Correspondence from the Scottish Funding Council, dated 14 November 2012, regarding the Auditor General for Scotland’s report entitled “Scotland’s colleges – Current finances, future challenges”

Benefits of regionalisation and mergers

I am writing to follow up Leslie Evans’ letter to you of 14 November. In that letter, she said that she had asked me to let you have the Scottish Funding Council’s current assessment of the expected benefits and costs of restructuring of the college sector.

Audit Scotland’s report Scotland’s Colleges: current finances, future challenges recommended that the Government ‘provide a clear assessment of the benefits and cost of regionalisation (including structural change), how these benefits contribute to its reform objectives and how they will be funded’. This letter is intended to contribute to the overall response to that request.

Benefits of regionalisation

In her letter, Ms Evans describes the rationale behind regionalisation. However, in order to set the context for the specific discussion of the costs and financial benefits of restructuring below, it is worth repeating that the key benefit of regionalisation and the associated programme of mergers is that college education can be delivered more effectively – for students and for the benefit of regional economies – by a system of larger colleges serving broad regions; and this will be more efficient than the system of over 40 colleges, often competing for students in overlapping catchments.

This change is particularly important in the current challenging public spending context. Colleges have been making savings across the existing structure and arguably could continue to do so. However, by merging, they are enabled to achieve savings in a way which reduces management costs – in both central management and academic management – without damaging the quality, volume or spread of academic provision, thereby protecting the interests of their learners. Evidence of the ability of larger colleges to be able to spend less on administration and support services is available in a large scale study carried out for the Learning and Skills Council in England by KPMG (Delivering value for money though infrastructural change, LSC, 2010). That study concluded:

‘Notwithstanding some caveats on the data sources, it is possible to demonstrate the following general conclusions, which are confirmed from other sources:

- **Efficiency**: larger colleges have lower administration costs as a percentage of total costs than smaller colleges and are also able to provide provision with a lower level of base funding for 16-18 year olds.
- **Success rates**: size of college has very little impact on success rates – although there is a slight positive correlation between college size and success rates. Furthermore, larger colleges achieve, on average better OFSTED gradings than those obtained by smaller colleges.’

Evidence on the ability of newly merged colleges in Scotland to maintain quality is in the reviews by Education Scotland (and prior to that HMIe) of recently merged colleges. Most recently for example, the Education Scotland review of the newly formed City of Glasgow College was very positive.
Therefore, in our future funding for colleges (from 2013-14 and beyond) SFC will fund colleges in a way that recognises the potential efficiencies of the large, single-college regions. In effect we will move from a one size fits all funding allocation to one that recognises scale.

The savings from mergers

The Audit Scotland report Scotland’s Colleges: current finances, future challenges correctly states that when managed well, college mergers can produce savings.

As stated in Ms Evans’ letter, the SFC’s current estimate of potential efficiencies from mergers is around £50M annually. This estimate is for the eventual recurrent annual potential efficiency saving once the merger programme is complete and the efficiencies have been realised in the new colleges/federations. Our current estimate is that that the programme will be largely implemented by the beginning of academic year (AY) 2015-16. Clearly in the years before then (the current academic year, 2012-13 and AY2013-14), the potential efficiency will be less than this eventual steady state.

Our estimates on the potential efficiency savings across the sector are based on the efficiencies reported by the City of Glasgow College merger, the business plans of the Edinburgh College and the SRUC mergers that took place earlier this year, and the emerging business plans of three other planned mergers (Ayrshire, West and Clyde). We have used evidence from these mergers to make estimates for the mergers for which we do not yet have firm information, by scaling the figures for savings on mergers for which we do have information on to the size of the colleges for which we don’t. SFC regularly updates these estimates as new information becomes available.

We have aimed to be very measured in estimating the savings created by mergers. For example, our estimates are based on a lower savings figure for the City of Glasgow’s annual recurrent saving (£5M) than the more recent £5.8M quoted by Audit Scotland in its report. The Edinburgh College merger business plan assumes that that merger can deliver savings of £9M annually by 2014-15.

We have adopted this conservative approach to estimating savings for two reasons. First, we recognise that colleges have been reducing costs anyway in recent years in response to public spending constraints and that this will have an impact upon their capacity to deliver further savings. Second, we recognise too, that some of the savings of merger can take some time to materialise and may require investment in order to be delivered.

The main area of savings – and the one that accounts for the bulk of our estimate of the potential efficiencies – is that associated with staff restructuring. In the case of the City of Glasgow merger, Audit Scotland notes that these savings are around £4.6M of the £5.8M annual savings total. In the case of Edinburgh College, staff savings are estimated in the business plan to be £9M annually by 2014-15.

There are other savings in areas such as procurement, shared services, and ICT costs. However, we recognise that these are more difficult to quantify in most mergers, in terms of their size, how much investment is required to achieve them and how long they take to achieve. The merger of the University of Paisley and Bell College to form the University of
the West of Scotland in 2007 provides useful evidence of the scale of non-staff savings that can be made (though that merger also made considerable staff savings too). By the time of the post-merger evaluation of that merger in 2009 the new university was able to report recurrent annual savings of £409,000 on ICT alone. They also reported savings of £146,000 in marketing costs.

We are not assuming any estates savings in these mergers.

As indicated above, the savings from mergers are achieved over several years before reaching a steady state. In past mergers, it has often taken some time to achieve savings as the work on implementing the merger – and in particular on staff restructuring – has taken place well after vesting day. However, in more recent mergers, colleges have made an earlier start and have begun to make savings prior to vesting day. These savings are therefore coming earlier in the process than has been the case in the past.

**The costs of mergers**

We recognise that for mergers to be effective they require investment on the ‘spend to save’ principle. The two most recent mergers give a good indication of the scale of this.

- The Edinburgh College merger is estimated to cost around £14.6M. Of that, around £8M will come from the SFC/College Transformation Fund (CTF).

- The merger to form SRUC was estimated by the merger partners to cost £10.2M in total. SFC/CTF funding will cover just under half that amount.

For the proposed mergers that are at a relatively advanced stage of their planning – West, Ayrshire and Clyde – the individual mergers are estimated (by the colleges) to have a cost of between £7M and £10M. We estimate that that expenditure will lead to annual savings of between £4.8M and £7.9M for these individual mergers, with a substantial part of the savings available in AY 2013-14 and the full amount in 2014-15.

We recognise that not all of the costs of merger are ones that can be detailed in advance and that some of the costs of existing mergers may not have been specifically identified as such by the colleges involved. The post-merger evaluation work that we have in hand will help to identify any such costs.

**Supporting mergers**

In supporting the cost of mergers, the SFC will prioritise those areas of merger activity that can produce the most robust cost reductions. This means that we are more likely to support the staff restructuring element of a merger – with a Voluntary Severance scheme that has an early impact on efficiency – rather than, say, ICT investment which might take longer to produce savings.

In deciding on the level of support from SFC and CTF funds for a merger, we will take into account the ability of the college to fund the remaining element of the necessary costs. In the two most recent examples (Edinburgh and SRUC), external – that is, SFC/CTF – funding has accounted for around half of the estimated cost. This proportion is not one that is constant: in some mergers we will pay a higher proportion, in others lower. While we have
not concluded the negotiations on the West, Ayrshire and Clyde mergers, it is likely that external investment will account for just over half of the total cost of these three mergers – though in varying proportions, depending on the resources that the colleges themselves have available, including reserves.

As the Committee is aware from Ms Evans’ letter, the Council and the Government have made around £25M available in 2012-13 to support mergers, between the CTF and SFC’s own strategic funding. Clearly there will also be costs in 2013-14 and beyond. It is not possible to give a detailed analysis of the cost of all of the mergers at this stage. Some are at an early stage of planning. In other cases we are only just beginning to discuss funding arrangements. However, given that the examples I have mentioned above fall within a fairly well defined range and that some of the variation is to do with scale of the colleges being created, we can make a reasonable estimate of the total likely costs and budget accordingly. I will take this into account in advising my Council as it makes budget decisions for 2013-14 and beyond.

Our estimate at this stage is that continuing the SFC element of merger funding at around £10M in each of 2013-14 and 2014-15 will be required. That would mean that the total merger programme (including the City of Glasgow merger which just preceded regionalisation) would cost around £54M of one-off expenditure of SFC/CTF funds.

As well as financial support for mergers, we recognise that it is important to support colleges in the merger process. As is noted in the Audit Scotland report on colleges, we have recently revised our guidance on mergers. This guidance is consistent with the key messages from the Audit Scotland report on public body mergers. SFC’s Outcome Agreement Managers are also working very closely with colleges as they prepare their merger plans. As mergers progress to the implementation stage – as the Edinburgh College and SRUC mergers have already done – we will use the outcome agreements with the new colleges to monitor progress beyond vesting day.

Conclusion

In our letter of guidance from the Cabinet Secretary for Education and Lifelong Learning, he asked the SFC to make efficiency savings of £18M in 2013-14 and £33M in 2014-15. On our current estimates (based upon mergers that have been completed and our discussions with the colleges that are currently engaged in a merger process) the aggregate of potential merger efficiencies in these years means that these savings are achievable.

If this letter has not covered all of the areas that you would like information on I will, of course be happy to provide further information.

MTS Batho
Chief Executive

cc: Leslie Evans, Scottish Government
Dear Ms Evans

Auditor General for Scotland report - “Scotland’s colleges – Current finances, future challenges”

At its meeting on 24 October the Public Audit Committee took evidence from the Auditor General for Scotland (AGS) on her report entitled “Scotland’s colleges – Current finances, future challenges”. The relevant Official Report will be available at the following link by close on 30 October:

http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/29860.aspx

The evidence included discussion of the proposed regionalisation of colleges. The Committee appreciates that the overarching intention of the forthcoming regionalisation of colleges is to contribute to the Government’s national objectives of developing a highly educated and skilled workforce and providing more effective and sustainable delivery of learning and skills.

As you will be aware, in response to the AGS report, the Scottish Government has agreed to provide a detailed assessment of: the expected benefits and costs of college regionalisation (including structural change); how these benefits contribute to its reform objectives; and how costs are to be funded (AGS report, recommendation page 4).

The Committee notes that the Post-16 Education Reform Bill, which will progress the creation of the 13 regional boards, may be introduced to Parliament in November 2012. The Committee notes that without a detailed justification for change within such an assessment, it may be difficult for the Parliament to effectively scrutinise the forthcoming legislation.

The Committee therefore agreed, following evidence from the AGS, to write to you to request that the assessment of costs and benefits for the regionalisation proposal be provided to the Parliament at the Scottish Government’s earliest opportunity.

Additional information that the Committee would also be grateful for is detailed below.

Public body mergers
The Committee also looked at the ongoing programme of college mergers in evidence and was concerned that a lack of information on objectives and delivery of the mergers echoes issues raised in Audit Scotland’s previous published report Learning the Lessons of public body mergers. This report made recommendations around leadership and governance, measuring impact on organisational performance and accountability for the costs and savings associated with mergers. In responding to Learning the Lessons of public body mergers, the Scottish Government assured the Committee, at its meeting on 26 September, that lessons would be learned and that Audit Scotland’s recommendations and accompanying good practice guidance would be applied to future mergers.
The Committee would welcome information on how the Scottish Government will use the recommendations in both the AGS colleges report and the mergers report to inform the overseeing of current and future college mergers.

**Outcome agreements**
The AGS also reported in evidence that the first set of college sector outcome agreements concentrate on input and process measures and that future agreements would need further refinement, for example to detail how colleges would contribute to Government objectives such as employability.

The Committee would welcome an assurance that future outcome agreements will have a greater focus on how colleges will contribute to the Government’s wider objectives.

**Demand for college places**
The AGS reports that there is likely to be a 24% real terms reduction in Scottish Government revenue grant support to colleges between 2011/12 (£545 million) and 2014/15 (£471 million) (AGS report, paragraph 38), with reduced income from other sources (paragraph 40) and an increased demand for college places due to unemployment (paragraph 41). The Committee would welcome information on how the Scottish Government will seek to ensure that Scotland’s colleges will meet increasing demand for college education with diminished resources.

In relation to this, the Committee notes that there is currently no national picture of the number of applicants to Scotland’s colleges and would ask whether the Scottish Government intends to start collecting this information as part of the forthcoming changes. This would enable the Government to determine to what extent demand is outstripping supply.

**Community planning partnerships**
Finally, the Committee would welcome information on how the proposed regions will collaborate with relevant Community Planning Partnerships to contribute to addressing local development needs such as demand for particular skills.

I should be grateful if you could provide a response to this letter by Tuesday 13 November to allow the Committee to consider it at its meeting on Wednesday 21 November. Should you require any further information please do not hesitate to contact the Assistant Clerk, Jason Nairn on 0131 348 5236 or by email at pa.committee@scottish.parliament.uk.

Yours sincerely

Iain Gray MSP, Convener