Correspondence from the Scottish Funding Council to the Public Audit Committee, dated 13 November 2013

Please find below my response to the questions raised in your letter of 8 November 2013.

Reclassification as public bodies
Work on reclassification is overseen by a project board, led by SFC and comprising SG, regional leads, Colleges Scotland and colleges. It meets monthly to ensure effective delivery of the project; additionally, the Council continues to work closely with colleges to ensure they have the support they need to effect the necessary changes. I attach a summary of key milestones at Annex A. I should add that Audit Scotland’s reports for both 2010-11 and 2011-12 indicate the financial standing of the sector remains sound. We do not expect reclassification to change that position.

Transfer of reserves
Under the proposals developed by the project board, cash reserves - not income and expenditure reserves (which totalled £214 million at the end of July 2012) - will be transferred to Arms-Length Foundations (ALFs) prior to the 2014-15 financial year. We are currently clarifying with individual colleges the amounts they intend to transfer.

When assessing the financial sustainability of a college, we take into account both the operating position and also the net current asset position (as a measure of solvency). Insolvency is the situation where an entity cannot raise enough cash to meet its obligations, or to pay debts as they become due for payment.

Whilst the transfer to ALFs in 2013-14 will create operating deficits in some colleges in that year, this is not a concern provided the deficit is not expected to recur or forecast to continue. Colleges will be transferring only surplus cash to ALFs; sufficient cash will be retained to meet their day to day requirements. From April 2014 onwards, colleges will draw down cash from SFC on a monthly basis according to their actual cash requirement.

Merger costs and savings
In November 2012, in written evidence to the Committee, the SFC’s then Chief Executive confirmed he expected to see £50m of efficiency savings by 2015-16 (AY), when the merger programme was due to complete. This estimate was based on the evidence from previous college mergers, and the plans of those preparing to merge in 2013.

Subsequently, in February 2013, the Scottish Government announced additional funding for 13-14 and 14-15. This had the effect of offsetting planned funding cuts (Audit Scotland noted, in its report “this has affected the level of efficiency savings which colleges are required to deliver”).

However, the sector is more efficient as a result of the reform programme. Between 2012-13 and 2015-16, the volume of activity we will ask colleges to deliver will increase by over 7%, while at the same time there will be a real-terms reduction in the value of funding of around 4.5%. The combined real terms efficiency gain equates to £49m. This will be achieved as a result of the reform programme - through staff restructuring and economies of scale – largely through mergers.

Most of these savings will be achieved through staff restructuring, with voluntary severance schemes generally having a payback period of one year. Typically, mergers have a
voluntary severance scheme at the time of merger and often another as restructuring takes place - usually during the first year after merger. We therefore anticipate that most of the savings will be fully delivered two years after mergers. They will, of course continue to deliver annual savings beyond that.

Through our Outcome Agreement Managers ongoing dialogue with colleges we will monitor progress with mergers and specifically the way that individual merged colleges realise savings from mergers. In addition we will formally monitor this through our post-merger evaluations. These take place in two parts: an early evaluation after six months and a full evaluation after 2 years.

Further to paragraphs 41-45 of Audit Scotland’s 2013 college Report, the SFC contributes to merger costs based on the following considerations:

- existing plans, for example where there are plans for capital improvements;
- existing levels of reserves;
- the level of payback period for severance (SFC will not fund more than one-year).

As noted in the report, we expect colleges to contribute up to half of the costs using cash reserves. However, the actual contributions will vary widely depending on the above considerations.

Taken together with our deployment of the £15m made available through the College Transformation Fund (that we administer), the SFC’s additional contribution to mergers costs totals £37.5m, broken down as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011-12</td>
<td>£4.6m</td>
</tr>
<tr>
<td>2012-13</td>
<td>£11.4m</td>
</tr>
<tr>
<td>2013-14</td>
<td>£17.3m</td>
</tr>
<tr>
<td>2014/15</td>
<td>£4.2m</td>
</tr>
</tbody>
</table>

This makes for a total investment in merger costs of some £53m.

The merger programme is by far the biggest spend to save programme in which we have invested in recent years. In addition, we are currently funding a shared services programme between West Lothian College and West Lothian Council. We intend to spend £400,000 on this across academic years 12-13 (£255,000) and 13-14 (£155,000).

**Severance payments**
The SFC’s severance guidance to colleges sets out our expectations in relation to severance arrangements for senior members of staff. Weblinks to relevant document are as follows (the circular letter issued in March 2004 updated the monetary thresholds defining senior staff):

Guidance on Severance Payments (2000)  

Guidance on Severance Payments (Circular 13/04)  
http://www.sfc.ac.uk/library/06854fc203db2fbd000000fb7da95bba/index.html

In terms of how we record college expenditure, we expect the actual costs of severance to be published in college accounts. Prior to that, the SFC scrutinises college merger proposal
documents which include estimates of overall severance costs. Additionally, we ask colleges to provide information on numbers of staff leaving and associated costs before making any payment towards such costs.

As you will see, the guidance on severance arrangements sets out broad principles on negotiating severance packages together with good practice in relation to governance. We expect colleges’ internal auditors to consider any risks presented by processes relating to severance; and external auditors should review severance settlements for senior members of staff, advising SFC if, in their view, these do not conform to our guidance. We have received no such advice.

**College course provision and student numbers**

In its letters of guidance (in particular 2011-12 and 2012-13), the Scottish Government asked SFC to ensure that colleges prioritise learning for 16 to 24 year olds and to deliver qualifications which develop the skills and capabilities required for entry to and progress in the labour market. It is full-time courses which are most likely to provide meaningful employment skills; colleges have therefore prioritised courses most likely to lead to employment.

In line with Scottish Government guidance, we are funding the college sector in a way which is allowing the volume of learning to be maintained. It is for each college to determine the curricular offer that best meets the needs of their region, consistent with the government’s policy priorities. In doing so, we expect them to deliver a balanced portfolio of courses that responds effectively to the differing needs of learners and employers. The type of provision we agree with colleges is reflected in the relevant outcome agreement.

**Change in student numbers for 2012/2013 compared with 2011/2012**

Student numbers data for 2012/13 are not yet available.

The age and gender profile of student provision in 2011/12 and 2012/13

This information is not yet available for 2012/13.

In its letters of guidance, the Scottish Government made clear that, in focusing on young people, colleges should also give priority to those seeking jobs and to those with out of date or low skill levels. This includes older learners, including those returning to learning to improve their employment prospects. More specifically, in supplementary guidance of 28 March 2013 (that took account of additional funding agreed for colleges in the Scottish Government’s budget for 2013-14), the Government asked us to encourage colleges to provide part-time provision that met the needs of their region, including women returners. We therefore announced an additional 2,000 FTEs for part time programmes in 2013-14. These were targeted towards the older age group and in particular towards older females. SFC increased our childcare fund for part time study by £500,000 to help support these learners.

Please do not hesitate to contact me should you require any further information or clarification on the foregoing, either in writing or in person.

**Laurence Howells**

Interim Chief Executive
Annex A – Reclassification of incorporated colleges - key milestones

Arms length foundations
- Draft constitution (memorandum and articles of association) (completed mid-September)
- Identify initial trustees (mid-November)
- Initial trustees sign memorandum and articles of association and submit to Companies House (to establish company limited by guarantee) (mid to late November)
- Complete and submit to the Office of the Scottish Charity Regulator (OSCR) the application for charitable status, constitution and business plan (mid to late November)
- Responses from OSCR on business case and registration (mid to late February)
- Submit application to HMRC for recognition as charity for tax purposes (mid to late February)
- Transfer of cash-backed reserves to foundations (to be completed by 31 March 2014)

Budgeting and SFC returns
- Mid-September 2013: 2012-13 historical monthly cash flow and cash balance information to be provided to SFC to enable modelling work to prepare for compliance with HM Treasury consolidated budgeting guidance.
- February 2014: Annual cash flow forecast return to SFC along with confirmed annual budget.
- From 1 April 2014: Colleges to comply with HM Treasury Consolidated Budgeting Guidance.
- April 2014 and monthly thereafter: Reporting cash-flow to SFC reporting actuals against forecast and identifying future cash requirements.

Financial reporting
- 1 August 2013 to 31 March 2014 (eight months), using the current HE/FE Statement of Recommended Practice (SORP).
- 1 April 2014 to 31 March 2015 (twelve months), using the current HE/FE SORP.
- 1 April 2015 to 31 March 2016 (twelve months), using the new HE/FE SORP.
- 1 April to 31 March for each subsequent year, using the new HE/FE SORP.
Correspondence from the Public Audit Committee to the Scottish Funding Council, dated 8 November 2013.

At the Committee meeting on 6 November, the Scottish Funding Council agreed to provide additional written evidence on some matters raised by Committee members. Please find these issues set out below, along with some additional issues on which SFC’s views would be welcome. As discussed with Martin Fairburn, it would be helpful to have this information by 13 November 2013, in order to inform the papers for the Committee meeting on 20 November. Please do contact me if this deadline causes you any difficulty.

Reclassification as public bodies
Paragraphs 67-70 of the AGS report provides information on Scotland’s colleges’ reclassification as public sector bodies from April 2014 and highlights that the SFC has established a project board to help colleges plan for this. Members would welcome an update on progress toward reclassification including any key milestones between now and April 2014.

The Committee notes that the reclassification of colleges as public bodies means that they will be unable to carry over reserves and therefore “arms-length” trusts are intended to be established to address this. Members would welcome further information on:

- what anticipated levels of reserve will be transferred into individual College trusts and SFC’s umbrella trust;
- the extent to which Colleges’ current income and expenditure reserves (which totalled £214 million1 at the end of July 2012) will be transferred into these arms-length trusts over the financial year (2014/15);
- what will happen to remaining income and expenditure reserves outstanding at 2014/15 but which is not transferred to any trust.

College principals informed the Committee that due to the transfer of surpluses into arms-length trusts, colleges would therefore incur large deficits and would therefore appear as insolvent. At the Committee meeting the SFC agreed to provide clarification of this matter due to the technical nature of the information requested.

Merger costs
Paragraphs 41 to 45 of the AGS report provides information on the costs of mergers and highlights variations in the amounts the SFC expects individual colleges to contribute to merger costs. The Committee would welcome further information on the basis on which the SFC does/does not contribute to merger costs and the basis on which it expects colleges to contribute to these costs.

Paragraphs 49 - 51 of the AGS report outlines that the SFC estimated that savings from planned reforms would amount to £50 million by 2015-16, however it adds that the SFC will continue to refine estimates as the reforms progress. Further information would be welcome on:

- any updated estimates of how much SFC expects savings to be and how it is monitoring the delivery of savings by colleges;
- any updated estimates of how long the SFC expects it will take for savings to be delivered;

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1 Exhibit 3 of the AGS report entitled Scotland’s colleges 2013
• whether SFC have contributed to any ‘spend to save’ initiatives and if so, how much and in what year.

**Severance payments**
You offered to provide the Committee with the SFC’s guidance on severance payments. Members would also welcome some additional information on severance payments, including:
• whether the SFC records how much has been spent by individual colleges on severance payments;
• whether all such payments have been consistent with the guidelines issued by the SFC.

**College course provision**
The Committee received evidence from the college principals that there had been reductions in the number of students attending college courses, as well as in the range of provision provided, (such as evening classes). College principals suggested that a shift in emphasis towards full time education courses, has resulted in a reduced provision of education for older students (those over 24), those wishing to retrain or up-skill, or those who are already in full time employment. The Committee would welcome your comments on these views including:
• the change in student numbers for 2012/2013 compared with 2011/2012;
• any reduction in course provision (such as changes in evening class provision);
• the age and gender profile of student provision in 2011/12 and 2012/13; and an explanation of the reasons for any change (such as changes in course provision).

Should you have any questions or require any further clarification on information contained in this letter, please do not hesitate to contact me. The Scottish Government are due to give evidence to the Committee on 4 December 2013.

Yours sincerely