

Our ref: 246807707

29 September 2016

Jenny Marra MSP
Convener of the Public Audit Committee
Room T 3.60
The Scottish Parliament
Edinburgh EH99 1SP

Dear Ms Marra,

Response to Public Audit Committee on four reports by the Auditor General for Scotland

I have pleasure in writing with our reply to the Committee's letters dated 14 September 2016, requesting responses to the relevant parts of the following four reports from the Auditor General for Scotland:

- Audit of higher education in Scottish universities
- Scotland's colleges 2016
- 2014-15 audit of Edinburgh College
- 2014-15 audit of Glasgow Colleges' Regional Board

Our detailed responses are set out in the four annexes to this letter.

In the rest of this letter I provide the Committee with a high level overview of the college and university sector in order to set these more detailed responses in some context.

Scottish Funding Council
Apex 2
97 Haymarket Terrace
Edinburgh
EH12 5HD
T 0131 313 6500
F 0131 313 6501
www.sfc.ac.uk

We aim to have effective partnerships with colleges and universities through outcome agreements that ensure that the investment we make in further and higher education will mean better outcomes for students, communities and businesses and will have a positive impact on society and on the economy. And we are working closely with other organisations with a part to play in achieving the Scottish Government's national priorities for a better Scotland.

College sector

In recent years the college sector has undergone significant reform in its structure, governance and operations. In our recent publication, 'Impact and success of the programme of college mergers in Scotland' we assessed the structural changes that have re-shaped the college sector in Scotland from 43 individual colleges to thirteen college regions. Our overall conclusion is that the implementation and outcome of the merger programme has been a success, though we recognise that some colleges are still addressing particular challenges of merger, including financial and operational issues. SFC and the sector has learned lessons as a result of this evaluation process and in addition to referencing good practice, the report also highlights what would need to be addressed in any future mergers. Given the importance of this report, we have attached a copy for the Committee's reference.

In terms of impact, the college sector continues to perform well across most measures:

- Colleges have taught over 116,000 full-time equivalent students in each year since the beginning of the mergers.
- The proportion of school leavers from Scottish state schools progressing to further or higher education has increased from 51% in 2007-08 to over 60% in recent years.
- The proportion of full-time FE students successfully completing their course has risen from 58% in 2008-09 to 64% in 2014-15, and from 64% to 71% for HE students.
- While this shows an improving trend over time, the proportion of full-time FE students successfully competing in 2014-15 was 1.9 percentage points lower than in 2013-14, and for HE students was 0.1 percentage points lower.
- Positive destinations for college leavers increased from 91.5% in 2013-14 to 95.6% in 2014-15 (for confirmed destinations). The increase was for those entering further study, which was up 4.1 percentage points, with those entering employment reducing by 3.0 percentage points.

- Enrolments on non-recognised qualifications have fallen by nearly 40% since 2012-13.

Looking ahead, the key challenges for the college sector include:

- continuing to improve the student experience, when performance is already at historically high levels;
- using the capacity in the college sector to continue to develop new learner journeys linking school, college and sometimes university; and
- in the context of general public spending pressures, financial sustainability.

University sector

Reports over the last few weeks have confirmed that the Scottish university sector continues to be one of the most successful in the world:

- Five of Scotland's universities are in the top 200 worldwide, according to the 2017 Times Higher Education world university rankings, which is more per head of population than almost any other country.
- In the 2016-17 QS World University Rankings Scotland has maintained its position of three universities in the top 100 and four in the top 200.

The statistics on student success show a generally positive picture, albeit with areas for improvement:

- In past years the sector has delivered beyond its funded places target. In 2015-16 the sector taught 8,500 full-time equivalent students beyond the number of funded places, representing 6.5% of the total for Scottish and EU students eligible for funding.
- As already noted, the proportion of school leavers from Scottish state schools progressing to further or higher education has increased from 51% in 2007-08 to over 60% in recent years.
- The number of Scottish students studying at degree level has been steadily increasing in recent years, and for 2014-15 was at an all-time high.
- The proportion of Scottish-domiciled undergraduate entrants to universities from the 20% most-deprived areas has risen over the past five years from 12.8% to 14.1%, although we recognise that we need to make more significant progress on this issue.

- Focusing in on the school leaver cohort highlights a greater challenge, as 9.6% of the school leavers entering year 1 at university are from the 20% most deprived areas.
- In 2014-15, 95.1% of UK domiciled leavers from full-time undergraduate courses at Scottish HEIs were successful, in terms of being in employment or further study, six months after leaving.

In the area of research, Scotland's performance is very good, demonstrated by the results of the most recent Research Excellence Framework in which the Scottish sector increased the proportion of Scottish research graded at the highest level, and matched or exceeded the performance of the other UK nations. We are seeking to improve the impact of that success on inclusive economic growth through several strategies, including Innovation Centres. Today, we have published a review by Professor Graeme Reid on progress with the Innovation Centre programme. Professor Reid is of the view that the innovation centres are making good progress and that there are ways by which the programme could be enhanced for the future, and his recommendation identify these actions. Again, given the importance of this report, I have included a copy for the Committee.

Like the college sector, the university sector also faces short, medium and long-term challenges, some of the most significant of which are:

- the impacts of Brexit;
- continuing to widen access to a broader profile of Scottish society; and
- although the financing of the university sector is significantly different from that of the college sector, the constraint on public spending is a significant factor.

I hope the foregoing and the attached detailed responses will be helpful to the Committee.

Yours sincerely,

John Kemp
Interim Chief Executive

Annex A: ‘Audit of higher education in Scottish universities’

The Scottish Government and SFC should ensure they have a shared understanding of the impact of policy and funding decisions, taken by both the SFC and Scottish Government, on the SFC’s ability to maximise its contribution to achieving the Scottish Government’s higher education policy ambitions

We agree with this recommendation, though we believe that this an area where there is already a great deal of shared understanding.

The responses to the other matters in this annex describe the detail of how SFC will address this recommendation, principally through:

- the new Strategic Funding Group, which includes Scottish Government, Scottish Funding Council and Universities Scotland; and
- in collaboration with key stakeholders, SFC’s work to improve outcome agreement alignment, content and reporting.

The Scottish Government and SFC should undertake and publish research on trends in applications, offer rates and acceptances for Scottish university places to assess what impact the limits on funded places are having on access to the university system for Scottish and EU students. They should consider the implications of this research for existing policy ambitions and funding approaches.

SFC will work with the Scottish Government and Commissioner for Fair Access on the detail of this recommendation.

There is a wealth of data available through UCAS and HESA on applications, offers acceptances and places filled by Scottish and EU students. In 2014-15 the number of Scottish domiciled first degree students at Scottish HEIs was at a record high and the proportion of Scottish state school leavers going into higher education has increased from 30% in 2017-08 to 37% from in 2014-15.

The SFC should ensure it has strategies for research and innovation that set out clearly:

- **what the SFC’s aims and objectives are for these areas**
- **how it plans to achieve its aims and objectives**
- **how performance will be measured**
- **align with the outcomes and activities in the SFC’s new strategic plan and Scotland’s Economic Strategy**

We agree with this recommendation.

As reflected in the responses to other recommendations and to take account of the conclusions from the Enterprise and Skills Review (when it has concluded), SFC will now review its existing strategies and approaches for research and innovation to maximise their impact and alignment.

SFC's current research strategy is stated in the 2015-18 Strategic Plan. The top three priorities in this strategy being: to prioritise investment in research on developing world-leading and internationally excellent research; to invest strategically in collaborative research initiatives – such as research pooling – which increase Scotland's research competitiveness and achieve value for money; and to work with universities and other stakeholders to leverage increased levels of research investment into Scotland.

SFC's current measures of performance include the assessment of research excellence in the UK-wide REF exercise and the share of UK research council funding that Scotland's universities attract. SFC's use of both formulaic and strategic funding is targeted at excellence and this selectivity has formed the basis of SFC's strategy for retaining and developing the sector's strong international competitiveness. SFC has established a working group to examine the support of research excellence in Scotland in future years.

SFC's innovation strategy, as expressed in SFC's Strategic Plan, is focussed on inclusive economic growth arising from college and university innovation support and on the two-way flow of ideas stimulating the academic sectors as well as businesses. To achieve this SFC has focussed its current investments principally on Interface and the Innovation Centre programme. SFC's Innovation strategy will be guided by the review of the Innovation landscape being carried out by Scottish Government and will be highly dependent on the recommendations of the current Enterprise and Skills review.

The SFC should finalise its long-term capital investment strategy

We agree with this recommendation.

A draft long-term capital investment strategy is being prepared for discussion at the next Board meeting of SFC. The strategy will be a living document which will focus on prioritisation of capital investment in a more or less resource-constrained environment, considering both need and opportunity in both university and college sectors. The capital investment strategy will extend to include digital and our approach to lowering the carbon footprint of the sectors' estate.

The SFC should ensure decisions on funding and activities in key areas, such as research, innovation, and teaching, fully align with, and support, achieving the Scottish Government's policy ambitions

We agree with this recommendation.

SFC's 2015-18 Strategic Plan sets out how its strategies and actions map across to the four priorities of Scotland's Economic Strategy: investment, innovation, inclusive growth and internationalisation. Working with Scottish Government, SFC will continue to fine-tune its Performance Management Framework to ensure that alignment is maintained and to take account of the conclusions of the Enterprise and Skills Review and future letters of guidance.

In August of this year the SFC, Scottish Government and Universities Scotland established the Strategic Funding Group. This tripartite working group considers the 'longer term financial requirements to support a flourishing university sector delivering high quality teaching and research excellence and opportunities for further efficiencies and enhanced productivity'. It looks at the support necessary to maintain a world-class university sector and identifies ways to increase the contribution of universities to shared priorities including widening access and economic growth. This Group will also consider the implications of the outcome of the EU Referendum and how these might be managed to best effect.

Outcome agreements also offer a significant vehicle for the SFC, Scottish Government and the university sector to work together to achieve the policy ambitions of the Government. They are intended to help universities demonstrate their distinct contribution to the Scottish Government's priorities as set out in the Scottish Economic Strategy, the Programme for Government and in Ministerial Letters of Guidance to SFC. SFC, Scottish Government and the university sector continue to work closely together to refine the outcome agreement process and to improve reporting (see below).

The SFC should finalise its performance management framework to enable it to assess and report publicly on its progress in implementing its strategic plan

We have implemented this recommendation.

SFC's Performance Management Framework has now been revised to reflect the new strategic plan (although it will be subject to continuous development). Going forward, that will be a key source for the information published in SFC's annual report and accounts on progress with SFC's strategic plan.

The SFC should regularly assess and clearly report on the performance of the higher education sector, including its financial health

We agree with this recommendation.

SFC will continue to develop its existing outcome agreement reporting arrangements, which will include financial health in the future.

SFC uses a set of National Measures to assess and monitor the performance of the university sector. The outcome agreement process has twelve measures for which there is a time series of data broken down by individual universities. The measures cover key access and retention statistics broken down by protected characteristics and other key groups. There is also key information collected by the Higher Education Statistics Agency (HESA); for example, graduate destinations and UK Performance Indicators.

Much of this information is published in *'University Outcome Agreement – Summary of Progress and Ambitions'* and *'Learning for All: Measures of Success'*. We will continue to reflect on how this can be developed. Information on financial health will be added to future outcome agreement publications.

The SFC should review the outcome agreement process, with universities and the Scottish Government, to ensure that:

- **it is fully aligned with the SFC's new strategic plan**
- **outcome agreements provide sufficient assurance that public funding is contributing effectively to delivering national objectives**
- **individual universities' performance against targets is presented in a transparent and consistent way in the outcome agreements.**

We agree with this recommendation.

The next iteration of our outcome agreement guidance (to be published within the next few weeks) will reflect our new strategic plan.

Building on existing arrangements, SFC is meeting regularly with the Scottish Government to review and refine the national priorities within the Outcome Agreement guidance and to set overall targets for the sector, ensuring alignment with SFC's strategic plan. From early in 2017 SFC will review the outcome agreement arrangements in collaboration with Scottish Government and Universities Scotland to:

- ensure that aspirational targets for individual institutions are set over the three year period of the Outcome Agreement, which support national priorities and targets; and
- improve the consistency of how performance is reported.

The Scottish Government, SFC and universities should progress plans to develop a long-term framework, as set out in the Scottish Government’s 2015 Draft Budget document, for the Scottish Government and the higher education sector to work together to maximise the benefits of higher education for Scotland

We agree with this recommendation.

As already noted, in August of this year the SFC, Scottish Government and Universities Scotland established the Strategic Funding Group, which will consider the development of appropriate long-term frameworks and strategies.

The Scottish Government, SFC and universities should progress work to develop an agreed approach to achieving the national targets for widening access.

We agree with this recommendation.

SFC staff worked closely with Scottish Government colleagues in on the joint secretariat that supported the Commission on Widening Access to develop the *Blueprint for Fairness* report, in which the targets are contained. SFC is now meeting with Scottish Government staff fortnightly to implement the report. We will also work with Universities Scotland in its implementation.

Universities should work individually, across the sector, and with partners, to

- **further develop efficient ways of delivering high-quality teaching, research, and innovation. This includes looking at different ways of working, such as increased collaboration, joint provision, and the use of new technologies**
- **identify further opportunities to diversify, and maximise, income streams as part of ensuring their longer-term financial sustainability.**

Although this recommendation is addressed to the university sector, SFC will work with it to build on existing work to continually enhance efficiency and maximise income streams. SFC has discussed this recommendation with Universities Scotland, which has confirmed that it would be very happy to provide a full response to the Committee.

Annex B: ‘Scotland’s colleges 2016’

The Scottish Government and the SFC should specify how they will measure and publicly report progress in delivering all of the benefits that were expected from regionalisation and mergers, in line with our recommendation from last year, which was endorsed by the Public Audit Committee

Since the Auditor General’s Report was published, the SFC has reported on the merger programme in ‘Impact and success of the programme of college mergers in Scotland 2012-13 and 2013-14’, published on 22 August 2016. This describes the impact of the merger programme and the impact of the larger colleges created by the programme. In most cases these merged colleges are regional colleges.

The Scottish Government and the SFC should publish information on the costs and savings achieved through the merger process, in line with our recommendation from last year, which was endorsed by the Public Audit Committee

We agree with this recommendation.

SFC’s report ‘Impact and success of the programme of college mergers in Scotland 2012-13 and 2013-14’ included information for each merger on both savings and costs. We did not include the costs of harmonisation of salaries for all colleges, though we are working to fully establish these. Care is being taken to ensure the harmonisation costs identified are those which relate directly to the mergers, as distinct from those additional costs which stem from the separate decision to move towards pay harmonisation across the sector.

The Scottish Government and the SFC should work with colleges to determine the current condition of the college estate and prepare a plan to ensure that it is fit for purpose

We agree with this recommendation.

SFC is currently commissioning the production of a baseline report on the condition of the college estate. Thereafter SFC will undertake a comprehensive review of the capital needs of the college estate and develop a long-term plan. SFC aims to have this in place by the early part of the 2017-18 financial year and to reflect it in future iterations of the Council’s 10-year infrastructure strategy.

The Scottish Government and the SFC should use the Scottish Government’s end-to-end review of the skills agencies in Scotland to re-examine, clarify and set out the role of the SFC, particularly in relation to college governance

The Scottish Government has stated that the Enterprise and Skills review is focused on the role of the support offered by our enterprise and skills agencies, including

Scottish Enterprise, the Scottish Funding Council, and Skills Development Scotland, with a view to ensuring that they are delivering the joined-up support that young people, universities, colleges, training providers, businesses and the workforce need. The Scottish Government has also stated that the Review will be taken forward in two stages, with the first stage concluding shortly.

With regard to college governance, SFC's role is now focussed on ensuring compliance with the Scottish Public Finance Manual, through SFC's Financial Memorandum with colleges, a copy of which is available here:

- http://www.sfc.ac.uk/guidance/Governance/FinancialMemorandum/financial_memorandum.aspx

The SFC has also supported the work of the Good Governance Task Group which was chaired by the Cabinet Secretary for Education and Lifelong Learning in early 2016 and considered a range of issues relating to college governance. The SFC has also supported the development of the 'Code of Good Governance for Scotland's Colleges', which SFC has formally endorsed using its powers under the Further and Higher Education (Scotland) Act 2005. Compliance with the Code is therefore now a condition of SFC's funding.

The Scottish Government and the SFC should identify and implement a better approach to allocating depreciation budgets to colleges

We agree with this recommendation.

The key issue in this area concerns the establishment of a proportionate mechanism for approval of colleges' proposed utilisation of depreciation funds; the existing process involves detailed interaction between SFC, Scottish Government and Colleges Scotland. Colleges need to have certainty in this area in the context of maintaining effective budgetary control and financial management arrangements. This is a complex matter and SFC is continuing to work closely with Scottish Government and colleges to develop an enhanced approach for the application of depreciation funds.

The SFC should require colleges to report how they have spent depreciation cash funding in their accounts, including a breakdown of the spending

We agree with this recommendation.

Additional guidance has been included in SFC's Accounts Direction to colleges for the year ending 31 July 2016. Where a college has incurred a deficit as a result of spending net depreciation funds, it is required to include a note and table in the annual report and accounts explaining how the funds have been accounted for and

the impact on the operating position for the year. The Direction includes an illustrative form of words which colleges can supplement if necessary to reflect local circumstances.

The SFC should explore with colleges a way to better assess demand for college courses across Scotland

We agree with this recommendation.

SFC works with the college sector to set activity targets for outcome agreements. We use as the main evidence base our demographic model, which helps to align the number of college places to the needs of each region. The demographic model essentially aims to quantify the number of young people in the region who are not at school or university or are not in a job or training programme. The demographic model also quantifies those claiming Job Seekers Allowance (JSA) in the 20 to 24 age-group and older students who have been claiming JSA for more than a year or are from the most deprived areas. We also provide places to each region to upskill those in employment to help advance the economy. SFC also take into account colleges' performance against previous years' targets, specific regional factors in relation to supply and demand, and institutional sustainability (i.e. so that there are no large swings in activity targets year on year).

Taking account of the recommendation, SFC will now work with the Scottish Government and colleges to adapt the parameters in the model for future years to reflect changing priorities and regional situations.

We have also worked with Colleges and Government on the collection of consistent application data across Scotland in order to better understand demand. We will work with these partners to widen that project to all colleges.

The SFC should publish information about leaver destination at national, regional and college levels

SFC published the 'College Leaver Destinations 2014-15' report on 21 September 2016. This was the second College Leaver Destination publication and the first not classified as experimental statistics. The 2014-15 report gives the first detailed account of full-time qualifying student destinations on completion of courses in Scotland's colleges.

The report sets out the distinct role of college courses within further and higher education, which typically involve further study in college and university as well as routes to employment. The 2014-15 report extends to include deprivation and equalities information as well as regional and college breakdowns.

Other recommendations

Although the following three recommendations are addressed to the college sector, SFC will work with it to take these matters forward. SFC has discussed these recommendations with Colleges Scotland, which has confirmed that it would be very happy to provide a full response to the Committee.

Colleges should develop long-term (a minimum of five years) financial strategies. These should be underpinned by medium-term (between three and five years) financial plans that link to workforce plans and take account of significant financial pressures such as national collective bargaining, estate development and maintenance and student support funding

SFC is working with colleges, Scottish Government and key stakeholders to explore ways to provide for greater flexibility around financial planning which will help colleges to deal with uncertainty and address ongoing cost pressures.

Colleges should implement a more systematic approach to workforce planning to ensure that they have the appropriate resources and skills to achieve their strategic goals

SFC will work with colleges and Scottish Government to look at future workforce requirements for the sector. This work will take account of the Audit Scotland good practice guide *Scotland's public sector workforce* as well as the Scottish Government's Labour Market Strategy and Fair Work Convention.

Colleges should make agendas, supporting papers and minutes (subject to confidentiality issues) for board and committee meetings publicly available within appropriate timeframes.

The college sector has embraced the need to focus on achieving the highest standards of governance. A 'Code of Good Governance for Scotland's Colleges' has been developed and the sector's Good Governance Steering Group continues to meet to oversee its implementation and review. SFC will work with colleges to ensure that College board activities are sufficiently transparent, in line with the requirements of the Code, which states: "The board must ensure that its decision-making processes are transparent ... [and] this includes ... the prompt production, dissemination and online publication of board/committee agendas, minutes and papers to the public".

Annex C: '2014-15 audit of Edinburgh College'

We have been working closely with Edinburgh College on supporting and ensuring delivery of a Business Transformation Plan to address the financial issues raised in the Auditor General's report.

Outlined below is the support provided by SFC and the progress that Edinburgh College has made, to address the College's financial and organisational challenges in the period since that covered by the Auditor General's Report.

Business Transformation Plan

Edinburgh College submitted a Business Transformation Plan (BTP) to SFC at the end of March 2016. The scope of the BTP is broad, and with 19 projects there is a significant volume of work to be undertaken over the next three years. SFC is broadly supportive of the College's plan and the direction outlined in the BTP. We have asked for a prioritisation of work around the core areas of: priority based budgeting; curriculum planning; learning, teaching and assessment strategy; and teaching staff realignment.

To date SFC has agreed to support two elements of the BTP financially. These were an initial tranche of voluntary severance and a cash facility to ensure the viability of the College over the coming year as it adjusts to the changed activity target. The first phase of voluntary severance was supported up to a total of £650,000. As a condition, SFC sought assurances on severance management to ensure the scheme was appropriately targeted. As a result, the College has secured on-going staffing savings of £1,072,133. This has also resulted in a restructured senior management and leadership team.

Management of college cash flow will be assisted through a cash facility of £2.9M for 2016-17 to support College with the consequences of the reduction of 12,000 credits from its SFC funding and 2,230 credit transfer to SRUC (as part of an agreed transfer of specialist provision).

In order to ensure a shared understanding of, and to rigorously assess the plan, auditors Scott Moncrieff were commissioned to review the BTP. The review was supportive of the objectives of the BTP and made recommendations to enhance financial monitoring and the management of project interdependencies. The recommendations have been considered with the College which is now working to implement the recommendations. SFC has indicated to the College that it will support the plan on a phased basis – providing flexibility to respond to changing financial contexts and opportunities. The plan includes in its early stages a review of all programme frameworks, improvement of induction and application processes,

and the formal review of the College curriculum – the impacts of which should begin to have an effect in 2016-17.

SFC is meeting with the College monthly to ensure the BTP is on track and is being implemented in a systematic and sustainable way.

2016-17 student recruitment

As some of the financial issues at the college have related to under-recruitment of students and subsequent reductions in activity targets, SFC is monitoring closely the College's progress towards achievement of the its 2016-17 target of 186,000 Credits. At our most recent meeting (on 26 September) the college assured us it was confident of reaching its activity target at this stage. We will continue to monitor this closely.

Annex D: '2014-15 audit of Glasgow Colleges' Regional Board'

From SFC's most recent observation and assessment of the Glasgow Colleges' Regional Board (GCRB) over this summer, it is clear that GCRB and its members have made significant and effective progress in both:

- operating effectively as a Regional Strategic Body, in line with the post-16 legislation; and
- fulfilling its role in securing coherent provision, of a high quality, of fundable further and higher education in Glasgow's colleges.

Also, SFC is reassured that the operational and management arrangements of GCRB have had time to settle in over the last six months following a period of focused activity during the Academic Year 2015-16.

SFC has confirmed with the current GCRB Chair the remaining funding, monitoring and financial actions we would want to see before we could make a recommendation to our Board on fully operation fundable body status. The actions and progress are noted below:

- to agree the split across the three colleges of the 2016-17 funding allocation (***this has now been agreed and confirmed with SFC, awaiting final signed AY2016-17 Outcome Agreement***);
- to confirm that a Financial Memorandum is in place with the three assigned colleges and issues around the role of the Accountable Officer have been clarified (***this is currently being addressed***);
- to put in place the appropriate procedures and processes required for the GCRB to assume full monitoring, reporting and financial responsibilities as required by a fundable body (**see below**).

SFC agreed to work with the GCRB Executive Director during the autumn to map out and identify a plan and timeline for a transitional period ensuring these matters are addressed at an early date; and by December 2016 at the latest. The GCRB Executive Director will report this plan to the GCRB Audit Committee in early October.

The SFC Interim Director for Access, Skills and Outcome Agreements will attend the GCRB meeting late in October to discuss with the Board its progress on achieving operational fundable body status and particularly on the transition phase from October to December 2016. Following this meeting SFC will make a recommendation on GCRB's operational fundable body status to its Council Board in December 2016.

Background information: membership/staff changes at GCRB from April 2015

April 2015	Interim GCRB Chair appointed and SFC seconded a senior member of staff to GCRB as Interim Chief Officer.
February 2016	A new Chair appointed.
May 2016	A permanent Executive Director (Chief Officer) appointed