SCOTT-MONCRIEFF
EDINBURGH AND GLASGOW

Carnegie College
(formerly Lauder College)
Annual Report to the Board of Management and the Auditor General for Scotland 2006/07

12 December 2007

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1 Summary

Governance

- The College's Corporate Governance Statement confirms that the College has been fully compliant with the key principles of the 2003 Combined Code on Corporate Governance during 2006/07. A revised Combined Code on Corporate Governance was issued in 2006 and is applicable for reporting periods beginning on or after 1 November 2006. We recommend that the College reviews its current corporate governance arrangement against the 2006 Code.
- Our audit has identified no significant weaknesses in relation to governance or systems of internal control. In general, the College's internal control systems appear to be adequate, well designed and operating effectively.

Finance

- Our audit opinion on the truth and fairness of the annual accounts and the regularity of transactions is unqualified. The accounts comply with the Accounts Direction issued by the Scottish Funding Council (SFC) and the Statement of Recommended Practice on Accounting for Further and Higher Education (SORP). The deadline for submitting the accounts, of 31 December 2007, will be achieved.
- The College group has achieved a surplus of £657,000 in 2006/07 (2005/06 - £319,000). These figures include profits from the College's subsidiary, Carnegie Enterprise Limited (formerly Enterprise Lauder Limited), of £309,000 (2005/06 - £345,000).

Conclusion

This report concludes the 2006/07 audit of the Carnegie College (formerly Lauder College) Group. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing and Ethical Standards.

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

12 December 2007

2 Introduction

2.1 Audit Appointments

The Auditor General for Scotland is responsible for reporting to the Scottish Parliament on how public bodies spend public money, manage their finances and achieve value for money in the use of public funds. In discharging this responsibility the Auditor General appoints auditors to Scotland's Colleges and sets the terms of their appointment.

The Auditor General for Scotland has appointed Scott-Moncrieff as external auditor of Carnegie College (formerly Lauder College) ("the College") for the six year period 2005/06 to 2010/11.

We have also been appointed as external auditors of the College's trading subsidiary, Carnegie Enterprise Limited (formerly Enterprise Lauder Limited) ("CEL").

This annual report summarises our 2006/07 audits of the College and its subsidiary and highlights the key issues arising from our work.

2.2 Independence and ethical standards

Ethical Standard 1 – Integrity, objectivity and independence, issued by the Auditing Practices Board (APB), requires external auditors to inform the Audit Committee on a timely basis of all significant facts and matters that bear upon the auditors' objectivity and independence.

We can confirm that we have complied with the APB Ethical Standards throughout the audit and that, in our professional judgement, we have remained independent and our objectivity has not been compromised in any way during the course of our audit.

2.3 Key risks

Our audits are risk based. This means that we focus our resources in the areas of highest risk to the College. The key audit issues identified for the 2006/07 audit were summarised in our external audit plan presented to the Audit Committee on 30 May 2007. These audit issues were:

- Completion of the new Sustainable Development Centre during 2006/07 (see section 4.6);
- Compliance with 2003 Combined Code on Corporate Governance (see section 3.3);
- Proposed land sale to Fife Council (see section 4.6).

This report includes our findings in relation to these key risk areas.

2.4 Scope of the audit

Our audit work can be classified under the headings of governance and finance. The main audit objective for each of these areas is summarised below.

2.4.1 Audit areas and audit objectives

Audit area	Audit objective
Governance	To review the College's governance arrangements in relation to: • systems of internal control and risk management, • the prevention and detection of fraud and irregularity, • standards of conduct and prevention and detection of corruption.
Finance	To provide an opinion on the truth and fairness of the College's financial statements and on the regularity of transactions.

The remainder of this report sets out the results of our work in 2006/07 under these headings. The action plan in section 5 details the recommendations we have made.

3 Governance

3.1 Introduction

It is our responsibility to review the College's governance arrangements in relation to:

- systems of internal control and risk management,
- the prevention and detection of fraud and irregularity,
- standards of conduct and prevention and detection of corruption.

It is also our responsibility to review the College's governance arrangements in relation to its financial position. This is reported in Section 4 – Finance.

3.2 Corporate Governance Statement

3.2.1 Requirement for a Corporate Governance Statement

Colleges are required to include a statement on their corporate governance arrangements within their annual accounts. The statement describes the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management, and reports on the College's compliance with the Combined Code.

We are required to report whether the College's Corporate Governance Statement complies with the requirements of the Scottish Funding Council (SFC).

3.2.2 The College's Corporate Governance Statement for 2006/07 – fully compliant

The College's corporate governance statement for 2006/07 explains that the College was fully compliant with the 2003 Code throughout the period.

3.2.3 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.

3.2.4 Combined Code 2006

A revised Combined Code on Corporate Governance was issued in June 2006, which supersedes the Code issued in 2003.

The Combined Code 2006 is applicable for reporting years beginning on or after 1 November 2006 and therefore the College is encouraged to adopt the revised code for its 2007/08 annual accounts. We recommend that the College reviews its corporate governance arrangements against the 2006 Code in preparation for making its Corporate Governance Statement in 2007/08 (**Action Point 5.2.1**).

The 2006 Combined Code contains a provision (B.2.1) which requires that the Board Chairman should not chair the remuneration committee, although the Board Chairman is allowed to be a member of the committee. This provision is designed to support the principle that "no director should be involved in deciding his or her own remuneration". As College Board Chairs are not remunerated the Board could continue with its current arrangements and still be in compliance with the Combined Code, as long as the arrangements are explained in the 2007/08 Corporate Governance Statement.

3.3 Risk management

Risk management is important to the establishment and regular review of systems of internal control. We have reviewed the College's risk management arrangements.

The College has a risk register in place and this is maintained by the Assistant Principal – Finance. The register is subject to regular review and update by senior management. The significant risks are reported to each Audit Committee. The Audit Committee minutes are reviewed by the Board, ensuring that the Board is aware of the significant risks to the College. The significant risks not considered at the Audit Committee are considered by the Executive Group.

We have concluded that the College has robust risk management systems in place.

3.4 Internal audit

Internal audit is a key component of the College's corporate governance arrangements. The College's internal audit service is provided by Chiene and Tait.

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 SFC 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.

3.4.1 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.

During 2006/07 we have reviewed the following internal audit reports:

- Corporate Governance
- Marketing and Public Relations
- Payroll
- School of Engineering and Technology
- IT Support and Maintenance
- Follow Up

We are grateful to Chiene and Tait for their assistance during the course of our audit work.

3.5 Prevention and detection of fraud and irregularity

We are required to consider the arrangements made by management for the prevention and detection of fraud and irregularity. Fraud is defined as deception made for personal gain and irregularity is defined as transactions which do not comply with Scottish Ministers' guidance. We consider the arrangements made by management in the following ways:

- We consider the financial instructions issued by the College to ensure that they deal adequately with fraud and irregularity and provide a framework for exercising strong internal control,
- Our systems based 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 the extent and adequacy of the internal audit function within the College.

We are pleased to report that we identified no issues of concern in relation to the arrangements for the prevention and detection of fraud or irregularity.

3.6 Standards of conduct, integrity and openness

We are required to consider the arrangements made by management in relation to standards of conduct and prevention and detection of corruption.

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. Guidance on standards of conduct, accountability and openness has been issued by the Scottish Executive.

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

We are pleased to report that our audit identified no issues of concern in relation to standards of conduct and the prevention and detection of corruption.

4 Finance

4.1 Introduction

We are required to audit the financial statements in accordance with International Standards on Auditing and to give an opinion on:

- whether they give a true and fair view of the financial position of the College and its expenditure and income for the period;
- whether they have been prepared in accordance with relevant legislation and applicable accounting standards;
- the regularity of the expenditure and receipts.

We are also required to review the College's governance arrangements in relation to the financial position.

4.2 Carnegie College (formerly Lauder College)

4.2.1 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 2006/07 comply fully with the Accounts Direction issued by SFC.

4.2.2 Statement of Recommended Practice – SORP 2003

The purpose of the SORP on Accounting for Further and Higher Education is to ensure that the financial statements of colleges and universities are prepared on a comparable and consistent basis.

The SORP takes account of best accounting practice, the requirements of the Funding Councils, the accounting provisions of the Companies Act and other relevant legislation. The SORP applicable to accounts ended 31 July 2007 was issued in 2003

We are pleased to report that the 2006/07 annual accounts of the College comply with the FE/HE SORP 2003 in all material respects.

4.2.3 FE/HE SORP 2007

A revised SORP was issued in July 2007 and is applicable to the 2007/08 annual accounts. The revised SORP has been prepared on the assumption that Further and Higher Education institutions will not be adopting International Financial Reporting Standards (IFRSs) in the near future and has been based on UK Generally Accepted Accounting Principles (UK GAAP).

The main impact of the revision is the requirement for the College to include an Operating and Financial Review (OFR) to accompany its annual accounts. An OFR is intended to be more detailed and forward looking than the current Report of the Board of Management. To minimise disruption during the year end audit process, we recommend that the College prepare its OFR in advance of the 2007/08 accounts preparation process (**Action Point 5.2.2**).

4.2.4 Annual accounts and audit timetable

The accounts are due to be approved by the Board of the College on 12 December 2007, and submitted to the Auditor General for Scotland thereafter.

We did not receive draft accounts on 1 October 2007 as agreed in our plan. We did receive a reasonably complete set of draft accounts and supporting papers soon after the commencement of our audit. This was a notable improvement on prior year. However, it was not until one week into our audit that we received a fully completed draft of the College's accounts.

We recommend that management ensure that a complete draft of the accounts is made available from the outset of our audit in future years (**Action Point 5.2.2)**. Other than the delay highlighted above, the audit process went well and the accounts, once received, were of a high standard with no significant adjustments arising from our audit.

4.2.5 Unqualified audit 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 2007 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, in all material respects, expenditure and income were incurred or applied for their intended purposes and in accordance with guidance issued by the Scottish Ministers and the SFC.

We have issued an unqualified audit opinion on the truth and fairness of the accounts and on the regularity of transactions.

4.3 Carnegie Enterprise Limited (formerly Enterprise Lauder Limited)

CEL's financial statements are prepared under the Companies Act and Financial Reporting Standards (FRS). We are pleased to report that the accounts comply with these requirements in all material respects.

The CEL accounts are also due to be approved by the CEL Board in December 2007.

We have issued an unqualified audit opinion on the truth and fairness of the CEL financial statements.

4.4 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.

4.4.1 Financial position and performance

The College group has achieved a surplus of £657,000 in 2006/07 compared to £319,000 in 2005/06. The group surplus comprises:

Surplus / (deficit)	2006/07 - £	2005/06 - £
Group surplus per annual accounts – on continuing operations before exceptional item	657,000	24,000
Exceptional item – gain on sale of assets	-	295,000
Group surplus per annual accounts – on continuing operations after exceptional item	**657,000**	**319,000**
Represented by:		
College surplus/(deficit)	348,000	(26,000)
CEL profit	309,000	345,000

The College forecast a group surplus of £354,000 for 2006/07. The College has attributed the increased surplus to better than expected European grant income (up 31% from previous year) as well as an overall efficiency drive, particularly with pay costs, throughout the College.

CEL achieved a profit for 2006/07, although at £309,000 this was slightly down on the £345,000 made in 2005/06. The College expect that the continued profitability of CEL will mean that the accumulated profit and loss deficit within the company will be eradicated in the early months of 2008.

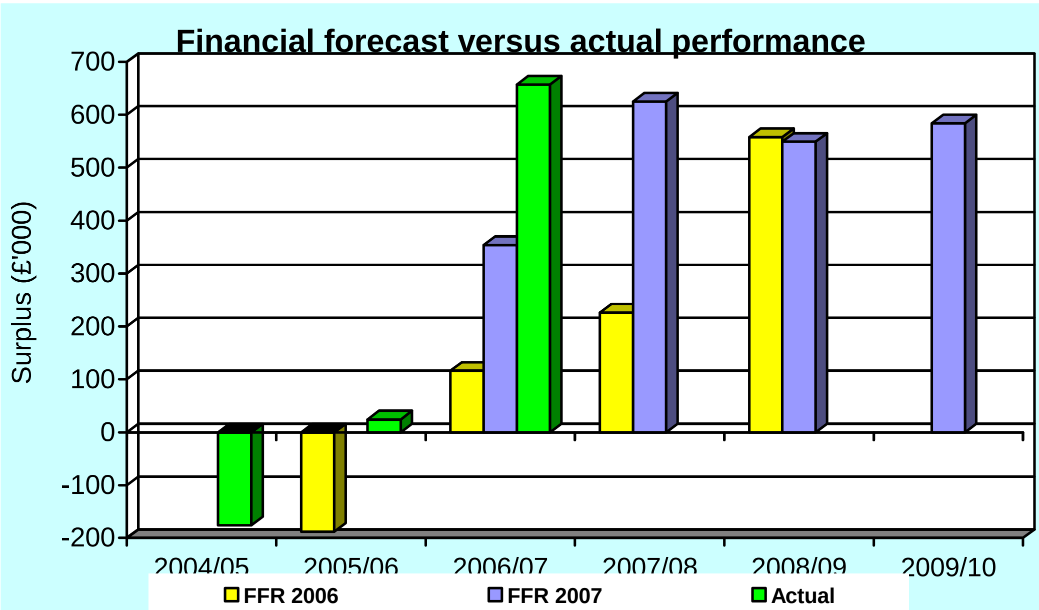
In total, the College has reserves and deferred capital grants of £13,602,000, with a group position of £13,627,000. Of the College reserves, £3,579,000 is held within the revaluation reserve created when the College was incorporated. The balance sheet has also been boosted by a decrease in the pension liability from £2,096,000 in 2005/06 to £498,000 in 2006/07. Together with the surplus for the year, this has had the effect of moving the College's general reserve from a deficit to a surplus.

4.4.2 Financial Planning

Budgets are devised prior to the start of the year and are presented to the Finance Committee, which reviews the information and recommends the budgets to the Board for approval. Management accounts are discussed by Executive Management on a regular basis and presented to each Finance Committee and Board meeting for review.

The College submits annual Financial Forecast Returns (FFRs) to SFC detailing the expected results for the current year and the next three years. SFC uses the FFRs to assess the financial performance of individual colleges and of the sector as a whole.

The graph below compares the College's actual results with the FFR forecasts and shows the latest predictions within the 2007 FFR. The surpluses reported here are based on the surplus on operations prior to gain on sale of property and transfers between reserves.



As shown above, the College is expecting to continue on a strong financial footing over the next few years, with achievement of ongoing surplus. The forecast for 2007/08 presented in the FFR 2007 is much more positive than that predicted in FFR 2006, although the forecast result for 2008/09 is very similar.

In our opinion the College has adequate financial planning arrangements in place.

4.5 Key audit issues

4.5.1 Completion of Sustainable Development Centre (SDC)

Work on the College's new Sustainable Development Centre began in autumn 2005. Construction was completed during 2006/07 and the asset is now operational. The total cost of the asset is £4.775 million, which is slightly over the £4.5 million budget in place this time last year. The facility represents a ground-breaking project within the FE sector. The College has accrued its retention-related payments and it is expected that these will be settled in the near future.

We have audited the Sustainable Development Centre addition and can confirm that the College's accounting for this transaction complies with Financial Reporting Standard 15: Tangible Fixed Assets (FRS 15).

4.5.2 Land Sale to Fife Council

The proposed sale of land at Halbeath to Fife Council was in the early stages of discussion as at 31 July 2007. Accordingly, the transaction is not reflected in the 2006/07 accounts. However, our discussions with the Assistant Principal - Finance and review of minutes have identified that the sale has progressed since the year end and it is expected to go through in early 2008. Indications at this point in time suggest a £400,000 receipt from the Council in respect of the sale. As the land is being held at a nominal value of £1 in the accounts, this would result in approximately £400,000 gain on disposal in the College's 2007/08 financial statements.

4.6 Loss of charitable status

The Office of the Scottish Charity Regulator (OSCR) published the results of the pilot scheme to review charitable status. This included a review of John Wheatley College in Glasgow. OSCR concluded that the charity test was not met because of the ability of Scottish Ministers to direct or otherwise curtail the College's activities. The College has a two year period for a resolution to be found.

Loss of charitable status would result in increased non-domestic rates and potential corporation tax liabilities. The College has been monitoring developments closely and is currently reviewing its own structure and arrangements with a view to the potential loss of charitable status.

5 Action Plan

Our annual report action plan details the control weaknesses and opportunities for improvement that we have identified during 2006/07. These are the issues that we believe need to be brought to the attention of the College.

It should be noted that the weaknesses identified 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.

5.1 Priority rating

To assist the College in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated. The rating structure is summarised as follows:

Priority 1	High risk, material observations requiring immediate action.
Priority 2	Medium risk, significant observations requiring reasonably urgent action.
Priority 3	Low risk, minor observations which require action to improve the efficiency, effectiveness on economy of operations or which otherwise require to be brought to the attention of senior management.

5.2 Issues from our 2006/07 audit

Title	Issue Identified	Risk and Recommendation	Management Comments
5.2.1 **Combined Code 2006** **(Section 3.2.4)**	A revised Combined Code on Corporate Governance was issued in June 2006, which supersedes the Code issued in 2003. The Combined Code 2006 is applicable for reporting years beginning on or after 1 November 2006. The College does not have an up to date comprehensive self-assessment of compliance with the 2003 Combined Code.	Without a self-assessment, there is a risk that the College's statement of compliance with the Combined Code is inaccurate. The College should take this opportunity with the introduction of a new Combined Code to perform a self-assessment against the requirements of the 2006 Combined Code. The College should retain this self-assessment as a working document to be regularly updated in line with developments in corporate governance. ***Priority 2***	Agreed. ***Responsible Officer:*** Assistant Principal / Director of Finance ***Implementation Date:*** January 2008
5.2.2 **FE/HE SORP 2007** **(Section 4.2.4)**	A revised SORP was issued in July 2007 and is applicable to the 2007/08 annual accounts. The main impact of the revision is the requirement for the College to include an Operating and Financial Review (OFR) to accompany its annual accounts.	The preparation of the OFR may delay the 2007/08 annual accounts preparation process. To minimise disruption during the year end accounts process, we recommend that the College prepare its OFR in advance of the 2007/08 accounts preparation process. Priority 2	Agreed. ***Responsible Officer:*** Assistant Principal / Director of Finance ***Implementation date:*** January 2008

5.3 Follow up of issues from the 2005/06 audit

Title	Original Recommendation	Original Management Comments	Update at October 2007
5.3.1 **Combined Code 2003**	The College should review its current corporate governance arrangements against the requirements of the 2003 Combined Code. The College should take action to address any areas of non-compliance to ensure that is compliant for its 2006/07 financial statements.	Agreed. This will reviewed during 2006/07. **Responsible Officer:** Assistant Principal / Director of Finance **Implementation Date:** During 2006/07	As confirmed in the report, the College has complied with the requirements of the Combined Code 2003. **Action taken as agreed**
5.3.2 **Accounts preparation process**	The College was not prepared for the audit. We did not receive draft accounts or working papers on 2 October as agreed. Future delays in the accounts preparation and audit process will result in additional fees and also jeopardises the College meeting its submission deadlines. We understand that the College has now filled its vacancy and are of the opinion that the accounts will be ready as agreed in future.	The vacancy has now been filled. We expect to adhere to the accounts preparation timetable in future. **Responsible Officer:** Assistant Principal / Director of Finance **Implementation Date:** During 2006/07	We received reasonably complete draft accounts and supporting papers soon after the commencement of our audit. However, it was not until a few days into our audit that we received a fully completed draft of the College's accounts. Once received the accounts were of a high standard. We would hope that the College has a full and complete first draft of annual accounts ready at the commencement of our 2007/08 audit. **Ongoing**

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