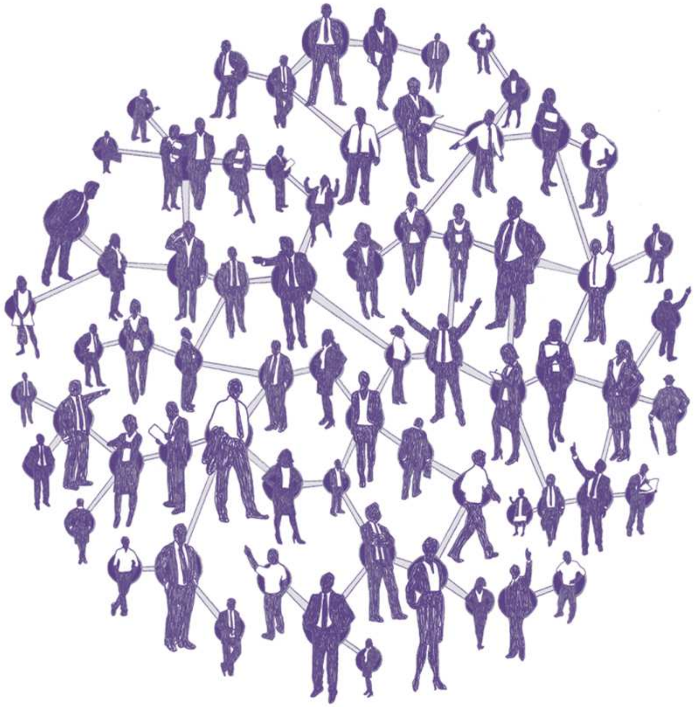
The Audit Findings for Borders College

Period ended 31 March 2014



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22 September 2014

Dear Sirs

Audit Findings for Borders College for the period ended 31 March 2014

This Audit Findings report highlights the significant findings arising from the audit for the benefit of those charged with governance and the Auditor General of Scotland, as required by International Standard on Auditing (UK & Ireland) 260. Its contents will be discussed with the Audit Committee.

As auditors we are responsible for performing the audit, in accordance with International Standards on Auditing (UK & Ireland), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

The contents of this report relate only to those matters which 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. 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 do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

We have issued an unmodified opinion on the College's 2013-14 financial statements. We did not identify any audit adjustments, demonstrating the strong quality of the preparation of the financial statements.

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.

Yours faithfully,

Gary Devlin

Contents

Financial results

Introduction

Before taking account of the exceptional items in the current financial period – i.e. the impairment review of the College's estate and the donation to the arm's length foundational trust – the College has reported a relatively stable financial position, with a surplus of £49k. The £542k donation to the trust and the impairment charge of £1,152k convert this surplus to an overall deficit of £1,645k for the period to 31 March 2014.

Key areas of expenditure

The College reported expenditure of £8,028k in the current financial period. The table below shows a breakdown of this expenditure figure.

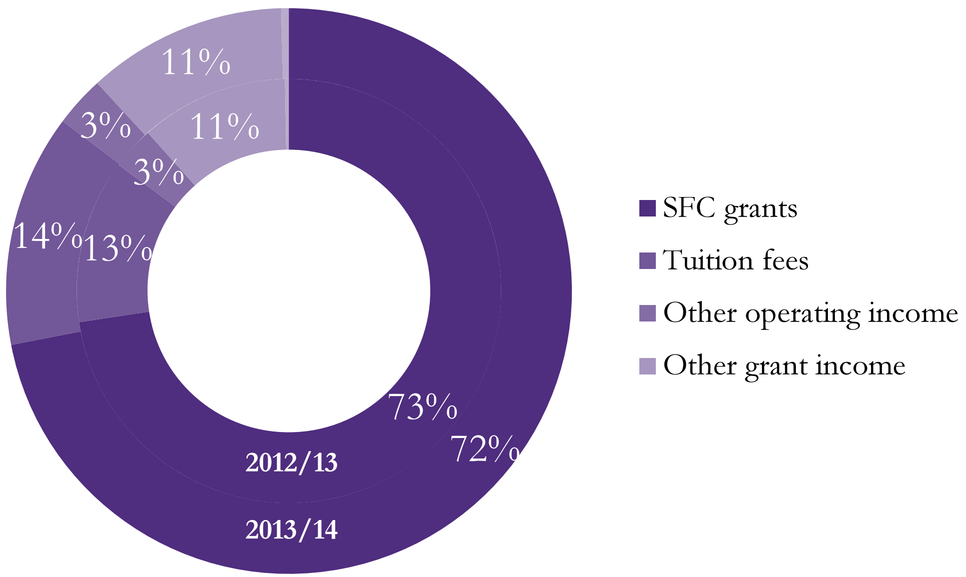
	2013/14 £'000	2012/13 £'000
Staff costs	4,801	6,733
Other operating expenses	2,027	2,676
Donation to charitable trust	542	-
Depreciation	530	881
Interest payable	128	235
	8,028	10,525

Source: Borders College Annual Report 2013/14

Staff costs, depreciation and other operating expenses are broadly in-line with the prior year, when the shorter 8 month accounting period ending 31 March 2014 has been taken account of. This is as expected, following no major changes to the operations of the College.

Income for the year

The College receives income from multiple sources as shown in figure 1 below. It is clear from this analysis that the main source of funding continues to be grants from the Scottish Funding Council.



Source: Borders College Annual Report 2013/14

Income source distribution is in-line with the prior year overall.. There has been a small reduction in SFC grant income following budget cuts. The slight drop in this revenue source has been countered by an increase in Tuition Fee income. The Skills Development Scotland Employability contract has also increased partnership income by £235k in 2013/14.

Financial results (continued)

Financial Position

The College's balance sheet overall reflects a positive financial position with total net assets of £22,262k (2013: £27,364k). However, the general reserves are negative £485k (2013: positive £3,363k).

	2014 £'000	2013 £'000
Non- Current Assets	29,881	32,171
Current Assets	4,308	4,143
Current Liabilities	(2,294)	(1,547)
Non current liabilities (excl. pension liability)	(5,676)	(5,715)
Pension liability	(3,957)	(1,688)
Total net assets	**22,262**	**27,364**

Source: Borders College Audited Accounts 2013/14

There has been a significant movement in non-current assets due to revaluation in the period, which impaired the value of land and buildings by £2,085k.

The increase in current liabilities predominantly relates to movement in other creditors and accruals of £816k. At the 2014 period end the College have included an accrual of £241k in respect of untaken annual leave, which although not required under UK GAAP will be required going forward in accordance with IFRS. Further, general period end accruals and deferred income have increased significantly by £473k which is a timing effect due to the change in financial year end from the academic year.

Due to changes in the actuarial assumptions used to estimate the pension liability, there was a significant increase in the net pension liability, which decreased the net asset position of the college.

Due to changes in the actuarial assumptions used to estimate the pension liability, there was a significant increase in the net pension liability, which decreased the net asset position of the college. The total net assets excluding the pension liability decreased to £26,219k (2013: £29,052k).

Governance

Introduction

The College's governance and risk management arrangements continue to operate effectively.

Office of National Statistics (ONS) reclassification

As a result of the reclassification of the College from the Non-Profit Institutions Serving Households (NPISH) sector to the central government sector, there are significant implications for Borders College. We identified the following key areas that were required to be addressed for the period to 31 March 2014:

- Consideration of an arm's length trust was required in order to mitigate the effects of the ONS reclassification and the effect on reserves
- Consideration of the future impact of the Lennartz VAT scheme as reserves were currently being built to pay for the liability
- Establishment of a program of on-going updates to the Board and key stakeholders regarding the change of accounting year
- Awareness of the increased requirement for external reporting
- Consideration of the change in budgeting deadline for reporting to the SFC
- A review of the closedown plan and re-aligning this to the new financial year end

During the audit work carried out to date, we have not identified any concerns with regards to the above. We note the College have formed an arm's length trust, Borders Further Education Trust, which has been approved by the Office of the Scottish Charity Regulator. We understand that banking arrangements were not fully in place by the College period end and as such a donation of £542k was made into the umbrella trust, Scottish Colleges' Foundation, with the intention to further donate these funds to the Borders Further Education Trust post period end.

We are satisfied that the College has put the appropriate arrangements in place to support the transition, particularly in relation to the following three key areas:

- Budgeting and reporting
- Management of working capital
- Governance arrangements

Governance arrangements

We have undertaken a review of governance arrangements in place at the College as part of our audit work. We identified no weaknesses in the entity level controls.

Prevention and detection of fraud and irregularity

The integrity of public funds is a key concern for the organisation and for auditors. As external auditors, we are required to consider the arrangements made by management for the prevention and detection of fraud and irregularities. Our enquiries of management and the College's internal auditors found that there were no internal frauds during 2013-14. We conducted testing on journal entries and related party transactions to highlight any unusual transactions. There were no issues arising from this testing.

Performance

Introduction

Outcome agreements were introduced by the SFC in the previous academic year ended 31 July 2013, and set out what Colleges plan to deliver in return for their funding from the SFC. Their focus is on the contribution that the Colleges make towards improving life chances, supporting world-class research and creating sustainable economic growth for Scotland.

Outcome agreements

The College have a range of objectives and activities set by the SFC as follows:

- Efficient regional structures
- Right learning in the right place
- High quality and efficient learning
- A developed workforce
- Sustainable institutions

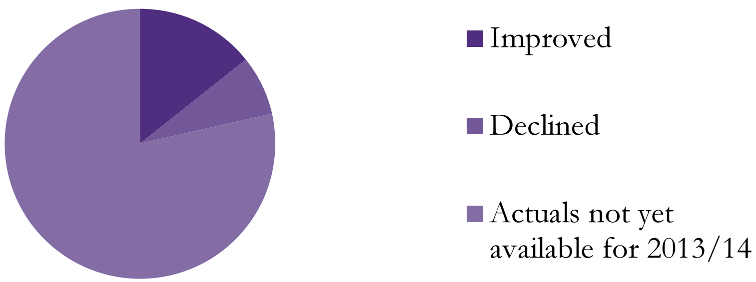
We have reviewed the College's progress against the above objectives. The College has continued its successful Scottish Borders campus working with Heriot-Watt University. This partnership continues to allow savings to be made through shared facilities as well as being able to offer a wide variety of options to students.

Key performance indicators

The SFC requires Colleges to publish certain KPI's in its Operating and Financial Review.

We have reviewed the movements of these KPI's in figure 2 between 2012/13 and 2013/14.

KPI	Explanation of movement
Non-SFC Income as a % of total income	Improvement is due to an increase in SDS income as a result of an active effort to increase funding from other sources.
Ratio of days cash to total expenditure	This movement from 110 days to 81 days can be attributed to timing differences due to the change from financial year ended of 31 July 2013 to a 8 month period ended 31 March 2014. This has been further impacted by the inclusion of holiday pay accrual at 31 March 2014, as previously noted in our analysis of the financial results on page 5.
Operating surplus	The decline is a result of a shorter financial period and exceptional costs consisting of an impairment and donation, as detailed in the our analysis of the financial results on page 4.
Staff costs as a percentage of turnover	Staff costs have increased to 64% of turnover due to the inclusion of holiday pay accrual of £241k accrual in respect of untaken annual leave at 31 March 2014, as detailed in our analysis of the financial results on page 5.
All other KPIs	Due to the change in accounting period from the year ended 31 July 2013 to period ended 31 March 2014 comparatives are not yet available for these academic year KPIs.



Source: Borders College Annual Report 2013/14

Findings in relation to significant risks

	Risks identified in our audit plan	Commentary	Communicated in Audit Plan?
1.	**Improper revenue recognition** • Under ISA 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue	• We reviewed the College's revenue recognition policies for appropriateness and consistency with previous periods. The only significant point noted is the impact of the ONS re-classification meaning the College's financial year end has moved from 31 July to 31 March. We have carried out the following work: – attribute testing of Unit-E income within tuition and fee revenues – statistical sample testing of SUN income within tuition and fee revenues – testing of significant grant income to signed outcome agreements – testing of other income to signed service agreement and cash received – analytical review of material revenues **Conclusion** • No issues were noted from our testing. The College's revenue recognition policy is appropriate and consistent. We are satisfied that revenue has been appropriately recognised for the 8 month period to 31 March 2014.	Yes
2.	**Management override of controls** • Under ISA 240 there is a presumed risk that the risk of management over-ride of controls is present in all entities	• The financial statements include several estimates which have been reviewed as follows: – the assumptions in the FRS 17 report have been reviewed and no material issues were noted, with the pension deficit considered to be reasonable – substantive testing on the sufficiency of the bad debt provision has been carried out, with the provision considered to be reasonable – an assessment of the property impairment review was carried out, this has been discussed in further detail at point 3 below • A download of all journal entries posted in the period was obtained and our data interrogation software was used to extract high value and unusual postings based on descriptions, dates and the identity of user. No issues were identified from the journal posted in the period. **Conclusion** • Our audit work has not identified evidence of management override of controls. In particular the findings in our journal entry testing has not identified any significant issues. One minor control issue has been identified, however this has no impact of the financial statements for the period ended 31 March 2014.	Yes

Findings in relation to reasonably possible risks

	Risks identified in our audit plan	Commentary	Communicated in Audit Plan?
1.	**Property, plant & equipment impairment** • In advance of the ONS re-classification of the College as a central government body, the College has reviewed its estate and has carried out an impairment review. We identified this area as a risk due to the fact that the estate comprises a significant portion of the College's assets and a level of estimation is involved in valuing the properties.	• We reviewed the property valuation report for reasonableness and assessed the competency of Allied Surveyors as valuation experts. • We agreed that the financial statements contained an accurate reflection of the contents of the report and that the accounting treatment for the revaluations had been applied in accordance with accounting standards and the SORP. **Conclusion** • We are satisfied that the amounts included in the financial statements accurately reflect the valuation of the College's estate and that the adjustments required in the financial statements have been processed correctly.	Yes
2.	**Tuition and fee revenues misstated** • We identified that tuition and fee revenue may not be correctly stated. This area was deemed to be a risk due to the significant volume of transactions and the material value of this income stream.	• We have carried out testing on a sample of Unit-E income to signed student enrolment forms and a sample of SUN income to invoice and cash received. • We reviewed the period end balance of tuition and fee revenue debtors and agreed a sample to post-period end cash received. **Conclusion** • From our testing, we are satisfied that tuition and fee revenues are appropriately recorded.	Yes
3.	**Employee remuneration accruals understated** • Employee costs account for a significant proportion of expenditure (60%) in the period. There are a high volume of transactions posted throughout the year and a level of estimation involved in recording the associated employee accruals, therefore we identified this area was at risk of understatement.	• We carried out walkthroughs of the payroll processes and controls in operation. • We performed attribute testing on 25 individual payments made during the period and analytically reviewed the movements in staff costs from the previous year. • We analysed and tested the employee remuneration accruals in detail, including the most significant accrual – the untaken holiday pay accrual (£241k). This accrual will require to be accounted for under IFRS. Although there was no clear guidance at the time of preparing the accounts as to the need for this accrual to be calculated for the period ended 31 March 2014, it has been included in the financial statements so as to avoid any potential re-statement in the financial statements for the year ending 31 March 2015. **Conclusion** • From our testing, we are satisfied that employee remuneration accruals are not understated.	Yes

Findings in relation to reasonably possible risks (continued)

	Risks identified in our audit plan	Commentary	Communicated in Audit Plan?
4.	**Operating expenditure incorrectly stated** • Following the ONS re-classification, the College donated a material balance to an Arm's Length Foundational Trust prior to the period end. This area was deemed to be a risk due to the level of expenditure transferred.	• We reviewed the donations made to the umbrella trust, Scottish Colleges' Foundation, and traced these to bank statements to ensure the payments were made before the period end. **Conclusion** • From our testing, we are satisfied that the donations were made before the period end and to a charitable trust , independent of the College.	Yes

Other communication requirements

	Issue	Commentary
1.	**Matters in relation to fraud**	• We have previously discussed the risk of fraud with the Audit Committee and we have not been made aware of any incidents in the period and no other issues have been identified during the course of our audit procedures
2.	**Matters in relation to related parties**	• We are not aware of any related party transactions which have not been disclosed to us. However, we did note that the related party disclosure of transactions and balances in the first draft of the financial statements was not fully compliant with FRS 8 (Related Party Disclosures) and the SORP. We discussed the issue with management and noted that this error was the result of advice from a previous third party. The issue has since been corrected and we are satisfied that all related party transactions and balances have been disclosed to us and that all have been given the correct accounting treatment in the final financial statements
3.	**Matters in relation to laws and regulations**	• We are not aware of any significant incidences of non-compliance
4.	**Written representations**	• Representations have been received from those charged with governance in respect of the donation to the Scottish Colleges' Foundation prior to the period end and in relation to its independence from the College • Representations have been received from those charged with governance in respect of the significant assumptions used in making accounting estimates for: – Accruals – Bad debt provision – Impairment review of property
5.	**Going concern**	• Our work has not identified any reason to challenge the College's decision to prepare the financial statements on a going concern basis
6.	**Confirmation requests from third parties**	• We requested confirmation letters from those solicitors who worked with the College during the period - all confirmation requests have been received with no issues noted
7.	**Disclosures**	• Our review found no material omissions in the financial statements

Internal controls

- The purpose of an audit is to express an opinion on the financial statements.
- Our audit included consideration of internal controls relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control
- The matters being reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with ISA 265
- If we had performed more extensive procedures on internal control, we might have identified more deficiencies to be reported

	Assessment	Issue and risk	Recommendations
1.	●	• **Journal Entry Controls** We note that the Financial Controller has the ability to and has posted a limited number of journals throughout the period. There is no authorisation process for the journals posted by the Financial Controller which may lead to a risk that journals are posted without being checked by more senior management. Additionally, we note that the Director of Finance and Resources currently has access to the system to post journal entries which gives the risk of management override of controls by way of posting journals to the ledger with no further authorisation process occurring (although we recognise that the Director of Finance and Resources does not post journals currently and we found no evidence of any journals posted during our audit work).	• We recommend that the Director of Finance and Resources has access rights to post journal entries removed. We further recommend that an exception report be run quarterly to identify any journals posted by the Financial Controller and that this is reviewed and authorised by the Director of Finance and Resources.

Assessment
- ● Significant deficiency – risk of significant misstatement
- ● Deficiency – risk of inconsequential misstatement

Misstatements

No material misstatements have been identified during the course of our audit work.

Non-audit fees and independence

	Fees
External audit - College	13,150
Other services	None

- The above non-audit services are consistent with the College's policy on the allotment of non-audit work to your auditors

Independence and ethics:

- Ethical standards and ISA UK 260 require us to give you full and fair disclosure of matters relating to our independence. In this context, 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
- We confirm that we have implemented policies and procedures to meet the requirement of the Auditing Practices Board's Ethical Standards

Communication of audit matters with those charged with governance

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the Company accounting and financial reporting practices, significant matters and issue arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence		✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements		✓
Non compliance with laws and regulations		✓
Expected modifications to the auditor's report, or emphasis of matter		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to Going Concern		✓

International Standards on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table here.

This document, The Audit Findings, outlines those key issues and other matters arising from the audit, which we consider should be communicated in writing rather than orally, together with an explanation as to how these have been resolved.

Distribution of this Audit Findings report

Whilst we seek to ensure our audit findings are distributed to those individuals charged with governance, as a minimum a requirement exists for our findings to be distributed to all the company directors and those members of senior management with significant operational and strategic responsibilities. We are grateful for your specific consideration and onward distribution of our report, to those charged with governance

Respective responsibilities

As auditor we are responsible for performing the audit in accordance with ISA's (UK and Ireland), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance.

The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Appendix A: Overview of audit findings

Account	Material misstatement risk?	Description of risk	Changes to Audit Plan?	Sufficiency of controls?	Significant audit findings?
Tangible fixed assets	Reasonably Possible	Property values are impaired	No	●	None
Endowment assets	Remote	-	No	●	None
Debtors	Remote	-	No	●	None
Assets held for resale	Remote	-	No	●	None
Cash at bank	Remote	-	No	●	None
Creditors (due < 1 year)	Remote	-	No	●	None
Creditors (due > 1 year)	Remote	-	No	●	None
Provisions for liabilities	Remote	-	No	●	None
Pension liability	Remote	-	No	●	None
Deferred capital grants	Remote	-	No	●	None
I&E reserve	Remote	-	No	●	None
Pension reserve	Remote	-	No	●	None
Restricted reserve	Remote	-	No	●	None
Revaluation reserve	Remote	-	No	●	None

Changes to Audit Plan

- We have not had to alter or change our Audit Plan as previously communicated to you on 20 February 2014

Controls Controls
For further details see Internal controls
- Significant deficiency
- Deficiency
- No findings
- Controls not tested

Appendix A: Overview of audit findings (continued)

Account	Material misstatement risk?	Description of risk	Changes to Audit Plan?	Sufficiency of controls?	Significant audit findings?
Grant revenue	Remote	-		●	None
Tuition and fee revenue	Reasonably Possible	Tuition and fee revenues are incorrectly stated		●	None
Other revenue	Remote	-		●	None
Staff costs	Reasonably Possible	Employee remuneration accruals are incorrectly stated		●	None
Other operating costs	Reasonably Possible	Operating expenses are incorrectly stated		●	None
Depreciation	Remote	-		●	None
Interest payable	Remote	-		●	None
(Loss)/Gain on sale of asset	Remote	-		●	None
Impairment charge	Remote	-		●	None
Taxation	Remote	-		●	None

Changes to Audit Plan

- We have not had to alter or change our Audit Plan as previously communicated to you on 20 February 2014

Controls
For further details see Internal controls
- ● Significant deficiency
- ● Deficiency
- ● No findings
- ● Controls not tested

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