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.
Introduction

1. I have received the audited financial statements and the auditor’s report for Lews Castle College for 2015/16. I am submitting these financial statements and the independent auditor’s report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

2. The purpose of this report is to draw Parliament's attention to concerns about an inability to achieve activity targets at Lews Castle College during 2015/16 and the potential impact on financial sustainability in the longer term.

The auditor’s opinion

3. The auditor gave an unqualified opinion on Lews Castle College's financial statements for 2015/16 but, in his audit report, he highlighted concerns about financial sustainability arising from the college not achieving student activity targets. The auditor also highlighted that delays in appointing board members had a significant impact on governance arrangements and committee meetings in 2015/16.

Background

4. Lews Castle College is an independent legal body with charitable status as defined by the Further and Higher Education (Scotland) Act 1992 (the 1992 Act). It is governed by a board which is responsible for determining the overall strategy of the college and the proper use of public funds, the quality of provision and appointing the Principal and other senior staff. In 2015/16, the college had 2,016 registered students and employed 111 FTE members of staff.

5. Colleges are organised into 13 college regions. Ten of the regions contain a single college, while three are multi-college regions (Glasgow, Highlands and Islands and Lanarkshire). In each multi-college region, there is a regional strategic body which is responsible for planning and funding delivery of learning across all of the colleges in the region. The regional body is also responsible for working with the Scottish Funding Council (SFC) to determine and agree the priorities for the region. Lews Castle College is part of the Highlands and Islands Region, and the associated regional strategic body is the University of the Highlands and Islands (UHI). UHI took on its regional strategic body responsibilities from August 2014.

6. The college’s total income in 2015/16 was £5.7 million. The college reported a deficit of £274,000 (five per cent of income). After excluding items that do not reflect in-year financial payments but instead relate to longer-term considerations (that is, depreciation and pension accounting adjustments), and adjusting for the final instalment of short-term strategic funding from the SFC, the finances showed a break-even position.\(^1\)

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\(^1\) The SFC provided strategic funding to support a review of the college's processes and procedures for assessing, processing and claiming extended learning support (ELS). ELS is provided for individual students with particular educational support needs who are studying on a mainstream programme.
7. While the college is not in immediate financial difficulty, it failed to achieve its learning activity target in 2015/16. The college has missed its target persistently over an extended period, and the margin by which it missed the target in 2015/16 was significantly higher than in previous years (Exhibit 1). The college sector has experienced significant change over this period. Changes in national policy focus, reductions in funding, the reclassification of colleges as public bodies and changes in regional governance arrangements have created a challenging environment for the sector. Continued under-delivery could result in both a reduction in funding and recovery of funding for activity not delivered.

**Performance and financial sustainability**

8. The SFC allocates funding to the 13 college regions in Scotland in exchange for each region delivering an agreed volume of student activity. Student activity is measured in ‘credits’. In multi-college regions, the SFC provides funding to the regional body for each region. The regional body is then responsible for agreeing activity levels with, and allocating funding to, the colleges in the region. Lews Castle College, like other colleges in the Highlands and Islands region, contributes to the regional target. This means that under-delivery in one college in the region can be off-set by over-delivery in another college.

9. The SFC can seek to recover funding from a region where the target is not met. Any decision by the SFC to recover funding would depend on the wider Highlands and Islands regional performance and the approach taken by UHI.

10. UHI provided Lews Castle College with £3.8 million of funding in 2015/16, of which £2.29 million was for further education activity. The college agreed to deliver 6,376 units (‘credits’) of further education activity. The college delivered only 5,131 credits, over 19 per cent short of the target. The region, overall, exceeded its target and the SFC did not seek recovery of funding. UHI did not seek any recovery from the college.

11. Historically, the SFC allowed colleges a degree of leeway in achievement of their targets. This was intended to reflect the fact that the circumstances under which some students leave a college are beyond the immediate control of the college. If targets were adjusted to reflect this leeway, the college would have missed the adjusted target in three of the four years in which a leeway applied. The degree by which the college has missed its target has increased significantly since 2012/13 (Exhibit 1). The credits target for 2016/17 remains at 6,376 and will be challenging for the college to achieve.

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2 The SFC leeway was no longer applicable from 2012/13. This was the first year of regional outcome agreements, which incorporate a wider range of measures. The level of funded activity is one of the measures.
Exhibit 1
The college has persistently failed to meet its activity target over a long period of time
The proportion of the target achieved has decreased by 12 per cent since 2012/13.

<table>
<thead>
<tr>
<th>Accounting Year</th>
<th>Measure</th>
<th>Target</th>
<th>Achieved</th>
<th>Over/(under) (%)</th>
<th>SFC leeway (%)</th>
<th>Achieved within leeway</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008/09</td>
<td>WSUMs</td>
<td>8,935</td>
<td>7,020</td>
<td>(21.4)</td>
<td>2</td>
<td>No</td>
</tr>
<tr>
<td>2009/10</td>
<td>WSUMs</td>
<td>8,935</td>
<td>8,333</td>
<td>(6.7)</td>
<td>2</td>
<td>No</td>
</tr>
<tr>
<td>2010/11</td>
<td>WSUMs</td>
<td>9,067</td>
<td>8,841</td>
<td>(2.5)</td>
<td>2</td>
<td>No</td>
</tr>
<tr>
<td>2011/12</td>
<td>WSUMs</td>
<td>8,699</td>
<td>8,430</td>
<td>(3.1)</td>
<td>5</td>
<td>Yes</td>
</tr>
<tr>
<td>2012/13</td>
<td>WSUMs</td>
<td>8,427</td>
<td>7,803</td>
<td>(7.4)</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>2013/14</td>
<td>WSUMs</td>
<td>8,994</td>
<td>8,336</td>
<td>(7.3)</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>2014/15</td>
<td>WSUMs</td>
<td>8,994</td>
<td>8,082</td>
<td>(10.1)</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>2015/16</td>
<td>Credits</td>
<td>6,376</td>
<td>5,131</td>
<td>(19.5)</td>
<td>n/a</td>
<td>n/a</td>
</tr>
</tbody>
</table>

Notes: Prior to 2015/16, learning activity was measured in 'weighted student units of measurement' (WSUMs). The SFC changed the measure to credits from 2015/16.

Source: Scottish Funding Council and Lews Castle College accounts

12. While the SFC did recover funding for under-delivery against target in 2008/09, neither it nor UHI has sought to recover funding from the college in any of the subsequent years. The auditor has highlighted the risk that continued under-achievement could result in reductions in future funding settlements. SFC funding accounts for around two-thirds of the college's total income, and any reduction or recovery could have a significantly detrimental effect on the college's financial sustainability. The current situation also means that the college was funded in excess of what it needed to deliver its levels of activity. In effect, other colleges in the region subsidised Lews Castle College..

Reasons for under-delivery

13. The college has indicated that the national policy focus on full-time courses leading to employment (introduced in 2009) and on provision for young people (2011) affected the college's ability to meet targets. The college previously catered for a larger proportion of part-time learners and older (over 24 years of age) learners. The college has also indicated that a changing local demography, particularly a reduction in the number of young people, has contributed to the college's difficulty in delivering the target. The board and its committees did consider performance regularly, including the risks associated with under-delivery, but there is little evidence of the board taking effective action to adjust the college's operations to address these risks and the changes described above. The college did develop new marketing,
employer engagement and curriculum strategies from 2014, but these have not delivered
intended increases in student numbers.

14. The SFC began to introduce a new funding model for the college sector in 2015/16. Both the
college and UHI have acknowledged that delays in them fully understanding the effects of this
change led to difficulties in applying a revised approach to the allocations made by UHI for
2015/16. Instead, UHI based the 2015/16 allocations, of both funding and targets, on 2014/15
figures, and the college cites this as a significant factor in the disparity between its
performance and its target in 2015/16. Essentially, it considers the target was higher than it
should have been. UHI is working with colleges in the region during 2016/17 to review and,
where necessary, adjust the targets to reflect the change in the funding model. UHI plans to
implement a new allocation approach in 2017/18. Lews Castle College expects this work to
result in its activity target reducing significantly, with the revised target likely to mirror current
activity.

15. The prospects of the college successfully resolving issues relating to under-delivery will be
dependent on the outcome of the UHI review described at paragraph 14. A significant
reduction in target will have implications for the college’s funding allocation. Given the
relatively small size of the college, and the area it covers, any significant reduction in funding
would be a challenge. The college is currently considering the cost reduction measures that
might be necessary to accommodate the reduction in funding.

Governance

Seven experienced independent members left during the year, including the Chair. The
Board’s standing committees did not meet between December 2015 and October 2016.
During that period all committee business, other than that of the audit committee, had to be
considered by the Board in full at its meetings in March, June and September 2016.

17. New Board members are now in place. Of the 13 current members, six had served on the
board in the years immediately prior to 2015/16 and one served on the Board in a previous
period. At the time of the annual audit, a full induction process had not been completed for
new members. However, by the time this report was prepared, all but one new board member
had received induction training. While there is no indication that the absence of standing

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3 Prior to 2015/16, learning activity was expressed in ‘student units of measurement’ (SUMs), where one
SUM equated to 40 hours of learning. Therefore, a course that involved 640 hours of learning would equal
16 SUMs. Over and above this, the SFC applied a weighting for each subject in recognition that some
courses cost more to run than others, eg engineering courses cost more than social studies courses. The
adjusted units were referred to as weighted SUMs (WSUMs). The new funding model removes the
weightings applied under WSUMs and instead categorises courses in five price groups. Each group has a
credit value attached to it. The new funding model is being introduced on a transitional basis, during which
time no college will receive a reduction in funding of more than one per cent.

4 This high turnover reflects the fact that a new board was established at the point of regionalisation,
following implementation of the Post-16 Education (Scotland) Act. Many of the departing members’
appointment terms ended during 2015/16.
committees affected delivery targets, the new board will play a key role in implementing necessary changes to the college's activity target and to its cost base.

**Conclusion**

18. Lewis Castle College is not in immediate financial difficulty but its failure to effectively address underlying problems with its activity target places the college at risk of financial penalty and funding reductions. It needs to take steps now to agree an appropriate activity target with UHI, and to make adjustments to its cost base to match this. I note that the college is working with UHI to address this and I have asked the auditor to keep the position under review.