

# Inverness College

**Annual Audit Report to the  
Board of Management and the  
Auditor General for Scotland -  
year ended 31 July 2019**

**19 December 2019**



# Contents

Section	Auditor Responsibility	Page
<b>Executive Summary</b>	Summarise the key conclusions from our 2018/19 audit	03
<b>Financial statements audit</b>	Provide an opinion on audited bodies' financial statements Review and report on, as appropriate, other information such as the annual governance statement, management commentary and remuneration report	06
<b>Wider scope dimensions</b>	Demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited body's: <ul style="list-style-type: none"><li>▶ arrangements for securing financial sustainability</li><li>▶ suitability and effectiveness of corporate governance arrangements</li></ul>	16
<b>Appendices</b>	Undertake statutory duties, and comply with professional engagement and ethical standards:  Appendix A: audited body's responsibilities Appendix B: required auditor communications Appendix C: independence and audit quality Appendix D: action plan Appendix E: follow up of prior year recommendations Appendix F: differences identified during the audit Appendix G: timing and deliverables of the audit	25

## About this report

This report has been prepared in accordance with Terms of Appointment Letter from Audit Scotland dated 31 May 2016 through which the Auditor General for Scotland has appointed us as external auditor of Inverness College ("the College") for financial years 2016/17 to 2020/21. We undertake our audit in accordance with the Public Finance and Accountability (Scotland) Act 2000 and our responsibilities as set out within Audit Scotland's Code of Audit Practice. This report is for the benefit of the College and is made available to the Auditor General for Scotland and Audit Scotland. 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.

# Key Conclusions from our 2018/19 audit

<p><b>Financial statements: Audit Opinion</b></p>	<p>We have concluded our audit of the College's financial statements for the year ended 31 July 2019. We identified two unadjusted audit difference arising from the audit. Two audit adjustments were processed by management as part of the audit.</p> <p>We concluded the other information subject to audit, including parts of the Remuneration Report and the Annual Governance Statement were appropriate.</p>	<p style="writing-mode: vertical-rl; text-orientation: mixed;">GREEN</p>
<p><b>Presentation and disclosures</b></p>	<p>The quality of the draft financial statements and supporting working papers provided by management were of a similar quality to previous years. The draft financial statements, and a number of the key supporting schedules were received subsequent to the initially agreed audit timetable.</p> <p>We were satisfied that the Annual Governance Statement materially reflects the requirements of the Scottish Funding Council's 2018/19 Accounts Direction.</p>	<p style="writing-mode: vertical-rl; text-orientation: mixed;">AMBER</p>
<p><b>Wider Scope: Financial Sustainability</b></p>	<p>The College has prepared a five year Financial Forecast Return for the Scottish Funding Council, which forecasts an underlying operating deficit of over £4 million in the period to 2023/24 if no mitigating actions are taken. The College has also prepared a balanced forecast position for this period, assuming savings made through staff cost reductions, commercial and other income increases and efficiency savings.</p> <p>During 2018/19 management has made progress in identifying the possible savings to be achieved in order to secure a balanced operating position over the next five years. There remains a significant risk around delivery of these savings given the current status of development of detailed plans, and inherent risks in delivery of savings without impacting the College's ability to meet key corporate objectives and targets.</p>	<p style="writing-mode: vertical-rl; text-orientation: mixed;">AMBER</p>
<p><b>Governance and Transparency</b></p>	<p>A number of areas of good governance are in place and operating effectively across the College. The College has made appropriate disclosures within the Annual Governance Statement relating to its risks and control environment, and its compliance with the Code of Good Governance for Scotland's colleges. We concluded that the College's preparations for EU withdrawal appear appropriate.</p> <p>We have noted a number of areas where resource constraints occurring in the year have limited progress, both in respect of implementation of previous audit recommendations, and where the College's arrangements for ensuring transparency around governance matters have not been kept up to date through the year. We have raised a recommendation around the College's arrangements for participation in the Audit Scotland National Fraud Initiative exercises.</p>	<p style="writing-mode: vertical-rl; text-orientation: mixed;">AMBER</p>



# Introduction

## Our key contacts:

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## Purpose of this report

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

This Annual Audit Report is designed to summarise our key findings and conclusions from our audit work. It is addressed to both members of the Board of Management and the Auditor General for Scotland, and is presented to those charged with governance. This report is provided to Audit Scotland and will be published on their website.

We draw your attention to the fact that our audit was not designed to identify all matters that may be relevant to the College. Our views on internal control and governance arrangements have been based solely on the audit procedures performed in respect of the audit of the financial statements and the other procedures performed in fulfilling our Annual Audit Plan.

A key objective of our audit reporting is to add value by supporting the improvement of the use of public money. We aim to achieve this through sharing our insights from our audit work, our observations around where the College employs best practice and where practices 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. Such areas we have identified are highlighted throughout this report together with our judgements and conclusions regarding the College’s arrangements.

## Our independence

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

## Scope and Responsibilities

The Code sets out the responsibilities of both the College and the auditor (summarised in Appendix A). We outlined these in our Annual Audit Plan, which was presented to the Audit Committee on 28 May 2019.

Our Annual Audit Plan set out an overview of our audit scope and approach for the audit of the 2018/19 financial statements. We can confirm that we carried out our audit in accordance with the plan.

Overall Materiality

£550,000

1.5% of the College's gross expenditure

Tolerable Error

£275,000

Materiality at an individual account level

Reporting threshold

£25,000

Level that we will report to committee

As outlined in our Annual Audit Plan, based on considerations around the expectations of financial statement users and qualitative factors, we apply a lower materiality level of £1,000 to the audited section of the Remuneration Report. We also apply professional judgement to consider the materiality of Related Party Transactions to both parties.

### Financial statement audit

We are responsible for conducting an audit of the College's financial statements. We undertake our audit in accordance with the Code of Audit Practice (the Code), issued by Audit Scotland in May 2016; relevant Auditing Standards and applicable Practice Notes issued by the Financial Reporting Council; relevant legislation; and other guidance issued by Audit Scotland.

Our findings are summarised in Section 2 of this report.

### Wider Scope audit

Our responsibilities extend beyond the audit of the financial statements. The Code requires auditors to provide judgements and conclusions on dimensions of wider scope public audit. During our planning procedures, and in accordance with Audit Scotland planning guidance, for 2018/19 we assessed the College as meeting the definition of a smaller body for the purposes of our wider scope audit consideration. Our focus has therefore been on the College's arrangements:

- ▶ to secure financial sustainability; and
- ▶ the appropriateness of the disclosures in the governance statement.

Our findings against each dimension are summarised in Section 3 of this report.



# Financial Statements audit

## Introduction

The annual financial statements provide the College with an opportunity to demonstrate accountability for the resources at its disposal, and report on its overall performance in the application of those resources during the year. We are responsible for conducting an audit of the financial statements of the College and provide an opinion on the financial statements as to:

- ▶ whether they give a true and fair view of the state of affairs of the College as at 31 July 2019 and the deficit for the year then ended;
- ▶ whether they have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- ▶ whether they have been prepared in accordance with the requirements of the Further and Higher Education (Scotland) Act 1992 and directions made thereunder 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).

This section of our report summarises the audit work undertaken to support our audit opinion, including our conclusions in response to the significant and other risks identified in our Annual Audit Plan.

Our Annual Audit Plan was considered by the Audit Committee on 28 May 2019. The plan highlighted two areas that we identified as a significant risk of material misstatement or fraud risk:

- ▶ the risk of fraud in revenue and expenditure recognition (significant risk); and
- ▶ misstatements due to fraud or error (fraud risk).

The plan also highlighted two areas of higher inherent risk within the 2018/19 financial statements:

- ▶ Valuation of Property, Plant and Equipment;
- ▶ Pension Liability and Asset Valuation; and
- ▶ Capital Financing Arrangements.

## **Compliance with financial reporting requirements**

As part of our oversight of the College's financial reporting process, we report on our consideration of the quality of working papers and supporting documentation prepared predominantly by the finance team to support the audit.

The financial statements were prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder issued by the Scottish Funding Council, the Charities and Trustees Investment (Scotland) Act and regulation 14 of The Charities Accounts (Scotland) Regulations 2006 (as amended).

## **Presentation and quality of financial statements**

Reflective of resource constraints and changes within the finance team, management provided draft financial statements on 11 November 2019, subsequent to the initially agreed timetable for audit of 7 October. A number of areas of the financial statements, including the Annual Governance Statement, were updated subsequent to the initial onsite audit. These factors significantly impacted the efficiency of the process.

In line with previous years, the draft financial statements required a number of updates to reflect the requirements as outlined in the SFC's 2018/19 Accounts Direction. There needs to be an increased focus by management to ensure the draft financial statements presented for audit are updated for changes in requirements and subject to internal quality review, prior to being presented for audit.

## **Audit outcomes**

We identified two unadjusted audit difference arising from the audit that breached our reporting threshold. Two audit adjustments were processed by management as part of the audit. Both the adjusted, and unadjusted differences are outlined in Appendix F.

Our overall audit opinion is summarised on the following page.

### **Recommendation 1:**

In line with previous years, the College should continue to focus on enhancement to its financial management arrangements, in particular with regards to robust financial statement preparation and quality assurance processes.

# Our audit opinion

Element of opinion	Basis of our opinion	Conclusions
<p><b>Financial statements</b></p> <p>The financial statements provide a true and fair view of the state of affairs of the College at 31 July 2019 and of the deficit for the year then ended</p> <p>The financial statements are prepared in accordance with the financial reporting framework</p>	<p>We report on the outcomes of our audit procedures to respond to our assessed risk of misstatements, including significant risks within this section of our report. We did not identify any areas of material misstatement.</p> <p>We are satisfied that accounting policies are appropriate and estimates are reasonable.</p> <p>We have considered the financial statements against the financial reporting requirements, and additional guidance issued by the SFC and Audit Scotland.</p>	<p>We issued an unqualified audit opinion on the 2018/19 financial statements for the College.</p>
<p><b>Going concern</b></p> <p>We are required to conclude and report on the appropriateness of the use of the going concern basis of accounting</p>	<p>We conduct core financial statements audit work, including management's assessment of the appropriateness of the going concern basis.</p> <p>Wider scope procedures, including financial forecasts are considered as part of our work on financial sustainability.</p>	<p>We have no matters to report.</p>
<p><b>Other information</b></p> <p>We consider whether the other information in the financial statements is materially inconsistent with other knowledge obtained during the audit</p>	<p>We conduct a range of substantive procedures on the financial statements. Our conclusion draws upon:</p> <ul style="list-style-type: none"> <li>▶ Review of committee minutes and papers, regular discussions with management, our understanding of the College and the sector.</li> </ul>	<p>We are satisfied that the annual report materially meets the core requirements set out in the Accounts Direction.</p>
<p><b>Report on regularity of income and expenditure</b></p> <p>We are required to consider whether in all material respects the income and expenditure in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by Scottish Ministers</p>	<p>Our procedures include:</p> <ul style="list-style-type: none"> <li>▶ Understanding the applicable enactments and guidance issued by the Scottish Ministers</li> <li>▶ Performed detailed testing of income and expenditure testing to ensure transactions are in line with enactments and guidance</li> </ul>	<p>We are satisfied that in all material respects income and expenditure are regular.</p>
<p><b>Matters prescribed by the Auditor General for Scotland</b></p> <p>Audited part of Remuneration Report has been properly prepared.</p> <p>The Performance Report and Annual Governance Statement are consistent with the financial statements and have been properly prepared.</p>	<p>We are required to report on whether the sections of the Remuneration and Staff report, and Accountability report have been properly prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.</p>	<p>We have no matters to report.</p>
<p><b>Matters on which we are required to report by exception</b></p>	<p>We are required to report on whether:</p> <ul style="list-style-type: none"> <li>▶ adequate accounting records have not been kept; or</li> <li>▶ the financial statements and the audited part of the Remuneration and Staff Report are not in agreement with the accounting records; or</li> <li>▶ we have not received all the information and explanations we require for our audit</li> </ul>	<p>We have no matters to report.</p>



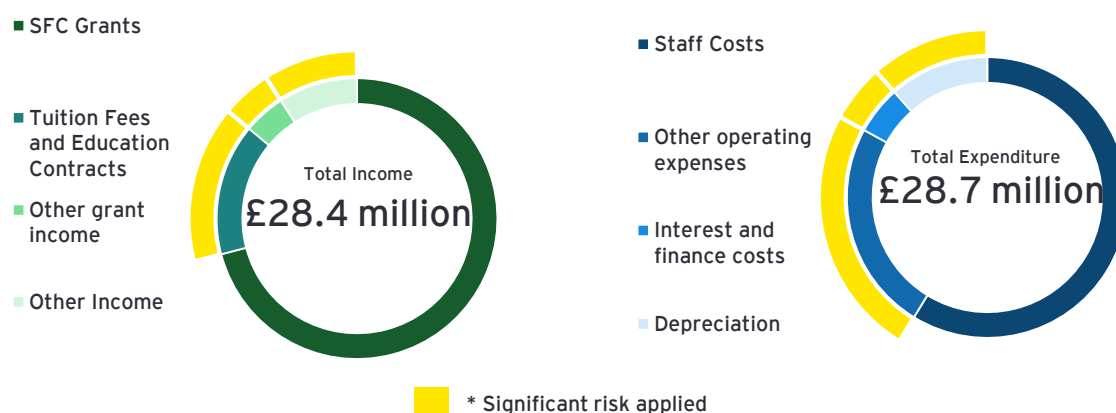
# Significant and fraud audit risks

## 1. Risk of Fraud in Income and Expenditure Recognition

As we outlined in our Annual Audit Plan, ISA (UK) 240 requires us to assume that fraud risk from income recognition is a significant risk. In the public sector, we extend our consideration to the risk of material misstatement by manipulation of expenditure.

In our audit planning, we rebutted the risk of improper recognition of Scottish Funding Council (“SFC”) core grant funding because there is no judgement in respect of this income stream. With regards to expenditure, we rebutted the risk of improper recognition of payroll expenditure. The charts below highlight how our assessment impacts our testing strategy on the College’s financial statements.

**Exhibit 1: Key components of the College’s income and expenditure**



Source: 2018/19 Financial Statements: Statement of Comprehensive Income and Expenditure

Our testing has identified one adjusted and one unadjusted misstatement relating to revenue and expenditure recognition above our reporting threshold. We have not identified any further differences as a result of additional procedures performed in these areas.

### Specific procedures relating to significant risks

We undertake specific, additional procedures over income and expenditure streams where we identified a significant risk, including:

- ▶ Review and challenge management’s accounting estimates over revenue or expenditure recognition for evidence of bias.
- ▶ Review transaction listings for individually material balances as well as unusual items to agree to supporting documentation and third party evidence.
- ▶ Test a representative sample of transactions across the remaining income and expenditure population to ensure coverage of testing across all balances.
- ▶ Review and test income and expenditure to ensure it is accounted for in the correct financial period.
- ▶ Perform a search for material payments and receipts received after year end and ensured these had been accounted for in the correct period.

## Our Audit of Other Income and Expenditure

We undertook walkthroughs in respect of the processes management has established to account for material income and expenditure streams. We obtained data downloads from the College's financial ledger to allow us to trace key transactions from initiation to recording in the financial statements.

### Other audit procedures: non-significant risk areas:

Our audit work on other areas, where there were no significant risks, identified no audit misstatements. We did not identify any areas of significant estimation or judgement as part of our audit work in these areas.

**Scottish Funding Council income:** We agreed receipts in the year for SFC grant income to the financial ledger and SFC grant award notification. We have assessed the College's compliance with required grant requirements (such as credits achievement) and did not identify any potential clawback of funding.

**Employee expenses:** We established expectations of payroll costs in the year based on staff numbers and salary movements, and compared our expectations to actual results and investigated variances.

We have outlined our consideration of the valuation of pension assets and liabilities held by the College later in this report. In respect of all pension transactions impacting the SOCIE we agreed these journals to the underlying FRS 102 report prepared by the College's actuary.

## 2. Risk of Misstatement due to Fraud or Error

Our Annual Audit Plan recognised that under ISA (UK) 240, management is considered to be in a unique position to perpetrate fraud in financial reporting because of its ability to manipulate accounting records directly or indirectly by overriding controls that otherwise appear to be operating effectively. We respond to this risk on every engagement.

### Our audit procedures

### Our findings

We have not identified any material weaknesses in controls or evidence of material management override.

We have not identified any instances of inappropriate judgements being applied. We did not identify any other transactions during our audit which appeared unusual or outside the College's normal course of business.

<p>We considered the risk of fraud, inquired with management about their assessment of the risks of fraud and the controls to address those risks. We also updated and developed our understanding of the oversight of those charged with governance over management's processes over fraud.</p>
<p>We tested the appropriateness of manual journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.</p> <p>We obtained a full list of journals posted to the general ledger during the year, and used our bespoke data analysers to identify any unusual journal types or amounts based on our identified risk areas for the audit.</p>
<p>Management disclose their assessment of the critical accounting judgements and key estimates in the financial statements. We reviewed each significant accounting estimate for evidence of management bias, including retrospective consideration of management's prior year estimates.</p> <p>We identified and considered the appropriateness of key accounting estimates, including provisions, and their susceptibility to bias.</p>
<p>Evaluate the business rationale for any significant unusual transactions.</p>
<p>Review of property, plant and equipment expenditure to ensure it fulfils the accounting requirements to be capitalised.</p>
<p>We consider the consistency and application of accounting policies, and the overall presentation of financial information.</p>

<p>We have not identified any material weaknesses in controls or evidence of management override.</p>
<p>We identified a number of manual journals requiring further consideration using criteria we established based on our understanding of the College. All journals tested were assessed as appropriate and verified to supporting documentation.</p>
<p>We reviewed each estimate and concluded there was no evidence of material bias.</p> <p>We are also content that the disclosures that management have made in the relevant section of the financial statements are appropriate.</p>
<p>No unusual transactions were identified outside the normal course of business.</p>
<p>No issues were noted through testing performed.</p>
<p>There are no accounting practices that materially depart from what is acceptable under the accounting framework.</p>

# Other Inherent Risk Areas

Our Annual Audit Plan highlighted additional areas of inherent risk. We identified no further areas of risk as part of our audit procedures. The results of our procedures on inherent risk areas are summarised below.

## Our audit procedures

### Valuation of Property Plant and Equipment

The College's PPE portfolio totals £56.6 million (2017/18: £50.9 million).

During the year, the College's property assets were subject to a revaluation in line with the requirements of the underlying accounting code, resulting in an uplift of £3 million on the asset values.

Our work focused on judgements, and accounting, in relation to the valuation of the College's land and buildings.

- ▶ Considered the work performed by the College as part of its annual review of the valuation of the College estate, and utilised local market data to challenge the valuation.
- ▶ Challenged management's assessment of the estate valuation at the year end and any indicators of impairment.
- ▶ Considered changes to useful economic lives as a result of the most recent valuation.
- ▶ Confirmed that the revaluation exercise has been correctly processed in the financial statements through testing of accounting entries.
- ▶ Reviewed the College's backlog maintenance estates plans, including consideration of possible indicators of impairment of the existing estate and whether backlog maintenance expenditure in the year had been correctly accounted for as capital or revenue expenditure.
- ▶ Tested the acquisition of new assets in the year ensuring that they were correctly accounted for.
- ▶ Considered the accounting treatment for the SFC funding related to the demolition costs around the disposal of the Longman building.

## Our findings

We reviewed the assumptions used in the valuation of land and buildings and have challenged the accuracy and appropriateness of assumptions, and agreed the workings to underlying asset information.

We did not identify any issues in respect of the valuation exercise.

We identified no differences in the accounting treatment through the course of our audit work in this area.

## Our audit procedures

### Valuation of Pension Liabilities

The College's share of the Highland Pension Fund deficit is a material estimated balance in the financial statements. Under the Higher and Further Education SORP (2015), the liability is disclosed on the College's balance sheet. At 31 July 2019, the College's share of the pension scheme net liability totalled £10.3 million (2017/18: £4.3 million) and the present value of the unfunded obligation in relation to early retirements agreed in previous years is £2.1 million (2017/18: £2 million)

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

We have focused on the following areas, which are consistent with those of management:

- ▶ The reasonableness of the underlying assumptions used by the College's actuary, including those associated with recent judgements on McCloud and Guaranteed Minimum Pensions (GMP).
- ▶ Ensuring the information supplied to the actuary in relation to the College was complete and accurate.
- ▶ Ensuring the accounting entries and disclosures made in the financial statements were consistent with the actuary's report.

We have liaised with the appointed auditor of the Highland Pension Fund to obtain assurances over the information supplied to the actuary in relation to the College.

We have assessed the work of the Pension Fund actuary including the assumptions they have used by utilising our in-house experts. We have assessed both the robustness of the methodology used to derive the key actuarial assumptions and the reasonableness and consistency of the assumptions underpinning such reports, using guidance available.

We performed additional testing on the College's share of the Fund pension assets at 31 July, performing roll forward procedures on its share of assets from 31 March to the College balance sheet date.

We assessed the approach taken by the actuary to account for the estimated impact of the recent rulings made around the McCloud judgement and various rulings around GMP.

We reviewed the calculation of the College's early retirement liabilities at 31 July 2019.

## Our findings

The initial actuarial valuation report that the College obtained to support the draft financial statements had accounted for the impact of McCloud but not GMP. An updated actuarial valuation to account for the valuation estimate of GMP has now been obtained by the College, however management has not updated the financial statements for the past service cost. An unadjusted audit difference has been raised in Appendix F.

Assumptions used by the actuary and adopted by the College are considered to be generally acceptable. The sensitivities surrounding these assumptions have been correctly disclosed in the notes to the financial statements.

## Our audit procedures

### Capital financing arrangements

In 2015 the College took possession of its new campus buildings, using the Scottish Futures Trust's Non-Profit Distributing (NPD) model.

Under the NPD arrangement, the College makes monthly service charge "unitary charge" payments which include the capital element of the loan funding together with interest, facilities management and building lifecycle costs. As at 31 July 2019 the present value of future lease payments was reported as £37.1 million.

Given the material value of the NPD liability as well as the complexity of the associated accounting treatment we consider this as an area of higher inherent risk.

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

- ▶ Reviewed the capital funding transactions, including SFC capital grants, against the requirements of FRS 102 and the SORP
- ▶ Reviewed the College's recognition of assets held for disposal, including the valuation of these within the financial statements and the accounting treatment of disposals of the former campus during the year
- ▶ Performed test of details over the transactions posted in the financial year, agreeing to supporting documentation from third parties
- ▶ Utilised our internal specialists to consider the accounting treatment, including review of the key assumptions driving the model, and disclosures against the requirements of the SORP and FRS 102.
- ▶ Agreeing disclosures made in the financial statements to the College's NPD model.

## Our findings

In both 2016/17 and 2017/18 we made a recommendation for management to review the model and accounting treatment to ensure it continues to meet the requirements of FRS 102. This was specifically in respect of whether the model should contain contingent rent. While some progress has been made by management, this process has yet to be fully implemented.

We are satisfied that the NPD liability and associated accounting treatment and disclosure is free from material misstatement for the year ended 31 July 2019.

### Recommendation 2:

Management should ensure it annually reviews the accounting model to consider the key assumptions, and in particular whether the model should incorporate contingent rent.

# Looking ahead

## **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 changes to accounting treatments. We do, however, anticipate that the College will be required to adopt a number of changes to disclosure requirements.

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

### **Recommendation 3:**

The College should conduct an impact assessment on the implementation of the revised SORP.



# Wider Scope Dimensions

## Introduction

Under Audit Scotland's Code of Audit Practice (May 2016), we are required to reach conclusions in relation to the effectiveness and appropriateness of the College's arrangements for each of the wider scope audit dimensions. We apply our professional judgement to risk assess and focus our work.

In accordance with Audit Scotland planning guidance, for 2018/19 we have assessed it is appropriate to classify the College as a smaller body for the purposes of our wider scope audit consideration.

As a result, our work has focused on our consideration of the College's arrangements to secure financial sustainability and governance and transparency matters. The judgement of applying the smaller body clause is revised annually to reflect that the risks to wider scope dimensions may change.

Under the smaller body provision we will consider:

- ▶ **Financial Sustainability:** the College's medium and longer term outlook to determine if planning is effective to support service delivery. This includes arrangements to develop viable and sustainable financial plans.
- ▶ **Governance and Transparency:** the appropriateness of the disclosures in the governance statement and whether they accurately reflect our knowledge of the College. We also consider the effectiveness of governance arrangements, and transparent reporting of financial and performance information.



# Financial Sustainability

The College has prepared a five year Financial Forecast Return for the Scottish Funding Council, which forecasts an underlying operating deficit of over £4 million in the period to 2023/24 if no mitigating actions are taken. The College has also prepared a balanced forecast position for this period, assuming savings made through staff cost reductions, commercial and other income increases and efficiency savings. During 2018/19 management has made progress in identifying the possible savings to be achieved, however there remains a significant risk around delivery of these savings given the current status of development of detailed plans. There are also inherent risks in delivery of savings without impacting the College's ability to meet key corporate objectives and targets.

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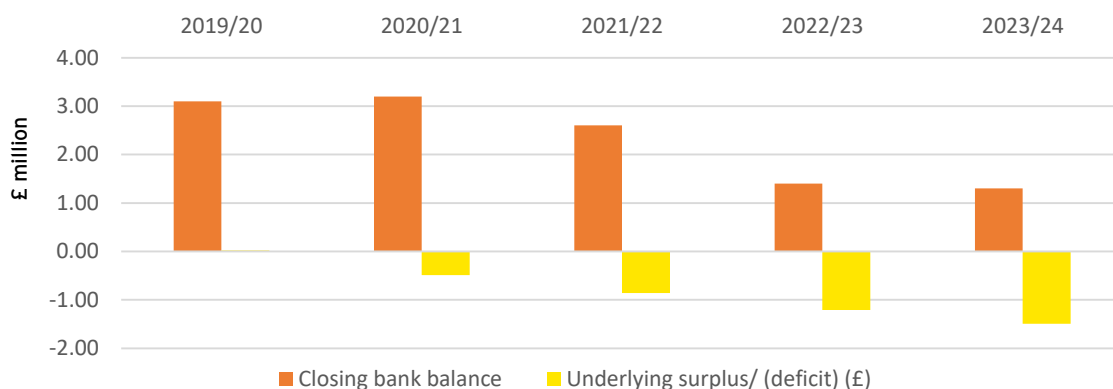
## **The context for financial sustainability in the College sector**

In June 2019, Audit Scotland published their annual report on the further education sector, *Scotland's Colleges 2019*. The report provides an overview of college finances based on the latest annual financial statements and financial forecast returns. The sector reported an improved, but marginal underlying surplus in 2017/18 but the report notes a widening gap between college's income and expenditure. Twelve incorporated colleges, including Inverness College, currently forecast recurring financial deficits by 2022/23.

Scottish Government revenue funding to the sector has increased year on year since 2016/17 in real terms, but this increase has solely related to funding the costs of harmonising staff terms and conditions. This means that there has been limited additional funding for cost pressures such as cost of living increases, increases in employer pension contributions and inflationary cost increases.

The Scottish Funding Council's 2017 estates condition survey indicates that college buildings require urgent and significant investment. Reduced capital funding poses a risk to some colleges' ability to continue to deliver their core services in a safe environment and to invest in new technologies to generate efficiencies and enhance the student experience.

**Exhibit 2: The College's "base" FFR highlights that the College is forecasting underlying operating deficits in each of the next five years without intervention. The cumulative gap to 2023/24 is estimated at £4 million.**



Source: Inverness College Financial Forecast Return, September 2019

### Financial performance in 2018/19

The College reported an accounting deficit of £0.3 million for the year (2017/18: £1.4 million). Following an actuarial loss of £4.7 million, the College reported total comprehensive expenditure of £5.1 million (2017/18 income: £5.7 million). The College had an underlying operating surplus after removal of non-cash accounting adjustments (relating to pension and capital accounting adjustments) of £329,000 (2017/18: £305,000 surplus).

The College delivered its FE provision target in 2018/19 with 29,211 credits against a target of 29,211. The College failed to deliver its HE provision (measured in FTE) delivering 1,578 against a target of 1,618.

### Medium term financial strategy and plan

The College has prepared five-year financial forecasts for the period 2019 to 2024 and submitted these to the SFC in the form of the template Financial Forecast Return ('FFR'). The forecast is based on assumptions provided by the SFC in addition to College specific assumptions for areas such as other income and staff numbers. The assumptions have been subject to scrutiny by the College's senior management team and Finance Committee.

Good practice in respect of ensuring financial sustainability for the College would dictate that management identifies how it intends to address savings gap across the five year period, in the form of a medium term financial plan. We noted in our previous audit report the risk around financial savings actions impacting strategic and operational delivery without a robust link between the College's financial plans and strategic plans. While College's Finance Strategy has been approved by the Board in March 2019, no specific action has been taken in the year to align the strategic and operational plans to financial plans. Given the scale of the savings requirements and the impact on the College these could have there remains a significant risk of operational impact from ongoing financial savings activity.

#### Recommendation 4:

The College should continue to regularly monitor its forecast position, including delivery of its required savings, and its cash position and future forecast. The impact that planned cost reductions and other savings could have on operational and strategic delivery should be subject to ongoing review in conjunction with UHI, as RSB, and SFC, through a robust financial plan aligned to the College's strategy.

### 2018/19 College financial forecast return

In September 2019 the College prepared a base financial forecast return for the five year period to 2024, forecasting a £4 million underlying operating deficit over this period (outlined in exhibit 2 on the previous page). The College also submitted an updated “balanced” FFR to the SFC outlining a balanced underlying operating position, with £4 million of total savings through the period to 2024. These savings were planned from staff reductions of 24 FTE from 2021 through to 2024 and increased commercial and other income. These reductions are currently planned through natural turnover of staff and careful workforce management, however management notes the risk that should this not be achieved in the timeframe required a voluntary severance scheme may require to be sought to ensure the savings are met.

#### **Exhibit 3: The College’s “balanced” FFR is designed to achieve £4 million in total savings over the five year period, with new savings every year outlined below accumulating to savings of £4.4 million**

	2019-20	2020-21	2021-22	2022-23	2023-24	Total / £000's
Staff cost savings	198	108	276	301	190	1,073
Estates and other savings	183	-	-	-	-	183
Commercial income	-	-	97	45	95	237
<b>Total new savings per year</b>	<b>381</b>	<b>108</b>	<b>373</b>	<b>346</b>	<b>285</b>	<b>1,493</b>

Source: Inverness College Financial Forecast Return, September 2019

### Significant and ongoing financial challenges

In our 2017/18 Annual Audit Report we noted that the College was forecasting significant accounting and underlying deficits through to 2023, and that while the College was sighted to the issue there was a significant amount of work to be done, both in terms of balancing the forecast underlying operating position and developing a more robust medium term financial plan which was aligned to the College’s future strategic objectives and which quantifies how it would address future underlying deficits. During 2018/19 management has made progress in identifying the possible savings to be achieved in order to achieve a balanced operating position over the next five years, however there remains a significant risk around delivery of these savings given the current status of savings actions, and as outlined on the previous page alignment of the College’s financial and strategic plans has not yet developed in the year.

### Key risks and uncertainties

In addition to the risks around delivery of a balanced financial position through 2023/24, the College drew the SFC's attention to its assessment of the most significant risks that may impact the delivery of the FFR (Exhibit 4 below). This included a summary of its mitigations around these risks.

#### Exhibit 4: The College has identified the following key risks that impact the College's sustainability in the medium term

Risk identified	Risk mitigating actions
1. Pay costs, particularly in relation to the outcomes from national pay bargaining and the uncertainty surrounding the support staff job evaluation.	Mitigated through tight vacancy management and redeployment of staffing resource as possible. A detailed workforce planning exercise has commenced which will model future requirements and impacts, identifying areas at risk and potential for redundancies. Reduction in staffing of approximately 24 FTE over the period of the forecast to ensure adjusted operating position is balanced.
2. Reduced grant funding both through SFC funding and RSB allocations.	Review of curriculum offer and interdependencies across the UHI partnership. Cost savings to be found, specifically staffing which may impact on breadth of curriculum offered locally. Increase other funding streams through contracts with SDS and other agencies.
3. Financial instability of UHI academic partners due to increased cost base and reduced income and/or ineffective business models.	Strategic review of UHI funding models. Consideration of different operating models through UHI Programme Board.
4. Failure to achieve student activity targets.	Rigorous curriculum planning process in place, proactive development of school/college relationships, proactive development of relationships with employers, excellent quality management processes, systematic monitoring of applications through to enrolment.
5. College fails to identify and take opportunities for development and progression	Identification of opportunities by SMT through development of external relationships in key sectors.
6. Required reductions in staffing unable to be achieved through natural turnover and voluntary severance scheme required.	Detailed workforce planning to address future staffing requirement. Potential staffing reduction of 24 FTE required by 2023/24

Source: Inverness College FFR September 2019

# Governance and Transparency

A number of areas of good governance are in place and operating effectively. The College has made appropriate disclosures within the Annual Governance Statement relating to its risks and control environment, and its compliance with the Code of Good Governance for Scotland's colleges. We concluded that the College's preparations for EU withdrawal appear appropriate.

We have noted some areas where resource constraints have limited progress in respect of implementation of previously agreed internal audit recommendations. Also we noted that arrangements for ensuring transparency around governance matters have not been kept up to date through the year. We also raised a recommendation around the College's arrangements for participation in the Audit Scotland National Fraud Initiative exercises.

A  
M  
B  
E  
R

## **Governance arrangements**

The College has in place a number of the key requirements for good governance. We consider the following to be examples of good governance:

- ▶ The Board and committee minutes and set out clearly the matters considered and discussed.
- ▶ The Board has approved detailed terms of reference for its standing committees which are subject to regular review.
- ▶ Historically the College has published Board agendas and minutes on its website in a timely manner and information, including financial performance, is generally clear and concise.

At the yearend management has noted that short term unforeseen resource constraints resulted in a number of delays to publishing Board information on the College website, and is seeking to address this once replacement resource is in place.

**Recommendation 5:**

Management should ensure that they formalise their assessment around governance statement compliance and ensuring required information is published on a timely basis on the College website.

**Annual Governance Statement**

We reviewed the Annual Governance Statement within the financial statements against the requirements outlined in the SFC's 2018/19 Accounts Direction. This includes the requirements to conclude on the College's compliance with the 2016 Code of Good Governance for Scotland's colleges, or to explain any areas of non-compliance. Our consideration of the governance statement has included:

- ▶ Ensuring that the College has met all requirements of the SFC's 2018/19 Accounts Direction.
- ▶ Ensuring that the content of the statement is consistent with our understanding of the College's governance arrangements and any issues identified during the year.
- ▶ Ensuring that the College has performed a self-assessment of compliance with the Code of Good Governance for Scotland's colleges and that this assessment is reflected in the governance statement.

The College has not identified any areas of non-compliance in the year. In line with previous years we continue to recommend the College formalises its assessment of compliance with the Code and good practice consideration around governance statement disclosures. Management has noted that short term unforeseen resource constraints at the yearend prevented this development, however will seek to implement once the relevant resource gaps are addressed in 2019/20.

**Prior Year recommendation follow up**

We have reviewed the College's actions in response to prior year recommendations in Appendix E. We noted that for all three recommendations raised in the 2017/18 Annual Audit Report work remains outstanding by management.

All external audit recommendations relate to the overall financial management arrangements and capacity of the finance team. We have raised a specific recommendation to ensure this underlying matter is addressed in 2019/20 and the specific recommendations not actioned to date will be followed up on as part of our 2019/20 financial statement audit.

The College's internal auditors have noted they are currently undertaking an independent exercise to assess the progress made by the College in implementing internal audit recommendations made in previous years. To date they have noted a sufficient level of commitment and effort in clearing as many outstanding recommendations as possible from previous audit reports. Though we also noted a number of previously agreed internal audit recommendations which have yet to be implemented.

**Recommendation 1:**

The College should seek to finalise its implementation of prior year audit recommendations as soon as possible.

### **Systems of internal control**

Within the annual governance statement, the College has concluded that “the Board of Management has concluded that the College has effective systems and processes in place to manage corporate governance and internal control”.

Through our audit of the financial statements, we have tested the design and implementation of key controls related to areas of significant risk to the financial statements. This work has included documenting the key internal financial controls and performing walkthroughs to ensure controls are operating as designed. Based on the work undertaken, our work has not identified any significant weaknesses in the College’s systems of internal control.

### **Enquiries of those charged with governance**

In line with previous years, during 2018/19 we formally wrote to the Chair of the Audit Committee to make inquiries around the College’s governance arrangements, including consideration by those charged with governance in respect of compliance with laws and regulations; identification of fraud, error and breaches of internal control; and material litigation and claims. No matters have been raised through the responses we have been provided.

Internal audit’s opinion for the year was based on its agreed audit plan, as approved by the Audit Committee. For 2018/19, the internal auditor’s opinion notes that “In our view, based on the reviews undertaken during the period, and in the context of materiality, the risk management activities and controls in the areas which we examined were found to be suitably designed to achieve the specific risk management, control and governance arrangements. Based on our verification reviews and sample testing, the risk management, control and governance arrangements were operating with sufficient effectiveness to provide reasonable, but not absolute assurance that the related risk management, control and governance objectives were achieved for the period under review”.

### **National Reports**

It is important that the College has embedded arrangements to ensure that consideration is appropriately given to national reports published by Audit Scotland. We noted that the College is taking steps during 2018/19 to ensure that reports are circulated to the Audit Committee on receipt, and the impact on the College is considered at the following meeting.

**Recommendation 6:**

The College should ensure it takes steps to participate in full in future NFI exercises, and ensures it considers the outputs and recommendations from this year's exercise to improve its own internal control arrangements.

**National Fraud Initiative (NFI)**

NFI is a counter-fraud exercise co-ordinated by Audit Scotland and overseen by the Cabinet Office to identify fraud and error. The NFI exercise produces data matches by comparing a range of information held on public bodies' systems to identify potential fraud or error.

We submitted an assessment of the College's participation in the exercise to Audit Scotland in June 2019, updating our assessment as part of the year end audit. We noted that the College has investigated one match identified through the process at the time of the yearend audit procedures. We have concluded that the College has significant work to do to embed good practice around NFI arrangements.

**EU withdrawal**

As in 2017/18, Audit Scotland has maintained an interest in public bodies' preparedness for EU withdrawal. We assessed the College's arrangements against three key factors, relating to the workforce, funding and regulations. The College's response and preparations for Brexit have been led by the Principal and is monitored through the College's risk register. The College has considered the impact of EU withdrawal on funding and College activities, identifying where this could have a future impact on the College's financial position, as well as the possible impact on staff and students. It is continuing to monitor the latest developments and mitigate its financial plans accordingly.

While risks remain for all public sector bodies, we are satisfied that the College's arrangements to prepare for EU withdrawal are appropriate and informed by wider sector involvement.





# Appendices

A - Code of Audit Practice: responsibilities

B - Independence and audit quality

C - Required communications with the Audit and Risk Committee

D - Action plan

E - Follow up of prior year recommendations

F - Audit differences identified during the audit

G - Timing and deliverables of the audit

# 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.

### Standards of conduct / prevention and detection of fraud and error

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 and audit quality

Professional ethical standards, and the Terms of our Appointment, require us to communicate all significant facts and matters that have a bearing on EY's objectivity and independence as auditor of the College.

## Matters that we are required to communicate

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

There are no relationships from 1 August 2018 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.

## Confirmations

We confirm that there are no changes in our assessment of independence since our confirmation in our Annual Audit Plan, dated 28 May 2019.

We complied with the Financial Reporting Council's Ethical Standards and the requirements of Audit Scotland's Terms of Appointment. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.

We consider that our independence in this context is a matter which you should review, as well as us. It is important that management and members of the Board consider the facts known collectively to you and come to a view.

## Audit Fees

	2018/19	2017/18
<b>Component of fee:</b>	<b>2018/19</b>	<b>2017/18</b>
<i>Auditor remuneration</i>	<b>£14,700</b>	£14,370
<i>Fee variation in respect additional focus areas</i>	<b>£1,470</b>	-
Pooled costs	<b>£850</b>	£920
Contribution to Audit Scotland costs	<b>£890</b>	£880
<b>Total fee</b>	<b>£17,910</b>	£16,090

We have outlined our audit fees for the 2018/19 above as agreed with management in our Annual Audit Plan. In our plan we also outlined a number of areas where additional work may be required, in particular around financial sustainability and pension liability testing. We will review final fee variations and agree with management in advance of finalising the financial statement audit. As outlined earlier, the efficiency of the audit has been significantly impacted during the year, resulting in additional work and rescheduling of audit resource. We are in the process of quantifying the impact and will liaise with management to also agree this element of the fee variation.

Matters that we are required to communicate

International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

The EY 2019 UK Transparency Report, can be accessed on our website at [https://www.ey.com/Publication/vwLUAssets/ey-uk-2019-transparency-report/\\$FILE/ey-uk-2019-transparency-report.pdf](https://www.ey.com/Publication/vwLUAssets/ey-uk-2019-transparency-report/$FILE/ey-uk-2019-transparency-report.pdf). The report explains our outlook and how we are structured and governed, including the role of our Independent Non-Executives and how we apply the requirements of the UK's Audit Firm Governance Code. We refer to the quality of our audits and our commitment to recruiting, developing and diversifying our people and talent pool. We also explain how we manage our risks and remain innovative and technologically advanced in what we do and how we do it.

Maintaining high audit quality across all of our engagements is of paramount importance to us. Our transformational Audit Quality Programme continues and is a part of the global EY Sustainable Audit Quality Programme (SAQ).

Our Audit Quality Board (AQB) continues to oversee all matters relating to audit quality and sets the agenda for the Audit Quality programme. The AQB meets monthly and also holds an annual strategy session. The AQB reports to the EY UK Board. The AQB receives regular updates on regulatory matters, results of internal and external reviews, results of root cause analysis, resourcing, the SAQ programme and pursuit approvals, as well as a comprehensive dashboard on quality measures.

Our Audit Quality Support Team (AQST), which started within the SAQ programme, reviews 40 to 50 audits each audit cycle providing challenge and guidance to the engagement teams. These are in-depth reviews carried out by experienced auditors independent of the audit team. AQST reviews enhance the quality of both the audit under review and other audits on which team members apply the lessons learned. The AQST has now become a business-as-usual function.

Audit Quality Framework / Annual Audit Quality Report

Audit Scotland's Appointments and Assurance Team are responsible for applying the new Audit Quality Framework across all financial audits and performance and Best Value audits. This covers the quality of audit work undertaken by Audit Scotland staff and appointed firms. The team are independent of audit delivery and provide assurance on audit quality to the Auditor General and the Accounts Commission.

We support Audit Scotland in their commitment to reporting on audit quality through responding to requests for information and providing the results of internal quality reviews undertaken in respect of relevant public sector audits in Scotland.

The most recent audit quality report which covers our work since appointment can be found at: [www.audit-scotland.gov.uk/uploads/docs/report/2018/as\\_audit\\_quality\\_1718.pdf](http://www.audit-scotland.gov.uk/uploads/docs/report/2018/as_audit_quality_1718.pdf).

# Appendix C: Required Communications

Required communication	Our reporting to you
<p><b>Terms of engagement / Our responsibilities</b></p> <p>Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.</p> <p>Our responsibilities are as set out in our engagement letter.</p>	<p>Audit Scotland Terms of Appointment letter - audit to be undertaken in accordance with the Code of Audit Practice</p>
<p><b>Planning and audit approach</b></p> <p>Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.</p>	<p>Annual Audit Plan</p>
<p><b>Significant findings from the audit</b></p> <ul style="list-style-type: none"> <li>▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures</li> <li>▶ Significant difficulties, if any, encountered during the audit</li> <li>▶ Significant matters, if any, arising from the audit that were discussed with management</li> <li>▶ Written representations that we are seeking</li> <li>▶ Expected modifications to the audit report</li> <li>▶ Other matters if any, significant to the oversight of the financial reporting process</li> </ul>	<p>Annual Audit Plan Annual Audit Report</p>
<p><b>Going concern</b></p> <p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> <li>▶ Whether the events or conditions constitute a material uncertainty</li> <li>▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements</li> <li>▶ The adequacy of related disclosures in the financial statements</li> </ul>	<p>Annual Audit Report</p>
<p><b>Misstatements</b></p> <ul style="list-style-type: none"> <li>▶ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation</li> <li>▶ The effect of uncorrected misstatements related to prior periods</li> <li>▶ A request that any uncorrected misstatement be corrected</li> <li>▶ Corrected misstatements that are significant</li> <li>▶ Material misstatements corrected by management</li> </ul>	<p>Annual Audit Report</p>
<p><b>Fraud</b></p> <ul style="list-style-type: none"> <li>▶ Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity</li> <li>▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist</li> <li>▶ A discussion of any other matters related to fraud</li> </ul>	<p>Annual Audit Report</p>
<p><b>Consideration of laws and regulations</b></p> <ul style="list-style-type: none"> <li>▶ 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</li> <li>▶ 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</li> </ul>	<p>Annual Audit Report (to be issued on completion of audit work) or as occurring if material.</p>

## 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

No significant matters have been identified.

### Independence

Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence

Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:

- ▶ The principal threats
- ▶ Safeguards adopted and their effectiveness
- ▶ An overall assessment of threats and safeguards
- ▶ Information about the general policies and process within the firm to maintain objectivity and independence

Annual Audit Plan

This Annual Audit Report - Appendix B

### Internal controls

Significant deficiencies in internal controls identified during the audit

This Annual Audit Report - no significant deficiencies reported

### Subsequent events

Where appropriate, asking the audit committee whether any subsequent events have occurred that might affect the financial statements.

We have asked management and those charged with governance. We have no matters to report.

### Material inconsistencies

Material inconsistencies or misstatements of fact identified in other information which management has refused to revise

This Annual Audit Report

# Appendix D: Action Plan

This action plan summarises specific recommendations included elsewhere within this Annual Audit Report. We have graded these findings according to our consideration of their priority for the College or management to action.

## Classification of recommendations

**Grade 1:** Key risks and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently management needs to address and seek resolution urgently.

**Grade 2:** Risks or potential weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.

**Grade 3:** Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.

No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
1	<p>Management provided draft financial statements on 11 November, subsequent to the initially agreed timetable for audit of 7 October. A number of areas of the financial statements, including the Annual Governance Statement, were updated subsequent to the initial onsite audit.</p> <p>In line with previous years, the draft financial statements required a number of updates to reflect the requirements as outlined in the SFC's 2018/19 Accounts Direction. There needs to be an increased focus by management to ensure the draft financial statements presented for audit are updated for changes in requirements.</p> <p>We note that all three of the finance responsible recommendations from our 2017/18 Annual Audit Report remained outstanding at the time of the audit.</p>	<p>In line with previous years, the College should continue to focus on enhancement to its financial management arrangements, in particular with regards to a robust financial statement preparation and quality assurance process. Management should ensure the prior year recommendations in Appendix E to this report are actioned on a timely basis.</p> <p style="text-align: right;"><i>Grade 1</i></p>	<p>The Board of Management have committed to investing in additional resource capacity within the Finance team.</p> <p>Responsible officer: Director of Finance.</p> <p>Implementation date: 31 January 2020.</p>
2	<p>The NPD model, and assumptions contained therein, does not factor in a contingent rent element which we would expect in such an arrangement. Furthermore, the model has the effect of smoothing lifecycle costs over the term of the agreement. Consequently, there is a risk future accounting recognition may not fully reflect the substance of the transaction in accordance with FRS 102.</p> <p>We made a recommendation to management to review the model and accounting treatment to ensure it continues to meet the requirements of FRS 102 during the previous audits. This has not yet been implemented.</p>	<p>Management should ensure it annually reviews the accounting model to consider the key assumptions, and in particular whether the model should incorporate contingent rent.</p> <p style="text-align: right;"><i>Grade 2</i></p>	<p>Agreed.</p> <p>Responsible officer: Director of Finance</p> <p>Implementation date: 31 July 2020.</p>

# Appendix D: Action Plan

This action plan summarises specific recommendations included elsewhere within this Annual Audit Report. We have graded these findings according to our consideration of their priority for the College or management to action.

## Classification of recommendations

<b>Grade 1:</b> Key risks and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently management needs to address and seek resolution urgently.	<b>Grade 2:</b> Risks or potential weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.	<b>Grade 3:</b> Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.
<p>3 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 changes to accounting treatments. We do, however, anticipate that the College will be required to adopt a number of changes to disclosure requirements.</p> <p>We will work with management during 2019/20 to ensure the correct application of the new requirements.</p>	<p>The College should conduct a formal impact assessment on the implementation of the revised SORP.</p> <p style="text-align: right;"><i>Grade 3</i></p>	<p>Agreed.</p> <p>Responsible officer: Finance Manager.</p> <p>Implementation date: 31 July 2020.</p>



## Classification of recommendations

**Grade 1:** Key risks and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently management needs to address and seek resolution urgently.

**Grade 2:** Risks or potential weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.

**Grade 3:** Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.

No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
4	<p>Good practice in respect of ensuring financial sustainability for the College would dictate that management identifies how it intends to address the savings gap across the five year period, in the form of a medium term financial plan. We noted in our 2017/18 Annual Audit Report the risk around financial savings actions impacting strategic and operational delivery without a robust link between the College's financial plans and strategic plans.</p> <p>No specific action has been taken in the year to align the strategic and operational plans to financial plans. Given the scale of the savings requirements and the impact on the College these could have there remains a significant risk of operational impact from ongoing financial savings activity.</p>	<p>The College should continue to regularly monitor its forecast position, including delivery of its required savings, and its cash position and future forecast.</p> <p>The impact that planned cost reductions and other savings could have on operational and strategic delivery should be subject to ongoing review in conjunction with UHI, as RSB, and SFC, through a robust financial plan aligned to the College's strategy.</p> <p style="text-align: right;"><i>Grade 1</i></p>	<p>The Board of Management will meet with the Senior Management team on 31 January 2020 to agree a forward financial plan focusing on sustainability and workforce planning.</p> <p>Responsible officer: Director of Finance.</p> <p>Implementation date: 28 February 2020.</p>

## Classification of recommendations

**Grade 1:** Key risks and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently management needs to address and seek resolution urgently.

**Grade 2:** Risks or potential weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.

**Grade 3:** Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.

No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
5	Management has noted that that short term unforeseen resource constraints at the year prevented the development of good practice around a number of governance arrangements, and it will seek to ensure these are implemented once the relevant resource gaps are addressed in 2019/20.	Management should ensure that they formalise their assessment around governance statement compliance and ensuring required information is published on a timely basis on the College website.  <i>Grade 2</i>	Agreed.  Responsible officer: Board Secretary.  Implementation date: to be confirmed.
6	We submitted an assessment of the College's participation in the NFI exercise to Audit Scotland in June 2019, updating our assessment as part of the year end audit. We noted that the College has only investigate one match to date identified through the process, and did not respond to messages or matches identified by other bodies.  We have concluded that the College has significant work to do to embed good practice around NFI arrangements.	The College should ensure it takes steps to participate in full in future NFI exercises, and ensures it considers the outputs and recommendations from this year's exercise to improve its own internal control arrangements.  <i>Grade 2</i>	The current financial system is unable to produce the data required for NFI participation. This should be rectified by the update taking place. Additional staff will be given access to ensure that matches and messages are dealt with timeously.  Responsible officer: Finance Manager.  Implementation date: 31 March 2020.

# Appendix E: Follow up of prior year recommendations

This section of our report summarises our assessment of the College's progress against the recommendations that we identified during our 2017/18 audit.

Prior year recommendations			
No.	Recommendation / grading	Management response/ Implementation timeframe	Our assessment of progress
1	<p><b>Financial process improvements</b></p> <p>Throughout the course of our audit, we identified a number of areas where supporting documentation could be improved or where balances in the financial statements had no supporting documentation. While progress has been made, further improvements are required to financial processes, in particular in relation to the analysis of yearend debtors and creditors, as well as more general SAM and SIT system processes.</p> <p>Management recognises the need for ongoing improvement, and a restructuring of the finance team is being implemented to provide support in these areas.</p> <p style="text-align: right;">Grade two</p>	<p>Agreed.</p> <p>Recruitment to the vacant posts within the revised structure is underway. In addition, support is being provided by the UHI Business Improvement team to identify potential process changes.</p>	<p>We have outlined our consideration of progress earlier.</p> <p>All posts in the revised finance team structure were filled and work undertaken by the UHI Business Improvement team was completed. However, since then there have been further changes which has impacted on progressing with improvements.</p> <p>We note as part of the consideration that not all finance related recommendations below have been actioned, and that the College Finance Director is due to leave post in the new year with an interim solution identified.</p> <p>See recommendation one in Appendix D.</p>
2	<p><b>Non-Profit Distribution model</b></p> <p>The NPD model, and assumptions contained therein, does not factor in a contingent rent element which we would expect in such an arrangement. Furthermore, the model has the effect of smoothing lifecycle costs over the term of the agreement. Consequently, there is a risk future accounting recognition may not fully reflect the substance of the transaction in accordance with FRS 102.</p> <p>In the prior year, we made a recommendation to management to review the model and accounting treatment to ensure it continues to meet the requirements of FRS 102. This has not yet been implemented.</p> <p style="text-align: right;">Grade two</p>	<p>Agreed. The exercise will be completed in 2018/19 as a priority and considered by management and the Board accordingly.</p>	<p>This action remains outstanding. Management intends to implement its review in 2019/20 on appointment of a new finance director.</p> <p>See recommendation one and two in Appendix D.</p>

## Prior year recommendations

No.	Recommendation / grading	Management response/ Implementation timeframe	Our assessment of progress
3	<p><b>Medium term financial plan</b></p> <p>The College is currently forecasting a significant underlying deficit across the five year period through 2022/23. Good practice in respect of ensuring financial sustainability for the College would dictate that management has identified how it intends to address this gap across the five year period, in the form of a medium term financial plan.</p> <p>Management is aware of the financial shortfalls being forecast and is in the process of developing a finance strategy through to 2023. This has been initially reviewed by the Board and is being updated to reflect feedback, including the incorporation of scenario planning into the strategy. This will be further updated at scheduled Board away days and management aims to finalise the revised strategy early in 2019.</p> <p style="text-align: right;"><i>Grade 1</i></p>	<p>Agreed.</p> <p>The Senior Management Team are working to prepare a detailed financial plan to support a new Finance Strategy. This process has commenced with a view to completion in March 2019.</p>	<p>We have outlined our assessment of the College's progress in this area in our wider scope - financial sustainability - reporting.</p>

# Appendix F: Errors identified during the audit

This table sets out the unadjusted errors identified during the audit above our reporting threshold.

Unadjusted differences				
No.	Description	Income and Expenditure Impact	Other Comprehensive Income and Expenditure Impact	Balance Sheet Impact
1	<i>GMP impact per FRS 102 report</i>	Dr Past Service Cost £41,200		Cr Pensions Liability (£41,000)
2	<i>Reduction of GTEIL Credits</i>	Dr Other Income £225,000		Cr Accrued Income (£225,000)

This table sets out the adjustments processed in the financial statements finalisation above our reporting threshold.

Adjusted differences				
No.	Description	Income and Expenditure Impact	Other Comprehensive Income and Expenditure Impact	Balance Sheet Impact
1	<i>Income relating to 2018/19 receipted in October 2019 that was not accrued at the year end date</i>	Cr Revenue (£101,239)		Dr Accrued Income £101,239
2	<i>Release of Foundation Apprenticeship Income for milestones completed by 31 July 2019.</i>	Cr Revenue (£73,736)		Dr Deferred Income £73,736

# Appendix G: 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 a timetable showing the key stages of the audit and the deliverables through the 2018/19 audit cycle.

	Audit Activity	Deliverable	Timing
MAR			
APR	<ul style="list-style-type: none"> <li>Review of current issues impacting the College throughout the audit process</li> </ul>	Periodic current issues return submission	22 March 2019 8 November 2019
MAY	<ul style="list-style-type: none"> <li>Audit planning and setting scope and strategy for the 2018/19 audit</li> </ul>	Annual audit plan	28 May 2019
JUNE	<ul style="list-style-type: none"> <li>Walkthrough visit</li> </ul>	Completion of internal documentation	June 2019
AUG	<ul style="list-style-type: none"> <li>Review progress of the NFI exercise</li> </ul>	Submit NFI questionnaire	30 June 2019
SEPT			
OCT	<ul style="list-style-type: none"> <li>Year-end substantive audit fieldwork on unaudited financial statements</li> </ul>	Audited financial statements	October 2019
NOV	<ul style="list-style-type: none"> <li>Conclude on results of audit procedures and finalise Annual Audit Report</li> </ul>	Issue Annual Audit Report	31 December 2019
DEC	<ul style="list-style-type: none"> <li>Issue opinion on the College's financial statements</li> </ul>	Submit Audit Scotland Minimum dataset request	

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