SCOTT-MONCRIEFF

EDINBURGH AND GLASGOW

Carnegie College

Annual Report to the Board of Management and the Auditor General for Scotland 2008/09

December 2009

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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 opinion on the truth and fairness of the College's financial statements and the regularity of transactions is unqualified. Our audit opinion on the truth and fairness of the CEL financial statements is unqualified.

The 2008/09 consolidated financial statements showed an operating deficit, before a £4,000 gain on disposal of fixed assets, of £1.112m (2007/08: surplus of £170,000). The College had originally budgeted for a group surplus of £550,000. The group's outturn position included £671,000 of exceptional restructuring costs related to the College's restructuring of academic and support services during 2008/09 and the associated staff severance costs. The restructuring exercise was in response to growing costs pressures which became apparent in mid-year forecasts, and which therefore were not incorporated into the College's original budgets. The economic downturn impacted on the CEL outturn, which led to a significantly lower contribution to the group position than originally forecast.

The College is forecasting operating surpluses of £716,000 in 2009/10 and £710,000 in both 2010/11 and 2011/12 its latest Financial Forecast Return (FFR) to the Scottish Funding Council (SFC). The forecasts include projected savings of £900,000 per annum arising from the restructuring exercise.

Governance

The College's Corporate Governance Statement confirms that it has been compliant with the key principles of the 2008 Combined Code during 2008/09, except for the Board Chair also acting as Chair of the Remuneration Committee. The College undertook a self assessment against the requirements of the 2008 Combined Code and found no other areas of non-compliance. This is not considered to be a significant weakness in governance arrangements as members are not remunerated. We have reviewed the statement and are satisfied that it is consistent with SFC'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 2008/09 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
December 2009

Introduction

1. This report summarises the findings from our 2008/09 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 to the Audit Committee on 16 September 2009. 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 2008/09:

   - College reconfiguration
   - Estates
   - Fife Council Pension Fund liabilities
   - Combined Code 2008

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 2009 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 complete and we have issued an unqualified audit opinion on the truth and fairness of the financial statements and on the regularity of transactions.

Carnegie Enterprise Limited financial statements

8. 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

9. The 2008/09 consolidated financial statements of the College and CEL show an operating deficit, before a £4,000 gain on disposal of fixed assets, of £1.112m in 2008/09 (2007/08: surplus of £170,000 - £570,000 after gain on disposal of fixed assets).

10. The original budget forecast surpluses for the College and CEL of £75,000 and £474,000 respectively. As shown in the table below, the variance from original forecasts related to a combination of reduced income (in particular commercial income generated by CEL), staff severance costs and additional staffing and operating costs.

Budget to actual reconciliation

	£'000
Surplus per original budget (consolidated)	**549**
Variances:	
Lower than budgeted return from CEL	(430)
Exceptional restructuring costs	(671)
Additional staffing and operating cost movements	(569)
Provision created	(70)
Other variances	79
Actual deficit per financial statements (consolidated)	**(1,112)**
Variance from original budget	**(1,661)**

Carnegie Enterprise Limited

11. CEL is a wholly owned subsidiary of the College and as such is fully consolidated into the College's financial statements. During 2008/09 CEL generated income significantly lower than originally forecast due to the economic downturn. This was only partially offset by reduced operating costs, leading to a profit of £34,000.

12. Both the CEL Board and the College Board of Management were advised of and discussed the potential impact of the economic downturn, particularly regarding commercial activity, within the first quarter of the financial year. Action was taken to ensure appropriate revised cash flows were in place and financial forecasts were adjusted to reflect a more realistic set of circumstances and targets.

Exceptional Restructuring Costs

13. The group incurred a total of £671,000 in costs associated with the restructuring exercise (CEL element: £10,250). During the year the College identified that a total of £1m of recurring savings were required. As all non-staff savings had been consolidated within original draft budgets, the College decided that savings would have to be generated through reductions in staff costs.

14. The Senior Management Team undertook a significant exercise, in parallel with the curriculum review and consultation with the unions, to identify areas where savings within staff costs could be made. The resultant severance costs incurred impacted heavily on the 2008/09 financial outturn. However, the Board believe these measures were essential in order to deliver required savings from 2009/10 onwards. The College estimates it will make annual savings of £900,000 following this exercise.

Additional staffing and operating cost movements

15. College staffing costs were significantly higher than original budget due to the appointment of temporary teaching staff within the year. (The College has addressed this for 2009/10 by being tighter on staffing budgets and reviewing timetabled teaching hours to ensure that all permanent staff are timetabled before any temporary staff are appointed). Further, forward projections on the Fife Council Pension Fund suggested expected returns on the scheme's investment would be equal to the shortfall which required to be funded. Due to movements aligned to the economic downturn during the year this turned out to lead to a net cost within the overall staff cost movement, of almost £150,000.

16. There was also an overspend on materials, particularly in engineering as the original budget had been set incorrectly. This error was addressed in-year to allow the College to prepare a more accurate budget. The College incurred substantial unbudgeted software licence costs of approximately £60,000.

17. Partly offsetting the above, depreciation was £87,000 below forecast and interest payable £27,000 less than budget.

Provision

18. Included within the annual accounts is a provision that the College has created for an ongoing legal dispute. The estimated provision of £70,000 is based on legal advice and is reflected within the College's operating costs. Due to the nature and timing of the expenditure it would not have been possible for the College to include this estimate within its initial forecasts.

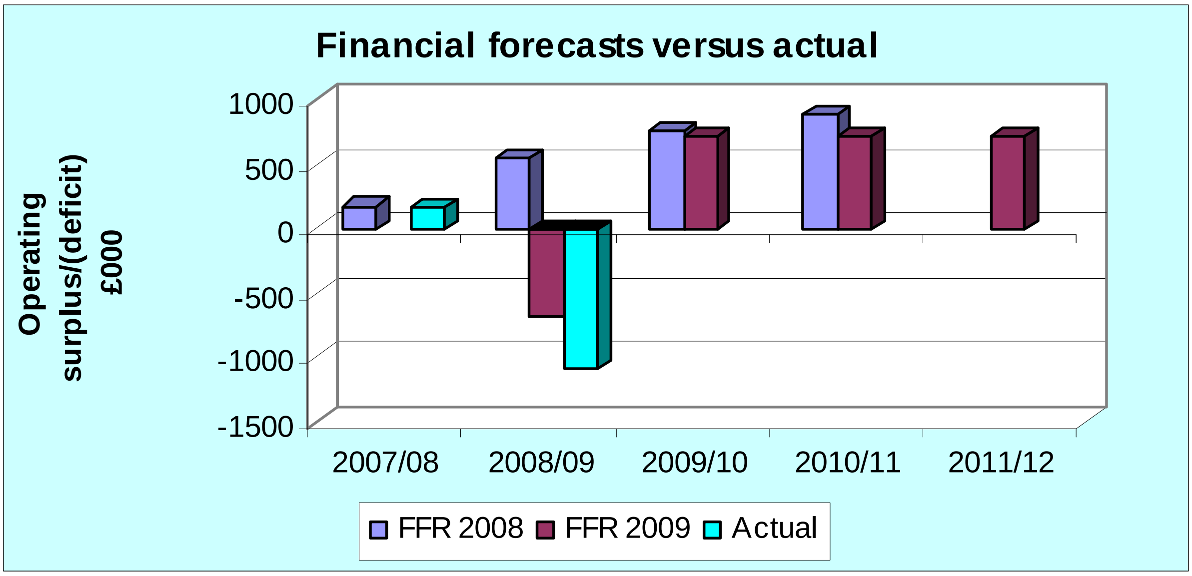
Balance sheet

19. The College has a healthy balance sheet at 31 July 2009, with net group assets of £9.015m (2007/08: £14.014m). The year-on-year movement is mainly through the group deficit for 2008/09, coupled with the increase in the net pension liability of £3.427m. The group has a negative cash and bank figure of £1.103m, after the College increased its overdraft facility during the year to pay the severance costs incurred.

Financial forecasts

20. 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.

21. The graph below compares the actual results for 2007/08 and 2008/09 with previous FFR forecasts and shows the latest predictions within the 2009 FFR.



Source: College 2008 and 2009 FFR returns

22. As shown above, the College is expecting to make operating surpluses of £716,000 in 2009/10 and £710,000 in both 2010/11 and 2011/12. The 2009 FFR incorporates the savings attributed to 2008/09 restructuring exercise.

Financial planning and monitoring arrangements

23. 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.

24. 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.

25. The College revised its budgets in November 2008 to reflect additional information regarding costs and forecast income, given the external economic environment. This provided a more realistic basis on which to measure and compare outturn financial performance.

26. We acknowledge that 2008/09 represented a challenging year across the FE sector. However, the College's original 2008/09 budget has been shown to be significantly adverse compared to forecasts. The College has reconsidered its budgeting approach for 2009/10 and has taken steps to be more prudent and improve outturn position going forward. For example, the College estimates it will make annual savings of £900,000 following the VSS exercise and it is being prudent in no longer incorporating any projected surpluses from CEL in its budget forecasts.

Financial statements preparation

27. We are grateful to the Assistant Principal / Director of Finance and 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 good standard.

28. 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 have an adverse impact on our audit work.

Audit adjustments

29. The College is recognising £27,000 in relation to fee-waiver income above the allocation SFC has confirmed to date. SFC has generally funded such 'additional' claims in previous periods. However, the current economic climate and the rise in the level of such claims across the sector as a whole has increased the uncertainty over the SFC response to this situation for 2008/09. As a result - and from our consideration of past SFC action and future fee waiver uplifts being applied - we have proposed a more prudent approach of recognising half of this amount in 2008/09. (If subsequently received in full, the balance would be recognised within the 2009/10 financial statements).

30. The above adjustment has not been made in the accounts. We do not consider it to be material and we have included it within our schedule of unadjusted errors as an appendix to our letter of representation.

31. We did agree three adjustments with management, which have been reflected in the revised accounts. There were misstatements within the balance sheet with £55,000 of debit balances within trade creditors and £92,000 of credit balances within trade debtors. We also agreed one adjustment of £70,000 to correct the accounting treatment of a provision made by management in the accounts. Other adjustments identified were generally of a presentational and disclosure nature.

Review of accounting systems

32. 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.

Asset verification

33. The College's fixed assets are revalued every five years, with an interim valuation performed in year three. No verification exercise was undertaken during 2008/09. We recommend that the College conducts an annual verification exercise in years when revaluations are not being performed.

Action Plan Follow Up - Point 2

34. A small number of assets within the CEL accounts had been incorrectly recorded within the fixed asset register at their inception. The resulted in a small error in the timing of depreciation charges for these assets. Our audit testing confirmed that the error was only attributable to a limited number of assets and that the impact on the accounts was very small. Going forward, however, asset additions should be recorded in the asset register correctly and an appropriate depreciation charge should be applied which matches the useful economic life of the asset.

Action Plan - Point 1

35. Other than the issues above, we identified no reportable control weaknesses during our audit of the accounting systems. In general, the systems of internal financial control appear to be adequate, well designed and operating effectively.

Other issues arising from the audit

36. In order to assist understanding of the financial statements and our audit, we have summarised below the issues that we believe are of particular significance to the 2008/09 financial statements, as identified in our 2008/09 External Audit Plan.

Estates

37. The College approved its Estates Strategy in December 2007 which included a number of proposals for improvement and rationalisation of its estate. Initial 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 did not materialise and this remains remote option for the College. Other options range from disposal of existing premises and development of new premises to a significant refurbishment of the existing Halbeath campus.

38. Due to the downturn in the economy, development plans have been delayed. The Estates Strategy has not had a major impact on the 2008/09 financial statements.

39. The College did have notable capital additions of £873,000 (CEL: £63,000) during the year, primarily relating to work on the Beauty Therapy Centre. The College disposed assets with a carrying value of £62,830 in 2008/09, generating a gain on disposal of £3,528.

40. During our audit we confirmed that the College’s capital transactions had been appropriately reflected within the annual accounts.

Fife Council Pension Fund liabilities

41. 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.

42. 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.

43. 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 £4.461m as at 31 July 2009, an increase of £3.427m compared to prior year. The increase in the liability is reflective of the external economic environment and adverse changes in actuarial assumptions.

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

College Reconfiguration

45. As part of the College's restructuring exercise, the College has moved from a six school to three school model to deliver services as efficiently and effectively as possible.

46. A total of 29 College staff took severance as part of the process, and a total of £671,000 in costs associated with the restructuring exercise was incurred (CEL element: £10,250).

47. We have confirmed that the severance costs have been accurately reflected within the College's financial statements and that estimated savings (of £900,000 per annum) have been incorporated into the College's future financial forecasts.

Governance

48. 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

49. 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

50. 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.

51. A revised Combined Code on Corporate Governance was issued in June 2008, which supersedes the Code issued in 2006. The College has stated the extent of its compliance with the 2008 code for the first time in its 2008/09 financial statements.

52. The College's Corporate Governance Statement for 2008/09 explains that the College was compliant with the 2008 Combined Code, as applicable to the sector, throughout the period with the exception of provision B.2.1 of the Code, as the Board Chair also chairs the Remuneration Committee. This is not considered to be a significant weakness in governance arrangements as members are not remunerated.

53. 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

54. We are satisfied that the statement is consistent with SFC guidance and that the contents are not inconsistent with information gathered during the course of our normal audit work.

Combined Code self assessment

55. We recommended in our 2007/08 Annual Report that the College should review its corporate governance arrangements against the 2008 code. We confirmed during our 2008/09 audit that the College undertook a review of compliance against the combined code and no areas of non-compliance were identified, other than that disclosed above.

Corporate planning

56. During the year the College produced an updated strategic plan for the period 2009-14. The plan builds upon the strategic aims of the previous 2006-09 plan, and adds in a new aim to *"invest in the development of robust information systems, intelligence gathering and knowledge management."* The College also has an operational plan which underpins the strategic plan. This outlines the College's operational targets, including financial targets.

Risk management

57. 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.

58. The College has an established Risk Management Policy, with underpinning procedures in place. The College revised its strategic risk register during the year to further improve clarity and understanding. The Assistant Principal / Director of Finance is responsible for maintaining the register. Amendments to the register are reported to the Audit Committee at quarterly meetings, as delegated by the Board. The Audit Committee is supported in the monitoring and management of risk by the College's Executive Group.

59. Overall, the College's risk management systems in place appear sufficient and appropriate.

Internal audit

60. Internal audit is a key component of the Board's corporate governance arrangements. The Board's internal audit service is provided by Chiene + Tait. We have considered the internal audit arrangements and concluded that there is a sufficient and appropriate service in place

61. To avoid duplication of effort and ensure an efficient audit process, we have made use of internal audit work where appropriate. We reviewed the following internal audit reports and integrated the findings with our own external audit work:

- Academic Support Groups
- Data Interrogation of Payroll
- Quality review
- Data Protection
- SUMS audit

- Follow-up

Internal audit's conclusion

62. 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.

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

Prevention and detection of fraud and irregularity

64. 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.

65. 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.

66. The College has a robust system in place for ensuring compliance with all relevant guidance and regulations. 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, which is monitored by the Principal's Secretary.

67. 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

68. As part of our audit we are required to consider the arrangements made by management in relation to standards of conduct and prevention and detection of corruption.

69. 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. The Scottish Government has issued guidance on standards of conduct, accountability and openness.

70. 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.

71. We are pleased to report that our audit identified no issues of concern in this area.

Looking Forward

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

Financial position

73. SFC has provided significant increases in funding to the Scottish Further Education sector in the past decade. The Spending Review and indications from the Scottish Government are that there will be no further significant increases. Coupled with increasing cost pressures this will result in limited financial resources for the sector.

74. The College has identified that annual savings of £1m are required in order for the College to meet its financial targets. The restructuring exercise undertaken during 2008/09 is forecast to generate £900,000 of savings, with further non-payroll efficiency savings being targeted across the College on an in-year basis.

Estates Strategy

75. One of the College's strategic aims is to develop an estate that is fit for 21st century learning. Due to the downturn in the economy, development plans have been delayed.

76. The College is still exploring a range of estate development options and aims to confirm the preferred option by 2012-13. During 2009-10, the focus is to be on the use of the existing premises in line with the recently restructured academic and support services. We will review developments with the Estates Strategy and the impact on College resources as part of our 2009/10 audit.

Edinburgh Napier University Collaboration

77. The College is exploring potential joint venture options with Edinburgh Napier University, believing that strategic aims could be met more efficiently and effectively through joint working arrangements. This is particularly so in relation to higher education objectives. The College has also acknowledged that collaboration could offer benefits in terms of its estates utilisation.

78. As yet, no formal arrangement has been agreed between the organisations. However, we will monitor ongoing developments and consider any impact this may have on the College's as part of our 2009/10 audit.

Appendix 1 – Action Plan

79. Our annual report action plan details the control weaknesses and opportunities for improvement that we have identified during 2008/09. These are the issues that we believe need to be brought to the attention of the College.

80. 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

81. 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:

Grade 5	Very high risk exposure - Major concerns requiring Board attention.
Grade 4	High risk exposure - Material observations requiring management attention.
Grade 3	Moderate risk exposure - Significant observations requiring management attention.
Grade 2	Limited risk exposure - Minor observations requiring management attention
Grade 1	Efficiency / housekeeping point.

Issues arising during our 2008/09 audit

No	Title	Issue identified	Risk and recommendation	Management comments
1	**Fixed Asset Accounting System** **(Para 34)**	A small number of assets within the CEL accounts had been incorrectly recorded within the fixed asset register at their inception. The resulted in a small error in the timing of depreciation charges for these assets. Our audit testing confirmed that the error was only attributable to a limited number of assets and that the impact on the accounts was very small.	There is a risk that assets are incorrectly stated in the accounts. Asset additions should be recorded in the asset register correctly and an appropriate depreciation charge should be applied which matches the useful economic life of the asset. ***Grade 1***	Agreed. **Responsible officer:** Principal Management Accountant **Implementation date:** Ongoing.

Follow up from our 2007/08 audit issues

No	Title	Original recommendation and management response	Update at October 2009
1	**Journal authorisations**	**Original Recommendation** Journals can be raised by any member of the finance team and there is no authorisation process. The College should consider controls in relation to reviewing journals prior to posting and/or reviewing posted journals on a regular basis for any unusual items. **Management Response** Agreed.	The College has introduced a journal review procedure. A monthly review of all manual journals posted is undertaken by the Finance Manager. The review includes investigation of any large or unusual amounts, as well as confirming that all journal entries have been posted by authorised users. We confirmed that this procedure was in place and operating as designed during 2008/09. **Completed**

No	Title	Original recommendation and management response	Update at October 2009
2	**Fixed Asset Verification**	**Original Recommendation** The College does not undertake a verification exercise of fixed assets held for 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 to confirm the existence of all assets held. **Management Response** Agreed.	The College did not undertake an asset verification exercise during the year. An exercise was undertaken after the year end and the College will implement this exercise annually. **Responsible officer:** Head of Finance **Implementation date:** July 2010
3	**Combined Code 2008**	**Original Recommendation** 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. **Management Response** Agreed.	We confirmed during the year that the College undertook a self-assessment against the Combined Code and confirmed that, with the exception of the points noted within the annual accounts, were compliant with the Code. **Completed**

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