Scott-Moncrieff

Carnegie College

Annual Report to the Board of Management and the Auditor General for Scotland 2010/11

December 2011

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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 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 2010/11 consolidated financial statements show an operating deficit of £577,000.

The College has restated its 2009/10 surplus to £1.527m within the 2010/11 accounts (previously reported as £337,000), due to the prior year adjustment to reflect the CPI/RPI pensions change in the Income and Expenditure Account. This is as a result of the updated accounting guidance issued since the 2009/10 accounts were signed.

In its latest Financial Forecast Return the College projects a further deficit of £135,000 in 2011/12.

Governance

The College's Corporate Governance Statement confirms that the College has been fully compliant with the key principles of the UK Corporate Governance Code during 2010/11, except for two provisions which the College does not believe relevant to the FE sector. We have reviewed the College's statement and can confirm that this is in line with the SFC's guidance and is not inconsistent with our understanding of the College's governance arrangements based on the information gathered as part 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 2010/11 audit of Carnegie College and CEL Ltd. We have performed our audit 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
14 December 2011

Introduction

1. This report gives a summary of the findings from our audit of Carnegie College and Carnegie Enterprise Ltd. The scope of our audit was set out in our External Audit Strategy and Plan which was presented to the Audit Committee on 14 September 2011. Our audit has focused on the financial statements and governance arrangements at the College.

2. Our plan summarised five key issues in relation to the 2010/11 audit:

   - SFC funding for fee waiver
   - College/CEL Ltd reconfiguration
   - Fife Council Pension Fund Liabilities and accounting for the 2009/10 actuarial adjustment in relation to the move from RPI to CPI
   - Continuing treatment of the $1m Canadian donation received in 2009/10
   - CEL Ltd financial position

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

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

Finance

5. This section of the report summarises our findings in relation to the College's financial performance for the year and its position at 31 July 2011. We also discuss any significant issues identified during our audit.

6. 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 College's governance arrangements in relation to the College's financial position.

Group Financial Statements

7. We are required to give an opinion as to whether the financial statements present a true and fair view of the financial position of the College and CEL as at 31 July 2011 and of its expenditure and income for the financial year. We are also required to include a regularity assertion in our independent auditors' 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 Scottish Funding Council (SFC).

8. Our audit is now complete and we have issued unqualified audit opinions on the truth and fairness of the accounts and on the regularity of transactions.

9. The signed financial statements will now be submitted to Audit Scotland, who will pass them to the Scottish Government for laying before the Scottish Parliament.

Carnegie Enterprise Limited financial statements

10. 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. The College continues to offer its support to CEL, which offers sufficient assurance in relation to the ability of CEL to continue as a going concern.

Financial position

The College has reported a deficit of £0.577m for the year to 31 July 2011, with significant restructuring costs incurred

11. The consolidated financial statements show a deficit of £577,000 in 2010/11. This includes exceptional restructuring costs of £518,000 incurred as a result of a substantial staff restructuring exercise during 2010/11. The College undertook this exercise in response to funding pressures, and is facing up to a further restructuring exercise to enable it to meet ongoing funding challenges.

12. The College has restated its 2009/10 surplus to £1.527m within the 2010/11 group accounts (previously disclosed as £0.337m), due to the prior year adjustment to reflect the CPI/RPI pensions change in the Income and Expenditure Account. This is as a result of the updated

accounting guidance issued since the 2009/10 accounts were signed. This is discussed further in paragraphs 27-29.

13. Income has reduced by £1.457m (6.2%) compared to 2009/10. This is mainly due to a reduction in SFC allocations of £0.497m and a reduction in other operating income £0.967m. The reduction in other operating income is mainly due to decreased income from CEL.

Carnegie Enterprise Limited

14. CEL is a wholly owned subsidiary of the College and as such is fully consolidated into the College's financial statements. CEL reported a deficit of £99,000 in 2010/11 compared to a surplus of £100,000 in 2009/10. This was primarily due to a decrease in conferencing and training income generated during the year, reflective of the challenging trading environment.

Balance sheet

The College has a healthy net asset position

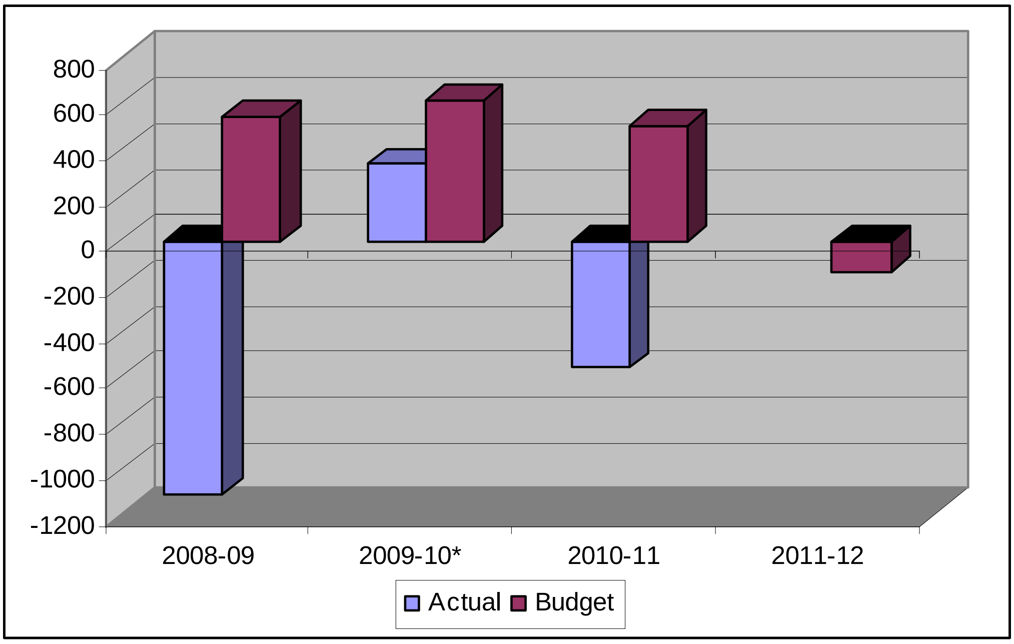
15. The group has reserves of £3.034m at 31 July 2011 (£1.948m as at 31 July 2010) and holds £8.559m of deferred capital grants (£8.501m at 31 July 2010). The position has strengthened due to the reduction in the pension liability of £1.710m.

Financial forecasts

SFC funding has been confirmed for 2011/12 with a small deficit forecast

16. The College has returned the 2011 Financial Forecast Return (FFR) to the Scottish Funding Council (SFC). SFC uses the FFR to assess the financial position and performance of individual colleges and the sector as a whole. SFC has confirmed funding for 2011/12, but, unlike previous years, the College has not been asked to provide three year projections given uncertainty over the financial position of the sector as a whole. Given the College's projected deficit for 2011/12 shown in the most recent FFR (which does not included the costs associated with a further restructuring exercise being undertaken this year) and the College's 2010/11 financial performance, this presents a significant risk. The College should seek to formalise its medium term plans as soon as it receives clarity on funding from SFC. Diagram 1 below compares the actual results with FFR forecasts and sets out projections for 2011/12.

Diagram 1 - Actual performance and FFR Forecasts of surplus (£'000)



Source: Financial Forecast Return

**adjusted to remove the exceptional gain relating to FRS 17 CPI/RPI restatement, to provide "like-for-like" comparison*

17. The College is projecting an operating deficit of £135,000 in 2011/12. This does not include the impact of proposed further restructuring costs.

Financial planning and monitoring arrangements

The College has appropriate financial management arrangements in place

18. As part of our audit, we considered 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. The Board has established a Finance Committee which meets four times a year. Budgets are devised at the start of the year and approved by the Board of Management. Management accounts showing performance to date and updated forecasts are presented at each Finance Committee. All significant variances from budget are investigated and explained.

20. In our opinion the College has appropriate financial management arrangements in place and we are pleased to note that it is taking further steps to address the future funding challenges posed by the current economic climate.

Financial statements preparation

21. We are grateful to the Assistant Principal/ Director of Finance and the finance staff for their assistance and support during the course of the audit.

Audit adjustments

22. During the course of our audit a small number of audit adjustments to the financial statements were identified and agreed. The majority of the changes made were of a presentational and disclosure nature. Only one adjustment, of £20,000 to include in expenditure for 2010/11 amounts paid by the College to the scholarship fund, was made which had an effect on the deficit recognised in the year. Another adjustment of some £16,000 (£14,000 of which would also impact on the outturn position), to reflect an error in double-accounting for VAT, has not been made by the College and so will be appended to our letter of representation.

23. We also identified a small number of adjustments to the balance sheet which did not impact directly on the outturn position. These were to adjust for the grossing up of creditors and debtors, and the overstatement of creditors, debtors, accrued income and deferred income transactions. These adjustments have been made by the College.

Fife Council Pension Fund

24. 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 for the non-teaching staff.

25. 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* (FRS17), 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.

26. 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 of £1.985m in the balance sheet. The College has consistently reported significant FRS 17 liabilities over the past few years. The Fife Council Pension Fund's actuaries provide the College with an updated valuation on an annual basis which is reflected in the pensions liability disclosed on the balance sheet. We have reviewed the College's accounting for these pension schemes and found that it complies with the requirements of FRS 17.

27. In 2009/10, there was also a one-off pension adjustment of £1.190m in favour of the College, which was reflected in the Statement of Recognised Gains and Losses (STRGL). This transaction was required because on 22 June 2010 the Chancellor of the Exchequer's Budget Statement confirmed that future pension increases were to be linked to the Consumer Prices Index (CPI) rather than Retail Prices Index (RPI).

28. The College's 2009/10 treatment - to take the adjustment through the STRGL - was based on the Draft Urgent Issue Task Force Note 48 (UITF 48) which was issued to inform the accounting for this change. It was only after the accounts were signed that the Final UITF 48 was updated and issued. The Final UITF 48 was changed in such a way as to indicate that accounting for the adjustment through the STRGL was not the most appropriate treatment in the College's circumstances.

29. As a result, the College has processed a prior year adjustment to account for the RPI/CPI move through the College's income and expenditure account. This is why the 31 July 2010 column on the Income and Expenditure Account and certain of the notes are labelled as "restated". This has been treated as a prior period adjustment arising from a change in accounting policy. We have confirmed that the College has made the appropriate accounting entries and disclosure in the financial statements. It is this matter which has led to the College restating its 2009/10 surplus to £1.527m (previously disclosed as £0.337m) within the comparative column of the 2010/11 accounts.

Review of accounting systems

30. During our audit work we have considered the College's accounting systems and internal controls. We identified one reportable control issue during our audit of the accounting systems. This relates to the recognition in the balance sheet of amounts in relation to future periods which have not been paid or received in the current year.

Action plan point 1

31. Otherwise, in general, the College's systems of internal financial control appear to be adequate, well designed and operating effectively.

Other issues of significance in the 2010/11 audit

Early retirement provision

32. The College has previously offered early retirement to staff as part of the management restructuring programme. The College makes monthly payments to cover any shortfall arising from the decision to grant early access to retirement benefits. In line with *Financial Reporting Standard 12 - Provisions, Contingent Liabilities and Contingents Assets* (FRS 12), the College creates a provision for the future payments in relation to these early retirements. The provision for early retirement was £0.422m at 31 July 2011 (£0.425m at 31 July 2010).

33. We reviewed the College's accounting treatment of its liabilities arising from early retirements and confirmed that this was consistent with the calculated liability as provided by Hymans Robertson LLP.

SFC funding - fee waiver

34. We reviewed the College's accounting treatment for fee waiver and confirmed that this was accounted for appropriately.

College/CEL Ltd reconfiguration

35. We reviewed the College's accounting treatment of the reconfiguration exercise and related severance agreements and confirmed this has been properly reflected in the financial statements.

36. The College is also continuing to pursue the potential of the Andrew Carnegie Business School brand. This may have implications which span both the College and CEL Ltd, including the option to combine and/or restructure existing operations. We have confirmed there are no significant implications for the 2010/11 period, but this should be kept under review in future periods.

Governance

37. 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.

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

Corporate Governance

The College's governance arrangements remain strong

39. 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 UK Corporate Governance Code.

40. The College's Corporate Governance Statement for 2010/11 states that the College was fully compliant with the UK Corporate Governance Code throughout the period, except for two provisions which the College does not believe relevant to the FE sector. This is fully disclosed in the College's annual accounts and concerns the Board Chair also chairing the Remuneration Committee and the Board Chair not sitting on or attending the Audit Committee.

41. We reviewed the Corporate Governance Statement by:

- checking the statement against SFC and Audit Scotland 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.

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

The UK Corporate Governance Code has come in to effect for Colleges in 2010/11

43. A new Corporate Governance Code was published in June 2010 and has come in to effect for 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.

44. The College considered the implications of the new code, in line with our recommendation in our 2009/10 annual report.

45. The Board found that the new code did not add materially to the existing corporate governance and risk management procedures already in place. This analysis appears reasonable, and is in keeping with our cumulated understanding of the Board's governance arrangements.

Risk management

The College has appropriate strategic risk management systems in place

46. 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.

47. The College has a formal Risk Management Policy in place which has been formally approved by the Board of Management. The Assistant Principal/Director of Finance is responsible for maintaining the risk register. The Audit Committee agenda includes a regular item for the consideration of risk and all amendments to the risk register are reported to the Committee.

Internal audit

48. The internal audit service is a key component of the College's internal control framework. As part of our corporate governance responsibilities, we have considered the College's arrangements to ensure that the work of internal audit is sufficient in quality and volume and complies with best practice. Our review was performed in accordance with the Code of Audit Practice and *International Standard on Auditing 610: Considering the work of internal audit* (ISA 610).

Considering the work of internal audit

49. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the College's total audit resource. For 2010/11 the internal audit service has been provided by Henderson Loggie. We have considered internal audit findings as part of our audit and have

sought to minimise duplication of effort, to ensure the total audit resource to the College is used efficiently and effectively.

50. Henderson Loggie have concluded in their annual report that Carnegie College operates adequate and effective internal control systems (with) proper arrangements in place to promote and secure value for money. We are grateful to Henderson Loggie for their assistance during the course of our audit work.

Prevention and detection of fraud and irregularity

51. As part of our audit we consider how the College ensures compliance with all relevant guidance and regulations. This includes a consideration of the College's arrangements for the prevention and detection of fraud and irregularity.

52. The College has a fraud prevention policy, including 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.

53. All SFC circulars and general correspondence and other guidance are received by the Principal's Secretary. All relevant regulatory information is then distributed to the appropriate members of staff. A database is held of all SFC circulars and responsible officers dealing with the relevant circular, which is monitored by the Principal's Secretary.

54. 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

55. We are required to consider the arrangements made by management in relation to standards of conduct and prevention and detection of corruption. Propriety requires that public business is conducted with fairness and integrity. This includes avoiding personal gain from public business, being even-handed in the appointment of staff, letting contracts based on open competition and avoiding waste and extravagance. Guidance on standards of conduct, accountability and openness has been issued by the Scottish Government.

56. 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 arrangements in place for ordering, procurement and disposal of assets.

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

Looking Forward

Financial position

58. There is increasing uncertainty over the level of future funding that will be provided to the sector. Indications from the Scottish Government are that the reductions in funding experienced in 2010/11 may continue over the next few years. Coupled with increasing cost pressures this will result in significant financial challenges for the College and the sector as a whole.

59. SFC has confirmed funding for 2011/12, but, unlike previous years, the College has not been asked to provide three year FFR projections given uncertainty over the financial position of the FE and public sector as a whole. This puts pressure on the College's ability to plan its medium term financial future. It is undoubtedly a significant variable which complicates strategic decision making.

International financial reporting standards

60. The College's financial statements are still 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.

61. Colleges will continue to converge with international financial reporting standards (IFRS) as UK GAAP converges with IFRS. It appears likely that full implementation of IFRS will not take place before 2013/14.

62. As we have previously noted, 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 and we endorse any moves the College may make to work towards IFRS transition in a structured and well-planned way.

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 2010/11 audit

No	Title	Issue Identified	Risk and recommendation	Management Comments
1	**Cut off**	We found a number of immaterial misclassifications of manual debtors and creditors. These included recognition of the same transaction as both a debtor and a creditor.	The accounting treatment results in both assets and liabilities shown in the balance sheet being overstated. The College should review its processes for recording transactions which span period end or which wholly relate to future periods. **Grade 2**	Agreed. **Responsible officer:** Head of Finance **Implementation date:** For 2011/12 accounting period

Follow-up of previous external audit recommendations

No	Title	Original recommendation and management response	Update at October 2011 by Scott Moncrieff
1	**Endowment Fund**	**Original Recommendation** The college should ensure that these funds are administered separately and in line with the restrictions given 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*** **Management response** Agreed	We have confirmed that the endowment has been accounted for appropriately in 2010/11.

No	Title	Original recommendation and management response	Update at October 2011 by Scott Moncrieff
2	**Corporate Governance Code**	**Original Recommendation** 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. ***Grade 3*** **Management response** Noted	The College has found that the new code did not add to the existing corporate governance and risk management procedures already in place at the College. We have found this analysis to be reasonable.

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