SCOTT-MONCRIEFF

EDINBURGH AND GLASGOW

Carnegie College

Annual Report to the Board of Management and the Auditor General for Scotland 2007/08

10 December 2008

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Executive Summary

Finance

We have completed the audits of Carnegie College and the College's subsidiary Carnegie Enterprise Limited (CEL). Our audit opinions on the truth and fairness of the financial statements and the regularity of transactions are unqualified.

The consolidated financial statements of the College and CEL show a surplus before transfer from revaluation reserve of £570,000 in 2007/08 (2006/07 – surplus of £657,000). This includes a gain on sale of fixed assets of £400,000. The College had originally budgeted for a group surplus of £625,000 including the gain on sale. The £55,000 variance against budget was due to a fall in CEL's income in the last four months of the year which has been attributed to the general economic downturn.

The College is forecasting surpluses between 2008/09 and 2010/11 in its latest Financial Forecast Return (FFR) submitted to the SFC.

Governance

The College's Corporate Governance Statement confirms that the College has been fully compliant with the key principles of the 2006 Combined Code on Corporate Governance during 2007/08. We have reviewed this statement and are satisfied that the statement is consistent with the Scottish Funding Council's guidance and that the contents are not inconsistent with information gathered during the course of our normal audit work.

We did not identify any areas of concern from our review of the College's corporate governance arrangements in so far as they relate to prevention and detection of fraud and irregularity or standards of conduct and prevention and detection of corruption.

Conclusion

This report concludes the 2007/08 audits of Carnegie College and CEL. We have performed our audits in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards.

This report has been discussed and agreed with the Assistant Principal / Director of Finance. We would like to thank all members of the College's management and staff who have been involved in our work for their co-operation and assistance during our audit.

Scott-Moncrieff
10 December 2008

Introduction

1. This report summarises the findings from our 2007/08 audits of Carnegie College and Carnegie Enterprise Limited. The scope of our audit was set out in our External Audit Strategy & Plan which was presented in its final form to the Audit Committee on 1 September 2008. The main focus of our external audit has been on the financial statements and governance arrangements.

2. Our plan summarised the following key audit issues for 2007/08:

   - Estates Strategy
   - European grants
   - Fife Council Pension Fund liabilities
   - Operating and Financial Review
   - Land Sale to Fife Council

3. This report includes our findings in relation to these key issues and a follow-up of issues identified during our previous audits.

4. This report will be submitted to the Auditor General for Scotland and will be published on Audit Scotland's website, www.audit-scotland.gov.uk.

Finance

5. It is the responsibility of the College to conduct its financial affairs in a proper manner. It is our responsibility to audit the financial statements of the College and its subsidiary and also to consider the College's governance arrangements in relation to its financial position.

Group financial statements

6. We are required to give an opinion as to whether the group financial statements present a true and fair view of the consolidated financial position of the College and CEL as at 31 July 2008 and of its expenditure and income for the financial year. We are also required to include a regularity assertion in our audit report stating whether, 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 financial memorandum with SFC.

7. Our audit is now complete and we have issued unqualified audit opinions on the truth and fairness of the financial statements and on the regularity of transactions.

8. We will now submit the signed financial statements to Audit Scotland who will pass them to the Scottish Government for laying before the Scottish Parliament.

Carnegie Enterprise Limited financial statements

9. The College has also appointed us as external auditor to its subsidiary company – Carnegie Enterprise Limited (CEL). We have issued an unqualified audit opinion on the truth and fairness of the CEL financial statements.

Financial position

10. As shown in the table below, the College achieved a group surplus for the year to 31 July 2008 of £570,000 which was £55,000 behind forecast. This equates to 0.2% of total income.

	2007/08 Actual (£)	**2007/08 Budget (£)**	**2006/07 Actual (£)**
Group surplus on continuing operations before exceptional item	170,000	225,000	657,000
Gain on disposal of assets	400,000	400,000	-
Group surplus on continuing operations after exceptional item	**570,000**	**625,000**	**657,000**

11. The College's internal financial forecasts were consistent with the forecast surplus reported to the Scottish Funding Council (SFC) in the College's 2007 Financial Forecast Return (FFR).

12. The group surplus of £570,000 was achieved through a College surplus of £474,000 (2006/07 - £348,000) and CEL profit of £96,000 (2006/07 - £309,000). CEL had been forecasting a

significantly higher profit, in line with the profits achieved in 2006/07 and 2005/06, which would have eliminated its accumulated profit and loss account deficit during 2007/08. However the company's financial performance was affected by lower than expected income in the last four months of the year, which has been attributed to customers reducing training budgets as a result of the economic downturn. Although the reduced income was partially offset by reduced overhead costs, CEL's overall position was down on original forecasts. As a result, the balance on CEL's profit and loss account remains in an accumulated deficit position (£123,000) at 31 July 2008.

13. The College's surplus of £474,000 exceeded the forecast at the start of the year for a number of reasons including additional grant income as well as cost reduction.

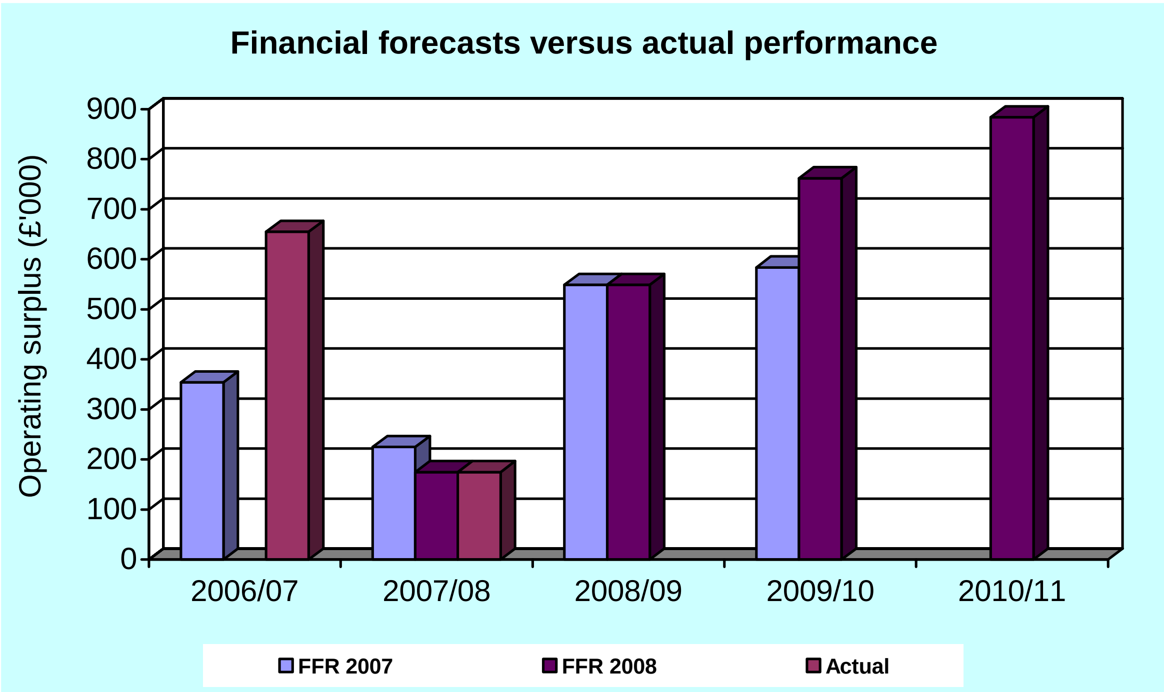
Balance sheet

14. The College has a healthy balance sheet at the year-end with group net assets of £14.014 million. Net current assets stand at £216,000 including £509,000 in bank and cash.

Financial forecasts

15. 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.

16. The graph below compares the actual results for 2007/08 with the FFR forecasts and shows the latest predictions within the 2008 FFR. The operating surplus refers to surplus before gain on sale of fixed assets and any exceptional items.



17. As shown above, the College is expecting to make surpluses between 2008/09 and 2010/11. As stated in its Strategic Plan the College has a target of increasing turnover to £25m and achieving an operating surplus of 3% of total income by 2008/09. The College has acknowledged in the annual Strategic Plan Refresh that it is unlikely to meet these targets. The College's group financial statements showed total income of £23.6m and operating surplus as percentage of income of 0.7% in 2007/08.

Financial planning and monitoring arrangements

18. The College has a responsibility 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.

19. Budgets are devised at the start of the year and these are approved by the Board of Management. The College has a Finance Committee which meets four times a year. Management accounts showing forecast year end positions against budget are presented at each Finance Committee. Significant variances from budget are investigated in detail and management incorporate performance during the period in the decision making process.

20. In our opinion the College has effective financial management arrangements in place.

Financial reporting framework

21. The principal elements of the College's financial reporting framework are:

- Accounts Directions issued by the Scottish Funding Council
- Further Education / Higher Education Statement of Recommended Practice (FE/HE SORP) 2007

22. We are pleased to confirm that the College's 2007/08 financial statements comply with the Accounts Direction and FE/HE SORP 2007 in all material aspects.

FE/HE SORP 2007

23. A revised SORP was issued in July 2007 and was applicable for the first time to the College's 2007/08 financial statements. The main impacts of the revised SORP on the College's financial statement were:

- The Board of Management Report has been replaced with an Operating & Financial Review which includes more detailed analysis of the College's financial and non-financial performance.
- Changes in the required disclosure of defined benefits pension schemes.
- Removal of designated funds from the primary financial statements and the notes to the financial statements.

Financial statements preparation

24. We are grateful to the Assistant Principal / Director of Finance, Head of Finance and Development Funding and the finance staff for their assistance and support during the course of the audit. We found the draft financial statements and supporting working papers to be of a very high standard.

25. There have been staff changes in the Finance Department during the year and this led to a reallocation of the responsibilities for preparing the financial statements. We are pleased to report that this did not result in any delays to the audit.

26. In addition, we found that the College had adequate resource available in the Finance Department to meet the College's financial management and reporting needs going forward.

Audit adjustments

27. We are pleased to report that we did not identify any material adjustments to the draft financial statements. Adjustments identified were generally of a presentational nature.

Review of accounting systems

28. One of the objectives of our audit was to review the accounting systems and internal controls operating at the College to ensure they formed an adequate basis for the preparation of the financial statements.

29. Our audit concluded that accounting systems are generally well designed and operating effectively. We have identified a small number of potential improvements which are set out on the attached action plan.

Action plan – 1 & 2

Other issues arising from the audit

30. In order to assist Board members' understanding of the financial statements and our audit, we have summarised the issues below that we believe are of particular significance in 2007/08.

Estates

31. The College approved its Estates Strategy in December 2007 which included a number of proposals for improvement and rationalisation of its estate. Since the Estates Strategy was drafted, the College has been in discussions with developers over the disposal of the College's Halbeath site in exchange for a purpose built campus at the old Hyundai site in Dunfermline. Negotiations are on-going and the College will not progress with the Estates Strategy until it is clear whether a move to the old Hyundai site is an option. As there are no firm plans in place, the College's Estates Strategy has not has an impact on the 2007/08 financial statements.

32. The College capitalised expenditure of £1.818 million during the year. This was mostly on equipment, including £735,000 for new equipment at the Rosyth campus.

Fife Council Pension Fund liabilities

33. The College's employees belong to two principal defined benefit pension schemes, the Scottish Teachers' Superannuation Scheme (STSS) for the teaching staff and the Fife Council Pension Fund (FCPF) for the non-teaching staff.

34. The STSS is a multi-employer, notionally funded scheme and the College is unable to identify its share of the underlying assets and liabilities of the scheme. In line with Financial Reporting Standard 17 – *Retirement Benefits* (FRS 17), the College does not recognise any asset or liability relating to the STSS and the scheme is effectively accounted for as if it was a defined contribution scheme.

35. The Fife Council Pension Fund is also a multi-employer scheme but the College can identify its share of underlying assets and liabilities and has therefore recognised a net liability in its balance sheet. The College reported a liability of £1.034m as at 31 July 2008, an increase of £536,000. The increase in the liability is principally due to a lower than expected return on the College's pension assets during the year. This was partially offset by a reduction in the College's pension liabilities due to changes in actuarial assumptions.

36. We have reviewed the College's accounting for the pension liability and confirmed that it complies with the requirements of FRS 17 amendment and the new FE/HE SORP and that its disclosure is consistent with the actuaries' valuation.

European grants

37. The current round of European grants has come to an end and a new funding round has been launched. The College was successful in the joint application but was unsuccessful in its own application and the total level of funding available has decreased. The current year's financial statements show that European Grant income only accounts for 3.1% of total income compared with 5.7% of total income in 2006/07.

38. The accounting treatment of the European grants has been appropriate and that the reduced level of expected funding has been factored into the College's financial forecasts.

Disposal of land to Fife Council

39. The College sold a strip of land at the Halbeath Campus to Fife Council who planned to build a road through the land. The College previously used the land as a car park and the Council agreed to pay for the creation of an equal number of car parking spaces as part the consideration for the land. The College received disposal proceeds of £400,000 during the year and recognised the disposal in its 2007/08 financial statements.

40. The disposal included a clause that required the College to repay a proportion of the proceeds if land adjacent to the disposed land was not used for educational purposes. The College consider the likelihood of repayment to be remote and have decided not to recognise a contingent liability in the financial statements.

APUC

41. APUC (Advanced Procurement for Universities and Colleges) Ltd was established in response to the McClelland report – *Review of Public Procurement in Scotland*. The new electronic procurement system is still in its development stage and as such it is too early for the College to assess if there has been any significant benefit from using the new system.

Loss of charitable status

42. The Office of the Scottish Charity Regulator (OSCR) previously published the results of the pilot scheme to review charitable status of a selection of charities including 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 Scottish Government has since announced its intention to protect the charitable status of Scottish FE Colleges and an order has been laid before the Scottish Parliament to this effect.

Governance

43. It is the College's responsibility to ensure that it has adequate governance arrangements in place. It is our responsibility to review and report on these arrangements as they relate to:

- the College's review of its systems of internal control, including reporting arrangements;
- the prevention and detection of fraud and other irregularities;
- standards of conduct and arrangements for the prevention and detection of corruption;
- the College's financial position.

44. We reported on the College's financial position in the Finance section of this report. This section includes our comments on other aspects of the College's governance arrangements.

Corporate Governance Statement

45. Colleges are required to include in their financial statements a statement covering the responsibilities of the Board of Management in relation corporate governance arrangements. The statement should describe the ways in which the College has complied with good practice in corporate governance, including the arrangements for risk management, and report on the College's compliance with the Combined Code on Corporate Governance.

46. The College's Corporate Governance Statement for 2007/08 explains that the College was fully compliant with the 2006 Combined Code throughout the period with the exception of provision B.2.1 of the Code as the College's Chair also chairs the Remuneration Committee. The College does not consider this to be a weakness in governance arrangements as the Chair is not remunerated and therefore is not responsible for setting his own remuneration.

47. We reviewed the Corporate Governance Statement by:

- checking the statement against Scottish Funding Council guidance;
- considering the adequacy of the process put in place by the Principal and Board of Management to obtain assurances on systems of internal control;
- assessing whether disclosures in the statement are consistent with our knowledge of the College.

48. We are satisfied that the statement is consistent with the Scottish Funding Council's guidance and that the contents are not inconsistent with information gathered during the course of our normal audit work.

Combined Code 2006

49. 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 has stated compliance with the 2006 code for the first time in its 2007/08 financial statements.

50. We recommended in our 2006/07 Annual Report that the College should review its corporate governance arrangements against the 2006 code. Although no formal evaluation exercise was performed, all Board members were made aware of the requirements of the 2006 code and the extent to which the College complies has been disclosed in the accounts.

Corporate planning

51. The College has a Strategic Plan which covers the period 2006-09. The Plan operates through the same three year cycle as the Scottish Funding Council Corporate Plan which, in some ways, informs, supports and complements the College's Strategic Plan.

52. The College reviewed and updated its Strategic Plan in 2007/08. During 2008/09 the College plans to develop a Strategic Plan to cover the period 2009-12.

Risk management

53. Risk management is important to the establishment and regular review of systems of internal control. We review the College's risk management arrangements as part of our audit work on corporate governance.

54. The College has a Risk Management Policy and risk management procedures, which were revised during 2007/008, are outlined in the College's Financial Regulations. The College's risk management arrangements were reviewed and revised during the year. The Assistant Principal / Director of Finance is responsible for maintaining the Strategic Risk Register and changes to the risk register are reported to the Audit Committee at quarterly meetings. 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.

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

Internal audit

56. 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. In the previous year 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 SFC's Code of Audit Practice.

57. To avoid duplication of effort and ensure an efficient audit process, we have made use of internal audit work where appropriate. During 2007/08 we have reviewed the following internal audit reports:

    - IT follow-up
    - Tuition fees
    - Human resource management

- Project development
- SUMS audit
- Follow-up

58. We considered the results from these reports on our own risk assessments and adjusted our planned work accordingly.

Internal audit's conclusion

59. Internal audit has concluded in its annual report that management has substantial assurance that the internal controls and governance frameworks which it operates are sufficient to ensure the effective and efficient operation of the organisation.

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

Prevention and detection of fraud and irregularity

61. 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.

62. The College has a fraud prevention policy, fraud response plan and whistle blowing policy in place. The College has identified a fraud liaison officer and a whistle-blowing officer. There were no frauds identified during the year.

63. All SFC and other guidance and regulations are received by the Principal's secretary. All relevant regulatory information is distributed to the appropriate members of staff. A database is held of all SFC circulars and responsible officers. All relevant guidance is presented to the Board of Management meetings ensuring that all those concerned have access to adequate and relevant information.

64. 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 with regard to the legality of transactions.

Standards of conduct

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

66. 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 Government.

67. 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. We also considered controls over ordering and procurement and disposal of assets.

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

Looking Forward

69. In this section, we highlight some recent or emerging issues that are likely to impact on our next year's audit.

Financial position

70. The Scottish Funding Council has provided significant increases in funding to the Scottish FE sector in the past decade. The Spending Review and indications from the Scottish Government are that they will be no further significant increases. In addition to this the College will have reduced European grant income. Coupled with increasing cost pressures this will result in limited financial resources for the Further Education sector.

Estates Strategy

71. The College will be deciding on its estates plans in the near future and this will impact on its financial resources. We will closely monitor the College's financial position in future years when the implications of any formal plans have been incorporated into the analysis.

Combined Code 2008

72. The Financial Reporting Council (FRC) issued an updated Combined Code in June 2008. The updated code is applicable to accounting periods beginning on or after 28 June 2008. The updated code includes two amendments from the 2006 code. The first amendment is in relation to FTSE 100 companies and does not apply to the College. The second amendment is to allow the Chairman to sit on the Audit Committee where the Chairman was considered independent on appointment. The College's 2008/09 Corporate Governance Statement should state compliance with the 2008 Code. We will determine whether the College has complied with the Combined Code 2008 during our 2008/09 audit.

Action Plan – 3

Appendix 1 – Action Plan

73. Our annual report action plan details the control weaknesses and opportunities for improvement that we have identified during 2007/08. These are the issues that we believe need to be brought to the attention of the College.

74. 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.

Priority rating

75. 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.

Issues from our 2007/08 audit

Action point	Para ref	Issue identified and recommendation	Management response
1	29	**Journal review** Journals can be raised by any member of the finance team and there is no authorisation process. This creates a risk that incorrect information is entered into the College's nominal ledger. The College should consider: • Reviewing journals prior to posting • Reviewing posted journals on a regular basis for any unusual items. ***Priority 2***	Agreed ***To be actioned by:*** Head of Finance and Development Funding ***No later than:*** January 2009

Action point	Para ref	Issue identified and recommendation	Management response
2	29	**Fixed asset verification** The College does not undertake a verification exercise of fixed assets held on a regular basis. There is a risk that the financial records do not reflect the underlying assets. The College should conduct an annual verification exercise to confirm the existence and condition of all assets held. ***Priority 2***	Agreed ***To be actioned by:*** Assistant Principal / Director of Finance ***No later than:*** July 2009
3	72	**Combined Code 2008** A revised Combined Code on Corporate Governance was issued in 2008, which supersedes the Code issued in 2006. We recommend that the College updates its self-assessment to reflect the requirements on the new Code. ***Priority 3***	Agreed ***To be actioned by:*** Assistant Principal / Director of Finance ***No later than:*** July 2009

Follow-up of issues from previous external audits

Follow-up point	Original recommendation and management response	Update at December 2008
Combined Code 2006	A revised Combined Code on Corporate Governance was issued in June 2006, which superseded the Code issued in 2003. We recommended that the College should perform a self assessment against the requirements of the Combined Code. ***Priority 2*** **Management Response:** Agreed. ***Responsible Officer:*** Assistant Principal / Director of Finance ***Implementation Date:*** January 2008	The College performed a self-assessment during the year and reported the results of this assessment in its Corporate Governance Statement. ***Action taken as agreed***
FE/HE SORP 2007	A revised SORP was issued in July 2007 and was 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. To minimise disruption during the year end accounts process, we recommended that the College prepare its OFR in advance of the 2007/08 accounts preparation process. ***Priority 2*** **Management Response:** Agreed. ***Responsible Officer:*** Assistant Principal / Director of Finance ***Implementation Date:*** July 2008	Operating and Financial Review had been prepared in advance of our final audit visit. ***Action taken as agreed***

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