Carnegie College

Annual Report to the Board of Management and the Auditor General for Scotland 2009/10

December 2010

Scott-Moncrieff

Carnegie College

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

The 2009/10 consolidated financial statements show an operating surplus of £337,000 (2008/09: deficit of £1.108m). The College is expecting to make an operating surplus of £504,000 in 2010/11 before returning deficits of £139,000 in both 2011/12 and 2012/13 in its latest Financial Forecast Return (FFR) to the Scottish Funding Council (SFC). This is reflective of the increasingly challenging funding environment in which the College will be operating.

On 22 June 2010, the Chancellor of the Exchequer's Budget Statement outlined that future pension increases were to be linked to the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI). This has had a substantial impact on the College's actuarial valuation and is expected to significantly reduce the College's pension liabilities going forward. There is also a one-off adjustment in favour of the College of £1.190m arising from this change, reflected in the College's Statement of Recognised Gains and Losses in the year.

Governance

The College's Corporate Governance Statement once again confirms that it has been compliant with the key principles of the 2008 Combined Code during 2009/10, except for the Board Chair also acting as Chair of the Remuneration Committee. This is not considered to be a significant weakness in governance arrangements as board 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 2009/10 audits of Carnegie College and CEL Ltd. 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
15 December 2010

Introduction

1. This report summarises the findings from our 2009/10 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 15 September 2010. 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 2009/10:

   - SFC Funding for Fee Waiver
   - College reconfiguration
   - Job Evaluation Process
   - Estates
   - Fife Council Pension Fund liabilities
   - Mediaspace Lease review
   - Treatment of the $1m Canadian donation

3. This report includes our findings in relation to these key issues as well as our follow-up of issues identified in previous years.

4. The 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. In this section we summarise the key aspects of the College's reported financial position and performance to 31 July 2010. We also outline significant financial issues identified during the course of our audit. 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 and to consider the governance arrangements in relation to the College's 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 2010 and of the expenditure and income for the financial year. We are also required to include a regularity assertion as part of 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

The College reported good financial results for the year to 31 July 2010

9. The 2009/10 consolidated financial statements show an operating surplus of £337,000 (2008/09: deficit of £1.108m). This 2009/10 surplus is a significant turnaround to the deficit reported in 2008/09. That deficit was largely as a result of the voluntary severance exercise undertaken in that year (£671,000), coupled with some unexpected staff costs and a lower than budgeted return from CEL Ltd. In 2009/10, the College has seen the benefits of the voluntary severance exercise and has implemented further measures to improve staff utilisation.

10. The surplus returned for 2009/10 is largely in line with the budget surplus of £550,000 (note that this budget surplus reflects the position before the I&E impact of FRS 17 is factored in). The main reason for the variance relates to pension costs of £183,000 which were not included in the budget as these costs are taken from the actuarial valuation of the pension fund which is not received until after year end.

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. The company's trading continues to be adversely impacted by the challenging financial operating environment, although tight control of the cost base to align with business activity throughout 2009/10 has led to a £100,000 profit being returned. This represents a near three-fold increase on the £34,000 profit in 2008/09.

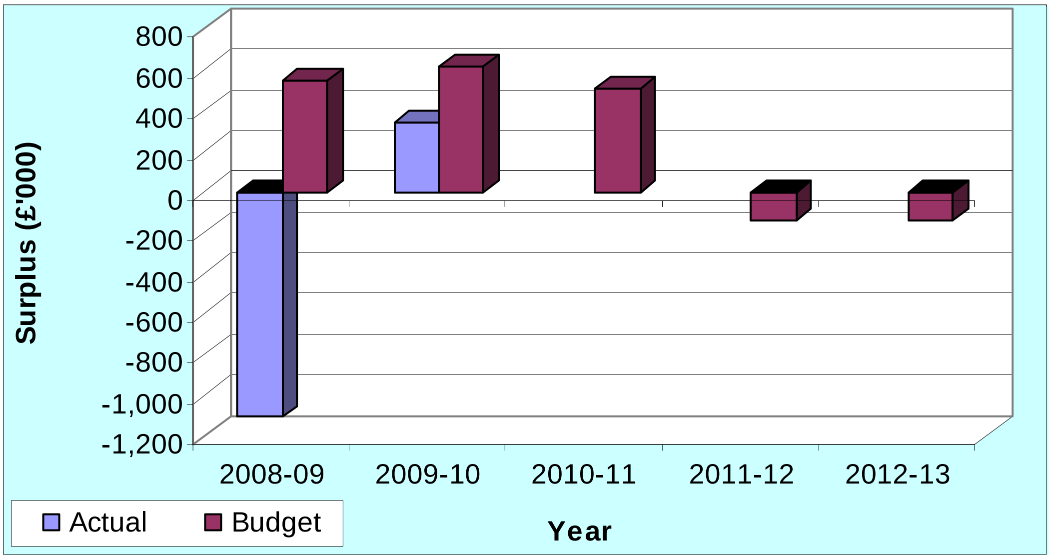
Balance sheet

12. The College has a healthy balance sheet at 31 July 2010, with net group assets of £10.449m (2007/08: £9.015m). The year-on-year movement mainly relates to the surplus for the year and the movement on the pension reserve to reflect changes in the pension scheme position as at 31 July 2010.

Financial forecasts

13. 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. Diagram 1 below compares the actual results for 2009/10 with FFR forecasts and sets out projections for the next three years.

Diagram 1 – Actual Performance and FFR forecasts



Source: Annual Accounts and College FFR returns to SFC

14. As shown above, the College is expecting to make an operating surplus of £504,000 in 2010/11 before returning deficits of £139,000 in both 2011/12 and 2012/13. The figures in 2009/10 onwards incorporate the savings arising from the 2008/09 restructuring exercise. These projections are reflective of the increasingly challenging funding environment in which the College will be operating. Assumptions factored into the latest FFR return include 3% reductions in SFC funding in 2011/12 and 2012/13 respectively and a decrease of some 20% in tuition fee and education contract income in 2010/11.

Financial planning and monitoring arrangements

The College has appropriate financial management arrangements in place

15. 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.

16. 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 meeting. Significant variances from budget are investigated in detail and management incorporate performance during the period in the decision making process.

17. In our opinion the College has appropriate financial management arrangements in place and we are pleased to note that it is taking steps to address the future funding challenges posed by the current economic climate. However, continued work is required to monitor ongoing developments in this area and achieve recurring financial balance in the coming years.

Financial statements preparation

18. 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.

Audit adjustments

19. During the course of our audit a small number of adjustments to the financial statements were identified. The table below outlines the impact of the adjustments on the outturn position. The majority of the changes made were of a presentational and disclosure nature.

Table 1 - Adjustments identified during the audit impacting on the outturn

	£'000
Surplus per accounts originally presented for audit	**1,527**
Adjustments identified during the audit:	
Amendment to FRS 17 accounting (CPI/RPI movement): see paragraph 30 for further details	(1,190)
Actual surplus per audited accounts	**337**

20. We also agreed adjustments to the College's accounting for fixed assets, reflecting the change in payments being made by the College for the Mediaspace facility at Halbeath. This effectively revised the value of the asset on the balance sheet to reflect the present value of future minimum

lease payments (net book value of £2.08m as at 31 July 2010). The disclosure in relation to this transaction has also been updated in the accounts.

21. One adjustment proposed within the College accounts which was not accepted management was in relation to SFC fee waiver recognition. As in previous years, the College has recognised fee waiver income above the initial allocation confirmed by SFC. SFC has funded such additional claims in the past. However, there is increasing uncertainty through a combination of the adverse economic climate, the rise in these claims across the sector and more recently from SFC introducing a 15% excess threshold, at which it is expected future claims will generally be capped. The amount the College is recognising in 2009/10 for fee waiver is £156,000 over the 15% threshold (although 2009/10 will be a transitional year, during which it is unclear what effect this 15% threshold will have on additional claims). As the College has not made this adjustment (which would reduce the surplus to £181,000 for the year), we will include this difference within our letter of representation. We do not believe this adjustment is material to the accounts.

22. An audit adjustment of £4,000 was also identified within the CEL Ltd accounts, in relation to a debtor being recognised which has been outstanding for several periods. As this adjustment has not been made we will include it within the CEL Ltd letter of representation. We do not believe this adjustment is material to the accounts.

Review of accounting systems

23. 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.

Endowment accounting

24. One of the presentational adjustments we discussed and agreed with College management during our audit was in relation to accounting for the $1m (Canadian) / £640,000 philanthropic donation. This donation has been made to support the new Whitlock Energy Collaboration Centre at the Rosyth Campus. The Statement of Recommended Practice: Accounting for Further and Higher Education (SORP 2007), coupled with the SFC model set of accounts, sets out a specific accounting approach that effectively keeps this restricted funding separately identifiable within the College’s accounts. This has resulted in an expendable endowment of £632,000 within the College’s balance sheet as at 31 July 2010.

25. The College will have to ensure that these funds are administered separately and, given the restrictions as a condition of receiving the funding, applied solely towards the Whitlock Energy Collaboration Centre. This can have various implications, including the need to maintain sufficient and appropriate accounting records for the endowment and ensuring appropriate banking/investment tracking arrangements are put in place.

Action plan point 1

26. Other than the issue 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 of particular significance to the 2009/10 audit

27. 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, and which have not already been discussed fully in our report.

Fife Council Pension Fund liabilities

28. 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.

29. 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.

30. 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 £3.695m as at 31 July 2010, compared to £4.461m as at 31 July 2009. The main reason for the reduction was that on 22 June 2010, the Chancellor of the Exchequer's Budget Statement outlined that future pension increases were to be linked to the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI). As CPI will generally be lower than RPI this change in assumption reduces the College's pension liability. There is also a one-off adjustment in 2009/10 in favour of the College of £1.190m arising from this change. This was originally being accounted for in the College's Income and Expenditure account but after review of relevant accounting guidance it was agreed to reflect the movement in the College's Statement of Recognised Gains and Losses in the year.

31. 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 actuarial valuation report.

Estates

32. Given the financial climate and other external factors, there have been no significant developments in this area in 2009/10. We will monitor any progress made and consider any impact on the 2010/11 annual accounts.

Job evaluation exercise

33. The College continues to progress its job evaluation exercise for non-academic staff. We have not identified any implications arising for 2009/10. We will continue to monitor developments into 2010/11 in this area.

Governance

34. 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

35. 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

Governance arrangements at Carnegie College remain strong

36. Colleges are required to include in their annual accounts a statement covering the responsibilities of their 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.

37. The College's Corporate Governance Statement for 2009/10 explains that the College was fully compliant with the 2008 Combined Code throughout the period, as applicable to the sector, except for provision B.2.1 as the Board Chair also chairs the Remuneration Committee. This is not considered to be a weakness in governance arrangements as members are not remunerated.

38. 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

39. 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.

In 2010/11, the College will have to report against revised Corporate Governance standards

40. A new Corporate Governance Code was published in June 2010 and will apply to financial years beginning on or after 29 June 2010. The UK Corporate Governance Code, formerly known as the Combined Code, sets out standards of governance for listed companies. The Code is also applicable to publicly funded bodies that are required to prepare an annual statement on internal control or corporate governance for inclusion in their annual accounts. The "comply or explain" provision is retained in this new version of the code.

41. We recommend that the College reviews its corporate governance arrangements against the new Code in preparation for making its Corporate Governance Statement in its 2010/11 annual accounts. We have undertaken an analysis of the key changes applicable to education bodies and will be sharing this guidance with College management to help inform this assessment.

Action plan point 2

Risk management

The College has appropriate strategic risk management systems in place

42. 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.

43. 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.

44. Overall, the College's risk management systems in place are sufficient and appropriate.

Internal audit

45. Internal audit is a key component of the Board's corporate governance arrangements. The Board's internal audit service in 2009/10 was provided by Chiene + Tait. We have considered the internal audit arrangements and concluded that there is an effective service which complies with relevant sector guidance.

46. 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:

- Risk Management
- Internal Communications

- Curriculum Development and Management
- HR Absence Management
- Business Continuity Management
- SUMS audit
- Follow Up

Internal audit 2009/10 conclusion

47. 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 and that the strategic and operational risks to which the organisation is exposed are being managed".

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

Prevention and detection of fraud and irregularity

49. We are required to consider the arrangements made by management for the prevention and detection of fraud and irregularity. We also consider the arrangements that the College has in place to ensure compliance with all relevant guidance and regulations.

50. 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.

51. The College has an appropriate 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. 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.

52. We identified no issues of concern in relation to the arrangements for the prevention and detection of fraud, with regard to the legality of transactions or in relation to compliance with relevant guidance and regulations.

Standards of conduct

53. 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.

54. 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.

55. 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.

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

Looking Forward

Financial position

57. There is increasing uncertainty over the level of future funding that will be provided to the sector and indications from the Scottish Government are that there will be no significant increases in future funding. Coupled with increasing cost pressures, this will result in limited financial resources for the sector. Whilst College management have been making plans to react and respond to this situation, the true impact has yet to be confirmed and the College's assumptions underpinning its response have yet to be tested. Whatever the outcome, all indications are that the coming years will prove a time of more restraint for the FE sector than compared with recent periods.

International financial reporting standards

58. The College's financial statements are currently prepared on the basis of UK accounting standards (UK GAAP) which the Statement of Recommended Practice: Accounting for Further and Higher Education (SORP) Board believes continues to be appropriate for colleges.

59. The Scottish Funding Council's expectation is that Colleges will continue to converge with international financial reporting standards (IFRS) as UK GAAP converges with IFRS over the next few years. It appears likely that full implementation will not take place before 2013. Whilst this is some time away, the conversion process requires sufficient and appropriate information to be available to support the production of comparator balances. Effectively, this means work to produce full IFRS-compliant financial statements will begin at least one year before the actual implementation date. In some areas, such as in relation to fixed assets and component accounting, the earlier the work begins the more straightforward the conversion process may be.

60. We will continue to monitor developments in this area and ensure that the College continues to follow the appropriate accounting standards. We will also continue the dialogue we have opened with College finance management regarding the implications of the move to IFRS for the College.

Appendix 1 – Action Plan

Our annual report action plan details the financial control weaknesses and opportunities for improvement that we have identified during our audit visit in addition to any reportable matters arising from our review of performance and governance systems.

The action plan details the officers responsible for implementing the recommendations and implementation dates. The College should assess these recommendations for their wider implications before approving the action plan. Following submission of this report to the Audit Committee, we will send a copy to the Auditor General.

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.

Grading

To assist the Board in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been graded. The grading 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 2009/10 audit

No	Title	Issue identified	Risk and recommendation	Management comments
1	**Endowment account** **(Para 25)**	There are specific accounting requirements which the College must follow in relation to the £640,000 restricted donation for the Whitlock Energy Collaboration Centre.	There is a risk of non-compliance with accounting requirements. The College should ensure that these funds are administered separately and, given the restrictions as a condition of receiving the funding, applied solely towards the Whitlock Energy Collaboration Centre. Areas for specific consideration include maintaining sufficient and appropriate accounting records for the endowment and putting appropriate banking/investment arrangements in place. **Grade 3**	Agreed. **Responsible officer:** Assistant Principal / Director of Finance **Implementation date:** ongoing

No	Title	Issue identified	Risk and recommendation	Management comments
2	**Corporate Governance Code** **(Para 41)**	The UK Corporate Governance Code, formerly known as the Combined Code, sets out standards of governance, against which publicly funded bodies are required to prepare a corporate governance statement. This replaces the 2008 Combined Code.	To mitigate against the risk of non-compliance, we recommend that the College reviews its corporate governance arrangements against the new Code in preparation for making its Corporate Governance Statement in its 2010/11 annual accounts. We have undertaken an analysis of the key changes applicable to education bodies and will be sharing this guidance with College management to help inform this assessment. **Grade 3**	Noted. **Responsible officer:** Assistant Principal / Director of Finance **Implementation date:** for 2010/11 reporting period

Follow up of our previous audit recommendations

No	Title	Original recommendation and management response	Update at October 2010
1	**Fixed Asset Accounting System**	**Original Recommendation** Asset additions should be recorded in the CEL Ltd asset register correctly and an appropriate depreciation charge should be applied which matches the useful economic life of the asset. **Management Response** Agreed.	Our testing in 2009/10 has not identified any further concerns. **Completed**

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