Mr James Dornan MSP  
Convener  
Education and Skills Committee  
T3.40  
The Scottish Parliament  
Edinburgh  
EH99 1SP

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Dear Convener

Pre-budget scrutiny of Scottish Funding Council (SFC)

Thank you for your letter of 29 September asking me for a written submission to inform the Committee’s pre-budget scrutiny of four public bodies. As we have done a significant amount of work relating the SFC, this submission relates to that body only. I have made a separate submission relating to Skills Development Scotland, Scottish Qualifications Authority and Education Scotland.

I have drawn on the findings of my recent reports Audit of higher education in Scottish universities and Scotland’s colleges 2016. As you will be aware, I presented these reports to the Public Audit and Post-Legislative Scrutiny Committee on 6 October and that committee has decided to take evidence from the SFC and others. My submission also draws on the annual audit report for the SFC for 2015/16.

I have structured my response using the key points highlighted in your letter of 16 September 2016 to the SFC. I would also draw your attention to the SFC’s submission to the Public Audit and Post Legislative Scrutiny Committee, dated 29 September 2016, on my reports. That submission outlines the SFC’s response to the recommendations contained in my higher education and colleges reports.

How the SFC measures its impact on National Outcomes and National Indicators

My report, Audit of higher education in Scottish universities, identified areas that the SFC could improve in relation to how it measures impact:

- elements of the outcome agreement process could be improved to ensure outcome agreements between universities and the SFC are effective. In particular:
  - ensuring the high-level aims and measures used in outcome agreements are aligned with the SFC’s strategic outcomes
  - ensuring the national measures used in outcome agreements appropriately measure how activities are contributing to key aims and that performance against all measures is reported
  - improving the consistency and clarity in how outcome agreements are written and presented so that it is easy for stakeholders to identify exactly how universities are contributing to achieving national priorities.

- The SFC needs to finalise its own performance management framework, ensuring there is a comprehensive suite of performance measures and that it is clear how the outcomes and indicators set out in the framework relate to its strategic plan.

In my report, Scotland’s colleges 2016, we noted that the college sector has experienced a large amount of change over the past five years, including a series of mergers. This has seen the number of incorporated colleges reduce from 37 in 2011-12 to 20 in 2014-15. We reported that:
The SFC (and the Scottish Government) have not publicly set out when the benefits of these college mergers will be achieved and how they will measure them. As colleges were not made aware of how intended benefits were to be measured at the time of the merger, they did not record information at that time to establish a baseline set of data. The result of this is that the two-year post-merger evaluations (produced in 2016) lack baseline data in several areas (student destinations, student satisfaction and employer engagement). Given the limited scope to retrospectively obtain this information, it will be difficult for the Scottish Government and the SFC to fully measure whether the merger programme delivered all of the expected benefits.

The SFC's recent report, 'Impact and success of the programme of college mergers in Scotland', included some of the costs of mergers but was incomplete, as it did not include the costs of harmonising staff pay and conditions for the colleges involved in mergers. The SFC recently indicated that it is working to establish these costs.

**How the SFC’s strategies and financial plans prioritise streams of work that have the greatest impact in delivering those outcomes**

My higher education report found that the SFC needs to do more to ensure that the funding it receives from the Scottish Government makes the maximum contribution to achieving the Scottish Government’s ambitions for higher education. Key findings include:

- There is a need for the SFC to review its strategies for research and innovation and finalise its national capital investment strategy to ensure they are fully aligned with the SFC’s strategic plan and Scotland’s Economic Strategy. It is important that these strategies are set out in a clear and transparent way that makes it easy for stakeholders to identify the aims and objectives associated with the strategy; the actions the SFC plan to take to achieve the aims and objectives; and how performance will be measured.

- The way that the SFC allocates funding to universities makes achieving the Scottish Government’s higher education policy ambitions challenging:
  - The current funding approach to improving access to university for students from college and deprived backgrounds is under pressure due to budgetary restrictions. Achieving the new national widening access targets will require a strategic approach by the Scottish Government, SFC, and universities and may have financial implications.
  - In terms of research, most of the universities with the highest levels of world class (4*) research in Scotland received reduced Research Excellent Grant (REG) funding from the SFC after the 2014 Research Excellence Framework (REF) exercise, despite improving their performance. Overall performance improved across the sector but this was not accompanied by an increase in the total amount of REG funding available from the SFC. This led to the existing research budget being spread more widely across the sector than in previous years. This means universities are under increasing pressure to generate income from other sources to fund their research activities and to continue to make efficiency savings. This is because the majority of research grants won by universities do not cover the full costs of undertaking that research. In 2014/15, grants from the UK Research Councils covered 74.3% of the full economic costs of undertaking the research, while grants from charities and industry covered 65% and 74.5% respectively of the full economic costs of the research.
  - Achieving high-quality learning and teaching is increasingly dependent on universities’ ability to make efficiency savings and subsidise the cost of teaching from other sources. The price the SFC pays to universities per funded place for Scottish and EU students (on average, £5,179 in 2014/15 and £6,999 when the tuition fee element is included) does not directly reflect the actual cost of the activity in each university. It is not clear to what extent the public funding of Scottish and EU students is intended to cover the costs of their teaching. In 2016, the SFC reduced the price per funded place for 2016/17 by 2.9% compared to the previous year. This was due to budget pressures, rather than a reduction in the cost of teaching. This means there is increasing pressure on universities to increase income in other areas to...
subsidise the cost of teaching Scottish and EU students, deliver teaching and learning in
different ways, or to make further efficiency savings.

My colleges report highlights that two significant policy changes introduced by the SFC and the Scottish
Government over the past decade have contributed towards a 14% increase in the number of under 25 year
olds in full-time education since 2007-08. The changes also contributed towards a 48% reduction in part-
time students and a 41% reduction in the student population overall. Most of the reductions in student
numbers have been among women and people aged over 25 years. We found that:

- the SFC did not carry out an equality-impact assessment on its 2009 policy change to focus
  funding on vocational courses lasting more than 10 hours, although it did carry out such an
  assessment for the later Scottish Government ‘Opportunities for all’ commitment in 2011. We
  noted that the Equalities Act 2010 and earlier Equality Act 2006 place duties on public bodies to
  use equality-impact assessments to assess the potential impact of proposals for new or revised
  policies or practices. This relates to characteristics like gender, race and disability.

- neither the SFC (or the Scottish Government) have analysed how the fall in part-time places and
  the focus on younger students have affected those who have not been able to get a place at
  college, and what they chose to do instead. This is largely because information on college
  demand is not held at a national level due to each college having its own application process. We
  have recommended that the SFC should explore with colleges a way to better assess demand
  for college courses across Scotland. This will also contribute towards the recommendation in
  ‘Audit of higher education in Scotland’ to assess what impact the limits on funded places are
  having on access to the university system for Scottish and EU students.

We also reported that both further education full-time attainment and retention dropped slightly in 2014-15,
after a period in which they had both increased year on year. We noted that destination data was published
for the first time for those completing their studies in 2013-14. The data indicated that 82% went on to a
positive destination, (65% into further education or training; and 17% into employment). Data for 2014-15
was published recently and indicated a slight increase in those going into positive destinations and a slight
drop in those going into employment.

**How the SFC undertakes long term financial planning and manages change effectively**

My higher education report highlights a number of financial risks and challenges facing the higher education
sector. These will need to be addressed by a coordinated approach by all stakeholders, including the SFC.

We found that the SFC needs to do more to assess, and report on, the medium-to-long-term financial
sustainability of the sector. The SFC examines universities’ three-year financial forecasts and annual
financial statements to identify universities with financial risks. However, it does not comprehensively
analyse longer-term sector trends to identify wider risks facing the sector. Examples might include sector
trends in non-EU student numbers and fee income, or financial trends and policy changes in competitor
countries. This means the SFC cannot assess the sector’s medium-to-longer-term financial sustainability
and any threats to its continued viability.

Our colleges report focused on the financial health of colleges, all of which are highly dependent on SFC
funding. We found that Scottish Government funding to the sector - through the SFC - reduced by 18% in
real terms between 2010/11 and 2014/15, but remains broadly static for 2015/16. The financial performance
of the sector in 2014-15 deteriorated from the previous year with four colleges experiencing underlying
financial challenges. In their financial forecasts in June 2015, eight colleges were forecasting a deficit for
2015-16, and 11 for 2016-17. The SFC has begun to implement a new funding model for colleges. It is
currently in a transitional stage, during which time annual funding reductions to any college will be limited to
1%. The SFC has yet to confirm when the new funding model will be fully implemented.

The amount of capital funding available to colleges has decreased by 77% since 2010/11. We found that the
SFC's method of allocating capital funding does not take account of need. The SFC did not hold a national
estate condition survey report to allow it to identify need in order to distribute capital resources most
effectively. The SFC accepted this point and is currently commissioning a baseline report on the condition of
the college estate.
The SFC itself is subject to an annual audit review by my appointed external auditors. Relevant findings from the 2015/16 annual audit report are:

- The SFC made a net over-commitment of £10 million in university funding allocations for the 2015-16 academic year, placing additional pressure on its operating budget. Internal audit conducted a review and found that factors leading to the over-commitment included a lack of scrutiny and transparency over financial reporting, the separation between funding and finance processes, and a breakdown in the funding allocation process. A series of improved controls were identified and a significant proportion had been addressed prior to the year end.

- The SFC does not currently prepare medium to long-term budgets. Looking forward, there is an opportunity for the SFC to consider its approach to longer-term financial planning alongside the financial spending review due to take place in 2017.

- The SFC is currently managing a further operational funding reduction that is likely to require more voluntary severance. SFC does not have a workforce plan to allow it to approach this from an informed position, although it is working on one. The SFC carried out a review of its workforce in 2015/16 which found that it needed to invest in learning and development of staff at a number of levels to allow for progression and movement.

**College governance**

The Committee did not specifically ask the SFC about college governance arrangements, but my findings are relevant to the Committee’s consideration of the bodies’ performance.

I have prepared a number of statutory reports on individual colleges in the last three years, specifically Coatbridge, Glasgow Clyde and North Glasgow colleges. The Cabinet Secretary for Education and Lifelong Learning established the College Good Governance Task Group as part of the Scottish Government’s response to these failures. Implementation of the Group’s recommendations should help to mitigate the risk of significant governance failures in the future.

The SFC’s role in regulating college governance is not clear. The SFC’s relationship with the Scottish Government is formalised in a Management Statement and Financial Memorandum which was last reviewed in 2006 and states that the SFC’s role is ‘to promote sound governance’. A number of significant changes and issues have arisen in the sector since this was last reviewed and I have recommended that the Scottish Government should use its end-to-end review of the skills agencies in Scotland to re-examine, clarify and set out the role of the SFC.

Regional Outcome Agreement Managers were introduced by the SFC in 2012 and have improved relations with colleges and allowed both parties to identify and resolve issues sooner than would have happened previously. The statutory reports at Coatbridge College and Glasgow Colleges Regional Board indicate that these have not been enough to quickly resolve some significant governance failures.

I hope this information is helpful to the Committee. If members would like any further information please contact Fraser McKinlay, Director of Performance Audit and Best Value.

Yours sincerely

Caroline Gardner
Auditor General for Scotland