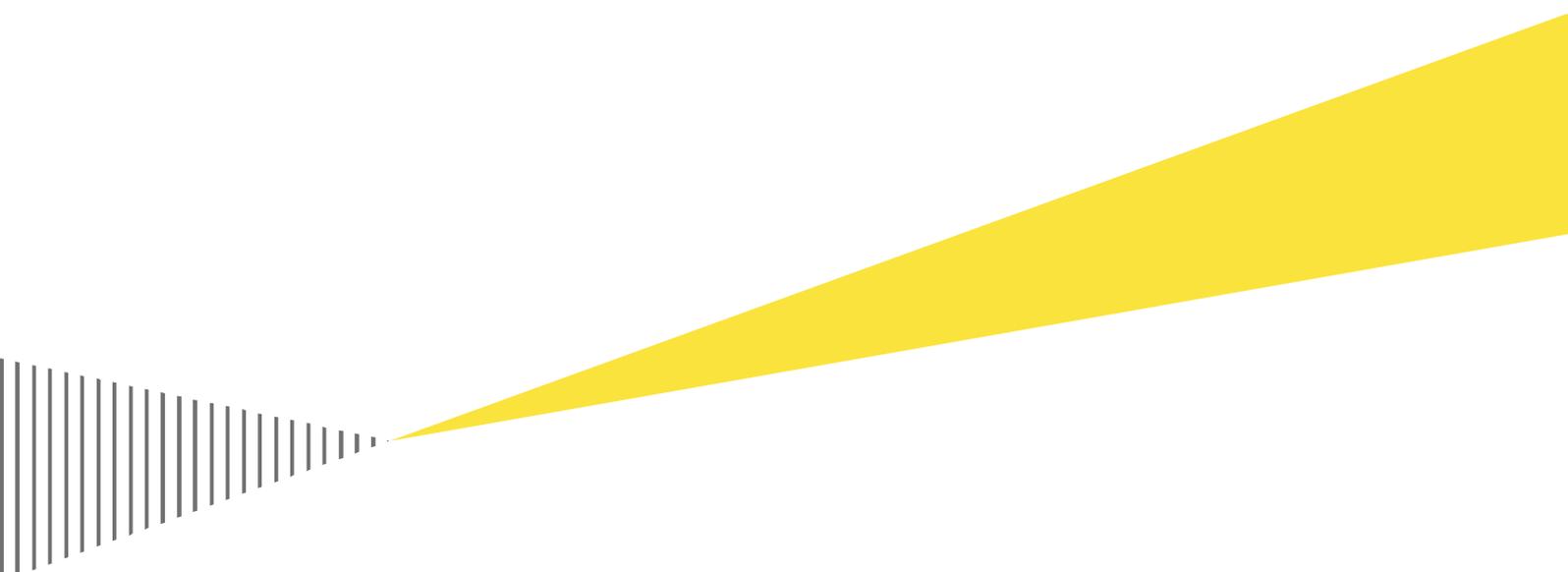


# Moray College

Year ending 31 July 2017

Annual Audit Plan

Audit Committee – 23 May 2017



Building a better  
working world

#### **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 Moray College (the College) for financial years 2016/17 to 2020/21.

This report is for the benefit of the College and is made available to the Auditor General for Scotland and Audit Scotland (together the Recipients). This report has not been designed to be of benefit to anyone except the Recipients. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Recipients, even though we may have been aware that others might read this report.

Any party other than the Recipients that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Recipient's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, Ernst & Young LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Recipients.

#### **Complaints**

If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with Stephen Reid who is our partner responsible for services under appointment by Audit Scotland, telephone 0131 777 2839, email sreid2@uk.ey.com. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, or with how your complaint has been handled, you can refer the matter to Russell Frith, Assistant Auditor General, 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.

## Public sector audit framework

Pages 3-5

The Code of Audit Practice (the Code) <http://www.audit-scotland.gov.uk/report/code-of-audit-practice-2016> sets out the responsibilities of audited bodies, in accordance with statute and other relevant guidance, in respect of the preparation of financial statements.

We issue our audit opinion on the 'truth and fairness' of the College's financial statements in accordance with management's timetable, and by 31 December 2017. The nature of public sector audit means that the focus of audit work is broader than just the financial statements, covering the four dimensions of public sector audit as set-out in the Code.

## Understanding the College

Pages 6-7

Our audit approach responds to our understanding of the College, and the environment in which it operates.

The College faces significant financial challenges. In March 2017, the Auditor General for Scotland issued a report, the 2015/16 Audit of Moray College, under section 22 of the Public Finance and Accountability (Scotland) Act 2000. This report concluded that the College will continue to face financial difficulties without fundamental changes to its costs and financial management arrangements'.

The College is implementing a financial recovery plan to address the issues highlighted and delivery of a financially sustainable operating model.

## Financial statements audit

Pages 8-13

### Materiality

Planning Materiality for the audit has been determined at £125,000, representing 1% of estimated gross expenditure. Tolerable Error is set at £62,500. Our Summary of Audit Differences (SAD) nominal amount is £6,250.

### Risk assessment

In line with auditing standards we identify significant risks in respect of fraud in income and expenditure recognition, in respect of the risk of management override of controls and over completeness of remuneration report disclosures.

In line with auditing standards we identify significant risks in respect of fraud in income and expenditure recognition, in respect of the risk of management override of controls and over completeness of remuneration report disclosures. The valuation of property, plant and equipment, pension liabilities, and voluntary severance scheme payments are assessed as inherent risks.

### Audit approach

We obtain an understanding of the College's control environment and key accounting processes in operation. We also consider and test the key management procedures across accounting processes, as appropriate.

Management has primary responsibility for the prevention and detection of fraud. We design appropriate audit procedures in response to identified fraud risk factors, for the purpose of detecting material misstatements.

## Wider scope audit and other work

Pages 14-15

The wider scope audit as set out in the Code plays a key role in the public sector audit framework in Scotland.

The College's financial position has deteriorated in recent years, with increasing deficits being reported over the past six years. The College has established a financial recovery plan aimed at delivering a surplus for 2018/19. The delivery of the plan is critical in securing the financial sustainability of the College. We have therefore identified financial sustainability and financial management as wider scope audit focus areas. Notwithstanding this risk assessment, we also carry out standard procedures in respect of corporate governance and value for money arrangements.

## Team, fees and deliverables

Pages 16-18

Stephen Reid is your audit engagement partner, supported principally by Keith Macpherson and Rob Jones.

Audit Scotland communicate an expected fee broken down by auditor remuneration, pooled costs and central overheads.

Reflecting the additional audit work that will be required around the identified audit focus areas of financial sustainability and financial management, and taking account of the lower level of Tolerable Error set due to the risks identified which increases the testing required, we anticipate the need to set a fee above the expected fee element. We are in the process of scoping this additional work with management and will report on the proposed fee in due course.

## Appendices

Pages 19-23

We confirm our independence to act as your external auditor.

We provide you with details of the key communications we are required to provide you with in accordance with Auditing Standards.

# **1. Public sector audit framework**

The Auditor General for Scotland has appointed us as auditor of the College under the Public Finance and Accountability (Scotland) Act 2000 (“the Act”). The period of appointment is 2016-17 to 2020-21, inclusive.

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 Auditing Practices Board; relevant legislation; and other guidance issued by Audit Scotland.

This Annual Audit Plan, prepared for the benefit of College management and the Audit Committee, sets out our proposed audit approach for the audit of the financial year ending 31 July 2017, in accordance with the responsibilities placed on us through the public sector audit framework in Scotland.

## Financial statements audit

### *The College's responsibilities*

Moray College (the College) is responsible for the preparation of the 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. The Code also sets out the College's responsibilities for maintaining accounting records and supporting working papers that have been prepared to an acceptable professional standard.

In accordance with the Accounts Direction for Scotland's colleges and universities, the College is also required to prepare and publish, along with the financial statements, a performance report, an accountability report, a corporate governance statement, a remuneration and a staff report and, where applicable, a parliamentary accountability report, that are consistent with the disclosures within the financial statements.

### *Our responsibilities*

We are responsible for conducting an audit of the financial statements of the College. We will provide an opinion on the financial statements as to:

- Whether they give a true and fair view in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council of the state of the College's affairs as at 31 July 2017 and its surplus or deficit for the year then ended.
- Whether they have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including FRS 102: The Financial Reporting Standard applicable in the UK and Ireland.
- Whether they have been properly prepared in accordance with the in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder issued by the Scottish Funding Council, the Charities and Trustee Investment (Scotland) Act 2005 and regulation 14 of The Charities Accounts (Scotland) regulations 2006 (as amended).

We also review and report on the consistency of the other information prepared and published by the College along with its financial statements.

## Wider scope audit

### *The College's responsibilities*

The Code sets out the broader responsibilities of the College in respect of ensuring proper financial stewardship of public funds. In particular the College should establish proper arrangements:

- For ensuring the proper conduct of its affairs, including the legality of activities and transactions and for monitoring the adequacy and effectiveness of these 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
- To ensure that their financial position is soundly based having regard to, for example, balances and reserves including strategies about levels held, their future use and how they plan to deal with uncertainty in the medium and longer term
- 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.

The Code of Audit Practice sets out the four audit dimensions which comprise the wider scope audit framework for the public sector in Scotland. These are:

- Ø Financial sustainability
- Ø Financial management
- Ø Governance and transparency.
- Ø Value for money.

As auditors we are required to provide judgements and conclusions on the four wider-scope audit dimensions.

## Wider scope audit (continued)

### Our responsibilities

Our responsibilities extend beyond the audit of the financial statements. The Code requires auditors to provide judgements and conclusions on the four dimensions of wider-scope public audit. Our audit work over the wider scope audit dimensions complements our financial statements audit.

 <b>Financial management</b>	 <b>Financial sustainability</b>	 <b>Governance and transparency</b>	 <b>Value for money</b>
<p>We conclude on the effectiveness of financial management arrangements. This includes considering whether there is sufficient financial capacity and resources, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p>	<p>We consider the medium and longer term outlook to determine if planning is effective to support service delivery. This will focus on the arrangements to develop viable and sustainable financial plans.</p>	<p>We review the adequacy of governance arrangements. In particular, we consider and report on; whether these are appropriate and operating effectively and that there is effective scrutiny, challenge and transparency on decision-making.</p>	<p>We consider whether value for money can be demonstrated in the use of resources. This includes the extent to which there is an alignment between spend, outputs and outcomes delivered and that there is a clear focus on improvement.</p>

## Key messages

The Code of Audit Practice (the Code) <http://www.audit-scotland.gov.uk/report/code-of-audit-practice-2016> sets out the responsibilities of audited bodies, in accordance with statute and other relevant guidance, in respect of the preparation of financial statements.

We issue our audit opinion on the 'truth and fairness' of the College's financial statements in accordance with management's timetable, and by 31 December 2017. The nature of public sector audit means that the focus of audit work is broader than just the financial statements, covering the four dimensions of public sector audit as set-out in the Code.

## **2. Understanding the College**

## 2. Understanding the College

In accordance with the principles of the Code, our audit work is designed to be proportionate and risk based. It is based on an understanding of the strategic environment in which the College operates.

Through our knowledge and experience, plus our assessment of how the wider environment impacts on your activities, we tailor our approach to risk assessment.

Through discussion with senior management, and from review of corporate planning documents, we develop an understanding of your priorities and the specific challenges which the College faces.

### Strategic context

The college sector has undergone substantial changes in recent years affecting how they operate. Audit Scotland's overview report on the sector, while making recommendations for both the Scottish Government and the Scottish Funding Council (SFC), drew attention to the fact that colleges in general should (i) develop long-term financial strategies, underpinned by medium-term financial plans; (ii) implement a more systematic approach to workforce planning to ensure they have the appropriate resources and skills; and (iii) make agendas, supporting papers and minutes (subject to confidentiality issues) for board and committee meetings publicly available within appropriate timeframes.

### Understanding the College's priorities

The College is part of the highland and Islands college region and strategic partner to the University of the Highlands and Islands (UHI), attracting over 4,100 full and part-time students. The College delivers a range of education provision covering all Scottish Credit and Qualification Framework levels.

The College's strategic objectives were reviewed and refreshed in 2016 following the appointment of a new permanent Principal and a significant change in Board of Management with nine new Board members appointed during the year. The College published a three year Strategic Plan 2017-20, defining the College's key strategic aims and objectives over the term of the plan. This adopts the values of UHI's Strategic Plan and Vision for 2015-20 covering: collaboration; openness; respect; and excellence. The College aims to be a high quality teaching and learning institute through working closely with partners including UHI, schools, employers and the community.

### Financial planning

A key area of strategic focus for the College is in establishing a financially sustainable operating model. The College has incurred a sustained period of increasing deficits, as a result of increasing costs pressures in payroll and operating costs. In addition, significant capital investment in the Alexander Graham Bell Centre in recent years has utilised potential sources of finance from its Arms Length Foundation which had closing reserves of £67,000.

Within the 2015/16 annual external audit report, Audit Scotland concluded that the College was not financially sustainable in its current operating model. Following audit, in March 2017, the Auditor General for Scotland issued a report on the 2015/16 Audit of Moray College under section 22 of the Public Finance and Accountability (Scotland) Act 2000. This report concluded that: '*Moray College will continue to face financial difficulties without fundamental changes to its costs and financial management arrangements*'. Following an internal review of the College's activities and associated income and expenditure, the College has agreed a financial recovery plan with UHI. This was submitted to the Scottish Funding Council in February 2017. The effective implementation of the recovery plan will be critical in securing the financial sustainability of the College.

### Financial Management

To deliver the required savings, significant operational changes are likely to be required. These need to be carefully considered and managed to minimise the impact on the student learning experience. Critical to this is effective financial management, however, the Section 22 report also raised concerns around the College's financial planning and monitoring arrangements, particularly around the transparency of the financial decision making process.

In both these aspects, the fact that the College has been operating without a permanent director of finance during the year has increased the burden on existing staff in managing these challenges.

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### Key messages

The College faces significant financial challenges. In March 2017, the Auditor General for Scotland issued a report on the 2015/16 Audit of Moray College under section 22 of the Public Finance and Accountability (Scotland) Act 2000. This report concluded that the College will continue to face financial difficulties without fundamental changes to its costs and financial management arrangements.

The College is implementing a financial recovery plan to address the issues highlighted and delivery of a financially sustainable operating model.

### **3. Financial statements audit**

We provide an opinion on the financial statements as to whether they give a true and fair view of the financial position of the College, and whether they have been properly 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). We also review and report on the consistency of the other information prepared and published by the College along with its financial statements.

We undertake our financial statements audit work in accordance with the four phases of EY's Global Audit Methodology: *Planning; Identification and assessment of risk; Design and execution of our response to those risks; and Conclude and communicate.*

## Planning our audit work

### **Initial planning, independence and quality assurance**

Our initial planning for any audit engagement includes client and engagement acceptance, which includes our documentation of the service requirements. We did not identify any specific audit risks arising from these procedures.

Part of these procedures are designed to ensure compliance with all relevant ethical standards, including independence which we assess for both EY as a firm and the individuals assigned to the audit. We set out more information on our independence in Appendix A.

We identify the team with primary responsibility for performance of the audit. Stephen Reid is the audit partner-in-charge.

### **Materiality**

In accordance with ISA 320 we apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion. Materiality is the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. We determine:

- Ø Planning materiality (PM) – this is set for the financial statements as a whole, and is used to set the scope for our audit. We have determined this to be £125,000, representing 1% of estimated gross expenditure.
- Ø Tolerable Error (TE) – materiality at an individual account balance, which is set so as to reduce to an acceptably low level that the aggregate of uncorrected and undetected misstatements exceeds PM. Due to the fact that there were a number of audit adjustments in 2015/16, our audit methodology requires us to set TE at a lower percentage of PM than would be the case of audit adjustments did not arise. We have therefore set this at 50% of PM, being £62,500.
- Ø Summary of Audit Differences (SAD) Nominal amount – this is the amount below which misstatements, whether individually or accumulated with other misstatements, would not have a material effect on the financial statements. We have set this at £6,250.

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

The amount we consider material at the end of the audit may differ from our initial determination. At the end of the audit we will form, and report to you, our final opinion by reference to all matters that could be significant to users of the financial statements, including the total effect of any audit misstatements, and our evaluation of materiality at that date.

### **Financial statement risks**

We outline our initial assessment of the financial statement risks facing the College, identified through our knowledge of the environment in which the College operates; discussion with those charged with governance and management; and through handover and transition arrangements with your previous auditor.

Our risk assessment is ongoing throughout the conduct of our audit and we will report to you any notable changes in our risk assessment during the course of our work.

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## Key messages

Planning Materiality for the audit has been determined at £125,000, representing 1% of estimated gross expenditure. Tolerable Error is set at £62,500. Our Summary of Audit Differences (SAD) nominal amount is £6,250.

In line with auditing standards we identify significant risks in respect of fraud in income and expenditure recognition, in respect of the risk of management override of controls and over completeness of remuneration report disclosures. The valuation of property, plant and equipment, pension liabilities, and voluntary severance scheme payments are assessed as inherent risks.

# 3. Financial statements audit (cont.)



Auditing standards require us to consider whether any of the risks identified are 'significant' risks to our audit of the College. Significant risks are defined as those with a higher likelihood of occurrence and, if they were to occur, a higher magnitude of impact which could result in a material misstatement of the financial statements. We are required to specifically highlight these significant risks to 'those charged with governance' i.e. the Audit Committee.

We perform specific procedures over significant risks, including consideration of the design and implementation of controls to address these risks plus performance of additional substantive procedures in response to the specific risk.

Risk assessment includes the inherent risk relating to the susceptibility of a transaction, disclosure or account balance in the financial statements to material misstatement. These inherent risks are broader in nature than significant risks, but require tailored audit procedures to be performed.

Significant risks (including fraud risks)	Our audit approach
<p><b>Risk of fraud in revenue recognition</b></p> <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.</p> <p>Given the nature of SFC funding to the College, we rebut the presumed revenue recognition risk for this income stream. However we recognise a revenue recognition risk for tuition income and other material income in respect of possible manipulation of cut-off around the financial year end.</p> <p>We also recognise the same risk around incorrect recognition of non-pay expenditure in line with Practice Note 10.</p>	<p>We will:</p> <ul style="list-style-type: none"> <li>▶ review and test all relevant income and expenditure policies against the relevant accounting standards and SORP</li> <li>▶ review, test and discuss with management any accounting estimates on income and expenditure recognition for evidence of bias</li> <li>▶ develop a testing strategy to test material income and expenditure streams</li> <li>▶ review and test income and expenditure cut-off around the year end.</li> </ul>
<p><b>Risk of management override</b></p> <p>Management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has put in place a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.</p> <p>The risk of management override is pervasive to the audit and impacts the testing of all areas. Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk. This takes account of the fact that management are in a unique position to override controls which otherwise appear to be operating effectively.</p>	<p>Based on the requirements of auditing standards our approach will focus on:</p> <ul style="list-style-type: none"> <li>▶ identifying fraud risks during the planning stages</li> <li>▶ inquiry of management about risks of fraud and the controls put in place to address those risks</li> <li>▶ consideration of the effectiveness of management's controls designed to address the risk of fraud</li> <li>▶ determining an appropriate strategy to address those identified risks of fraud</li> <li>▶ focusing our audit procedures on manual journals that could be used by management to manipulate the true and fair position of the College's financial statements.</li> </ul>
<p><b>Remuneration report</b></p> <p>The previous auditor reported on issues in preparation of the full disclosures required under the Financial Reporting Manual (FRoM) in respect of remuneration. This resulted in delays to inclusion of the information and consideration as to whether a qualification was required for non-compliance with required disclosure. A recommendation was included in the 2015/16 annual audit report to ensure this was addressed early by management in 2016/17.</p>	<p>We will confirm with management that plans are established to obtain the required disclosure information on a timely basis. Complete and accurate draft financial statements are a key element of an efficient financial reporting and audit process. Given the absence of senior finance personnel during the year, we will give due attention to ensuring management have put in place appropriate steps to address this issue.</p>

### 3. Financial statements audit (cont.)



In addition to the significant risk areas highlighted above, our audit work will also consider the following areas of audit emphasis, reflecting the fact that these areas have additional compliance, regulatory or sustainability implications. Our risk assessment includes the inherent risk relating to the susceptibility of a transaction, disclosure or account balance in the financial statements to material misstatement. These inherent risks are broader in nature than significant risks, but require tailored audit procedures to be performed.

We also highlight key changes and developments under International Standards on Auditing and Financial Reporting Standards.

Other financial statement risks – inherent risks	Our audit approach
<p><b>Valuation of property, plant and equipment</b></p> <p>The College's property portfolio totals £23.6 million as at 31 July 2016. Land and buildings are revalued to fair value with a full revaluation taking place at least every five years with an interim valuation conducted every three years.</p> <p>The last full valuation took place on 31 July 2014, therefore the College will be conducting an interim valuation as at 31 July 2017.</p> <p>Given the size of this balance and the fact that a number of assumptions are made in the valuation, we assign a higher inherent risk to property, plant and equipment.</p> <p>We do not, however, at the planning stage have any specific concerns over management's approach to property valuations.</p>	<p>Our approach will focus on:</p> <ul style="list-style-type: none"> <li>▶ analysis of the source data and inquiries as to the procedures used by management's specialist to establish whether the source data is complete</li> <li>▶ assessment of the reasonableness of the assumptions and methods used, including their compliance with the SORP</li> <li>▶ consideration of the appropriateness of the timing of when the specialist carried out the work</li> <li>▶ assessment of whether the substance of the specialist's findings are properly reflected in the financial statements.</li> </ul>
<p><b>Valuation of pension liabilities</b></p> <p>The College participates in two pension scheme; the Local Government Pension Scheme (LGPS) administered by Highland Council and the Scottish Teachers Superannuation Scheme (STSS). While both are defined benefit pension schemes, the College is unable to identify its share of the underlying assets and liabilities of the STSS scheme on a consistent and reasonable basis and therefore, the scheme is accounted for as if it were a defined contribution scheme.</p> <p>The LGPS is accounted for as a defined benefit scheme. The net pension liabilities on the Balance Sheet arising from participation in the scheme were £7 million. In addition the College recognises a provision for future early retirement liabilities of £2.9 million.</p>	<p>Our response will comprise:</p> <ul style="list-style-type: none"> <li>▶ obtaining an actuarial report at the year end date for the LGPS and considering the reasonableness and consistency of underpinning assumptions, in light of guidance available</li> <li>▶ we will utilise our in-house actuaries to assess the reasonableness of key assumptions such as discount rate, inflation and expected market return</li> <li>▶ we will perform substantive testing on the underlying pension data</li> <li>▶ we will undertake substantive testing on the provision for early retirement liabilities, including agreement of payments made and estimation of liabilities.</li> </ul>
<p><b>Voluntary severance arrangements</b></p> <p>The College has proposed a voluntary severance programme. The financial recovery plan has targeted annual savings of £350,000 through the scheme.</p> <p>It is important to ensure the College's proposed voluntary severance programme is controlled and well governed with clear and transparent decision making processes. Subject to approval of voluntary severance funding from SFC, the programme is likely to span financial years. It is important that any committed severance costs are reflected within the financial statements. This may require consideration of the status of the programme as at the balance sheet date.</p>	<p>Based on the requirements of auditing standards and SFC guidance, our approach will focus on:</p> <ul style="list-style-type: none"> <li>▶ reviewing the governance arrangements over the severance programme</li> <li>▶ testing a sample of severance offers to ensure these have been calculated in accordance with the agreed terms of the severance programme and appropriately authorised</li> <li>▶ considering the completeness and accuracy of any voluntary severance provisions recognised on the balance sheet.</li> </ul>

In addition to our identified areas of inherent risk to the College, we also highlight key changes and developments under International Standards on Auditing and Financial Reporting Standards.

### **Key accounting and auditing updates**

The Financial Reporting Council has introduced a number of revised International Standards on Auditing (UK) (ISAs (UK)) which are effective to audits of financial statements commencing on or after 1 June 2016. On adoption of ISAs (UK), all audit reports will need to comply with revised requirements in ISA (UK) 700 (Revised June 2016), which affect the structure of the audit report and some of the detailed content. For example, the content of the report needs to be re-ordered with the auditor's opinion being at the start of the report, followed by the basis for the opinion. The exact format of our opinion will follow Audit Scotland guidance.

### **Consultation on FRS 102: *The Financial Reporting Standard applicable in the UK and Republic of Ireland***

We would draw your attention to the fact that the Financial Reporting Council issued FRED 67 'Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland' for consultation in March 2017, with responses due 30 June 2017. The further and higher education SORP 2019 will be based on the revisions to FRS 102 arising from this triennial review and so the College may wish to consider making a response.

Our approach is designed to develop an audit strategy that is responsive to the College's risks of material misstatement for transactions and account balances in the financial statements. It is designed to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud.

In addition, we plan and perform certain general audit procedures on every audit to address areas that are not directly related to financial statement account assertions. Examples of such procedures include compliance with applicable laws and regulations, litigation and claims, related parties and consideration of fraud.

As a first year audit, we also have additional procedures to perform in respect of opening balances.

## Overview of audit approach

We determine which accounts, disclosures and relevant assertions could contain risks of material misstatement based on our understanding of the business, understanding of internal control arrangements and our determination of planning materiality.

We document and walkthrough the key accounting processes within the College, in particular with respect to classes of transactions associated with identified significant and fraud risks. We also consider, and where appropriate and beneficial to the efficiency of the audit process, test management procedures established across key financial processes.

To ensure efficiency in our audit work, we employ data analytics as appropriate to allow the testing of full populations of financial transactions where possible to minimise extensive sample testing and reduce the burden of compliance on management and the finance team.

## Responsibilities in respect of fraud and error

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

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk.

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

- Ø Identifying fraud risks during the planning stages.
- Ø Enquiry of management about risks of fraud and the controls to address those risks.
- Ø Understanding the oversight given by those charged with governance of management's processes over fraud.
- Ø Consideration of the effectiveness of management's controls designed to address the risk of fraud.
- Ø Determining an appropriate strategy to address any identified risks of fraud.
- Ø Performing mandatory procedures regardless of specifically identified risks.

## First year audit procedures

As a first year audit, we also have additional procedures to perform in respect of opening balances. We follow Audit Scotland's protocol for handover from the previous auditor and will be holding discussions with your previous auditor in advance of the year end audit, in addition to reviewing the key reporting outputs as part of our planning procedures. Also, we are required to perform a full review of opening balances, with a specific focus on judgemental areas such as provisions and accrued income as at 31 July 2016. As part of our interim audit procedures we will review these year end balances, in particular assessing the retrospective accuracy of key estimates through evaluating the trued up value after 31 July 2016.

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## Key messages

We obtain an understanding of the College's control environment and key accounting processes. We also consider and test the key management procedures across accounting processes, as appropriate.

Management has primary responsibility for the prevention and detection of fraud. We design appropriate audit procedures in response to identified fraud risk factors, for the purpose of detecting material misstatements.

## **4. Wider scope audit and other work**

# 4. Wider scope audit and other work



Together the Auditor General for Scotland and the Accounts Commission agreed the four dimensions set out in the Code which comprise the wider-scope audit for public sector in Scotland. These are: financial sustainability, financial management, governance and transparency, and value for money.

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

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

## Risk Assessment

In March 2017, the Auditor General for Scotland reported on the 2015/16 audit of Moray College under section 22(3) of the Public Finance and Accountability (Scotland) Act 2000. The report highlighted significant concerns around the College's financial management and reporting arrangements including a lack of audit trails to support some budget and forecast figures or clear explanation for significant variances between budgets and actual results. The report also concluded that the College's financial position was not sustainable highlighting that fundamental change was required to reduce the cost base and deliver a sustainable, balanced budget.

We have therefore identified audit focus areas around these two dimensions of the wider scope audit. Notwithstanding this risk assessment, we also carry out standard procedures in respect of corporate governance and value for money arrangements.

Wider Scope Audit Focus Areas	Our audit approach
<p><b>Financial sustainability</b></p> <p>In 2015/16, the College reported a deficit of £876,000. While this included technical adjustments for depreciation and pension costs, the College had an underlying deficit of £158,000. Over the last six years, the College has been incurring increasing deficits. In 2015/16, Audit Scotland highlighted concerns around the financial position of the College, including an urgent need to draw down advances on the funding allocation for 2016/17 from the University of the Highland and Islands (UHI) to meet operational costs.</p> <p>The College's financial recovery plan, submitted to SFC in February, aims to deliver an operating surplus by 2018/19. Key areas of focus are: targeting cost reductions; review of activity targets with UHI; and targeting other income growth. To generate savings a voluntary severance programme has been approved and rolled out across the College. Delivering the required level of savings and potential income growth while minimising the impact on learners, represents a significant challenge to the College and will require robust financial management and governance.</p>	<p>Our approach will focus on:</p> <ul style="list-style-type: none"> <li>▶ the effectiveness of the financial planning systems and identifying and addressing risks to financial sustainability across shorter and longer terms</li> <li>▶ the progress made by the College in the delivery of the recovery plan submitted to SFC</li> <li>▶ whether the College can demonstrate the affordability and effectiveness of funding and investment decisions that it has made and how these will support long-term sustainability</li> <li>▶ the arrangements for aligning financial savings plans with the College's strategic and operational objectives, including minimising any adverse impact on learner experience</li> <li>▶ the appropriateness of the arrangements to address identified funding gaps and whether the College can demonstrate that these arrangements are working.</li> </ul>
<p><b>Financial management</b></p> <p>For 2016/17, the College is forecasting a deficit of £472,000. The College faces considerable financial pressures particularly through rising payroll and operating cost pressures exceeding income levels.</p> <p>In 2015/16, Audit Scotland highlighted issues around the College's financial management arrangements including transparency over budget assumptions and budget monitoring arrangements. Management has agreed actions to address these. During a period of significant financial challenge for the College, it is critical that robust and effective financial management arrangements are in place.</p>	<p>Our approach will focus on consideration of whether:</p> <ul style="list-style-type: none"> <li>▶ the College can demonstrate the effectiveness of the budgetary control system in communicating accurate and timely financial performance, including addressing the issues raised by Audit Scotland in 2015/16</li> <li>▶ the College has established effective financial governance arrangements, including oversight and challenge of financial plans</li> <li>▶ the College has assured itself that its financial capacity and skills are appropriate.</li> </ul>

## Key messages

The wider scope audit as set out in the Code plays a key role in the public sector audit framework in Scotland.

The College's financial position has deteriorated in recent years, with increasing deficits being reported over the past six years. The College has established a financial recovery plan aimed at delivering a surplus for 2018/19. The delivery of the plan is critical in securing the financial sustainability of the College. We have therefore identified financial sustainability and financial management as wider scope audit focus areas. Notwithstanding this risk assessment, we also carry out standard procedures in respect of corporate governance and value for money arrangements.

## **5. Team, fees and deliverables**

## 5. Team, fees and deliverables



We identify an audit team with the relevant skills and experience. All member of our core team have experience in the audit of further education. The engagement team is led by Stephen Reid, who is one of three partners leading EY's Government and Public Sector practice in the UK. Stephen is supported by Keith Macpherson, our Head of Government & Public Sector Audit in Scotland. Rob Jones will be the manager for the financial statements audit.

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

### Audit team

Individual	Contact details
Stephen Reid	T: 07795 307 033 E: sreid2@uk.ey.com
Keith Macpherson	T: 07831 136 496 E: kmacpherson@uk.ey.com
Rob Jones	T: 0141 226 7396 E: rjones9@uk.ey.com

### 2016/17 Audit fee arrangements

The expected fee for each body, set by Audit Scotland, assumes that it has sound governance arrangements and operating effectively throughout the year, prepares comprehensive and accurate draft financial statements and meets the agreed timetable for the audit. It also assumes there is no major change in respect of the scope of work in the year from what would normally be expected by the Code, including in respect of wider scope audit work. The expected fee is not therefore based on findings from prior year audit reports, or other statutory reports.

Expected Fee Element – per Audit Scotland fee letter	2016/17	2015/16*
Auditor remuneration	£13,130	n/a
Pooled costs	£820	n/a
Contribution to Audit Scotland costs	£750	n/a
<b>Total expected fee</b>	<b>£14,700</b>	<b>£16,800</b>

\* The breakdown of the prior year fee into these components is not available from Audit Scotland. Actual external audit costs per the prior year financial statements were £19,000

The auditor remuneration element of the fee is for final agreement between College management and the appointed auditor, and can be increased, dependent on circumstances in the audited body.

### Agreement of 2016/17 audit fee

In considering our fee positioning for 2016/17 we therefore take account of the risk assessment. Given the identified wider scope audit focus areas in respect of financial sustainability and financial management, and also taking account of the lower level of Tolerable Error set due to both prior year audit adjustments and the increased risk profile, which increases the level of testing required, we anticipate the need to set a fee above the expected fee.

We are in the process of scoping this additional work with management and will report on the fee once this has been agreed.

### Key messages

Stephen Reid is your audit engagement partner, supported principally by Keith Macpherson and Rob Jones. Audit Scotland communicate an expected fee broken down by auditor remuneration, pooled costs and central overheads.

Reflecting the additional audit work that will be required around the identified audit focus areas of financial sustainability and financial management, and taking account of the lower level of Tolerable Error set due to the risks identified which increases the testing required, we anticipate the need to set a fee above the expected fee element. We are in the process of scoping this additional work with management and will report on the proposed fee in due course.

## 5. Team, fees and deliverables (continued)



We agree a timetable with management, in line with the College's internal reporting requirements, and in accordance with Audit Scotland's planning guidance.

There are a number of deliverables required during the year, as set out in the table.

As part of our transparency to you, and to allow you to assess the performance of your external auditor, we will report to you annually on how we have performed against the timetable for audit deliverables.

### Timeline and deliverables

Audit activity	Deliverables
<b>Planning: January – May 2017</b>	
<ul style="list-style-type: none"> <li>▶ Introductory meetings with senior management</li> <li>▶ Handover discussions with outgoing auditor</li> <li>▶ Review of Audit Scotland planning guidance</li> <li>▶ Review of College documentation</li> </ul>	<ol style="list-style-type: none"> <li>1. Annual Audit Plan, presented to Audit Committee, May 2017</li> </ol>
<b>Identification of risks and design and execution of response to those risks: May – October 2017</b>	
<ul style="list-style-type: none"> <li>▶ Onsite fieldwork, documentation and walkthrough of key accounting processes</li> <li>▶ Testing of key management procedures as appropriate</li> <li>▶ Understanding of College's response to results from National Fraud Initiative (NFI)</li> <li>▶ Performance of year-end substantive audit fieldwork on draft financial statements</li> </ul>	<ol style="list-style-type: none"> <li>2. Submit NFI return to Audit Scotland by 30/6/2017</li> <li>3. Submit any fraud returns to Audit Scotland by 26/5/2017</li> </ol>
<b>Conclude and communicate: November – January 2018</b>	
<ul style="list-style-type: none"> <li>▶ Conclude on results of audit procedures</li> <li>▶ Audit clearance meeting with senior management, and report findings to those charged with governance</li> <li>▶ Issue opinion on the College's financial statements</li> <li>▶ Submission of minimum dataset to Audit Scotland</li> </ul>	<ol style="list-style-type: none"> <li>5. Annual Audit Report – to Audit Committee (date tbc)</li> <li>6. Certify Annual Financial Statements – by 31/12/2017</li> <li>7. Submit Minimum Dataset Return to Audit Scotland by 3/1/2018</li> </ol>

# Appendices

**A – Auditor Independence**

**B – Required Communications**

In order to carry out our duties and responsibilities as auditor, we are required to consider our independence and objectivity within the context of the regulatory and professional framework in which we operate.

The Financial Reporting Council's Ethical Standards and International Standard on Auditing (UK) 260 (Revised June 2016), *Communication with those charged with governance*, require us to communicate on a timely basis and at least annually on all significant facts and matters that bear upon our independence and objectivity since our last letter.

The aim of these communications is to ensure full and fair disclosure is made by us to you on matters in which you have an interest.

Required communication	
Planning stage	Final stage
<ul style="list-style-type: none"> <li>▶ The principal threats, if any, to objectivity and independence identified by EY including consideration of all relationships between you, your affiliates and directors and us.</li> <li>▶ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality Review.</li> <li>▶ The overall assessment of threats and safeguards.</li> <li>▶ Information about the general policies and process within EY to maintain objectivity and independence.</li> </ul>	<ul style="list-style-type: none"> <li>▶ A written disclosure of relationships (including the provision of non-audit services) that bear on our objectivity and independence, the threats to our independence that these create, any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed.</li> <li>▶ Details of non-audit services provided and the fees charged in relation thereto.</li> <li>▶ Written confirmation that we are independent.</li> <li>▶ Details of any inconsistencies between APB Ethical Standards, Audit Scotland's Terms of Appointment and your policy for the supply of non-audit services by EY and any apparent breach of that policy.</li> <li>▶ An opportunity to discuss auditor independence issues.</li> </ul>

During the course of the audit we must also communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of our safeguards, for example when accepting an engagement to provide non-audit services.

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

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

### **Relationships, services and related threats and safeguards**

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including any principal threats. However we have adopted the safeguards below to mitigate these threats along with the reasons why they are considered to be effective.

#### **Self-interest threats**

A self-interest threat arises when EY has financial or other interests in your entity. Examples include where we have an investment in your entity; where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with the College.

At the time of writing, there are no long outstanding fees.

We believe that it is appropriate for us to undertake permissible non-audit services, and we will comply with any of the policies that the College may have approved and that are in compliance with Audit Scotland's Terms of Appointment. At the time of writing, no non-audit services have been provided.

A self-interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to the College. We confirm that no member of our audit engagement team, including those from other service lines, is in this position, in accordance with the requirements of the Financial Reporting Council's Ethical Standards and International Standard on Auditing (UK) 260 (Revised June 2016).

#### **Self-review threats**

Self-review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

There are no self-review threats at the date of this report.

## **Management threats**

Partners and employees of EY are prohibited from taking decisions on behalf of management of your entity. Management threats may also arise during the provision of a non-audit service where management is required to make judgements or decisions based on that work.

There are no management threats at the date of this report.

## **Other threats**

Other threats, such as advocacy, familiarity or intimidation, may arise.

There are no other threats at the date of this report.

The 2016/17 audit year is the first year that Stephen Reid has led the audit of Moray College. We assessed this relationship prior to the commencement of the audit period and concluded that there are no considerations that compromise, or could be perceived to compromise, Stephen Reid's independence or objectivity.

## **Overall Assessment**

Overall we therefore confirm that EY is independent and the objectivity and independence of Stephen Reid, the Audit Engagement Partner and the audit engagement team have not been compromised.

EY has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained. Details of the key policies and processes within EY for maintaining objectivity and independence can be found in our annual Transparency Report, which the firm is required to publish by law. The most recent version of this report is for the year ended June 2016 and can be found here: <http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2016>

There are certain additional communications that we must provide to the Audit Committee , which are set out below.

Required communication	Reference
<p><b>Planning and audit approach</b></p> <ul style="list-style-type: none"> <li>▶ Communication of the planned scope and timing of the audit including any limitations.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Plan</li> </ul>
<p><b>Significant findings from the audit</b></p> <ul style="list-style-type: none"> <li>▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures</li> <li>▶ Significant difficulties, if any, encountered during the audit</li> <li>▶ Significant matters, if any, arising from the audit that were discussed with management</li> <li>▶ Written representations that we are seeking</li> <li>▶ Expected modifications to the audit report</li> <li>▶ Other matters if any, significant to the oversight of the financial reporting process</li> <li>▶ Findings and issues regarding the opening balances on initial audits</li> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>
<p><b>Misstatements</b></p> <ul style="list-style-type: none"> <li>▶ Uncorrected misstatements and their effect on our audit opinion</li> <li>▶ The effect of uncorrected misstatements related to prior periods</li> <li>▶ A request that any uncorrected misstatement be corrected</li> <li>▶ In writing, corrected misstatements that are significant</li> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>
<p><b>Fraud</b></p> <ul style="list-style-type: none"> <li>▶ Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity</li> <li>▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist</li> <li>▶ A discussion of any other matters related to fraud</li> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Plan</li> <li>▶ Annual Audit Report</li> </ul>
<p><b>Related parties</b></p> <p>Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</p> <ul style="list-style-type: none"> <li>▶ Non-disclosure by management</li> <li>▶ Inappropriate authorisation and approval of transactions</li> <li>▶ Disagreement over disclosures</li> <li>▶ Non-compliance with laws and regulations</li> <li>▶ Difficulty in identifying the party that ultimately controls the entity</li> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>
<p><b>External confirmations</b></p> <ul style="list-style-type: none"> <li>▶ Management's refusal for us to request confirmations</li> <li>▶ Inability to obtain relevant and reliable audit evidence from other procedures</li> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>

## B. Communications (cont.)



Required communication	Reference
<b>Significant deficiencies in internal controls identified during the audit</b>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>
<b>Consideration of laws and regulations</b> <ul style="list-style-type: none"> <li>▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off</li> <li>▶ Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of</li> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>
<b>Independence</b> <p>Communication of all significant facts and matters that bear on EY's objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> <li>▶ The principal threats, and any safeguards adopted and their effectiveness</li> <li>▶ An overall assessment of threats and safeguards</li> <li>▶ Information about the general policies and process within the firm to maintain objectivity and independence</li> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Plan</li> <li>▶ Annual Audit Report</li> </ul>
<b>Going concern</b> <p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> <li>▶ Whether the events or conditions constitute a material uncertainty</li> <li>▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements</li> <li>▶ The adequacy of related disclosures in the financial statements</li> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>
<b>Group audits</b> <ul style="list-style-type: none"> <li>▶ An overview of the type of work to be performed on the financial information of the components, and of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components</li> <li>▶ Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work</li> <li>▶ Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted</li> <li>▶ Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements</li> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>
<b>Fee information and confirmation of additional certification work</b> <ul style="list-style-type: none"> <li>▶ Details of the audit fee</li> <li>▶ Summary of additional audit certification work undertaken</li> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Plan</li> <li>▶ Annual Audit Report</li> </ul>

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#### 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.

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