North Highland College

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

17 December 2019

Building a better working world

Contents

About this report

This report has been prepared in accordance with Terms of Appointment Letter from Audit Scotland dated 31 May 2016 through which the Auditor General for Scotland has appointed us as external auditor of North Highland 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

Area	Conclusion	Rating
Financial statements: Audit Opinion	We have concluded our audit of the College's financial statements for the year ended 31 July 2019. We identified one unadjusted audit difference arising from the audit. Four audit adjustments were processed by management as part of the audit. We concluded the other information subject to audit, including parts of the Remuneration Report and the Annual Governance Statement were appropriate.	GREEN
Presentation and disclosures	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. We were satisfied that the Annual Governance Statement materially reflects the requirements of the Scottish Funding Council's 2018/19 Accounts Direction.	GREEN
Wider Scope: 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 £2.4 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, savings on estate maintenance and income increases. A significant share of these savings are still in the initial stages of planning and contingent on significant changes to the College's operations. Despite being well sighted on the financial pressures facing the College and having been active in the year in seeking to address the future position, management has recognised a significant future financial risk to the College without additional funding or further cost reductions. There is also a significant risk that further cost reductions to staffing will have a material impact on the College's capacity to deliver its operational and strategic plans.	RED
Governance and Transparency	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. We have noted a number of areas where progress in respect of previous recommendations had been limited in the year, and the College has significant work to do in respect of its participation in Scotland's NFI exercises.	AMBER

Introduction

Our key contacts:

Stephen Reid
Partner
sreid2@uk.ey.com

Rob Jones
Senior Manager
rjones9@uk.ey.com

Steven Caldwell
Assistant Manager
steven.caldwell@uk.ey.com

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 North Highland 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 22 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. 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	Tolerable Error	Reporting threshold
£194,000	£97,000	£9,000
1.5% of the College's gross expenditure	Materiality at an individual account level	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 22 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; 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. There needs to be an increased focus by management to ensure the draft financial statements presented for audit are subject updating for changes in requirements.

Audit outcomes

We identified one unadjusted audit difference arising from the audit that breached our reporting threshold. Four 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
Financial statements 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 The financial statements are prepared in accordance with the financial reporting framework	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. We are satisfied that accounting policies are appropriate and estimates are reasonable. We have considered the financial statements against the financial reporting requirements, and additional guidance issued by the SFC and Audit Scotland.	We issued an unqualified audit opinion on the 2018/19 financial statements for the College.
Going concern We are required to conclude and report on the appropriateness of the use of the going concern basis of accounting	We conduct core financial statements audit work, including management's assessment of the appropriateness of the going concern basis. Wider scope procedures, including financial forecasts are considered as part of our work on financial sustainability.	We have no matters to report.
Other information We consider whether the other information in the financial statements is materially inconsistent with other knowledge obtained during the audit	We conduct a range of substantive procedures on the financial statements. Our conclusion draws upon: - Review of committee minutes and papers, regular discussions with management, our understanding of the College and the sector.	We are satisfied that the annual report materially meets the core requirements set out in the Accounts Direction.
Report on regularity of income and expenditure 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	Our procedures include: - 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	We are satisfied that in all material respects income and expenditure are regular.
Matters prescribed by the Auditor General for Scotland Audited part of Remuneration Report has been properly prepared. The Performance Report and Annual Governance Statement are consistent with the financial statements and have been properly prepared.	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.	We have no matters to report.
Matters on which we are required to report by exception	We are required to report on whether: - 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	We have no matters to report.

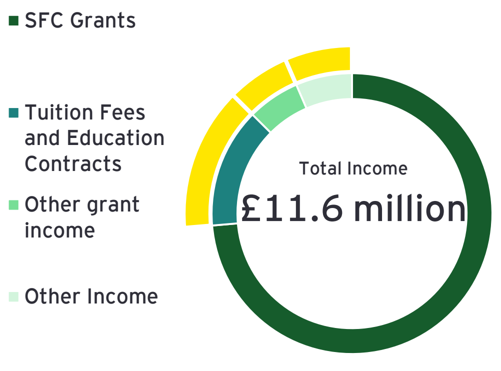
Significant and fraud audit risks

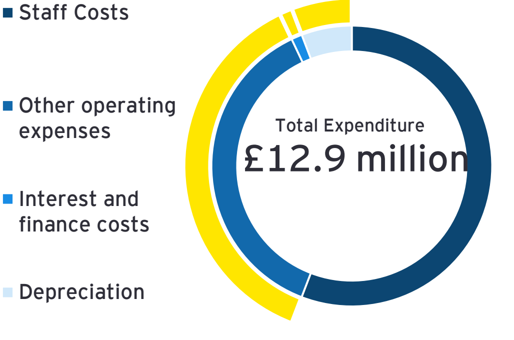
1. Risk of Fraud in Income and Expenditure Recognition

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





* Significant risk applied

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

Our testing identified six audit differences relating to revenue and expenditure recognition, with a net impact of decreasing the College's deficit by £42,000. These are outlined in Appendix F.

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.

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.

Our audit procedures	Our findings
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.

Valuation of Property Plant and Equipment	Our audit procedures	Our findings
The College's PPE portfolio totals £18 million (2017/18: £16.9 million). During the year, the College's property assets were subject to a valuation uplift through indexation in line with the accounting requirements for the years in-between valuation, which resulted in an increase in the asset values of £1 million. Our work focused on judgements, and accounting, in relation to the valuation of the College's land and buildings, in particular assets currently held for sale by the College, namely Ross House (£0.4 million), and Wick College (£0.1 million)	▶ Considered the work performed by the College as part of it's 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.	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 an audit adjustment relating to the treatment of assets held for sale. See Appendix F for details. We identified a number of differences in the accounting treatment for the processing of transactions in the year and the yearend valuation, which are outlined in appendix F. We did not identify any other audit matters to report.

	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 £6.5 million (*2017/18: £2.6 million*) and the present value of the unfunded obligation in relation to early retirements agreed in previous years is £0.68 million (*2017/18: £0.67 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 updated the financial statements for the past service cost. An unadjusted audit difference has been raised at 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

Recommendation 1:
The College should conduct an impact assessment on the implementation of the revised SORP.

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.

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 £2.4 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, savings on estate maintenance and income increases. A significant share of these savings are still in the initial stages of planning and contingent on significant changes to the College's operations.

Despite being well sighted on the financial pressures facing the College and having been active in the year in seeking to address the future position, management has recognised a significant future financial risk to the College without additional funding or further cost reductions. There is also a significant risk that further cost reductions to staffing will have a material impact on the College's capacity to deliver its operational and strategic plans.

RED

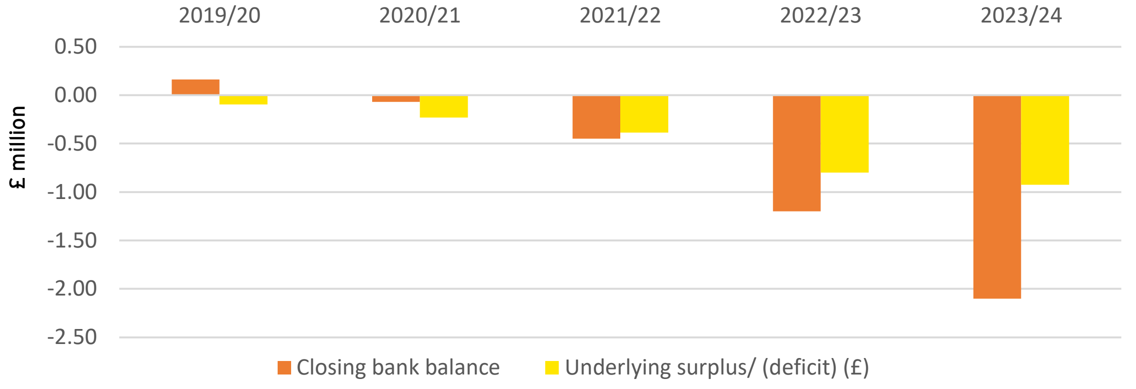
The context for financial sustainability in the College sector

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 North Highland 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 2.4 million.



Source: North Highland 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 and increasing financial challenges in recent years. In our 2017/18 Annual Audit Report we noted that the College was forecasting significant accounting and underlying deficits through to 2023, and at the time was forecasting negative cash from around the mid-point of 2019/20. We noted that management had demonstrated awareness of the severity of the financial position and was sighted on the need to make savings.

In line with the agreed audit actions at the time, during 2018/19 management completed an exercise to review the efficiency of curriculum delivery models for both further and higher education courses. This has resulted in some courses being terminated, others being refocussed and new courses introduced. In addition to measures implemented to increase college income, work is now in progress to deliver a total of 7 FTE savings in teaching and support services, resulting in planned savings of up to £300,000 over by the end of 2020.

Financial performance in 2018/19

The College reported an accounting deficit of £1.3 million for the year (2017/18: £1 million). Following an actuarial loss of £3.2 million and an unrealised gain on revaluation of fixed assets of £1 million, the College reported total comprehensive expenditure of £3.4 million (2017/18 income: £5.4 million). The College had an underlying operating deficit after removal of non-cash accounting adjustments (relating to pension and capital accounting adjustments) of £361,000 (2017/18: £111,000 surplus).

The College recorded its highest level of FE provision to date in 2018/19, 20,003 credits compared to 19,724 in 2017/18. Its delivery of SFC funded undergraduate HE provision (measured in FTE) reduced to 370 FTE students, compared to a 2017/18 delivery of 423 and 2018/19 target of 440.

2018/19 College financial forecast return

In September 2019 the College submitted a base financial forecast return to the SFC for the five year period to 2024, forecasting a £2.4 million operating deficit over this period, outlined above. The College also submitted an updated "balanced" FFR outlining a balanced underlying operating position, with £2.4 million of savings from staff and maintenance cost reductions, and increased income over the next five years. However, management has noted that at this stage most of the projected longer term savings from 2021/22 are not planned and agreed in detail, and there remains significant risk of achieving the full required savings. The Board has continued to seek additional funding from the University of the Highlands and Islands (UHI), as Regional Strategic Board (RSB) and the SFC.

Exhibit 3: The College's "balanced" FFR includes £2.4 million that the College is aiming to achieve savings through to 2023/24.

	2019-20	*2020-21*	*2021-22*	*2022-23*	*2023-24*	*Total / £000's*
Income increases	50	100	150	200	200	700
Staff cost savings	45	83	100	350	450	1,028
Estate maintenance cost savings	0	50	136	250	276	712
Total	**95**	**233**	**386**	**800**	**926**	**2,440**

Source: North Highland College Financial Forecast Return, September 2019

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 that impact the College's sustainability in the medium term

Risk identified	Risk mitigating actions
1. Ongoing challenges of funding from the SFC for the College. This has been made clear to the SFC at Strategic discussions.	This has been raised with the SFC and UHI as the Regional Strategic Body. The new interim Vice Chancellor is setting up a review of funding allocations to UHI Academic Partners through the UHI Programme Board.
2. Risks around the timing of the delivery of sale of Ross House to be sold and proceeds used along with other funding to build a golf facility on the Burghfield Campus.	The College's Director of Finance & Corporate Services oversees the monitoring of both project elements to help ensure this project overall is delivered on budget.
3. The Scottish Colleges Foundation has awarded funding for a Business Development Unit whose job it will be to target additional external funding. This is more challenging than in an urban environment where there are more business opportunities.	Monitor the progress of the Business Development Unit regarding monies taken in and costs associated with generating external income
4. Students number targets will not be achieved.	Early FE student recruitment was under pressure in 2018-19, but the College reacted to ensure Core and ESF credit targets were met. HE student numbers were near 70 short of target in 2018-19. A Curriculum Review was completed in 2018-19 with a number of actions now being progressed
5. Increased staff costs from National Bargaining and increased pension costs. Concern that these will not be fully covered by additional funding .	Unless National Bargaining costs are met in full and costs associated with pension rises, then the college will continue to be under financial pressure. Further work has been done which should see another £100,000 staff costs savings delivered over the next three years (approximately £33,000 per annum)
6. Slow progress of the UHI Partnership Assembly around integrated operations and associated governance changes.	The College Board to have a watching brief on this issue. It may be that if the Partnership Assembly makes limited progress, then the College Board may have to consider alternative ways to make the College more financially sustainable.

Source: North Highland College FFR September 2019

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. Its RSB should be kept informed on a routine basis and as soon as it is known if advanced funding is required. The College should review its loan covenant position in advance of 31 July 2020 and, should it be necessary, discuss any potential breaches with the lender.

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.

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. We note 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, and that for 2019/20, the College is forecasting that student recruitment targets will be achieved. However, given the scale of the medium term saving requirements, and the likely impact on the College, there remains an ongoing significant risk of operational impact from delivery of the current savings plans.

Loan funding and cash position

In 2016/17 and 2017/18 we have reported that the College required agreements with Bank of Scotland to waive loan covenants on its outstanding loan balance. At 31 July 2019 the College was again in breach of its covenants for the outstanding balance of £1.3 million (2017/18: £1.4 million). As no covenant waiver with the lender at 31 July the loan was reclassified in the financial statements as a current liability.

In our 2017/18 reporting we noted the College forecast negative cash through the mid-point of 2019/20 at which point it would require support from UHI. The forecast position has improved following the action taken by the College and an advance of funding from UHI of £350,000 (2017/18: £300,000), and a number of assumptions around future one-off funding streams (see following page). The College has £256,000 cash on hand at 31 July 2019 and is forecasting to stay in a positive cash position through 2019/20 irrespective of delivery of targeted savings. However, it will continue to rely on advanced funding of its core SFC grant from UHI to maintain a positive cash position.

As part of its going concern assessment in advance of approval of the financial statements the College undertook the following actions:

- Confirmed with the lender that it will waive enforcement of bank loan covenants for the next 12 months from the reporting date.
- Reviewed the most recent 2019/20 budget and forecast cashflow through 2019/20.
- Agreed with UHI that in its role as the RSB it will continue to support the College through short term advanced funding if necessary.

Governance and Transparency

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.

We have noted a number of areas where progress in respect of previous recommendations had been limited in the year, and the College has significant work to do in respect of its participation in Scotland's NFI exercises.

AMBER

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 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.
- 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: We continue to recommend that the College should undertake an exercise to fully update its assessment of compliance with the Code of Good Governance for Scotland's Colleges, drawing on best practice and support from UHI and partner colleges.

The College has not identified any areas of non-compliance in the year, and has addressed the one matter identified in the previous assessment completed in 2017/18. In 2017/18 we recommended the College update its self-assessment, expanding on and enhancing its documentation and support for its assessment of compliance. This was partially completed for 2018/19.

Prior Year recommendation follow up

Recommendation 4: The College should seek to finalise its implementation of recommendations around its previous assessment of Board effectiveness as soon as possible.

We have reviewed the College's actions in response to prior year recommendations in Appendix E. We noted that progress has been made in relation to the specific recommendations around the core financial statements audit. In respect of our recommendations around financial sustainability, we have noted management has made progress on the actions agreed last year, however there remains a significant risk around the future sustainability of the College. We have noted limited progress in respect of the recommendations made around governance arrangements, including the arrangements for assessing the College's compliance with the Code of Good Governance (outlined on the previous page) and progress around implementing the recommendations from the most recent assessment of its Board effectiveness.

The Board's internal auditors have also conducted follow up work to assess the level of compliance with internal audit recommendations. They concluded that progress had been made addressing outstanding actions from previous years.

Systems of internal control

Within the annual governance statement, the College has concluded that "the Board of Management has no matters to report in respect of failures in the expected standards of good governance, risk management and control for the year ended 31 July 2019".

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.

National Fraud Initiative (NFI)

Recommendation 5: 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.

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 not submitted any data as part of the NFI exercise and that the College had significant work to do to embed good practice around NFI arrangements. Since our assessment the College has worked to provide the data, and by the conclusion of the audit had partially provided this and was working to provide the rest of the data in advance of the next Audit Scotland assessment in early 2020.

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. 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 going forward. It is continuing to monitor the latest developments and mitigate its financial plans accordingly.

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 by either management or the Audit Committee.

Internal audit's opinion for the year was 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, North Highland 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 Board members on receipt, and the impact on the College is considered where relevant.

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
Auditor remuneration	***£12,620***	*£12,330*
Fee variation in respect additional focus areas	***£2,500***	*£900*
Pooled costs	**£730**	£790
Contribution to Audit Scotland costs	**£760**	£680
Total fee	**£16,610**	£14,700

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.

EY

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. 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
Terms of engagement / Our responsibilities Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties. Our responsibilities are as set out in our engagement letter.	Audit Scotland Terms of Appointment letter – audit to be undertaken in accordance with the Code of Audit Practice
Planning and audit approach Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Annual Audit Plan
Significant findings from the audit ▸ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▸ Significant difficulties, if any, encountered during the audit ▸ Significant matters, if any, arising from the audit that were discussed with management ▸ Written representations that we are seeking ▸ Expected modifications to the audit report ▸ Other matters if any, significant to the oversight of the financial reporting process	Annual Audit Plan Annual Audit Report
Going concern Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: ▸ Whether the events or conditions constitute a material uncertainty ▸ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▸ The adequacy of related disclosures in the financial statements	Annual Audit Report
Misstatements ▸ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation ▸ The effect of uncorrected misstatements related to prior periods ▸ A request that any uncorrected misstatement be corrected ▸ Corrected misstatements that are significant ▸ Material misstatements corrected by management	Annual Audit Report
Fraud ▸ Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ▸ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ▸ A discussion of any other matters related to fraud	Annual Audit Report
Consideration of laws and regulations ▸ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ▸ Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of	Annual Audit Report (to be issued on completion of audit work) or as occurring if material.

Required communication	Our reporting to you
Related parties Significant matters arising during the audit in connection with the entity's related parties including, when applicable: ▸ Non-disclosure by management ▸ Inappropriate authorisation and approval of transactions ▸ Disagreement over disclosures ▸ Non-compliance with laws and regulations ▸ Difficulty in identifying the party that ultimately controls the entity	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	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.	The College should conduct a formal impact assessment on the implementation of the revised SORP. *Grade 3*	Agreed. An assessment will be completed in advance of the 2019/20 financial yearend. Responsible officer: Director of Finance & Corporate Services Implementation date: 30th September 2020

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	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. The savings identified have been made in conjunction with a review of the overall teaching curriculum to minimise the operational impact on the College. However, given the scale of the savings requirements identified and the impact on the College these could have there remains a significant risk of operational impact from ongoing savings activity.	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. *Grade 1*	Agreed. The College continues to monitor its position closely and in conjunction with the RSB. Responsible officer: Principal/Director of Finance & Corporate Services Implementation date: ongoing throughout 2019/20.
3	The College has not identified any areas of non-compliance with the Code of Good Governance, in the year, and has addressed the one matter identified in the previous assessment completed in 2017/18. In 2017/18 we recommended the College update its self-assessment, expanding on and enhancing its documentation and support for its assessment of compliance. This was not completed for 2018/19.	We continue to recommend that the College should undertake an exercise to fully update its assessment of compliance with the Code of Good Governance for Scotland's Colleges, drawing on best practice and support from UHI and partner colleges. *Grade 2*	Agreed. A full assessment will be completed in 2019/20. Responsible officer: Board Secretary Implementation date: 30th April 2020

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	The College has not finalised the implementation of recommendations from its previous assessment of Board effectiveness.	The College should seek to finalise its implementation of recommendations around its previous assessment of Board effectiveness as soon as possible. *Grade 1*	Agreed. The College will work to finalising implementation of all recommendations in 2019/20. Responsible officer: Principal/Board Secretary Implementation date: 30th April 2020
5	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 not submitted any data as part of the NFI exercise and that the College had 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. *Grade 2*	Agreed. The College finance team has experienced a number of capacity issues with staff shortages and issues extracting the information from its system in the format required by Audit Scotland, but is continuing to work to resolve this. Responsible officer: Director of Finance & Corporate Services. Implementation date: Ongoing throughout 2019/20.

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	**College estate valuation processes** Based on the conclusions and adjustments from our audit work, in our view the valuation of the College estate is an area which requires increased focus from management, in particular around the accounting requirements throughout the year in advance of preparation of the yearend financial statements. Management should ensure appropriate processes are in place to consider and review the College estate, both throughout the year and in advance of the preparation of the financial statements. *Grade two*	Agreed. The Director of Finance and Estates consulted the College's external valuer previously engaged in valuation exercises however responses were delayed, therefore management used a best estimate to ensure timely completion of the accounts. Management will engage with the valuer earlier in future years and will consider the accounting valuations for any assets for sale in advance of the yearend.	Management has addressed the specific action point around the use of valuers in deriving key inputs into the fixed asset valuation process in the year. The valuation of the College estate (as outlined on page 12) continues to be an area of significant judgement for the financial statements and will continue to stay an area of focus for both management and audit.
2	**Forecast financial position** Management has commenced an exercise to review the efficiency of curriculum delivery models for both Further and Higher education courses. This is due to be completed during 2018/19 and management will use the results to create a deficit action plan to address short term and longer term savings requirements from the 2019 financial year onwards. . Management should complete the review of the curriculum delivery model as a priority, and consider the potential impact of the review against its required forecast financial savings, reporting as appropriate to its RSB and the SFC once robust revised forecasts can be made. *Grade one*	Agreed. The exercise will be completed in 2018/19 as a priority and considered by management and the Board accordingly.	We have outlined our findings in response to this recommendation as part of our work around financial sustainability in section 3 to this report.

Prior year recommendations			
No.	**Recommendation / grading**	**Management response/ Implementation timeframe**	**Our assessment of progress**
3	**Financial and operational planning alignment** 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. Given the financial savings that may be required, it is particularly important that management take steps to identify and consider the impact of financial decisions on operations, and visa versa. It is important that financial and strategic decisions are taken in alignment and that this alignment is demonstrated to those charged with governance. *Grade one*	Agreed. A significant sensitivity in future planning is how long colleges are required to fund inflation pay rises with no SFC funded support. Management recognises the significant challenge in achieving the savings required by the year 2022/23 from the current annual spend, within the current governance framework and without impact on FE and HE targets. Once management has confirmed the savings required with the RSB and SFC it will provide a summary of options for the Board on the financial savings options and the likely strategic and operational impact.	We have outlined our findings in response to this recommendation as part of our work around financial sustainability in section 3 to this report.

Prior year recommendations			
No.	**Recommendation / grading**	**Management response/ Implementation timeframe**	**Our assessment of progress**
4	**Board effectiveness review** We have reviewed the updated action plan provided by management and noted that, while the majority of actions have been addressed, a number of the more complex and fundamental actions are still to be addressed. Those outstanding include fundamental review of the committee structure, performance appraisal of Board members and performance management arrangements as noted above. We note there has been significant turnover of the Board membership in the year which has impacted delivery and progress on a number of these requirements. However, it is important these more fundamental issues are addressed in a timely manner to ensure a fully robust governance framework. *Grade one*	Agreed. In 2019, the Board will continue to review progress on the action plan and update / revise in the context of this recommendation. A Board self-effectiveness review will be carried out before the end of the academic year 2018/19 to identify areas of risk that members feel the Board may have. Longer serving members will be given appraisals regarding performance, and actions for the future. New members will also be given appraisals once they have settled into their new roles and have attended a few meetings. Both of these actions will be complete by June 2019.	We have outlined our findings in response to this recommendation as part of our work around governance and transparency in section 3 to this report.
5	**Governance compliance – self assessment** In our view, while the governance statement reflects management's view of compliance for 2017/18 in line with its own self-assessment, and our audit work has not identified any further areas of non-compliance, a more detailed assessment would be beneficial going forward. Management should ensure a full, detailed review of compliance with the Code is completed at the earliest opportunity. *Grade two*	Agreed. A more detailed review of governance compliance will be carried out by the Board Secretary and Senior Management by April 2019 using the UHI provided framework.	We have outlined our findings in response to this recommendation as part of our work around governance and transparency in section 3 to this report.

Appendix F: Errors identified during the audit

This table sets out the unadjusted differences 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	*Prepayment Incorrectly Calculated*	Cr Expenditure - £21,200		Dr Prepayment - £21,200
2	*Reverse Water Accrual*	Cr Expenditure - £19,212		Dr Accrual - £19,212
3	*To increase the bad debt provision*	Dr Expenditure - £13,442		Cr Bad Debt Provision - £13,442
4	*Under accrued income*	Cr Income - £25,000		Dr Accrued Income - £25,000
5	*Reversal of DCG Release relating to AHFS*	Dr Income - £9,210		Cr Deferred Capital Grants - £9,210
6	*Capitalise expenditure relating to Burghfield extension*			Dr Fixed Assets - £43,180 Cr Trade Creditors - £43,180
7	*Account for Job Evaluation process in 2018/19*	Dr Expenditure - £20,000 Cr Revenue - £20,000		Dr Deferred Income - £20,000 Cr Provisions -£20,000
	Total	**(£42,760)**		**£42,760**

Appendix F: Errors identified during the audit (continued)

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	*Adjusting Accounting treatment of Assets held for sale*	Cr Depreciation - (£9,850)		Dr Revaluation Reserve - £40,160 Dr Assets Held for Sale- £11,080 Cr Fixed Assets NBV - £31,020 Cr Accumulated Depreciation - £10,370
2	*Removal of credit balances from Debtors*			Dr Debtors -£20,600 Cr Creditors - £20,600
3	*Removal of debit balances from Creditors*			Dr Debtors - £12,000 Cr Creditors - £12,000
4	*Accounting for GMP*	Dr Past service cost - £11,000		Cr Pension Liability - £11,000
5	*Reclassify bank loan as short term liability*			Dr Creditors >1 year - £1,214,000 Cr Creditors < 1 year - £1,214,000
	Total	**Dr £1,150**		**Cr (£1,150)**

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.

Month	Audit Activity	Deliverable	Timing
MAR – MAY	Review of current issues impacting the College throughout the audit process	Periodic current issues return submission	22 March 2019 8 November 2019
MAY / JUNE	Audit planning and setting scope and strategy for the 2018/19 audit	Annual audit plan	22 May 2019
JUNE	Walkthrough visit	Completion of internal documentation	June 2019
JUNE	Review progress of the NFI exercise	Submit NFI questionnaire	30 June 2019
SEPT – DEC	Year-end substantive audit fieldwork on unaudited financial statements	Audited financial statements	September 2019
	Conclude on results of audit procedures and finalise Annual Audit Report	Issue Annual Audit Report	31 December 2019
	Issue opinion on the College's financial statements	Submit Audit Scotland Minimum dataset request	

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

ey.com