Auditor General for Scotland

The Auditor General’s role is to:

• appoint auditors to Scotland’s central government and NHS bodies
• examine how public bodies spend public money
• help them to manage their finances to the highest standards
• check whether they achieve value for money.

The Auditor General is independent and reports to the Scottish Parliament on the performance of:

• directorates of the Scottish Government
• government agencies, eg the Scottish Prison Service, Historic Scotland
• NHS bodies
• further education colleges
• Scottish Water
• NDPBs and others, eg Scottish Police Authority, Scottish Fire and Rescue Service.

You can find out more about the work of the Auditor General on our website:
www.audit-scotland.gov.uk/about/ags

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.
Contents

Summary 4
Key messages 7
Part 1. Colleges’ financial standing in 2011-12 9
Part 2. Colleges’ progress towards reform 20
Part 3. Looking forward 27
Endnotes 36
Appendix 1. College regions 38
Appendix 2. Financial performance of colleges 2011-12 40
Appendix 3. Financial performance of college regions 2011-12 42
Summary

Key facts

- Full-time and part-time students who attended college in 2011-12: 258 thousand
- College staff in 2011-12, in full-time equivalents: 11,600
- Hours of learning delivered by colleges in 2011-12: 78 million
- Colleges’ overall expenditure in 2011-12: £688 million
- Incorporated colleges in 2011-12 (falling to 32 by June 2013): 37
- College sector’s income provided by the Scottish Government in academic year 2011-12 (73 per cent of colleges’ overall income): £505 million

Note:
1. This figure does not include around £80 million in bursaries and other student support funds which are provided to colleges for the benefit of individual students.
Introduction

1. Colleges are the main providers of further education in Scotland, and in 2011-12 about 260,000 people attended college to pursue a variety of qualifications. Colleges delivered 78 million hours of learning activity across a wide range of courses, and employed about 11,600 full-time equivalent staff. Scotland’s colleges have an important role in helping to achieve sustainable economic growth by contributing to the development of a highly educated and skilled workforce.

2. The college sector is undergoing significant structural reform. In November 2012, Scottish ministers introduced the Post-16 Education (Scotland) Bill which included provisions to restructure the sector into 13 newly created college regions by August 2013. As part of the reforms, a number of colleges are merging with a view to delivering planned efficiencies and better outcomes for students, such as providing learning opportunities which are more aligned with the needs of local employers. Between 1993 and 2011, the number of incorporated colleges decreased from 43 to 37 due to a series of mergers, and the current reforms will further reduce the number of colleges to 21 by the end of 2013. Funding for the college sector has decreased in recent years and the Scottish Government expects continued efficiencies from the merger programme and wider reforms to allow further real-terms reductions in funding (that is, allowing for inflation) until the end of the current spending review in 2014/15.

3. In October 2012, Audit Scotland published Scotland’s colleges: current finances, future challenges which examined the financial standing of the college sector in 2010-11. The report established a position immediately before structural reforms and planned public sector spending reductions took effect, against which progress could be measured later. In this report, we compare colleges’ financial position in 2011-12 to the position in 2010-11 and the expected position in 2012-13, and provide an update on the sector’s progress towards the structural reforms which are currently taking place. At the time of our audit, the regionalisation programme was still under way, so we have not commented in detail on how well the sector is implementing the reforms.

About the audit

4. Our October 2012 report concluded that the overall financial standing of the college sector in 2010-11 was generally sound, but the financial position of individual colleges varied widely. Some colleges were more financially stable than others, but most operated to tight financial margins so relatively small variations from plans affected their ability to achieve a surplus. Public sector funding constraints and the need to deliver efficiency savings from planned mergers meant that colleges would continue to face financial challenges.

5. This report provides an update on the financial standing of both the college sector as a whole and of individual colleges in 2011-12, and the sector’s progress towards structural reform. It has three parts:

- **Part 1** assesses colleges’ financial standing in 2011-12, and reviews how much learning they delivered

- **Part 2** reviews the college sector’s recent progress towards regionalisation and other aspects of structural reform
• **Part 3** examines some of the key issues that Scotland’s colleges are likely to face in the coming years, including further reductions in income and their reclassification as public bodies.

6. We have based our assessment of colleges’ financial standing largely on:

• an analysis of colleges’ audited annual accounts for the year to July 2012, laid in the Scottish Parliament between January and June 2013

• college auditors’ reports

• other information held by the Scottish Funding Council (SFC).

Our report therefore examines colleges’ financial position at the end of July 2012.

7. Our financial analysis concentrates on the sector as a whole but there can be wide variation between individual colleges. We therefore provide commentary on individual colleges where it helps to put the overall picture in perspective, and to highlight colleges where financial sustainability may be more at risk. It will be important to ensure that newly merged colleges are financially stable. The college sector aims to complete the planned structural reforms by the end of 2013, and this report reflects the position in August 2013.

8. Our report includes a number of recommendations which aim to help the Scottish Government, the SFC and colleges to implement the planned structural reforms effectively and to ensure the financial sustainability of the college sector. We recognise that the Scottish Government and the SFC are already taking steps to implement some of these recommendations and it is important that these organisations continue to support the college sector effectively. We plan to review progress against these recommendations in 2014.
1 The overall financial standing of the college sector in 2011-12 continued to be generally sound. A reduction in SFC grant funding of £56 million in real terms compared to 2010-11 contributed to colleges’ overall income falling by nine per cent. However, this was offset by cost savings, mainly through colleges employing fewer staff.

2 Most colleges are currently either merging or forming federations with other colleges to create 13 new college regions. This restructuring represents a major change for the college sector, and colleges aim to complete the process as planned by the end of 2013. The SFC is providing about £54 million to help fund the college regionalisation programme, with colleges meeting up to half the total costs of individual mergers. The SFC expects the structural reforms to generate about £50 million in savings each year from 2015-16.

3 The college sector faces an overall 11 per cent real-terms reduction in revenue grant funding from the Scottish Government between 2011/12 and 2014/15. Some college regions are likely to see larger reductions in their grant funding than others, meaning they face greater challenges to reduce their costs. Reducing staff numbers is likely to continue to be colleges’ main way of delivering savings but they will need to retain the skills and experience they require to maintain the quality of learning they provide.

4 The reclassification of colleges as public bodies from April 2014 will require them to operate within the same annual budget limits as other Scottish Government bodies. This will restrict colleges’ scope to build up financial reserves although the Scottish Government and the SFC are investigating ways of minimising the impact of reclassification on colleges’ finances.

5 An increased emphasis on longer courses has led to reductions in the total number of students attending college. While colleges continue to meet annual targets for learning activity, a greater emphasis on full-time education and prioritising places for younger students may limit learning opportunities for older people.
Key recommendations

The Scottish Government and the Scottish Funding Council should:

• monitor the progress in achieving savings and other benefits from mergers to help with financial planning

• monitor the impact of prioritising younger students and full-time courses on learning opportunities for older people

• work with colleges and regions to assess and manage the effect that the reclassification of colleges as public bodies has on their financial standing.

The Scottish Funding Council should:

• work with colleges to ensure that the lessons from completed mergers are available to colleges that are currently going through the merger process

• further develop outcome agreements to provide a greater focus on the outcomes of colleges’ planned contributions to national priorities and objectives for post-16 education

• monitor colleges’ progress towards contributing more effectively to community planning.

Colleges should:

• identify the risks to future capacity and ability to meet learning needs associated with reducing staff numbers, and take appropriate steps to mitigate these risks

• consider what steps are required to meet the needs of older people and other groups of learners

• implement the Scottish Government’s recommendations to improve the application process to help monitor the demand for college places.
Part 1

Colleges’ financial standing in 2011-12

Key messages

1. The overall financial standing of the college sector in 2011-12 continued to be generally sound. Colleges reported an overall operating surplus of £2 million in 2011-12 compared with an overall deficit of £29 million in 2010-11. Colleges also reported accumulated surpluses totalling £214 million and had a combined total of £199 million cash and cash equivalents at 31 July 2012.

2. Most colleges continue to operate to tight financial margins, where the amount of surplus or deficit is rarely more than three per cent of income. Some colleges appear more financially sustainable than others, but there is often no discernible pattern in colleges’ ability to achieve a surplus from one year to the next. About a third of colleges that reported deficits in 2010-11 reported surpluses in 2011-12, or vice versa.

3. A reduction in SFC grant funding of £56 million in real terms contributed to colleges’ overall income falling by nine per cent between 2010-11 and 2011-12. In response, colleges reduced their spending, mainly by employing fewer staff. Between 2010-11 and 2011-12, colleges reduced their recurring staff costs by £56 million in real terms, resulting in about 1,200 full-time equivalent staff leaving college employment.

4. An increased emphasis on longer courses has led to reductions in the total number of students attending college. However, colleges continue to meet annual targets for learning activity.

9. This part of the report analyses colleges’ financial standing in 2011-12, largely based on their audited accounts. These accounts cover colleges’ financial year which currently runs from 1 August to 31 July. As with our analysis of the sector’s financial standing in 2010-11, we have focused on the following indicators:

- Annual surplus or deficit, which reflects the difference between colleges’ income and expenditure.

- Accumulated surplus or deficit, which indicates colleges’ financial performance over time, and their ability to finance future capital investment from reserves.
• The value of pension reserves, which indicates colleges’ ability to meet the pension costs of current and former employees.

• Cash and cash-equivalent balances, which reflect colleges’ ability to meet their short-term financial commitments.

Colleges reported an overall surplus of £2.2 million in 2011-12

In 2011-12, colleges’ income totalled £690.1 million and their expenditure totalled £687.9 million, resulting in an overall operating surplus for the sector of £2.2 million (0.3 per cent of total income). The surplus in 2011-12 continues the lack of consistent trend in the college sector reporting annual surpluses and deficits. The sector reported surpluses in four of the last six years but deficits in 2008-09 and 2010-11 (Exhibit 1).

Exhibit 1
Colleges’ operating surpluses and deficits since 2006-07
Scotland’s colleges reported a small overall surplus in 2011-12.

11. Colleges normally plan to deliver a small surplus each year but some appear more able to deliver this consistently. Eight colleges that reported deficits in 2010-11 reported surpluses in 2011-12, and five colleges that reported surpluses in 2010-11 reported deficits in 2011-12. This demonstrates the tight margins that colleges work to, where relatively small but unexpected events can turn planned surpluses into deficits, or vice versa.

12. In 2011-12, 27 of Scotland’s 37 colleges reported a surplus compared to 24 in 2010-11 (Exhibit 2, page 11). The total surplus reported by these 27 colleges in 2011-12 was £9.5 million, ranging from £11,000 in Angus College to £1.3 million in Aberdeen College. No college reported a surplus exceeding five per cent of its total income.
Ten colleges reported deficits in 2011-12, amounting to £7.3 million in total. Three colleges were responsible for about 90 per cent of this deficit:

- Forth Valley College reported income of £29.7 million and expenditure of £34.3 million, resulting in an operating deficit for the year of £4.6 million (15.5 per cent of income). This deficit was largely due to one-off exceptional costs, including:
  - the college writing off non-capital costs after completing a programme to develop its buildings and properties (£3.4 million)
  - a loss on the revaluation of fixed assets (£0.6 million)
  - staff severance costs associated with planned restructuring (£1.1 million).

- Edinburgh’s Telford College reported income of £31.9 million and expenditure of £33.0 million, resulting in an operating deficit for the year of £1.1 million (3.4 per cent of income). The deficit was largely due to staff severance costs (£2.0 million) associated with planned restructuring.

- Adam Smith College reported income of £31.0 million and expenditure of £31.8 million, resulting in an operating deficit for the year of £0.8 million (2.6 per cent of income). The deficit was mainly due to the college creating a provision of up to £1.2 million in respect of potential repayments of European grant funding. The college’s 2011-12 accounts also include creditors of £5.5 million in respect of EU grant repayments which it has accepted are required. This followed the identification of significant irregularities in how the college managed EU funds, including apparently...
systemic over-claiming of staff time. Fuller details of this issue are in the Auditor General’s report on the 2011-12 audit of Adam Smith College.\(^6\)

14. The other seven colleges reported deficits ranging from £23,000 in Reid Kerr College to £0.4 million in Moray College. Like Forth Valley and Edinburgh’s Telford Colleges, these seven colleges largely attributed their deficits to staff severance costs, which are expected to generate savings in subsequent years.

**Colleges’ Income and Expenditure Reserves totalled £214 million at the end of 2011-12**

15. Colleges accumulate different types of reserve. In some cases, notably revaluing fixed assets, the reserve is created by implementing accounting standards and does not involve the creation of spendable cash. The Income and Expenditure Reserve (I&E reserve) is colleges’ most common cash-backed reserve and is created by accumulating annual surpluses or deficits.\(^2\) A surplus I&E reserve usually means that funds are being set aside for future investment, and helps ensure that the college can cope with an operating deficit in any one year and still remain financially viable.

16. At the end of 2011-12, the overall net surplus on colleges’ I&E reserves was £213.9 million (about a third of their 2011-12 spending), a three per cent increase compared with 2010-11 (£207.7 million). A total of 34 colleges reported having a surplus on their I&E reserve at the end of 2011-12, ranging from £0.6 million in Stow College to £31.7 million in Edinburgh’s Telford College. The four colleges with the largest I&E reserves – Aberdeen, City of Glasgow, Motherwell and Edinburgh’s Telford – accounted for almost half of the sector’s overall I&E reserve surplus (Exhibit 3).

---

**Exhibit 3**

**Colleges’ income and expenditure reserves in 2011-12**

A total of 34 colleges reported having a surplus on their I&E reserve at the end of 2011-12.

[Bar chart showing colleges' I&E reserve status as of 2011-12.]

Source: Colleges’ audited accounts for 2011-12
17. A deficit on the I&E reserve may indicate financial problems and we therefore pay closer attention to these colleges. As in 2010-11, West Lothian, Forth Valley and Lews Castle Colleges all reported deficits on their 2011-12 I&E reserves:

- The deficit on West Lothian College’s I&E reserve decreased from £7.5 million as at July 2011 to £7.1 million at July 2012, largely as a result of the college reporting a surplus of £0.6 million during the year. Most of the I&E reserve deficit is associated with the college voluntarily terminating a PFI contract in April 2007, and we have no concerns over the college’s underlying financial position.

- The deficit on Forth Valley College’s I&E reserve increased from £2.5 million at July 2011 to £6.4 million at July 2012. The increase is largely due to the college’s deficit of £4.6 million reported during 2011-12 (paragraph 13) and, in particular, writing off non-capital costs associated with developing its buildings and properties. This is an accounting transaction, and the increase in the college’s I&E reserve deficit does not indicate a worsening financial position.

- The deficit on Lews Castle College’s I&E reserve decreased by £20,000 between July 2011 and July 2012, and now stands at £1.5 million. In our analysis of colleges’ 2010-11 accounts we noted the college had limited financial reserves; the SFC is requiring it to repay £0.8 million over five years after it submitted incorrect Extended Learning Support claims in 2007-08 and 2008-09. The SFC has subsequently agreed to provide the college with an additional £0.5 million grant, so the college now has to repay only £0.3 million. Nevertheless, the college’s I&E reserve deficit is likely to continue for some time and will be cleared only through a sustained period of annual surpluses.

18. Accumulating a surplus I&E reserve is usually regarded as good management practice because it allows colleges to consider their long-term investment plans, while also setting aside funds to meet unforeseen circumstances. Of the overall I&E reserve of £214 million at the end of July 2012, our analysis suggests that colleges have earmarked about £35 million of this total to meet specific purposes. For example, Aberdeen College has allocated about £11 million to fund improvements to its buildings and properties, while James Watt College and Inverness College have earmarked about £6 million and £2 million, respectively, for capital projects.

The overall deficit in colleges’ pension reserves almost doubled to £115 million between 2010-11 and 2011-12

19. College teaching staff are usually members of the Scottish Teachers’ Superannuation Scheme (STSS). Other college staff are usually members of the Local Government Pension Scheme (LGPS), and colleges’ pension reserves only reflect their share of the assets and liabilities of the LGPS. A pension reserve deficit means that the college’s share of the liabilities of the pension scheme exceeds its share of the scheme’s assets. The college sector reported a total pension reserve deficit of £115.3 million at the end of 2011-12. This was an increase of about 93 per cent from the 2010-11 deficit figure (£59.8 million), and more than a tenfold increase since 2006-07 when the deficit was £10.8 million. A total of 32 colleges reported deficits on their 2011-12 pension reserves, ranging from £0.8 million (Barony College) to £9.6 million (James Watt College). All 32 colleges reported an increased pension deficit compared to 2010-11.
20. The actuarial valuation of pension scheme assets and liabilities is a complex process that takes account of several factors. These include life expectancy, salary levels and length of service, and pension increases. A number of factors have influenced the almost doubling of colleges’ pension reserve deficits between 2010-11 and 2011-12:

- A reduction in the assumed rate of return from the investment of scheme assets.
- A reduction in the discount rate for liabilities, which has the effect of increasing their present value.
- An increase in the number of college staff taking early retirement. These staff are likely to receive a lower pension than if they had worked to normal retirement age. But early access to their pension pot combined with the lower discount rate increases the present value of pensions payable.

21. A net pension deficit is sustainable in the short term because the liabilities will become payable over a long period. Nevertheless, pension costs are a significant proportion of total public sector spending that will require ongoing monitoring. The UK government is introducing a number of reforms to public sector pension schemes, including:

- Increasing employee contributions over a three-year period, starting in 2012-13 (excluding local government pension schemes).
- Equalising normal pensionable age with the state pension age, except for police and fire service personnel.
- Linking future inflationary pension increases to the Consumer Price Index, instead of the Retail Price Index. This came into effect in April 2011.
- Introducing, from April 2015, new pension schemes in which annual pensions will be calculated based on career average revalued earnings (CARE) instead of final salary.

**Compared with 2010-11, fewer colleges had enough cash to meet short-term commitments in 2011-12**

22. Cash and cash equivalents (CCE) are cash and assets that can be readily converted into cash. They indicate whether a college is able to meet its immediate financial commitments and to continue trading. Note that it is not appropriate to add the I&E reserve and CCE to provide an indication of a college’s total cash reserves. The I&E reserve is created through the accumulation of annual surpluses and deficits. The CCE is the cash position at a particular time, that is, the end of the financial year. Adding the I&E reserve to the CCE therefore involves an element of double-counting.

23. At 31 July 2012, colleges had a total of £199.1 million of CCE, a decrease of about three per cent compared with 2010-11 (£204.7 million). However, due to reduced expenditure in 2011-12 (paragraphs 29-31), colleges had enough CCE at the end of 2011-12 to pay for 106 days of expenditure compared with 97 days at the end of 2010-11. Under current arrangements, the SFC considers it good practice for colleges to have at least 60 days’ cash to meet immediate financial commitments.
24. While the overall college sector had adequate CCE at 31 July 2012, the CCE position varied widely among individual colleges:

- As in 2010-11, Carnegie College was the only college to report a CCE deficit (£1.4 million). Most of this CCE deficit is associated with bank loans and overdrafts used to finance exceptional restructuring costs.

- A further eight colleges did not have enough cash to meet the SFC’s ‘good practice’ minimum of 60 days’ cash. They ranged from Reid Kerr College and Barony College with less than one day (£29,000 and £13,000 CCE, respectively) to Coatbridge College with 53 days (£1.6 million CCE). In 2011, five colleges were in this position at 31 July.

- The other 28 colleges had year-end CCE surpluses to meet at least 60 days of expenditure, ranging from £1.9 million CCE (Oatridge College) to £26.6 million CCE (City of Glasgow College). Fourteen of these colleges reported a CCE surplus sufficient to meet at least 120 days of expenditure (Exhibit 4).

Exhibit 4
Colleges’ cash and cash equivalents for 2011-12
Cash and cash equivalents at 31 July 2012 varied widely between individual colleges.

<table>
<thead>
<tr>
<th>College</th>
<th>CCE (£ million)</th>
<th>Days of expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carnegie</td>
<td>-1.4</td>
<td>0</td>
</tr>
<tr>
<td>Reid Kerr</td>
<td>-29</td>
<td>0</td>
</tr>
<tr>
<td>Barony</td>
<td>-13</td>
<td>0</td>
</tr>
<tr>
<td>Coatbridge</td>
<td>53</td>
<td>0</td>
</tr>
<tr>
<td>Oatridge</td>
<td>1.9</td>
<td>120</td>
</tr>
<tr>
<td>City of Glasgow</td>
<td>26.6</td>
<td>120</td>
</tr>
</tbody>
</table>

25. A lack of cash can be an indicator that an organisation has financial problems. We therefore asked the auditors of Reid Kerr and Barony Colleges for their views on the colleges’ cash position. The auditors told us that these colleges normally operate to tight cash margins and they had no significant concerns over the colleges’ financial sustainability.
Colleges’ financial position in 2011-12 reflects reductions in both income and expenditure

26. The overall financial standing of the college sector continues to be generally sound, although colleges had to reduce their costs in 2011-12 in response to falling income. Colleges achieved this through planned reductions in spending and by implementing structural reforms aimed at delivering financial efficiencies and other benefits.

Colleges’ income fell by nine per cent in 2011-12 mostly as a result of reduced Scottish Government funding

27. Based on information in their audited accounts, colleges’ overall income totalled £690.1 million in 2011-12, about nine per cent less in real terms compared with 2010-11. All areas of college income fell, although the reduction was biggest in Scottish Government grant support provided through the SFC. This fell from £561.2 million in 2010-11 (at 2011-12 prices) to £505.5 million in 2011-12 (10.0 per cent in real terms) (Exhibit 5).

Exhibit 5
Colleges’ income in 2010-11 and 2011-12
Colleges’ income fell by nine per cent in real terms between 2010-11 and 2011-12.

<table>
<thead>
<tr>
<th></th>
<th>2010-11</th>
<th>2011-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>SFC grants</td>
<td>£83m</td>
<td>£74.4m</td>
</tr>
<tr>
<td>Tuition fees and education contracts</td>
<td>£114.4m</td>
<td>£109.7m</td>
</tr>
<tr>
<td>Other</td>
<td>£561.2m</td>
<td>£505.5m</td>
</tr>
<tr>
<td>Total income</td>
<td>£759m</td>
<td>£690m</td>
</tr>
</tbody>
</table>

Note: All figures are in real terms, that is, at 2011-12 prices.
Source: Audit Scotland analysis of colleges’ 2010-11 and 2011-12 audited accounts

28. As in previous years, SFC grants accounted for about three-quarters of the college sector’s total income during 2011-12, and all colleges continue to rely heavily on this source of funding. James Watt College was most reliant on SFC grant income in 2011-12 (88 per cent of total income), while Oatridge College and Barony College were the least reliant (50 per cent of total income). Between 2006-07 and 2009-10, SFC revenue grant funding to colleges increased by about ten per cent in real terms, but since then it has fallen by about 11 per cent (Exhibit 6, page 17).

Colleges reduced their spending by about 13 per cent in 2011-12, mainly through lower staff costs

29. Colleges have responded to the reduction in income by reducing their costs. In 2011-12, colleges spent £687.8 million, about £100 million less than in 2010-11 in real terms and equating to a reduction of 13 per cent (Exhibit 7, page 17). In percentage terms, the biggest reduction was in depreciation and impairment charges which decreased by about 47 per cent (£43 million). This reduction was due mainly to an unusually high accelerated depreciation charge at the City of Glasgow College in 2010-11 related to redevelopment of the college’s campus.
Exhibit 6
SFC grant funding to colleges, 2006-07 to 2011-12
SFC revenue grant funding to colleges decreased by about 11 per cent in real terms between 2009-10 and 2011-12.

Note: All figures are in real terms, that is, at 2011-12 prices.
Source: Colleges’ audited accounts 2006-07 to 2011-12

Exhibit 7
Colleges’ expenditure in 2010-11 and 2011-12
Colleges reduced their spending by about £100 million in real terms between 2010-11 and 2011-12.

Source: Audit Scotland’s analysis of colleges’ 2010-11 and 2011-12 audited accounts

30. In cash terms, staff costs decreased the most. Colleges spent about £439 million on staff costs in 2011-12, including £417 million on recurring costs and about £21 million on staff severance payments. Recurring staff costs were about £56 million lower in real terms in 2011-12 compared with 2010-11 (12 per cent), and severance costs were about £6 million lower in real terms (22 per cent). Severance agreements contributed to the total number of people employed by colleges falling from about 12,800 full-time equivalents (FTE) at the end of
2010-11, to 11,600 FTE staff at the end of 2011-12 (a reduction of nine per cent). Colleges planned these reductions in staff numbers and costs in the context of the reform of the sector, which will lead to most colleges either merging or forming federations with other colleges to create 13 new college regions (Part 2).

31. Most of the reduction in staff costs during 2011-12 fell on teaching staff, who typically account for about 70 per cent of total staff costs. Compared with 2010-11, recurring costs of teaching staff reduced by about 16 per cent (Exhibit 8).

Exhibit 8
Colleges’ recurring staff costs, 2009-10 to 2011-12
Teaching staff costs decreased by 16 per cent between 2010-11 and 2011-12.

An increased emphasis on longer courses has led to reductions in total student numbers

32. In 2011-12, about 258,000 people (measured by headcount) attended college, some 48,000 fewer than in 2010-11 (16 per cent), and a decrease of about a third since 2008-09. In August 2009, in line with Scottish Government policy, the SFC issued guidance to colleges to reduce the number of courses that did not lead to a recognised qualification or that lasted less than ten hours. As a result, since 2008-09 the number of part-time students has decreased by over 40 per cent, while the number of full-time students has increased by about 15 per cent. The total number of students attending college expressed as FTEs has, however, remained broadly constant at about 120,000 to 125,000 a year (Exhibit 9, page 19).

33. The SFC funds colleges based on the amount of learning activity provided rather than the number of students attending courses. Learning activity is measured by ‘weighted student units of measurement’ (WSUMs), where one SUM equates to 40 hours of classroom-based learning and one Scottish Qualifications Authority credit. The SFC weights these units by subject to reflect the costs of teaching different subjects, and each year it provides funding to colleges to deliver a specific volume of WSUMs. Colleges have, as a whole, exceeded these targets every year since 2005-06 (Exhibit 10, page 19).
34. In 2011-12, the WSUM target fell by about five per cent which reflected the reduction in funded college places for school students below S3. These students are expected to study full-time at school, although colleges will continue to provide education to older (S3 to S6) school pupils to help them move into employment or further education.16

Exhibit 9
Students attending Scotland’s colleges, 2006-07 to 2011-12
In recent years, the number of part-time students has decreased while the number of full-time students has increased.

Exhibit 10
Colleges’ delivery of weighted student units of measurement (WSUMs), 2005-06 to 2011-12
Colleges have exceeded their WSUM target every year since 2005-06.
Part 2
Colleges’ progress towards reform

Key messages

1. Most colleges are currently either merging or forming federations with other colleges to create 13 new college regions. This restructuring represents a major change for the college sector, and colleges aim to complete the process as planned by the end of 2013.

2. The SFC is providing about £54 million to help fund the college regionalisation programme. Colleges are expected to meet up to half the total costs of individual mergers but the amount that each college will contribute varies widely. The costs of recent and current mergers have still to be finalised. The SFC expects the structural reforms to generate about £50 million in savings each year from 2015-16.

3. The Scottish Government is implementing other aspects of structural reform, including establishing regional boards and the Further Education Strategic Forum. The SFC has also refined colleges’ outcome agreements and is taking steps to improve colleges’ links to community planning.

35. This part of the report provides an update on the college sector’s progress towards the planned structural reforms. At the time of our audit, the regionalisation programme was still under way. Therefore, we have not commented in detail in this report on how well the sector has implemented the reforms.

The college sector aims to complete the planned structural reforms by the end of 2013

36. In October 2012, we reported that the college sector was about to undergo major structural reform and would be organised into 13 regions. The Scottish Government’s preferred option was for mergers between individual colleges to create a single college in each region but ministers chose not to exercise their statutory powers to compel mergers between colleges.

37. Most colleges are continuing with the mergers we outlined in our October 2012 report. Colleges in two regions have since revised their plans for structural reform:

- Aberdeen College and Banff and Buchan College, which had previously planned to form a federation for the Aberdeen and Aberdeenshire region, agreed in October 2012 to merge the two colleges to make financial savings. The colleges now plan to merge in November 2013.
Four colleges – Coatbridge, Cumbernauld, Motherwell and South Lanarkshire – had previously planned to form a federation for the Lanarkshire region. In January 2013, Cumbernauld College and Motherwell College announced plans to merge in autumn 2013. The new college, to be called New College Lanarkshire, will form a federation with Coatbridge College and South Lanarkshire College.

Colleges aim to complete the restructuring programme as planned by the end of 2013. Four college regions were created from a series of mergers in August 2013, and the remaining mergers are due to take place in November 2013. The mergers will reduce the number of colleges from 37 in 2011-12 to 21 (Appendix 1). We will review colleges’ progress towards structural reform in 2014.

The Scottish Government’s College Regionalisation Change Team is providing support for colleges which are merging. It regularly monitors the risks associated with the planned mergers and takes steps to mitigate their effects. This has included working with the SFC, college representatives and specialist consultants to implement the structural reforms, and consulting with the college sector to secure support for the reforms.

In our previous report on colleges’ finances, we recommended that colleges use available guidance on mergers, or learn the lessons of previous mergers, to manage their own mergers effectively. While we have not audited the mergers of individual colleges, there is some evidence of colleges adopting good practice and seeking to learn the lessons from completed mergers. For example, staff who were involved in the merger that created the City of Glasgow College are currently advising on mergers in other regions, including Aberdeen/shire and Tayside. The City of Glasgow College has also established a Merger and Partnership Research Centre which offers a range of information and advisory services to help other colleges with their mergers. In addition, some colleges are implementing aspects of the SFC’s guidance on mergers and federations, including:

- appointing project managers to manage the mergers
- consulting with stakeholders
- setting up partnership boards and workstream groups to consider different aspects of the merger process.

The Scottish Funding Council is providing about £54 million to support structural reform

The SFC has estimated that it will provide about £54 million up to 2014-15 to support college structural reform, including mergers. Colleges must bid for this funding, and demonstrate how they will use any funding they receive to deliver clear financial benefits within a year. The SFC’s funding is intended primarily to fund severance schemes to reduce staff numbers and costs, and comprises:

- about £9 million in 2010 to fund the merger of three colleges to create the City of Glasgow College
£25 million in 2012-13, comprising £15 million from the Scottish Government’s College Transformation Fund (CTF) and £10 million from the SFC

about £10 million in each of 2013-14 and 2014-15.\textsuperscript{23}

42. The SFC’s estimates are based on the costs of completed mergers to date and discussions with staff at colleges that are currently merging. In addition, the financial memorandum which accompanied the introduction of the Post-16 Education (Scotland) Bill included estimated costs of up to £3 million in the period to 2015-16 to fund the cost of board appointments and the establishment of regional boards. The Scottish Government now expects that the actual costs of establishing regional boards will be less than £3 million as the colleges in Aberdeen/shire region have subsequently agreed to merge, removing the need for a regional board for that area.\textsuperscript{24, 25}

Colleges are contributing up to half the total costs of planned mergers

43. The Griggs Review recommended that colleges should return financial reserves over ten per cent of annual revenue to the Scottish Government to help fund the planned reforms.\textsuperscript{26} The Cabinet Secretary for Education and Lifelong Learning subsequently decided not to implement this recommendation. He indicated that, where they have the money to do so, the Scottish Government would expect colleges to use their financial reserves to meet a significant portion of their merger costs.\textsuperscript{27}

44. The SFC expects colleges to contribute up to half the costs of current mergers using their cash reserves. However, the amount that colleges in individual regions will be expected to contribute varies widely. For example:

- The SFC does not expect colleges in the Ayrshire region to contribute towards merger costs, but colleges involved in the Glasgow Clyde merger are expected to contribute almost half of their merger costs.

- For those mergers that colleges are helping to fund, the SFC expects colleges to contribute between seven and 25 per cent of their forecast available cash reserves in 2012-13 (Exhibit 11, page 23).

45. The SFC takes into account existing plans in determining how much colleges should contribute to fund merger costs. For example, Kilmarnock College is currently planning a new campus so the SFC does not expect the Ayrshire region to use its reserves to help pay for merger costs. On the other hand, the three colleges making up the Glasgow Clyde sub-region currently have no major capital improvement plans, so they are expected to use more of their reserves to meet merger costs.

The merger that created the City of Glasgow College is delivering benefits but the costs of recent and current mergers are not yet known

46. In preparing their merger proposals, the Scottish Government required colleges to prepare business cases. These set out the expected costs and benefits of mergers, including staff and other cost savings and educational benefits. Inevitably, it will be some time before the actual costs and benefits of recent and current mergers are known. However, there is some evidence that benefits are being delivered, although actual costs may vary from plans.

47. The City of Glasgow College was created in September 2010 from the merger of Central College Glasgow, Glasgow Metropolitan College and Glasgow College
Exhibit 11
Colleges’ contributions to the costs of planned mergers
Colleges’ contributions range from zero to almost half the total costs of mergers.

Note: 1. At the time of its merger, Fife College expects to have only minimal cash reserves. The SFC expects the merged college to contribute to the costs of the merger over the subsequent four to five years.

Source: Scottish Funding Council analysis of college mergers business cases, 2013
of Nautical Studies. The merger cost £8.6 million, mainly in staff severance costs. In May 2013, the SFC reported that the merger had delivered savings of about £5 million so far, and that the college had estimated total savings of over £26 million between 2010 and 2015. The merger had also delivered other benefits, including:

- a wider choice of courses for students, with continued access to specialist courses aimed at supporting the economy
- improved links with higher education
- positive relationships with employers.

48. Edinburgh College was created by merging Stevenson College, Telford College and Jewel & Esk College in October 2012. The business case for the merger estimated that merger costs would be £14.7 million. Of this, £10.7 million related to voluntary severances. The cost of the merger is now expected to be over £17 million, with the SFC providing about £8 million. The business case estimated that the merger will save £9 million each year by 2014-15.

The Scottish Funding Council estimates that the planned reforms will generate £50 million in savings each year from 2015-16

49. In written evidence to the Scottish Parliament Public Audit Committee in November 2012, the SFC referred to Ministerial guidance from the Scottish Government in which it had been asked to make efficiency savings of £18 million in 2013-14, rising to £33 million in 2014-15 as a result of structural reforms and additional efficiencies across the college sector. Based on its (then) current understanding of college mergers and federations that had either been completed or were under way, the SFC took the view that these savings were achievable. The SFC also stated that it expected to see annual savings reach about £50 million by 2015-16 once the reform programme was complete and efficiencies had been fully realised.

50. While we have not reviewed the robustness of the SFC’s estimates as part of this audit, the SFC stated in its evidence to the Public Audit Committee that it adopted a conservative approach in estimating the savings resulting from the regionalisation programme. It recognised that colleges had taken steps to reduce their costs in recent years in response to decreased public spending, and this would affect their ability to make further savings. The SFC also recognised that some savings from the planned reforms would take time to materialise and some changes would require initial ‘spend to save’ investment such as severance payments to reduce staff numbers.

51. In February 2013, the Scottish Government announced £61 million of additional funding for the college sector for 2013/14 (£10 million) and 2014/15 (£51 million). This may affect the level of efficiency savings which colleges are required to deliver. The SFC will continue to refine its estimates of the efficiency savings across the college sector as the structural reforms progress and other efficiencies are achieved. We will keep this area under review.

The Scottish Government and the Scottish Funding Council are currently implementing other aspects of structural reform

52. The Scottish Parliament passed the Post-16 Education (Scotland) Bill in June
2013 and it received Royal Assent on 7 August. The Scottish Government has outlined transitional arrangements for regional boards and expects to appoint regional chairs no later than May 2014.

53. The Scottish Government is currently establishing the Further Education Strategic Forum to allow the college sector to discuss with representatives from business and other sectors how colleges can contribute to the Scottish economy and wider society. The first meeting of the forum is planned for autumn 2013.

The SFC has refined colleges’ outcome agreements and is encouraging colleges to improve their links to community planning

54. As part of the reform of post-16 education in Scotland, the SFC has introduced outcome agreements which set out what colleges are expected to deliver in return for SFC funding. The first outcome agreements, which the SFC agreed with each college for 2012-13, focused on planning and the other steps needed to implement structural change. In our October 2012 report on colleges’ finances, we recommended that the SFC should develop outcome agreements for the sector which provide a greater focus on colleges’ contribution to national objectives and priorities for post-16 education. The SFC and colleges have subsequently negotiated outcome agreements for 2013-14 which have an increased focus on outputs, including commitments from colleges to:

- increase education provision by four per cent over the planned target for 2012-13
- target 70 per cent of education provision on 16- to 24-year-olds
- provide extra full-time and part-time provision to meet the needs of women and older people
- improve the quality of education so that 1,000 more full-time students successfully complete their courses
- create more efficient regional structures, with eight mergers planned by November 2013.

55. The Scottish Government also expects college regions to develop effective links with community planning partnerships (CPPs) to ensure that college learning integrates with the wider needs of the region. Education Scotland recently explored the current nature and impact of colleges’ contributions to community planning. It reported a number of positive developments, including:

- Overall, colleges have developed effective working relationships with their respective CPPs and engage positively with strategic boards, CPP thematic groups, or both of these.
- All colleges take account of the needs of their communities and CPPs in their strategic or corporate plans.
- There are good examples of colleges taking the lead within CPP thematic groups on issues such as employability and skills.
Education Scotland also identified a number of areas for development. These include the need for colleges and their community partners to share data and intelligence more effectively to inform planning and the monitoring of outcomes. The SFC also made a number of recommendations intended to help colleges deliver high-quality outcomes and experiences for learners. In particular, it recommended that colleges:

- work with community partners when developing regional outcome agreements
- ensure that these agreements properly reflect their contributions to CPPs’ priorities and wider Single Outcome Agreements.

**Recommendations**

**The Scottish Government and the Scottish Funding Council should:**

- monitor the progress in achieving efficiency savings and other benefits from mergers to help with financial planning.

**The Scottish Funding Council should:**

- work with colleges to ensure that the lessons from completed mergers are available to colleges that are currently merging
- further develop outcome agreements to provide a greater focus on the outcomes of colleges’ planned contributions to national priorities and objectives for post-16 education
- monitor colleges’ progress towards contributing more effectively to community planning.
Part 3
Looking forward

Key messages

1 Colleges face an 11 per cent real-terms reduction in revenue grant funding from the Scottish Government between 2011/12 and 2014/15. Some college regions will face larger reductions in funding than others and will therefore have to reduce their costs more.

2 Staff costs form about 60 per cent of a typical college’s expenditure and it is understandable that colleges consider reducing staff numbers as a key way to deliver savings. However, managing staff reductions creates risks. It is important that colleges retain staff with the right skills and experience when considering which staff to release in order to maintain the quality of learning they deliver.

3 The reclassification of colleges as public bodies from April 2014 will require colleges to operate within the same annual budget limits as other Scottish Government bodies. This will restrict colleges’ ability to build up financial reserves although the Scottish Government and the Scottish Funding Council are investigating ways of minimising the impact of reclassification on colleges’ finances.

4 The increasing emphasis on full-time education and prioritising education for younger students may limit learning opportunities for older people. The college sector needs to monitor the demand for college places to meet both national priorities and local needs for further education.

This part of the report presents Scottish Government budget information up to 2014/15 (based on a financial year which runs from 1 April to 31 March) and reviews some of the financial and other challenges facing colleges. In particular, public sector budget constraints mean that Scottish Government funding for the college sector is likely to fall over the next three years. The challenge for colleges will be how best to reduce their costs while, at the same time, continuing to deliver quality learning activity.

Scottish Government revenue funding to colleges is expected to fall by 11 per cent over the three years to 2014/15

In September 2011, the Scottish Government proposed that revenue grant funding for the college sector would fall in cash terms from £545 million in 2011/12 to £471 million in 2014/15. The Scottish Government subsequently
announced a range of proposed budget increases totalling £128.5 million (Exhibit 12).

59. These changes mean that the college sector can expect to see its annual revenue grant funding fall by about £62 million in real terms (11 per cent) between 2011/12 and 2014/15 (Exhibit 13, page 29). While this exceeds the SFC’s anticipated efficiency savings of £33 million in 2014-15 following structural reforms and other planned efficiencies across the college sector, the additional funding for colleges announced in February 2013 may affect the level of efficiency savings which colleges are required to deliver.

Exhibit 12
Scottish Government amendments to planned funding for colleges, 2011/12 to 2014/15
Since October 2011, the Scottish Government has announced budget increases for colleges totalling £128.5 million.

Notes:
1. The Scottish Government provided this money to Skills Development Scotland (SDS) to fund college places through the New College Learning Programme in 2012-13.
2. In 2013-14, a number of college places will be procured by SDS through the Employability Fund. This will be funded through a budget transfer of £6m from SFC to SDS.
Source: Scottish Government budget publications
Exhibit 13

Scottish Government revenue grant funding to colleges, 2006/07 to 2014/15

Colleges’ revenue funding is planned to fall by about 11 per cent in real terms between 2011/12 and 2014/15.

![Chart showing revenue grant funding to colleges from 2006/07 to 2014/15]

Note: The chart shows revenue grant funding in 2011/12 prices as this was the base year the Scottish Government used in its Scottish Spending Review 2011.
Sources: SPICe Briefing Draft Budget 2013/14: Further Education, SPICe, October 2012; and Scottish Government statement, February 2013

60. In addition to revenue funding, colleges also receive a capital budget allocation from the Scottish Government (via the SFC) to improve their buildings and properties. From 2000/01 to 2010/11, there was significant investment in the college estate. During this period, the capital budget more than trebled and almost a third of the estate was built. In 2011/12, the capital grant fell by more than a half, and proposed capital grant funding will decrease further by over 40 per cent between 2011/12 and 2014/15. The college sector is now making greater use of the Non Profit Distributing (NPD) model to fund major capital projects. The Scottish Government will provide ring-fenced grant allocations to colleges to enable them to meet the capital and interest charges on the loan the private sector is assumed to have taken on to afford the construction costs of such projects. Colleges will be expected to meet the other recurring costs associated with these projects, such as annual service charges, from their annual grant allocations or financial reserves.

61. SFC grants make up a high proportion of colleges’ income. It is unlikely that colleges will be able to offset a real-terms reduction of 11 per cent by increasing their income from other sources. Colleges’ income from these other sources, including EU funding, tuition fees and investments, fell by ten per cent in real terms between 2008-09 and 2011-12. These other sources of income are likely to continue to decline, at least in the short term, due to factors such as fewer fee-paying, non-EU students attending Scottish colleges due to immigration constraints. There may also be pressure on European funding streams although the scale of any such funding reduction is not known at this stage.
Some colleges may have to reduce their costs more than others

62. With reduced SFC grant funding and the structural changes facing the sector, the SFC will need to continue to monitor colleges and take action, where necessary, to help ensure their financial sustainability. Our analysis of individual colleges’ 2011-12 audited accounts gives an indication of the financial standing of each of the new regions at the end of July 2012 (Appendix 3). Summing the financial results of individual colleges, ten of the 13 regions would have generated a surplus for 2011-12. The other three regions would have reported an operating deficit:

- Central region, a single-college region comprising Forth Valley College, reported an operating deficit of £4.6 million (paragraph 13).
- Fife region would have reported an operating deficit of £0.5 million as the deficit reported by Adam Smith College (£0.8 million) was greater than the combined surpluses generated by Carnegie College (£0.15 million) and Elmwood College (£0.11 million).
- Edinburgh region would have reported an operating deficit of £0.2 million as the deficit reported by Telford College (£1.1 million) was greater than the combined surpluses generated by Jewel & Esk College (£0.6 million) and Stevenson College (£0.3 million).

63. The college regions varied widely in how much they relied on SFC income in 2011-12, from 65 per cent in the Highlands and Islands to 83 per cent in the Ayrshire region (Exhibit 14, page 31). This suggests that some regions will be more significantly affected than others by the expected reductions in Scottish Government funding.

64. To help with their financial planning, the SFC provides colleges with indicative funding allocations usually each February, although the figures are subject to updating if, and when, the Scottish Government subsequently makes additional funding available for the sector. The SFC’s grant figures for colleges for 2012-13 included, for the first time, funding allocations for the new college regions. The allocations for 2012-13 also included details of an additional £8 million which was targeted towards regions which the SFC identified as having the most significant gaps between the need for college places and provision. Our analysis of regional funding allocations found that all college regions will experience a real-terms reduction in grant funding between 2011-12 and 2012-13, ranging from about nine per cent in Edinburgh to about two per cent in Lanarkshire (Exhibit 15, page 31). These variations reflect ministerial guidance that the college sector move towards ‘needs-based’ funding which better reflects local demand for college places and colleges’ ability to generate efficiency savings. Those college regions facing the largest grant reduction will therefore have to reduce their costs more than others.

Concentrating savings on staff costs is understandable but has risks

65. Staff costs typically account for about 60 per cent of a college’s costs. It is therefore understandable that colleges consider reducing staff numbers as a key way to deliver cost savings. However, concentrating savings on staff costs creates risks that need to be managed. In particular, colleges need to strike a balance between reducing staff numbers further and maintaining the quality of education they provide.
Exhibit 14
Percentage of college regions’ total income from SFC grants, 2011-12

In all regions, more than 60 per cent of colleges’ total college income is directly from the SFC but there is wide variation across regions.

Source: Audit Scotland's analysis of colleges' 2011-12 audited accounts

Exhibit 15
Change in SFC grant funding to college regions between 2011-12 and 2012-13

College regions face real-terms reductions in funding in 2012-13 of between two and nine per cent.

Note: The 2012-13 allocations do not include the £13.1 million which the Scottish Government provided to Skills Development Scotland to fund college places through the New College Learning Programme.

Source: Audit Scotland's analysis of SFC Circular SFC/09/2011 and SFC's Final 2012-13 college funding allocations
Our analysis of colleges’ accounts has shown that, to date, colleges have delivered most savings by reducing teaching staff costs (paragraph 31). The SFC expects that once college mergers take place, further reductions in both administrative and academic management costs should be feasible.

The business case proposing the merger of three colleges to create Edinburgh College in October 2012 identified a number of risks associated with reducing staff numbers (Case study 1). One of the main concerns when considering severance arrangements was to ensure that the new college kept staff with the skills and experience it needed. Colleges that are merging should be aware of, and take action to address, similar risks. Our recent report Managing early departures from the Scottish public sector, published in May 2013, provides guidance in this area.

Case study 1
Risks associated with reducing staff numbers at Edinburgh College

The business case for creating Edinburgh College by merging Stevenson, Telford and Jewel & Esk Colleges estimated that about 240 full-time posts (about 21 per cent of the total) will be lost by 2014. Of these, about 145 are expected to be management posts (60 per cent), with the remainder being teaching and support staff. The business case identified a number of risks stemming from plans to reduce staff numbers, including:

- a smaller senior management team may limit its capacity to develop new initiatives and take part in external activities, and this may increase the workload for managers at the next level if they have to take on these roles
- early loss of key management staff and skills may impact on the required change activity as the new college is created
- early reductions in teaching staff may lead to the college not having enough staff to deliver existing courses.

Source: Edinburgh Colleges – Merger Business Case, April 2012

The reclassification of colleges as public bodies may restrict their scope to build up financial reserves

In October 2010, the Office for National Statistics (ONS) announced that incorporated colleges throughout the UK would be reclassified as public sector bodies from April 2014. This reclassification follows an assessment by ONS of the levels of ministerial control exerted over colleges against European-wide criteria for determining the classification of individual organisations. ONS’ decision means that colleges will be treated as part of central government for financial budgeting and reporting purposes. Colleges’ reclassification means that:

- they will operate within the same annual budget control limits as other Scottish Government bodies
• their accounting year is likely to move to a financial year running from 1 April to 31 March to align with the rest of the public sector.

68. Under reclassification, ministers have committed to maintain college funding at current levels. Colleges will now have to operate within an annual budget which reflects their income and expenditure, including Scottish Government funding. Colleges will still be able to spend income which they generate from other sources within the same financial year. However, their net expenditure must avoid creating a surplus or deficit within Scottish Government budget control limits. As a result, the change in colleges’ status means that access to accumulated reserves at the point of reclassification, and the ability of colleges to generate and use future surpluses, will be constrained. This will limit colleges’ flexibility when setting budgets and managing resources unless action is taken to minimise the effects of ONS’ decision.

69. Colleges’ borrowing is also likely to be affected as this will also need to be managed within Scottish Government annual budget limits. Combined with the restrictions on colleges’ ability to generate and use reserves, this may limit the financial sources available to colleges to fund capital expenditure.

70. Since May 2013, the SFC and the Scottish Government have engaged regularly with college principals, finance directors and regional leads to discuss the implications of the ONS’ decision for the college sector. The SFC has established a project board to help colleges to plan for reclassification and is looking at ways to minimise the impact of government budgeting rules on the college sector, specifically concerning the use of reserves. The SFC and the Scottish Government will continue to support the college sector as it moves towards reclassification.

The college sector needs to monitor the demand for college places to meet both national priorities and local needs for further education

71. The recent reductions in colleges’ revenue funding have resulted in the SFC lowering its expectations as to the amount of college learning delivered. The WSUMs target decreased from about 2.32 million in 2010-11 to about 2.23 million in 2011-12 (a reduction of four per cent), and is expected to decrease to 2.11 million in 2012-13 (a further reduction of five per cent on the 2010-11 target). However, the Scottish Government expects that efficiency savings from the merger programme will allow colleges to deliver more learning for less money in the future. As a result, the SFC has indicated that there will be a four per cent increase in the WSUMs target in 2013-14 compared to 2012-13.

Prioritising younger students and full-time education may limit opportunities for older people

72. As part of its national policy objective to tackle youth unemployment, the Scottish Government introduced its Opportunities for All initiative in April 2012. This programme guarantees a place in learning or training to all 16- to 19-year-olds not currently in employment, education or training. Ministers have asked colleges to prioritise places for 16- to 19-year-olds, and where possible to ensure that places are available for 20- to 24-year-olds.

73. Although the overall amount of learning provided by colleges has remained broadly similar since 2005-06, the number of hours of learning delivered to 16-
to 24-year-old students increased by about 14 per cent in the seven years to 2011-12. During the same period, the number of hours of learning delivered to students aged 25 and over fell by about 22 per cent (Exhibit 16). The college sector has expressed concern that increasing emphasis on providing full-time courses which lead to a recognised qualification (paragraph 32) may lead to reduced learning opportunities for potential students who are less likely to study full time, such as those aged 25 and over and women returning to education. However, the Scottish Government considers that the additional £61 million funding for colleges for 2013/14 and 2014/15 announced in February 2013 should allow them to provide more courses to meet the needs of older people and women in their local regions.45

Exhibit 16
Hours of learning delivered, by age group, 2005-06 to 2011-12
Learning hours have increased for 16- to 24-year-olds but decreased for older students.

![Chart showing hours of learning delivered by age group from 2005-06 to 2011-12.](chart)

Source: Scotland’s colleges: A Baseline Report for Academic Year 2011-12, Scottish Funding Council, March 2013

74. In March 2013, the Scottish Government published a report which highlighted the different processes used by colleges when dealing with applications, some of which will impact on applicants’ choices and opportunities for progression.46 The report included a number of recommendations to improve the application process and associated information for both learners and colleges. Given the ministerial priorities for college learning, it is important that the sector implements these recommendations and other improvements to monitor the demand for college places to help meet both national priorities and local needs for further education.
Recommendations

The Scottish Government and the Scottish Funding Council should:

- work with colleges and regions to assess and manage the impact of colleges’ reclassification on their financial standing
- monitor the impact of prioritising younger students and full-time courses on learning opportunities for older people.

Colleges should:

- identify the risks to future capacity and ability to meet learning needs associated with reducing staff numbers, and take appropriate steps to mitigate these risks
- consider what steps are required to meet the needs of older people and other groups of learners
- implement the Scottish Government’s recommendations to improve the application process to help monitor the demand for college places.
1. Colleges’ financial year currently runs from 1 August to 31 July, the same as the academic year. The Scottish Government’s financial year runs from 1 April to 31 March. It can therefore be difficult to compare colleges’ financial year figures with those from the Scottish Government. To help provide clarity, in this report, we use ‘2011-12’ when referring to colleges’ financial or academic year, and ‘2011/12’ when referring to the Scottish Government’s financial year.

2. The Bill received Royal Assent in August 2013.

3. The 37 colleges were incorporated under the Further and Higher Education (Scotland) Act 1992. Other colleges also receive Scottish Government funding but are not incorporated under the Act: Newbattle Abbey College, Orkney College, Sabhal Mor Ostaig, Shetland College and West Highland College.

4. Under the Public Finance and Accountability (Scotland) Act 2000, Scottish ministers are required to lay the audited accounts in the Scottish Parliament by 30 April of the following year. Due to financial management problems, Adam Smith College’s audited 2011-12 accounts were due to be laid in the Scottish Parliament in September 2013, around five months after the statutory deadline.

5. The Scottish Funding Council’s statutory responsibilities include: developing policies and strategies that support national priorities and objectives for further and higher education; distributing funding to colleges for their day-to-day teaching operations and to support capital investment; monitoring the college sector’s financial health and its contribution to meeting national objectives; and working with colleges and other bodies to ensure the quality of teaching is enhanced and assessed.

6. The 2011/12 audit of Adam Smith College: A report by the Auditor General for Scotland under Section 22(3) of the Public Finance and Accountability Scotland (Act) 2000, August 2013.

7. The Income and Expenditure Reserve is also referred to as the General Fund in some colleges’ accounts but its function is the same.


9. The STSS and LGPS are both defined-benefit schemes in which employers and employees contribute to pension funds. However, because colleges are unable to identify separately their share of assets and liabilities of the STSS, accounting rules allow them to treat the STSS as a defined contribution scheme.

10. The 2011-12 accounts of the other five colleges had no pension reserves because actuaries are unable to identify the colleges’ share of the pension schemes assets. These colleges treat the scheme as if it was a defined contribution scheme and make contributions according to actuarial valuations.

11. Cash equivalents in this analysis are short-term investments and expendable endowments.

12. Days’ cash is calculated by dividing CCE, the end-of-year balance, by daily expenditure (expenditure / 365).

13. Reid Kerr College and Barony College also had bank overdrafts at 31 July 2012 which, overall, gave them negative net cash balances of £1.6 million and £0.3 million, respectively.

14. These figures do not include around £80 million in bursaries and other student support funds which were provided to individual students in 2011-12. Colleges account for this money through Notes to the Accounts rather than through their Income and Expenditure Accounts.


18. A merger involves the creation of a new single college from two or more existing colleges. A federation involves increased cooperation and coordination between colleges, shared decision-making and operations, and a central strategy and resource allocation to which all colleges in the federation are bound.

19. The four regional colleges created on 1 August 2013 were Ayrshire College, Fife College, Glasgow Clyde College and West College Scotland.

20. Learning the lessons of public body mergers (PDF), Audit Scotland, June 2012.
21 Guidance on mergers and federations, Scottish Funding Council, September 2012.

22 This does not include the costs of supporting the merger of Barony, Elmwood and Oatridge Colleges with the Scottish Agricultural College to form Scotland’s Rural College (SRUC).

23 Scottish Funding Council’s written evidence to the Scottish Parliament Public Audit Committee, 14 November 2012.

24 Financial Memorandum for the Post-16 Education (Scotland) Bill.


28 Letter from the SFC to the Cabinet Secretary for Education and Lifelong Learning, 13 May 2013.

29 Scottish Funding Council’s written evidence to the Scottish Parliament Public Audit Committee, 14 November 2012.

30 Scotland’s colleges: current finances, future challenges (PDF), Audit Scotland, October 2012.

31 College Sector Outcome Agreements Summary 2013-14, Scottish Funding Council, June 2013.

32 Colleges and Community Planning, Education Scotland on behalf of the Scottish Funding Council, May 2013.


35 NPD contracts are a form of Public Private Partnership which involve the private sector paying the upfront construction cost of the asset and the ongoing maintenance costs over the lifetime of the contract. The public sector pays an annual charge for use of the asset, made up of capital costs, interest and an annual operating charge. At the end of the contract, the assets may be transferred to public sector ownership. NPD contracts limit the profits that the private sector company may retain and any surplus profit is reinvested in the public sector.

36 There are currently three major capital developments which will be funded using the NPD model, at Kilmarnock College, Inverness College and the City of Glasgow College. These capital projects have a combined value of around £300 million.

37 Final 2012-13 college funding allocations, including additional £5.7m student support funding, Scottish Funding Council, February 2013.

38 SFC/02/2012: Indicative college sector financial decisions for academic year 2012-13, Scottish Funding Council, February 2012.

39 In most cases, we calculated regional funding allocations for 2011-12 by simply adding the funding allocations for each college in a region. For James Watt College (which is split between Ayrshire and West regions) and Elmwood College (which is split between Fife and SRUC), we used the SFC’s calculations of 2011-12 funding based on the 2012-13 allocations. Note that the allocations include funding for support payments to individual students so they are not comparable with the figures for colleges’ grant income which we identified from their audited 2011-12 Income and Expenditure Accounts.

40 Cabinet Secretary for Education and Lifelong Learning letters to the Scottish Funding Council, 25 January 2012 and 21 September 2012.

41 Scottish Funding Council’s written submission to the Scottish Parliament Public Audit Committee, 14 November 2012.

42 College Sector Outcome Agreements Summary 2013-14, Scottish Funding Council, June 2013.

43 Opportunities for All: Supporting all young people to participate in post-16 learning, training or work, Scottish Government, November 2012.

44 Cabinet Secretary for Education and Lifelong Learning letter to the Scottish Funding Council, 21 September 2011.

45 Cabinet Secretary for Education and Lifelong Learning letter to the Scottish Funding Council, 28 March 2013.

## Appendix 1

### College regions

<table>
<thead>
<tr>
<th>Planned structural reform</th>
<th>Region</th>
<th>Current colleges</th>
<th>Planned merger date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Four regions already contain one college and will be unaffected by mergers</td>
<td>Borders</td>
<td>Borders</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>Forth Valley</td>
<td>Forth Valley</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Dumfries and Galloway</td>
<td>Dumfries and Galloway</td>
<td></td>
</tr>
<tr>
<td></td>
<td>West Lothian</td>
<td>West Lothian</td>
<td></td>
</tr>
</tbody>
</table>
| Single colleges will be created from mergers in six regions | Aberdeen and Aberdeenshire | • Aberdeen  
• Banff and Buchan | November 2013 |
|                           | Ayrshire                 | • Ayr  
• Kilmarnock  
• James Watt (North Ayrshire campuses) | August 2013 |
|                           | Edinburgh                | • Edinburgh’s Telford  
• Jewel & Esk  
• Stevenson | Already merged in October 2012 |
|                           | Fife                     | • Adam Smith  
• Carnegie  
• Elmwood (non-land based courses only) | August 2013 |
|                           | Tayside                  | • Angus  
• Dundee | November 2013 |
|                           | West                     | • Clydebank  
• Reid Kerr  
• James Watt (Inverclyde campuses) | August 2013 |
|                           | Lanarkshire              | • Coatbridge  
• Cumbernauld  
• Motherwell  
• South Lanarkshire | November 2013 (Cumbernauld and Motherwell) |

One region will comprise a federation of colleges, within which two colleges (Cumbernauld and Motherwell) will merge to form a single college.

*Cont.*
### Planned structural reform

<table>
<thead>
<tr>
<th>Region</th>
<th>Current colleges</th>
<th>Planned merger date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Glasgow</td>
<td>City Centre</td>
<td></td>
</tr>
<tr>
<td></td>
<td>City of Glasgow</td>
<td>N/A&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
<tr>
<td>North &amp; East</td>
<td>• John Wheatley</td>
<td>November 2013</td>
</tr>
<tr>
<td></td>
<td>• North Glasgow</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Stow</td>
<td></td>
</tr>
<tr>
<td>Clyde</td>
<td>• Anniesland</td>
<td>August 2013</td>
</tr>
<tr>
<td></td>
<td>• Cardonald</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Langside</td>
<td></td>
</tr>
<tr>
<td>The Highlands and Islands</td>
<td>• Inverness</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>• Lews Castle</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Moray</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• North Highland</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Perth</td>
<td></td>
</tr>
</tbody>
</table>

Notes:
1. Barony College, Oatridge College and Elmwood College (land-based courses) merged with the Scottish Agricultural College in October 2012 to form Scotland’s Rural College (SRUC), a new higher education institute focused on rural and land-based education.
2. The City of Glasgow College was created in September 2010 from the merger of Central College Glasgow, Glasgow Metropolitan College and Glasgow College of Nautical Studies.
## Appendix 2

Financial performance of colleges 2011-12

<table>
<thead>
<tr>
<th>College</th>
<th>Operating surplus/ (deficit) (£ million)</th>
<th>Operating surplus/ (deficit) as percentage of income (%)</th>
<th>Cash and cash equivalents surplus/ (deficit) (£ million)</th>
<th>I&amp;E reserve surplus/ (deficit) (£ million)</th>
<th>Pension reserve surplus/ (deficit) (£ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aberdeen</td>
<td>1.314</td>
<td>3.4</td>
<td>18.796</td>
<td>22.515</td>
<td>0.000</td>
</tr>
<tr>
<td>Adam Smith</td>
<td>(0.767)</td>
<td>(2.5)</td>
<td>8.773</td>
<td>4.311</td>
<td>(7.432)</td>
</tr>
<tr>
<td>Angus</td>
<td>0.011</td>
<td>0.1</td>
<td>4.495</td>
<td>5.572</td>
<td>(4.492)</td>
</tr>
<tr>
<td>Anniesland</td>
<td>0.457</td>
<td>3.3</td>
<td>6.441</td>
<td>3.546</td>
<td>(1.682)</td>
</tr>
<tr>
<td>Ayr</td>
<td>0.224</td>
<td>1.6</td>
<td>1.982</td>
<td>4.646</td>
<td>(1.498)</td>
</tr>
<tr>
<td>Banff and Buchan</td>
<td>(0.165)</td>
<td>(1.3)</td>
<td>4.754</td>
<td>1.877</td>
<td>0.000</td>
</tr>
<tr>
<td>Barony</td>
<td>(0.144)</td>
<td>(2.3)</td>
<td>0.013</td>
<td>1.088</td>
<td>(0.753)</td>
</tr>
<tr>
<td>Borders</td>
<td>0.276</td>
<td>2.4</td>
<td>2.957</td>
<td>4.726</td>
<td>(4.131)</td>
</tr>
<tr>
<td>Cardonald</td>
<td>0.844</td>
<td>4.1</td>
<td>7.334</td>
<td>8.212</td>
<td>(2.464)</td>
</tr>
<tr>
<td>Carnegie</td>
<td>0.147</td>
<td>0.7</td>
<td>(1.069)</td>
<td>2.077</td>
<td>(4.951)</td>
</tr>
<tr>
<td>City of Glasgow</td>
<td>0.438</td>
<td>0.8</td>
<td>26.555</td>
<td>22.931</td>
<td>(6.747)</td>
</tr>
<tr>
<td>Clydebank</td>
<td>0.095</td>
<td>0.6</td>
<td>3.458</td>
<td>4.121</td>
<td>(5.137)</td>
</tr>
<tr>
<td>Coatbridge</td>
<td>0.256</td>
<td>2.2</td>
<td>1.628</td>
<td>6.897</td>
<td>(2.074)</td>
</tr>
<tr>
<td>Cumbernauld</td>
<td>0.209</td>
<td>2.1</td>
<td>2.068</td>
<td>2.191</td>
<td>(1.802)</td>
</tr>
<tr>
<td>Dumfries and Galloway</td>
<td>0.024</td>
<td>0.2</td>
<td>4.265</td>
<td>6.528</td>
<td>(3.119)</td>
</tr>
<tr>
<td>Dundee</td>
<td>0.285</td>
<td>1.0</td>
<td>6.341</td>
<td>6.493</td>
<td>0.000</td>
</tr>
<tr>
<td>Edinburgh's Telford</td>
<td>(1.078)</td>
<td>(3.4)</td>
<td>13.955</td>
<td>31.725</td>
<td>(3.994)</td>
</tr>
<tr>
<td>Elmwood</td>
<td>0.258</td>
<td>2.2</td>
<td>4.742</td>
<td>5.121</td>
<td>(1.842)</td>
</tr>
<tr>
<td>Forth Valley</td>
<td>(4.569)</td>
<td>(15.4)</td>
<td>3.377</td>
<td>(6.368)</td>
<td>(9.133)</td>
</tr>
<tr>
<td>Inverness</td>
<td>0.506</td>
<td>3.3</td>
<td>5.648</td>
<td>1.489</td>
<td>(4.438)</td>
</tr>
<tr>
<td>James Watt</td>
<td>0.726</td>
<td>2.1</td>
<td>10.649</td>
<td>1.505</td>
<td>(9.552)</td>
</tr>
<tr>
<td>Jewel &amp; Esk</td>
<td>0.593</td>
<td>3.0</td>
<td>4.717</td>
<td>13.942</td>
<td>(4.966)</td>
</tr>
<tr>
<td>John Wheatley</td>
<td>0.073</td>
<td>0.7</td>
<td>1.213</td>
<td>1.595</td>
<td>(1.518)</td>
</tr>
</tbody>
</table>

Cont.
<table>
<thead>
<tr>
<th>College</th>
<th>Operating surplus/deficit (£ million)</th>
<th>Operating surplus/deficit as percentage of income (%)</th>
<th>Cash and cash equivalents surplus/deficit (£ million)</th>
<th>I&amp;E reserve surplus/deficit (£ million)</th>
<th>Pension reserve surplus/deficit (£ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kilmarnock</td>
<td>0.639</td>
<td>4.6</td>
<td>4.167</td>
<td>3.028</td>
<td>(3.851)</td>
</tr>
<tr>
<td>Langside</td>
<td>(0.081)</td>
<td>(0.5)</td>
<td>5.308</td>
<td>2.376</td>
<td>(2.894)</td>
</tr>
<tr>
<td>Lewis Castle</td>
<td>(0.047)</td>
<td>(0.7)</td>
<td>0.079</td>
<td>(1.551)</td>
<td>(1.201)</td>
</tr>
<tr>
<td>Moray</td>
<td>(0.416)</td>
<td>(3.8)</td>
<td>2.884</td>
<td>0.627</td>
<td>0.000</td>
</tr>
<tr>
<td>Motherwell</td>
<td>0.523</td>
<td>1.8</td>
<td>10.503</td>
<td>24.921</td>
<td>(3.887)</td>
</tr>
<tr>
<td>North Glasgow</td>
<td>(0.057)</td>
<td>(0.4)</td>
<td>5.646</td>
<td>6.047</td>
<td>(2.233)</td>
</tr>
<tr>
<td>North Highland</td>
<td>0.375</td>
<td>2.6</td>
<td>1.480</td>
<td>1.676</td>
<td>(3.605)</td>
</tr>
<tr>
<td>Oatridge</td>
<td>0.151</td>
<td>2.0</td>
<td>1.921</td>
<td>4.824</td>
<td>(0.832)</td>
</tr>
<tr>
<td>Perth</td>
<td>0.078</td>
<td>0.4</td>
<td>5.584</td>
<td>5.386</td>
<td>0.000</td>
</tr>
<tr>
<td>Reid Kerr</td>
<td>(0.023)</td>
<td>(0.1)</td>
<td>0.029</td>
<td>3.051</td>
<td>(6.115)</td>
</tr>
<tr>
<td>South Lanarkshire</td>
<td>0.172</td>
<td>1.6</td>
<td>2.437</td>
<td>1.582</td>
<td>(0.901)</td>
</tr>
<tr>
<td>Stevenson</td>
<td>0.253</td>
<td>0.9</td>
<td>11.267</td>
<td>11.592</td>
<td>(2.990)</td>
</tr>
<tr>
<td>Stow</td>
<td>0.060</td>
<td>0.5</td>
<td>2.237</td>
<td>0.617</td>
<td>(2.519)</td>
</tr>
<tr>
<td>West Lothian</td>
<td>0.555</td>
<td>4.5</td>
<td>2.506</td>
<td>(7.059)</td>
<td>(2.511)</td>
</tr>
</tbody>
</table>
## Appendix 3
### Financial performance of college regions 2011-12

<table>
<thead>
<tr>
<th>Region</th>
<th>Operating surplus/deficit (£ million)</th>
<th>Operating surplus/deficit as percentage of income (%)</th>
<th>Cash and cash equivalents surplus/deficit (£ million)</th>
<th>I&amp;E reserve surplus/deficit (£ million)</th>
<th>Pension reserve (£ million)</th>
<th>SFC grant funding (% of total funding)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aberdeen and Aberdeenshire</td>
<td>1.149</td>
<td>2.2</td>
<td>23.550</td>
<td>24.392</td>
<td>0.000</td>
<td>72</td>
</tr>
<tr>
<td>Ayrshire</td>
<td>1.153</td>
<td>2.7</td>
<td>10.409</td>
<td>8.276</td>
<td>(9.170)</td>
<td>83</td>
</tr>
<tr>
<td>Borders</td>
<td>0.276</td>
<td>2.4</td>
<td>2.957</td>
<td>4.726</td>
<td>(4.131)</td>
<td>74</td>
</tr>
<tr>
<td>Central</td>
<td>(4.569)</td>
<td>(15.4)</td>
<td>3.377</td>
<td>(6.368)</td>
<td>(9.133)</td>
<td>77</td>
</tr>
<tr>
<td>Dumfries and Galloway</td>
<td>0.024</td>
<td>0.2</td>
<td>4.265</td>
<td>6.528</td>
<td>(3.119)</td>
<td>80</td>
</tr>
<tr>
<td>Edinburgh</td>
<td>(0.232)</td>
<td>(0.3)</td>
<td>29.939</td>
<td>57.259</td>
<td>(11.950)</td>
<td>76</td>
</tr>
<tr>
<td>Fife</td>
<td>(0.530)</td>
<td>(1.0)</td>
<td>9.364</td>
<td>8.180</td>
<td>(13.028)</td>
<td>69</td>
</tr>
<tr>
<td>Glasgow</td>
<td>1.734</td>
<td>1.2</td>
<td>54.734</td>
<td>45.324</td>
<td>(20.057)</td>
<td>73</td>
</tr>
<tr>
<td>Highlands and Islands</td>
<td>0.496</td>
<td>0.7</td>
<td>15.675</td>
<td>7.627</td>
<td>(9.244)</td>
<td>65</td>
</tr>
<tr>
<td>Lanarkshire</td>
<td>1.160</td>
<td>1.9</td>
<td>16.636</td>
<td>35.591</td>
<td>(8.664)</td>
<td>70</td>
</tr>
<tr>
<td>Tayside</td>
<td>0.296</td>
<td>0.7</td>
<td>10.836</td>
<td>12.065</td>
<td>(4.492)</td>
<td>77</td>
</tr>
<tr>
<td>West</td>
<td>0.508</td>
<td>0.9</td>
<td>9.876</td>
<td>8.075</td>
<td>(16.983)</td>
<td>80</td>
</tr>
<tr>
<td>West Lothian</td>
<td>0.555</td>
<td>4.5</td>
<td>2.506</td>
<td>(7.059)</td>
<td>(2.511)</td>
<td>79</td>
</tr>
<tr>
<td>SRUC</td>
<td>0.175</td>
<td>0.8</td>
<td>5.016</td>
<td>9.241</td>
<td>(2.782)</td>
<td>56</td>
</tr>
</tbody>
</table>

Notes:
1. SFC’s final 2012-13 college funding allocations included a breakdown for those colleges that are to be split between regions. All figures, including reserves, have been apportioned to regions on this basis.
2. Edinburgh’s Telford, Jewel & Esk and Stevenson Colleges merged on 1 October 2012 to form Edinburgh College.
Scotland’s colleges 2013

This report is available in PDF and RTF formats, along with a podcast summary at: www.audit-scotland.gov.uk

If you require this publication in an alternative format and/or language, please contact us to discuss your needs: 0845 146 1010 or info@audit-scotland.gov.uk