SCOTT-MONCRIEFF
EDINBURGH AND GLASGOW

Borders College

Annual Report to the Board of Management and the Auditor General for Scotland 2005/06

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1 Key Issues

Financial Statements (Section 3)

- Our audit opinion on the truth and fairness of the annual accounts and on the regularity of transactions is unqualified.
- The accounts comply with the Accounts Direction issued by SFC and the Statement of Recommended Practice on Accounting for Further and Higher Education. The deadline for submitting final accounts to SFC will be achieved.
- The College is reporting a consolidated deficit on continuing operations of £12,000 after charging £92,000 relating to a provision for restructuring following the closure of the Knitwear Design and Technical Centre within BC Business Consultants Ltd on 31 October 2006.
- Our 2004/05 review of the proposed co-location with Heriot-Watt University's, Scottish Borders campus reported an estimated total development cost of £22 million. At this time Borders College had identified £14.2m in funding, leaving a funding gap of £7.8m. In 2005/06 we note that, in conjunction with other partners, the College has established additional sources of funding to eliminate this funding gap.

Corporate Governance (Section 4)

- We identified no major errors or weaknesses during our audit. In general, the College's systems of internal control appear to be adequate, well designed and operating effectively.
- The Corporate Governance Statement states that the College has been fully compliant with guidance on corporate governance for the year ending 31 July 2006. This was confirmed by our report on Combined Code compliance in March 2006.

Conclusion

- This report concludes the 2005/06 audit of Borders College. We have performed our audit in accordance with the Code of Audit Practice and Statement of Responsibilities published by Audit Scotland.
- The report has been discussed and agreed with the Head of Finance and the Principal and has been prepared for the sole use of the College, the Auditor General for Scotland and Audit Scotland.
- We would like to thank all members of College management and staff who have been involved in our work for their co-operation and assistance during our audit visits.

Scott-Moncrieff
14 December 2006

2 Introduction

2.1 Audit framework

The Auditor General for Scotland is the Scottish Parliament's watchdog for ensuring propriety and value for money in the use of public funds. The Auditor General is therefore responsible for appointing auditors to further education colleges and for setting the terms of their appointment.

Audit Scotland has prepared a Code of Audit Practice, which sets out the way in which auditors should carry out their functions, and a Statement of Responsibilities which explains where the responsibilities of the auditor begin and end.

2.2 Purpose of this report

The purpose of this report is to summarise the results of our audit work for 2005/06. The report describes the ways in which the requirements of the Statement of Responsibilities and the Code of Audit Practice have been met by both the College and ourselves.

3 Financial Statements

3.1 Accounts Direction

The College was required, in preparing its annual accounts, to comply with directions given by the Scottish Funding Council (SFC). We are pleased to confirm that the College's annual accounts for 2005/06 comply fully with the Accounts Direction issued by SFC.

Statement of Recommended Practice (SORP)
The purpose of the SORP on Accounting for Further and Higher Education is to ensure that the financial statements of colleges are prepared on a comparable and consistent basis. The SORP reflects best accounting practice, the requirements of the Funding Council, the accounting provisions of the Companies Act and other relevant legislation.

We can report that the 2005/06 annual accounts of the College comply with the revised SORP in all material respects.

Annual Accounts and Audit Timetable
The deadline for the submission to SFC of FE college audited annual accounts is 31 December. We are pleased to report that the accounts will be approved by the Board of Management on 14 December 2006 and will be submitted to SFC and the Auditor General prior to the 31 December deadline.

The 2005/06 audit has gone on longer than expected due to a number of issues. Assistance was provided in implementing FRS17 in both the College and BC Business Consultancy Ltd. The estates restructuring programme and the BC Business Consultancy loss (due to the redundancy provision) were further audit issues.

Auditors' Report – Unqualified Opinion
We are required to give an opinion as to whether the accounts present a true and fair view of the financial position of the College at 31 July 2006 and of its income and expenditure for the financial year.

We are also required to include a regularity assertion in our audit report stating that expenditure and income were incurred or applied for their intended purposes and in accordance with guidance issued by the Scottish Ministers and the financial memorandum with SFC.

We are pleased to confirm that our audit opinions on the truth and fairness of the accounts and on the regularity of transactions are unqualified. Our auditors' report is included within the annual accounts package.

3.2 Financial Memorandum

The financial memorandum sets out the formal relationship between the Funding Council and Borders College. On the 10th October 2005 the Board of Management approved the adoption of the renewed financial memorandum.

3.3 Financial Position

In 2005/06 the College has reported an income and expenditure (I&E) deficit of £12,000 and a historical cost surplus of £32,000.

The results for the last 5 years are summarised below:

Surplus/ (deficit)	2005/06 £000	2004/05 £000	2003/04 £000	2002/03 £000	2001/02 £000
I&E	(12)	(2,015)	(130)	13	(311)
Historical cost	32	(63)	(37)	106	(207)

The College achieved a significant improvement in 2002/03 in comparison with 2001/02. This however declined in 2003/04 due to a one-off increase in the pension provision of £142,000. The above 2004/05 figures have been restated in light of FRS17. The actual 2004/05 figures were I&E (£1,980,000) and historical cost (£28,000). In 2004/05 whilst the College reported a large income and expenditure deficit due to a property impairment, the historical cost deficit, and hence the impact on accumulated reserves, was minimal due to the release from the revaluation reserve. The absence of such an adjustment in 2005/06 has resulted in the reporting of a healthier financial position.

3.4 FRS 17 – Retirement Benefits

Financial Reporting Standard 17 – Retirement Benefits (FRS 17) has been adopted in full within the financial statements for the year ended 31 July 2006. FRS17 has resulted in the College's share of the net pension assets or liabilities within the Scottish Borders Pension Fund being shown on the balance sheet for the first time.

As illustrated in note 23, the retirement benefits to the College's employees and former employees are provided by either the Scottish Public Pensions Agency (SPPA) or the Scottish Borders Council Pension Fund (SBCPF) schemes. Both schemes are defined benefit schemes.

With the exception of liabilities arising from early retirements, the College is unable to separately identify its share of assets and liabilities in the SPPA scheme as the scheme is notionally funded. The College has applied the concession allowed by FRS 17 and has accounted for the SPPA scheme as a defined contributions scheme.

A £2.3m pension liability has been reported in 2005/06 (£1.9m: 2004/05) in relation to the SBCPF scheme. A prior period adjustment was made to the 2005 figures. This resulted in the restatement of the 31 July 2005 Group Income and Expenditure account from (£0.6m) to (£2.1m). The increase in the liability in 2005/06 has exacerbated the Group Income and Expenditure account position which, as at 31 July 2006, displays an accumulated deficit of £2.7 million.

SFC Strategy for Financial Security

Prior to the inclusion of FRS17 the SFC had stated that pension deficits did not directly threaten a college's financial health and so should be distinguished from deficits arising from overspending.

Circular FE/47/06 released by the SFC in 2006 revised this policy by stating:

"….the Council considers that the FRS17 standard, which impacts on all public and private sector organisations, reflects a more realistic method of measuring pension costs than SSAP 24. Accordingly, the Council does **not** propose adjusting for the impact on institutions' income and expenditure accounts in calculating the underlying operating position from 2005-06 onwards".

This change in treatment reinforces the importance of the College's estate restructuring programme in securing its future financial health.

3.5 Estate Restructuring

Borders College Estate

In August 2003, the College submitted to the SFEFC a fully costed business case identifying four options for its future estate structure. At the request of the SFEFC a fifth option of co-location with Heriot-Watt University's, Scottish Borders campus was put forward. In March 2004 the College submitted a revised Business Case covering the five options. The proposal to co-locate with Heriot-Watt University was approved in December 2004 and, in July 2005, the Funding Council commissioned a review of the proposed co-location at the existing Netherdale Campus in Galashiels. The indicated total development costs as at February 2006 were approximately £31.4 million.

Sources of Funding

The College has identified the following sources of funding:

Source of Funding	£million
SFC	16.3
European Funding	2.8
Borders College Contribution	5.1
LTIF	5.2
Heriot Watt contribution	2.0
TOTAL	**31.4**
TOTAL DEVELOPMENT COST	**31.4**
FUNDING GAP	**Nil**

As illustrated above the College has secured £31.4m in funding. Based on the indicated total development cost of £31.4million a zero funding gap has been identified.

European Regional Development Funding (ERDF)

As illustrated in the above table, the College has successfully secured European funding to the value of £2.8 million. The funding contract stipulates that the money be spent by 2008 and failure to abide by this will result in the funds requiring to be repaid. The College is controlling this risk area by performing a review of all those projects scheduled for completion by 2008 and ensuring the funds are used in a timely and efficient manner.

3.6 Review of Accounting Systems

To ensure an adequate basis for the preparation of the financial statements, a review of the currently operating accounting systems and internal controls has been undertaken.

No major control weaknesses were identified during our audit of the accounting systems. In general, the College's systems of internal control appear to be adequate, well designed and operating effectively. It was however noted that the same person can both prepare and authorise journals posted into the ledger system, therefore, circumnavigating the control process for journal review.

3.7 BC Business Consultants Ltd

BC Business Consultants delivers training and support for the development of businesses in the Borders and Southern Central Scotland. In prior years the company has chosen to Gift Aid its profits to the College. In October 2006 the Scottish Knitwear Design and Technical Centre was closed resulting in a number of redundancies. Consequently the company has reported a 2005/06 deficit of £24,000 and therefore no gift aid has been made to the College.

4 Corporate Governance

4.1 Corporate Governance Framework

The Board of Management has formally established the following sub-committees, which contribute to the culture of risk management and internal control at the College:

- Audit Committee
- Chairman's Committee
- Finance & General Purposes Committee
- Remuneration Committee
- Nominations Committee

The work of these committees is described in the Corporate Governance Statement within the annual accounts.

4.2 Corporate Governance Statement

Requirement for a corporate governance statement
Colleges are required to include within their annuals accounts a statement covering the responsibilities of their Board of Management in relation to corporate governance. The statement describes the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management.

The SFC has stated that all Colleges should be in a position to prepare a corporate governance statement that complies fully with the 2003 Combined Code on Corporate Governance. Early adoption is encouraged.

The College's corporate governance statement for 2005/06 – fully compliant statement
The Turnbull report *Internal Control: Guidance for Directors on the Combined Code* states that a sound system of internal control depends on a thorough and regular evaluation of the risks faced by the College. The College has again made a fully compliant statement in 2005/06.

Corporate Governance Report
In March 2006 we carried out a detailed assessment of the College's compliance with the 2003 Combined Code provisions contained in each of the following areas:

- directors;
- remuneration;
- accountability and audit;
- relations with shareholders, and;
- institutional shareholders.

A review of the College's internal financial control environment against expected minimum financial controls was also performed.

Overall we found the College to be in compliance with all material aspects of the Code. However we did identify areas where minor improvements may be required to demonstrate best practice. An action plan detailing specific recommendations is included in Section 5.5

Unqualified Audit Opinion

We have reviewed the corporate governance statement included within the annual accounts. Our audit opinion on this statement is covered by our auditors' report and is unqualified in this respect.

4.3 Internal Audit

Internal audit is a key component of the College's corporate governance arrangements. The College appointed Wylie and Bisset as internal auditors from 2004/05.

As required by the Code of Audit Practice we undertook a review of the College's arrangements to ensure that the work of internal audit is sufficient in quality and volume and performed in accordance with the Code of Audit Practice. The review concluded that the internal audit service provided to the College was in compliance with the Code of Audit Practice.

Reliance on Internal Audit

To avoid duplication of effort and ensure an efficient audit process we planned our audit work to place reliance wherever possible on the work of internal audit.

We have made use of internal audit work in the following areas:

- Personnel and Payroll
- Budgetary and Financial Controls
- Corporate Governance
- Risk Management
- IT Systems
- Overhead and Income Generation

We are grateful to the staff of Wylie and Bisset for their assistance during the course of our audit work.

4.4 Fraud, Irregularity and Corruption

College's Responsibilities

To ensure the integrity of public funds, the College is responsible for establishing arrangements to prevent and detect fraud and other irregularity, including:

- Developing, promoting and monitoring compliance with standing orders and financial institutions,
- Implementing strategies to prevent and detect fraud and other irregularity,
- Receiving and investigating allegations of breaches of proper standards.

Auditors' Responsibilities
We consider the arrangements made by management in the following ways:

- Our audit is planned so as to provide a reasonable expectation of detecting misstatements in the annual accounts resulting from fraud or irregularity.
- We focus on specific areas of high risk for potential fraud and irregularity and review the arrangements in place in these areas.
- We review Audit Scotland's Technical Bulletins with regard to fraud reports and ensure that the College has adequate arrangements in place to prevent similar frauds occurring.
- We review the extent and adequacy of the Internal Audit function within the College.
- We examine the financial instructions issued by the College to ensure that they deal adequately with fraud and corruption and provide a framework for exercising strong internal control.

Conclusion
We are pleased to report that our audit identified no issues of concern in relation to fraud, irregularity and corruption.

4.5 Standards of Conduct, Integrity and Openness

Propriety requires that public business is conducted with fairness and integrity. This includes avoiding personal gain from public business, being even-handed in the appointment of staff, letting contracts based on open competition and avoiding waste and extravagance.

Our work in this area included a review of the arrangements for adopting and reviewing standing orders, financial instructions, registers of interest and schemes of delegation and complying with national and local Codes of Conduct.

Conclusion
We are pleased to report that our audit identified no material issues of concern in relation to standards of conduct, integrity and openness.

4.6 Financial Standing

It is the responsibility of the College to conduct its financial affairs in a proper manner. As part of our audit, we are required to consider the College's financial standing, including the arrangements in place for financial planning, budgetary control and financial reporting. It is important that such arrangements are adequate in order to properly control the College's operations and use of resources.

Conclusion
In our opinion the College has established adequate arrangements for financial planning, budgetary control and financial reporting.

4.7 Risk Management

We reported in our 2004/05 Annual Report that the College had established robust and effective arrangements for risk management and these have been working well for a number of years.

In 2005/06 we have noted that a specific risk register has been put in place to manage the Co-location project. Various external workshops have been undertaken and a diverse Project Board established.

The correlation of strategic and operational plans with specific risks has resulted in the College successfully embedding a risk management culture throughout the organisation.

The College's continuing development of risk management and its importance enabled the efficient administering of the Hawick flood in October 2005. The result was minimal impact on students and staff an accomplishment also recognised in an exceptional HMI report.

Internal audit carried out a review of risk management in 2005/06 and concluded that the systems used by the College were satisfactory in most areas.

Conclusion
In our opinion, the College has established robust and effective arrangements for risk management.

5 Action Plan

5.1 Summary

Section 5.3 contains two medium risk issues identified during the audit.

Section 5.4 contains the results of our follow-up of the high, medium and low risk issues raised in 2004/05.

Section 5.5 contains the results of our follow-up of the recommendations made in our Corporate Governance Review (carried out in 2006).

It should be noted that the weaknesses in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist.

5.2 Priority Rating

The priority rating is intended to assist the College in assessing the significance of the issues raised and prioritising the action required to address them. The rating structure is summarised as follows:

Priority 1	High risk, material observations requiring immediate action;
Priority 2	Medium risk, significant observations requiring reasonable urgent action;
Priority 3	Low risk, minor observations which require to be brought to the attention of management

5.3 2005/06 Key issues

Two priority two issues were identified during our final audit in 2005/06. These are outlined as follows:

Title	Issue Identified and Risk	Recommendation	Management Comments
Project Costs	Project costs have not been allocated to separate cost codes. This lack of segregation makes capital monitoring difficult particularly when considering the Highmill project which is owned by Heriot-Watt. **Priority 2**	We recommend that the College identify and allocate project costs to specific cost codes. **Responsible Officer:** Head of Finance. **Implementation Date:** March 2007	Project codes have been assigned and High Mill costs are now being separated. An exercise is being undertaken to assign all back-dated costs. **Implementation** - **Immediately**
Authorisation of Journals	It was noted that the same person can both prepare and authorise journals posted into the ledger system, therefore, circumnavigating the control process for journal review. **Priority 2**	We recommend that those journals prepared by the Financial Controller be checked and approved by either the Head of Finance or the Finance Manager. Journals inputted by BC Business Consultants Finance Manager should be periodically reviewed and signed off by senior Finance staff at the College. **Responsible Officer:** Head of Finance. **Implementation Date:** March 2007	To be addressed immediately. **Implementation - Immediately**

5.4 Follow-up of 2004/05 key issues

Title	Recommendation	Management Comments	Update 2005/06
Funding Gap	The funding gap for the Estates project has been identified as £7.8m. Currently the College are relying on this being met by the Funding Council and/or Heriot-Watt University. There are no firm offers in place to meet the funding gap and this presents a risk to the future viability and affordability of the College's plans. We recommend that steps are taken to secure a source of finance to meet the funding gap as soon as possible. **Priority 1**	Agreed. The College is in ongoing negotiations with the Funding Council and the University to secure additional funding to bridge the funding gap. Early in 2006 the Funding Council will meet to consider this issue. **Responsible Officer:** Head of Finance **Implementation Date:** March 2006	The College has successfully secured the necessary funding to fill the gap identified in 2004/05. **Recommendation implemented**

Title	Recommendation	Management Comments	Update 2005/06
Borrowing Limits	It was noted during the audit that the College has obtained an overdraft agreement with Clydesdale Bank Plc for £4,492,000. In line with Corporate Governance guidelines the College has obtained permission from the Funding Council to borrow £3.5m and has still to seek permission for the additional amount. There is a risk that the Funding Council is not aware of the College's borrowing position. There is a further risk that permission for the borrowing may not be obtained. We recommend that the Funding Council is informed of the additional borrowing as soon as possible and that authorisation for the full amount is obtained. **Priority 1**	We have drafted a letter to SFC seeking consent for the additional borrowing required. **Responsible Officer:** Head of Finance **Implementation Date:** Already actioned	The College received SFC consent for the additional borrowing required. **Recommendation implemented**

5.5 Identified Actions – Corporate Governance Review 2006

Area:	**A – Directors**
Main principle:	**A4 – Appointments to the Board**

Observation and Risk	Recommendation	Management Response	
Code provision A.4.6 states that a separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to Board appointments. The existence of the nominations committee has previously disclosed however no information regarding the process used to appoint members was included.	The College should consider disclosing the appointment process in its annual Corporate Governance Statement.	**Responsible officer:** Head of Finance **Implementation date:** 31 Dec 2006 The Annual Corporate Governance Statement will set out the arrangements in place for Board appointments. **31 July 2006 Follow Up** **Recommendation implemented.**	
		Priority	**3**

Area:	**A- Directors**
Main principle:	**A6 – Performance appraisal**

Observation and Risk	Recommendation	Management Response	
Code provision A.6.1 requires the College to "state in the annual report how performance evaluation of the Board, its committees and individual directors has been conducted". The College has carried out a self-evaluation exercise of the Board's performance and has processes in place to conduct performance appraisals for Non-Executive Directors. This has not previously been disclosed by the College.	The College should demonstrate through disclosure in its annual report and financial statements that a performance appraisal framework for the Board, its committees and individual members exists and that annual assessment exercises are carried out.	**Responsible officer:** Secretary to the Board **Implementation date:** 31 Dec 2006 The annual report will disclose that performance appraisal has taken place. **31 July 2006 Follow Up** **Under consideration.**	
		Priority	**3**

Area:	**B – Remuneration**
Main principle:	**B1 – Remuneration policy**

Observation and Risk	Recommendation	Management Response
Code provision B.1.1 states that "the performance related elements of remuneration should form a significant proportion of the total remuneration package of executive directors". Performance related remuneration can be used to link rewards to corporate and individual performance. The current executive and senior management remuneration packages do not contain a performance related element. This is consistent with sector-wide practice.	The total remuneration package for executive directors and senior management should be designed to align their interests to those of the College and its stakeholders. The College should consider whether the use of performance related remuneration would be appropriate.	**Responsible officer:** Chair – Remuneration Committee **Implementation date:** 31 Dec 2006 This issue will be brought to the attention of the Remuneration Committee. **31 July 2006 Follow Up** <u>Borders College</u> Under discussion. <u>BCC</u> In 2005/06 the company has agreed to pay a salary increment based on the operating profit before the exceptional item with the FRS17 effect added back. This is presently 0.75%. **Priority** — **3**

Area:	**B – Remuneration**
Main principle:	**B1 – Remuneration policy**

Observation and Risk	Recommendation	Management Response	
Code provision B.1.3 states that remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Currently the College does not remunerate non-executive members. This is consistent with a sector-wide policy.	The College should consider whether the remuneration of non-executive members is adequate given the time commitment and responsibilities of the role.	**Responsible officer:** Chair of the Board **Implementation date:** 31 Dec 2006 Chair to consider this matter. **31 July 2006 Follow Up** Currently under consideration the likelihood is however low.	
		Priority	**3**

Area:	**D – Relations with shareholders** **E – Institutional shareholders**
Main principle:	**All**

Observation and Risk	Recommendation	Management Response	
The Code requires a "common sense" approach to its application including consideration of the specific circumstances applying to the organisation. The College is a Body Corporate under the Further and Higher Education (Scotland) Act 1992, and as such does not have shareholders.	The College should consider applying the provisions of these sections to their context. The provisions of area D could be used to assess the College's relationship with key stakeholders including national and local bodies. The provisions of areas E could be applied to the College's relationship with the Scottish Funding Council, from which the majority of the College's income is received.	**Responsible officer:** SMT of College **Implementation date:** Dec 2006 The College already communicates with key stakeholders and the Funding Council. The College will consider the appropriateness of applying these sections. **31 July 2006 Follow Up** Under consideration.	
		Priority	**3**

Area:	Schedule C – Disclosure of corporate governance arrangements

Observation and Risk	Recommendation	Management Response	
The Good Governance Standard for Public Services was published by the Independent Commission on Good Governance in Public Services in January 2005. This document contains details of best practice in the public sector and self-assessment tools for governing bodies and stakeholders.	The College should consider assessing its governance arrangements against the content of the Standard to ensure consistency with best practice is maintained. In particular the College may wish to assess the content of its website using Appendix B to the standard.	**Responsible officer:** Chair Audit Committee **Implementation date:** 31 Dec 2006 Audit Committee to consider this approach **31 July 2006 Follow Up** Still to be considered.	
		Priority	**3**

Area:	Minimum financial controls

Observation and Risk	Recommendation	Management Response	
The College has financial regulations detailing the procedures for all key financial systems. These were approved by the Board in 2001 however there is no evidence that these have been reviewed since. There is a risk that approved procedures are not consistent with current practices.	The College should review its key procedural documentation on a regular basis to ensure that it remains consistent with current systems and practices.	**Responsible officer:** Head of Finance **Implementation date:** 31 Dec 2006 The regulations will be reviewed and updated where required by 31st December 2006. **31 July 2006 Follow Up** Up-dated financial regulations have not yet been put in place. Andrew Haddon (Finance Director) intends this to be completed by the 31 Dec 2006 deadline.	
		Priority	**3**

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