



Lews Castle College

**Annual Audit Plan Addendum
Year ended 31 July 2020**

Audit Committee – 29 September 2020



Building a better
working world

Introduction

The Impact of Covid-19 on our audit

Our annual audit plan was agreed with management and presented at the Audit Committee meeting in May 2020. We provided an overview of our audit scope and approach for the audit of the financial statements and the wider scope audit work. This addendum provides an update to the Audit Committee on the planned scope and approach to the external audit for 2019/20 in light of the significant impact of the Covid-19 global pandemic on the further education sector, and associated impact on the accounting arrangements and disclosure requirements.

Our audit procedures have been re-assessed to ensure they address the changing risks and issues which have emerged as a result. Our aim is to deliver a high quality audit while supporting the College to prioritise its core services and strategic aims. We outline below the key areas of impact for our audit in 2019/20, while recognising that the College faces significant challenge and uncertainty in the months and years ahead.

1. Impact on our audit risk assessment

On page 3, we outline the key areas of impact on the risks presented within our annual audit plan, in particular the impact on the valuation of Property, Plant and Equipment and LGPS assets and liabilities.

We have reviewed our consideration of the overall materiality levels used for the audit and concluded that the levels remain appropriate.

2. Impact on the financial statements

On pages 5-6, we highlight our expectations of areas of impact within the financial statements, in particular possible changes to narrative reporting and disclosures to reflect the impact and uncertainty around the current situation.

3. Wider scope risk assessment

On page 8, we outline proposals to reprioritise wider scope work to focus on key areas of risk during the crisis. As a result we have

- increased our focus on the financial sustainability of the College;
- incorporate the financial management dimension of wider scope audit into our planned audit work; and
- focused our consideration around other wider scope dimensions on the impact of Covid-19 during the year.

4. Audit Logistics

The deadlines set by the SFC for the submission of audited financial statements remain the same, with the option for flexibility. On page 9 we set out:

- our current expectations that the timetable will be broadly in line with the original plan;
- the primacy of maintaining audit quality; and
- logistical arrangements to allow us to conduct the audit remotely.

1. Impact on audit risk assessment

Changes to our risk assessment as a result of Covid-19

We set out below the significant and inherent risks identified for 2019/20 alongside our other areas of audit focus. We have highlighted any changes in audit focus or new risks alongside any revisions to the expected audit approach. The risks identified may change further as a result of any significant findings or subsequent issues we identify during the audit.

Significant Risk:

Risk of fraud in revenue and expenditure

No change in risk, additional audit focus around revenue recognised in relation to activities or services delayed by Covid-19. There remains a significant risk around the recognition of income and expenditure transactions around year end.

We will consider the recognition of any grant or tuition income for courses which were not completed at the financial yearend due to Covid-19. We will also consider accounting and disclosure of Covid-19 related income and expenditure.

Fraud Risk:

Misstatement due to fraud or error

No change in risk but additional audit focus around year end provisions and estimates that are related to or impacted by Covid-19. We recognise that the control environment for financial statement close processes will likely have evolved due to remote working arrangements. We will assess whether this had an impact on the effectiveness of management's controls designed to address the risk of fraud.

Our specific focus remains on key areas of judgements and estimates, significant unusual transactions and journal entries made by management, and the completeness and valuation of accrued income and expenditure recorded by management at the balance sheet date.

Significant risk:

Valuation of property, plant and equipment

No change in risk, increased focus around ongoing valuation of property, plant and equipment and assets held for sale. The Royal Institute of Chartered Surveyors (RICS) has issued guidance highlighting that the uncertain impact of Covid-19 on markets may cause valuers to conclude that there is a material uncertainty at 31 March 2020. While this guidance may not be in place for 31 July 2020, there remains increased uncertainty around the valuation of assets in the current environment. Caveats may be included within valuation reports and other information provided by valuers, highlighting uncertainties which give rise to additional risks relating to financial statement disclosures as well as the valuations themselves.

To address the increased risk, we will consider the use of internal specialists to examine any information provided by the College's independent valuers for the valuation of the College estate at 31 July 2020. There will also be additional focus on management's assessment of the need to revalue assets not subject to full valuation in 2019/20, to comply with the relevant accounting requirements that assets are valued with sufficient regularity to avoid misstatement, and not just within an arbitrary period.

1. Impact on audit risk assessment (continued)

Inherent risks:

Valuation of pension assets and liabilities

No change in risk, increase in audit focus around the valuation of pension assets and impact of legal judgements on liabilities. Since our audit planning report there are a number of areas of increased focus required around the valuation of the College's share of the Highland Council Pension Fund assets and liabilities.

- A number of local government pension funds have reported material uncertainties around the valuation of its assets at 31 March 2020 and there has been increased volatility in relation to investment returns. This will result in additional consideration being required to accurately assess the roll forward of the College's share of those assets to 31 July 2020. In addition, some local government audits have been delayed due to Covid-19 which may lead to delays in obtaining the assurances we require from the pension fund auditors.
- Last year the College accounted for the impact of the McCloud judgement impacting future liabilities in the Pension Fund as a past service cost. A consultation has now been issued on how these costs may be addressed going forward, and should be included in the College's actuaries' assessment of its pension liability at 31 July 2020.
- Similar to the impact of the McCloud judgement in 2018/19, in July 2020, Scottish Ministers acknowledged that a recent employment tribunal ('the Goodwin tribunal') will require changes to the Local Government Pension Scheme which may impact the College's pension liability. The impact will be considered by the College's and our actuaries.

Audit focus area:

Changes to accounting framework - 2018 SORP

No change in risk or audit focus. While the accounting framework or disclosure requirements have not changed as a result of Covid-19, we have outlined in this addendum the significant impact on the existing disclosure requirements.

2. Impact on the College's Financial Statements

We remain satisfied that the values reported to you in our Audit Planning Report for planning materiality, performance materiality and our audit threshold for reporting differences remain appropriate.

Our review and reassessment of materiality

In our annual audit plan, we communicated that our audit procedures would be performed using a materiality of £135,000. We have considered whether any change to our materiality is required in light of Covid-19. Following this consideration we remain satisfied that the overall materiality values reported remain appropriate. As outlined on the previous page we will reduce materiality to reflect additional risks around parts of the financial statements more directly impacted by Covid-19.

Our evaluation requires professional judgement and so takes into account qualitative as well as quantitative considerations. 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. We will report any changes to our materiality as part of our Annual Audit Report.

The ongoing disruption to daily life and the economy as a result of the Covid-19 virus will have a pervasive impact upon the financial statements.

The financial statements will need to reflect the impact of Covid-19 on the College's financial position and performance.

Accounting policies

Covid-19 will have a pervasive impact on the financial statements. We have outlined below the areas where we believe there is the potential for the most material impact on the Council's financial position at yearend:

- Revenue and Expenditure recognition: Covid-19 specific government support is a new transaction stream and may require development of new accounting policies and treatments. Other policies made need clarified to ensure clarity around how the impact of Covid-19 has been addressed.
- Property, Plant and Equipment: PPE may be impaired if future service potential is reduced by the economic impact of Covid-19. The College may also have already incurred capital costs on projects where the economic case for completion has fundamentally changed. There may be material uncertainties recognised in relation to the valuation of PPE.
- Pensions: volatility in the financial markets is likely to have a significant impact on the valuation of both pension assets and liabilities, and there is the possibility of significant changes to the underlying actuarial assumptions impacting the valuation of liabilities.
- Receivables: there may be an increase in amounts provided for or written off as irrecoverable and impairment of year-end balances due to the increased number of businesses and individuals expected to be under financial stress.

A number of revised disclosures will be required to reflect the impact of the pandemic, including on the financial position and future financial sustainability.

We will continue to work closely with management to share experience and good practice from other education bodies across the UK.

Key disclosures within the Financial Statements

Front end narrative – performance reporting

An addendum to the Government Financial Reporting Manual 2019-20 ('the FReM') was published and permits entities to omit the performance analysis in order to minimise the reporting burden on public sector entities during the Covid-19 crisis. Colleges may decide to include more comprehensive performance analysis.

It will be important that the impact of Covid-19 is disclosed accurately, completely and that disclosures are relevant and tailored to the College. This includes disclosures around the impact on the College's financial and operational performance, its future plans and risks.

Governance Statement

The College's governance statement will need to capture how the control environment has changed during the period impacted by Covid-19, both up to the balance sheet date and through to the approval of the financial statements, and what steps were taken to maintain a robust control environment during the disruption. This includes how key governance functions are continuing to operate, such as key committee meetings and the delivery of internal audit's programme of work.

Accounting estimates and judgements

Additional disclosures will be required throughout the financial statements to reflect the additional risks facing the College, and how these have impacted the key judgements and estimates made in preparation of the financial statements. In particular, we have referenced the potential material uncertainties around the valuation of property, plant and equipment, pension assets and liabilities, and debtors at the balance sheet date.

Events after the balance sheet date

Significant events after the balance sheet date require to be disclosed within the financial statements, either through the post balance sheet events note or in specific accounting notes or the management commentary and governance statement, as appropriate. The detail required in the disclosures will reflect the specific circumstances of the College, however given ongoing uncertainty and daily changes to key issues impacting the College, there is a greater focus on ensuring these disclosures remain up to date in advance of anticipated approval of the financial statements in December 2020.

We will review the updated going concern disclosures within the financial statements, and associated financial viability disclosures within the governance statement. We expect any material uncertainties around the College's future financial position to be fully disclosed.

Disclosures on Going Concern

International Auditing Standard 570 Going Concern, as applied by Practice Note 10: *Audit of financial statements of public sector bodies in the United Kingdom*, requires auditors to undertake sufficient and appropriate audit procedures to consider whether there is a material uncertainty on going concern that requires reporting by management within the financial statements, and within the auditor's report.

In accordance with the FReM, the College shall prepare its financial statements on a going concern basis unless informed by the relevant national body of the intention for dissolution without transfer of services or function to another entity.

Covid-19 has created a number of financial pressures throughout the public sector, including further education. Uncertainty remains about the level of financial support that may become available from the SFC to reflect the financial consequences of Covid-19. As a result, the SFC's 2019/20 Accounts Direction requires an explanation of the adoption of the going concern basis and mitigating actions taken as a result of Covid-19 to be included as part of the going concern commentary within the College's financial statements, both in the Performance Overview and Annual Governance Statement.

Management's assessment of its future financial position and the related financial statement disclosures will be an area of significant focus for our yearend audit work. Management's assessment and associated disclosures will need to cover at least a 12 month period from the date of approval of the financial statements, but should include consideration throughout the remainder of the College's strategic plan period and through its medium term financial plan period and beyond.

Disclosures made in the financial statements should include the process that has been undertaken to revise financial plans and cashflow in the light of Covid-19 as well as the outcome of this process. Consideration should also be given as appropriate and material to cash liquidity forecasts, sensitivities and assumptions in forecasting, and mitigating actions planned by management to address any worsening financial performance, including the potential for required support from third parties. In particular the College should consider and disclose its assumptions around current and future compliance with existing loan covenants and its impact on future repayments and requirements for external support.

We recognise that this is a new area of focus at a challenging time for the finance team and we will therefore share with management:

- guidance on the detailed requirements for a going concern assessment;
- a template assessment as an example/guide to follow; and
- example disclosures from our experience to date in auditing financial statements after the impact of Covid-19.

3. Wider scope risk assessment

We have tailored our wider scope audit work to focus on financial sustainability and the specific impact of Covid-19 on the other wider scope audit dimensions.

Wider Scope Risk Assessment

We have outlined below our assessment of the impact of the pandemic on the work planned under wider scope dimensions.

Financial sustainability

In our annual audit plan, we outlined a significant wider scope risk around the continuing financial pressures faced by the College. The financial environment in which the College operates was already challenging, and the Covid-19 pandemic has resulted in further, significant financial pressures. It is expected that, while the College has managed to mitigate some of the impact of Covid-19 on its financial performance in 2019/20, it will be significantly impacted going forward in its plans due to the pandemic. There is a significant risk the financial pressures for future years will prevent the College from being able to develop viable and sustainable financial plans.

Financial management

The importance of strong financial management has never been greater than during the current environment. We recognise that the College's financial management and internal control arrangements will have evolved as part of the response to the pandemic. As part of our yearend audit procedures we will review changes to the financial management arrangements to assess the impact, and consider the impact of the pandemic on pre-existing financial controls such as budget setting and routine expenditure review and approval.

Governance and transparency

Prior to the pandemic, we noted a number of areas where progress in respect of previous recommendations for improving governance had been limited, both from external audit and other externally facilitated reviews, and the pace of improvement indicated insufficient capacity to address the issues previously identified.

We also noted in our annual audit plan a significant risk of Covid-19 materially impacted the College's ability to deliver good governance arrangements, both in terms of the impact on the College's way or working and the impact on key individuals charged with delivering good governance. Our work for the year will focus on the College's actions to address improvement requirements from previous audits and arrangements to ensure effective governance was in place through the Covid-19 lockdown period. We will consider:

- How the College ensured the quality of arrangements in place to support good governance during the Covid-19 pandemic including ensuring that there is sufficient transparency around governance and decision making arrangements.
- Is the Governance Statement within the financial statements complete and does it reflect key matters impacted by Covid-19, such as delays in the completion of internal audit work and non-compliance with the code of good governance where actions were not able to be implemented?

4. Audit Logistics

Changes to reporting timescales

The SFC has maintained the same deadline for submission of audited financial statements as previous years, 31 December 2020.

Audit quality retains primacy over regulatory deadlines.

In line with previous years the SFC accounts direction has confirmed that Incorporated and non-incorporated colleges are required to provide their annual report and accounts, together with the associated audit reports by 31 December. However, it has been acknowledged that, due to the exceptional circumstances arising from Covid-19, this deadline may not be achievable for some colleges.

The Financial Reporting Council ("FRC") has issued guidance for both auditors and preparers of the financial statements on issues arising from the Covid-19 pandemic. The guidance to date highlights the practical difficulties in preparing financial statements and performing audits in the new way of working. It is clear that auditors will be required to develop alternative audit procedures to gather sufficient and appropriate audit evidence. The guidance is clear that the new way of working should not undermine the delivery of high quality financial statements preparation or quality audits, which should continue to comply fully with international auditing standards. Where additional time is required to complete audits due to ongoing and developing risks, it is important that this is taken to maintain audit quality rather than seeking to conclude early to meet arbitrary or regulatory deadlines.

The College is currently planning to work to the original timetable for the preparation of the draft financial statements and we are working to a materially similar timetable for the audit and finalisation of the financial statements in December. To date management has not identified any slippage in planned work around the preparation of the financial statements. We will continue to work with management to meet these timetables and keep them under review through the audit process.

Information Produced by the Entity (IPE)

There will be an increased focus around the completeness, accuracy, and appropriateness of information produced by management to support our audit work due to the inability of the audit team to verify original documents or re-run reports on-site from the College's systems. To address the risks around this we will consider the following procedures as appropriate:

- use the screen sharing function of Microsoft Teams to evidence re-running of reports used to generate the IPE we audited;
- agree IPE to scanned documents or other system screenshots; and
- should it be necessary, agree limited onsite visits under appropriate arrangements to verify specific requested documentation and reports in person.

Fee variations will be agreed with management and reported to the Audit Committee in our 2019/20 Annual Audit Report.

Audit Fees

The expected base fee for the College, set out in our annual audit plan, assumes there is no major change in respect of the scope of work in the year, that the College has sound governance arrangements in place and operating effectively throughout the year, prepares comprehensive and accurate draft financial statements and supporting schedules, and meets the agreed timetable for the audit, and an unqualified audit opinion resulting from the audit. Should any of these circumstances change throughout the audit, it is anticipated that additional costs may be incurred through the course of the audit which will be subject to recovery in line with the agreed process and rates set out by Audit Scotland.

In our audit planning report we noted that we had not been able to fully consider and quantify the potential impact of Covid-19 on the financial statements and wider scope audit work. While there remains uncertainty around the quantum of additional time required, the changes impacting the College and the associated risks to the audit outlined in this addendum will have a significant impact on the audit work we need to perform to conclude on the financial statements, in particular:

- The greater use of internal specialists required to support our work on significant and inherent risk areas, in particular around the valuation of pension assets and liabilities;
- Additional work required around the appropriateness of going concern and financial sustainability disclosures in the financial statements and the associated wider scope audit consideration required around financial sustainability;
- The additional work related to the inclusion in our wider scope audit work of financial management considerations this year, in particular assessing the impact of Covid-19 on the existing financial control environment; and
- The pervasive impact of Covid-19 on the financial statements disclosures required, including the performance reporting, governance statement, key judgements and estimates and post balance sheet events note.

Where further additional work is required, fee variations will be agreed with management and reported to the Audit Committee in our 2019/20 Annual Audit Report.

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