018. 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. As the full valuation was performed as at 31 July 2018, no revaluation is planned 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 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.	We will undertake 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 • consider the College's impairment review process for land and buildings.

5. WIDER SCOPE WORK

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.

We set out below the work that we intend to perform to reach these judgements:

Dimension	Description	Our planned approach
Financial sustainability	Extending our work on the going concern assumption in the financial statements looking forward two to five years from the reporting date, reviewing and assessing the college's arrangements for financial planning and affordable and sustainable service delivery	We intend to consider: • the financial planning system in place for short, medium and long term periods • the adequacy and accuracy of financial reporting arrangements • the reasonableness of affordability assumptions made in financial planning
Governance Statement	The Governance Statement sets out the internal control arrangements and governance framework in place for the year under review	We intend to consider: • the effectiveness of internal control arrangements • the appropriateness of disclosures made in the Governance Statement • whether the disclosure requirements of the Accounts Direction and the Code of Good Governance for Scotland's Colleges have been met
Financial Management	Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.	We intend to consider: • the monitoring of the effectiveness of internal control arrangements • whether the College's budgetary control system is timely and accurate • whether and how the college has assessed their financial capacity and skills
Value for Money	Value for money concerns using resources effectively and continually improving services.	We intend to consider: • the College's evidence of providing value for money • the focus on improving value for money and the pace of change at the College.

5. WIDER SCOPE WORK (CONTINUED)

Identified significant risks to our wider scope work

We have also considered, as part of our planning, whether there are significant risks that would impact on any of the four areas of our wider scope work that require special audit consideration. At the planning stage we have identified one significant risks, as detailed below. Should our assessment of risk, or our planned approach to address the risk change during the course of the audit, we will report this to the Audit Committee.

Description of significant risk	Planned response
Financial sustainability Our 2017/18 Annual Audit Report concluded that Ayrshire College had adequate planning arrangements in place, however, financial sustainability concerns had been identified. The College and its Board are aware of the financial challenges and associated risks that it faces. A funding gap of £11.89m has been identified over a 5 year period principally as a result of the contractual PFI capital and interest payments of £1.4m per annum in respect of the Kilwinning Campus along with increasing staff costs as a result of National Bargaining. The College engaged in discussions with the SFC and has prepared a detailed Financial Sustainability Plan to obtain additional strategic funding in 2019/20 and 2020/21, with further funding of £1.3m for a voluntary severance scheme being committed by the SFC in 2018/19. The plan was submitted in December 2018. The rationale of the plan is to reduce operational costs to enable the affordability of the contractual PFI payments from core funding. The SFC has also pledged support of £0.7m each year for a two year period (2019/20 and 2020/21) to help the College meet it's PFI payment in respect of Kilwinning Campus. As the Financial Sustainability Plan is still in its infancy and voluntary severance is still in the process of being arranged, we consider there still remains a risk to the College achieving financial sustainability. The College also continues to manage its Estate portfolio and budgeted expenditure to ensure that cost savings are made wherever possible.	We intend to consider: • the forecast financial position in the five year financial plans submitted to the SFC; • the financial and resource implications of any voluntary severance scheme proposed to be run by the College; • the College's achievement of requirements set by the SFC on receipt of funding; • alternative plans being considered by the College to ensure a balanced budget is achieved; and • the financial reporting arrangements in place at the College.

6. FEES FOR AUDIT AND OTHER SERVICES

Fees for audit and other services

Our fees for the audit of the financial statements and for any other services are outlined in the tables below.

Service	2018/19 proposed fee £	2017/18 final fee £
Auditor remuneration	29,780	26,580
Pooled costs	1,570	1,700
Contribution to Audit Scotland costs	1,650	1,480
Total Fee	**33,000**	**29,760**

The fees outlined above are provided on the basis that we will receive a high-quality set of draft financial statements, supported by good working papers. Should we be required to perform significant levels of additional audit work, or face significant delay in our audit, we will discuss the impact of this on our proposed fee with management.

Audit Scotland planning guidance allows the auditor to increase the auditor remuneration by to 10%. We have applied that increase this year in light of the additional work required from the Wider Scope significant risks.

7. OUR COMMITMENT TO INDEPENDENCE

We are committed to independence and are required by the Financial Reporting Council to confirm to you at least annually, in writing, that we comply with the Financial Reporting Council's Ethical Standard. In addition, we communicate any matters or relationship which we believe may have a bearing on our independence or the objectivity of the audit team.

Based on the information provided by you and our own internal procedures to safeguard our independence as auditors, we confirm that in our professional judgement there are no relationships between us and any of our related or subsidiary entities, and you and your related entities creating any unacceptable threats to our independence within the regulatory or professional requirements governing us as your auditors.

We have policies and procedures in place which are designed to ensure that we carry out our work with integrity, objectivity and independence. These policies include:

- all partners and staff are required to complete an annual independence declaration;
- all new partners and staff are required to complete an independence confirmation and also complete computer-based ethical training;
- rotation policies covering audit engagement partners and other key members of the audit team;
- use by managers and partners of our client and engagement acceptance system which requires all non-audit services to be approved in advance by the audit engagement partner.

We confirm, as at the date of this document, that the engagement team and others in the firm as appropriate, and Mazars LLP are independent and comply with relevant ethical requirements. However, if at any time you have concerns or questions about our integrity, objectivity or independence please discuss these with Lucy Nutley in the first instance.

Prior to the provision of any non-audit services, Lucy Nutley will undertake appropriate procedures to consider and fully assess the impact that providing the service may have on our auditor independence.

Any emerging independence threats and associated identified safeguards will be communicated in our Annual Audit Report.

8. MATERIALITY AND MISSTATEMENTS

Definitions
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.

Summary of initial materiality thresholds

Threshold	Initial threshold £
Overall materiality	1,042,000
Performance materiality	834,000
Trivial threshold for errors to be reported to the Audit Committee	31,000
Specific materiality for Remuneration and Staff Report	500

Materiality
Judgements on materiality are made in light of surrounding circumstances and are affected by the size and nature of a misstatement, or a combination of both. Judgements about materiality are based on consideration of the common financial information needs of users as a group and not on specific individual users.

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.

Whilst planning, we make judgements about the size of misstatements which we consider to be material and which provides a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

The materiality determined at the planning stage does not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, will be considered as immaterial.

We revise materiality for the financial statements as our audit progresses should we become aware of information that would have caused us to determine a different amount had we been aware of that information at the planning stage.

We consider that gross expenditure remains the key focus of users of the financial statements and, as such, we base our materiality levels around this benchmark. We will identify a figure for materiality but identify separate levels for procedures design to detect individual errors, and also a level above which all identified errors will be reported to the Audit Committee.

We expect to set a materiality threshold at 2% of gross expenditure (£1,042,000).

After setting initial materiality, we continue to monitor materiality throughout the audit to ensure that it is set at an appropriate level.

8. MATERIALITY AND MISSTATEMENTS (CONTINUED)

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 the level we use to calculate our sample sizes, and is our acceptable difference in any substantive analytical procedures. 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.

Specific Materiality

We assess specific materiality if there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the users of the financial statements. Specific materiality focuses on the qualitative nature, as well as the size, of an item. It recognises that, in some circumstances, it may take a much smaller misstatement to influence the user of the financial statements.

We are required to provide an opinion as to whether the audited part of the Remuneration and Staff Report has been properly prepared. Given the sensitivity of the disclosures made in the Remuneration and Staff Report, we have assessed a specific materiality for this work at £500, being the level that would impact rounding for figures shown to the nearest £'000.

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. Based on our preliminary assessment of overall materiality, our proposed triviality threshold is £31,000 based on 3% of overall materiality. If you have any queries about this please do not hesitate to raise these with Lucy Nutley.

APPENDIX A – KEY COMMUNICATION POINTS

ISA (UK) 260 'Communication with Those Charged with Governance', ISA (UK) 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' and other ISAs (UK) specifically require us to communicate the following:

Required communication	Audit Strategy Memorandum	Audit Completion Report
Our responsibilities in relation to the audit of the financial statements and our wider responsibilities	✓	
Planned scope and timing of the audit	✓	
Significant audit risks and areas of management judgement	✓	
Our commitment to independence	✓	✓
Responsibilities for preventing and detecting errors	✓	
Materiality and misstatements	✓	✓
Fees for audit and other services	✓	
Significant deficiencies in internal control		✓
Significant findings from the audit		✓
Significant matters discussed with management		✓
Our conclusions on the significant audit risks and areas of management judgement		✓
Summary of misstatements		✓
Management representation letter		✓
Our proposed draft audit report		✓