

AUDIT REVIEW

Governance and financial management at Moray College



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A report to the Scottish Parliament by the Auditor General for Scotland

Auditor General for Scotland

The Auditor General for Scotland is the Parliament's watchdog for ensuring propriety and value for money in the spending of public funds.

He is responsible for investigating whether public spending bodies achieve the best possible value for money and adhere to the highest standards of financial management.

He is independent and not subject to the control of any member of the Scottish Executive or the Parliament.

The Auditor General is responsible for securing the audit of the Scottish Executive and most other public sector bodies except local authorities and fire and police boards.

The following bodies fall within the remit of the Auditor General

- departments of the Scottish Executive eg the Health Department
- executive agencies eg the Prison Service, Historic Scotland
- NHS boards and trusts
- further education colleges
- water authorities
- NDPBs and others eg Scottish Enterprise.

Audit Scotland

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Accounts Commission and the Auditor General for Scotland. Together they ensure that the Scottish Executive and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

Executive summary and conclusions

1. In February 2001 the chief executive and accountable officer of the Scottish Further Education Funding Council (SFEFC) reported to the council on a number of issues of serious concern relating to governance and financial management at Moray College. The college's financial position had been deteriorating over a number of years. Although it worsened significantly during the 2000/01 financial year the college had not produced a robust financial recovery plan. The college also needed substantial improvement in its governance arrangements to comply with the good practice SFEFC had set for colleges in its Financial Memorandum and Code of Audit Practice. Many of these weaknesses in governance and financial management had been evident since allegations of misconduct at the college were investigated by the Scottish Office with the assistance of the National Audit Office in 1999. That investigation formed the basis of a report by the chief executive and accountable officer of SFEFC in 2000.
2. The concerns highlighted to the SFEFC Council indicated that there were significant weaknesses in governance and financial management within the college. One purpose of my report is to record these weaknesses and the action which has been taken or is planned to overcome them. Secondly, my report raises issues for the college, for SFEFC and for governance and accountability in the FE sector as a whole. These issues arise because progress to resolve the weaknesses at the college has been too slow although SFEFC was diligent in pursuing matters within its existing powers.

Background

3. Moray College is one of the 43 incorporated further education colleges in Scotland, which between them received some £365 million of grant in aid from the Scottish Further Education Funding Council in 2000-01. Colleges are independent corporate bodies governed by boards of management who are required to provide suitable and efficient further education to students. In July 1999 SFEFC assumed responsibility for securing the adequate and efficient provision of further education, primarily through the distribution of grant in aid funds to colleges in accordance with Ministerial policy guidance and by promoting the value for money delivered by the sector.
4. Scottish Ministers have a duty to secure adequate and efficient provision of further education in Scotland. They may establish, merge or close colleges and, in exceptional circumstances, they may remove and replace members of college boards of management. Normally, new board members are appointed by existing board members, with specific nominations reserved for college staff and the student body. Certain of the Ministers' duties are delegated to SFEFC, including the power to do all that is necessary or expedient to exercise the duty to secure adequate and efficient provision of further education.

5. College boards of management are corporate bodies with a duty of managing and conducting the college and of ensuring that the college provides suitable and efficient further education to its students. The boards set policy and strategic direction for the college and designate an accountable officer, normally the college principal, who is responsible for the stewardship of college funds and other resources.

Governance

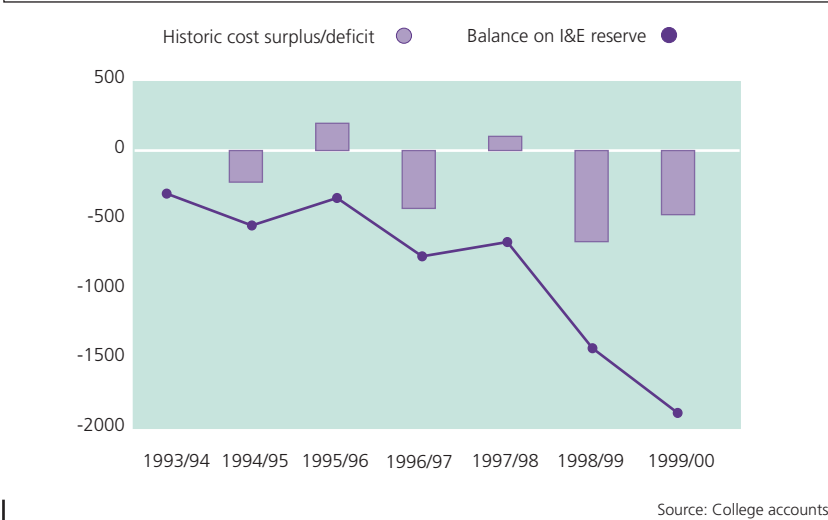
6. In May 1998 the Scottish Office Minister of State for Education received anonymous correspondence containing allegations about misconduct at Moray College. The allegations were also sent to the National Audit Office (NAO) in Scotland. An initial investigation by the Department and the NAO into the allegations, undertaken in August and September 1998, concluded that further investigation into aspects of the allegations was warranted. A further series of visits was therefore made to the college to examine documentary evidence and undertake confidential interviews with relevant staff and board members of the college to ascertain the facts.
7. On 1 July 1999 responsibility for the investigation transferred from SOEID to SFEFC. During July and August 1999 Professor Sizer, the SFEFC Chief Executive, drew together the results of the investigation and over a six week period in September and October 1999 gave the college board and Dr Chalmers, the college principal, the opportunity to comment on its factual accuracy and the balance of its conclusions. While the college accepted many of the findings, the principal disagreed with the results and conclusions reached. Professor Sizer took account of the views expressed in producing a final report which was presented to the SFEFC Council in February 2000.
8. The final report highlighted significant weaknesses in the performance of the college principal in his capacity as accounting officer and made 24 recommendations for improvement (Appendix 3). These included action by the college to recover sums paid to Dr Chalmers for retrospective mileage allowances and sums he received concerning his involvement in the University of the Highlands and Islands (UHI) project, to review the contractual relationship between the college and a company owned by a member of the college board, and to improve financial control and governance arrangements within the college.
9. Decisions on the case for disciplinary action against any member of staff employed by a college rest with the college board of management. In December 1999 the board of management of Moray College decided that Dr Chalmers should be suspended from his duties as Principal and Accounting Officer with effect from 6 January 2000 with a view to taking disciplinary action against him. On 10 January 2000 Dr Chalmers provided the college with a medical certificate indicating that he had become unfit for work on 5 January 2000 and thereby commenced a period of extended sick leave that concluded with Dr Chalmers' retirement on the grounds of ill-health. In December 2000 the college board informed SFEFC that they had decided, in the light of advice from their solicitor, not to proceed further with the disciplinary procedures. The college and Dr Chalmers signed a compromise agreement to formalise the termination of his employment with the college. A condition of the agreement was that Dr Chalmers would, on receipt of the lump sum element of his pension, repay to the college monies received from UHI and for retrospective car expenses.

10. Throughout the year, while Dr Chalmers was on sick leave, SFEFC sought information on progress with disciplinary procedures. SFEFC reminded the college of its '*Guidance on Severance Arrangements to Senior Staff in Scottish Further Education Colleges*' and in particular the fundamental principle included in the guidance that early retirement was not an alternative to disciplinary action. SFEFC also sought advice from the Scottish Public Pensions Agency (SPPA) on the propriety of the process leading to the award of Dr Chalmers' pension and the roles and responsibilities of the parties involved. SPPA are responsible for the payment of pension benefits to an individual in accordance with the regulations of the relevant pension scheme on the termination of his/her contract of employment. SFEFC found, inter alia, that, in providing factual information in support of the Dr Chalmers' application for ill-health retirement, the college did not inform SPPA of the SFEFC report on the investigation of misconduct or that the principal was suspended pending disciplinary action. While there was no formal requirement for the college to do so, SFEFC considered that the fact it did not was a major omission.
11. SFEFC undertakes an ongoing review of the Further Education sector through its Financial Appraisal and Monitoring Services (FAMS). A FAMS review of Moray College in February 2000 coincided with the chief executive's report to the SFEFC board on alleged misconduct at the college and identified a number of weaknesses in governance and financial control. The FAMS report (Executive Summary at Appendix 4) made recommendations to the board of management in three key areas: the framework of corporate governance; the management control framework; and audit arrangements.
12. In January 2001 FAMS undertook a follow-up review of progress against their earlier recommendations and of progress as a result of the investigation of alleged misconduct. Their findings formed the basis of a report to the SFEFC Audit Committee that was subsequently presented to the SFEFC Council by its accountable officer (Appendix 5) on the continuing weaknesses in each of the three areas identified in the earlier FAMS report.

The college's financial position

13. Further education colleges are required to maintain a sound system of financial control, to inform SFEFC of any significant changes to planned financial results and to produce audited accounts for Parliament. The FAMS review at Moray College in February 2000 found that the college's Income and Expenditure Reserve Account was likely to be in deficit for a fourth consecutive year. The deficit had grown from in-year deficits in previous years and by 1999/2000 had reached £1.9 million (Exhibit 1).

Exhibit 1: Annual deficit and balance on income and expenditure reserve 1995/96 to 1999/2000



14. In response to the accumulated deficit the college produced a draft recovery plan. However, FAMS found that the college's plan did not arrest or address the underlying causes of the accumulated deficit, nor did it provide a secure foundation for the financial future of the college. FAMS therefore recommended that the college submit a recovery plan addressing the areas of weakness by June 2000.
15. A draft recovery plan was submitted by the college to SFEFC in November 2000. The plan forecast a deficit for 2000/01 of £200,000, though SFEFC subsequently found that the forecast was significantly understated, and by November 2000 the college's year to date deficit had reached £350,000. Furthermore, because the college had failed to achieve the target level of student activity contained in forecast returns to SFEFC, the amount of grant payable to the college was likely to be significantly lower than forecast and that, consequently, the forecast level of deficit for 2000/01 had been revised to £750,000.
16. Because of concerns about its financial position the college undertook to review its draft recovery plan. In January 2001 SFEFC agreed to finance the cost of the services of a financial consultant to assist the college to produce a revised draft recovery plan by May 2001.
17. The persistent weaknesses in governance and financial control highlighted by FAMS are a serious cause for concern. The action necessary to improve management of the college raises important issues which must be addressed by the board of management if the college is to succeed in providing suitable and efficient further education for its students.

Issues for the Department and SFEFC

18. The Scottish Ministers have a duty to secure adequate and efficient provision of further education in Scotland. If it appears that the affairs of the board of management of any college of further education have been or are being mismanaged, Ministers may remove board members (other than the principal) and, subject to certain restrictions, appoint new members.

19. Alongside its responsibility for securing the adequate and efficient provision of further education, SFEFC may use the following powers:
 - to do all that is necessary or expedient to fulfill that duty
 - those relating to the funding of further education as defined in the 1992 Act
 - to give consent to the board of management of an FE college to borrow money from any source, give any guarantee or indemnity or create any trust or security over or in respect of any of their property
 - under Section 18 of the 1992 Act give consent to the disposal of certain types of property.
20. Management of the college is a statutory duty of the board of management and SFEFC has no specific powers to intervene in the direct management of a college which is facing difficulties. In the case of Moray College, SFEFC has used its existing arrangements to produce regular updates on the college's progress in addressing weaknesses in governance and to monitor the scale of the college's financial difficulties. In addition the SFEFC accountable officer has had meetings with the chair of the college's board of management.
21. Although concerns over college management first became evident in an investigation into allegations of misconduct which began over two years ago, SFEFC has not, despite considerable efforts, persuaded the college to make all the necessary changes. Similarly, even though SFEFC first sought a college recovery plan to address financial problems in February 2000, a robust plan has yet to be produced. This case highlights the limitations of the effectiveness of the accountability framework within the further education sector.

Issues for Moray College

Governance

22. The report on the investigation into allegations of misconduct at the college and the results of SFEFC's FAMS review of the college have pointed to major weaknesses in governance procedures operated at the college. While the board is seeking improvements in a range of areas, much remains to be done before the college achieves best practice.
23. As a result of the allegations of misconduct at the college and the subsequent departure of the college principal, the board of management has been facing a significant challenge in restoring confidence in its management. A key issue for the college board is to ensure that its governance procedures are robust and properly applied. It is therefore disappointing that the improvements identified by SFEFC have not yet been implemented in full.

Financial recovery

24. Since incorporation in 1993 the college has had a history of financial deficits such that by July 2000 it had accumulated a deficit of £1.9 million. The college expects to incur a further deficit of some £750,000 in the year to 31 July 2001. SFEFC have been pressing the college to produce a recovery plan to address the underlying causes of continuing deficits since February 2000. However the college has yet to produce a clear and robust plan.

25. Reported annual deficits in income over expenditure have led to excessive accumulated deficits which, ultimately, the college may not be able to finance. It is therefore essential that action is taken by the board to bring the college's finances into balance at the earliest possible opportunity. The college must therefore fulfill its commitments to provide a clear and robust recovery plan and thereafter must ensure that actions in the recovery plan are implemented.

Overall conclusion

26. The investigation into misconduct at Moray College and the monitoring and reviews conducted by SFEFC recorded inadequate standards of governance. As governance is a responsibility of the board this reflects poorly on them. The membership of the board has progressively changed, but the college has been slow in resolving its remaining problems. This shortfall in standards of governance, taken with declining financial performance, points to a lack of strategic control and weaknesses in the financial management of Moray College.
27. The problems experienced at Moray College indicate features of the current governance and accountability arrangements which may contain wider risks for the sector as a whole. One feature is the responsibility of college boards of management to appoint their own board members. This arrangement may not comply with the general expectation that there should be open, transparent and impartial procedures for making public appointments. The power of Scottish Ministers to remove or replace members of college boards is currently limited. There are also limits to the powers of the chief executive of SFEFC, in his capacity as accountable officer, to ensure propriety and value for money in the stewardship of funds allocated to individual colleges. I therefore suggest that Scottish Ministers may wish to review governance and accountability in the further education sector.

Introduction

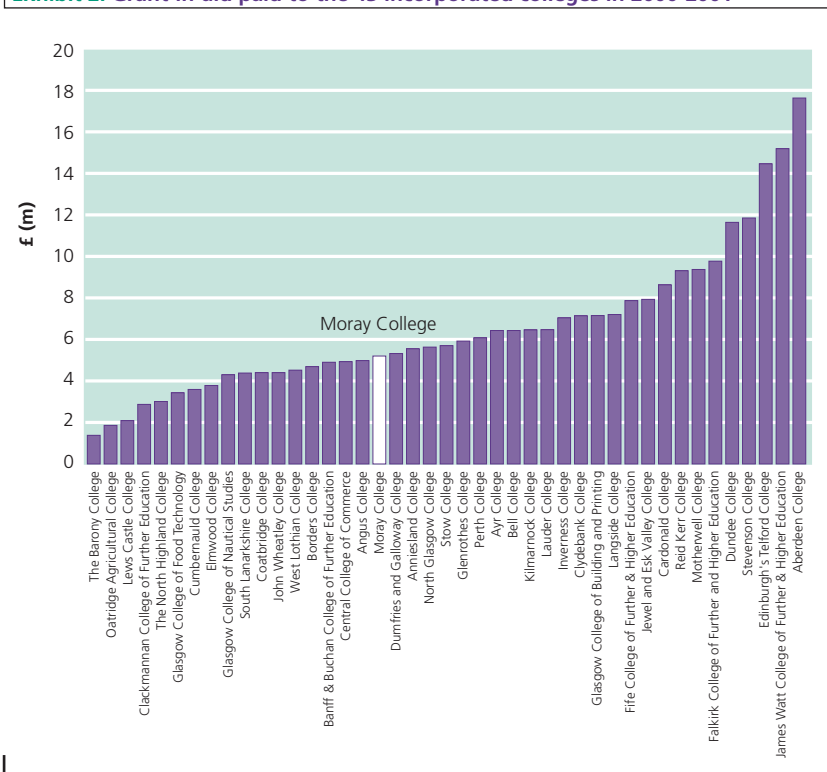
Further education in Scotland

1.1 Under the Further and Higher Education (Scotland) Act 1992 (the 1992 Act), most further education colleges were transferred from local authority control on 1 April 1993. They became independent corporate bodies, governed by boards of management, and assumed ownership of all their assets and liabilities at the date of transfer. Incorporation removed local education authority controls and boundaries and colleges became free to attract students from different and wider catchment areas, in competition with schools, other colleges, and private training providers. There are currently 43 incorporated and four unincorporated colleges providing education and training opportunities for a wide range of people from school leaving age upwards.

Grant-in-aid funding to colleges

1.2 The main source of funding for the 43 incorporated colleges is grant-in-aid payments from the Scottish Executive. In the period from 1 April 1993 to 30 June 1999 grant in aid was paid directly to the colleges by the Scottish Office Education and Industry Department (SOIED). On 1 April 1999 a new body, the Scottish Further Education Funding Council (SFEFC), took over responsibility for securing the adequate and efficient provision of further education, primarily through the distribution of grant in aid funds to colleges in accordance with Ministerial policy guidance and by promoting and monitoring the value for money delivered by the sector. In 2000/01 SFEFC distributed some £365 million to the colleges, representing some 65 per cent of annual expenditure incurred by the colleges (Exhibit 2).

Exhibit 2: Grant-in-aid paid to the 43 incorporated colleges in 2000-2001



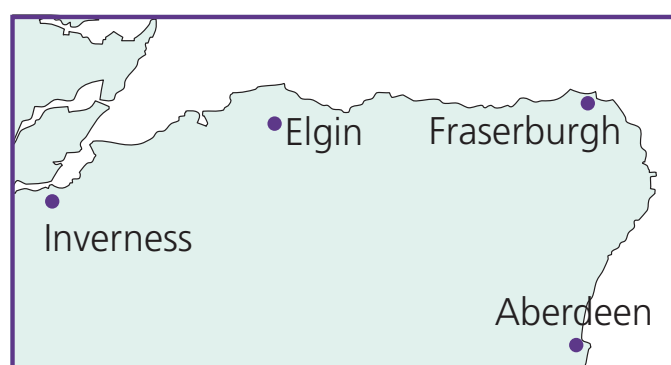
Audit arrangements

- 1.3 Under the terms of the Public Finance and Accountability (Scotland) Act 2000 responsibility for the audit of further education colleges was transferred with effect from 1 April 2000 to the Auditor General for Scotland. Transitional arrangements applied to the audit of accounts prepared by the colleges for a 16 month period to 31 July 2000. The audits, which had been commissioned by the colleges in accordance with a Recommended Code of Guidance on Audit produced by SOEID, were reported to the Auditor General after their completion.

Moray College

- 1.4 Moray College is based in Elgin, Morayshire. It was established in 1971, as Elgin Technical College, under the control of the local education authority and was incorporated on 1 April 1993. The college offers students a wide range of academic and vocational courses covering: Built Environment, Business Services, Care, Communication, Educational Support, Engineering, Hospitality, Information Technology, Personal Care, Science, Maths, Rural Studies and Sport. The college has been an active participant in the University of the Highlands & Islands (UHI) Project and is now an academic partner of the UHI Millennium Institute. Through this the college offers BA degree courses in Business Administration, Rural Development Studies, Art & Design and Social Sciences.
- 1.5 Moray College has a large catchment area, the nearest other FE colleges being at Fraserburgh (60 miles), Inverness (37 miles), and Aberdeen (67 miles) (Exhibit 3). In addition to its main site in Elgin, the college also operates outreach centres in Aberdeen, Buckie, Forres, Keith and Nairn. The centres are equipped with computing equipment and communication facilities to enable a wide range of courses to be delivered, to meet local needs and to enable students to progress in work and academically.

Exhibit 3: Location of Moray College



- 1.6 In the academic year 1999-2000 the college had some 5,000 students, 25 per cent of whom were over 21. In the financial year August 2000 to July 2001, SFEFC allocated the college grant in aid funding of £5.2 million in support of its activities, representing some 70 per cent of total projected income for the college for the year.

Concerns over governance and financial management at Moray College

- 1.7 In February 2001 the chief executive and accountable officer of SFEFC reported on a number of issues relating to governance and financial management at Moray College which he suggested should be of serious concern to the SFEFC Council. The college's financial position, which had been deteriorating over a number of years, had worsened significantly during the 2000/01 financial year but the college had not produced a robust financial recovery plan. The college also has much to do to improve its governance arrangements to comply with the good practice SFEFC had set for colleges in its Financial Memorandum and Code of Audit Practice. Many of these weaknesses had been evident since allegations of misconduct at the college had been investigated in 1998 and 1999.
- 1.8 The concerns highlighted to the SFEFC Council indicated significant weaknesses in governance and financial management within the college. One purpose of my report is to record these weaknesses and the action that has been taken or is planned to overcome them. Secondly, my report raises issues for the college, for SFEFC and for governance and accountability in the FE sector as a whole. These issues arise because progress to resolve the weaknesses at the college has been too slow although SFEFC was diligent in pursuing matters within its existing powers.

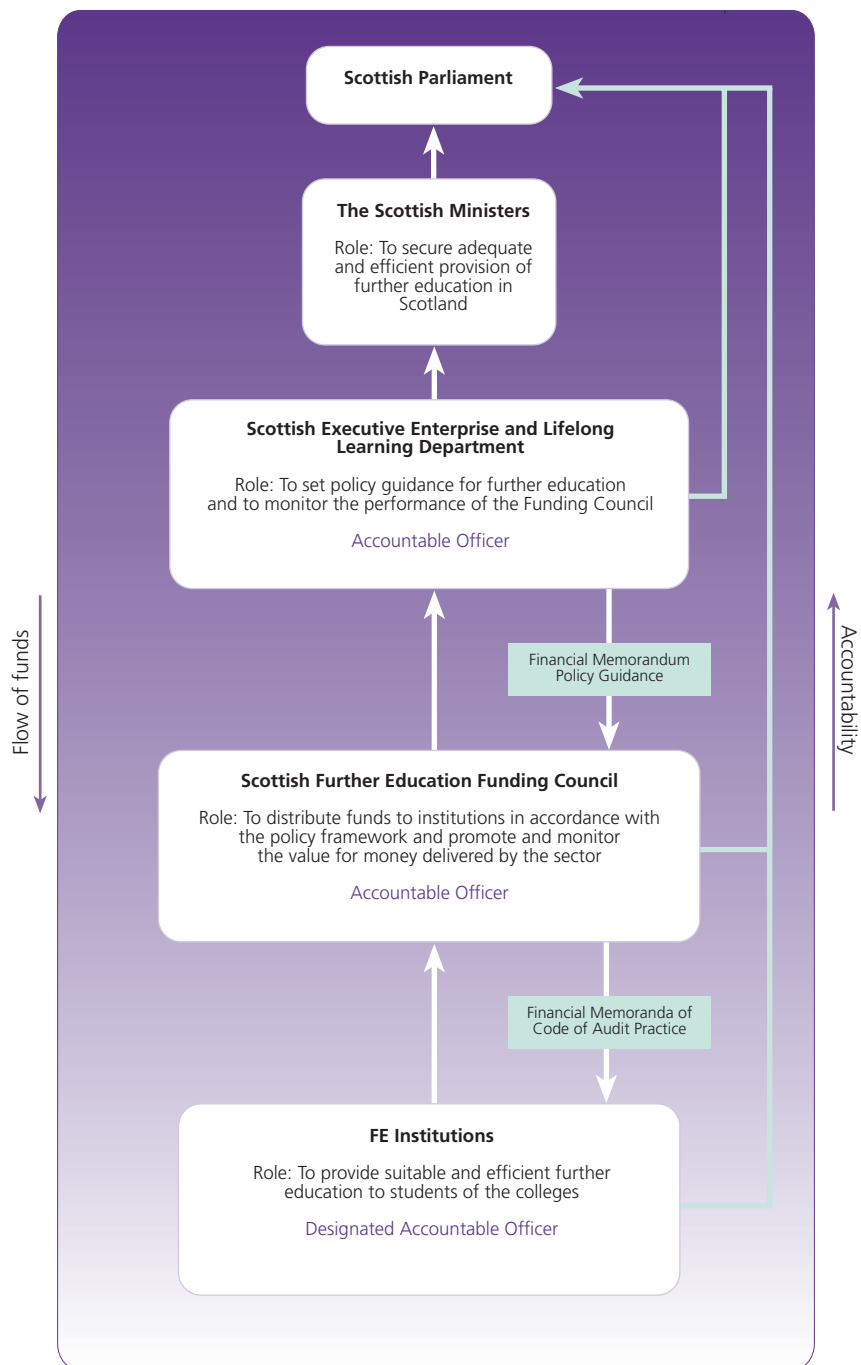
Methodology

- 1.9 This report is based on a review of relevant papers prepared by SFEFC and on SFEFC's findings in each of the areas under examination. The conclusions contained in this report take into account recommendations and observations made in the Second and Fourth Reports of the Committee on Standards in Public Life (the Nolan Committee – Appendix 1).

Roles and responsibilities

2.1 The roles and responsibilities involved in accountability for expenditure in further education colleges in Scotland are set out in Exhibit 4.

Exhibit 4: Chain of accountability for Scottish further education institutes



Duties of board of management

- 2.2 A college board of management is a body corporate created by section 11(2) of the 1992 Act. It has the duty of managing and conducting its college and of ensuring that the college provides suitable and efficient further education to students of the college. Under the Act boards of management of further education colleges should consist of not less than ten nor more than sixteen persons. The board should include the principal of the college, a person elected by the college's teaching staff, a person elected by the college's non-teaching staff, a person nominated by the college's students' association and a person nominated by the local enterprise company for the area in which the college is located. Changes in the composition of the board of management of Moray College are set out in Appendix 2.
- 2.3 Under the transitional arrangements of the 1992 Act, the members of the college council immediately prior to the date of incorporation became the members of the board of management. Thereafter, appointment to board membership was by the existing board members or by nomination to the places allocated under the 1992 Act to specified categories of the college staff and the student body – except in the case of the college principal who is a member of the board of management under the 1992 Act by virtue of his position.
- 2.4 Boards of management are primarily responsible for setting the policies and strategic direction of the college and for monitoring the implementation of these by the college senior management, which is led by the principal. The board of management is also responsible for designating an accountable officer for the college who, in that capacity, is responsible and personally accountable for the stewardship of the public and other monies given to the college. The college accountable officer, who will normally be the principal, is required to answer to the accountable officer for the Scottish Further Education Funding Council on the college's use of monies made available to it and to accompany him, if required, before any hearing of the Parliament's Audit Committee.
- 2.5 Each college has a standard financial memorandum agreed with SFEFC governing the use of SFEFC funds and specifying the general conditions under which funding is provided. Subject to this the colleges' boards of management have discretion over the use of the funds each college receives, and are ultimately responsible for proper stewardship of those funds, for ensuring that they are used for the purposes intended and for delivering value for money in the use of all the college's resources.

Duties of the Scottish Ministers

- 2.6 Under Section 1 of the 1992 Act the Scottish Ministers have a duty to secure adequate and efficient provision of further education in Scotland. In exercise of this duty ministers have the power to do all that is expedient for the purposes and in particular may:
- establish new colleges of further education
 - merge two or more colleges of further education
 - close colleges of further education.

- 2.7 Ministers may also, under Section 21 of the 1992 Act, give boards of management directions of a general or specific character with regard to the discharge of their functions; and it is the duty of a board of management to whom any such directions are given to comply with the directions. Under Section 24 of the 1992 Act, if it appears that the affairs of the board of management of any college of further education have been or are being mismanaged, ministers may by order:
- remove all of the members of the board or any of them (other than the principal of the college) and
 - subject to certain restrictions, appoint new members to the board in place of those so removed.

Role of the Enterprise and Lifelong Learning Minister and the Department

- 2.8 The Minister for Enterprise and Lifelong Learning and the Scottish Executive Enterprise and Lifelong Learning Department (the Department) set the policy guidance according to which SFEFC and the colleges are expected to deliver an adequate and efficient provision of further education in Scotland. The Department also sponsors SFEFC and monitors its performance against the terms of a management statement issued by the Department which sets a broad policy, management and financial framework for SFEFC operations, in particular:
- the rules and guidelines relevant to the exercise of SFEFC's powers, functions and responsibilities
 - the conditions under which public funds are paid to SFEFC
 - how SFEFC will account for its performance.
- 2.9 The head of the Department is the accountable officer for the vote from which grant-in-aid is paid, and is accountable to the Scottish Parliament for the issue of funds to SFEFC. The accountable officer is also responsible for ensuring that the financial and other management controls applied by the Department are appropriate and sufficient to safeguard public funds; that those applied by SFEFC in handling these funds conform with the requirements of propriety, good financial management and value for money; and that SFEFC observes the conditions of a financial memorandum issued by the Department in its use of the funds.

Role of SFEFC

- 2.10 The Scottish Further Education Funding Council (Establishment) (Scotland) Order 1998 (the Establishment Order) delegates to SFEFC the duties of ministers for securing adequate and efficient provision of further education in Scotland. In doing so SFEFC may use the following powers:
- to do all that is necessary or expedient to exercise the duty to secure adequate and efficient provision of further education in Scotland
 - those relating to the funding of further education defined in the 1992 Act
 - to give consent to the board of management of an FE college to borrow money from any source, give any guarantee or indemnity or create any trust or security over or in respect of any of their property
 - under Section 18 of the 1992 Act to give consent to the disposal of certain types of property.

- 2.11 SFEFC is also required to comply with any directions of a general or specific character with regard to the discharge of its functions given by ministers; to keep proper accounts and prepare an annual account in accordance with the financial memorandum; to provide ministers with such information and advice in connection with the provision of further education as ministers may request; and to provide ministers with such information and advice as SFEFC may think fit.
- 2.12 The chief executive of SFEFC is the designated accountable officer for SFEFC. The accountable officer is responsible to the Scottish Ministers and for ensuring that the funds received by SFEFC are put to uses consistent with the purpose for which they were given and are used in compliance with any conditions attached to their use. For these responsibilities the accountable officer is accountable to the Scottish Parliament and is liable to be summoned before the Audit Committee in company with the Departmental accountable officer. The SFEFC accountable officer may also be required to appear before other parliamentary subject committees.

Investigation into allegations of misconduct

- 3.1 In May 1998 the Scottish Office Minister of State for Education received anonymous correspondence containing allegations about misconduct at Moray College. The allegations were also sent to the National Audit Office (NAO) in Scotland. Subsequent discussions between SOEID and the NAO concluded that the allegations were sufficiently serious to require independent investigation.
- 3.2 An initial investigation by the Department and the NAO into the allegations, undertaken in August and September 1998, concluded that further investigation into aspects of the allegations was warranted. In October 1998 the Departmental accounting officer wrote to the chairman of the college's board of management informing him that a second phase of the investigation would be undertaken by the Department in full consultation with the NAO. Over the next six months a further series of visits was therefore made to the college to examine documentary evidence and undertake confidential interviews with relevant staff and board members of the college to ascertain the facts concerning the matters under consideration.
- 3.3 On 1 July 1999, the date on which SFEFC took on its full responsibilities, responsibility for processing this matter transferred from the Departmental accounting officer to the SFEFC accounting officer. In August 1999 Professor Sizer, as the SFEFC accounting officer, drew together the results of the investigation into a single document which was delivered to the board of management of the college and to the (then) college principal, Dr Chalmers. Both parties were provided with an opportunity to comment on the factual accuracy of the investigations findings and on the balance of its conclusions. Both the college board and Dr Chalmers provided their own detailed responses to the investigation findings and while the college accepted the thrust of the findings, Dr Chalmers did not. The chief executive of SFEFC considered both responses in producing a final report on the investigation to the SFEFC Council.
- 3.4 Professor Sizer's report, which was endorsed by SFEFC's Audit Committee, was presented to the SFEFC Council in February 2000 and sent to the Department's accountable officer and to the Auditor General. The report contained conclusions on four areas covered in the allegations: remuneration and other payments to the principal and other senior staff; expenses of the principal and those of other senior staff; employment matters; and issues relating to the board of management.
- 3.5 The report highlighted significant weaknesses in Dr Chalmers' performance as an accounting officer and made 24 recommendations for improvement in college procedures. These are set out in an action plan that records progress made in implementing the report's recommendations, the latest version of which is in Appendix 3. The recommendations included action by the board to recover sums paid to Dr Chalmers for the retrospective increase in mileage allowances and in relation to monies paid to the college for the principal's involvement in the UHI project that were subsequently paid to Dr Chalmers, to review the contractual relationship between the college and a company owned by a member of the college board, and to improve financial and management

control and governance arrangements within the college. The report also recommended that SFEFC should seek formal reports from the college's board of management on progress to recover the sums in question and to consider recovering equivalent amounts from the college.

- 3.6 Decisions on the case for disciplinary action against any member of staff employed by a college rest with the college board of management. Following its own internal investigation the college suspended Dr Chalmers from his duties as principal and accounting officer with effect from 6 January 2000. On 10 January 2000, Dr Chalmers provided the college with a medical certificate indicating that he had become unfit for work on 5 January 2000. Thereafter Dr Chalmers commenced a period of extended sick leave which culminated in Dr Chalmers retiring on ill-health grounds. The principal's solicitor advised the college that because of the nature and seriousness of the illness, Dr Chalmers would not be able to undergo the college's disciplinary process.
- 3.7 In December 2000 the college informed SFEFC that a decision not to proceed further with disciplinary procedures had been taken in the light of advice from the college's solicitor. The college and Dr Chalmers signed a Compromise Agreement to formalise the termination of the principal's employment with the college. A condition of the agreement was that Dr Chalmers would, on receipt of the lump sum element of his pension, repay to the college monies received from UHI and in respect of retrospective increases in car expenses.
- 3.8 Throughout the year, while Dr Chalmers was on sick leave, SFEFC sought information on progress with disciplinary procedures. SFEFC reminded the college of its *'Guidance on Severance Arrangements to Senior Staff in Scottish Further Education Colleges'* and in particular the fundamental principle included in the guidance that early retirement was not an alternative to disciplinary action. SFEFC also sought advice from the Scottish Public Pensions Agency (SPPA) on the propriety of the process leading to the award of Dr Chalmers' pension and the roles and responsibilities of the parties involved. SPPA are responsible for the payment of pension benefits to an individual in accordance with the regulations of the relevant pension scheme on the termination of his/her contract of employment. SFEFC found, inter alia, that in providing factual information in support of the Dr Chalmers' application for ill-health retirement, the college did not inform SPPA of the SFEFC report on the investigation of misconduct or that the Principal was suspended pending disciplinary action. While there was no formal requirement for the college to do so, SFEFC considered that the fact that it did not, was a material omission.
- 3.9 The college appointed a new principal, Dr J Logan, in April 2001.

Action to improve financial control and governance

Review by SFEFC financial, appraisal and monitoring services (FAMS)

- 4.1 SFEFC undertakes an ongoing review of the FE sector. A Financial Appraisal and Monitoring Services (FAMS) directorate has been established to, among other things, undertake the following:
- analyse financial forecasts, mid-year financial information, annual financial statements, and, where required, financial recovery plans produced by colleges
 - assess colleges' financial control and audit, governance and managements arrangements
 - initiate and undertake studies and other such projects and disseminate good practice aimed at developing and improving financial management and governance in the sector.
- 4.2 A FAMS visit to Moray College in February 2000 coincided with the chief executive's report to the SFEFC board on alleged misconduct at the college and identified a number of weaknesses in governance and financial control arrangements. The subsequent report by FAMS (dated March 2000) contained 31 recommendations covering three key areas of: the framework of corporate governance; the management control framework; and audit arrangements. The Executive Summary of the FAMS report and the recommendations made are set out in Appendix 4. The main conclusions of the report were:
- the college faced ongoing financial difficulties which were likely to result in an accumulated deficit of some £1.7 million by July 2000
 - the college had not taken action to introduce a comprehensive budgetary control system and its financial management regulations were out of date
 - although a governance framework was in place there were weaknesses in terms of college procedures and committee membership
 - the college's Audit Committee showed weaknesses in terms of membership, remit and reporting arrangements.

College action plans

- 4.3 SFEFC required the college to produce quarterly reports on progress in response to the recommendations in the report on the investigation into alleged misconduct based on an agreed action plan (Appendix 3). The plans showed details of action to be taken, a completion date and an individual within the college responsible for taking forward each of the recommendations. The quarterly reports provided evidence that the board of management had reviewed the existence, operation and effectiveness of systems and processes in certain broad areas, including overall arrangements for corporate governance and human resource management.

- 4.4 The first report on progress was received on 30 June with subsequent updates received on 30 September 2000, 31 December 2000 and 31 March 2001. The college has recorded progress in fully addressing a number of recommendations. As at 31 March 2001 SFEFC identified certain key matters still needed to be resolved. These include the need to review the contract of the college principal; to review the provision of vehicles to certain members of staff; to develop clear guidance on official business expenses; to compare the conditions of employment of certain staff and to review governance arrangements and procedures.
- 4.5 In January 2001 the FAMS team undertook a follow-up visit to monitor progress made against the recommendations in their February 2000 report and also to examine evidence of progress noted in the college's action plan on the recommendations contained in the report of the investigation of alleged misconduct. The follow-up visit involved a review of a wide range of documentation held by the college. Details of the documentation involved are set out in Exhibit 5.

Exhibit 5: Documentation examined by SFEFC FAMS during follow-up visit to Moray College in January 2001

- Minutes of the College Board of Management since February 2000
- College Finance Committee minutes since February 2000
- College Audit Committee minutes since February 2000 (including internal audit reports)
- College Remuneration Committee minutes since February 2000
- Papers considered by the College Finance Committee in December 2000
- Corporate governance documentation including the Schedule of Delegation
- Draft finance regulations

Source: SFEFC papers

- 4.6 The 2001 follow-up report, which formed the basis of a report to SFEFC Audit Committee, the consideration of which was reported to the full council (Appendix 5) found some continuing weaknesses in each of the three areas identified in the earlier FAMS report.

Corporate governance

- 4.7 The 2000 FAMS report and the report on the investigation into alleged misconduct recommended that the college should put in place a formal scheme of delegated authority. The 2001 FAMS report found that a scheme of delegated authority was in place but that the delegation was very wide-ranging and did not meet the recommendations made in the 2000 FAMS report. Specifically, the college procedures did not include a detailed scheme of delegations that granted and placed limits on authority and did not establish a reporting and accountability mechanism, nor did it comply with the terms of the college's financial memorandum or SFEFC's Code of Audit Practice.
- 4.8 The 2000 FAMS team report and the report on the investigation into alleged misconduct recommended that an independent clerk to the board should be appointed. The 2001 FAMS report found that, although a clerk had been appointed, the role, remit and terms of reference for the position have still to be agreed.

- 4.9 The 2000 FAMS report recommended that the college's board of management should recruit board members with financial expertise. The 2001 report found that, although new members had been recruited, it was unclear what financial experience and expertise they possessed. This was particularly important in the light of a deteriorating financial position faced by the college which the board had not addressed in a meaningful way.
- 4.10 The FAMS 2000 report noted the importance of an up-to-date register of members' interests as an important element in the openness and transparency arrangements of publicly funded organisations, and a code of conduct outlining how board members should conduct themselves as an essential element of corporate governance. The 2001 report found, however, that the college's register of members' interests was not complete and that a code of conduct for the board had still to be developed.

Management control framework

- 4.11 The 2000 FAMS report had recommended a review of information provided to the college's Finance Committee. The 2001 report found that the review was still underway although information being presented to the committee clearly indicated the weakness of the college's financial position. The FAMS team noted, however, that minutes of the college's board and Finance Committee did not indicate what action the board or the college executive were taking or proposed to address this situation.
- 4.12 The FAMS 2001 report noted that a recommendation to review the college's financial regulations and procedures was not complete a year after the FAMS initial visit. The college produced a final draft of revised regulations for the meeting of its Finance Committee in February 2001.

Audit arrangements

- 4.13 The 2000 FAMS report identified a need to update terms of reference for the college's Audit Committee to comply with the college's Financial Memorandum and SFEFC's Code of Audit Practice and had recommended training for new board members, particularly board members serving on the Audit Committee. The 2001 report found that although terms of reference had been updated, they did not comply with an updated Financial Memorandum and new Code of Audit Practice issued by SFEFC.
- 4.14 The 2001 FAMS report noted that, contrary to FAMS' earlier recommendation, the Audit Committee continued to consider all internal audit reports produced in a year at a single meeting and expressed concern that the internal audit plan was undertaken over a short time period, rather than over the course of the year. FAMS also noted that a delay in the appointment of internal auditors had led to a failure to meet an earlier recommendation for the college's Audit Committee to review all aspects of internal control and that the college had not taken forward a recommendation to find out why their internal and external auditors had not identified the fundamental weaknesses identified by the earlier FAMS report.

The financial health of the college

- 5.1 Colleges are required to maintain a sound system of financial control, inform SFEFC of any significant changes to planned financial results and to produce audited accounts for Parliament.

The Financial Memorandum issued by SFEFC to Moray College requires the college, inter alia, to:

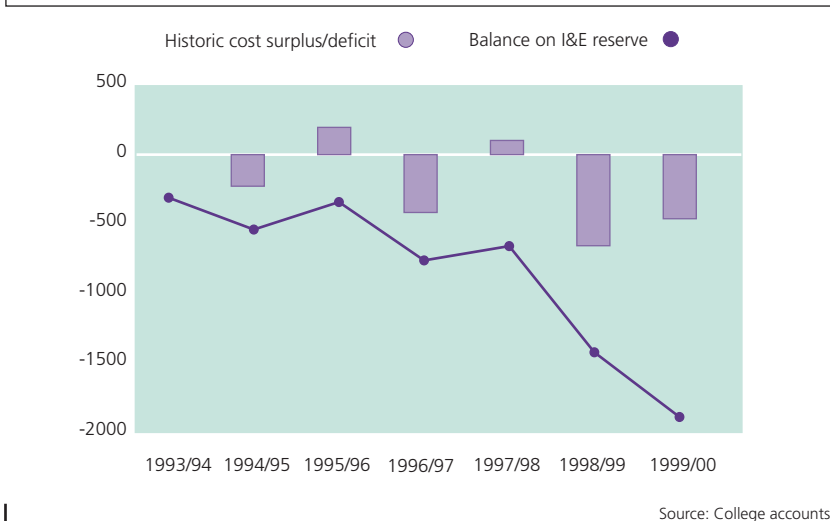
- ensure that it has a sound system of internal financial management and control and a robust mechanism for considering financial issues. The college is also required to submit to SFEFC an annual budget of income and expenditure authorised by its board of management in such form as SFEFC may require
- inform SFEFC of the likelihood of an unplanned (or greater than planned) annual deficit as soon as is practicable
- clear any cumulative deficit on the total of the income and expenditure account within a reasonable and defined period of time, normally the end of the third accounting period after the period in which the deficit began to accumulate.

Under Schedule 2 of the Further and Higher Education (Scotland) Act 1992 college boards of management are required to keep proper accounts to be prepared and audited in such a manner as the Secretary of State may direct and to submit audited accounts to the Secretary of State as soon as practicable after the end of each financial year. From 1 April 2000 the responsibility for securing the audit of FE college accounts transferred to the Auditor General for Scotland.

Financial position during 1999-2000

- 5.2 The SFEFC FAMS visit to Moray College in February 2000 found that cumulative balance on the college's Income and Expenditure Account was likely to be in deficit for a fourth consecutive year. The deficit on the account had grown in earlier years as the college incurred in-year deficits and, at the date of the team's visit, draft accounts for the college for 1999/2000 were indicating a historic deficit which would further increase the deficit on the Income and Expenditure Reserve to £1.7 million (Exhibit 6).

Exhibit 6: Annual deficit and balance on income and expenditure reserve 1995/96 to 1999/2000



5.3 The college addressed the requirement to take action to eliminate the cumulative deficit by producing a draft recovery plan. FAMS found, however, that the college's plan did not arrest or address the underlying causes of the accumulated deficit, nor did it provide a secure foundation for the financial future of the college. The need for a comprehensive revision of the plan was highlighted by FAMS who also recommended that the college submit a recovery plan addressing the areas highlighted by June 2000.

Submission of accounts for period ending 31 July 2000

5.4 Section 22(5) of the Public Finance and Accountability (Scotland) Act 2000 requires Scottish Ministers to lay before Parliament a copy of every account and report sent to them via the Auditor General not later than nine months after the end of the financial period to which the account relates. In order to meet this requirement in the further education sector the Auditor General wrote to the auditors of each college setting out audit certification and reporting deadlines of 31 December 2000 for the accounts for 16 month period ending 31 July 2000.

5.5 Moray College did not meet the deadline for submitting audited accounts to the Auditor General. In December 2000 the college wrote to SFEFC indicating that the college would not be in a position to provide audited accounts for the period to 31 July 2000 until March 2001. SFEFC subsequently learned that the college's external auditor did not expect to start his audit until 5 February 2001 and wrote to the college expressing concerns that the college was not giving the matter sufficient priority.

5.6 The college provided an explanation as to why accounts for both 1998/99 and 1999/2000 had been delayed. As a result of long term sick absence affecting key personnel within the college, work on the preparation of the 1998/99 accounts had not been completed, nor audit work finished, until December 2000. Since that date the college had given priority to producing accounts for the period ending 31 July 2000 and the college expected that audited accounts would be available in March 2001.

5.7 In the event the college's audited accounts were not forwarded to the Auditor General until 3 April 2001. The accounts showed that the accumulated deficit on the college's Income and Expenditure Reserve at that date was £1.9 million.

Financial position during 2000-2001

- 5.8 The college could not provide a recovery plan to meet the deadline of June 2000 as recommended by FAMS. The college subsequently notified SFEFC that because of the complexities of developing a comprehensive financial forecast for the longer term it would not be possible to produce a draft by the date set by SFEFC. After due consideration, taking account of the scale of the task and experience elsewhere, SFEFC accepted the college's position and agreed to defer the deadline until September 2000.
- 5.9 After further correspondence between SFEFC and the college a financial forecast return and a draft recovery plan was submitted by the college to SFEFC in November 2000. The plan included financial forecasts for 2000/01 indicating a deficit for the year of £200,000.
- 5.10 SFEFC's subsequent examination of documentation held by the college found that the level of forecast deficit was significantly understated. A review of papers submitted to the college's Finance Committee during FAMS follow-up visit to the college in January 2001 found that by November 2000 the college's year to date deficit had reached £350,000. FAMS also found that the opening balances used as the basis of the college's forecast could not be verified because of the delay in producing final accounts for the college in earlier years.
- 5.11 Further investigation by the FAMS found that in fact the financial position of the college had deteriorated significantly. Later papers submitted to the college board revealed that, because the college had failed to achieve the target level of student activity contained in forecast returns to SFEFC, the amount of grant payable to the college was likely to be significantly lower than forecast and that, consequently, the forecast level of deficit for the year had been revised to £750,000.
- 5.12 SFEFC considered that the deterioration of the financial position at the college raised serious concerns about college management. Although FAMS had met the college chairman and acting principal in December and January 2001, the college did not at that stage signal the significant change in the position. In SFEFC's view this represented a material omission and was in breach of the terms of the college's financial memorandum. The deterioration also raised major concerns over the practicality of the college's draft recovery plan. Shortly after this situation came to light, the acting principal and the chairman of the college's board of management were required to attend a meeting with the SFEFC accountable officer and the chair of the SFEFC audit committee to provide assurance that this matter was being addressed and that a robust recovery plan would be prepared.
- 5.13 In the light of the concerns about the financial position the college has undertaken to review its draft recovery plan. In order to ensure that such a review is comprehensive and takes into account all the factors SFEFC would expect to be considered in producing a robust plan, SFEFC have agreed to finance the cost of a financial consultant with wide experience in the FE sector to assist the college in this process.

Appendix 1:

Recommendations and observations of the Second and Fourth Reports of the Committee on Standards in Public Life

Recommendations of the second report	Government response
The principles of good practice on appointments, training, openness, codes of conduct and conflicts of interest, set out here in our first report, should be adopted with suitable modifications across the sectors covered in this report	Accepted in full
Local public spending bodies should institute codes of practice on whistleblowing, appropriate to their circumstances, which would enable concerns to be raised confidentially inside and, if necessary, outside the organisation.	The Government agreed that the question of how staff in these sectors should best be able to raise concerns in a timely and confidential manner is an important one. In Scotland, the question of whistleblowing is also under consideration by individual institutions.
Appointments to the governing bodies of universities and colleges should be made on the basis of merit, subject to the need to achieve a balance of relevant skills and background on the board.	Such appointments are for individual institutions to consider. The principle of appointment on the basis of merit is however well established.
The automatic representation of the TECS and LECS on college governing bodies should be ended	The Government decided on this statutory link to signal the importance they attach to colleges and LECS working closely together to meet local labour market needs. Such co-operation remains important and the retention of the link is desirable for this purpose.
Individual universities and colleges should be encouraged to set out key information to a common standard in their annual reports or equivalent documents where they do not already do so. Material on governance should be included in the annual reports or equivalents of further and higher education institutions. Representative bodies should take the lead in promoting this with the support of the funding councils	The Scottish Office requires colleges to produce an annual report and has issued guidance on content, to ensure for example that reports set out consistent information on performance indicators. Colleges will be asked to secure compliance with the Committee's recommendation for the 1997 reporting year.
Representative bodies, with the help of the funding councils, should produce a common standard of good practice on the limits of commercial confidentiality and should encourage all institutions to be as open as possible subject to those limits. All institutions should have publicly available registers of interests.	The Scottish Office Direction on college accounts includes a requirement to list any material interest which board of management members may have in college contracts. The Association of Scottish Colleges has also issued a model Register of Members' Interests.
Institutions of higher and further education should make it clear that the institutions permits staff to speak freely and without being subject to disciplinary sanctions or victimisation about academic standards and related matters providing that they do so lawfully, without malice, and in the public interest.	The Report's discussion of academic freedom and its compatibility with public accountability is welcome. It is for further education institutions to ensure that their staff may speak freely about academic matters within the constraints of the law.
Where it is absolutely necessary to include confidentiality clauses in service and severance contracts, they should expressly remind staff that legitimate concerns about malpractice may be raised with the appropriate authority (the funding council, the National Audit Office, Visitor, or independent review body as applicable) if this is done in the public interest.	This recommendation is for the institutions themselves to consider. Further education colleges are required to establish remuneration committees and in their accounts to disclose compensation payments for loss of office of senior staff.
The higher education funding councils, institutions, and representative bodies should consult on a system of independent review of disputes. A similar process of consultation should be undertaken by the equivalent further education bodies.	The Association of Scottish Colleges is considering how best to take this forward.

Observations raised in the Fourth Report of the Committee on Standards in Public Life

- The funding and regulatory bodies should monitor and report on the ways in which good standards of conduct are communicated to staff, and understood by them.
- The bodies responsible for institutions within the further education sector should look again at the recommendation which proposed a system of independent review of disputes.
- Representative bodies should ensure that whistleblowing procedures are in place within institutions and allow staff appropriate external avenues in which to raise concerns about malpractice.
- Responsible departments should disseminate guidance on good practice about payment of expenses to board members.
- All members of boards, whether elected or appointed, should be appointed for fixed terms, and such terms should not normally exceed four years.
- It is important that rules governing conflicts of interest are introduced across all sectors.
- The funding and regulatory bodies should standardise governance information within annual reports in all sectors.
- All organisations should re-examine their arrangements for publicising codes of practice, and whistleblowing arrangements, to ensure that staff are left in no doubt about these.

Appendix 2: Changes in the composition of the board of management of Moray College

Membership of Moray Collage Board of Management		
At May 1998	At May 2001	
Mr I Lawson (Chairman) (Term expired 03/99)	Mr J A Kerr (Chairman) (from 04/99)	
Dr R J Chalmers (Principal) (Retired 12/00)	Mr D N Bedford (Convenor, Staffing Com. from 06/00)	
Mrs B Beaton (Resigned 11/00)	Dr J Logan (Principal)	
Mr D Caldwell (Convenor, Finance Com.) (Resigned 03/01)	Mr W Dean	
Air Vice Marshall G Chesworth (Term expired 03/99)	Mrs U Gordon	
Mr R Cunningham (Resigned 01/00)	Mr D Graham (Support Staff)	
Mrs L Donaldson (Resigned 06/00)	Mr K J Fairweather	
Ms B Ewan (Student)	Dr R D M MacLeod	
Mr J A Kerr (Convenor, Staffing Com.)	Mr J L Preston (Teaching Staff)	
Mr W J Laing (Term expired 03/99)	Mr R Ruane	
Mr F Oliveira (Convenor, Property Com.) (Resigned 03/99)	Mr A R Scott (Convenor, Property Com. from 06/00)	
Mr I Urquhart	Mr D Smith (Student)	
Mrs L Wheeler (Teaching Staff)	Mr I Urquhart (Convenor, Finance Com. from 06/00)	
Mr A R Scott		
Mr A J L Smith (Support Staff) (Resigned 04/99)		
Mr N Strachan (Resigned 11/00)		
The following persons, not being elected staff members or nominated student members of the college, were appointed and left the board of management between May 1998 and 31 March 2001.		
Mr M Greenwood	Appointed 06/99	Resigned 12/00
Professor J P Smith	Appointed 06/99	Resigned 06/00

Source: Moray College annual reports and SFEFC papers

Appendix 3:

Scottish further education funding council report

Moray College; Investigation of Misconduct Action Plan, as at 31 March 2001

	Recommendation	By Whom	Completion Date	Remarks
1	As a matter of urgency, the Board should examine critically the functions and effectiveness of its Remuneration Cttee to ensure that in future it complies with guidance issued, and operates with best practice	Clerk to Board		Actioned. Remit of the Remuneration Cttee reviewed and expanded, and approved by Board 26 Jun 00. Final revision of Scheme of Delegation approved by Board 25 Sep 00.
2	The Board should ensure that an adequately experienced committee clerk is appointed who should attend all meetings of the Remuneration Cttee. The Clerk's role would be to provide guidance on matters of procedure and to document the decisions taken.		8 Nov 99	Actioned. Part-time Clerk to Board appointed. Attends & records all Board and Cttee meetings, and fulfils advisory role to Board
3	The Board should review the contract and conditions of service of the Principal to ensure that his duties are clearly defined and properly understood.	Board Chairman	31 Jan 01	New contract drawn up following comparison exercise with other colleges.
4	The Board should carry out a review to determine whether all payments made by the College to Dr Chalmers were consistent with his contract.	Board Chairman	6 Dec 00	Actioned. Recovery of monies agreed prior to signing of Compromise Agreement on 6 Dec 00. To be repaid within 7 days of receipt of pension lump sum. Monies now repaid
5	The Board should seek to recover £2691 from Dr Chalmers, which represents the difference between the mileage payments at 9p and those at 25p per mile made to Dr Chalmers in the period from April 1997 to 5 August 1998.	Board Chairman	6 Dec 00	Actioned. Recovery of monies agreed prior to signing of Compromise Agreement on 6 Dec 00. To be repaid within 7 days of receipt of pension lump sum. Monies now repaid
6	The Board should establish a formal scheme of delegated authority from the Board to the Chairman, its Committees, and to the Principal, including appropriate arrangements for reporting to the Board of Management the use of that authority. Such a scheme should be fully documented to ensure that the parameters of discretionary action are clear and understood.	Clerk to Board	30 Sep 00	Actioned. Approved by Board and issued October 2000. Subject to further review by the Board and the Clerk commencing 2 April 2001

	Recommendation	By Whom	Completion Date	Remarks
6	The Board should seek to recover from Dr Chalmers the £7500 payment he received in respect of services provided to UHIP.	Chairman through College Solicitors	6 Dec 00	Actioned. See 1.4
7	The Board should seek an explanation from their external auditors regarding the failure to ensure the College's 1994-95 audited financial statements reported the full remuneration package received by the Principal.	Convenor Finance Committee		External Auditors advise exclusion determined by Principal and Mr Marshall, as claimed College was merely acting as agent for UHI. No written confirmation of such discussions available. Auditors have changed their audit procedures in respect of the Principal's salary, and now review each monthly payroll.
8	The Board should carry out a review to ensure that the payment of £4500 to Mr Marshall was appropriate in all of the circumstances in which it was made and that it was consistent with his contracts.	Chairman Staffing Committee	30 Sep 00	Actioned. Response received from Mr Marshall 28 Sep 00. Board accepted payment had been properly authorised by the Accounting Officer.
9	The Board should review the provision of vehicles to Dr Chalmers, Mr Marshall and Mr Ellwood, taking into account the availability of alternative, including pool vehicles.	Convenor Property Committee		Declaration of intent from Board that College vehicles will not be provided to individuals in future, without strong business case. Principal did not have College vehicle. Restructuring exercise currently underway will result in end of requirement for vehicles for J Ellwood and J Marshall. Vehicle for D Graham to be reviewed regarding use outside office hours.
10	The Board should seek appropriate professional advice from its external auditors prior to advising the Inland Revenue on the appropriateness of the historical mileage payments made to Dr Chalmers and of the College returns to the Inland Revenue.	Convenor Finance Committee		Actioned. Confirmed by SFEFC on 15 Dec 00 that no further action required.
11	The Board should, as a matter of urgency, review the College's policy and procedures in relation to travel claims and ensure that relevant guidance and instructions on the completion and approval of travel claims are issued to all staff within the College and to Board of Management members.	Acting Principal	31 Aug 00	Actioned. Current College policy is printed on the reverse of all travel claims.
12	The Board should give consideration to recovering the mileage overclaims by Dr Chalmers highlighted above.	Chairman through College Solicitors	6 Dec 00	As at 1.5(f)
13	The Board should develop clear and definitive written instructions stating the acceptable practices and allowable expenditure regarding official business expenses, giving due regard to the business needs of the College, best practice, and value for money. The instructions must emphasise not only the respective responsibilities of claimants but also what is expected of those authorising expenses claims for payment, including Board members.	Acting Principal	31 Mar 01	Ongoing.

	Recommendation	By Whom	Completion Date	Remarks
14	As a matter of urgency, the Board should review whether there is a business need for the College to continue to operate credit cards. If the review concludes that cards should continue, the operation of and control over the College's credit cards should be governed by a written policy supported by procedure notes that identify clearly the responsibilities of cardholders to ensure propriety over all transactions.	Acting Principal	31 Mar 01	The card held by Dr Chalmers is not in use, and will be recovered as part of the Compromise Agreement. Mr Marshall continues to use his card with total propriety. All statements are scrutinised by A/Principal prior to payment authorisation.
15	The Board should take steps to ensure that the broad policy on overseas visits recently published by the College is underpinned by appropriate procedures to govern approval, conduct, and reporting arrangements.	Acting Principal	31 Mar 01	This policy is part of the update of Fin Regs. As at 2.3.
16	The Board should establish a framework for evaluating potential employee benefit schemes, such as the computer purchase scheme, including value-for-money criteria against which individual proposals can be assessed and approved.	Acting Principal	31 Mar 01	See 2.5
17	The Board should undertake a comprehensive review of its personnel policies, procedures and practices. This review should include the following: - appointment of staff including how conflicts of interest should be handled; - job evaluation procedures; - terms and conditions of employment and the existence of and justification for exceptions to standard practice; - severance arrangements; - the extent to which personnel records are complete and accurate.	Chairman Staffing Committee	31 Dec 00	Personnel policies have been re-written/reviewed, and are currently with the JCCs for agreement. Personnel records reviewed as part of Internal Audit External auditors have carried out random checks of personal files and contracts of employment.
18	The Board should compare the formal terms and conditions under which Nursery staff are employed with the situation in practice, in order to ensure that staffing requirements for the Nursery are secured efficiently and economically.	Chairman Staffing Committee	31 Dec 00	Wider review of Nursery arrangements to be one of a number of Value-for-Money studies undertaken in the context of Financial Recovery
19	The Board should carry out a review of its governance arrangements and procedures to ensure they comply with best practice.	Clerk to Board	31 Aug 00	Actioned. Scheme of Delegation approved. Declarations of Interest revised and completed by all Board members. Further review of scheme of delegation to be carried out by Board and Clerk commencing 2 April 2001.
20	The Board should determine the precise nature of the contractual relationship with HRM North.	Acting Principal	26 Jun 00	Actioned. College's Financial & Tendering regulations attached.
21	The Board should ensure that services currently supplied by HRM North are subject to competitive tender at the first opportunity.	Acting Principal	26 Jun 00	Actioned. As above. Agency staff employed on an ad hoc basis through a variety of sources.

	Recommendation	By Whom	Completion Date	Remarks
22	If Mrs Donaldson remains a member of the Staffing Committee, the Board should consider her appropriateness of this appointment, given her business relationship with the College.	Board Chairman	19 Jun 00	Actioned. Mrs Donaldson resigned from the Board immediately following the Audit Cttee meeting on 19 Jun 00.
23	The Board is to investigate the overpayment of Relocation expenses to the Personnel Manager.	Acting Principal	26 Jun 00	Actioned. Accepted by Board that irregularities had occurred in payment method and authorisation, but overpayment repaid 12 May 99. Clear policy on Relocation Expenses in place.

Appendix 4:

Extracts from SFEFC final report on Review of Internal Controls, Financial Management and Corporate Governance at Moray College, March 2000

1 Executive Summary

- 1.1 From our recent on-site visit, and the financial information received from the College, it is evident that the College faces ongoing financial health problems. If the historic deficit of £384k for 1999/00 materialises as forecast in the BMQ Feb 2000, this will result in the College having a retained I&E Reserve deficit of £1.7m. As the I&E Reserve will be in deficit (for more than three years), under the terms of the Financial Memorandum (provisional), the College is required to produce a recovery plan indicating how the accumulated deficit can be eliminated. The recovery plan should aim to arrest and address the causes of the deficit as well as securing the financial future of the College. A draft of the recovery plan approved by the Board of Management should be submitted to SFEFC by 30 June 2000.
- 1.2 The college's system of budgetary control has shown some weaknesses in the past, however there are currently arrangements in place to move to a comprehensive control system from August 2000. The financial management regulations and procedures reviewed during the FAMS visit were found to be significantly out of date (when comparing procedures to practice), accordingly they require to be comprehensively redrafted and updated to reflect the current practices at Moray College.
- 1.3 From the work undertaken at Moray College, it is concluded that although the governance framework is in place, there are weaknesses in terms of college procedures and committee membership. Development of the Standing Orders and other college procedures is required to bring the college's corporate governance arrangements into line with sector practices. This was also reported in Professor Sizer, the SFEFC Accounting Officer's report on the Investigation of Misconduct at the College. It has been agreed that the Board will undertake a full review of its governance structures and processes and report to Professor Sizer by 19 June 2000.
- 1.4 The College's Audit Committee shows weakness in terms of membership, remit and reporting arrangements. The Committee should consider placing greater emphasis on Value for Money issues. The College's existing Audit Needs Assessment requires to be reviewed, with greater focus being given to audit risk as the basis of audit coverage derived from the ANA.
- 1.5 Recommendations have been made within each section of this report and have been graded to show their level of importance. These recommendations are summarised in the Annex to this report, providing College management with the opportunity to respond and to identify target dates for implementation.

Review of Internal Controls, Financial Management and Corporate Governance at Moray College

	Recommendation	Grading	Management Response, Responsible Officer and Target Implementation Date	FAMS Response
1	It is recommended that the College submit a Recovery Plan which arrests and addresses the cause of the accumulated deficits and which provides the College with a secure financial future. The Recovery Plan should be submitted to SFEFC by 30 June 2000.	Grade A	Agreed. Discussed by the Board on 26 June in the context of College Budget 2000/2001.	Following Professor Sizer's letter of 11 July, the college has until 30 September to produce the recovery plan. The plan should incorporate the assumptions underpinning the Financial Forecast Return.
2	It is recommended that the College develop a formal Schedule of Delegation to its sub-Committees and the Principal.	Grade A	See Investigation of Misconduct Report Ref Paras 87	Ongoing. See FAMS responses to Investigation of Misconduct Action Plan Item 1.6.
3	It is recommended that the Standing Orders are updated to reflect all guidance and relevant good practice guidance in corporate governance issued since 1994. The Standing Orders should include the requirements of the 1992 Act and ensure that any Terms of Reference given to committees cross-refer to the Standing Orders.	Grade A	See Investigation of Misconduct Report Ref Paras 87 and 205	Ongoing. See FAMS responses to Investigation of Misconduct Action Plan Item 4.1.
4	It is recommended that consideration be given by the College's Board of Management to meeting more than three times per year, in order to conduct the business of the College.	Grade A	Agreed at Board meeting on 26 June. Acting Principal to prepare draft schedule for next meeting on 21 August.	Noted.
5	It is recommended that Board members with financial expertise are recruited to the Finance Committee and Audit Committee. If Board members do not have these skill sets, one option available to the Board of Management, would be to co-opt individuals with the relevant skills onto the respective committees.	Grade A	Changes to convenorships of Board Committees agreed at the Board meeting on 26 June. Recruitment of additional members to be actioned subsequent to 26 June meeting.	Noted. Details of new Board Committee structure should be passed to FAMS when finalised.
6	It is recommended that the College's Board of Management consider adopting a formal annual Schedule of Events.	Grade B	Agreed. Acting Principal to draft in the light of the decision re item 4 above for implementation in 2000/2001.	Noted.
7	It is recommended that the College complete their review of the Register of Member's Interests. When completed, the Register should be made publicly available and reflect the current and developing requirements of public accountability.	Grade B	To be actioned for start of session 2000/2001 by Clerk to Board of Management.	Noted.
8	It is recommended that every effort is made to ensure that a representative from the LEC and Student Association are appointed to the Board of Management in order to fill the existing vacancies	Grade B	Clerk written to LEC - response awaited. Acting Principal to work with Student Liaison Officer to secure student representation for 2000/2001.	Noted. Details of new Board Committee structure should be passed to FAMS when finalised.

	Recommendation	Grading	Management Response, Responsible Officer and Target Implementation Date	FAMS Response
9	It is recommended that the College develop a formal Code of Conduct for Board members.	Grade B	Agreed. Clerk to draft for Board to approve by October 2000.	Noted. Code of Conduct should be passed to FAMS when approved by the Board.
10	It is recommended that the role of the Clerk to the Board is clarified, and that the formal reporting lines of that post are clearly identified.	Grade B	Acting Principal, Acting Personnel Manager and Clerk met following Staffing Meeting on 17 April. Hours agreed. Additional matters to be clarified by start of session 2000/2001.	Noted.
11	It is recommended that disclosure of all conflicts of interest are made in the minutes of the Board of Management and its sub-committees.	Grade B	Agreed 'Declaration of Interests' is now a standard agenda item at all Board meetings.	Noted.
12	It is recommended that the regulation and operation of the Remuneration Committee is clarified in the Standing Orders, and that Terms of Reference be created for the Committee.	Grade B	See Investigation of Misconduct Report Ref Para 87	Ongoing. See FAMS responses to Investigation of Misconduct Action Plan Item 1.1.
13	It is recommended that a review of the financial information provided by the Finance Department to the Board and the Finance Committee is carried out. It is also recommended that a detailed commentary that would also be of benefit to the Finance Committee and the Board of Management should be provided with financial information.	Grade A	Agreed. To be discussed at first round of meetings in 2000/2001.	Noted. The college will be asked to provide detailed financial information as part of the monitoring of the Recovery Plan process.
14	It is recommended that the Financial Regulations are revised and brought up to date and should include a section on the College's system of budgetary control.	Grade B	Agreed. Acting Principal and Resource Manager to draft for first meeting of Finance Committee in session 2000/2001.	Noted. The revised Financial Regulations should be submitted to FAMS when finalised.
15	It is recommended that consideration be given to devolving income budgets to accountable budget holders.	Grade C	Agreed. Initial delegation occurred for April - July 2000. To be continued for 2000/2001. Resource Manager to implement.	Noted.
16	It is recommended that the College develops a policy on budget over and underspends as part of the review of budgetary control within the Financial Regulations.	Grade C	See 14 above.	Noted. See 14 above.
17	It is recommended that the Financial Regulations and Procedures of the College are updated for the start of the new academic year. The new procedures should be scrutinised by the Finance Committee and approved by the Board of Management. As a minimum they should consider all essential procedures. Where more than one piece of guidance is to be adopted, it is important that consistency is ensured by linking it with existing guidance.	Grade A	To be prepared by Acting Principal and Resource Manager for first meeting of Finance Committee in 2000/2001.	Noted.

	Recommendation	Grading	Management Response, Responsible Officer and Target Implementation Date	FAMS Response
18	It is recommended that consideration is given to ensuring that the Finance and Student Data systems are made compatible, thereby keeping the duplication of tasks to a minimum.	Grade B	Agreed. IT Manager has initiated an exercise with relevant staff. Outcome to be costed, and considered by Board in Autumn.	Noted.
19	It is recommended that the revised Standing Orders provide clear Terms of Reference for the Audit Committee.	Grade A	Agreed at Board meeting on 26 June.	Noted.
20	It is recommended that the duties, remit, obligation and constitution of quorum for the Audit Committee are clarified within the Terms of Reference set out in the revised Standing Orders.	Grade A	Agreed at Board meeting on 26 June.	Noted.
21	It is recommended that financial expertise is ensured in the membership of the Audit Committee. The revised Standing Orders should also include a section allowing the co-option of individuals onto sub-committees.	Grade A	Mr D Caldwell (previously Convenor of Finance Committee) is now Convenor of Audit. Additional recruitment to Board to take place in Autumn. Standing Orders agreed on 26 June include power to co-opt.	Noted.
22	It is recommended that the Audit Committee produce a formal annual report to the Board of Management, as is required by the Financial Memorandum (provisional).	Grade A	Format, content and timing of report to be established early in new session.	Noted. It is a requirement of paragraph 3.24 of the SFEFC Code of Audit Practice that the report is sent to FAMS.
23	It is recommended that the Audit Committee consider the External Auditors Management Letter and the draft College Annual Accounts as part of its fundamental duties.	Grade A	Acting Principal to bring these matters to the first meeting of the re-constituted Audit Committee.	Noted.
24	It is recommended that the Audit Committee consider VFM issues and that this is developed into a formal strategy for inclusion in the College's audit arrangements.	Grade A	Acting Principal to bring these matters to the first meeting of the re-constituted Audit Committee.	Noted. When completed, the college's VFM strategy should be passed to FAMS.
25	It is recommended that the Audit Committee receives and considers the reports of the Internal Auditors over the course of the year, rather than at one time. Doing so will allow any recommendations and subsequent actions to be adequately implemented throughout the year.	Grade B	Agreed. Acting Principal to ensure that IA reports are presented timeously to meetings of the Audit Committee.	Noted.
26	It is recommended that some degree of training is provided for members of the Audit Committee. It is further recommended that members are kept fully informed of current guidance and changes to audit practice.	Grade B	Agreed. To be considered at first meeting of reconstituted Audit Committee in Autumn 2000.	Noted.

	Recommendation	Grading	Management Response, Responsible Officer and Target Implementation Date	FAMS Response
27	It is recommended that the revised Standing Orders include a specific section on reporting the decisions of the Audit Committee to the Board of Management and how such recommendations are addressed by the Board.	Grade C	Revised remit includes duty to report to Board and to make recommendations.	Noted.
28	It is recommended that the Board of Management through the College Audit Committee reviews all aspects of internal control at the College.	Grade A	To be implemented in the context of agreeing Internal Audit Needs Assessment (ANA) for 2000/2001 - 2003/2003.	Noted. The finalised ANA should be passed to FAMS.
29	It is recommended that explanations should be requested by the Audit Committee from Scott Oswald, to find out how it did not identify and report on the fundamental weaknesses identified in this report.	Grade A	Letter sent. Reply to be discussed by Audit Committee at its first meeting in 2000/2001.	Noted.
30	It is recommended that in the light of findings from the investigation referred to in paragraph 5.18, that the external auditors review, on an ongoing basis, the College's compliance with extant sector guidance on corporate governance.	Grade A	Agreed. External Auditors will be directed according to this recommendation in future.	Noted.
31	It is recommended that explanations should be requested by the Audit Committee from PriceWaterhouseCoopers, to find out how it did not identify and report on the fundamental weaknesses identified in this report.	Grade A	Letter sent. Reply to be discussed by Audit Committee at its first meeting in 2000/2001.	Noted.

Key: Grade A Fundamental issues requiring urgent attention by management
Grade B Not fundamental but nevertheless important issues requiring early attention
Grade C Less significant or procedural matters which should be pursued within a reasonable time scale

Appendix 5:

Paper presented to SFEFC on concerns over continuing problems at Moray College

Moray College

Summary

1. This paper covers three main areas with regard to Moray College. In each of these areas there has been found to be matters about which the council should be seriously concerned. The areas are as follows:
 - the deterioration in the College's financial health and the need for it to prepare a robust recovery plan;
 - progress with regard to Professor Sizer's Report of the National Audit Office (NAO)/Scottish Office Education and Industry Department's (SOEID) investigation into allegations of misconduct, previously reported to the council; and
 - progress with regard to FAMS' assessment of the College's governance, financial control and audit arrangements.
2. It is important that practical steps are taken at the earliest instance to address the College's deteriorating financial situation. A meeting between the Chairman of the Audit Committee and the Accountable Officer for SFEFC, with the Chair of the Board of Management and the Acting Principal of the College, to discuss the issues identified in this paper, took place on Wednesday 14 February 2001.

Conclusions

3. There are practical issues to bear in mind in considering how the Council's concern should be taken forward. It needs to be recognised firstly that in the past 15 months or so the Board of Management and senior management of the College has had to deal with several major issues simultaneously. This has placed a major strain on the College's ability to respond effectively to all of the challenges it has faced and continues to face.
4. Since December 1999, the College has operated with an Acting Principal, which has contributed to uncertainty about the College's strategic direction. This is not intended to be a criticism of the Acting Principal, but more a recognition that the College requires greater clarity about its medium-term objectives and how it will deliver them. Specifically, there is a clear need for a greater sense of leadership at the College.
5. A third point relates to the fact that the College is a partner in UHI, the future of which is only now beginning to emerge. These factors help to explain why the College is in its current situation but do not in any way excuse it. The Board of Management are ultimately responsible for what happens at the College and it is from the Board and its Accountable Officer that assurances must be gained that action is being taken to remedy the shortcomings highlighted throughout the paper.

Recommendations

6. The Council is invited to comment on the paper and, in particular, the specific conclusion at paragraph 10 and the overall summary and conclusion at paragraphs 18-22.
7. It is recommended that Council endorses the action taken by the Chief Executive, as its Accountable Officer, to seek assurances with regard to:
 - the College's overall financial health, particularly about the deterioration in its financial position and the need for the College to put in place a robust financial recovery plan;
 - the outstanding matters that need to be addressed relating to Professor Sizer's Report of the Investigation of Misconduct as referred to in paragraphs 11-13; and
 - implementation of the recommendations in the FAMS' report that have not yet been actioned.

Public Presentation

8. There has been significant interest in the governance, management and financial health of Moray College from staff at the College and their representatives, as well as local MSPs. This has concerned, in particular, the publication of the Report of the Investigation into Allegations of Misconduct. Previous discussions with representatives of Audit Scotland have suggested that the Auditor General may wish to publish a report on the College in due course. Accordingly, Professor Sizer, as SFEFC's Accountable Officer, will report to the Auditor General on the matters in this paper.

Financial Implications

9. The financial health of the College is in a serious situation, which, at this stage, cannot be accurately assessed. It has been agreed that SFEFC will pay for the services of a consultant to work for and with the College in preparing a financial recovery plan.

Further information

10. Further information is available from Financial Appraisal and Monitoring Services.

Moray College

Introduction

1. The purpose of this paper is to inform and update the Council about developments at Moray College in three areas, in each of which there are matters about which the Council should be seriously concerned. They are as follows:
 - the deterioration in the College's financial health and the need for it to prepare a robust financial recovery plan;
 - progress made relating to Professor Sizer's Report of the National Audit Office (NAO)/Scottish Office Education and Industry Department's (SOEID) investigation into allegations of misconduct, previously reported to the Council; and
 - progress with regard to FAMS' assessment of the College's governance, financial control and audit arrangements;
2. The Chief Executive, as the Council's Accountable Officer, and the Chair of the Council's Audit Committee, met formally with the Chair of the Board of Management and Acting Principal of the College on 14 February 2001, to discuss this situation and to seek assurances that shortcomings would be addressed.
3. Clearly, these areas are interrelated. However, in the first instance, they have been considered individually with specific conclusions drawn on that basis. The Council will be asked to consider these discrete assessments together, in terms of an overall view of the College's governance and financial management.

Financial health

4. A team from FAMS visited Moray College in February 2000 to carry out a monitoring visit as part of its ongoing review of the FE sector. From this visit, a report containing 31 recommendations was issued. The first recommendation in the report was as follows:

"It is recommended that the College submit a Recovery Plan which arrests and addresses the cause of the accumulated deficits and which provides the College with a secure financial future. The Recovery Plan should be submitted to SFEFC by 30 June 2000." [subsequently revised to September 2000]
5. In addition, the Financial Forecast Return submitted in September 2000 indicated that the College would incur an operating deficit of £200k. A first draft Recovery Plan submitted to SFEFC in November 2000, two months after the deadline, also forecast a deficit of £200k at 31 July 2001.
6. In January 2001 a follow-up visit by FAMS was carried out with the aim of determining what progress had been made with the FAMS' Action Plan. A review of Finance Committee papers for December 2000 indicated that, at the end of November, the College's year-to-date operating position was already an operating deficit of £350k. At this time the management accounts did not include balances from the 1998/99 or 1999/2000 accounts, as the financial statements for 1998/99 were not signed-off until December 2000 (15 months late). The financial statements for 1999/2000, due to be submitted in December 2000, have not yet been received. The College estimate they will be delivered in March 2001. It is unclear therefore what the opening financial position of the College was as well as its current financial position.

7. On further investigation it was ascertained that there had been a material shift in the forecast year-end position for 2000-01. Board papers indicated that the revised year-end position was now estimated to be an operating deficit of £750k, an adverse forecast movement in-year of £550k. While there is no immediate financial crisis, the College are forecasting to run out of cash in May 2001.
8. The Financial Memorandum requires the College to:
 - ensure that the College has a sound system of internal financial management and control and a robust mechanism for considering financial issues. The College shall, by 30 June each year, or such other date as may be agreed, submit to the Council a budget of income and expenditure authorised by the Board of Management for the financial years beginning 1 August following, in such form as the Council may require; and
 - inform the Council of the likelihood of an unplanned (or greater than planned) annual deficit as soon as is practicable.
9. This deterioration had not been communicated to SFEFC as required by the terms of the Financial Memorandum (paragraph 27.2). The failure to notify SFEFC is compounded by the fact that the College's first draft Recovery Plan sent to SFEFC in November 2000 was silent about this deteriorating financial situation. In addition, at meetings held with the College in December 2000 and January 2001 to discuss the Recovery Plan, it was not pointed out by the Chairman and Acting Principal that a material change with regard to the in-year financial position had taken place. This is considered to be a material omission on the part of the College and a specific explanation will be pursued.

Conclusion

10. The Council, primarily through its Accountable Officer, must seek assurances from the Board that the Board of Management will take immediate steps to arrest and address the causes of the College's deficit. In addition, the Board must initiate the development of a robust Recovery Plan that will remedy its financial situation and which will enable the College to comply with the FM. The Executive has serious concerns about the College's ability to develop such a plan in the short-term.

Report of the Investigation into Allegations of Misconduct

11. As the Council may recall at its meeting on 17 February 2000, it considered a report by Professor Sizer, in his role as Accountable Officer for SFEFC, into a joint NAO/SOED investigation into allegations of misconduct at Moray College. The Report, taking into account the Council's comments, and that of its Audit Committee, was subsequently issued to the College in March 2000.
12. In issuing his Report, Professor Sizer required the College to submit quarterly reports on progress, in response to the Report's 24 recommendations, in the form of an Action Plan. The purpose of the Action Plan was to set out details of actions taken and also to identify a completion date and a responsible individual. It should be borne in mind that, for the most part, the recommendations were high-level in nature. They required the Board of Management to review the existence, operation and effectiveness of systems and processes in certain broad areas, including overall arrangements for corporate governance and human resource management.

13. The first Action Plan was received on 30 June 2000 with subsequent updates received on 30 September 2000 and 31 December 2000. The most recent Action Plan was considered by the Council's Audit Committee at its meeting on 9 February 2001, together with a detailed commentary. While much has been done, there are some significant outstanding areas. It was agreed that Professor Sizer, in his role as SFEFC's Accountable Officer, would follow-up certain matters with the Board, where there is concern about progress made. It should also be borne in mind that the report to the Audit Committee will form the basis of a 'handover' report to the Auditor General for Scotland for his consideration.

FAMS monitoring visit and follow-up

14. As well as the need for a Recovery Plan, the FAMS' recommendations addressed the following main areas of weakness:
 - The framework of Corporate Governance;
 - Management control framework; and
 - Audit arrangements.
15. A number of these recommendations were also identified in Professor Sizer's Report, *Moray College: Investigation of Misconduct*. Both reports outlined action plans for the Board of Management to address.
16. At its follow-up visit in January 2001, FAMS also considered progress made by the College in dealing with those recommendations common to the FAMS' report and the *Investigation of Misconduct* Report.

Conclusion

17. From the work carried out and from the detailed findings outlined above, it was concluded that progress with regard to implementing FAMS' recommendations across a range of subjects has not been satisfactory. The Board and Acting Principal have been made aware of the seriousness of the situation that this poor performance represents.

Summary and Overall conclusion

18. This paper covers three main areas as set out in its first paragraph. In each of these areas there has been found to be matters about which the Council should be seriously concerned.
19. In considering how the Council's concern should be taken forward, there are practical issues that need to be borne in mind. Firstly, it needs to be recognised that, in the past 15 months or so, the Board of Management and senior management of the College has had to deal with several major issues simultaneously. This has placed a major strain on the College's ability to respond effectively to the challenges it faces.
20. Secondly, since December 1999, the College has operated with an Acting Principal which has contributed to uncertainty about the College's strategic direction. This is not a criticism of the Acting Principal, but more a recognition that the College requires greater clarity about its medium-term objectives and how it will deliver them. There is a clear need for a greater sense of leadership at the College.

21. A third point relates to the fact that the College is a partner in UHI, the future of which is only now beginning to emerge.
22. The combined effect of these factors helps to explain why the College is in its current situation but does not in any way justify it or make it acceptable or any less urgent. The Board of Management are ultimately responsible for what happens at the College and it is from the Board and its Accountable Officer that assurances must be gained that the shortcomings highlighted throughout this paper are remedied.

Recommendations

23. The Council is invited to comment on the analysis and findings in this paper and, in particular, the specific conclusion at paragraph 10 and the overall summary and conclusion at paragraphs 18-22.
24. It is recommended that the Council endorse the action taken by the Chief Executive, as its Accountable Officer, to seek assurances with regard to:
 - the College's overall financial health, particularly about the deterioration in its financial position and the need for the College to put in place a robust financial recovery plan;
 - the outstanding matters that need to be addressed relating to the Report by Professor Sizer on the Investigation of Allegations of Misconduct as referred to in paragraphs 11-13; and
 - implementation of the recommendations in the FAMS' report that have not yet been actioned.



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