



## Public Audit and Post-legislative Scrutiny Committee: further scrutiny of the “Audit of higher education in Scottish universities”

### Supplementary evidence 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 deficit<sup>1</sup>. 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 consequential that could be invested in higher education. The apprenticeship levy, which universities contribute to in significant levels as

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<sup>1</sup> THE published analysis 2 June 2016.

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 2016-17<sup>2</sup>.

### **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 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

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

**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 deficit<sup>3</sup>.
- 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.

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<sup>3</sup> THE published analysis 2 June 2016.

### **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.

The introduction of the apprenticeship levy and the Barnett consequentials 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 consequentials 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 apprenticeships<sup>4</sup>.

## 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.

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