

**North East Scotland
College
Annual Audit Report
Year ended 31 July 2018**

17 December 2018

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About this report

This report has been prepared in accordance with Terms of Appointment Letter from Audit Scotland dated 31 May 2016 through which the Auditor General for Scotland has appointed us as external auditor of North East Scotland College (the College) for financial years 2016/17 to 2020/21. We undertake our audit in accordance with the Further and Higher Education (Scotland) Act 1992 and section 44(1)(c) of the Charities and Trustees Investment (Scotland) Act 2005 and our responsibilities as set out within Audit Scotland's Code of Audit Practice (the Code), issued on 26 May 2016.

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

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

Complaints

If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with Stephen Reid who is our partner responsible for services under appointment by Audit Scotland, telephone 0131 777 2839, email sreid2@uk.ey.com. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, or with how your complaint has been handled, you can refer the matter to Diane McGiffen, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN. Alternatively you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

1. Executive Summary

Purpose of this report

In accordance with section 21 of the Public Finance and Accountability (Scotland) Act 2000, the Auditor General for Scotland appointed EY as the external auditor of North East Scotland College (the College) for the five year period 2016/17 to 2020/21. We undertake our audit in accordance with the Code of Audit Practice (the Code), issued by Audit Scotland in May 2016; Auditing Standards and guidance issued by the Financial Reporting Council; relevant legislation; and other guidance issued by Audit Scotland.

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 College and the Auditor General for Scotland, and presented to both College management and those charged with governance, identified as being the Board and the College's Audit and Risk Committee. After consideration by the College, this report is provided to Audit Scotland and 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 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 processes can be improved. We use these insights to form our audit recommendations to support the College in improving its practices around financial management and control, as well as around key aspects of the wider scope dimensions of audit. These are highlighted throughout the report together with our judgements and conclusions regarding arrangements.

Scope and responsibilities

The Code sets out the responsibilities of both the College and the auditor. We provided details of these in our Annual Audit Plan, which was presented to the Audit and Risk Committee on 7 June 2018. We summarise these responsibilities in Appendix A.

Our Annual Audit Plan set out an overview of our audit scope and approach for the audit of the 2017/18 financial statements. We carried out our audit in accordance with the plan. We applied the materiality levels below to our audit, as outlined in our audit plan and based on our consideration of the key risks and issues facing the College and its financial statements. We reassessed materiality on receipt of the draft financial statements and at the conclusion of our audit work, and concluded the levels identified during our planning work remained appropriate.

▶ Materiality for our audit - no change to that reported in our Annual Audit Plan	£900,000
▶ Tolerable Error is our materiality applied at an individual account balance - no change	£675,000
▶ Reporting threshold, set in line with the requirements of the Code - no change	£45,000

Financial statement audit

We are responsible for conducting an audit of the financial statements of the College. We 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 affairs of the College and its Group as at 31 July 2018 and its deficit for the year then ended;
- ▶ they have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- ▶ have been prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder issued by the Scottish Funding Council, the Charities and Trustee Investment (Scotland) Act 2005 and regulation 14 of The Charities Accounts (Scotland) Regulations 2006 (as amended).

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

Wider scope audit

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, as appropriate, compliments our financial statements audit.

Key contacts

Stephen Reid, Partner
sreid2@uk.ey.com

Sarah Croft, Manager
scroft@uk.ey.com

Ernst & Young LLP, Atria One, 144 Morrison Street, Edinburgh EH3 8EX

Independence

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

Financial statements audit

We have issued an unqualified audit opinion on the College's consolidated financial statements. We have concluded satisfactorily in respect of each of the significant risks and audit focus areas identified in our Annual Audit Plan.

The financial statements, including the Performance Report, Accountability Report and Remuneration and Staff Report were received in line with the agreed timetable. However, we made a number of suggestions to enhance the presentation and readability, and to ensure compliance with disclosure requirements. Overall our assessment is that there is room for improvement in the financial statement preparation process and quality review prior to passing to audit. We have made a recommendation to support continued improvement in the process.

There were two unadjusted differences arising from the audit.

Management responded positively to audit comments and addressed all matters for the final financial statements.

Group financial statements

The College prepares group financial statements, consolidating the results of the College and its subsidiary undertakings, Aberdeen Skills and Enterprise Training Limited and Clinterty Estates Limited. We do not audit the subsidiary entities.

Wider scope audit - key messages

We set out below our key messages in respect of each of the dimensions of public sector audit, along with our overall assessment of each of these in terms of red / amber / green. Our assessment is built on our overall consideration of the risks facing the College in each area, the extent to which these are mitigated by the College's processes and controls, and our assessment of management's process in implementing recommendations from the 2016/17 audit, where appropriate.

<p>Financial management</p>	<ul style="list-style-type: none"> ▶ We reviewed the College's financial regulations and are satisfied that these are comprehensive and are subject to regular update. The Vice Principal - Finance and Resources reports to the Principal, attends Board meetings and provides strategic input on financial matters. ▶ Financial performance is scrutinised by the senior management team, the Finance and Resources Committee and the Board. This monitoring includes expenditure against budget and the forecast outturn for the year. ▶ There is scope for greater focus and consideration on the specific risks in respect of EU Withdrawal on people, financial and rules and regulations and the College's plans for responding to these risks. 	<p>Green</p>
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Wider scope audit - key messages (cont.)		
Financial sustainability	<ul style="list-style-type: none"> ▶ The College reported a consolidated deficit of £3.9 million and an operating deficit after removal of non-cash accounting adjustments of £3.4 million. Capital expenditure was in line with budget. The main differences between budget and actual outturn related to one-off restructuring costs and the non-achievement of the ESF credit target. ▶ The College has prepared its five-year financial forecasts 2018 to 2023 in the form of the SFC's template financial forecast return. The forecasts have been prepared on the basis of the Board's strategic plans and supporting aims and objectives. Medium term forecasts to 2023 show an accounting and underlying deficit. While the College has initiated conversations with employees and students, it is yet to develop a medium term financial plan to address the forecast shortfalls. 	Amber
Governance & transparency	<ul style="list-style-type: none"> ▶ The College has in place the key requirements for good governance. We concluded that the Governance Statement materially complies with the SFC's 2017/18 Accounts Direction. ▶ Standing Orders regulate how the business of the College is conducted; detailed terms of reference are in place for the Board's standing committees. There is an established risk management policy in place. ▶ The College publicises Board and standing committee agendas, minutes and papers on their website on a timely basis and information, including financial performance, is generally clear and concise. 	Green
Value for money	<ul style="list-style-type: none"> ▶ A revised strategic plan was introduced from the start of the 2018/19 academic year. Developed by the Board with input from staff, students and stakeholders, the plan identifies the key strategic priorities over the period 2018-21. ▶ There is clear and timely reporting against performance indicators. Annual performance reports are published on the College's website. ▶ The College has an appropriate framework in relation to procurement. This is utilised by all College employees and updated regularly. 	Green

2. 2017/18 financial statements audit

2. Summary of 2017/18 audit opinion



The detailed form and content of our audit report, and the requirements underpinning the report, are set out in guidance issued by Audit Scotland. This covers our reporting requirements in accordance with International Standards on Auditing (UK), plus those matters prescribed by the Code.

Element of Audit opinion	Nature of opinion and basis for that
Opinion on financial statements	Unqualified opinion
<ul style="list-style-type: none"> ▶ Truth and fairness of the state of affairs of the College and its Group at 31 July 2018 and of the deficit for the year then ended ▶ Preparation of the financial statements in accordance with the relevant financial reporting framework 	<ul style="list-style-type: none"> ▶ Performance of audit procedures to respond to our assessed risk of misstatement, including significant risks ▶ Accounting policies are appropriate and estimates are reasonable ▶ Completion of financial statement disclosure checklists / consideration of relevant guidance issued by Audit Scotland
Conclusions relating to the going concern basis of accounting	No matters to report
<ul style="list-style-type: none"> ▶ The use of the going concern basis of accounting used in the preparation of the financial statements is not appropriate 	<ul style="list-style-type: none"> ▶ Supported by our core financial statements audit work, supplemented by our wider scope audit procedures in respect of financial sustainability
Other information in the financial statements	See governance and transparency
<ul style="list-style-type: none"> ▶ We are required to consider whether the other information in the financial statements is materially inconsistent with the annual accounts or our knowledge obtained in the audit 	<ul style="list-style-type: none"> ▶ Review of committee minutes and papers / discussions with management / understanding of the business
Opinions on matters prescribed by Audit Scotland	Unqualified opinions
<ul style="list-style-type: none"> ▶ The audited part of the Remuneration and Staff Report has been properly prepared in accordance with applicable regulations ▶ Information in the Accountability Report / Annual Governance Statement is consistent with the financial statements, and prepared in accordance with the relevant guidance 	<ul style="list-style-type: none"> ▶ We agreed the form of the report to the regulations and agreed the disclosures to underlying accounting records and supporting schedules ▶ We reviewed the content of the narrative statements to the information known to us in the audit, and against the requirements of the guidance
Matters on which we are required to report by exception	No matters to report by exception
<ul style="list-style-type: none"> ▶ Whether adequate accounting records have been kept ▶ Whether financial statements and the audited part of the Remuneration and Staff Report are not in agreement with the accounting records ▶ Whether we have not received the information we require for our audit 	<ul style="list-style-type: none"> ▶ We were provided with all the information we required ▶ We have been able to agree information to the accounting records

The annual financial statements enables the College to demonstrate its accountability for the resources at its disposal, and its overall performance in the application of those resources during the year. They also enable the College to demonstrate openness and transparency in its governance and remuneration arrangements.

Financial Statement preparation 2017/18

Compliance with 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 Trustee Investment (Scotland) Act 2005 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. However, a number of presentational amendments were required to ensure compliance with the SORP and 2017/18 SFC Accounts Direction. Overall our assessment of the financial statements is that there is room for improvement in the financial statement preparation process and quality review prior to passing to audit.

Recommendation 1

Audit differences

We identified two audit differences arising from our audit work. These were not adjusted by management in the final financial statements and are outlined in more detail in Appendix E. We concur with management's view that the differences are not material.

Update on 2016/17 audit recommendations

In 2016/17 we recommended the College complete an interim PPE valuation by 31 July 2018 in order to comply with the requirements on FReM. We confirm that this interim valuation was undertaken during the year. We are therefore satisfied this recommendation was appropriately actioned.

The annual financial statements enables the College to demonstrate its accountability for the resources at its disposal, and its overall performance in the application of those resources during the year. They also enable the College to demonstrate openness and transparency in its governance and remuneration arrangements.

Financial Statement preparation 2017/18: Other areas

Arms Length Foundation (ALF)

As a result of the reclassification of Scotland's Colleges from 1 April 2014, Arm's Length Foundations (ALF) were set up in order that any reserves were not required to be returned to the Scottish Government.

The opening balance of the ALF on establishment in 2014 was £13 million. The balance in the ALF as at 31 July 2017 was £1 million. At 31 July 2018 £596,000 remained in the ALF to be awarded in line with the ALF's charitable objectives. The governance arrangements between colleges and ALFs across the sector is an area of increased focus in 2017/18, in particular around the independence of the ALF and influence colleges can extend over their operations.

We have re-assessed the independence of the ALF at the yearend to consider the requirement for consolidation of the ALF into the College's financial statements. On balance, we have concluded that the ALF is independent of the College based on a number of factors, including:

- ▶ The ALF has a board of six trustees which is independent of the College. While there are two college members appointed as trustees, we have considered whether this indicates significant influence by the College and confirmed that this is not present. The College members on the ALF hold the same voting rights as all other trustees, do not have the right to appoint new trustees or veto any proposals
- ▶ All applications for funding are reviewed against the ALF's grant awarding policy by the ALF liaison committee and then the ALF Board
- ▶ Day to day management of the ALF is not delegated to, and does not involve, management of the College
- ▶ Whilst there have been no applications received from external parties, we confirmed they would be considered in the same way, provided they met with the ALF's charitable objectives.

Subsidiary and group consolidation

The College prepares group financial statements, consolidating the results of the College and its subsidiary undertakings', Aberdeen Skills and Enterprise Training Limited and Clinterty Estates Limited. We do not audit the subsidiary entities.

The annual financial statements enables the College to demonstrate its accountability for the resources at its disposal, and its overall performance in the application of those resources during the year. They also enable the College to demonstrate openness and transparency in its governance and remuneration arrangements.

Opinions on matters prescribed by the Audit Scotland

Performance Report: In accordance with the Code, we review the information contained within the Performance Report and confirm that this is consistent with the information reported within the financial statements. Audit Scotland requires us to also express an opinion on whether the Performance Report has been prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.

We reviewed the Performance Report and provided commentary to management on presentational changes required to ensure compliance with the SFC 2017/18 Accounts Direction. We are satisfied that the information within the Performance Report is consistent with the financial statements and has been materially prepared in accordance with applicable requirements.

In 2016/17 we recommended that management develop the performance information included with the annual performance report to provide a greater insight into the overall performance of the College. There are still developments that can be made in this area by management.

Recommendation 1

Accountability Report, including the Governance Statement: Audit Scotland requires us to read the information in the Governance Statement and express an opinion on whether it is consistent with the financial statements and that it has been prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.

We have reviewed the Governance Statement and provided commentary to management around enhancing the layout and structure of the information, including presentational changes required to ensure compliance with the SFC 2017/18 Accounts Direction. See further commentary within governance and transparency section of wider scope.

We are satisfied that the information with the Accountability Report is consistent with the financial statements and has been materially prepared in accordance with applicable requirements.

Remuneration and Staff Report: Auditors are required by the Code to audit the disclosures of remuneration and pension benefit, pay bands, and exit packages and express a separate opinion within their independent auditor's report on whether they have been properly prepared in accordance with the regulations.

We reviewed the Remuneration and Staff Report and provided commentary to management around enhancing the layout and structure of the information, including presentational changes required to ensure compliance with the SFC 2017/18 Accounts Direction.

We are satisfied that the auditable part of the Remuneration and Staff Report has been materially prepared in accordance with regulations.

Regularity Opinion: The Board is responsible for ensuring the regularity of expenditure and income. Auditors are responsible for expressing an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000.

In all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

2. Significant audit risks



Significant risk - risk of fraud in income and expenditure recognition: ISA (UK) 240 requires us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk. In the public sector, we extend that to consider the risk of material misstatements by manipulation of expenditure.

Our overall approach

As set out in our Annual Audit Plan, given the nature of funding to the College from the Scottish Funding Council (SFC), we rebutted the assumed fraud risk in respect of this income stream. However we recognised a revenue recognition risk for tuition income and other material income in respect of possible manipulation of cut-off around the financial year end.

We also recognised the same risk around incorrect recognition of non-pay expenditure in line with Practice Note 10.

What did we do in response to the significant risk?

We undertook the following procedures as part of our audit:

- ▶ Reviewed and tested revenue and expenditure recognition policies against the relevant accounting standards and the SORP
- ▶ Reviewed and discussed with management any accounting estimates on revenue or expenditure recognition for evidence of bias
- ▶ Developed a testing strategy in respect of material revenue and expenditure streams:
 - ▶ For tuition fees and education contracts, we performed an analytical review of the key movements in the year and substantive testing across a sample of contracts to ensure appropriate recognition
 - ▶ For SFC and other funding body grant income we reviewed all material grant funding recognised in the year for any indicators of either claw-back or that the terms and conditions of the financial memorandum have not been complied with in all material respects
 - ▶ For other income and expenditure, we performed analytical review and selected key item and representative samples and obtained the grant award agreements along with confirmation of the balance received / receivable by the College
- ▶ We performed focused additional testing around income and expenditure transactions posted near the year end to gain comfort that key items are recorded in the correct accounting period. In particular we focused on material transactions incurred after 31 July, but included in the 2017/18 financial ledger
- ▶ Reviewed and tested a sample of debtor balances at the year end, including any material balances. We undertook an assessment of aged balances held on the balance sheet at year end including investigation of unusual items, such as those past payment due date
- ▶ We tested an extended sample of year end income and expenditure accruals held on the balance sheet at 31 July. We obtained evidence to support management's conclusion that balances related to transactions in respect of the financial year in question

What are our conclusions?

Our testing has not identified any material misstatements relating to revenue and expenditure recognition. We did not identify any areas of significant estimation or judgement as part of our audit work in these areas.

2. Significant audit risks (cont.)



Significant risk - management override: As identified in ISA 240, management is in a unique position to perpetrate fraud in its 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

Audit procedures performed	What did we find?
We gave consideration to the risk of fraud, inquiring of management about their assessment of the risks of fraud and the controls put in place 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 material management override. As part of the audit process we wrote to the chair of the Audit and Risk Committee to make inquiries around both the governance arrangements at the College and any instances or possible non-compliance identified in the year. Those charged with governance identified through their response no instances of non-compliance. They also did not draw to out attention any significant matters or material weaknesses or concerns in respect of the College's governance arrangements.
Test 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 then tested a sample of these journals, understood their purpose and agreed and corroborated them to supporting documentation.
Review accounting estimates for evidence of management bias, including management's retrospective consideration of prior year estimates.	We identified and considered the appropriateness of key accounting estimates, including provisions, and their susceptibility to bias. Management has disclosed their consideration of the critical accounting judgements and key estimates in the financial statements. We have reviewed these and agree with the detail of the assessment performed.
Evaluate the business rationale for any significant unusual transactions	We did not identify any significant unusual transactions outside the normal course of business.
Consistency and application of accounting policies / overall presentation of financial information	We consider the accounting policies adopted by the College to be appropriate. There are no significant accounting practices which materially depart from what is acceptable under FRS 102 or the SORP.

What are our conclusions?

We have not identified any material weaknesses in the design and implementation of controls around journal processing. We did not identify any instances of evidence of management override of controls.

There was no disagreement during the course of the audit over any accounting treatment or disclosure. We encountered no significant difficulties in the audit.

2. Other inherent risks



Valuation of property, plant and equipment: Our overall approach

The value of property, plant and equipment (“PPE”) represents a significant balance on the College’s balance sheet and is subject to valuation changes, depreciation charges and possible impairment. The total value of the College estate at 31 July 2018 was £95.1 million, subject to an interim revaluation during the year with a full revaluation due in 2021.

As set out in our Annual Audit Plan, given that a number of assumptions are used in valuing property, plant and equipment, we assigned a higher inherent risk to the valuation of PPE at 31 July 2018.

What did we do in response to the risk?

We undertook the following procedures as part of our audit:

- ▶ Analysed the source data and made inquiries as to the procedures used by management’s specialist to establish the source data as complete
- ▶ Assessed the reasonableness of the assumptions and methods used, including their compliance with the SORP and FReM
- ▶ Considered the appropriateness of the timing of when the specialist carried out the work
- ▶ Challenged management’s experts around the key assumptions used in the report, as well as their expertise and process in determining the valuation of the College estate at the balance sheet date
- ▶ Considered management’s assessment of the interim estate valuation at the yearend and any indications of impairment
- ▶ Assessed that the substance of the specialist’s findings are properly reflected in the financial statements
- ▶ Reviewed the College’s backlog maintenance 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 a sample of additions and disposals in the year, considering the appropriateness of capitalisation in line with the College’s accounting policies and to ensure the corresponding replaced assets had been appropriately disposed

What are our conclusions?

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

Our testing has not identified any material misstatements relating to property, plant and equipment.

2. Other inherent risks (cont.)



Accounting for retirement benefits: Our overall approach

In line with accounting standards, the College recognises the cost of retirement benefits provided to its staff in the reported cost of service when they are earned by the employee and not when the pension benefits are actually paid.

The College's employees belong to two principal pension schemes, the Scottish Teachers Superannuation Scheme (STSS) and the North East Scotland Pension Fund (NESPF). The present value of unfunded obligations in relation to early retirements agreed in previous years is £7.1 million (2016/17: £7.4 million). As at 31 July 2018, the College's share of the pension scheme net liability is £8.2 million (2016/17: £25.8 million).

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

What did we do in response to the risk?

As a result of the thematic review performed by the Financial Reporting Council, there has been an increase in focus in accounting for retirement benefits and, as such, we have responded by performing more extensive audit procedures in the current year. We undertook the following procedures as part of our audit:

- ▶ Obtained the actuarial report at the year end date for the scheme and utilised our in-house experts to assess 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 wrote to the actuaries of the pension scheme to confirm their independence and expertise to ensure this was appropriate and sufficient for the purposes of preparing their FRS 102 report
- ▶ We wrote to the auditor of the North East Scotland Pension Fund to gain assurance over the completeness, and valuation of the Fund's assets at 31 March 2018, as well as the processes and controls to ensure accurate information is obtained in respect of the College's share of fund assets
- ▶ 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 reviewed the calculation of the College's valuation of future early retirement liabilities at 31 July

What are our conclusions?

We concluded that we were able to rely on the work of management's specialists - the pension fund actuaries - and were satisfied that the actuarial assumptions used in the preparation of the FRS 102 report were appropriate.

We obtained relevant assurances from the pension fund auditor to support our conclusions.

Our testing has not identified any material misstatements relating to future early retirement liabilities.

We noted a difference between the STSS calculation and what had been recorded in the financial statements to the value of £98,000. Management did not adjust this difference, taking the view that it was not material.

3. Wider scope audit

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

Green

- ▶ We have reviewed the College’s financial regulations and are satisfied that these are comprehensive and are subject to regular update. The Vice Principal - Finance and Resources reports to the Principal, attends Board meetings and provides strategic input on financial matters.
- ▶ Financial performance is scrutinised by the senior management team, the Finance and Resources Committee and the Board. This monitoring includes expenditure against budget and the forecast outturn for the year.
- ▶ There is scope for greater focus and consideration on the specific risks in respect of EU Withdrawal on people, financial and rules and regulations and the College’s plans for responding to these risks.

Elements of financial management, and our assessment of the College’s arrangements

We consider whether:

- ▶ Are standing financial regulations comprehensive, current and promoted across the College?
- ▶ The financial control environment and internal controls are operating effectively?
- ▶ Are there suitably qualified and experienced staff leading the College’s finance team?
- ▶ Are arrangements for monitoring and scrutinising the College’s financial position appropriate?

We have reviewed the College’s financial regulations and are satisfied that these are comprehensive and are subject to regular update. These were last reviewed and updated in January 2018. The financial regulations are available on the College’s intranet.

It is also the responsibility of the College to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Although our audit was not designed to express an opinion on the effectiveness of internal financial control we are required to communicate to you significant deficiencies which we identify. We have not identified any such matters.

The finance team comprises 9 FTE and is led by the Vice Principal - Finance and Resources, who is professionally qualified. The Vice Principal - Finance and Resources reports to the Principal and participates fully as a member of the senior leadership team, including attending Board meetings and providing senior management and the Board with strategic input on financial matters.

An important part of financial assurance is regular updates to the Board and monitoring of revenue and capital expenditure against budget, including the overall forecast outturn for the financial year. Financial flash reports are reviewed by the Board on a monthly basis. This includes monitoring of expenditure against budget and the forecast outturn for the year. These documents are shared with committee members one week prior to a meeting where key variances are discussed. Capital expenditure monitoring is incorporated as part of this financial monitoring process. Financial performance is scrutinised by the senior management team, the Finance and Resources Committee and the Board.

We reviewed the financial information monitored by senior management, committees and the Board and we are satisfied that the information is sufficiently detailed, including explanation of material variances to provide meaningful information to allow scrutiny and challenge of performance.

Focus on EU Withdrawal

Withdrawing from the European Union will have implications for the college sector. In October 2018 Audit Scotland published a paper setting out the key issues for the public sector. The issues were identified around three themes of people, financial and rules and regulations.

The risks and opportunities presented by EU withdrawal will vary markedly between organisations. Some parts of the public sector are already experiencing an impact. Audit Scotland expects all public bodies to be assessing the potential impact of EU withdrawal on their organisation, and identifying any specific risks and how they will respond to them.

Colleges Scotland research suggest around 3% of teaching staff are from the EU, and it expects that figure to be higher for support staff. Colleges Scotland and the SFC are working to analyse and model the impact of Brexit on the college sector.

Discussions with management and review of Board papers has confirmed that there has been limited consideration of the impact of EU Withdrawal thus far. We recommend the College consider the impact of EU Withdrawal and, in particular, specific risks in respect of people, financial and rules & regulations, on the College and their response to these risks.

Recommendation 2

EY view: There is scope for greater focus and consideration by the College on the particular and specific risks in respect of people, financial and rules and regulations and the College's plans for responding to these risks

Update on 2016/17 audit recommendations

In 2016/17 we recommended that management ensure that the Board are aware of the impact of key decisions on both outturn financial performance as well as ability to meet resource limits. As previously noted this is now performed regularly and we are therefore satisfied this recommendation has been actioned.

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Amber

- ▶ The College reported a consolidated deficit of £3.9 million and an operating deficit after removal of non-cash accounting adjustments of £3.4 million. Capital expenditure was in line with budget. The main differences between budget and actual outturn related to one-off restructuring costs and the non-achievement of the ESF credit target.
- ▶ The College has prepared its five-year financial forecasts 2018 to 2023 in the form of the SFC's template financial forecast return. The forecasts have been prepared on the basis of the Board's strategic plans and supporting aims and objectives. Medium term forecasts to 2023 show an accounting and underlying deficit. While the College has initiated conversations with employees and students, it is yet to develop a medium term financial plan to address the forecast shortfalls.

Elements of financial sustainability, and our assessment of the College's arrangements

We consider whether:

- ▶ The College's revenue and capital outturn for 2017/18 was in line with the approved budgets, with material changes to budgets identified and reported?
- ▶ The College has a medium term financial strategy and plan which takes into account risks and uncertainties?
- ▶ The College has arrangements to address any identified funding gaps?

The context for financial sustainability

In June 2018, Audit Scotland published their report *Scotland's colleges 2018*. This report provides an overview of the college sector in Scotland and, amongst other things, gives an update on college finances. The report highlighted that while the college sector's underlying financial position improved in 2016-17, several colleges face significant financial challenges. Scotland's 20 incorporated colleges reported an overall underlying financial surplus for 2016-17 of £0.3 million. This compares to an underlying deficit of £8 million in 2015-16. Across the sector, the cash held by colleges increased by 13 per cent in 2016-17 and the net value of their assets - such as land and property, compared against financial liabilities such as pension costs - grew by ten per cent. However, these sector-wide increases mask significant variations between colleges.

The report noted that several factors pose a risk to colleges' financial sustainability, including: the future impact of national bargaining for support staff; uncertainties around long-term funding of improved employment terms; the cost of maintaining buildings and land; and the potential impact of leaving the European Union.

The Scottish Funding Council's 2017 estates condition survey indicates that college buildings require urgent and significant investment. The survey estimates a backlog of repairs and maintenance over the next five years of up to £360 million. The SFC is providing £27 million of capital funding to colleges in 2018/19 to cover the very high priority needs identified in the condition survey.

2017/18 financial position

The 2017/18 budget was approved in June 2017. The College initially set a balanced budget. Subsequent to that this was revised to budget for a deficit of £1.4 million. The budget recognised major uncertainties around the Scottish Government's funding of national pay bargaining and the potential impact this could have on operating costs.

The College reported a consolidated deficit of £3.9 million for the year (2016/17: £859,000 surplus). Following adjustments of £18 million in relation to pension and unrealised gain on revaluation of fixed assets of £956,000. The College reported total comprehensive income of £14.9 million (2016/17: £14.9 million). The College had an operating deficit after removal of non-cash accounting adjustments (relating to depreciation and capital accounting adjustments) of £3.4 million (2016/17: surplus £363,000). The main differences between budget and actual relate to one-off restructuring costs (£1.1 million) and the non-achievement of the ESF Credit target by approximately 1,800 credits (1.3%).

Elements of financial sustainability, and our assessment of the College's arrangements (cont.)

Resource outturn

Colleges are classified as central government bodies and are also required to operate within a resource limit which is measured annually at 31 March. The resource budgets and final outturn for 2017/18 are outlined below:

Spend against Resource Budget	Revenue £'000	Capital £'000
Resource budget for year ended 31 March 2018	1,161	0
Expenditure against resource budget	1,161	0
Net overspend/underspend against budget	0	0

Source: North East Scotland College financial statements 2017/18

Capital expenditure

During 2017/18 the College budgeted to spend £551,000 on capital additions to be financed by SFC grant. By 31 July, reported capital spend was in line with budget.

The College has confirmed with the SFC funding of £1 million to be provided by 31 March 2019. The College's estimated value of backlog maintenance is £17.3 million. In 2016/17, in relation to the Aberdeen Campus development, we recommended management ensure that there is continued close monitoring of the proposed capital development, including transparent reporting to the Board of the progress of securing approval and finance for the development. Where delays are envisaged against existing targets, the financial impact should be carefully considered and reported on.

Management confirmed that following failure to achieve funding from the SFC, a new estates strategy is being developed to address the resource requirement of the Aberdeen campus, and how best to achieve its funding. It is important that this also sets out the College's plan to address backlog maintenance.

Recommendation 3

Medium term financial strategy and plan

The College has prepared its five-year financial forecasts 2018 to 2023 and submitted these to the SFC in the form of the template financial forecast return ("FFR"). The forecasts have been prepared on the basis of the Board's strategic plans and supporting aims and objectives using the assumptions prescribed by SFC. We have outlined the forecast position through to 2023 from the FFR below.

Year	17/18	18/19	19/20	20/21	21/22	22/23
Accounting deficit (£'000)	(3,984)	(627)	(1,008)	(1,227)	(1,292)	(1,392)
Underlying surplus / (deficit) (£'000)	(3,397)	363	(18)	(237)	(302)	(402)

Source: North East Scotland College

The FFR projects both an accounting and underlying deficit for the medium term to 2023. While the College has initiated conversations with employees and students on financial resilience, it is yet to develop plans to address the forecast shortfalls and improve financial performance. In order to ensure long term sustainability, we recommend the College develop a medium term financial plan to address and reduce the forecast deficits.

Recommendation 4

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.

Green

- ▶ The College has in place the key requirements for good governance. We concluded that the Governance Statement materially complies with the SFC’s 2017/18 Accounts Direction.
- ▶ Standing Orders regulate how the business of the College is conducted; detailed terms of reference are in place for the Board’s standing committees. There is an established risk management policy in place.
- ▶ The College publicises Board and standing committee agendas, minutes and papers on their website on a timely basis and information, including financial performance, is generally clear and concise.

Elements of governance and transparency, and our assessment of the College’s arrangements

We consider whether:

- ▶ The governance framework is sound and arrangements are operating effectively?
- ▶ Is there effective scrutiny, challenge and transparency on decision making?
- ▶ Is the Governance Statement complete and does it reflect key findings from audit, scrutiny and inspection?

Governance and transparency

While we have not identified any significant risks in relation to the College’s governance arrangements through our audit planning, we consider the adequacy and effectiveness of the College’s governance arrangements as part of our audit work. The Board is responsible for establishing robust governance arrangements. This includes ensuring effective systems of internal control, including arrangements to safeguard public money, and compliance with applicable laws and regulations.

The College has in place a number of the key requirements for good governance. We have reviewed Board minutes and papers and found these to set out clearly the matters considered and discussed. Standing Orders regulate how the business of the College is conducted. The Board has approved detailed terms of reference for its standing committees. The College publicises profiles of Board members, Board and standing committee agendas, minutes and papers on their website on a timely basis and information, including financial performance is generally clear and concise.

Risk management

The College’s approach to risk management is set out within the risk management policy. This was formally approved in October 2018. Once a month the Senior Management Team meets and assess the strategic risk register, to ascertain the completeness of the risks to ensure it is reflecting the current situation in the College. Matters are referred to standing committees, as appropriate. The Audit and Risk Committee reviews the risk register on a quarterly basis. The Board are also advised of new risks or changes to risks assigned to them in the Strategic Risk Register and reviews this at least annually.

Internal audit

The College’s internal audit service provides an important source of assurance to inform management and the Board’s assessment of the College’s governance arrangements. Internal audit’s opinion for the year was based on its agreed audit plan for the year, as approved by the Audit and Risk Committee. For 2017/18 the Internal Auditor’s annual statement of assurance notes “In our opinion North East Scotland College did have adequate and effective risk management, control and governance processes to manage its achievement of the College’s objectives at the time of our audit work. In our opinion, the College has proper arrangements to promote and secure value for money. However we have produced two weak reports during the year. These being, Data Protection (GDPR Compliance) which was followed up in July 2018 and resulted in an overall opinion of substantial as the recommendations were addressed or in the process of being addressed, and Value for Money - Transport. ”

Elements of governance and transparency, and our assessment of the College's arrangements (cont.)

Enquiries of those charged with governance

During 2017/18 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 were brought to our attention.

Governance Statement

We reviewed the Governance Statement within the financial statements against the requirements outlined in the SFC's 2017/18 Accounts Direction. This includes the requirement to conclude on the College's compliance with the Scottish Code of Good Governance, or to explain any areas of non-compliance. We also considered management's arrangements for its own self-assessment over compliance with the Code.

We made a number of recommendations to management to enhance the presentation and disclosures in the Governance Statement to ensure compliance with the core requirements. While the final financial statements are now materially compliant with the requirements, there are areas where the Governance Statement, and other disclosures, can be further enhanced to improve the readability to users.

Severance payments

During 2017/18 the College made payments of £764,000 to 23 employees who left the College under voluntary severance agreements. These payments were approved by the College's Remuneration Committee. We confirmed a sample of payments to evidence of approval from the committee, in line with the College's approved policy and SFC guidance.

Audit Scotland 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. This should include ensuring that management has evaluated the implications for the College and that the reports and assessment are shared with the board.

Discussions with management highlighted that national reports are reviewed by management and the impact on the College is considered. These are taken to the Board as and when deemed necessary.

National Fraud Initiative

In July 2018 Audit Scotland reported on the outcomes of the 2016/17 National Fraud Initiative ("NFI") exercise. The report noted that the arrangements in place around the Further Education sector were sound, but continue to be improved.

During 2017/18, the College received a list of 54 matches and actively investigated these. The College has received communication from Audit Scotland requesting the College's continued participation in the NFI for 2018/19. The NFI 2018/19 will follow the same process as the 2016/17 exercise. The College uploaded the requested data in October 2018.

Data matches will be made available to the College for investigation and reporting in January 2019.

Update on 2016/17 audit recommendations

In 2016/17 we noted management should continue to look to maximise the level of information made publically available and review its arrangements and policy for the classification of business as reserved to ensure these remain appropriate.

As noted above, the College publicises Board profiles of members, Board and standing committee agendas, minutes and papers on their website on a timely basis. We have also noted an improvement in the quantity of information redacted in minutes from the prior year.

Value for money is concerned with using resources effectively and continually improving services.

Green

- ▶ A revised strategic plan was introduced from the start of the 2018/19 academic year. Developed by the Board with input from staff, students and stakeholders, the plan identifies the key strategic priorities for the College over the period 2018-21.
- ▶ There is clear and timely reporting against performance indicators. Annual performance reports are published on the College's website.
- ▶ The College has an appropriate framework in relation to procurement. This is utilised by all College employees and updated regularly.

Elements of Value for money and our assessment of the College's arrangements

We consider whether:

- ▶ The College has a strategic plan that supports the delivery of services and achievement of key performance indicators?
- ▶ The College has visible performance reporting against measurable indicators?
- ▶ There is an adequate procurement process and is it followed by the College?

Strategic plan

A revised strategic plan was introduced from the start of the 2018/19 academic year. Developed by the Board with input from staff, students and stakeholders, the plan identifies the key strategic priorities for the College over the period 2018-21. It sets a clear direction for the College in responding to the needs of the region and in delivering on national policy.

The strategic plan notes five strategic themes:

- ▶ Being Responsive
- ▶ Developing People
- ▶ Working in Partnership
- ▶ Delivering Quality
- ▶ Building Sustainability

Each strategic theme has accompanying objectives and strategies to support achievement. The College will monitor their progress using the key strategic indicators identified and a table of progress against these indicators will be published annually.

Performance reporting

The College publishes its performance information annually on its website as well as including key measures within the financial statements and Board and committee papers published on the website. The Evaluative Report and Enhancement Plan and a performance report showing key financial information and performance indicators are also presented to the Board.

Elements of Value for money and our assessment of the College's arrangements (cont).

Procurement processes

The College has a procurement strategy, developed for the period 2016-2020. The strategy has been designed to ensure legislative compliance with the Procurement Reform (Scotland) Act 2014 and other relevant legislation. It is aligned with both the College's and the SFC's key strategic outcomes. A copy of the strategy is available on the College website.

The College utilises the procurement software PECOS. All purchases must be approved, with tiered levels of approval, depending on value. The Finance and Resources Committee review procurements for contracts above £50,000, as well as any retentions for contracts above this threshold. Based on the scope of our work, we have concluded that there is appropriate framework in relation to procurement.

Appendices

A - Code of Audit Practice: responsibilities

B - Independence and audit quality

C - Required communications

D - Action plan

E - Summary of audit differences

In our Annual Audit Plan, we provided a summary of the responsibilities on audited bodies falling within the public sector audit framework, as set out in the Code of Audit Practice (the Code).

Responsibilities of audited bodies	
Corporate governance	<p>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.</p>
Financial statements and related reports	<p>Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:</p> <ul style="list-style-type: none"> ▶ 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. <p>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.</p> <p>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.</p>
Standards of conduct / prevention and detection of fraud and error	<p>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.</p>
Financial position	<p>Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> ▶ 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	<p>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.</p>

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.

What 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 2017 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 April 2018.

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 - payable in the respect of the year ended 31 July 2018

Component of fee:	2017/18	2016/17
Auditor Remuneration	£31,300	£30,990
Pooled Costs	£2,010	£1,940
Contribution to Audit Scotland costs	£1,740	£1,760
Total fee	£35,050	£34,690

Audit Quality

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 2018 UK Transparency Report can be accessed on our website at www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018. This material is published to provide a timely and relevant source of information about EY in general, and our audit business in particular.

The disclosures are extensive. For example, they explain 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 Scotland – 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 at the College since appointment can be found at: www.audit-scotland.gov.uk/uploads/docs/report/2018/as_audit_quality_1718.pdf.

Required communication	Our reporting to you
<p>Terms of engagement / Our responsibilities</p> <p>Confirmation by the Audit and Risk Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.</p> <p>Our responsibilities are as set out in our engagement letter.</p>	<p>Audit Scotland Terms of Appointment letter - audit to be undertaken in accordance with the Code of Audit Practice</p>
<p>Planning and audit approach</p> <p>Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.</p>	<p>Annual Audit Plan - April 2018</p>
<p>Significant findings from the audit</p> <ul style="list-style-type: none"> ▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▶ Significant difficulties, if any, encountered during the audit ▶ Significant matters, if any, arising from the audit that were discussed with management ▶ Written representations that we are seeking ▶ Expected modifications to the audit report ▶ Other matters if any, significant to the oversight of the financial reporting process 	<p>This Annual Audit Report</p> <p>We request written representation from you in respect of key matters arising during the course of our audit, and in accordance with auditing standards. A copy of this letter is provided for your consideration and signature at the time of approval of the financial statements.</p>
<p>Going concern</p> <p>Events or conditions identified that may cast significant doubt on the College's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> ▶ Whether the events or conditions constitute a material uncertainty ▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▶ The adequacy of related disclosures in the financial statements 	<p>No conditions or events were identified, either individually or together to raise any doubt about the College's ability to continue for the 12 months from the date of our report.</p>
<p>Misstatements</p> <ul style="list-style-type: none"> ▶ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation ▶ The effect of uncorrected misstatements related to prior periods ▶ A request that any uncorrected misstatement be corrected ▶ Corrected misstatements that are significant ▶ Material misstatements corrected by management 	<p>This Annual Audit Report</p>
<p>Fraud</p> <ul style="list-style-type: none"> ▶ Enquiries of the Audit and Risk Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the College ▶ 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, relevant to the Audit and Risk Committee 	<p>This Annual Audit Report</p>
<p>Consideration of laws and regulations</p> <ul style="list-style-type: none"> ▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ▶ Enquiry of the Audit and Risk 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 and Risk Committee may be aware of 	<p>This Annual Audit Report</p> <p>We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations.</p>

Required communication	Reference
<p>Related parties</p> <p>Significant matters arising during the audit in connection with the College's related parties including, when applicable:</p> <ul style="list-style-type: none"> ▶ 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 College 	<p>No significant matters have been identified.</p>
<p>Independence</p> <p>Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, 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"> ▶ 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 	<p>Annual Audit Plan</p> <p>This Annual Audit Report - Appendix B</p>
<p>Internal controls</p> <p>Significant deficiencies in internal controls identified during the audit</p>	<p>This Annual Audit Report - no significant deficiencies reported</p>
<p>Subsequent events</p> <ul style="list-style-type: none"> ▶ Where appropriate, asking the Audit and Risk Committee whether any subsequent events have occurred that might affect the financial statements. 	<p>We have asked management and those charged with governance. We have no matters to report.</p>
<p>Material inconsistencies</p> <p>Material inconsistencies or misstatements of fact identified in other information which management has refused to revise</p>	<p>This Annual Audit Report</p>

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

Classification of recommendations					
Grade 1: Key risks and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently management needs to address and seek resolution urgently.		Grade 2: Risks or potential weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.		Grade 3: Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.	
No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe		
1	<p>There were a large number of presentational and disclosure adjustments to the financial statements as a result of the audit.</p> <p>These have been corrected by management but reflect the need for an increased focus to ensure that there is a robust review process over the completeness and accuracy of the financial statements prior to being made available for audit.</p> <p>In 2016/17 we recommended that management develop the performance information included with the annual performance report to provide a greater insight into the overall performance of the College. There are still developments that can be made in this area by management.</p> <p>There are areas where the Governance Statement, and other disclosures, can be further enhanced to improve the readability to users.</p>	<p>Management should review its financial statement preparation arrangements. Particular focus should be given to:</p> <ul style="list-style-type: none"> ▶ Ensuring preparation of the financial statements is assigned to appropriate individuals ▶ Ensuring sufficient time is built into the financial statement process to allow multiple levels of detailed review and subsequent updated versions of financial statements ▶ Ensuring preparation is completed in line with applicable guidance, ensuring changes in requirements are addressed on a timely basis. ▶ Revising the performance report to provide enhanced clarity and greater insight into the performance of the College, linking to the new strategic plan. ▶ Enhancing the presentation and structure of the financial statements to improve the readability to users. <p style="text-align: right;"><i>Grade 2</i></p>	<p>Agreed. The College's new Strategic Plan, which clearly links to national and regional priorities provides a clear basis for performance reporting.</p> <p>While the College has utilised a consistent format of report over recent years, we will ensure that further changes as required by the SFC Accounts Direction are incorporated in future years.</p>		
2	<p>There is scope for greater focus and consideration on the specific risks in respect of EU Withdrawal on people, financial and rules and regulations and the College's plans for responding to these risks.</p>	<p>In line with Audit Scotland guidance, the College should assess the potential impact of EU Withdrawal on their organisation, identifying any specific risks and how they plan to respond to them.</p> <p style="text-align: right;"><i>Grade 2</i></p>	<p>Agreed. This has already been considered by the Senior Management Team and will be added to the Corporate Risk Register, with mitigating actions included.</p>		

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			
No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
	<p>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.</p>	<p>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.</p>	<p>Grade 3: Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.</p>
3	<p>Management confirmed that following failure to achieve funding from the SFC, a new estates strategy is being developed to address the resource requirement of the Aberdeen campus, and how best to achieve its funding. It is important that this also sets out the College's plan to address backlog maintenance, to ensure compliance with SFC guidance.</p>	<p>The College requires to develop and approve a backlog maintenance plan. <i>Grade 2</i></p>	<p>Agreed. This will be included as part of the development of the new Estates Strategy, to be completed by summer 2019.</p>
4	<p>Medium-term forecasts to 2023 show an accounting and underlying deficit. Whilst the deficit being generated is principally as a result of the Cash Budget for Priorities, the current forecast currently doesn't allow for much flexibility in the event of unforeseen circumstances. The College has initiated conversations with employees and students, however it is yet to develop a medium-term financial plan to address the forecast shortfalls.</p>	<p>The College needs to develop a medium-term financial plan to address forecast underlying deficits to support the College's financial sustainability. <i>Grade 1</i></p>	<p>The College's financial plans have been prepared in line with SFC direction to fully utilise the resource available to it, including the Cash Budget for Priorities. Have said that, we acknowledge that this leaves little flexibility to meet unforeseen circumstances and management intends to create flexible headroom in future years to allow for innovation and emerging issues.</p>

E – Summary of audit adjustments



This appendix sets out the reportable adjustments that remain unadjusted in the financial statements. We concur with management's view that the differences are not material and we do not consider these to require adjustment.

	Income and Expenditure impact / £	Balance Sheet impact / £
Unadjusted audit differences		
1. Adjustment to correct STSS contribution reconciliation difference		
Dr Pension Liability – STSS		98,859
Cr Pension Expenses	(98,859)	
2. Adjustment to correct recognition of goods not received until post year end		
Dr Creditors		133,248
Cr Stock		(133,248)

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