

Lews Castle College

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

17 December 2019



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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. 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

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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>Financial statements: Audit Opinion</p>	<p>We have concluded our audit of the College's financial statements for the year ended 31 July 2019. We identified three 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>G R E E N</p>
<p>Presentation and disclosures</p>	<p>The quality of the draft financial statements and supporting working papers provided by management were of a similar quality to previous years, and were received at the start of the audit in line with the agreed 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>G R E E N</p>
<p>Wider Scope: Financial Sustainability</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 £0.5 million in the period to 2023/24 if no mitigating actions are 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.</p> <p>Management has recognised a significant 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.</p>	<p>A M B E R</p>
<p>Governance and Transparency</p>	<p>A number of areas of good governance are in place and operating across the College, and 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.</p> <p>However, we have identified a number of areas where governance arrangements have grounds for improvement, and should be addressed as a priority. These areas included addressing non-compliance areas with the Code of Good Governance, maintaining policies and procedures, and implementing governance improvements from external reviews.</p> <p>Our view is that the overall pace of improvement at the College around governance arrangements in previous years and 2018/19 indicates there is insufficient management capacity to address the required improvements.</p>	<p>R E D</p>



Introduction

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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 Lews Castle 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 25 June 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. Minor changes were made to the level of materiality that we applied during the audit, to reflect the 2018/19 draft financial statements.

Overall Materiality

£120,000

1.5% of the College's gross expenditure

Tolerable Error

£90,000

Materiality at an individual account level

Reporting threshold

£6,000

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 25 June 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; and
- ▶ Pension Liability and Asset Valuation.

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

Management provided draft financial statements at the start of the audit, in line with the agreed timetable. The core financial statements were materially complete at the start of the audit, and supported with appropriate working papers. A number of areas of the financial statements, including the Annual Governance Statement, were updated subsequent to the initial onsite audit.

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. Continued focus is required by management to ensure the draft financial statements presented for audit reflect changes in accounting and disclosure requirements.

Audit outcomes

We identified three unadjusted audit difference arising from the audit that breached our reporting threshold. Two adjustments were processed 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.

Our audit opinion

Element of opinion	Basis of our opinion	Conclusions
<p>Financial statements</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>Going concern</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>Other information</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"> ▶ Review of committee minutes and papers, regular discussions with management, our understanding of the College and the sector. 	<p>We are satisfied that the annual report materially meets the core requirements set out in the Accounts Direction.</p>
<p>Report on regularity of income and expenditure</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"> ▶ Understanding the applicable enactments and guidance issued by the Scottish Ministers ▶ Performed detailed testing of income and expenditure testing to ensure transactions are in line with enactments and guidance 	<p>We are satisfied that in all material respects income and expenditure are regular.</p>
<p>Matters prescribed by the Auditor General for Scotland</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>Matters on which we are required to report by exception</p>	<p>We are required to report on whether:</p> <ul style="list-style-type: none"> ▶ adequate accounting records have not been kept; or ▶ the financial statements and the audited part of the Remuneration and Staff Report are not in agreement with the accounting records; or ▶ we have not received all the information and explanations we require for our audit 	<p>We have no matters to report.</p>

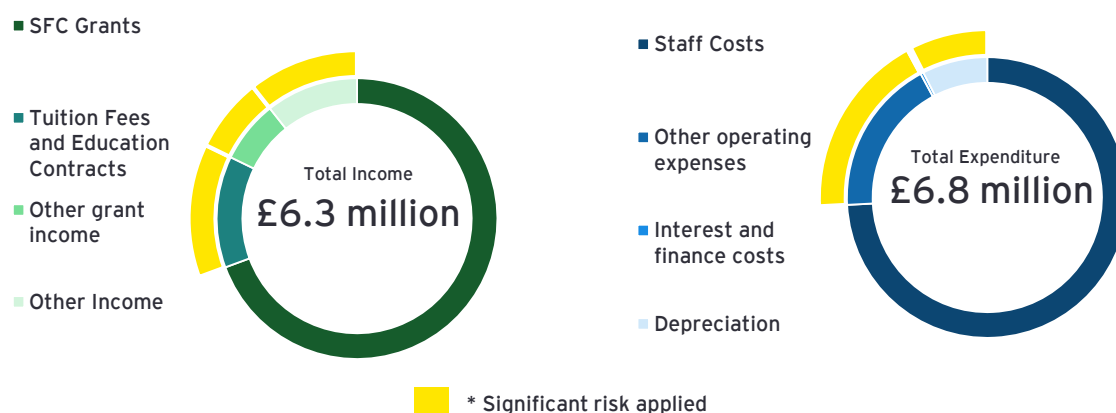
Significant and fraud audit risks

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 not identified any material misstatements relating to revenue and expenditure recognition. We identified one unadjusted audit difference with nil net impact on the College’s financial position.

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.

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.

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

We tested the appropriateness of manual journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.

We obtained a full list of journals posted to the general ledger during the year, and used our bespoke data analysers to identify any unusual journal types or amounts based on our identified risk areas for the audit.

We 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.

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.

We identified and considered the appropriateness of key accounting estimates, including provisions, and their susceptibility to bias.

We reviewed each estimate and concluded there was no evidence of material bias.

We are also content that the disclosures that management have made in the relevant section of the financial statements are appropriate.

Evaluate the business rationale for any significant unusual transactions.

No unusual transactions were identified outside the normal course of business.

Review of property, plant and equipment expenditure to ensure it fulfils the accounting requirements to be capitalised.

No issues were noted through testing performed.

We consider the consistency and application of accounting policies, and the overall presentation of financial information.

There are no accounting practices that materially depart from what is acceptable under the accounting framework.

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 £16.1 million (2017/18: £11.5 million).

During the year, the College's property assets were subject to revaluation in line with the accounting requirements, which resulted in an increase in the asset values of £4.3 million.

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, in particular for assets being held for sale by the College.
- ▶ 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.

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, however we identified a number of audit adjustments relating to the accounting entries to ensure the revaluation was reflected in the financial statements. See Appendix F for details.

Our audit procedures

Our findings

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 £2.3 million (2017/18: £0.7 million) and the present value of the unfunded obligation in relation to early retirements agreed in previous years is £0.9 million (2017/18: £0.9 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.

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 adjusted this in the financial statements, resulting in an unadjusted audit difference (see 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.

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 1:
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 £0.5 million in the period to 2023/24 if no mitigating actions are 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 significant 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.

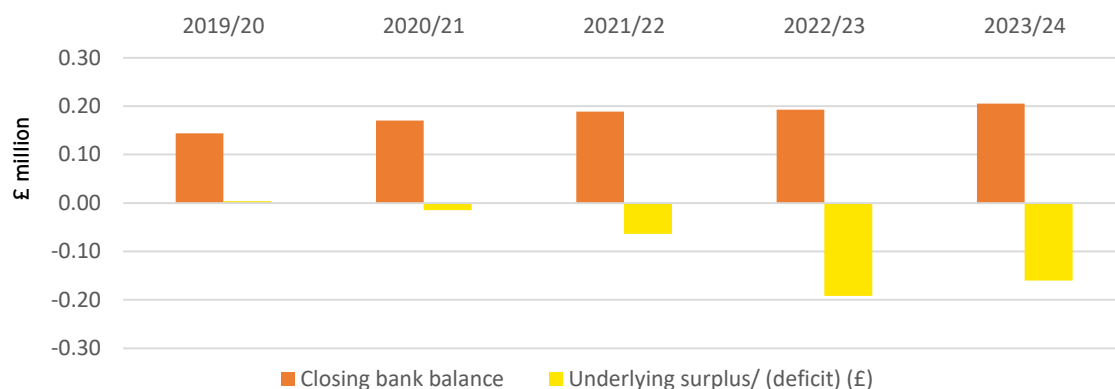
The context for financial sustainability in the College sector

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 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 for four of the next five years without intervention. The cumulative gap to 2023/24 is estimated at £0.5 million.



Source: Lews Castle College Financial Forecast Return, September 2019

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.

Significant and ongoing financial challenges

The College has experienced significant financial challenges in recent years. In our 2017/18 Annual Audit Report we concluded that the College was continuing to face pressures around its financial sustainability, and that its forecast underlying financial position was subject to a number of significant assumptions and sensitivities around future income receipt and costs, in particular around pay increases for staff and estate management costs. We noted that management had demonstrated awareness of the scale of the financial challenges and was sighted on the need to make savings. During 2018/19 management has reviewed its financial forecast position to identify possible areas for savings through to 2024.

Financial performance in 2018/19

The College reported an accounting deficit of £0.4 million for the year (2017/18: £0.3 million deficit). Following an actuarial loss of £1.3 million and an unrealised gain on revaluation of fixed assets of £4.3 million, the College reported total comprehensive income of £2.5 million (2017/18 income: £2.1 million). The College had an underlying operating deficit after removal of non-cash accounting adjustments (relating to pension and capital accounting adjustments) of £23,000 (2017/18: £25,000 surplus).

The College delivered FE provision of 5,266 credits compared to 5,125 in 2017/18, however it did not meet its credit target allocated of 5,348.

2018/19 College financial forecast return

In September 2019 the College submitted a financial forecast return to the SFC for the five year period to 2024. The College noted the balanced forecast position included an assumed £400,000 of savings to be achieved through the FFR period to 2024, through both staff cost reductions, and increased grant and tuition income over the next five years. Management has identified the staff posts required to make savings through the period, totalling five FTE's due to retire. However, management has noted that at this stage the income increase targets are high level targets, and there remains risk of non-achievement.

Exhibit 3: The College's "balanced" FFR includes £0.5 million of savings that the College is aiming to achieve through to 2023/24.

	2019-20	2020-21	2021-22	2022-23	2023-24	Total / £000's
<i>Income increases</i>	-	-	-	75	75	150
<i>Staff cost savings</i>	-	41	82	121	98	342
<i>Total new annual savings</i>	-	42	82	196	173	492

Source: Lews Castle College Financial Forecast Return, September 2019

Strategic and operational impact of savings

In our 2017/18 Annual Audit Report we highlighted 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 the specific savings identified to date have been in conjunction with a review of the overall teaching curriculum to minimise the operational impact on the College, there is still no formal alignment between the strategic and operational plans and targets for the College with its financial plans.

Recommendation 2:

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 staff cost reductions and other savings are having on operational and strategic delivery should be subject to ongoing review in conjunction with UHI, as RSB, and SFC.

Key risks and uncertainties

In addition to the risks around delivery of a balanced financial position through 2023/24, as outlined on the previous pages, 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 and assumptions that impact the College's sustainability in the medium term

Risk identified	Risk mitigating actions
<p>From 2022-23 onwards the forecasts show increases in income as follows:</p> <ul style="list-style-type: none"> • Short Courses increased by £15,000 • Managing Agency income increased by £25,000 • Evening Class income increased by £5,000 • Revenue Grants increased by £30,000 	<p>These increases are considered by management to be modest and provide realistic targets for the College to increase its short course and work-based learning activity.</p>
<p>SFC recurrent grant in aid has no change forecast in 2020-21 and 2021-22. The College does not forecast to be impacted by the reduction at regional level relating to ESIF funding. In 2022/23 funding is reduced by 4% in line with SFC guidance. Although this reduction has been included it has not been accepted by The Highlands and Islands region and discussions are ongoing with SFC.</p> <p>Discussions with UHI and SFC have clarified that there is currently no funding provided in relation to the College's requirement to pay an Islands Allowance, and that the additional cost in 2018/19 to the College was £296,000</p>	<p>Savings will be required in 2023-24 to staff salaries through non-replacement of retiring staff. While it may be possible to achieve these reductions due to retirement of staff an assumption has been made that the college will be able to maintain and improve its student recruitment with reduced staffing.</p> <p>The College continues to seek funding to cover the additional costs arising from the requirement to pay an Islands Allowance to staff.</p>
<p>SFC other grants have been increased in 2021 in line with the current government commitment to fully meet the costs of the increases in lecturers pension costs. This is then maintained across the remaining period. Staff salaries have been increased each year by 2% as advised by SFC.</p>	<p>There are likely to be some 14 members of staff retiring within the next 5 years and the current review of curriculum and new opportunities provides the opportunity to find the necessary efficiencies to meet this assumption.</p>

Source: Lews Castle College FFR September 2019

Governance and Transparency

A number of areas of good governance are in place and operating across the College, and 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.

However, we have identified a number of areas where governance arrangements have grounds for improvement, and should be addressed as a priority. These areas included addressing non-compliance areas with the Code of Good Governance, maintaining policies and procedures, and implementing governance improvements from external reviews.

Our view is that the overall pace of improvement at the College around governance arrangements in previous years and 2018/19 indicates there is insufficient management capacity to address the required improvements.

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Governance arrangements

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

- ▶ Board minutes 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, having recently been updated and revised in 2018.
- ▶ The College publishes Board agendas and minutes on its website in a timely manner and information, including financial performance, is generally clear and concise.

Annual Governance Statement

We reviewed the 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.

Recommendation 3:
In line with previous years we recommend priority is given to addressing the areas for improvement around the College's governance arrangements. In particular:

- Addressing all areas of non-compliance identified against the Code of Good Governance.
- Ensuring all policies and procedures are monitored routinely and updated as needed.
- Developing a detailed plan to address board effectiveness review recommendations, including any outstanding areas for improvement from the previous review and a detailed timeframe for implementation to be monitored by the Board.

The Board should consider if it and management has sufficient capacity to address the scale of improvements required in 2019/20.

Prior Year recommendation follow up and capacity around governance

In its 2018/19 annual governance statement, the College has identified two areas of non-compliance in the year, related to the makeup of the Board and the completion of Board and committee effectiveness reviews, and has outlined how it intends to ensure compliance going forward. However, the College has not outlined how it has addressed the three areas of non-compliance identified in 2017/18.

We have reviewed the College's actions in response to the prior year recommendations referenced in Appendix E. In particular in 2017/18 we noted the following matters around the College's governance arrangements:

- ▶ There was not a robust process to ensure all policies and procedures at the College were subject to timely review and update to ensure they remained current and fit for purpose. Management has now collated a full list of all policies and procedures, however this does not include responsible officers and deadlines for updating.
- ▶ There were a number of actions outstanding from previous Board effectiveness reviews. These actions are now supplemented, and in some cases superseded, by an effectiveness review undertaken in 2018/19. This review identified 17 areas where the Board considered it was "not working well enough" for the requirements of the College.

While some progress has been made in addressing the recommendations, overall our view is that this progress is limited and the pace of improvement around governance and transparency continues to be insufficient to ensure good governance across the College. This is consistent with our view in previous years, and there is a significant risk around implementation of improvements with the current capacity assigned to address these matters.

Systems of 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.

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.

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 as it relates to existing risks. Management has considered the impact of EU withdrawal on funding and College activities and not identified a material impact. This continues to be monitored by the College's Audit Committee through its risk register.

Enquiries of those charged with governance

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

Internal audit's opinion for the year is based on its agreed audit plan for the year, as approved by the Audit Committee. For 2018/19, the internal auditor's opinion notes that "TIAA is satisfied that, for the areas reviewed during the year, Lews Castle College has reasonable and effective risk management, control and governance processes in place".

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 has taken steps during 2018/19 to ensure that reports are circulated to senior management and Committees on receipt, and the impact on the College and region is considered as appropriate.

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 yearend audit. We noted that the College had submitted the required data as part of the NFI exercise and participated in assessing the responses and matched data provided. We noted no recommendations in respect of the College's NFI arrangements.



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 - Adjusted errors 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 22 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
Component of fee:	2018/19	2017/18
<i>Auditor remuneration</i>	£17,000	£16,610
<i>Fee variation in respect of wider scope focus areas</i>	£3,250	£2,900
Pooled costs	£980	£1,060
Contribution to Audit Scotland costs	£1,030	£920
Total fee	£22,260	£21,490

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.

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.

Appendix C: Required Communications

Required communication	Our reporting to you
<p>Terms of engagement / Our responsibilities</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>Planning and audit approach</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>Significant findings from the audit</p> <ul style="list-style-type: none"> ▶ 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 	<p>Annual Audit Plan</p> <p>Annual Audit Report</p>
<p>Going concern</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"> ▶ 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 	<p>Annual Audit Report</p>
<p>Misstatements</p> <ul style="list-style-type: none"> ▶ 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 	<p>Annual Audit Report</p>
<p>Fraud</p> <ul style="list-style-type: none"> ▶ 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 	<p>Annual Audit Report</p>
<p>Consideration of laws and regulations</p> <ul style="list-style-type: none"> ▶ 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 	<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>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. An impact assessment will be carried out in time to feed into the 2019/20 accounts process.</p> <p>Responsible officer: Head of Finance</p> <p>Implementation date: 31/07/20</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
2	In our 2017/18 Annual Audit Report we highlighted 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 the specific savings identified to date have been in conjunction with a review of the overall teaching curriculum to minimise the operational impact on the College, there is still no formal alignment between the strategic and operational plans and targets for the College with its financial plans.	<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 staff cost reductions and other savings are having on operational and strategic delivery should be subject to ongoing review in conjunction with UHI, as RSB, and SFC.</p> <p style="text-align: right;"><i>Grade 1</i></p>	<p>Agreed. Forecasts are regularly reported to Finance & General Purposes Committee, UHI and SFC as required.</p> <p>The FE Regional Board has agreed to review the financial forecasts of all the Region's Colleges to get a clearer idea of the implications of future finances on the operations of the Region and its Colleges. The College will contribute to this exercise to assess its own strategic and operational impact of required savings.</p> <p>Responsible officer: Head of Finance</p> <p>Date: ongoing throughout 2019/20</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
3	<p>We have reviewed the College's actions in response to the prior year recommendations referenced in Appendix E. While some progress has been made in addressing the recommendations, overall our view is that this progress is limited and the pace of improvement around governance and transparency continues to be insufficient to ensure good governance across the College. This is consistent with our view in previous years, and there is a significant risk around implementation of improvements with the current capacity assigned to address these matters.</p>	<p>In line with previous years we recommend priority is given to addressing the areas for improvement around the College's governance arrangements. In particular:</p> <ul style="list-style-type: none"> ▶ Addressing all areas of non-compliance identified against the code of good governance. ▶ Ensuring all policies and procedures are monitored routinely and updated as needed. ▶ Developing a detailed plan to address board effectiveness review recommendations, including any outstanding areas for improvement from the previous review and a detailed timeframe for implementation to be monitored by the Board. <p>The Board should consider if it and management has sufficient capacity to address the scale of improvements required in 19/20.</p> <p style="text-align: right;"><i>Grade 1</i></p>	<p>Agreed. The assessment of compliance has been considered by the Audit Committee and will continue to be under continual review. This will include updates on progress made in respect of addressing previously identified areas of non-compliance.</p> <p>The College has now a list of policies and procedures and this is being updated and actively monitored, however the task is not yet complete. The development of Single Policies has resulted in many of the College's local policies becoming redundant and care is being taken to make sure that we maintain a comprehensive range of policies while these new arrangements are being introduced.</p> <p>An effectiveness review was carried out in July 2019 and the resultant actions are in the process of being undertaken. The Board are aware of the scale of change required and will continue to monitor the situation. A Director of Transformational Change has been seconded from UHI for two years to assist with the change process.</p> <p>Responsible officer: Board of Management,</p> <p>Date: ongoing throughout 2019/20.</p>

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>Financial statements preparation process</p> <p>The timely preparation of financial statements is key aspect of effective financial management and governance arrangements. Management should ensure the financial statements are prepared in line with the agreed timetable, or that the audit timetable is agreed to allow management time to complete draft financial statements.</p> <p style="text-align: right;"><i>Grade two</i></p>	<p>Agreed.</p> <p>Initial draft financial statements were provided prior to the onsite audit work, with an updated draft supplied on 30th November. We will continue to strive to provide the statements in a timely manner in future audits.</p>	<p>Management prepared draft financial statements for the week of the audit, which were prepared to a higher standard of quality than 2017/18. There were a number of outstanding areas related to the College's Governance statement which we have outlined in our governance and transparency report. Management should continue to ensure focus is given to the preparation of the financial statements in line with the requirements of the underlying accounting standards and SFC accounts direction.</p>
2	<p>Financial forecast reporting arrangements</p> <p>We have noted that, while the core financial inputs into the FFR were completed in time with SFC requirements, the College did not completed its supporting commentary until November 2018 on request from the RSB. Due to the timing of completion of the FFR it was not subject to scrutiny by those charged with governance; the finance committee or Board prior to external submission and review.</p> <p>In our view the arrangements around distributing and explaining the College's financial position and forecast can be materially enhanced to ensure there is improved clarity and transparency of the College's financial position, together with the enhanced transparency around the risks facing the College.</p> <p style="text-align: right;"><i>Grade one</i></p>	<p>Agreed.</p> <p>Future FFR returns will be submitted to a relevant College committee for scrutiny.</p>	<p>Management completed its FFR and supported commentary in line with the requirements set by the SFC. In our view the commentary materially explained the key financial positions and risks for the College.</p>

Prior year recommendations

No.	Recommendation / grading	Management response/ Implementation timeframe	Our assessment of progress
3	<p>Financial forecast reporting arrangements</p> <p>Currently the College's strategic and operational plans are not aligned to financial plans, for example through the costing of strategic objectives and reconciliation of forecast expenditure to future funding.</p> <p>Given the forecast sensitivity around the College's financial position, and the wider position across the sector, it is important that strategic and operational plans are aligned to financial realities. Equally it is important that financial decisions taken are considered against the College's ability to achieve strategic aims.</p> <p style="text-align: right;"><i>Grade one</i></p>	<p>Agreed. This will be developed in the 2018/19 financial year.</p>	<p>We have reported on the financial and operational plans in our financial sustainability section.</p>

Prior year recommendations

No.	Recommendation / grading	Management response/ Implementation timeframe	Our assessment of progress
4	<p>Governance improvement arrangements</p> <p>In our 2016/17 Annual Audit Report we noted that a Board self-effectiveness review had recently been completed, and that the College should develop an action plan to address the 25 areas for improvement identified in the final report. During 2017/18 a number of actions have been addressed, however a number of significant areas remain outstanding with limited progress in the year. These areas of ongoing improvement have been disclosed within the College's Governance Statement.</p> <p>While noting the College has a risk register which is subject to review by the Board, the College does not currently have a risk management policy outlining its overall approach to risk. Through our inquiries we understand the College is still in the process of implementing a robust process for monitoring and updating key policy and procedures that support the underlying governance arrangements at the College (as well as more general procedures around key processes). This is a key underpinning part of ensuring good governance arrangements are embedded across the College.</p> <p>The outstanding areas of improvement to governance arrangements should be finalised at the earliest possible opportunity on a risk and priority basis.</p> <p>On a wider basis, the pace of improvement in our view suggests possible insufficient capacity to address required improvements and maintain a robust governance environment on a sustainable basis. Management should consider the requirements of good governance against the capacity currently in place to deliver it and take the required action in conjunction with the RSB.</p> <p style="text-align: right;"><i>Grade one</i></p>	<p>Agreed. Additional Board of Management members have recently been recruited to support improvement in the pace of change.</p>	<p>We have outlined our consideration of governance and transparency arrangements at the College in our wider scope section of this report.</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>Accrual for job evaluation exercise costs and associated income</i>	£84,714 (£84,714)		(£84,714) £84,714
2	<i>Accounting for impact of GMP on LGPS scheme</i>	£10,000		(£10,000)
3	<i>Loss on land revaluation transferred from the revaluation reserve to I&E</i>	£60,000	(£60,000)	
	Total	£70,000	(£60,000)	(£10,000)

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>Overstated depreciation and release of deferred capital grants due to timing of revaluation adjustments</i>	£188,517 (£188,517)		(£188,517) £188,517
2	<i>Capitalisation of PPE additions previously recognised through I&E and release of deferred capital grants</i>	(£1,552,842)		£1,552,842
	Total	(£1,552,842)		£1,552,842

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

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