



The Scottish Parliament
Pàrlamaid na h-Alba

PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE

AGENDA

4th Meeting, 2017 (Session 5)

Thursday 2 February 2017

The Committee will meet at 9.00 am in the Adam Smith Room (CR5).

1. **Decision on taking business in private:** The Committee will decide whether to take item 4 in private.

2. **Section 23 report - Audit of higher education in Scottish universities:** The Committee will take evidence on the Auditor General for Scotland report entitled "Audit of higher education in Scottish universities" from—

John Swinney MSP, Deputy First Minister and Cabinet Secretary for Education and Skills, and Aileen McKechnie, Director of Advanced Learning and Science, Scottish Government.

3. **Section 23 report - Scotland's colleges 2016:** The Committee will take evidence on the Auditor General for Scotland report entitled "Scotland's colleges 2016" from—

John Swinney MSP, Deputy First Minister and Cabinet Secretary for Education and Skills, and Aileen McKechnie, Director of Advanced Learning and Science, Scottish Government.

4. **Section 23 reports - Audit of higher education in Scottish universities and Scotland's colleges 2016:** The Committee will consider the evidence received at agenda items 2 and 3 and take further evidence from—

Caroline Gardner, Auditor General for Scotland;

Antony Clark, Assistant Director, Stuart Nugent, Audit Manager, and Kirsty Whyte, Audit Manager, Audit Scotland.

PAPLS/S5/17/4/A

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The papers for this meeting are as follows—

Agenda Items 2 and 3

Written submissions

PAPLS/S5/17/4/1

PRIVATE PAPER

PAPLS/S5/17/4/2 (P)

Public Audit and Post-legislative Scrutiny Committee

4th Meeting, 2017 (Session 5), Thursday 2 February 2017

**Section 23 reports: Audit of Higher Education in Scottish universities,
Scotland's colleges 2016**

Clerk's Note

1. At today's meeting, the Committee will take evidence from John Swinney MSP, Deputy First Minister and Cabinet Secretary for Education and Skills, on the AGS reports entitled "Audit of higher education in Scottish universities" and "Scotland's colleges 2016".
2. The Committee has previously taken evidence from the Scottish Government, Scottish Funding Council and Universities Scotland on the universities report, and from the Scottish Government and Scottish Funding Council on the colleges report.
3. The Committee's previous work on colleges can be read [here](#), and its previous work on universities can be read [here](#).
4. Although these are two separate items on the agenda, this paper contains the written submissions for both items.
5. The Committee has the following papers, attached below, for these items:
 - A written submission from the John Swinney MSP, Deputy First Minister and Cabinet Secretary for Education and Skills (attached at Annexe A and relevant to both items);
 - Follow-up information from the Scottish Government (attached at Annexe B and again relevant only to the item on universities); and
 - A written submission from Universities Scotland (attached at Annexe C and relevant only to the item on universities);

Gary Cocker
Assistant Clerk to the Committee

**WRITTEN SUBMISSION FROM JOHN SWINNEY MSP, DEPUTY FIRST
MINISTER AND CABINET SECRETARY FOR EDUCATION AND SKILLS**

Thank you for your letter of 6th December, inviting me to give evidence to the committee on 2 February, in relation to recent reports by the Auditor General, namely “Higher Education in Scottish Universities” and “Scotland’s Colleges 2016”. I can confirm that I will attend, and will be accompanied by relevant officials. The names of accompanying officials will be communicated to the committee in due course.

Your letter specified an extensive number of points that the committee would like to cover in the session. As requested, I have set out below some written responses to those points in the necessary detail to properly address the full range of questions posed.

As committee members will be aware, in the period since the committee last considered these reports, the Scottish Government has published its draft budget for 2017-18. I would draw the committee’s attention to the cash terms increases to the overall budgets allocated to both sectors.

We have announced an increase in college funding (resource and capital) by £41.4 million - 5.9% (in real terms) in 2017-18 - an investment which will help colleges continue to improve young people’s life chances and generate the skilled workforce needed to secure economic growth, while maintaining at least 116,000 full time equivalent college places. We have increased college capital funding in this budget by £20.4 million to £47.4 million. This increased investment will, among other things, allow work to begin on a new campus at Falkirk for Forth Valley College.

The 2017-18 draft budget also announced that, for the sixth year in succession, more than £1 billion will be invested in higher education. This level of funding will enable protection of core teaching and research grant investment and ensure that we continue to make good progress on widening access to university, while protecting free university tuition for all eligible undergraduates. Capital funding will increase by 77% to support research and infrastructure and ensure continued investment in excellent learning environments for students. This further significant investment will support universities to remain internationally competitive; to continue to be renowned for research excellence; and ensure access to higher education remains based on the ability to learn, not the ability to pay.

The committee may also wish to note the recent statistics which show that more Scottish domiciled students than ever before have been accepted to study at Scottish higher education institutions this academic year, an increase of 2% to 33,825. The same UCAS statistics also show a 1.1% increase in entry rates for 18 year olds from the 20% most deprived areas in Scotland - at 10.9%, the highest on record and 3.7% higher than in 2006. HESA statistics published earlier this month also show that there has been a 12% increase in Scottish-domiciled full-time first

degree entrants to Scottish HEIs between 2006-7 and 2015-16. They also show that first degree qualifiers from Scottish HEIs has increased by 3% to 37,140 in 2015-16.

The HESA statistics also reveal that enrolments in higher education courses provided at Scotland's colleges has increased by 2% in 2015-16. It is important to underline that we place far more emphasis on the role of colleges in delivering higher education than in the rest of the UK and the choice that this offers potential students. This greater role for colleges in providing higher education is one of the great strengths of the Scottish system.

As the committee continues its consideration of these reports, I would ask that it also recognises the continued success of both sectors and the pivotal contribution that both make in helping the Scottish Government achieve our vision for Scotland's future.

Higher Education in Scottish Universities

Enterprise & Skills Review: Your letter asked for confirmation as to how the "Enterprise and Skills Review will ensure the structure and operation of the overarching governance body do not create a risk of future reclassification of universities; and that the Scottish Government and SFC "actively consider the potential risks of reclassification whenever relevant funding, legislation and policy relating to universities is being developed".

In response, let me be clear that the establishment of the new overarching board will not affect the autonomy of Scotland's universities or how they are governed. In designing the new arrangements, Ministers have made clear to the university sector that they are acutely aware of any potential consequence of changing the classification relationship between Ministers and the universities, and will work with the sector to remove any apparent risk while achieving their ambition of greater alignment and impact across the education and skills system. This approach is consistent with Scottish Government commentary made during passage of the Higher Education Governance (Scotland) Act 2016.

The Scottish Government values the work of the SFC and, in particular, the expertise and knowledge it brings in relation to matters across the FE and HE sectors. There will be an important role for the SFC board and all our stakeholders during phase two of the Enterprise & Skills Review to support the development and implementation of the new statutory board, including shaping its supporting infrastructure and ensuring the right support for the operations of each of the bodies going forward.

Widening Access: Your letter asked "does SG consider that all suitably qualified Scottish-domiciled students should be able to access free higher education within a Scottish university and can you provide a range of estimates as to how much this may cost if the SG were to fund the places".

As set out above, recent UCAS statistics show that more Scots domiciled students than ever before have been accepted to study at Scottish higher education institutions this academic year. The Scottish Government will continue to do all that it can to ensure that all of our young people get an equal chance of getting a world class education.

It is difficult to estimate the cost of funding free higher education for all suitably qualified Scottish-domiciled students who apply to Scottish universities. It is not possible to determine the destination of applicants who did not receive a UCAS offer, as many will enter alternative routes to enhance their employability and skills, including attending college or embarking on Modern Apprenticeships (in 2015-16 there were 25,818 Modern Apprenticeship starts). These routes also receive public funding, and hence any funding implication of these alternative routes would need to be considered in any net estimate of the cost of providing funded places to the applicants not receiving a place through UCAS. Furthermore, the cost of a single university place can vary significantly depending on the course studied. This makes the task of robustly estimating the cost of providing funded places to all suitably qualified applicants problematic.

As noted above, a significant number of students undertake higher education courses at Scotland's colleges. Recent HESA statistics state that the figure is almost 50,000, around 17.5% of all higher education provision in Scotland. Indeed, when higher education in colleges is taken into account (including sub-degree provision), Scotland (55%) has a significantly higher initial HE participation rate than England (47%). The Sutton Trust report from May 2016 *Access in Scotland: Access to higher education for people from less advantaged backgrounds in Scotland*, acknowledged that, once the thousands of learners who progress from college to university are factored in, Scotland has a similar first degree participation rate to England. I am sure the committee would agree that the higher education provided through our colleges should be valued as highly as that provided through our universities.

Your letter also asked for "an update on the work being done to ensure that universities, are able to take account of markers of deprivation other than the Scottish Index of Multiple Deprivation in seeking to widen access"; and "a detailed analysis of the possible costs associated with the SG policy of widening access".

The final report of the Commission on Widening Access makes an important distinction between the use of SIMD as the best available and most sophisticated method of monitoring progress at a national level, sitting alongside additional measures appropriate to inform more sensitive decision making around individuals. The report recognises the place of both and makes clear that contextual admissions policies should continue to take account of a range of factors when making admissions decisions. It is also the case that improved participation of other under-represented groups, such as BME and disabled learners, is explicitly promoted

through outcome agreements between the SFC and individual institutions. It is therefore not the case that universities should focus access efforts entirely on SIMD; this is simply the best available measure to track national progress. The technical paper published alongside the Commission's report contains a more detailed analysis of these issues. The technical paper can be found at:

<http://www.gov.scot/Resource/0049/00496620.pdf>.

It should also be noted that we have accepted the Commission's commentary on the limitations of SIMD and have identified dedicated civil service resource to take forward recommendation 31; that the Scottish Government works with key partners to develop a more consistent and robust set of measures to identify access students. That work will take time, but it is underway and should deliver a positive resolution to the on-going debates around the most appropriate data and measures.

Some of the commentary around the estimated costs of meeting widening access targets appear to be predicated on the assumption that progress will be achieved purely through the funding of additional places. It is true that additional places have made an impact and that is why we continue to invest around £51 million every year in additional places for access and articulation from college. However, the Commission identified a whole series of other mechanisms through which progress can be achieved and made the point that there is considerable scope for the significant public and institutional resource already invested in access to deliver greater impact.

In this context it is also important to note that the Commission concluded that there is structural unfairness in the way that talent is currently evaluated and recruited. The view of Ministers is that this unfairness can only be tackled through systemic change and not simply through the continual expansion of the system. Indeed, Professor Peter Scott, Scotland's first ever Commissioner for Fair Access, has already made the point that socioeconomic inequality is a problem in higher education systems all over the world, irrespective of whether they are expanding or not. For this reason, Ministers are clear that, at its core, widening access is about a much fairer distribution of publicly funded opportunities.

Funding: Your letter went on to ask if "SFC funding for teaching is intended to cover the full cost of teaching Scottish and EU students; and if the "Scottish Government intends to take account of universities' income from other sources in making allocations for teaching and research.

Consideration of the report on Higher Education in Scottish Universities should recognise Audit Scotland's findings that "overall the sector was in good financial health in 2014-15"; that "universities as a whole had income of £3.5 billion"; that "the sector's overall income increased 38% in real terms between 2005-06 and 2014-15"; that its income from research grants and contracts had increased in real terms by 60% over the same period; that the sector made an overall surplus of £146 million in

2014-15 (with most universities generating a surplus every year in the past decade); and that overall reserves in 2014-15 stood at £2.5 billion.

The significant and continuing investment in the sector by the Scottish Government clearly provides a stable base which enables our universities to attract a wide range of additional funding. As John Kemp, Interim CEO of the SFC, told the committee in December, the SFC consider the financial health of the whole institution, and the allocations for teaching and research are decided by the SFC directly. He was also clear that it was often the case that external, non-public income for research will not cover the 'full economic costs' for the university. The Audit Scotland report also noted that funding from the UK Research Councils only covered 74.3% of its 'full economic cost', and UK charity funding covered only 65%.

The sector uses an approach called TRAC (**T**ransparent **A**pproach to **C**osting) to help cost activities. When the sector talks about public funding not covering the 'full economic costs' of teaching or research they are using TRAC as the basis for that view. Whilst TRAC can be a useful tool, it is important to understand that the figures published are for the sector overall, meaning that it could be the case that very high costs at a small number of institutions are impacting on the overall figure for the sector. The discussion arising from the TRAC figures also tends to focus on public funding levels rather than on rising costs at universities. The Audit Scotland report noted that overall spending in the sector had increased by 35% between 2005-06 and 2014-15.

In the current financial climate, it is critical that all public spending delivers maximum public value. Audit Scotland acknowledged in its report that it did not examine efficiency savings in detail as part of its audit. However, it did conclude that it is "essential that universities continue to identify ways to improve efficiency as overall sector spending continues to increase". It will be important to maintain close scrutiny over the scope for improved efficiency and effectiveness going forward.

Your letter also asked if "the Scottish Government intend to take steps to ensure that the Scottish Funding Council (SFC) is able to analyse and respond" to longer-term trends and challenges, such as growing competition for international students. It is worth underlining that the Scottish Government commitment to free tuition for Scottish-domiciled students at Scottish universities means that our higher education sector is largely insulated from competition for that sizeable group of students from universities in the rest of the UK. Both the Scottish Government and the SFC continue to carefully consider the potential implications of longer-term trends, and to work with the sector to respond appropriately. For example, we continue to work with Universities Scotland and individual institutions to promote Scotland as a great place to study, and continue to call on the UK Government to introduce a Post Study Work route which would provide an additional lever for attracting the best international student talent, securing essential income streams, and allowing talented graduates to continue contributing to Scotland after their studies end.

Scotland Colleges 2016 Report – updates

Your letter asked about “efforts to capture applications to each college by subject, in order to understand any disparities in student demand for places”. We intend to explore options for developing a common college application process in the forthcoming Learner Journey review.

You also asked about the “the on-going and likely future balance between available part time and full time courses, and difference in attainment between part time and full time students”. Over the last Parliament, we maintained 116,000 Full-time Equivalent college places. We will continue with this commitment, with an emphasis on purposeful, job-focused learning. Short courses leading to work or progression are also still available. The SFC’s Outcome Agreements ask colleges to remove barriers and to support full participation and successful outcomes for all groups of learners in their local community.

Your letter also asked about “on-going attainment and retention trends more generally, and how the college reform process is likely to improve these”. The SFC will continue to monitor student success rates through the Outcome Agreement process and will continue to gather evidence of what contributes to student success. The Learner Journey review will also provide an opportunity to consider improvements in these important areas.

Further information was also requested on “why some colleges are in deficit, the consequences of this and how it could be remedied”. The Audit Scotland report highlighted that the financial health of the sector remains relatively stable, and that the underlying financial deficit across the sector last year was less than 1% of income - £3 million. As the report also makes clear, a deficit does not necessarily mean an institution is in financial difficulty. The SFC works closely with colleges to ensure that deficits are kept to a minimum; that operational activity is not adversely affected; and, where required, special measures are put in place. SFC has advised that the deficits are largely due to one-off items (e.g. college restructuring costs) or technical matters (e.g. use of depreciation funds).

You asked for “an assurance that the issue of depreciation will be tackled and not simply presented in a more understandable way”. The Scottish Government and the SFC are working closely to identify an approach which continues to benefit the sector whilst adhering to central government and FE/HE sector guidance. The key issue here relates to the establishment of a proportionate mechanism for approval of colleges’ proposed utilisation of depreciation funds.

Further details were also requested on “how arms-length foundations have operated, including the amount of funds they hold and how funds have been accessed and spent to date”. Of the £100 million originally donated to arms-length foundations (ALFs) in 2014, the SFC estimates that around £55 million will have been returned to

the sector by the end of 2016-17, based on forecast information provided by colleges. Funds were deposited to ALFs to protect reserves that would otherwise have been lost to the sector following reclassification. ALFs are independent charities governed by a Board of Trustees, with specific rules in terms of funding activity. It is therefore for colleges themselves to apply to ALFs for the release of funding, which must be in line with their strictly determined Articles of Association. SFC advises that ALF funding has been used to support capital projects and one off 'spend to save' revenue projects. Based on current spend levels, existing ALF resources will be fully utilised by 2019-20.

You asked for an update on "work on the sector's capital funding and estate needs". The Scottish Government has asked the SFC to conduct a review of the estate needs of the sector. Phase 1, a baseline report, has already been published. SFC will undertake a comprehensive review and develop a long term plan for capital expenditure, to be in place in late Summer 2017.

You also asked for an update on "progress on the workforce planning across the college sector". The Scottish Government is continuing to work with the SFC and colleges to look at future workforce requirements for the sector. In doing so, it will take account of the Audit Scotland good practice guide 'Scotland's public sector workforce' and the ambitions of both the Labour Market Strategy and the Fair Work Convention. I understand that Colleges Scotland is currently considering proposals for the optimum *workforce of the future*, which should influence thinking around workforce planning for the sector.

General: Your letter closed by asking a few questions that go wider than individual sectors. You asked "how the Scottish Government's aim of closing the educational attainment gap in school is likely to influence future participation in FE/HE"; and "whether the public funding of early years, school education, college-level education or university-level education delivers the best return in terms of narrowing educational inequalities, and whether public sector budgets are funded accordingly".

We will continue to invest in early learning and childcare as we work towards delivering the increased entitlement of 1,140 hours per year by the end of this parliamentary session and are closing the attainment gap through increased targeted investment in schools. The budget will deliver £120 million in 2017-18 for schools to invest in ways that evidence tells them will close the attainment gap.

You mention the learner journey review in your letter, and we will be using this process to establish the evidence base and generate ideas about how we improve the 15-24 stage of young people's learning to ensure it as effective and efficient as possible - from an individual and system perspective - and that it provides support for those who need it. The review will address five areas: careers guidance, access, provision, transitions and funding, and will be commenced formally in the coming weeks. The Government began work in September, through commissioning

research on the learner journey from a user perspective. Once the review is formally underway we will work with young people and those who support them, as well as with other partners and stakeholders, to develop ideas about how to make the move from school and on through learning and to employment as straightforward as possible. The First Minister has been clear about the importance this Government places on excellence and equity in education while ensuring all priorities are met.

You also asked “whether the SFC and the Scottish Government have any specific progress goals for the college and university sectors (beyond anything set out in the national performance framework), such as that x% of students complete their study/ go on to a job or other positive destination/ rate their course as satisfactory, etc”. In order to ensure best value for public investment, the Scottish Government works with the SFC and the relevant sector to secure greater efficiencies, maintain the current high quality of education, streamline the learner journey and ensure core outcomes are protected and met. Outcome Agreements, agreed with the Scottish colleges and universities, are fundamental in ensuring these priorities are met while ensuring high quality effective learning and internationally competitive and impactful research is delivered. The latest SFC publications summarising progress and ambitions can be found at:

http://www.sfc.ac.uk/web/FILES/Funding_Outcome_Agreements_2016-17/College_Outcome_Agreements_Summary_2015-16.pdf

http://www.sfc.ac.uk/web/FILES/Funding_Outcome_Agreements_2016-17/University_Outcome_Agreements_Summary_2015-16.pdf

I trust that the committee finds this written submission helpful, and I look forward to providing further evidence on 2 February.

JOHN SWINNEY MSP

DEPUTY FIRST MINISTER AND CABINET SECRETARY FOR EDUCATION AND SKILLS

WRITTEN SUBMISSION FROM THE SCOTTISH GOVERNMENT

At my Committee appearance on 1 December 2016, I agreed to provide follow-up information relating to two points raised during the session.

Gail Ross MSP asked about the 2013 sale of mortgage-style loans, specifically in relation to information being provided in advance of that sale to those repaying the loans. I can inform the committee that the announcement made at the time clearly set out that the terms and conditions of existing loans would not be changed, and therefore recipients of a mortgage-style student loan and the latest SAAS version, Income Contingent Repayment loans, could be expected to repay both loans concurrently if the earnings thresholds were surpassed. This was an original condition of the loan, and present prior to the sale to Erudio Student Loans.

I can also confirm that formal letters were issued to customers confirming their loans had been sold to Erudio, providing contact details of the new company and how to make future payments/deferment applications.

The Committee may also wish to note that, in line with normal practice with regard to the sale or collection of loans, the communication plan and strategy was carried out at a UK-wide level by the UK Government Department for Business, Innovation and Skills. Neither the Scottish Government nor the devolved administrations in Wales and Northern Ireland undertook a separate communication plan.

The second point on which I agreed to provide further information relates to a question asked by Ross Thomson MSP concerning an item in The Herald newspaper reporting on costs associated with the Scottish Government policy of widening access to university.

The figure quoted in the article is the estimated cost of meeting the widening access targets purely through funding additional places, rather than through implementation of the many other mechanisms for achieving progress identified in the report of the Commission on Widening Access. Scottish Ministers already invest around £51m every year in additional places for access and articulation, and have been clear that they regard the implementation of the Commission's final report as an ambitious and credible plan for delivering step change.

In this context it may also be helpful to note that the Commission concluded that there is structural unfairness in the way that talent is evaluated and recruited. The view of Scottish Ministers is that this unfairness can only be tackled through systemic change and not simply through the continual expansion of the system. Indeed, Professor Peter Scott, the new Commissioner for Fair Access, has already made the point that socio-economic inequality is a problem in higher education systems all over the world, whether they are expanding or not. For this reason, Scottish

Ministers are clear that, at its core, widening access is about a much fairer distribution of publically funded opportunities.

I hope that this information is helpful to the Public Audit and Post-legislative Scrutiny Committee in its consideration of the reports.

Yours sincerely,

PAUL JOHNSTON

DIRECTOR-GENERAL LEARNING & JUSTICE

WRITTEN SUBMISSION FROM UNIVERSITIES SCOTLAND

This paper offers supplementary evidence on the Audit Scotland report of its audit of higher education in Scottish universities. We would encourage the Committee to revisit our [written evidence](#) to the Committee of 29 September 2016 and [oral evidence](#) on 1 December.

Key messages:

- **HE is under-funded.** Between 2010-11 and 2017-18 SFC funding to universities will have fallen by over 13% in real terms.
- In the July 2016 report into HE funding, the Auditor General notes that in 2014-15 public funding was not covering the costs of either teaching or research. She found that universities received only 94.2% of the cost of publicly-funded teaching and only 84.8% of the cost of research. She expresses concern that, overall, universities were not able to generate surpluses to meet funding council sustainability targets so that they can 'operate today without damaging the ability to do so tomorrow'.
- **Core grants cuts.** Since 2014-15 Audit Scotland data shows that SFC research funding was cut by a further 7% in real terms and teaching funding by 5% in real terms to and 2016-17.
- As a result, it is reasonable to assume that **in 2016-17 the sector received funding for less than 90% of the full economic costs of publically-funded teaching.**
- Whilst offering cash-terms protection of teaching and research funding, the Scottish Government 2017-18 budget for higher education will not begin to address these risks. Indeed, they are likely to intensify further.
- **Reserves don't address day-to-day funding pressures.** Audit Scotland recognised that university reserves "cannot necessarily be used to fund day-to-day running costs" (p35). In order to convert reserves into cash, an institution would have to sell all its assets.
- **Universities in deficit.** In 2014-15, seven Scottish institutions were in deficit¹. Of the 14 institutions with Financial Statements for 2015-16 published, seven report a deficit before actuarial losses for pensions. When those actuarial losses are included 10 of the 16 report a deficit in 2015-16. These figures for 2015-16 pre-date the 3.6% cash cut to the SFC revenue budget in 2016-17.
- **Opportunities for HE?** The UK Government's Autumn Statement announced a significant additional investment in research and development which will provide

¹ THE published analysis 2 June 2016.

consequentials that could be invested in higher education. The apprenticeship levy, which universities contribute to in significant levels as large employers, could also be a means to fund ambitious investment in graduate-level apprenticeships.

Unsustainable funding in the higher education sector

- The Auditor General looked at higher education funding to 2014/15. It identified “underlying risks” in universities’ finances in 2014-15 and “significant challenges ahead”.
- She points to real-terms erosion of teaching funding by 6 per cent between 2010-11 and 2014-15, including a real-terms cut of 69 per cent in capital funding over the same period.
- She notes that in 2014-15 public funding was not covering the costs of either teaching or research. She expresses concern that, overall, universities were not able to generate surpluses to meet funding council sustainability targets so that they can ‘operate today without damaging the ability to do so tomorrow’.
- Since the Audit Scotland report the financial risks identified by the Auditor general have intensified.
- Audit Scotland figures show a further 6% real terms cut in SFC funding between 2014-15 and 2016-17 and the draft budget for 2017-18 points to a further real terms cut of 1.4% in SFC funding overall.

Audit Scotland observed that current levels of public funding, which do not meet the full economic costs of teaching and research, mean that achieving sustainable levels of surplus is becoming an ever more distant target for universities.

The Audit Scotland report notes that:

“The overall sector surplus, as a percentage of total income in 2014/15, was 2.6 per cent, a reduction of 0.4 per cent since 2013/14” (page 36).

The report also notes that this is a gap of 3.9% (£136M) of sector income from the target surplus for sustainability as identified by the UK funding councils’ Transparent Approach to Costing (TRAC) process.

Audit Scotland notes:

- “Continuing pressure on Scottish Government finances in future years means it needs to ensure its approach to funding higher education is sustainable if its policy priorities are to be delivered” (page 5)
- “Universities need to generate increasing amounts of additional income or cost savings to cover the cost of teaching and research”. (page 37)

Reductions in SFC funding: core budgets for teaching and research

Funding for teaching and research is not at a level to meet costs:

- “In 2014/15, universities recovered 94.2 per cent of the full economic cost of publicly funded teaching, a reduction of 1.7 per cent since 2013/14” (page 29)
- “University research funding from all sources covered 84.8 per cent of the full economic cost of undertaking the research in 2014/15. This means that the funding received was less than the full costs incurred”. (page 37)

Between that reference year of 2014-15 and 2016-17 Audit Scotland data shows that SFC research funding was cut by a further 7% in real terms and teaching funding by 5% in real terms.

Given these cuts, the recovery of full economic costs is likely to have worsened significantly. It is reasonable to assume that in 2016-17 the sector received funding for less than 90% of the full economic costs of publically funded teaching.

The SFC revenue budget will see a further cash cut in 2017-18.

- The SFC revenue budget will be cut by 1.3% in cash terms in FY2017-18. Whilst savings from policy reforms, primarily Taught-postgraduate reform, will mean that core grants are expected to be maintained in cash terms (a 1.4% real terms reduction), the opportunity to retain those savings in the SFC budget and re-invest them to begin to address the challenges identified by the Auditor General was not taken up.
- The new arrangements to support taught postgraduate study are welcome. The changed arrangements were prompted by falls in recent years in the numbers of Scottish domiciled students taking up TPG opportunities. Looking to 2017-18, it is unclear at this point exactly how SFC will implement a withdrawal of funding and, given that recruitment for courses is already open, the extent to which institutions will be able to recoup those losses.

Whilst offering cash terms protection of teaching and research funding, the Scottish Government 2017-18 budget will not begin to address these risks. Indeed, they are likely to intensify further.

The SFC budget has seen new ongoing demands placed upon it, further decreasing its relative value

- Since 2013-14 the SFC has had to make a transfer to SAAS for the fee and bursary costs of additional places for access and articulation.
- The SFC grant letter for 2016-17 notes:
“We continue to transfer resource to SAAS in recognition of the financial impact on its budget of our additional places for Widening Access, Articulation and Skills

and the Part-time Fee Waiver Scheme. We have therefore budgeted £24.3 million in AY 2016-17 for the SAAS transfer”.

- We understand that SFC is budgeting for a transfer of the same amount in 2017-18 as these places have now been ‘mainstreamed’ within teaching funding.
- Additionally, whilst the additional places for articulation have been very welcome in creating opportunities for learners, all of the public funding for these 4,000 places is drawn from the SFC Higher Education budget, including funding for the college element of that study. In effect, it represents an ongoing transfer from the SFC HE budget to the SFC college budget.

Reductions in SFC funding: capital

Capital funding for the university estate has been cut badly in recent years. This is putting pressure on other, core, budgets too.

- SFC capital funding has declined sharply over recent years.
- The Audit Scotland report notes, “capital funding reduced from £83.5 million to £28 million in cash terms, a real-terms reduction of 69 per cent” (page 21).
- Whilst capital funding levels have subsequently begun to recover, and the increase in capital spending following the 2016 programme for government statement was welcome, there remain significant issues.
- Due to large one-off strategic commitments, the SFC capital budget for 2017-18 is insufficient to maintain even historically low levels of capital maintenance funding. Meanwhile revenue transfers are likely to be needed to meet other strategic commitments
- The draft Scottish Government budget for 2017-18 sets a SFC capital budget of £45.5M, a 77% increase on the figure in last year’s draft budget.
- However, in 2017-18 there will be £18M of commitments to one-off strategic projects including ministerial commitments to the restoration of the Mackintosh Building. There is also a need to provide £16M of match funding to UK research capital funding as part of the dual support system.
- As a result the budget is likely to only be sufficient to provide a sector capital maintenance grant of £11.5M, a 25% cash cut on the indicative figures for that grant at this point in 2016-17².

Transfers of revenue to capital, to make good shortfalls, have put pressure on the SFC revenue budget.

The Auditor General notes the significant reductions in SFC capital funding between 2010-11 and 2014-15. Over recent years SFC has used revenue to capital transfers

² See Table 8 <http://www.sfc.ac.uk/communications/Announcements/2016/SFCAN042016.aspx>

to meet commitments, including seeking to ensure that sufficient funds were available to match UK research capital funding.

We understand that SFC is likely to have to make a further transfer from revenue to capital in 2017-18 to meet some strategic capital commitments.

The impact of funding pressures

Audit Scotland notes that it has become more difficult in recent years for Scottish students to gain a place at a Scottish university

The Audit Scotland report notes:

- “It has become more difficult in recent years for Scottish students to gain a place at a Scottish university as applications have increased more than the number of offers made by universities”.
- “Implementing the Scottish Government’s ambitious policy on widening access within the current number of funded places will have consequences for other groups of students”.

Within the draft budget for 2017-18 SFC will have no capacity to make new investment in undergraduate places. Indeed, SFC continues to manage its planned overspend in 2016-17 that was needed to deliver the additional access and articulation places in that year.

Surpluses, deficit and reserves

The Audit Scotland report notes:

- “Surpluses and reserves are an important part of a university’s financial strategy. They are used, for example, to fund investments in a university’s estate, repay capital borrowing, allow universities to invest in opportunities that arise at short-notice, and help universities deal with unforeseen or longer-term financial difficulties.
- “Universities fund improvements to their estate and other assets mainly through a mix of direct SFC capital funding, their own surpluses and reserves, and commercial borrowing”. (page 36). Capacity to invest is crucial given that, “twenty-two per cent of the university estate is in poor condition”. (page 30)
- “Overall SFC capital funding declined from £83.5 million in 2010/11 to £28 million in 2014/15, a decrease of 69 per cent in real terms. As a result, universities have had to generate capital funding from other sources. The main way they have done this is by generating surpluses and using their reserves”. (page 36)

Levels of surplus across the sector are insufficient to deliver sustainability

- Audit Scotland found that universities were, “placing increasing reliance on generating income from fee-paying students from the rest of the UK and outside the European Union (EU)” (page 5). It is this income, secured in the face of global competition, which allows for the creation of surplus to subsidise publicly funded tuition.
- Obstacles to the recruitment of international (non-EU) students as a result of UK immigration policy have added to the challenges of generating sustainable levels of surplus and, therefore, to the risks facing the sector. Added to this, Brexit has introduced considerable additional uncertainty to the sector’s future operating environment, including uncertainty over the fee status of EU students applying to commence study in Autumn 2018.
- The generation of sufficient surplus for re-investment is essential to ensure that the quality of the student experience remains attractive to domestic and overseas students.
- Surpluses and reserves are concentrated in a small number of institutions. The Audit Scotland report notes: “Surpluses and reserves are concentrated in a small number of universities and some are heavily reliant on Scottish Government funding at a time when it is reducing”. (page 5)

Deficit: the latest Financial Statements (2015-16) show more institutions in deficit in 2016-17 and 2017-18.

- In 2014-15, 5 Scottish institutions were in deficit³.
- Of the 14 institutions with Financial Statements for 2015-16 published, 6 report a deficit before actuarial losses for pensions.
- A change to the reporting standard means that from academic year 2015/16 it will be necessary to actuarial losses for pensions. When that happens, 10 of the 16 universities report a deficit in 2015-16.
- These figures for 2015-16 pre-date the 3.6% cash cut to the SFC revenue budget in 2016-17.

Reserves don’t address day-to-day funding pressures

- It should be noted that to convert all reserves to cash an institution would have to sell all its assets. Simply looking at the sector’s overall reserves does not therefore address questions of sustainability.
- Audit Scotland stated: “Reserves cannot necessarily be used to fund day-to-day running costs”. (page 35)

Opportunities to fund higher education more sustainably?

New Barnett consequentials could be used to support expansion of the sector’s economic contribution.

³ THE published analysis 2 June 2016.

The introduction of the apprenticeship levy and the Barnett consequential from additional investment announced in the UK Government Autumn Statement offer a route to supporting the sector's economic contribution.

- The Autumn Statement announced a significant additional investment in research and development. It will be important for the Scottish Government to direct any consequential from uplifted QR funding in England to uplift SFC's REG funding.
- The Autumn Statement noted that "funding of £100 million will also be provided until 2020-21 to incentivise university collaboration in tech transfer and in working with business, with the devolved administrations receiving funding through the Barnett formula in the usual way". It is unclear as yet how the consequential flowing to Scotland will be used.

From April 2017 universities in Scotland will have to pay the apprenticeship levy, (totalling around £9m across the sector). There is a strong interest from across industry sectors in Scotland in growing graduate apprenticeship provision. In the context of the levy, the Scottish Government has set out plans to invest £4.7m in such apprenticeships⁴.

The future governance of the SFC

Following Phase 1 of the Enterprise and Skills Review the Scottish Government has indicated that it intends abolishing the Board of SFC. Universities Scotland [wrote](#) to the Cabinet Secretary for Economy, Fair Work and Jobs setting out the sector's support for the aims of the Review overall alongside specific concerns that would need to be addressed in Phase 2, including the broad range of existing powers of the SFC Board that fall outside the remit of the Review.

Universities Scotland, NUS Scotland and USU Scotland have also issued a [joint statement](#) setting out the issues that will require careful management in Phase 2 of the Review.

⁴ <https://consult.scotland.gov.uk/employability-and-training/apprenticeship-levy/results/scottish-government-response-to-the-uk-government-apprenticeship-levy----.pdf>