



# North Highland College

**Annual Audit Report to the  
members of the Board of  
Governors and the Auditor  
General for Scotland**

**10 February 2022**



**EY**

Building a better  
working world

# Contents

Section	Auditor Responsibility	Page
<b>Executive Summary</b>	Summarise the key conclusions from our audit	<b>03</b>
<b>Financial statements audit</b>	Provide an opinion on audited bodies' financial statements Review and report on, as appropriate, other information such as the annual governance statement, management commentary and remuneration report	<b>09</b>
<b>Wider scope dimensions</b>	Demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited body's: <ul style="list-style-type: none"><li>▶ financial position and arrangements for securing financial sustainability</li><li>▶ suitability and effectiveness of corporate governance arrangements</li><li>▶ effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets</li></ul>	<b>17</b>
<b>Appendices</b>	Undertake statutory duties, and comply with professional engagement and ethical standards:  Appendix A: audited body's responsibilities  Appendix B: independence and audit quality  Appendix C: required auditor communications  Appendix D: Summary of adjusted and unadjusted errors identified during the audit  Appendix E: Prior Year Action Plan  Appendix F: Timing and deliverables of the audit	<b>27</b>

## About this report

This report has been prepared in accordance with Terms of Appointment Letter from Audit Scotland dated 31 May 2016 through which the Auditor General for Scotland has appointed us as external auditor of North Highland College (the College) for financial years 2016/17 to 2021/22. As a result of the impact of Covid-19 our appointment was extended by a further 12 months to include the financial year 2021/22. We undertake our audit in accordance with the Public Finance and Accountability (Scotland) Act 2000 and our responsibilities as set out within Audit Scotland's Code of Audit Practice. This report is for the benefit of the College and is made available to the Auditor General for Scotland and Audit Scotland. This report has not been designed to be of benefit to anyone except the recipients. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the recipients, even though we may have been aware that others might read this report.

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

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If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with Stephen Reid who is our partner responsible for services under appointment by Audit Scotland, telephone 0131 777 2839, email sreid2@uk.ey.com. If you prefer an alternative route, please contact Hywel Ball, 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 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.

# Executive Summary: Key Conclusions from our 2020/21 audit

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**We have issued an unqualified audit opinion on the College's 2020/21 financial statements.**

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**We continued to review and update our risk assessment throughout the audit, including the materiality level applied. Our materiality levels were amended to reflect the increase in expenditure in 2020/21.**

## **Financial Statements**

We have completed our audit of the College's financial statements for the year ended 31 July 2021. We identified eight unadjusted audit differences and two adjusted audit difference arising from the audit which have been reflected within the financial statements. The draft financial statements and supporting working papers were provided in line with the agreed audit timetable and were of a reasonable standard. We worked with the finance team to update the financial statements disclosures, including in relation to areas where streamlining could occur to support the understandability of narrative sections and ensure focus on key areas.

We concluded that the other information subject to audit, including the applicable parts of the Remuneration Report and the Annual Governance Statement were appropriate. We were satisfied that the disclosures reflect the College's compliance with the *Code of Good Governance for Scotland's Colleges*, and the key changes in governance arrangements that were required as a result of changes to working practices due to Covid-19.

## **Going Concern**

Management is required to conclude on the going concern basis of preparation in the financial statements. As a result of the unprecedented financial and operational pressures faced by the College to respond to Covid-19, we placed additional emphasis on management's assessment of going concern and the related need to report on the impact of financial pressures on the College and its financial sustainability. We were satisfied that the College remains a going concern and has made appropriate required disclosures in the financial statements. We have considered the related risks to the financial sustainability of the College and its longer term delivery of strategic objectives in our wider scope reporting.

## Wider Scope and Best Value

We summarise the conclusion we reached in response to our work on the wider scope dimensions below.

### Financial Sustainability

The financial environment in which the College operates was already challenging, and the Covid-19 pandemic has resulted in further, significant financial pressures. While additional funding was awarded during 2020/21 which helped ease immediate pressures, the future outlook remains unclear. The College's FFR was submitted to the Scottish Funding Council in October 2021 showing a deficit of £0.216 million for 2021/22. This demonstrates the tight financial operating position that the College faces in an ever-changing external environment.

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### Governance and Transparency

The key features of good governance have remained in place at the College and have been operating effectively throughout the Covid-19 lockdowns. The College intends to implement a hybrid meeting structure moving forward, after seeking the views of members.

We have noted in Appendix E progress has been made against our audit recommendation with some remaining ongoing.

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### Financial Management

The College has an established budget setting and monitoring framework which includes presentation of financial updates to the Board and Finance and Audit committees throughout the year. We are satisfied that the core financial management arrangements were not materially impacted as a result of Covid-19 and the subsequent lockdowns with clear financial reporting continuing throughout the year.

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# Introduction

As a result of the impact of Covid-19, Audit Scotland agreed to extend our appointment as external auditor of the College by at least 12 months, to 2021/22.

## Purpose of this report

In accordance with the Public Finance and Accountability (Scotland) Act 2000 (“the Act”), the Auditor General for Scotland appointed EY as the external auditor of North Highland College (“the College”) for the five year period 2016/17 to 2020/21. Our appointment term has been extended by a further 12 months, to financial year 2021/22. 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 Board of Governors and the Auditor General for Scotland, and is presented to those charged with governance. This report is provided to Audit Scotland and will be published on their website.

We draw your attention to the fact that our audit was not designed to identify all matters that may be relevant to the College. Our views on internal control and governance arrangements have been based solely on the audit procedures performed in respect of the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

A key objective of our audit reporting is to add value by supporting the improvement of the use of public money. We aim to achieve this through sharing our insights from our audit work, our observations around where the College employs best practice and where practices can be improved. We use these insights to form our audit recommendations to support the College in improving its practices around financial management and control, as well as around key aspects of the wider scope dimensions of audit. Where we identify areas for improvement, we will highlight these throughout this report together with our judgements and conclusions regarding arrangements, and where relevant recommendations and actions agreed with management.

## Our independence

We confirm that we have undertaken client and engagement continuance procedures, which include our assessment of our continuing independence to act as your external auditor. Further information is available in Appendix B.

## Scope and responsibilities

The Code sets out the responsibilities of both the College and the auditor (summarised in Appendix A). We outlined these in our Annual Audit Plan, which was presented to the audit committee in May 2021.

## The impact of the Covid-19 pandemic

In 2019/20 we were required to supplement our Annual Audit Plan, with an addendum outlining the main anticipated areas of impact on the audit following our reassessment of all audit planning and risk assessments. As Covid-19 was a known factor in planning the audit in 2020/21, the same approach has not been required. We have, however, added to our planning and execution procedures throughout the audit to take into account various factors related to Covid-19, and have continued to reassess the risks facing the College in this light:

- ▶ 2020/21 was the first full year where there were material transactional impacts in the College's financial statements, in particular through the recognition of additional Covid-19 related costs and subsequent Scottish Funding Council funding support.
- ▶ While some of the uncertainty around the impact of Covid-19 on key balance sheet valuations had reduced from 31 July 2020 to the current yearend, this also remained a key area of audit focus.
- ▶ We continued to work with management to ensure the financial statements adequately reflected the impact of Covid-19, in particular through the performance and accountability reports, governance statement, and accounting estimates and judgements disclosures.

The 2020/21 audit was conducted fully remotely. Information was shared between the College and the audit team through our secure portal, and inquiries and investigation took place through Microsoft teams meetings. In order to mitigate the risk of not being able to view key documents and information on systems in person, additional supplementary procedures were completed to verify the information provided by management.

Both the audit team and College finance team worked in conjunction to ensure the additional impact of these working arrangements were minimised as far as possible. We would take this opportunity to thank the full team for their co-operation and support throughout this period.

The ongoing disruption to the delivery of further education as a result of Covid-19 continues to have a significant impact on the financial statements and subsequent audit.

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

We updated our assessment of materiality based on the 2020/21 financial performance of the College. Planning materiality was increased from £110,000 to £121,000.

### Our review and reassessment of materiality

Our Annual Audit Plan explained that our audit procedures would be performed using a materiality of £110,000 . We considered whether any change to our materiality was required in light of Covid-19 and the College’s 2020/21 financial performance.

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.

As outlined in our Annual Audit Plan, based on considerations around the expectations of financial statement users and qualitative factors, we apply lower materiality levels to the audit of the Remuneration Report and Related Party Transactions.

Overall Materiality

**£121,000**

1% of the College’s operating expenditure

Tolerable Error

**£60,500**

Materiality at an individual account level

Nominal amount

**£6,050**

Level that we will report to committee

### Financial statement audit

We are responsible for conducting an audit of the College’s financial statements. We undertake our audit in accordance with the Code of Audit Practice (the Code), issued by Audit Scotland in May 2016; relevant Auditing Standards and applicable Practice Notes issued by the Financial Reporting Council; relevant legislation; and other guidance issued by Audit Scotland.

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

- ▶ whether they give a true and fair view of the state of affairs of the College as at 31 July 2021 and the deficit for the year then ended;
- ▶ whether they have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- ▶ whether they have been prepared in accordance with the requirements of the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council, the Charities and Trustee Investment (Scotland) Act 2005, and regulation 14 of The Charities Accounts (Scotland) Regulations 2006 (as amended).

Our findings are summarised in Section 2 of this report.

### **Wider Scope audit**

Our responsibilities extend beyond the audit of the financial statements. The Code requires auditors to provide judgements and conclusions on the two dimensions of wider scope public audit set out in the Code which comprise the wider scope audit for small public sector bodies in Scotland. These are financial sustainability and governance and transparency. We outlined in our Annual Audit Plan that, given the impact of Covid-19 and associated risks around robust financial management, we would consider this dimension as part of our work in 2020/21.

Our findings are summarised in Section 3 of this report.





# Financial Statements audit

## Introduction

The financial statements provide the College with an opportunity to demonstrate accountability for the resources that it controls, and report on its overall performance in the application of those resources during the year.

This section of our report summarises the audit work undertaken to support our audit opinion, including our conclusions in response to the significant and other risks identified in our Annual Audit Plan.

The plan highlighted one area that we identified as a fraud risk relating to the risk of fraud in revenue and expenditure recognition, including through management override of controls.

## Compliance with financial reporting requirements

As part of our oversight of the College's financial reporting process, we report on our consideration of the quality of working papers and supporting documentation prepared, predominantly by the finance team, to support the audit.

The financial statements were prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder issued by the Scottish Funding Council, the Charities and Trustees Investment (Scotland) Act and regulation 14 of The Charities Accounts (Scotland) Regulations 2006 (as amended).

Management provided draft financial statements at the start of the audit, in line with the agreed timetable. The financial statements had been updated for the new requirements as outlined in the SFC's 2020/21 Accounts Direction for colleges.

## Audit Outcomes

We identified eight unadjusted audit differences and two adjusted audit difference arising from the audit which have been reflected within the financial statements. The differences mainly related to the recognition of income in the appropriate financial year and the valuation of fixed assets held on the balance sheet. Our overall audit opinion is summarised on the following page.

Management provided draft financial statements and supporting working papers in line with the agreed timetable.

# Our audit opinion

Element of opinion	Basis of our opinion	Conclusions
<p><b>Financial statements</b></p> <p>The financial statements provide a true and fair view of the state of affairs of the College at 31 July 2021 and of the deficit for the year then ended.</p> <p>The financial statements are prepared in accordance with the financial reporting framework</p>	<p>We report on the outcomes of our audit procedures to respond to our assessed risk of misstatements, including significant risks within this section of our report. We did not identify any areas of material misstatement.</p> <p>We are satisfied that accounting policies are appropriate and estimates are reasonable.</p> <p>We have considered the financial statements against the financial reporting requirements, and additional guidance issued by the SFC and Audit Scotland.</p>	<p>We have issued an unqualified audit opinion on the 2020/21 financial statements for the College.</p>
<p><b>Going concern</b></p> <p>We are required to conclude and report on the appropriateness of the use of the going concern basis of accounting</p>	<p>We conduct core financial statements audit work, including management's assessment of the appropriateness of the going concern basis.</p> <p>Wider scope procedures, including financial forecasts are considered as part of our work on financial sustainability.</p>	<p>Our audit opinion is unqualified in this respect.</p>
<p><b>Other information</b></p> <p>We consider whether the other information in the financial statements is materially inconsistent with other knowledge obtained during the audit</p>	<p>We conduct a range of substantive procedures on the financial statements. Our conclusion draws upon:</p> <ul style="list-style-type: none"> <li>▶ Review of committee minutes and papers, regular discussions with management, our understanding of the College and the sector.</li> </ul>	<p>We are satisfied that the annual report materially meets the core requirements set out in the Accounts Direction.</p>
<p><b>Report on regularity of income and expenditure</b></p> <p>We are required to consider whether in all material respects the income and expenditure in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by Scottish Ministers</p>	<p>Our procedures include:</p> <ul style="list-style-type: none"> <li>▶ Understanding the applicable enactments and guidance issued by the Scottish Ministers</li> <li>▶ Performed detailed testing of income and expenditure testing to ensure transactions are in line with enactments and guidance</li> </ul>	<p>We are satisfied that in all material respects income and expenditure are regular.</p>
<p><b>Matters prescribed by the Auditor General for Scotland</b></p> <p>Audited part of Remuneration Report has been properly prepared.</p> <p>The Performance Report and Annual Governance Statement are consistent with the financial statements and have been properly prepared.</p>	<p>We are required to report on whether the sections of the Remuneration and Staff Report, and Accountability Report have been properly prepared in accordance with the Further and Higher Education (Scotland) Act 1992 and directions made thereunder by the Scottish Funding Council.</p>	<p>We have no matters to report.</p>
<p><b>Matters on which we are required to report by exception</b></p>	<p>We are required to report on whether:</p> <ul style="list-style-type: none"> <li>▶ adequate accounting records have not been kept; or</li> <li>▶ the financial statements and the audited part of the Remuneration and Staff Report are not in agreement with the accounting records; or</li> <li>▶ we have not received all the information and explanations we require for our audit</li> </ul>	<p>We have no matters to report.</p>

# Significant and fraud audit risks

## **Risk of Fraud in expenditure recognition**

As we outlined in our Annual Audit Plan, ISA (UK) 240 requires us to assume that fraud risk from income recognition is a significant risk. In the public sector, we extend our consideration to the risk of material misstatement by manipulation of expenditure.

As outlined in our audit planning report, we rebut the risk of improper recognition of Scottish Funding Council (“SFC”) core grant funding because there is no judgement in respect of this income stream. With regards to expenditure, we rebut the risk of improper recognition of payroll expenditure.

## **Specific procedures relating to significant risks**

We undertake specific, additional procedures over income and expenditure streams where we identified a significant risk, including:

- ▶ Review and test all relevant income and expenditure policies against the relevant accounting standards and SORP;
- ▶ Review, test and challenge management around any accounting estimates on income and expenditure recognition for evidence of bias;
- ▶ Develop a testing strategy to test all material income and expenditure streams;
- ▶ Test all material grant income with performance conditions to ensure income is recognised correctly in line with the outlined requirements;
- ▶ Review and perform focused testing on income and expenditure around the year end to ensure correct recognition around cut-off between financial periods;
- ▶ Perform testing for any evidence of clawback of income where conditions for entitlement have not been met;
- ▶ Review and develop a testing strategy for Covid-19 related income streams, including furlough income and additional Covid-19 related grant income; and
- ▶ Assess and challenge manual adjustments or journal entries by management around the year end for evidence of management bias and evaluation of business rationale and evidence.

## **Our conclusions**

- ▶ Our testing identified a number of misstatements relating to revenue and expenditure recognition, as outlined in Appendix D to this report. These differences were immaterial individually and cumulatively. The impact of the misstatements was varied with some adjustments increasing and some reducing the College’s deficit, and as such we are comfortable there is not indication of fraud in the preparation of the financial statements.
- ▶ We have assessed the treatment of Covid-19 related income streams, including furlough income and additional Covid-19 related grant income. We concur with management’s accounting treatment for the new revenue streams.

### **Risk of management override**

Our Annual Audit Plan recognises that under ISA (UK) 240, management is considered to be in a unique position to perpetrate fraud in financial reporting because of its ability to manipulate accounting records directly or indirectly by overriding controls that otherwise appear to be operating effectively. We respond to this risk on every engagement.

### **Risk of Fraud**

We considered the risk of fraud, enquired with management about their assessment of the risks of fraud and the controls to address those risks. We also updated and developed our understanding of the oversight of those charged with governance over management's processes over fraud.

### **Testing on Journal Entries**

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

We obtained a full list of journals posted to the general ledger during the year, and used our bespoke data analysers to identify potentially unusual journals based on posting patterns, amounts or areas of greater risk of judgement or incentive for management to adjust according to our identified risk areas for the audit. We evaluated the business rationale for any significant unusual transactions. In particular we considered:

- ▶ Journal entries made directly into the general ledger of a material nature to key accounts which are considered more likely to have an incentive to be manipulated;
- ▶ Journals entries made around year end; and
- ▶ Journals adjusting between income and expenditure accounts and capital accounts.

We identified no unusual journals which could not be explained by management or which indicated any additional risk of fraud.

### **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 and we encountered no significant difficulties in the audit.

## Judgements and Estimates

ISA (UK) 540 on accounting estimates was issued in December 2019 and is applicable to the 2020/21 audit for the first time. In particular, risk factors relevant to the public sector included the following examples for consideration by auditors:

- ▶ a very high degree of estimation uncertainty caused by the need to project forecasts far into the future, such as liabilities relating to defined benefit pension schemes (outlined on page 14 of this report); and
- ▶ areas where there may be a lack of available comparators for estimates that are unique to the public sector, such as the valuation of important public assets (such as property, plant and equipment, outlined on page 15 of this report).

Our procedures included:

- ▶ Testing management's process method, key assumptions, data;
- ▶ Testing management's process-estimation uncertainty;
- ▶ Considering evidence from events up to the report date; and
- ▶ Developing our own point estimate of the appropriate valuation.

We reviewed each significant accounting estimate for evidence of management bias as outlined above, including retrospective consideration of management's prior year estimates.

Management disclosed its assessment of the critical accounting judgements and key estimates in the financial statements.

## Accounting Policies

We considered the consistency and application of accounting policies, and the overall presentation of financial information. We consider the accounting policies adopted by the College to be appropriate. There were no significant accounting practices which materially depart from what is acceptable under the Further and Higher Education SORP 2019.

### Our conclusions

- ▶ We did not identify any areas of significant estimation or judgement as part of our audit work where we disagreed with management over the accounting treatment.
- ▶ There were no significant accounting practices which materially depart from what is acceptable under the College's financial reporting framework.

# Other Inherent Risk Areas

Our Annual Audit Plan highlighted additional areas of inherent risk. We identified no further areas of risk as part of our audit procedures. The results of our procedures on inherent risk areas are summarised below.

## Valuation of net pension liabilities

The College participates in two pension schemes: the Local Government Pension Scheme (Highland Council Pension Fund) and the Scottish Teachers Superannuation Scheme (STSS). At 31 July 2021, the College's share of the pension scheme net liability totalled £9.832 million (2019/20: £11.620 million) and the present value of the unfunded obligation in relation to early retirements agreed in previous years was £0.619 million (2019/20: £0.643 million). Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. The information disclosed is based on the FRS 102 report issued to the College by the actuary. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.

Our approach included:

- ▶ obtaining an actuarial report at the year end date for the scheme and considering the reasonableness and consistency of actuarial assumptions underpinning such reports in conjunction with our internal specialists;
- ▶ performing substantive testing on the verification of the pension assets. Specifically, we engage with the auditors of Highland Council Pension Fund in line with the assurance protocols laid out by Audit Scotland for IAS 19 and FRS 102. We also analysed the fund's estimated asset position at 31 July 2021 from both its financial yearend position at 31 March 2021 and the prior year end for the College of 31 July 2020 against expectations based on equity and other market movements in that time period;
- ▶ developing our own point estimate for the College's liabilities in the Fund and comparing to the actuary's assessment;
- ▶ assessing the work of the actuaries in considering the impact of legal rulings impacting the liabilities in the fund; and
- ▶ reviewing the calculation of the College's valuation of future early retirement liabilities at 31 July 2021, including the integrity of the underlying pensioner data used by the actuary and College.

## Our conclusions

- ▶ In calculating the scheme assets as at 31 July 2021 the actuary performs a roll forward technique using investment returns and cash flow data since the last triennial valuation. We have outlined in Appendix D an audit adjustment in relation to valuation of the College's share of the Highland Pension Fund asset position at the College's balance sheet date. This relates to where the Fund's actuaries use estimates for yearend asset valuations, which are subsequently updated for actual investment returns if the difference is material post yearend.
- ▶ We have assessed the reasonableness of the calculation of the College's share of the Fund's liabilities and concluded these are consistent with our expectations.
- ▶ Assumptions used by the actuary and adopted by the College are considered to be generally acceptable. The sensitivities surrounding these assumptions have been correctly disclosed in the notes to the financial statements.

### **Inherent Risk - Valuation of Property, Plant & Equipment**

Given the size of this balance and the number of assumptions that are made in the valuation of the College estate, we assign a higher inherent risk to property, plant and equipment. In 2020 we reported that the Royal Institute of Chartered Surveyors (RICS) issued guidance highlighting that the uncertain impact of Covid-19 on markets may cause valuers to conclude that there is a material uncertainty in the valuation of assets at 31 July 2020. While this guidance was subsequently removed by 31 July 2021, there was a materially increased uncertainty around the valuation of assets in the current environment.

The College obtained a desktop update for the indexation uplift of its estate in the year. Management has also sought to continue its efforts to dispose of its two assets held for sale in the 2021 financial statements, being Wick College and Ross House.

Our approach focused on:

- ▶ analysis of the valuation of the College's estate, including consideration of the source data used in the indexation update process, assessment of the reasonableness of the assumptions and methods used in the valuation, consideration of the appropriateness of the timing of when the specialist carried out the work, and assessment of whether the substance of the specialist's findings are properly reflected in the financial statements;
- ▶ assessment of the potential for impairment across the College estate that has not been reflected in the financial statements or most recent formal valuation;
- ▶ agreement of assets held for sale valuation to third party correspondence; and
- ▶ consideration of the appropriateness of disclosures made by the College in the financial statements in respect to potential valuation uncertainties at 31 July 2021.

#### **Our conclusions**

- ▶ We concluded that there was one material audit difference in the approach and conclusions around management's valuation of the College's estate at 31 July 2021. Management chose to not adjust for this finding, however due to it being an uplift in valuation we are comfortable with their position. See Appendix D for further detail.
- ▶ We have agreed the valuation of Ross House at the yearend as being sufficiently supported by evidence of a potential sale at a higher level than the value the asset is held. We note that since the approval of the draft financial statements the sale has been completed.
- ▶ In prior year we had obtained support for the valuation of Wick College. However, since then the College has had minimal market interest for the property which indicated a viable sale. As such, we have agreed with management to impair the asset down to nil. See Appendix D for further detail.
- ▶ We concluded that all material uncertainties in respect of the valuation of assets were appropriately disclosed in the financial statements.

# Going concern

In accordance with the FRM, 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. However, International Auditing Standard 570 Going Concern, as applied by Practice Note 10: *Audit of financial statements of public sector bodies in the United Kingdom*, still require 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.

The rationale for going concern remains the same, but we continue to place increased focus on management's assertion of going concern and disclosures relating to financial sustainability as a result of the uncertainty and unprecedented budget pressures caused by Covid-19.

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 2020/21 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 going concern assessment and associated disclosures cover the period to 31 July 2023 with the cashflow forecast based on the financial forecast return submitted to the Scottish Funding Council in October 2021.

After completing its going concern assessment in line with the information and support provided through the earlier discussions in the audit process, the College has concluded that there are no material uncertainties around its going concern status. We have outlined our consideration of the College's financial position going forward in the financial sustainability section of this report. We considered this in conjunction with management's assessment on going concern, focusing on:

- ▶ the completeness of factors considered in management's going concern assessment;
- ▶ the integrity and robustness of the underlying cash flow forecasts supporting future financial projections, in particular if the College projects to require financial support during the going concern assessment period; and
- ▶ the completeness of disclosures in the financial statements in relation to going concern and future financial performance in line with the requirements of the SFC 2020/21 Accounts Direction.

## Our conclusions

- ▶ We were satisfied that the College remains a going concern and has made appropriate required disclosures in the financial statements.





## Wider Scope dimensions

### **Introduction**

Under Audit Scotland's Code of Audit Practice (May 2016), we are required to reach conclusions in relation to the effectiveness and appropriateness of the College's arrangements for each of the wider scope audit dimensions. We apply our professional judgement to risk assess and focus our work on each of the dimensions.

### **The Wider Scope dimensions**

#### **Financial Management:**

- ▶ Considers the effectiveness of financial management arrangements, including whether there is sufficient financial capacity and resources, sound budgetary processes and whether the control environment and internal controls are operating effectively. This dimension of wider scope work is not usually applicable to smaller bodies, however due to the increased risk around financial management at the College in the circumstances this year we have made the judgement to consider as part of our audit process.

#### **Financial Sustainability:**

- ▶ Considers the medium and longer term outlook to determine if planning is effective to support service delivery. This will focus on the arrangements to develop viable and sustainable financial plans.

#### **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.

We outlined in our Annual Audit Plan, presented to the Audit Committee in May 2021, how our consideration and audit work in respect of the wider scope dimensions would be impacted by Covid-19 this year. Our areas of audit focus in these areas have therefore been undertaken through the lens of Covid-19.

# Financial Sustainability

The financial environment in which the College operates was already challenging, and the Covid-19 pandemic has resulted in further, significant financial pressures, and creates a risk that the College will not be able to develop viable and sustainable financial plans due to external factors. While additional funding was awarded during 2020/21 which helped ease immediate pressures, the future outlook remains unclear.

The College submitted a financial forecast return in October 2021 to the Scottish Funding Council which outlines a cumulative underlying operating deficit position over the three years including a forecast deficit of £0.216 million for 2021/22. This demonstrates the tight financial operating position that the College faces in an ever-changing external environment.

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## The context for financial sustainability in the College sector

In June 2020, Scottish Ministers asked the Scottish Funding Council (SFC) to review how they could best fulfil their mission of securing coherent, good quality, sustainable tertiary education and research in these changing times. This review has been conducted over three phases with the final phase published in June 2021.

In October 2021, the Scottish Government published their response to the review's recommendations, with the recommendations being broadly accepted. The Scottish Government recognises that some recommendations will require further development for consultation. In some instances, the pace, scale and timing of implementation will be determined by wider spending and resource considerations. Of particular note in respect of financial sustainability is that the Cabinet Secretary for Finance and the Economy has confirmed her plans to publish a multi-year resource spending review framework for public consultation alongside Budget 2022-23 and the Medium Term Financial Strategy.

As part of the phase 3 publication, the SFC published their updated review of '*Coherence and Sustainability: Financial Sustainability of Colleges and Universities*'. The report presented an aggregate review of the financial health of Scottish institutions based on 2019-20 published financial statements and the latest forecasts for 2020-21.

Improvement in the sector's underlying operating position was achieved in 2019-20 with a small surplus achieved which was significantly improved from the original deficit forecast. A similar position is currently forecast for 2020-21 with the impact of Covid-19 not considered to be as severe as anticipated. Non-recurring funding was made available which has helped stabilise the sector's finances, however challenges remain in future years.

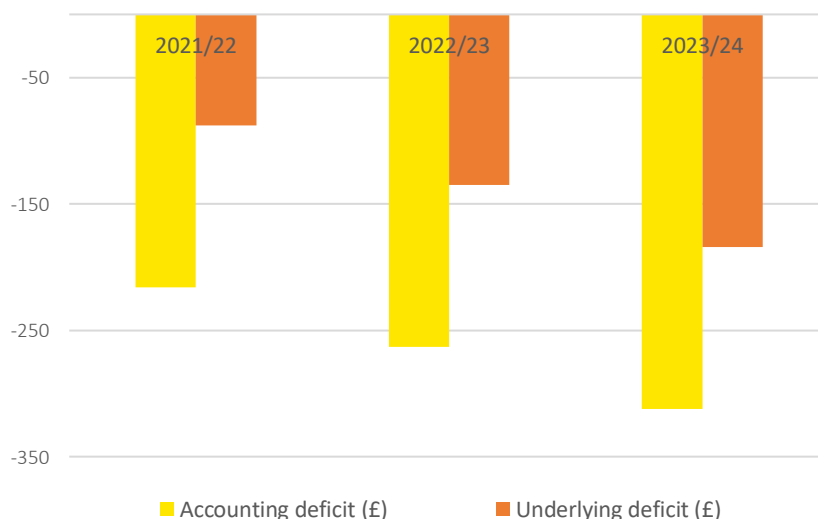
The SFC has recognised a number of key risk areas that could adversely impact colleges' financial performance and sustainability including:

- ▶ Maintaining short-term liquidity;
- ▶ Continued impact of the Covid-19 pandemic and the potential consequential failure to achieve income targets;
- ▶ Impact of cost efficiencies on both quality of student experience and on the health and wellbeing of college staff;
- ▶ Future arrangements for funding Foundation Apprenticeships;
- ▶ Additional staff costs arising from both cost of living pay awards, the outcome of the national bargaining job evaluation exercise for support staff and increases employer pension contributions; and
- ▶ Challenges of diversifying income and generating additional surplus.

#### Medium term financial forecasting

The College has prepared a three-year financial forecast for the period 2021 to 2024 and submitted these to the SFC in the form of the template Financial Forecast Return ('FFR'). The forecast is based on assumptions provided by the SFC in addition to College specific assumptions for areas such as other income and staff numbers. The assumptions have been discussed with the Principal and Chair of Finance Committee and will be subject to scrutiny by the College's Finance, Commercial and Estates Committee. As Exhibit 1 demonstrates, this analysis forecasts a small underlying operating deficit for the three years of the plan.

**Exhibit 1: The College's FFR highlights that the College is forecasting an underlying deficit for the 3-year period to 2023/24. An accounting deficit is also forecast for the same period.**



Source: North Highland College Financial Forecast Return, October 2021

The College's forecasts recognise significant uncertainty in the current environment. The main risks associated with the forecast income and expenditure in the financial forecast return are:

- ▶ The effect of Covid 19 on job vacancies in the Highlands and declining school demographics in the next few years mean Credit targets may be a challenge.
- ▶ Sustaining non-SFC income in a Covid 19 or semi-Covid 19 environment.
- ▶ The age and condition of some of the College estate is a concern. The College invested more monies into estate maintenance in 2020/21. However sustaining this longer term with current funding is a challenge.
- ▶ The Board has agreed in principle to progress towards a merger with Lews Castle College and West Highland College. We have considered this on page 26.

*See recommendation 1 in Appendix E for further detail.*

#### **Going concern cash flow forecasting**

We have outlined our work in respect of going concern on page 16 of this report. While the College has prepared its financial statements on a going concern basis as required by the FReM for a public body, it is required to consider its ability to meet liabilities as they fall due over the going concern assessment period to July 2023 being the next year end date which is greater than 12 months from the approval date for the financial statements.

As part of its financial forecasting arrangements the College has forecast its cash flow during this period, including testing a number of sensitivities which may be impacted by the current uncertainty around the 2021/22 and 2022/23 academic years as a result of Covid-19. As part of the FFR submission, the College has projected cashflows to 31 July 2023 with a closing balance of £0.561 million.

The College's cash flow forecasts demonstrates it has headroom of £270k at the lowest point in its going concern assessment period. It has considered the impact of the following stresses on cash flow during the period:

1. A shortfall of 10 students in 2021-22, and on target for 2022-23.
2. Assumes no clawback of FE funding in 2021-22.
3. Projecting a 500 credit shortfall, noted as a sector wide issue.

On this basis, management has concluded that there is no plausible scenario where the College will require financial support to meet its liabilities during the going concern assessment period.

*See recommendation 6 in Appendix E for further detail.*

# Financial Management

The College reported an adjusted operating surplus of £0.614 million, representing an increase of £0.569 million compared to 2019/20. We were satisfied that the College's financial monitoring and reporting was clear and consistent throughout the year.

The College has an established budget setting and monitoring framework which includes presentation of financial updates to the Board and Finance and Audit committees throughout the year. We are satisfied that the core financial management arrangements were not materially impacted as a result of Covid-19 and the subsequent lockdowns with clear financial reporting continuing throughout the year.

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## Financial performance and monitoring

The College reported a deficit of £0.652 million for the year (2019/20: £0.957 million). Following an actuarial gain of £2.92 million and a revaluation gain of £0.05 million, the College reported total comprehensive income of £2.318 million (2019/20: £5.017 million expenditure). The College had an operating surplus after removal of non-cash accounting adjustments (relating to pension and capital accounting) of £0.614 million (2019/20: £0.045 million).

2020/21 was the first full financial year that the College had fully operated in the context of Covid-19 and the financial performance in 2020/21 was significantly impacted by this. Despite the challenges that this brought, the College was able to improve their operating deficit largely due to additional SFC funding of £0.230 million.

In line with previous years, the College's financial performance was monitored throughout the year by management and the Finance and Audit committees. This process was not impacted by Covid-19, and there is evidence of financial monitoring, reporting and planning by the Board and Finance and Audit committees through the financial year, up to the approval of the 2021/22 budget.

Throughout 2020/21 management reported budget pressures and variances through its management accounting. These were significant in the year, however we are satisfied these related to the impact of Covid-19 on College operations and additional funding awarded late in the financial year.

### **Impact of Covid-19 on systems of internal control**

Within the Annual Governance Statement, the College has concluded that they have obtained assurance that the system of internal control was operating effectively during the year with no exceptions or issues identified. Through our audit of the financial statements, we consider the design and implementation of key controls related to areas of significant risk to the financial statements. This work has included documenting the key internal financial controls and performing walkthroughs to ensure controls are implemented as designed.

We undertook an initial assessment of the financial control environment as part of our planning work in May 2021, and updated our understanding as part of the yearend audit. Our work has not identified any significant weaknesses in the College's systems of internal control. In particular, we have not identified any significant changes to the design and implementation of controls as a result of the impact of Covid-19 on working arrangements.

### **Joint finance working arrangements and management capacity**

During the prior year management made us aware of new joint working arrangement in place with Inverness College, in particular the shared responsibility for the Director of Finance role across both colleges. We discussed the potential impact this may have on management's capacity at the College. We noted that some mitigating actions had been put in place to reduce pressure on the Director of Finance in other areas of responsibility, and that the decision had been subject to clear governance review arrangements.

We have not noted any material change in the capacity or capability of management to perform their function through the audit process this year. It is important that, particularly in the context of the additional pressures placed on management during the ongoing Covid-19 period, this arrangement is subject to ongoing review to ensure it does not impact the College's financial management arrangements.

*See recommendation 5 in Appendix E for further detail.*

### **National Fraud Initiative (NFI)**

NFI is a counter-fraud exercise co-ordinated by Audit Scotland and overseen by the Cabinet Office to identify fraud and error. The NFI exercise produces data matches by comparing a range of information held on public bodies' systems to identify potential fraud or error.

The College received matches for investigation in January 2021 and results of the investigation will be recorded on the NFI system. We noted progress continued to be made by the College and that we had no matters to report.

*See recommendation 4 in Appendix E for further detail.*

# Governance and Transparency

The key features of good governance have remained in place at the College and have been operating effectively throughout the Covid-19 lockdowns. The College responded quickly to ensure that governance arrangements were appropriate and operating effectively. The College intends to implement a hybrid meeting structure moving forward, after seeking the views of members.

We have noted in Appendix E progress has been made against our audit recommendation with some remaining ongoing.

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## Annual Governance Statement

The College has demonstrated through the year that it has the key requirements for good governance. The key aspects of governance arrangements in the year are required to be disclosed in the College's Annual Governance Statement within the financial statements. We reviewed the governance statement within the financial statements against the requirements outlined in the SFC's 2020/21 Accounts Direction and our understanding of governance arrangements in place up to 31 July 2021.

This includes the requirements to conclude on the College's compliance with the 2016 Code of Good Governance for Scotland's Colleges, or to explain any areas of non-compliance. Our consideration of the governance statement has included:

- ▶ Ensuring that the College has met all requirements of the SFC's 2020/21 Accounts Direction;
- ▶ Ensuring that the content of the statement is consistent with our understanding of the College's governance arrangements and any issues identified during the year; and
- ▶ Ensuring that the College has performed a self-assessment of compliance with the Code of Good Governance for Scotland's Colleges and that this assessment is reflected in the statement.

*See recommendation 2 in Appendix E for further detail.*

We reviewed the Annual Governance Statement against the required guidance and we were satisfied that it was consistent with both the governance framework, key findings from relevant audit activity and management's assessment of its own compliance with the Code of Good Governance for Scotland's Colleges.

The governance statement included an appropriate level of detail on how governance arrangements were maintained during the revised operating period, as a result of Covid-19.

### **Covid-19 Governance Arrangements**

Like all other public bodies in Scotland, the College moved to revised governance arrangements at the beginning of the UK lockdown period. Since March 2020, all Board and committee meetings have continued as scheduled via remote working arrangements, and all relevant business continued to be considered as required.

As restrictions started to ease, in May 2021, the College conducted a survey of Board Members to determine how meetings should continue to operate. Based on the results, the College intends to operate a hybrid model with committee meetings likely to remain remote but Board, Strategy and Development meetings being in person.

### **Enquiries of those charged with governance**

In line with previous years, we formally wrote to the Chair of the Audit 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.

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 2020/21, the internal auditor's opinion notes that, 'In our opinion North Highland 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.'



### **External effectiveness review**

All colleges are required to undertake an external effectiveness review (EER) at least every 3 years, in accordance with the Code of Good Governance for Scotland's Colleges. The College's external effectiveness review took place throughout March and April 2021 with a number of positive aspects identified. An action plan was drawn up which Senior Management continue to work towards implementing. Key aspects to note are:

- Following approval of the new Strategic Plan in October 2020 and the formulation of new KPIs, achievement of KPIs will be a regular item on the agenda of each Board meeting. In line with the new strategic plan re-engage with key stakeholders and resurrect invites to board meetings.
- An Annual workplan for the board and committees should be introduced which would allow members to understand and prepare for the annual cycle of business. Progress against the workplan should be reviewed mid-year and this review should be included as part of the workplan.
- Board and Committee papers would benefit from a more strategic focus and standard format with a clearer structure.
- During the period of virtual meetings consider taking written questions from members, via the board secretary, in advance of the meeting to allow college staff to prepare answers.
- Two new student members are required and should be fully inducted alongside the new board members.
- It has been agreed that the student report should be moved up the board agenda to be the first report that the board considers.
- The 2021 board self-evaluation should be undertaken in the latter part of the year.

*See recommendation 3 in Appendix E for further detail.*

### **EU withdrawal**

There continues to be a significant interest in public bodies' response to risks arising and the impact from EU withdrawal. Management has continued to consider and monitor the arrangements and risks around the UK's departure from the EU. The College is aware that there continues to be a potential for disruption to operations and costs arising from Brexit and continues to review any new information and guidance provided by bodies such as Scottish Government and the SFC as it is published. Management is confident at this stage that the College is mitigated from the immediate direct impacts of EU withdrawal on its operations and funding.

### **UHI Cyber Incident**

The UHI partnership suffered a Cyber Incident in March 2021. Many other colleges and universities in the UK were also affected during the past 24 months, and this had a serious effect, with many of the main IT systems being temporarily unavailable. Whilst main services were restored as efficiently as possible, staff had to move to cloud storage, as opposed to maintaining files on network drives, and this caused major disruption to the College for the remainder of the academic year.

Overall, we have seen a minor impact on the financial statement audit. We noted that due to the use of the cloud storage this has caused delays in staff's accessibility to information and some information was lost in the transfer. Where evidence had been missing other sources of support were provided enabling us to conclude on our testing. We note that continues to add pressure to the College finance team.

### **Merger with West Highland College and Lews Castle College**

During the audit process we became aware of a potential merger between North Highland, West Highland and Lews Castle colleges expected to vest in January 2023. The Principals of each of the colleges have identified similarities between the colleges which could create efficiencies if they were to operate under one institutions.

A project board has been set up with representatives from all colleges and the Scottish Funding Council. This board meet monthly and are in the current progress of submitting a proposal for financial backing for the project. They are looking to progress eight work streams starting in November 2021 which will look at the overall governance of the new institution and the harmonisation of terms & conditions for staff. A full consultation will be undertaken with external stakeholders.

We note that there will be no changes expected at present to the overall services provided by the individual colleges and that the intention is that all courses will be absorbed by the new institutions. As such, we are comfortable that this does impact on the College's ability to continue as a going concern to July 2023.



## Appendices

A - Code of Audit Practice: responsibilities

B - Independence and audit quality

C - Required communications with the audit and risk committee

D - Adjusted and unadjusted errors identified during the audit

E - Prior Year Action Plan

F - Timing and deliverables of the audit

# Appendix A: Code of Audit Practice Responsibilities

## Audited Body's Responsibilities

### Corporate Governance

Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including audit, risk and governance committees or equivalent) in monitoring these arrangements.

### Financial Statements and related reports

Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:

- ▶ preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation.
- ▶ maintaining accounting records and working papers that have been prepared to an acceptable professional standard and support their financial statements and related reports disclosures.
- ▶ ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority.
- ▶ maintaining proper accounting records.
- ▶ preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body.
- ▶ Management, with the oversight of those charged with governance, should communicate clearly and concisely relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework.

Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.

### Standards of conduct / prevention and detection of fraud and error

Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

### Standards of conduct / prevention and detection of fraud and error

Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- ▶ such financial monitoring and reporting arrangements as may be specified
- ▶ compliance with any statutory financial requirements and achievement of financial targets
- ▶ balances and reserves, including strategies about levels and their future use
- ▶ how they plan to deal with uncertainty in the medium and longer term
- ▶ the impact of planned future policies and foreseeable developments on their financial position.

### Best Value

The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.

# Appendix B: Independence and audit quality

Professional ethical standards, and the Terms of our Appointment, require us to communicate all significant facts and matters that have a bearing on EY's objectivity and independence as auditor of the College.

## Matters that we are required to communicate

The FRC Ethical Standard requires that we provide details of all relationships between Ernst & Young (EY), its directors and senior management and affiliates, and you, including all services provided by us and our network to you, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our integrity or objectivity, including those that could compromise independence and the related safeguards that are in place and why they address the threats.

There are no relationships from 1 August 2019 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.

## Confirmations

We are not aware of any inconsistencies between the College's policy for the supply of non audit services and FRC Ethical Standard. We are not aware of any apparent breach of that policy.

We confirm that, in our professional judgment, Ernst & Young is independent, our integrity and objectivity is not compromised and we have complied with the FRC Ethical Standard.

We confirm that your engagement team (partners, senior managers and managers and all others involved with the audit) and others within the firm, the firm and network firms have complied with relevant ethical requirements regarding independence.

## Audit Fees

	2020/21	2019/20
<b>Component of fee:</b>		
Auditor remuneration - expected fee	£15,600	£15,150
Additional audit procedures (see below)	£8,400	£8,900
Audit Scotland fixed charges:		
Pooled costs	£1,010	£870
Contribution to Audit Scotland costs	£660	£830
<b>Total fee</b>	<b>£25,670</b>	<b>£25,750</b>

The expected fee for each body is set centrally by Audit Scotland, and assumes that it 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. It also assumes there is no major change in respect of the scope of work in the year and an unqualified audit opinion resulting from the audit.

The fee variation of £8,400 reflects our additional work which was required around the College's financial sustainability risk, the additional work from inclusion of the financial management wider scope dimension, the follow up work required from a number of outstanding areas of focus in prior years, and the requirement to reduce materiality on our audit testing.

Matters that we are required to communicate

International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

The EY 2021 UK Transparency Report can be accessed on our website at [https://www.ey.com/en\\_uk/who-we-are/transparency-report-2021](https://www.ey.com/en_uk/who-we-are/transparency-report-2021). This material is published to provide a timely and relevant source of information about EY in general, and our audit business in particular. This includes our inaugural Audit Quality Report.

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 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: <https://www.audit-scotland.gov.uk/report/quality-of-public-audit-in-scotland-annual-report-202021>

# Appendix C: Required communications

Required communication	Our reporting to you
<p><b>Terms of engagement / Our responsibilities</b></p> <p>Confirmation by the audit, risk and governance 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><b>Planning and audit approach</b></p> <p>Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.</p> <p>When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.</p>	<p>Annual Audit Plan</p>
<p><b>Significant findings from the audit</b></p> <ul style="list-style-type: none"> <li>▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures</li> <li>▶ Significant difficulties, if any, encountered during the audit</li> <li>▶ Significant matters, if any, arising from the audit that were discussed with management</li> <li>▶ Written representations that we are seeking</li> <li>▶ Expected modifications to the audit report</li> <li>▶ Other matters if any, significant to the oversight of the financial reporting process</li> </ul>	<p>Annual Audit Plan</p> <p>Annual Audit Report</p>
<p><b>Going concern</b></p> <p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> <li>▶ Whether the events or conditions constitute a material uncertainty</li> <li>▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements</li> <li>▶ The adequacy of related disclosures in the financial statements</li> </ul>	<p>Annual Audit Report</p>
<p><b>Misstatements</b></p> <ul style="list-style-type: none"> <li>▶ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation</li> <li>▶ The effect of uncorrected misstatements related to prior periods</li> <li>▶ A request that any uncorrected misstatement be corrected</li> <li>▶ Corrected misstatements that are significant</li> <li>▶ Material misstatements corrected by management</li> </ul>	<p>Annual Audit Report</p>
<p><b>Fraud</b></p> <ul style="list-style-type: none"> <li>▶ Enquiries of the audit, risk and governance committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity</li> <li>▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist</li> <li>▶ A discussion of any other matters related to fraud</li> </ul>	<p>Annual Audit Report</p>

Required communication	Our reporting to you
<p><b>Consideration of laws and regulations</b></p> <ul style="list-style-type: none"> <li>▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off</li> <li>▶ Enquiry of the audit 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 Committee may be aware of</li> </ul>	<p>Annual Audit Report (to be issued on completion of audit work) or as occurring if material.</p>
<p><b>Related parties</b></p> <p>Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</p> <ul style="list-style-type: none"> <li>▶ Non-disclosure by management</li> <li>▶ Inappropriate authorisation and approval of transactions</li> <li>▶ Disagreement over disclosures</li> <li>▶ Non-compliance with laws and regulations</li> <li>▶ Difficulty in identifying the party that ultimately controls the entity</li> </ul>	<p>No significant matters have been identified.</p>
<p><b>Independence</b></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"> <li>▶ The principal threats</li> <li>▶ Safeguards adopted and their effectiveness</li> <li>▶ An overall assessment of threats and safeguards</li> <li>▶ Information about the general policies and process within the firm to maintain objectivity and independence</li> </ul>	<p>Annual Audit Plan</p> <p>Annual Audit Report - Appendix B</p>
<p><b>Internal controls</b></p> <p>Significant deficiencies in internal controls identified during the audit</p>	<p>Annual Audit Report - no significant deficiencies reported</p>
<p><b>Subsequent events</b></p> <p>Where appropriate, asking the audit, risk and governance committee whether any subsequent events have occurred that might affect the financial statements.</p>	<p>We have asked management and those charged with governance. We have no matters to report.</p>
<p><b>Material inconsistencies</b></p> <p>Material inconsistencies or misstatements of fact identified in other information which management has refused to revise</p>	<p>Annual Audit Report</p>



# Appendix D: Errors identified during the audit - Adjusted

This Appendix sets out the significant adjustments processed in the financial statements finalisation.

Adjusted differences				
No.	Description	Income and Expenditure Impact	Other Comprehensive Income and Expenditure Impact	Balance Sheet Impact
1	<i>Impairment of Wick College</i>		DR Revaluation gains/losses £100,000	CR Fixed Asset (£100,000)
2	<i>Adjustment relating to pension scheme asset valuation at 31 July 2021</i>		Cr Actuarial Gain/(Loss) in respect of Pension Scheme (£136,000)	Dr Pension Assets £136,000

# Appendix D: Errors identified during the audit - Unadjusted

This Appendix sets out the significant unadjusted audit differences identified during the audit.

Unadjusted differences				
No.	Description	Income and Expenditure Impact	Other Comprehensive Income and Expenditure Impact	Balance Sheet Impact
1	<i>Revaluation indexation</i>		CR Revaluation gains/losses (£365,813)	DR Fixed Asset £365,813
2	<i>Under Accrual of Brydon Cent PHD Income</i>	CR Income (£10,798)		DR Accrued Income £10,798
3	<i>Overstatement of Arena Monies Income</i>	CR Income (£6,968)		DR Deferred Income £6,968
4	<i>Overstatement of Income due to Double Counting of Sinclair</i>	CR Income (£8,762)		DR Deferred Income £8,762
5	<i>Overstatement ALF Income</i>	DR Income £61,051		CR Deferred Income (£61,05)
6	<i>Understatement of Annual Leave Accrual</i>	DR Income £15,000		CR Deferred Income (£15,000)
7	<i>Reclassification of SITs Control A/C</i>			DR Debtors £36,550 CR Deferred Income (£36,550)
8	<i>Write off of debit balances on the creditors ledger</i>	DR Expenditure £14,418		CR Creditors (£14,418)

# Appendix E: Action Plan, including an update on prior year recommendations

This action plan summarises specific recommendations included within the 2020 North Highland College Annual Audit Report and the latest status in respect of management's agreed actions.

## 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 recommendation	Management response	Management response / Implementation timeframe
1	<p>The College should continue to regularly monitor its forecast position, including delivery of its required savings, and its cash position and future forecast.</p> <p>The impact that staff cost reductions and other savings are having on operational and strategic delivery should be subject to ongoing review in conjunction with UHI, as RSB, and SFC.</p> <p style="text-align: right;"><i>Grade 1</i></p>	<p>Response: Monthly budget has been undertaken throughout the year and Executive Group have been updated. Within the funding parameters the college has, especially poor rurality, sustaining the college financially continues to be a challenge. The College is currently exploring the option of a merger with other colleges.</p> <p>Responsible officer: Principal/Director of Finance &amp; Corporate Services</p> <p>Implementation date: ongoing throughout 2021/22.</p>	<p><b>Action ongoing.</b></p> <p>We have outlined our consideration around the College's future financial position and planning in respect of this in more detail in the financial sustainability section of our wider scope reporting. This will continue to be an area of focus for the College going forward.</p> <p style="text-align: right;"><i>Grade 1</i></p>
2	<p>We continue to recommend that the College should undertake an exercise to fully update its assessment of compliance with the Code of Good Governance for Scotland's Colleges, drawing on best practice and support from UHI and partner colleges.</p> <p style="text-align: right;"><i>Grade 2</i></p>	<p>Response: A paragraph by paragraph assessment was carried out by the Board Secretary with input from the Principal and Director of Learning &amp; Teaching.</p> <p>Responsible officer: Board Secretary</p> <p>Implementation date: Completed</p>	<p><b>Action complete.</b></p> <p>Full assessment undertaken during 2020/21.</p>
3	<p>The College should seek to finalise its implementation of recommendations around its previous assessment of Board effectiveness as soon as possible.</p> <p style="text-align: right;"><i>Grade 1</i></p>	<p>Response: A full review was undertaken by On Board Training And Consultancy Ltd in 2021. Management have continued to work on the implementation of the review and recommendation. They note it is an ongoing process with regular review required.</p> <p>Responsible officer: Principal/Board Secretary</p> <p>Implementation date: ongoing throughout 2021/22 for 2021 review, completed for 2017.</p>	<p><b>Action is ongoing for 2021 external review.</b></p> <p>We note that a subsequent review has been undertaken in May 2021 and as such a new action plan is in place which contains follow up from items in the 2017 action plan.</p> <p>We have outlined our consideration against the 2021 review within this report on page 25.</p> <p style="text-align: right;"><i>Grade 2</i></p>

No.	Findings and recommendation	Management response	Management response / Implementation timeframe
4	<p>The College should ensure it takes steps to participate in full in future NFI exercises, and ensures it considers the outputs and recommendations from this year's exercise to improve its own internal control arrangements.</p> <p style="text-align: right;"><i>Grade 2</i></p>	<p>Response: All matches from the latest exercise have been investigated and closed with no further action necessary. Finance Staff will be updating the conflict of interest register later this year.</p> <p>Responsible officer: Director of Finance &amp; Corporate Services.</p> <p>Implementation date: Ongoing throughout 2021/22.</p>	<p><b>Action ongoing.</b></p> <p>The action in respect to full participation in the most recent NFI exercise is closed. However, we note that the findings in respect to the conflict of interest register are still outstanding.</p> <p style="text-align: right;"><i>Grade 2</i></p>
5	<p>It is important that, particularly in the context of the additional pressures placed on management during this Covid-19 period, the arrangement for Shared Services with Inverness is subject to ongoing review to ensure it does not impact the College's financial management arrangements.</p> <p style="text-align: right;"><i>Grade 2</i></p>	<p>Response: Efforts are being made to progress the Finance Team restructure. This has been slower than anticipated as a result of pressures throughout the financial year (including the cyber incident and ongoing pandemic).</p> <p>Responsible officer: Chair/Principal/Director of Finance and Corporates Services</p> <p>Implementation timeframe: Completed.</p>	<p><b>Action complete.</b></p> <p>We have no further matters to raise. We will continue to monitor these arrangements in place through financial management work during 2021/22 as part of our standard audit procedures and will report in case of any further issues are identified.</p>
6	<p>Management should ensure that its cash flow position and forecast for at least the next 12 months is subject to rigorous review on a routine basis.</p> <p>Any uncertainty around the College being able to support itself should be reported to the Regional Strategic Board and Scottish Funding Council to discuss support options.</p> <p style="text-align: right;"><i>Grade 2</i></p>	<p>Response: On-going revenue monitoring is well established as part of the College's financial management and the Finance Committee is regularly updated. On-going monitoring of cash is undertaken in the finance department, and monthly cash flow projections sent to SFC.</p> <p>Responsible officer: Director of Finance and Corporate Services</p> <p>Implementation timeframe: Completed.</p>	<p><b>Action complete.</b></p> <p>Given the forecasted deficit highlighted in the most recent financial forecast return it is essential management continue to monitor the cash flow position going forward. We are satisfied with the process established at the College and have no further matters to raise.</p>
7	<p>In our prior year report we noted that management did not initially prepare a formal SORP impact assessment as part of the 2019/20 financial statements preparation process. Management advised that they did complete a review, though this was not initially documented.</p> <p style="text-align: right;"><i>Grade 3</i></p>	<p>Monitoring and implementing changes to accounting frameworks and related SORPs, Directions and other statutory guidance is a key requirement of good financial management.</p> <p>Management should ensure these matters are addressed more formally going forward.</p> <p>Implementation timeframe: completed.</p>	<p><b>Action complete.</b></p> <p>There were no significant updates to the underlying accounting or disclosure frameworks in 2020/21. We have reported on management's preparation of the financial statements through this report as appropriate and have no matters to raise.</p>

# Appendix F: Timing and deliverables of the audit

We deliver our audit in accordance with the timeline set by the College, in accordance with guidance from Audit Scotland. Below is a timetable showing the key stages of the audit and the deliverables through the 2020/21 audit cycle.

	Audit Activity	Deliverable	Timing
APR	▶ Audit planning and setting scope and strategy for the 2020/21 audit	Annual Audit Plan	May 2021
MAY	▶ Walkthrough Visit	Completion of internal documentation	June 2021
JUN			
SEP			
OCT	▶ Year-end substantive audit fieldwork on unaudited financial statements	Audited Financial Statements	October 2021
NOV			
DEC	▶ Conclude on results of audit procedures	Issue Annual Audit Report	December 2021 - February 2022
JAN	▶ Issue opinion on the College's financial statements	Submit Audit Scotland minimum dataset request	December 2021 - February 2022

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