Key Issues Memorandum

Borders College

For the year ended 31 July 2012

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To the Audit Committee of Borders College and the Auditor General for Scotland

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The purpose of this memorandum is to highlight the key issues affecting the results of the College and the preparation of the College's financial statements for the year ended 31 July 2012. It is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We take responsibility for this memorandum, which has been prepared on the basis of the limitations set out in 'The small print' (Section 11).

We would like to take this opportunity to record our appreciation for the kind assistance provided by the finance team and other staff during our audit.

Grant Thornton UK LLP

Contents

1 Executive Summary

Financial reporting issues	
Audit opinion	• We have issued an unqualified opinion on the financial statements for the year ended 31 July 2012.

Controls issues	
Payroll Reconciliation	• We understand that no monthly payroll reconciliation is performed to agree payroll records to the general ledger. We recommend monthly payroll reconciliations are prepared on a timely basis.

Audit issues	
Key areas of audit risk	• We identified the key areas of audit risk to be in relation to completeness of income and completeness of employee remuneration. We noted no significant issues in relation to these areas. Our findings are detailed at Section 3.
Audit adjustments	• We identified no adjustments during our audit work.

2 Financial Results

2.1 Income and expenditure account

Table 1: Income and Expenditure account

	2011-12 £'000	2010-11 £'000
Income	11,390	12,311
Expenditure	10,877	11,664
Exceptional costs	237	263
Surplus for the year	**276**	**384**

Source: 2011-12 financial statements

For the year ended 31 July 2012, the College reported a surplus of £276,000 (2011: £384,000). Table 1 above highlights the financial results for the year.

The College originally budgeted for a break even position for the year ended 31 July 2012.

Income

Income has decreased overall by £921k (8%), reflecting a reduction in SFC grant income of £787k, decreased tuition fees of £80k and a decrease in other income of £54k.

The decrease in SFC funding reflects a 10% decrease in the main recurrent teaching grant as a result in a cut in funding by the Scottish Government.

Overall student numbers have decreased by 8%, with full time students numbers having increased by 6% and part time student numbers having decreased by 11%, which accounts for the decrease in tuition fees compared to the prior year (2012: £406k, 2011: £450k).

Other grant income has decreased by 4% mainly due to a reduction in the amount received from Scottish Borders Council in relation to the Adult Literacy project.

Expenditure

Expenditure has decreased by £787k (7%), mainly due to a decrease in staff costs of £780k, a marginal increase in other operating expenses of £2k, an increase in depreciation of £4k and a decrease in interest payable of £13k .

Overall staff numbers have decreased by 16 full time equivalents, with the number of teaching staff having decreased by 11, which accounts for the 10% decrease in staff costs (2012: £6,667k, 2011: £7,447k).

Exceptional costs

Exceptional costs include a one off impairment charge of £150k in relation to property at Hawick, which has been sold post year end. This charge has been included in the financial statements for the year ended 31 July 2012 to reflect the decrease in market value of the property.

Staff restructuring costs of £83k relate to further redundancies in the year (2011: £156k) in an endeavour to make efficiencies in line with continued reductions in available funding.

2.2 Balance sheet

Table 2: Consolidated Balance Sheet

	2011-12 £'000	2010-11 £'000
Fixed assets	33,843	34,925
Endowment assets	24	24
Current assets	3,649	2,995
Current liabilities	(2,171)	(1,914)
Creditors due over a year	(5,055)	(5,361)
Provisions	(819)	(647)
Pension Liability	(4,131)	(4,406)
Net Assets	**25,340**	**25,616**
Deferred capital grants	23,884	24,831
Endowments	24	24
General Reserve	4,726	4,326
Pension Reserve	(4,131)	(4,406)
Revaluation Reserve	837	841
Total Funds	**25,340**	**25,616**

Source: 2011-12 financial statements

For the year ending 31 July 2012, the College held net funds of £25.3 million (2011: £25.6 million). Table 2 highlights the key balance sheet items for the year.

Fixed assets

The decrease in the value of fixed assets is mainly due to depreciation charge in the year of £1,107. There were additions of £37k in relation to purchase of a new vehicle and equipment. There were vehicle disposals of £35k in the year ended 31 July 2012.

Current Assets

Debtors have increased by £169k over the prior period due to the timing of payments.

Investments related to the property at Hawick which has been sold post year end. The reduction of £150k at the year end relates to the impairment to reflect the fall in market value.

Cash balances have increased by £635k.

Current liabilities

Current liabilities have increased by £257k mainly due to an increase of £114k in other creditors and accruals and increase of £144k in bursary funds.

The movements within other creditors and accruals mainly relates to the inclusion of amounts due to the funding council following the decision to dispose of student buses, the full amount of original funding is required to be returned to the provider.

Creditors due over a year

Creditors due over a year have decreased by £306k to reflect payments made in respect of the Lennartz and Heriot-Watt University balances as in prior years.

Pension Liability

The pension deficit of £4,131k reflects the College's share of the assets and liabilities in the Scottish Borders Council Local Government Pension Fund, which is accounted for as a defined benefit scheme under FRS 17. The movement of £275k mainly reflects a decrease in current service cost as a result of the main impact of the staff restructuring being in the prior year.

Deferred capital grants

The decrease in deferred capital grants of £947k mainly relates to amounts released to the Income and Expenditure Account in the year.

3 Key audit issues

In this section we present our findings in respect of matters and risks identified at the planning stage of the audit and we provide details of additional matters that arose during the course of our work.

3.1 Status of audit

Our audit is complete following our discussions with management.

3.2 Matters identified at the planning stage

In the conduct of our audit, we have not had to alter or change our audit plan, which we communicated to you in our Audit Approach Memorandum.

Our responses to the matters identified at the planning stage are detailed below.

3.3 Matters identified during the course of the audit in relation to fraud

During the course of the audit we have identified no issues in relation to fraud.

3.4 Matters identified during the course of the audit in relation to related parties

During the course of the audit we have identified no material issues in relation to related parties.

3.5 Matters identified during the course of the audit in relation to compliance with relevant laws and regulations

During the course of the audit we have identified no issues in relation to non-compliance with relevant laws and regulations.

3.6 Matters identified at the planning stage

	Issue	Auditor commentary
1	**Financial Statement Risks - Income** There is a risk that income is not completely and accurately stated in the financial statements for the year ended 31 July 2012.	Our testing involved documenting the various income streams following review of fund provider documentation and discussions with key members of the Borders College finance team. We subsequently agreed the awards from the fund provider documentation to bank statements. We then performed analytical review of income to ensure material movements were reasonable and in line with expectations. Based on our testing performed, we are satisfied that income is not materially misstated within the financial statements for the year ended 31 July 2012.
2	**Financial Statement Risks – Employee Remuneration** There is a risk that employee remuneration expenses are not completely and accurately stated in the financial statements for the year ended 31 July 2012.	Our testing involved agreeing a sample of employees details to contract and salary documentation. We then agreed our sample to monthly payroll reports through to nominal ledger posting and payments to bank statements. Based on our testing performed, we are satisfied that employee remuneration is not materially misstated within the financial statements for the year ended 31 July 2012.
3	**Early Retirement Scheme** We understand the College has created further efficiencies and savings through a management restructuring programme, resulting in a number of redundancies in both 2010-11 and 2011-12. There is a potential risk that these transactions are not fairly stated in the financial statements at 31 July 2012.	We have reviewed the restructuring provision and agreed the movements within the year as reasonable. We have agreed the prior year provision as being fully paid in the year ended 31 July 2012. Based on our testing performed, we are satisfied no further provision for restructuring is required at the year ended 31 July 2012.

4	**Sale of surplus properties** We understand the College has disposed of property at Hawick subsequent to the year end. We further understand the College are currently marketing property at the Melrose Road. There is a potential risk that the carrying value of these properties is in excess of market value at 31 July 2012.	We have reviewed the impairment workings provided and agreed these to post year end disposal value in relation to the Hawick property with no issues noted. We have discussed the Melrose Road property with management and reviewed the market in this area and are satisfied there is no material impairment at the year ended 31 July 2012.
5	**Shared services** The college has a close collaborative partnership with Heriot Watt University both in teaching faculties and in support services.	We have reviewed the controls and systems in relation to these shared services and have noted no significant issues.

3.7 Matters identified during the course of the audit for Borders College

Other than the matters highlighted at the planning stage, there were no additional significant audit issues which arose through the course of our fieldwork.

3.8 Matters identified during the course of the audit for BC Business Consultants

There were no significant audit issues which arose through the course of our fieldwork.

4 Governance

4.1 Introduction

The Board are responsible for establishing arrangements for ensuring the proper conduct of its affairs, including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The Audit Committee has a role in monitoring these arrangements.

	Issue	Auditor commentary
1	**Financial position** As part of our audit planning procedures we noted that the forecast for 2011-12 was a breakeven position. We understood that to achieve this position against funding cuts for the year of nearly 10%, the College planned a number of measures including restructuring support service departments and implementing efficiencies in teaching faculties which would result in a number of redundancies.	We have reviewed the processes in place in relation to budget monitoring, financial systems, cash flow forecasting and monitoring and treasury management as part of the audit field work and have noted no significant issues. Based on our review, we are satisfied these processes are being used effectively in controlling and monitoring of the financial position of the College.
2	**Procurement** Public procurement in Scotland is subject to stringent UK and European legislation, together with specific requirements of the Scottish Government and Scottish Funding Council. As part of our audit planning procedures we noted that the College has a procurement policy which was last updated in August 2011. There is a potential risk that the policy is not always followed by all members of staff.	As part of our regulatory review of the College, we have reviewed the procurement policy against legislation and specific further education requirements and have noted no significant issues. Based on our review, no issues were noted in relation to the adopting of this policy by the College.

5 Performance

5.1 Introduction

All public bodies in Scotland have a duty to secure Best Value and continuous improvement. Borders College continues to work with the Scottish Government to identify further areas of efficiencies and savings.

	Issue	Auditor commentary
1	**Audit Scotland national reports** In August 2010, Audit Scotland published a national report on how public bodies are beginning to respond to the challenge of a significant reduction in budget. The report provides an overview of budgeting issues across the public sector and there is some key commentary on the reduction of the funding to the Further and Higher Education sector and the impact of the removal of the cap on tuition fees in England and Wales. In September 2010, Audit Scotland published a national report on the governance arrangements across the public sector. The report focused on three areas and provided recommendations on the following: • the role and accountability of boards • the skills and expertise of board members • how boards operate.	As part of our regulatory review of the College, we have reviewed the national reports and noted issues facing the College. We understand the College evaluation against the report was undertaken by the Audit Committee in March 2011. We further understand their findings were passed to the Board of Management in May 2011, who determined the College was fully meeting its obligations in relation to the national reports. We recommend that going forward the College continues to monitor and address the issues appropriately.

6 Financial reporting matters

6.1 Commentary on key judgements and estimates

Going concern

We have reviewed management budgets for the period to July 2015 and management accounts with commentary to September 2012. We are satisfied that the College is projected to operate with adequate headroom within its funding.

We recommend that management continues to closely monitor operations and maintains tight control of its working capital.

6.2 Review of principal accounting policies

We have reviewed the financial statements and have noted no significant issues in relation to the key accounting policies, judgements and estimates.

6.3 Disclosure omissions

Our review found no material omissions in the financial statements.

7 Audit adjustments

7.1 Misstatements

We are required to communicate all uncorrected misstatements to you, other than those considered to be clearly trivial. We have requested that management correct these misstatements and have included (where applicable) the reasons given by them as to why the misstatements remain uncorrected.

No misstatements were noted during our audit work for the year ended 31 July 2012.

8 Design effectiveness of internal controls

8.1 Accounting system and internal control

Our audit is not designed to identify all significant weaknesses in the College's internal controls but is designed primarily for the purpose of expressing our opinion on the financial statements of the College. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work did not encompass a detailed review of all aspects of the internal controls and cannot be relied upon necessarily to disclose all defalcations or other irregularities or to include all possible improvements in internal control.

See 'The small print' for further details of our approach in respect of internal controls.

8.2 Key findings

Key to assessment of internal control deficiencies

🔴	Material weakness - risk of material misstatement
🟡	Significant deficiency - risk of significant misstatement
🟢	Deficiency - risk of inconsequential misstatement

	Assessment	Issue and risk	Recommendation
1	🟢	**Payroll reconciliation** No payroll reconciliation was provided agreeing the monthly payroll reports to the trial balance. We were unable to fully reconcile payroll to the year-end trial balance. We performed additional audit procedures and are satisfied there are no material misstatements at the year ended 31 July 2012. However, there is a risk that by not carrying out regular reconciliations payroll costs may be misstated.	We recommend monthly payroll reconciliations are prepared to agree payroll records to nominal ledger postings to identify any potential issues on a timely basis. **Management response:** It has been agreed that the finance controller will perform a monthly payroll reconciliation going forward.

9 Financial reporting and legislative developments

UK GAAP

Improvements to FRSs

What is proposed?

As we have noted in previous years the Accounting Council is planning to replace all current UK financial reporting standards with a new framework, incorporating two new standards. The standards are "The FRS", a 300 page standard which will be applied by the majority of UK companies, and the Reduced Disclosure Framework, an option of IFRS with reduced disclosures available for subsidiaries and parent company individual accounts.

For more information on the proposals and their implications, visit our website, http://www.grant-thornton.co.uk/services/audit_and_assurance/the_future_of_uk_gaap.aspx.

What would this mean for the College?

Under the proposals, the College would be considered to be a public benefit entity, as its main purpose is not the generation of profit. The FRS includes supplementary paragraphs which address issues specific to public benefit entities, for example non-reciprocal transactions such as donations.

The College will be required to undergo transition to The FRS, as will its subsidiary companies. When undergoing transition to the new financial reporting regime, there are likely to be recognition and measurement differences on transition, for example the requirement to accrue for unused holiday balances. These differences are likely to impact on the reported profit and also on the balance sheet.

As a consequence, there may be an impact on:

- the amount payable under any employee bonus arrangements the College might put in place.

What other issues do I need to consider?

There are also operational issues which may need to be addressed in preparing for transition, such as:

- training requirements
- possible systems changes to ensure all information is captured
- education of stakeholders
- potential need for additional resources.

What about the not-for-profit SORPs?

The Accounting Council intends to retain the three not-for-profit SORPs, for Charities, Registered Social Landlords and Higher and Further Education Establishments. However as stated above these SORPs will need to be updated to reflect the requirements of The FRS.

How should I plan for the transition?

From our experience in helping other entities transition between frameworks we note that the key to managing the process successfully is thorough planning and ensuring the time and resource commitments are not underestimated.

Although the final standards will not be published until the end of 2012, and will not be effective until accounting periods beginning on or after 1 January 2015 at the earliest, it is not too soon to start considering how you will address the transition process.

For the College this will mean the first reporting period is likely to be the year ended 31 July 2016, which will mean comparative balance sheets will be required for 31 July 2015 and 31 July 2014.

Timely actions and the right support will ensure that the process goes as smoothly as possible.

We would be pleased to discuss this matter further and provide detailed guidance in regard to this transition.

Real Time Information (RTI)

The introduction of Real Time Information (RTI) will significantly change the way that employers report PAYE deductions from April 2013. Instead of notifying HM Revenue & Customs (HMRC) of pay and deductions made from employees' wages at the end of the tax year, employers will be required to do this each and every time that any payment is made to an employee, on or before the time the payment is made.

Employers with fewer than 5,000 employees must start filing RTI returns from 6 April 2013.

Non-compliance with the new rules could lead to payroll processing failures, reputational damage with HMRC and employees, and potential penalties by HMRC for late or incorrect submission of data. All employers will need to review their policies, processes and systems to make sure that they are robust enough, and contain the correct data, to enable them to file in real time.

We would be pleased to discuss this matter further and provide detailed guidance in regard to this transition.

Disguised remuneration

The new disguised remuneration legislation results in an upfront income tax charge and National Insurance contributions where a reward or sum of money is earmarked for or loaned to an employee by a third party as part of an arrangement in connection with employment.

The original draft of the legislation was very wide ranging and caught many commercial arrangements with no tax avoidance element. Although the latest changes to the legislation do address many of the anomalies, there are still key issues which need to be considered when a company is to introduce any reward, benefit or incentive arrangement which includes a party other than the employee and employer in the structure

10 Independence

Ethical standards require us to give you full and fair disclosure of matters relating to our independence.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

In accordance with best practice, we analyse our fees below:

	£
Audit of College	12,530
Audit of subsidiaries – BC Business Consultants Limited	1,100
Total audit	**13,630**

	£
Audit related assurance services – Audit of Student Support Funds	1,100
Other assurance services	-
Total assurance services	**1,100**
Total non-audit services	**-**

11 The small print

Purpose of memorandum

This Key Issues Memorandum has been prepared for the benefit of discussions between Grant Thornton, the Audit Committee of Borders College and the Auditor General for Scotland.

The purpose of this memorandum is to highlight the key issues affecting the results of the Group and the preparation of the College's financial statements for the year ended 31 July 2012.

This document is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We would point out that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements of the College.

This memorandum is strictly confidential and although it has been made available to management to facilitate discussions, it may not be taken as altering our responsibilities to the College arising under our audit engagement letter.

The contents of this memorandum should not be disclosed to third parties without our prior written consent.

Responsibilities of the Board of Management and auditors

The Board of Management are responsible for the preparation of the financial statements and for making available to us all of the information and explanations we consider necessary. Therefore, it is essential that the Board of Management confirm that our understanding of all the matters in this memorandum is appropriate, having regard to their knowledge of the particular circumstances.

Clarification of roles and responsibilities with respect to internal controls

The College's management is responsible for the identification, assessment, management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance to the Audit Committee that it has done so.

The Audit Committee is required to review the College's internal financial controls. In addition, the Audit Committee are required to review all other internal controls and approve the statements included in the annual report in relation to internal control and the management of risk.

The Audit Committee should receive reports from management as to the effectiveness of the systems they have established as well as the conclusions of any testing conducted by internal audit or ourselves.

We have applied our audit approach to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We would be pleased to discuss any further work in this regard with the Audit Committee.

ISAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit work
- significant findings from the audit