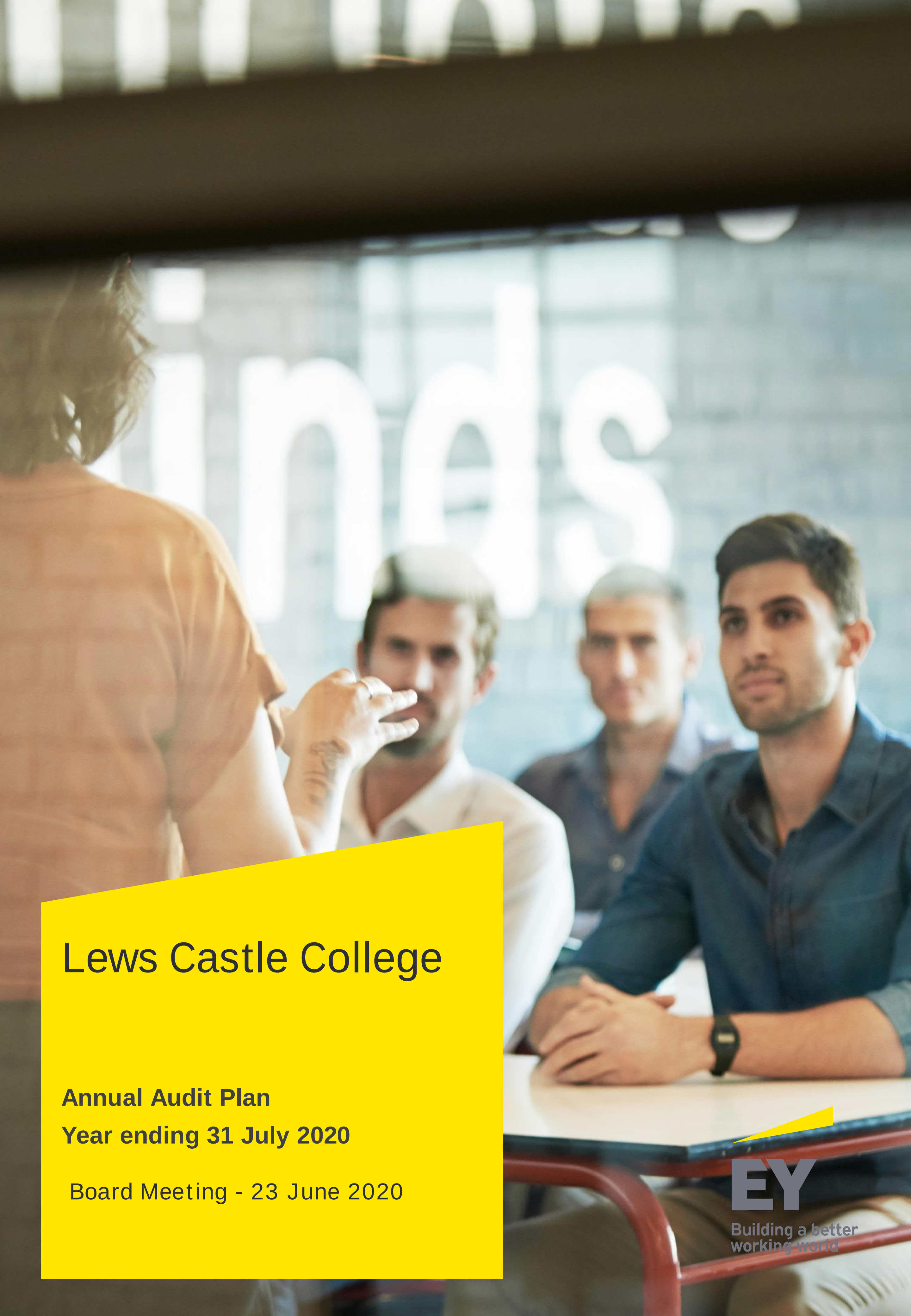

Lews Castle College

Annual Audit Plan

Year ending 31 July 2020

Board Meeting - 23 June 2020

EY
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 Lews Castle College ("the College") for financial years 2016/17 to 2020/21. We undertake our audit in accordance with the Public Finance and Accountability (Scotland) Act 2000 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 for Scotland 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

Our key contacts:

Stephen Reid
Partner
sreid2@uk.ey.com

Rob Jones
Senior Manager
rjones9@uk.ey.com

Our independence

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

Purpose of this report

In accordance with the Public Finance and Accountability (Scotland) Act 2000, Audit Scotland appointed EY as the external auditor of Lews Castle College (the College) for the five year period 2016/17 to 2020/21.

This Annual Audit Plan, prepared for the benefit of College management and the Audit Committee, sets out our proposed audit approach for the audit of the financial year ending 31 July 2020, the fourth year of our appointment. In preparing this plan, we have updated our understanding of the College through planning discussions with management, review of relevant documentation and committee reports, and our general understanding of the environment in which the College is currently operating.

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 our reporting together with our judgements and conclusions regarding arrangements.

After consideration by the College, the plan is provided to Audit Scotland and published on their website.

Scope and Responsibilities

We undertake our audit in accordance with the Code of Audit Practice (the Code), issued by Audit Scotland in May 2016; International Standards on Auditing (UK); relevant legislation; and other guidance issued by Audit Scotland. The Code sets out the responsibilities of both the College and the auditor, more details of which are provided in Appendix A.

Our Financial Statement Audit

We are responsible for conducting an audit of the financial statements of the College. We provide an opinion 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 the College's affairs as at 31 July 2020 and its surplus or deficit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including FRS 102: The Financial Reporting Standard applicable in the UK and Ireland; and
- whether they have been properly 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 the consistency of the other information prepared and published by the College along with the financial statements.

Materiality

Materiality levels have been set at the planning stage of the audit as follows:

Planning Materiality	Tolerable Error	Nominal amount
£135,000	£65,000	£5,000
2% of the College's net expenditure	Materiality at an individual account level	Level that we will report to committee

Based on considerations around the expectations of financial statement users and qualitative factors, we apply a lower materiality level to the audited section of the Remuneration Report. We also apply professional judgement to consider the materiality of related party transactions to both parties.

Wider Scope audit

Our responsibilities extend beyond the audit of the financial statements. The Code requires auditors to provide judgements and conclusions on the two dimensions of wider scope public audit, applicable to small bodies:

- Financial sustainability; and
- Governance and transparency.

Our audit work over the wider scope audit dimensions complements our financial statements audit. We have updated our understanding of the risks impacting the College through discussions with management, review of relevant committee reports, and our knowledge of the education sector.

Audit Risk Dashboard

Key Financial Statement Risks

Fraud Risk: Risk of fraud in revenue and expenditure recognition	In accordance with ISA (UK) 240, we consider the presumed fraud risk in respect of improper income recognition. Due to the nature of SFC funding to the College, we have rebutted the risk of fraud around this specific income stream. We extend our work to consider the recognition of expenditure, in accordance with Practice Note 10, issued by the Financial Reporting Council, as applicable to public sector audit.
Fraud Risk: Misstatement due to fraud or error	As identified in ISA (UK) 240, management is in a unique position to perpetrate fraud due to the ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively.
Inherent risks: Valuation of property, plant and equipment	The value of property, plant and equipment (PPE) represent significant balances in the College's financial statements. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.
Valuation of pension assets and liabilities	Accounting for the Local Government Pension Scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts, the assumptions underlying fair value estimates, and the valuation of the College's share of scheme assets at the year end.

Wider Scope Risks

Financial Sustainability: Continuing financial pressures	The financial environment in which the College operates was already challenging, and the COVID-19 pandemic will result in further, significant financial pressures. It is anticipated that the College will be unable to fully deliver upon savings and income growth targets in 2019/20 due to the global pandemic. This will increase the financial pressures for future years and creates a significant risk that the College will not be able to develop viable and sustainable financial plans due to external factors.
Governance and Transparency: Delivery progress in good governance arrangements	In our prior year audit reporting, we noted a number of areas where progress in respect of previous recommendations for improving governance had been limited and that the pace of improvement around governance arrangements indicated insufficient management capacity to address the scale of improvements required. There is also a significant risk of COVID-19 materially impacting the College's ability to deliver good governance arrangements, both in terms of the impact on the College's way of working and the impact on key individuals charged with delivering good governance.

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2. Sector developments

In accordance with the principles of the Code, our audit work considers key developments in the sector. We obtain an understanding of the strategic environment in which the College operates to inform our audit approach.

COVID-19 update and future plans

COVID-19 is a new illness that can affect the lungs and airways. It's caused by a virus called coronavirus. The impact on education services, the changes to behaviour around public gatherings and social interaction, and the political and economic consequences have already been and will continue to be significant.

The situation in respect of COVID-19 and its impact on the UK is developing on an ongoing basis. At the time of preparing this plan (June 2020) there remains a significant degree of uncertainty over the scope and scale of the ongoing impact by the College's financial year end of 31 July 2020 and beyond. Considerations include:

- There has been significant disruption to the College's day to day operations as it faces changes to working practices and reductions in capacity as staff are required to self-isolate.
- Colleges have moved to remote learning where possible, and there remains significant uncertainty around when classroom based teaching can resume.
- While the SFC has outlined that they will not seek to recover funds for shortfalls against outcome agreement targets where these are related to COVID-19 for the academic year 2019-20, colleges are likely to experience a significant loss in income for 2019/20 with the loss of non-SFC income such as tuition fee income, commercial contracts, SDS apprenticeship income, catering and nursery income. While there will be some cost associated savings achieved through reduced activity, it is unlikely that this will entirely net off the impact on the colleges surplus or deficit for the year.
- The SFC has announced funding allocations for 2020/21 and colleges will shortly be updating their financial forecast through to 2025. This may require further revision and update as the College's financial position and commitments continue to be impacted, while it is not known the period over which the impact may be ongoing.
- In respect of the financial statements, COVID-19 will have a pervasive impact, and has the possibility to materially affect the majority of the College's yearend balances as well as the transactions through the last four months of the financial year.
  - There is likely to be a significant impact on the College's share of the Highland Council Pension Fund liability as its underlying asset valuations are materially impacted at 31 July 2020.
  - There may also be a material impact on the valuation of the College's property, plant and equipment.
  - The recognition of income will require greater judgement as the College assesses whether conditions have been met and/or services performed in full.
- Additional disclosures will be required throughout the financial statements to reflect the additional risks facing the College and how these have impacted the key judgements and estimates made in preparation of the financial statements, as well as the required narrative disclosures on how this has impacted performance, risk assessment and mitigation, and the College's future plans.

COVID-19 is expected to have a significant impact on the financial health of the College sector with significant reductions in both non-core SFC income and other income.

The impact of COVID-19 on the preparation of financial statements and audit

The Financial Reporting Council highlighted that COVID-19 should not undermine the delivery of high quality audits.

The Financial Reporting Council ("FRC") has issued guidance for both auditors and preparers of the financial statements on issues arising from the COVID-19 pandemic. The guidance to date highlights the practical difficulties in preparing financial statements and performing audits in the new way of working. It is clear that auditors will be required to develop alternative audit procedures to gather sufficient, appropriate audit evidence.

The guidance is clear that the new way of working should not undermine the delivery of high quality financial statements preparation or quality audits, which should continue to comply fully with international auditing standards. Where additional time is required to complete audits due to ongoing and developing risks, it is important that this is taken to maintain audit quality rather than seeking to conclude early to meet arbitrary or regulatory deadlines.

Audit considerations at this time include:

- While the impact is unquantifiable at this time, audit processes will be subject to the same likely changes in working arrangements and possible reductions in capacity across both the College finance team and the audit team.
- We have outlined the planned timing for the key deliverables of the audit process in Appendix D. The current expectation is that this timetable will be impacted. While Audit Scotland has not yet issued revised audit deadlines for Further Education on the basis that circumstances will vary by audited body, they have recognised the likely impact this will have on the financial statements and audit process and encouraged ongoing dialogue. The Local Government deadlines have now been moved from September to November, and there is the potential for this to have an impact on further education deadlines.
- Our key audit risks and other matters for consideration have been outlined in this report based on our planning work to date, and our assessment at the time of drafting this plan is that the full impact of COVID-19 is still unknown. It is likely our consideration of audit risks will develop significantly in advance of the year end audit as more is understood around the impact. We will provide the Audit Committee with an update on key audits risks and other matters where they materially differ from this planning report in advance of the year end audit.

We will continue to work closely with management to consider the impact as it becomes better known and provide updates to the Audit Committee as appropriate. We will aim to take a pragmatic and flexible approach, while also recognising that strong financial management and good governance are more important than ever at this difficult time, over the financial year-end and into 2020/21.

Audit Scotland Colleges 2019

Audit Scotland published their Scotland's Colleges 2019 report in June 2019. The report considers both the financial health and performance of Scotland's colleges.

> Scottish Government is providing around £99 million over three years to fund the additional costs from national bargaining.

The report highlights that the Scottish Government has been providing colleges with real-terms increases in revenue funding since 2016/17. However, the most recent increase for 2019/20 covers only the additional cost of harmonising staff terms and conditions, the cost of living pay increases and increases in employers' pension contributions. The proportion of non-government income, such as education contracts and other commercial income, has reduced. Colleges' ability to access other sources of funding, such as cash and arm's-length foundation (ALF) balances, is also reducing. As a result, the gap between colleges' income and expenditure is widening. 12 incorporated colleges were forecasting recurring financial deficits by 2022/23.

In 2019/20, capital funding for the sector has fallen to £47.6million (2018/19: £76.7million). Reduced capital spending creates a risk that the cost of urgently needed backlog maintenance increases. This in turn poses a potential risk to some colleges' ability to continue to deliver their core services in a safe environment, and to invest in new digital infrastructure to generate efficiencies and enhance the student experience. The Scottish Government is working with the Scottish Futures Trust and the SFC to identify an appropriate revenue funding model for future investment in the college estate

2020/21 Budget

The College outcome agreement funding allocations for Academic Year 2020/21 were announced by the SFC on 7 April 2020. The funding announcement recognised that the rapidly shifting environment, however it was felt that announcing the funding allocations would help provide some stability for the sector.

Key aspects of the funding announcement are:

- SFC's revenue budget for 2020/21 has increased by 6.9% from 2019/20
- Teaching funding has been increased by 5% (£23 million)
- Funding is provided towards pension costs over the 16 month period April 2020 to July 2021
- Student activity (credit) volume for the sector is broadly unchanged however there are some changes to individual college/regional targets
- Capital funding has decreased by £11.9million

The sector was experiencing significant financial challenges and while the full impact of COVID-19 is not yet apparent, it is recognised it will significantly add to the existing financial pressures faced and amendments to the 2020/21 budget are likely.

3. Financial Statement Risks

Introduction

The College's annual financial statements enables the College to demonstrate accountability for, and its performance in the use of its resources. They are prepared in accordance with proper accounting practice and applicable law.

Audit Opinion

We are responsible for conducting an audit of the financial statements of the College. We will 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 the College's affairs as at 31 July 2020 and its surplus or deficit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including FRS 102: The Financial Reporting Standard applicable in the UK and Ireland; and
- whether they have been properly 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 the consistency of the other information prepared and published by the College along with the financial statements.

We will work with the Finance Team to support further improvements in the quality of the financial statements.

Other Statutory Information

The management commentary and narrative reporting continues to be an area of increased scrutiny as a result of rising stakeholder expectations, including continuing interest by the Financial Reporting Council. We will continue to work with the finance team and management to support the improvement of the financial statements, including narrative disclosures, in 2019/20.

Audit Approach

We determine which accounts, disclosures and relevant assertions could contain risks of material misstatement.

Our audit involves:
Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the College's internal control.
Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
Concluding on the appropriateness of management's use of the going concern basis of accounting.
Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the College.
Reading other information contained in the financial statements, including the board's statement that the annual report is fair, balanced and understandable, the Audit Committee reporting appropriately addresses matters communicated by us to the Committee and reporting whether it is materially inconsistent with our understanding and the financial statements.
Maintaining auditor independence.
Substantive tests of detail of transactions and amounts. For 2019/20 we plan to follow a predominantly substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

Materiality

For the purposes of determining whether the financial statements are free from material error, in accordance with ISA (UK) 320 we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements.

Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss expectations regarding our detection of misstatements in the financial statements if required.

Materiality Level	Rationale
Planning Materiality £135,000	Planning materiality (PM) – the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements. For planning purposes, materiality for 2019/20 has been set at £135,000. This represents approximately 2% of the College's expenditure for the year.
Tolerable Error £65,000	Tolerable error (TE) – materiality at an individual account balance, which is set so as to reduce to an acceptably low level that the aggregate of uncorrected and undetected misstatements exceeds PM. We have set it at £65,000 which represents approximately 50% of planning materiality.
Summary of Audit Differences £5,000	Summary of Audit Differences (SAD) Nominal amount – the amount below which misstatements whether individually or accumulated with other misstatements, would not have a material effect on the financial statements. The Code requires that auditors report at no more than £250,000. We have set it at £5,000, which represents approximately 5% of planning materiality.

In response to the number and value of prior year audit differences identified and the potential impact at the college of changes in the financial control environment in year in response to the shift to working remotely as a result of COVID-19, we have reduced our TE from 75% to 50% to address additional risk factors identified.

The bases for all other materiality figures are consistent with our approach in previous years. However, we are still in the process of considering the impact of COVID-19 on this year's audit, and therefore these figures may be reduced to reflect the pervasive additional risk to the College's financial statements and the significant impact COVID-19 has had on the stability of the sector generally. We will report changes to our materiality as part of our updated planning reporting and our yearend Annual Audit Report, as appropriate.

Our evaluation requires professional judgement and so takes into account qualitative as well as quantitative considerations implied in the definition. Factors which we consider include the perspectives and expectations of users of the financial statements as well as our risk assessment as to the likelihood of material misstatements arising in the financial statements.

Based on these considerations, we apply lower materiality levels to the following areas we consider to be material by nature rather than size:

- Remuneration Report and Related Party Transactions.

We will therefore review the disclosures related to the above areas in greater detail compared to the materiality thresholds outlined above.

Significant Risks

We have set out the significant risks (including fraud risks) identified for the current year audit along with the rationale and expected audit approach. The risks identified may change to reflect any significant findings or subsequent issues we identify during the audit.

Significant Risk - Risk of fraud in income and expenditure recognition

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

Other than Income and expenditure recognition, we have not identified any specific areas where management override will manifest as a significant fraud risk, however we will continue to consider this across the financial statements throughout the audit.

Given the nature of Scottish Funding Council (SFC) core teaching grant to the College through the University of the Highlands and Islands ("UHI"), we rebut the presumed revenue recognition risk for this income stream. However we recognise a revenue recognition risk for other SFC grants where performance conditions are in place, tuition fee income and other grants and operating income in respect of possible manipulation of cut-off around the financial year end.

We also recognise the same risk around incorrect recognition of other operating expenditure in line with Practice Note 10.

Work we will perform:

- review and test all relevant income and expenditure policies against the relevant accounting standards and SORP
- review, test and challenge management around any accounting estimates on income and expenditure recognition for evidence of bias
- develop a testing strategy to test material income and expenditure streams
- test all material grant income with performance conditions to ensure the income is recognised correctly in line with the outlined requirements
- review and perform focused testing on income and expenditure around the year end to ensure correct recognition around cut-off between financial periods.

Fraud Risk – Misstatement due to fraud or error

Management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has put in place a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.

The risk of management override is pervasive to the audit and impacts the testing of all areas. Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud.

As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk. This takes account of the fact that management are in a unique position to override controls which otherwise appear to be operating effectively.

Based on the requirements of auditing standards our approach will focus on:

- identifying fraud risks during the planning stages
- inquiry of management about risks of fraud and the controls put in place to address those risks including segregation of duties
- consideration of the effectiveness of management's controls designed to address the risk of fraud
- determining an appropriate strategy to address those identified risks of fraud
- performing mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements
- specific focus on the accounting for any identified key areas of judgement and estimates in the financial statements and significant and unusual transactions. This will include consideration of any provisions requiring to be made as at the balance sheet date for any restructuring arrangements entered into by the College.

We will report our findings in these areas to you within our 2019/20 Annual Audit Report.

Inherent Risk – Valuation of Property, Plant & Equipment

The College's property portfolio totals £16.3 million as at 31 July 2019 with the major elements of this being in respect of land and buildings. Land and buildings are revalued to fair value with a full revaluation taking place at least every five years, with an interim valuation due during this period between full valuations. The College undertook a full valuation of its three campuses as at 31 July 2019.

The valuation of property, plant and equipment is assessed as an inherent risk. Management involves specialists in the preparation of these accounting valuations. We utilise our own specialists, as appropriate, to support the core audit team in the performance of audit procedures on these balances.

Given the size of this balance and the number of assumptions that are made in the valuation, we assign a higher inherent risk to property, plant and equipment.

We do not at the planning stage have any specific concerns over management's approach to property valuations following the revaluation last year, however we do recognise the unique challenges to the College in obtaining a valuation for the College estate given its location and purpose.

Our approach will focus on:

- analysis of the source data and inquiries as to the procedures used by management's specialist to establish whether the source data is complete
- assessment of the potential for impairment across the College estate that has not been reflected in the financial statements or most recent formal valuation
- detailed testing of the assets under construction balance at the yearend, ensuring costs capitalised meets the capitalisation criteria under the applicable financial reporting framework.

Inherent Risk – Valuation of Pension Liabilities

The College participates in two pension schemes: the Local Government Pension Scheme (Highland Council Pension Fund (FPF)), and the Scottish Teachers Superannuation Scheme (STSS). While both are defined benefit pension schemes, the College is unable to identify its share of the underlying assets and liabilities of the STSS scheme on a consistent and reasonable basis and therefore, the scheme is accounted for as if it were a defined contribution scheme.

The Further and Higher Education SORP and the SFC Accounts Direction require the College to make extensive disclosures within the financial statements regarding its membership of the Highland Council Pension Fund.

The information disclosed is based on the report issued by the College's actuary.

Highland Council Pension Fund is accounted for as a defined benefit scheme. The net pension liabilities on the balance sheet arising from participation in the scheme at 31 July 2019 were £2.4 million.

In addition the College recognises a provision for future early retirement liabilities - £0.97 million as of 31 July 2019.

Accounting for this scheme involves significant estimation and judgement and the College engages an actuary to undertake the calculations on their behalf.

ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.

Our approach will include:

- obtaining an actuarial report at the year end date for the scheme and considering the reasonableness and consistency of assumptions underpinning such reports, in light of guidance available
- performing substantive testing on the verification of the pension assets, by engaging with the auditors of Highland Council Pension Fund in line with the assurance protocols laid out by Audit Scotland for IAS 19
- assessing the work of the actuaries, including the assumptions they have used by engaging internal actuarial specialists to provide input on the consistency and appropriateness of assumptions underpinning the valuation of the pension schemes, and how the impact of the GMP ruling has been considered in the pension liability valuation
- we will also review the calculation of the College's valuation of future early retirement liabilities at 31 July 2020.

Other audit considerations

We also plan and perform certain general audit procedures on every audit which may not be directly related to financial statement account assertions. Examples of such procedures includes compliance with applicable laws and regulations, litigation and claims and related parties.

Accounting Framework

Updated Statement of Recommended practice: accounting for further and higher education 2019 edition

The Statement of Recommended Practice (SORP): accounting for further and higher education has been updated to reflect the amendments made to FRS 102 following its triennial review in 2017. The revised SORP will be effective for financial periods beginning on or after 1 January 2019 and therefore will be applied by the College within their 2019/20 financial statements.

The triennial review was published by the Financial Reporting Council in December 2017. The majority of amendments were editorial in nature and clarified rather than changed accounting treatment. The amendments to the SORP follow a similar basis and it is not therefore anticipated that the College will be required to adopt substantive number of changes to accounting treatments. We do, however, anticipate that the College will be required to adopt a number of changes to disclosure requirements.

Updated SFC Accounts Directions for Scotland's Colleges

The SFC's Accounts Direction is published annually in July and provides College's with guidance on disclosure requirements for the financial statements.

We will work with management during 2019/20 to ensure the correct application of the new requirements.

Other audit responsibilities

Under the terms of our appointment, our role and responsibilities include a number of other assurance activities. This includes the provision of information to support Audit Scotland national reports and studies.

Anti-money laundering

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 came into force on 26 June 2017 and replace The Money Laundering Regulations 2007. The regulations impose an obligation on the Auditor General to inform the National Crime Agency if she knows or suspects that any person has engaged in money laundering or terrorist financing. As appointed auditor we will consider arrangements for the College to identify and report any instances of money laundering in line with Audit Scotland reporting arrangements.

Data analytics

Where possible and appropriate, we will use our bespoke data analysers to enable us to capture whole populations of your financial data, in particular covering journal entry transactions. These analysers help identify specific exceptions and anomalies within populations of data to focus substantive audit tests more effectively than traditional audit sampling.

We will report the findings of our work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Audit Committee through the yearend audit reporting process.

Going Concern – Compliance with ISA 570 Changes

This auditing standard has been revised in response to enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after.

The revised standard is effective for audits of financial statements for periods commencing on or after 15 December 2019, which for the College will be the audit of the 2020/21 financial statements. The revised standard increases the work we are required to perform when assessing whether the College is a going concern. It means UK auditors will follow significantly stronger requirements than those required by current international standards; and we have therefore judged it appropriate to bring this to the attention of the Audit Committee.

We will discuss the detailed implications of the new standard with management during the 2019/20 audit ahead of its application for 2020/21.

Use of specialists

When auditing key judgements, such as the valuation of property, plant and equipment, defined benefit pension scheme assets and liabilities, or certain assets and liabilities, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. In accordance with Auditing Standards, we will evaluate each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with the independence of the individuals performing the work.

We also consider the work performed by the specialist in light of our knowledge of the College's business and processes and our assessment of audit risk in the particular area. For example, we would typically perform the following procedures:

- Analyse source data and make inquiries as to the procedures used by the specialist to establish whether the source data is relevant and reliable.
- Assess the reasonableness of the assumptions and methods used.
- Consider the appropriateness of the timing of when the specialist carried out the work.
- Assess whether the substance of the specialist's findings are properly reflected in the financial statements.

Internal audit

We will review the internal audit plan and the results of internal audit's work, including the discussion of audit findings at the Audit Committee and management's response to findings. We will reflect the findings from internal audit reports, together with reports from any other work completed in the year, in our plan for the audit, where they raise issues that could have an impact on the financial statements or our wider responsibilities.

4. Wider Scope Dimensions: Risk assessment and approach

COVID-19 is a pervasive risk that impacts all wider scope dimensions. This will be an area of audit focus for 2019/20 considering how the College has adapted and the implications for the College's finances.

In undertaking our risk assessment in respect of the wider scope audit areas, we distinguish between the definition of 'significant risks' which apply to the audit of the financial statements, by referring in our report to 'Wider Scope Audit Focus Areas', where these have been identified

Together the Accounts Commission and the Auditor General for Scotland agreed the dimensions set out in the Code which comprise the wider scope audit for public sector in Scotland. We will audit the College under the small body provisions of the Code and consider financial sustainability and appropriateness of governance disclosures in the financial statement.

Basis for risk assessment

The Code sets out an expectation that 'significant' risks identified through our planning process that relate to the wider scope dimensions will be communicated with you.

Our procedures

As part of our risk assessment procedures, we have reviewed each dimension to assess potential areas of risk. We set out our areas of focus, along with specific significant risks relating to each dimension on the following pages.

Ongoing assessment

As noted throughout this report, it is expected that the impact of COVID-19 will be pervasive on the College in 2019/20. In all years we continue to consider the risk assessment of the College throughout the audit process, and the possible impact that new risks may have on our assessment, in particular the application of the smaller body for the status for the College. Given the circumstances there is likely to be a greater emphasis on this process in advance of our yearend audit, the possible impact being that we apply the larger body status to the College to also consider the wider scope dimensions of financial management and value for money.

In particular, the financial management dimension considers the effectiveness of financial management arrangements, including whether there is sufficient financial capacity and resources, sound budgetary processes and whether the control environment and internal controls are operating effectively. We recognise that financial management arrangements will have evolved as part of the College's response to COVID-19 and may be subject to significant extra pressure.

We will continue to consider our audit approach in respect of wider scope audit and will report any material changes, along with our findings from the year, to the committee as part of our annual audit report.

Financial Sustainability

Financial sustainability considers the medium and longer term outlook for the College to determine if planning is effective to support service delivery. We focus on the arrangements to develop viable and sustainable financial plans.

In September 2019, the College submitted a five year Financial Forecast Return for the Scottish Funding Council, which forecast an underlying operating deficit of over £0.5 million in the period to 2023/24 if no mitigating actions were taken. The College prepared a balanced forecast position for this period, assuming savings made through staff cost reductions and income increases. A significant share of these savings are planned through specific FTE reductions, but income increases are still in the initial stages of planning.

Management has recognised a future financial risk to the College without additional funding or cost savings. There is also an ongoing risk that further cost reductions to staffing will have a material impact on the College's capacity to deliver its operational and strategic plans.

Continuing financial pressures

The financial environment in which the College operates was already challenging, and the COVID-19 pandemic will result in further, significant financial pressures. This will further impact the College's ability to fully deliver planned savings or achieve income growth targets in 2019/20 due to the global pandemic. This will increase the financial pressures for future years and creates a significant risk that the College will not be able to develop viable and sustainable financial plans due to external factors.

Our work for the year will consider:

- Has the College revised medium term financial plans to take account of the materialising risks in relation to COVID-19 and has appropriate scenario planning taken place?
- Where gaps in financial plans are identified, is the College proactively engaging with the Scottish Funding Council and other stakeholders to address these gaps?

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.

In our 2018/19 Annual Audit Report we concluded that although the College had in place a number of areas of good governance, a number of areas were also identified where governance arrangements had grounds for improvement, including a number of areas from previous audit reports and self-assessments remaining in progress to varying degrees.

Delivering progress in good governance arrangements

We noted a number of areas where progress in respect of previous recommendations for improving governance had been limited and that the pace of improvement around governance arrangements indicated insufficient management capacity to address the scale of improvements required.

There is also a significant risk of COVID-19 further materially impacting the College's ability to deliver good governance arrangements, both in terms of the impact on the College's way or working and the impact on key individuals charged with delivering good governance.

Our work for the year will consider:

- Progress against prior year audit recommendations from both internal and external audit, including the College's arrangements for ensuring these are monitored and reported on a routine basis.
- How the College ensured the quality of arrangements in place to support good governance during the COVID-19 pandemic including ensuring that there is sufficient transparency around governance and decision making arrangements.
- Is the Governance Statement within the financial statements complete and does it reflect key findings from audit, scrutiny and inspection? Where non-compliance with the code of good governance is identified are appropriate mitigating actions in place and disclosed?
- Internal audit arrangements during 2019/20, including whether the internal audit programme was able to be completed.
- The adequacy of the College's preparations for EU withdrawal.

We will consider how governance arrangements were adapted during the COVID-19 pandemic to ensure good governance arrangements remained in place.

In line with auditing standards, as part of our consideration of the College's governance arrangements, we will be writing to the College Audit Committee to confirm how those charge with governance ensure oversight of management and appropriate governance arrangements are in place. This is not reflective of specific risks identified at the College but rather in line with our process to annually make formal inquiries beyond standard management meetings and representations.

Appendices

A – Code of Audit Practice: Responsibilities

B – Independence and audit quality

C – Required communications with the Audit Committee

D – Timing and deliverables of the audit

E – Audit fees

F – Additional audit information

Appendix A: Code of Audit Practice Responsibilities

Audited Body's Responsibilities

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

Appendix B: Independence Report

The FRC Ethical Standard and ISA (UK) 260 "Communication of audit matters with those charged with governance", requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

<table>
<tr><th colspan="2">Required communications</th></tr>
<tr><th>Planning stage</th><th>Final stage</th></tr>
<tr><td>

The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between the you, your affiliates and directors and us;
The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review;
The overall assessment of threats and safeguards;
Information about the general policies and process within EY to maintain objectivity and independence.
Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard.

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In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed;
Details of non-audit services provided and the fees charged in relation thereto;
Written confirmation that the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us;
Written confirmation that all covered persons are independent;
Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy;
Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and
An opportunity to discuss auditor independence issues.

</td></tr>
</table>

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements, the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period, analysed in appropriate categories, are disclosed.

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

Appendix C: Required Communications

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
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	Annual Audit Plan Annual Audit Report
Going concern Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: • Whether the events or conditions constitute a material uncertainty • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The adequacy of related disclosures in the financial statements	Annual Audit 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	Annual Audit Report
Fraud • Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity • 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	Annual Audit Report
Consideration of laws and regulations • Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off • Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of	Annual Audit Report or as occurring if material.

Required communication	Our reporting to you
Related parties Significant matters arising during the audit in connection with the entity'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 entity	Annual Audit Report or as occurring if material.
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 Annual Audit Report
Internal controls Significant deficiencies in internal controls identified during the audit	Annual Audit Report
Representations We will request written representations from management and/or those charged with governance.	Annual Audit Report
Subsequent events Where appropriate, asking the audit committee whether any subsequent events have occurred that might affect the financial statements.	Annual Audit Report
Material inconsistencies and misstatements Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Annual Audit Report
Fee Reporting • Breakdown of fee information when the audit plan is agreed • Breakdown of fee information at the completion of the audit • Any non-audit work	Annual Audit Plan Annual Audit Report

Appendix D: Timing and deliverables of the audit

We deliver our audit in accordance with the timeline set by the College, in accordance with guidance from Audit Scotland. Below is an indicative timetable showing the key stages of the audit and the deliverables through the 2019/20 audit cycle. This timetable is based on similar timeframes for deliverables and completion milestones as last year and was set before the COVID-19 outbreak. It will be subject to ongoing consideration as outlined on page 7 of our report and any revisions will be agreed with management and communicated to the Audit Committee as appropriate.

FEB MAR APR MAY JUN SEP OCT NOV DEC

Audit Activity	Deliverable	Timing
Review progress of NFI exercise	Submit NFI Questionnaire	28 February 2020
Audit planning and setting scope and strategy for the 2019/20 audit	Annual Audit Plan	June 2020
Walkthrough Visit	Completion of internal documentation	May / June 2020
Year-end substantive audit fieldwork on unaudited financial statements	Audited Financial Statements	October / November 2020
Conclude on results of audit procedures	Issue Annual Audit Report	31 December 2020
Issue opinion on the College's financial statements	Submit Audit Scotland minimum dataset request	31 December 2020

Appendix E: Audit fees

The audit fee is determined in line with Audit Scotland's fee setting arrangements, set out in recent communications to all audited bodies in line with their publication on 'Our Approach to setting audit fees' (http://www.audit-scotland.gov.uk/uploads/docs/um/audit_fee_approach.pdf).

Audit Fees		2019/20	2018/19
	Component of fee:		
	Auditor remuneration – expected fee	£20,320	£17,000
	Additional audit procedures (see below)	£TBD	£3,250
	Audit Scotland fixed charges:		
	Pooled costs	£1,160	£980
	Contribution to Audit Scotland costs	£1,110	£1,030
	Total fee	£22,590	£22,260

The base audit fee for each body, which is set centrally by Audit Scotland, assumes that the College has sound governance arrangements in place and operating effectively throughout the year, prepares comprehensive and accurate draft financial statements and supporting schedules, and meets the agreed timetable for the audit. It also assumes there is no major change in respect of the scope of work in the year and an unqualified audit opinion resulting from the audit. Should any of these circumstances not be in place throughout the audit, it is expected that additional costs will be incurred through the course of the audit which will be subject to recovery in line with the agreed process and rates set out by Audit Scotland. Under this process, fees can be agreed between the auditor and audited body by varying the auditor remuneration by up to 20% above the level set, or more with the approval of Audit Scotland.

All fee variations will depend on the progress made by management in providing robust impact assessments and supporting schedules in line with the underlying accounting requirements outlined by the Scottish Funding Council and Audit Scotland guidance. Where further additional work is required, fee variations will be agreed with management and reported to the Audit Committee in our 2019/20 Annual Audit Report.

At this stage we have not been able to fully consider and quantify the potential impact of Covid-19 on the financial statements accounting requirements, key judgements made by management, and the subsequent audit consideration we are required to undertake or additional work required to address the changes in the process of the preparation of the financial statements or audit. However, we anticipate that this and other audit matters will have a significant impact on 2019/20 audit fees:

- The impact of Covid-19 on the financial statements audit, including our requirement to reduce our overall audit materiality and subsequently increase testing, combined with expected additional significant individual risks and the impact on materiality of the number and value of audit misstatements identified in previous audits;
- The additional consideration required around the valuation of property, plant and equipment and the College's share of the Highland Pension Scheme; and
- The additional wider scope audit consideration required through both the financial sustainability and governance dimensions, and the possible inclusion of financial management as a dimension subject to audit consideration in the year.

Appendix F: Additional audit information

In addition to the key areas of audit focus outlined within the plan, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.

Our responsibilities required by auditing standards	• Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. • Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the College's internal control. • Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management. • Conclude on the appropriateness of the going concern basis of accounting. • Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation. • Read other information contained in the financial statements, the Audit & Risk Committee reporting appropriately addresses matters communicated by us to the Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and • Maintaining auditor independence.
Purpose and evaluation of materiality	For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements. Materiality determines the locations at which we conduct audit procedures and the level of work performed on individual account balances and financial statement disclosures. The amount we consider material at the end of the audit may differ from our initial determination. At this stage it is not feasible to anticipate all of the circumstances that may ultimately influence our judgement about materiality. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.
Audit Quality Framework / Annual Audit Quality Report	Audit Scotland are responsible for applying the Audit Quality Framework across all audits. This covers the quality of audit work undertaken by Audit Scotland staff and appointed firms. The team responsible are independent of audit delivery and provide assurance on audit quality to the Auditor General and the Accounts Commission. We support reporting on audit quality by proving additional information including the results of internal quality reviews undertaken on our public sector audits. The most recent audit quality report can be found at: www. https://www.audit-scotland.gov.uk/uploads/docs/report/2019/as_audit_quality_1819.pdf. EY has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained. Details can be found in our annual Transparency Report: https://www.ey.com/en_uk/who-we-are/transparency-report-2019

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