31 January 2013

Dear Convener

1. During scrutiny of the Draft 2014-15 Budget, Committee members raised a number of questions about the impact on our colleges of ONS reclassification and sought further information and reassurance on the steps the Scottish Government was taking to mitigate the associated risks.

2. As your letter of 11 December notes, there has recently been additional scrutiny of this issue through the Public Audit Committee’s (PAC) consideration of Audit Scotland’s ‘Scotland’s Colleges 2013’ report. In light of the PAC discussions, and the interest that your Committee has shown in the reclassification process, I am happy to provide the Committee with an update on the current position.

3. As I mentioned when I appeared before the Committee in October last year, a considerable amount of work has already been undertaken in light of the unwelcome decision by ONS. The Scottish Funding Council (SFC) has been leading a project team - including representatives from the college sector - charged with mitigating the associated risks. Their work is at an advanced stage, and focuses on two areas: the development of Arm’s Length Foundations (ALFs), and capacity building within the sector.

Arm’s Length Foundations

4. Along with the SFC and the college sector, we have worked collaboratively to develop a number of ALFs that will enable colleges to continue to be able to access any accumulated reserves at the point of reclassification and allow them to continue to plan for and apply any future reserves as part of a multi-year investment strategy.

5. SFC is supporting colleges to establish individual ALFs while also facilitating the establishment of an ‘umbrella’ ALF for the sector as a whole. This ‘umbrella’ ALF will be available to those colleges which do not wish to establish individual arrangements. I am pleased to report that good progress is being made to ensure both models are operational before 1 April 2014, thus ensuring existing college reserves can be protected at that point.
6. ALFs will be independent entities. However, their Articles of Association will ensure that Trustees allocate funds within an ALF in a way consistent with the wishes of the college, and with Ministers' policy aims for the sector as a whole. The accountability of ALFs, and the role of Trustees in particular, has been the subject of extensive scrutiny by the Public Audit Committee. On 4th December 2013, my officials gave evidence to the PAC on this matter; and, subsequently, Leslie Evans (Director General, Learning & Justice) wrote to the Committee on 18 January to provide additional information and assurances. I enclose a copy of that letter.

Capacity Building Activity

7. In addition to the establishment of ALFs, the SFC is also supporting colleges to manage the transition to reclassification through capacity building (for example, training events). SFC is also preparing to provide modest financial resource to help colleges meet any transitional costs associated with reclassification (for example, changes to systems).

8. Both this work, and the establishment of ALFs, have laid strong foundations in preparing the college sector for the changes that ONS reclassification will bring. Nonetheless, the changes demanded of us are an unwelcome distraction from the core business of improving learner outcomes. To that end, officials remain in dialogue with their counterparts from HM Treasury in an attempt to establish greater flexibility. I will be happy to write to the Committee again with a further update on these negotiations, and confirmation of the position on ALFs, once that is appropriate.

MICHAEL RUSSELL
Dear Convener

AUDITOR GENERAL FOR SCOTLAND (AGS) REPORT:
SCOTLAND'S COLLEGES 2013

1. I was grateful to attend, along with my colleagues, the Committee session on 4 December to discuss Audit Scotland's report 'Scotland's Colleges 2013'. As I said, we think the report helpfully reflects the progress colleges are making in delivering a substantial and progressive programme of public sector reform.

2. Thank you too for your letter of 9 December, seeking further clarification on a number of areas. I shall address them in the order in which you set them out.

Arms-length foundations (ALFs)

3. You asked for additional information on the transfer of surpluses to ALFs. The ONS's decision to reclassify colleges applies to incorporated colleges as institutions, and places a number of accounting, financial reporting and management requirements on all of colleges' income and expenditure. There is no distinction between the types of income colleges generate under reclassification, including HE funding. Any cash available to colleges, as either reserves before the 31 March 2014, or thereafter as a surplus at the end of each financial year, will be eligible for transfer to an ALF.

4. This approach will protect the ability of colleges to plan and conduct their operations over multiple years with multiple income streams, which are themselves subject to significant variation. With the support of the Scottish Funding Council (SFC), colleges expect to have made suitable arrangements before 31 March to ensure their existing reserves can continue to be used to meet learners' needs. Seven colleges have currently indicated to SFC an interest in participating in the sector-wide 'umbrella' solution. We understand that the remainder wish to pursue individual arrangements.
5. As a result of the ONS reclassification, the draft 2014-15 Scottish Budget presents college funding on a resource basis for the first time, reflecting the sector's income and expenditure. Financial monitoring and reporting arrangements between the Scottish Government and SFC will ensure SFC transparency over the detail of what colleges report to SFC. Meanwhile, financial monitoring and reporting arrangements between the SFC and colleges will ensure SFC can 'track' the application of public funding by institutions and regions. However, since public funding is primarily linked to the provision of a volume of learning activity, the SFC does not expect it routinely to contribute to the creation of surpluses.

6. This approach to financial monitoring will provide re-assurance on transfers to ALFs and transfers from ALFs - details which we will also expect to see presented in annual college accounts. Those college accounts will continue to be subject to scrutiny by Audit Scotland and Parliament. And when making any transfers to ALFs, colleges will have to adhere to the SFC's conditions of grant, and other requirements governing the use of their resources.

Arms-length foundations - Articles of Association

7. You also asked for details of the development of Articles of Association for ALFs. Broadly speaking, the law allows the Members of a Company to amend the Articles of Association, provided they are able to provide the necessary level of support for the proposed changes.

8. However, where that company is also a registered charity (which ALFs will be), its ability to amend its constitution is subject to much greater restriction from both a company law and a charity law perspective. The Office of the Scottish Charity Regulator (OSCR) would need to be consulted in advance of any change to the Articles of Association, and the charity would need to prove to OSCR that its funds would still be applied exclusively for charitable purposes.

9. Both OSCR and the Court of Session have wide-reaching powers to supervise charitable activities, and existing company law expressly provides that any attempt to widen the scope of a charity's constitution beyond what would satisfy the charity test would be invalid.

10. While advice to Ministers on the subject of ALFs is restricted and confidential, Ministers will ensure that appropriate management and monitoring arrangements are put in place through the SFC to ensure funds are applied in an appropriate manner, consistent with the aims of the sector. SFC's outcome agreements are clearly an important element of this effort.

Older and part-time learners

11. You asked for details of the outcomes related to additional funding for adult learners and part-time students. In response to supplementary guidance from the Scottish Government in March 2013, the SFC allocated £6.6m of additional funding for part-time provision for these purposes in 2013-14. This will have the effect of securing provision for around 2,000 full-time equivalent students. Details of the planned outcomes will be contained in college outcome agreements for 2013-14 and 2014-15.
College staffing and 'class sizes'

12. I should also like to take this opportunity to address matters of staffing, and its effect on the learner experience. First, we expect colleges to ensure the optimum class size. Clearly, as I mentioned during our discussion, this will vary, in line with the very wide range of provision colleges continue to offer. On staffing, the latest published data are Public Sector Employment (PSE) statistics covering the period to Quarter 3 2013. They reveal a modest fall on the same period in 2012, the large part of which is accounted for by the merger of Barony, Elmwood and Oatridge Colleges with the Scottish Agricultural College to create the Scottish Rural College. This new organisation is classed as 'other public bodies' rather than 'Further Education' within the PSE statistics. We cannot, at this stage, be precise about future staffing levels since they will be influenced by various factors, not least the Government's decision substantially to increase its planned college resource budgets for 2013-14 and 2014-15, and to set a level beyond the current 'floor' in 2015-16. As I said to the Committee, we will ask SFC to ensure the matter is kept under review.

13. For completeness, I should say that separate statistics on staffing relating to academic years 2011/12 and 2012/13 will be published by SFC tomorrow. However, the most up-to-date material will remain the PSE statistics to which I refer in the previous paragraph.

Please do not hesitate to contact me should you require any further information or clarification.

Yours sincerely

[Signature]

LESLIE EVANS