Scotland's colleges

Current finances, future challenges

AUDIT SCOTLAND

Prepared for the Auditor General for Scotland
October 2012

Auditor General for Scotland

The Auditor General for Scotland is the Parliament's watchdog for helping to ensure propriety and value for money in the spending of public funds.

She is responsible for investigating whether public spending bodies achieve the best possible value for money and adhere to the highest standards of financial management.

She is independent and not subject to the control of any member of the Scottish Government or the Parliament.

The Auditor General is responsible for securing the audit of the Scottish Government and most other public sector bodies except local authorities and fire and police boards.

The following bodies fall within the remit of the Auditor General:

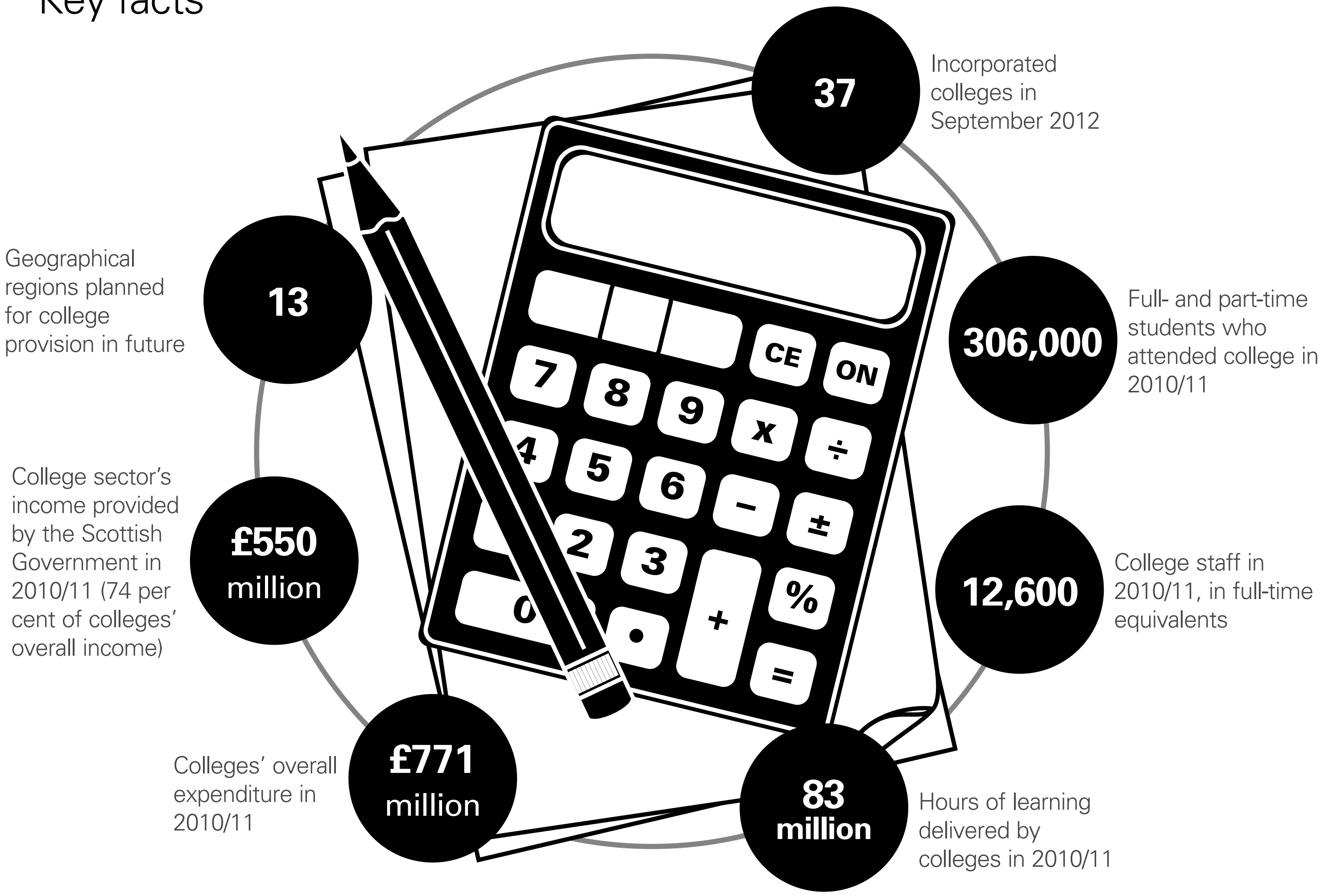
- directorates of the Scottish Government
- government agencies, eg the Scottish Prison Service, Historic Scotland
- NHS bodies
- further education colleges
- Scottish Water
- NDPBs and others, eg Scottish Enterprise.

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

Contents

Summary

Key facts



Colleges provide education and training to a large number of students.

Introduction

1. The college sector has a key role in supporting the achievement of sustainable economic growth by contributing to the development of a highly educated and skilled workforce. Colleges are the main providers of further education in Scotland, offering a diverse curriculum that includes vocational and higher education courses. Over 300,000 people from all walks of life attended college in 2010/11, ranging from school-leavers to adults returning to education for personal or career reasons.

2. Scotland had 37 incorporated colleges.[1] Colleges operate as independent corporate bodies and the Auditor General for Scotland (AGS) is responsible for auditing them. Together, they had income of £741.6 million in 2010/11 and spent £771.0 million. Overall, the Scottish Government provides colleges with about three-quarters of their income, with the balance coming from a variety of sources, such as tuition fees levied on non-Scottish domiciled students. Colleges face considerable financial pressures over the next few years, that will include planned reductions in Scottish Government funding.

3. In February 2012, Scottish ministers announced their intention to introduce structural changes to the college sector as part of overall reforms of post-16 education. As part of these reforms, ministers are expected to introduce legislation in the current Parliamentary session to allow the creation of 13 college regions. Regionalisation will also be associated with a number of mergers between individual colleges.

About this audit

4. Audit Scotland has produced three previous reports about the financial position of colleges, with our last report drawing on their 2006/07 accounts.[2] Collectively, these reports have depicted the improved financial stability of Scotland's colleges as a whole, partly due to significant increases in public sector funding.

5. We have produced this report to identify the financial standing of the college sector immediately before structural reforms and planned public sector spending reductions take effect. It establishes a position against which progress can be measured later, and summarises progress towards creating college regions.

6. The report is structured in three main parts:

- Part 1 provides contextual information on the college sector before the introduction of structural reform.
- Part 2 assesses the sector's financial standing in 2010/11.
- Part 3 sets out the progress made towards structural reform, and provides a commentary on some of the major risks which the sector faces.

7. We have based our assessment of colleges' financial standing largely on an analysis of colleges' audited annual accounts for the year to July 2011, laid in the Scottish Parliament between January and the end of April 2012, together with college auditors' reports and other information held by the Scottish Funding Council (SFC).[3] In addition, we held structured group discussions with appointed auditors and with senior managers and board members from a sample of colleges.[4]

8. 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 would help to put the overall picture in perspective, and to highlight those colleges where there may be more risk regarding their financial sustainability. While we recognise that many of these colleges will be subject to mergers in the near future, ensuring that the newly merged colleges are financially sustainable will be important. The college sector is moving through a period of rapid change and this report reflects the position as at the end of September 2012. A glossary of terms is included at Appendix 1.

Key messages

- The overall financial standing of the college sector in 2010/11 was generally sound. However, the financial standing of individual colleges varies. Most colleges operate to relatively tight margins and there is no consistent trend in the amount of surplus or deficit reported by the sector as a whole.
- Scotland's colleges face considerable challenges in the years ahead. As part of overall public sector spending reductions, Scottish Government revenue grant support to colleges is likely to fall from £545 million in 2011/12 to £471 million in 2014/15. This

1 The 37 colleges are 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 Mòr Ostaig, Shetland College and West Highland College.
2 The reports are: *Overview of further education colleges in Scotland 1999/2000*, published in October 2001; *Overview of further education colleges in Scotland 2000/01*, published in May 2002; and *Financial overview of Scotland's colleges 2006/07*, published in April 2008.
3 Colleges' financial year runs from 1 August to 31 July, the same as the academic year. Under the Public Finance and Accountability (Scotland) Act 2000, the Scottish ministers are required to lay the audited accounts in the Scottish Parliament by 30 April of the following year.
4 College representatives came from Clydebank College, Coatbridge College, Edinburgh's Telford College, John Wheatley College, Reid Kerr College, Stow College and West Lothian College.

represents a reduction of 24 per cent in real terms. The sector may also face pressure from a range of increasing costs.

- Planned structural reforms of the college sector may also create cost pressures, and are expected to result in the number of colleges in Scotland falling from 37 to no more than 23. The planned reforms have the potential to bring a more strategic approach to the management of the sector and more robust planning of the education provided in each region. But, complex change on this scale will inevitably lead to some disruption during the transition period. Further work is required to identify and articulate the costs and benefits of regionalisation, and to improve outcome agreements covering the sector's contribution to national objectives for education and learning.

- Strong national, regional and local leadership will be required to implement structural reform successfully and to ensure that colleges make an effective contribution to the development of a skilled and educated workforce. In addition, colleges and their boards will need to work closely with the SFC and the planned Further Education Strategic Forum to deliver the efficiency savings needed to ensure the continued financial sustainability of the sector.

Recommendations

The Scottish Government should:

- provide a clear assessment of the expected benefits and costs of regionalisation (including structural change), how these benefits contribute to its reform objectives and how costs are to be funded

- ensure the planned Further Education Strategic Forum has a clear remit that complements the Scottish Funding Council's role in providing guidance and oversight to the college sector.

The Scottish Funding Council should:

- develop performance management arrangements for the sector that allow the value for money of the public sector funds provided to be demonstrated

- develop outcome agreements for the sector that focus on colleges' contribution to national objectives and priorities for post-16 education

- further develop methodologies for assessing the financial health and performance of the new college regions, and take action in those areas at most risk to ensure their financial sustainability.

Existing colleges and proposed regional boards should:

- ensure that strategic planning for course provision in their areas responds to the national objectives and priorities for post-16 education, and also reflects the needs of local employers and students, and the views of community planning partners

- ensure that planning for course provision is based on robust financial and other resource plans

- learn from the experience of previous college mergers and other sources, such as the Scottish Funding Council's guidance on mergers and the Audit Scotland report *Learning the lessons of public body mergers*, to ensure effective management of their own mergers

- explore opportunities to reduce their costs through economies of scale, joint working and better partnership working. Colleges should develop clear assessments of the workforce skills and attributes needed in future to inform their strategies and procedures for staff changes and reductions.

Part 1. The college sector today

Colleges vary widely in size and character.

Key messages

- Colleges provide a wide range of educational opportunities, ranging from short-term courses to improve core skills, such as literacy and numeracy, to full-time degrees.
- Colleges vary widely in size and character. In expenditure terms, the recently formed City of Glasgow College is larger than the combined size of the ten smallest colleges.
- Governance arrangements in individual colleges are generally sound.

Exhibit 1
Number of colleges
Between April 1993 and July 2011, the number of incorporated colleges reduced from 43 to 37.

43	The 1992 Act saw the formation of 43 independent colleges
42	In 2004, Glasgow College of Food Technology and Glasgow College of Building & Printing merged and formed Glasgow Metropolitan College.
40	In 2005, Fife College and Glenrothes College merged and became Adam Smith College. Clackmannanshire College and Falkirk College also merged and became Forth Valley College.
39	In 2007, Bell College of Technology merged with Paisley University to become the University of the West of Scotland.
37	In 2010, Central College Glasgow, Glasgow Metropolitan College, and Glasgow College of Nautical Studies merged to form the City of Glasgow College.

Source: Audit Scotland

Colleges provide a wide range of educational opportunities

9. The Scottish Government considers that a skilled, educated and healthy working population is essential to allow businesses to compete internationally and to help achieve sustainable economic growth.[5] Colleges can enhance the employability of individuals by providing a wide range of educational opportunities, ranging from short-term courses that improve core skills, such as literacy and numeracy, to full-time degree-level courses.

10. Some 306,000 people attended college in 2010/11 and around a quarter of these studied on a full-time basis. Students undertook a wide range of qualifications:

- 50,000 studied higher education courses such as degrees, Higher National Certificates and Higher National Diplomas
- 26,000 studied courses equivalent to Scottish Vocational Qualification levels 1–3, many of them as part of the Scottish Government's Modern Apprenticeship programme
- 50,000 studied courses at Intermediate 1 and 2 levels, Higher, or Advanced Higher
- 109,000 studied other further education courses
- 102,000 mainly studied short-term courses, often of a vocational nature, leading to no formal qualification.[6]

11. Overall, colleges delivered 83 million hours of learning activity in 2010/11, covering a wide range of subject areas. Courses ranged from business and management to personal care and appearance, and from engineering to sport, food and technology and social studies.

Colleges vary widely in size and character

12. Before April 1993, local authorities funded colleges and monitored their activities. However, the Further and Higher Education (Scotland) Act 1992 incorporated 43 colleges as independent bodies with their own board of management. Between April 1993 and the end of colleges' 2010/11 financial year in July 2011, the number of incorporated colleges reduced to 37 due to a series of mergers (Exhibit 1).

13. The colleges vary widely in size and character. The City of Glasgow College, established in September 2010 from the merger of three local colleges, is Scotland's largest. It has around 34,000 student enrolments and employs over 1,000 full-time

5 *The Government Economic Strategy*, Scottish Government, September 2011.
6 *Facts and Figures 2012*, Scottish Funding Council, April 2012. The total number of courses studied exceeds the total number of people attending college because some people took more than one course.

equivalent (FTE) staff. Its expenditure of £103.5 million in 2010/11 exceeded the combined spend of the ten smallest colleges in Scotland (Exhibit 2). Barony College is the smallest college with expenditure of £5.7 million in 2010/11 and 93 FTE staff.

The Scottish Government provides funding to colleges but does not direct their day-to-day operations

Ministers have a duty to provide support to colleges

14. Scottish ministers' responsibilities for colleges are set out in the 1992 Act and the Further and Higher Education (Scotland) Act 2005 (the 2005 Act). Under the 2005 Act, Scottish ministers have a general duty to support the provision of further education and higher education by colleges as well as higher education institutions. The 1992 Act empowers ministers to close, merge or establish colleges. Ministers may also direct colleges about the discharge of their functions.

The Scottish Government funds colleges via the Scottish Funding Council

15. The Scottish Government provides guidance to the SFC on ministers' objectives and priorities for the sector, and funding for onward distribution to colleges. The SFC's main statutory responsibilities for colleges, as set out in the 2005 Act, are to secure the coherent provision of high-quality further and higher education. The SFC:

- develops policies and strategies that support national objectives and priorities for further and higher education
- distributes core grant funding to colleges for their day-to-day teaching operations, plus other grant funds such as those provided to support capital investment and student bursaries
- monitors the contribution that the college sector makes to meeting national objectives and priorities for further and higher education
- works with colleges, student representative bodies and Education Scotland to ensure that the quality of teaching is enhanced and assessed
- monitors the financial health and sustainability of colleges to safeguard the interests of learners and the investment of public funds
- advises the Scottish Government on further and higher education.

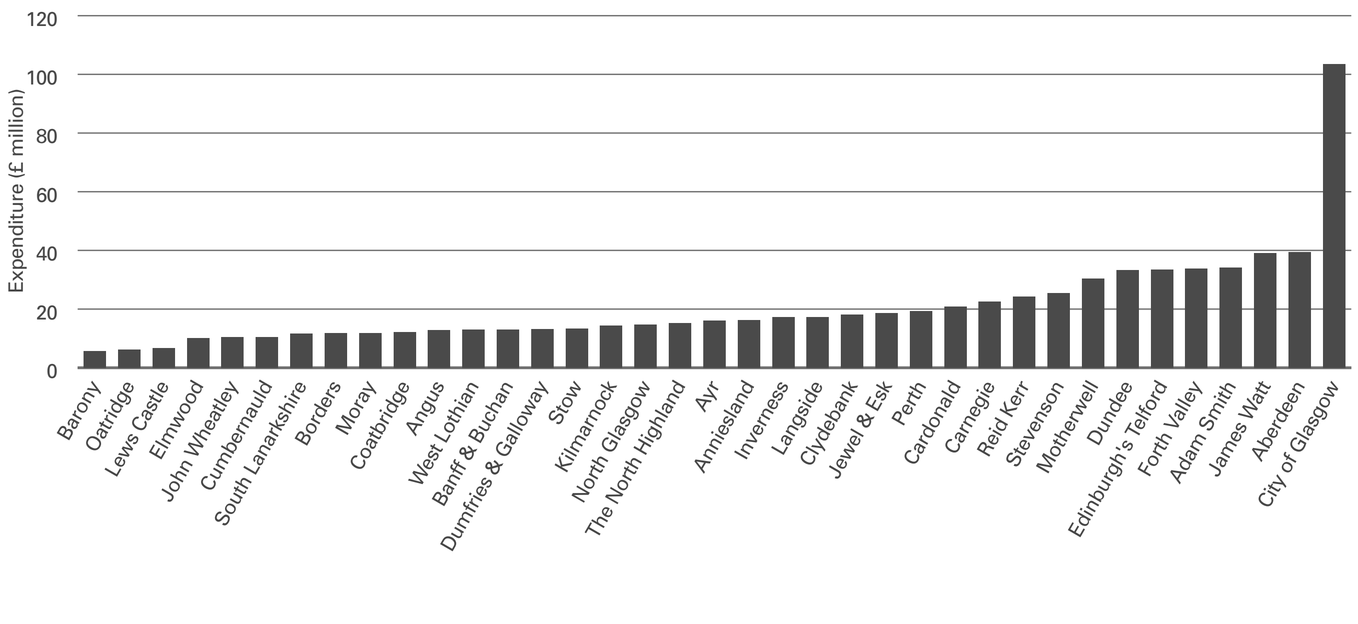
Boards of management are responsible for colleges' strategic direction and effective governance

16. The Scottish Government and the SFC do not normally have a role in the day-to-day management of individual colleges. A college's board of management is primarily responsible for setting the policies and overall strategic direction of the college, within the parameters set by the Government's strategic letter of guidance to the SFC. A financial memorandum specifies the conditions under which the SFC provides colleges with funding.

Exhibit 2

Colleges' operating expenditure in 2010/11

Around two-thirds of colleges spent less than £20 million in 2010/11.



Source: Colleges' audited accounts for 2010/11

Subject to these conditions, a college's board has considerable discretion over its use of public funds. College principals are directly accountable to their board of management but are also responsible to the SFC for ensuring the proper use of grant funding.

17. In their reports on the audits of 2010/11 college accounts, auditors were generally satisfied with colleges' corporate governance and expressed no serious concerns about the composition or effectiveness of colleges' boards of management. Colleges typically had at least one non-executive board member with recent and relevant financial experience, and auditors reported evidence of non-executive board members being proactive in scrutinising and challenging college management.

18. Nonetheless, difficulties can still arise. For example, there have been concerns about standards of governance at Adam Smith College. In March this year, the college's board of management asked the SFC to investigate allegations regarding the college's overall governance arrangements, including its procedures for dealing with staff complaints. In response to that investigation, the college developed an action plan and the SFC is monitoring its implementation. More recently, potential weaknesses in the way in which college funding had previously been managed have emerged, which the Scottish Government is now investigating.

Part 2. The financial standing of colleges

The sector's finances were generally sound in 2010/11, but colleges face risks to their financial sustainability.

Key messages

- The overall financial standing of the college sector in 2010/11 was generally sound. While colleges reported an overall operating deficit of £29 million in 2010/11, exceptional circumstances at the City of Glasgow College account for this. Colleges also reported accumulated surpluses totalling £206 million and had a combined £205 million of cash and cash equivalents as at 31 July 2011.
- There is, however, no consistent trend in the amount of annual surplus or deficit reported by the sector as a whole since 2006/07, and the financial standing of individual colleges differs widely. Some colleges appear more financially sustainable than others but most operate to tight margins so that relatively small variations from plans can affect their ability to achieve a surplus.
- The college sector faces a variety of financial challenges, in the years ahead, that will require them to reduce their costs. Scottish Government revenue grant funding is expected to reduce by £74 million from £545 million in 2011/12 to £471 million in 2014/15 (24 per cent in real terms). There are also a number of cost pressures, including the cost of restructuring, a potential rise in the demand for college places, and costs associated with buildings maintenance and rising energy prices.

19. This part of the report provides an analysis of the college sector's current financial standing based largely on their 2010/11 audited accounts. Assessment of an organisation's financial performance can use a number of different indicators. We focus on:

- Annual operating 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 deficit of £29 million in 2010/11

20. Colleges normally plan to deliver a small surplus each year. In 2010/11, colleges' income totalled £741.6 million and their expenditure amounted to £771.0 million, resulting in an overall operating deficit for the sector of £29.4 million (4.0 per cent of total income).

21. Since 2006/07, there has been no consistent trend in the amount of annual surplus or deficit reported by the sector as a whole. Overall, surpluses were reported in 2006/07, 2007/08 and 2009/10 but deficits were reported in the other two years (Exhibit 3). However, there has been a downward trend over time in the number of colleges reporting surpluses. In 2006/07, 35 out of 39 colleges reported surpluses but this fell to 24 out of 37 in 2010/11.

22. In 2010/11, 24 colleges reported surpluses totalling £12.7 million (Exhibit 4). Colleges' operating surpluses ranged from £1,000 in Banff and Buchan College to £2.0 million in Cardonald College. Four colleges reported surpluses exceeding five per cent of their total income: Coatbridge (11.2 per cent), Cardonald (8.7 per cent), West Lothian (5.3 per cent) and Elmwood (5.1 per cent).

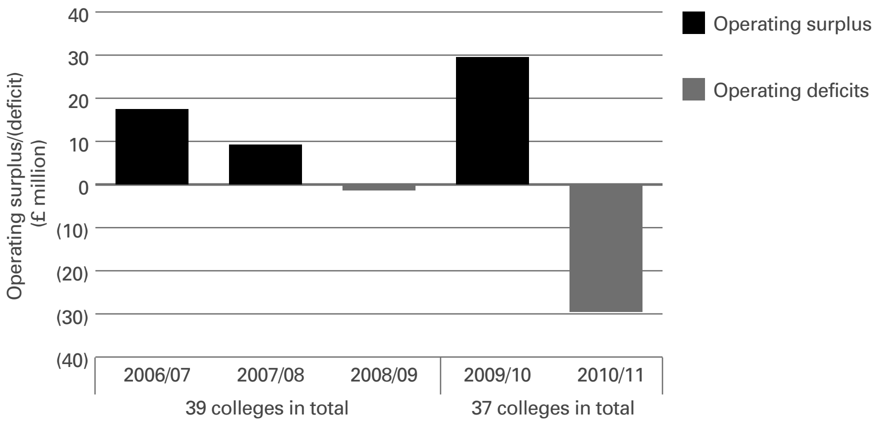
The sector's overall deficit was mostly due to the City of Glasgow College

23. The City of Glasgow College forecast an operating surplus of £0.4 million for 2010/11 at the beginning of the year but reported income of £69.1 million and expenditure of £103.5 million, resulting in an operating deficit of £34.4 million. However, the deficit for 2010/11 does not indicate any

Exhibit 3

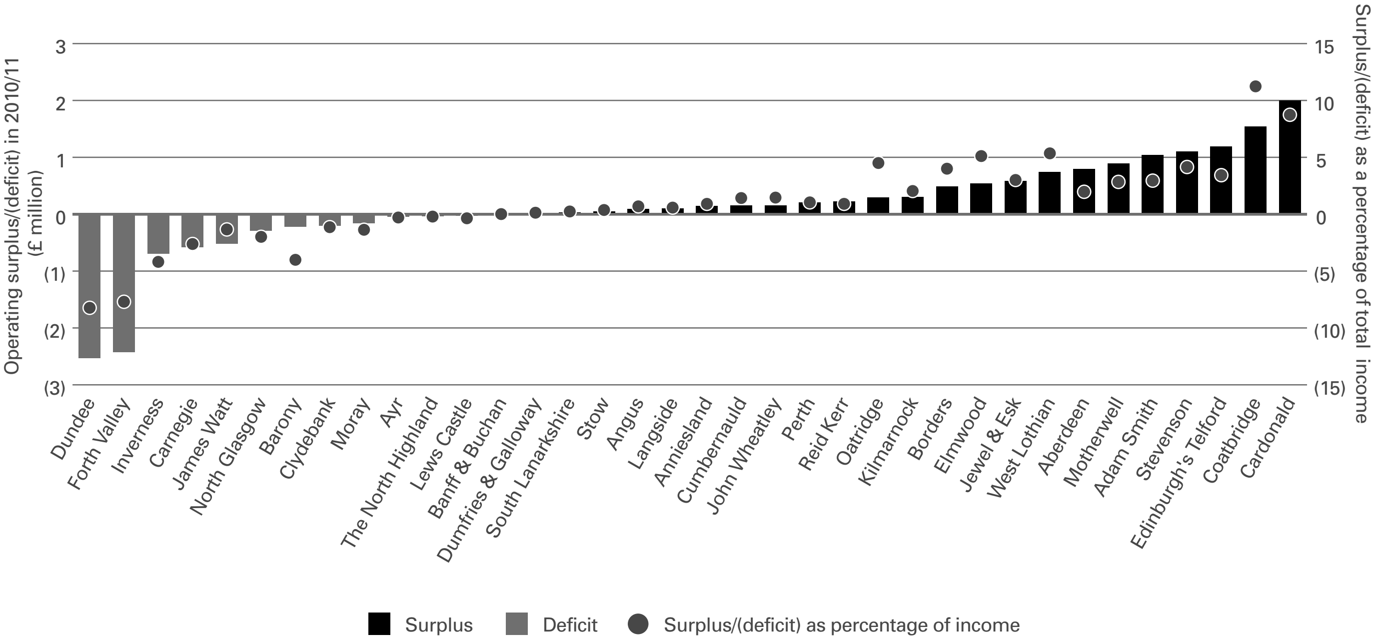
Colleges' operating surpluses and deficits since 2006/07

There is no trend in the sector's overall annual surplus or deficit.



Source: Colleges' audited accounts 2006/07 to 2010/11

Exhibit 4
Colleges' operating position in 2010/11
In 2010/11, 24 colleges reported surpluses and 13 reported deficits.



Note: To enable the surplus or deficit in other colleges to be more easily illustrated, we have not included the City of Glasgow College which reported a deficit of £34.4 million in 2010/11.
Source: Colleges' audited accounts for 2010/11

underlying issues with the college's financial health. The college's accounts attribute the deficit to an accelerated depreciation charge related to the redevelopment of the college's campus, partly offset by the release of deferred capital grants. Without these exceptional items, the college would have reported an operating surplus of £1.3 million for the year.

24. Excluding the City of Glasgow College, 12 colleges reported operating deficits totalling £7.7 million in 2010/11, ranging from £24,000 in Lews Castle College to £2.5 million at Dundee College. Five colleges reported a deficit exceeding two per cent of their income: Dundee College (8.2 per cent), Forth Valley College (7.7 per cent), Inverness College (4.2 per cent), Barony College (4.0 per cent) and Carnegie College (2.6 per cent). Most of these colleges attribute the deficit to management restructuring which they expect will generate future savings (Case study 1, overleaf).

Colleges' accumulated surpluses totalled £206 million at the end of 2010/11

25. A college's annual surplus or deficit is transferred to its Income and Expenditure (I&E) reserve, usually with the intention that any surplus be used to help finance future investments such as improvements to the campus or curriculum. The accumulation of an I&E reserve which takes account of planned investments is therefore good management practice. A surplus balance on the I&E reserve usually indicates that the college can cope with an operating deficit in any one year and still remain viable. A deficit on the I&E reserve could indicate financial problems.

26. The overall net surplus on colleges' I&E reserves was £206.4 million at the end of 2010/11, double the £98.9 million for 2006/07. A total of 34 colleges reported having a surplus on their I&E reserve at the end of 2010/11, ranging from £0.3 million in Inverness College to £33.0 million in Telford College. The four colleges with the largest I&E reserve accounted for almost half of the sector's overall I&E reserve surplus (Exhibit 5, overleaf).

27. Three colleges reported net I&E reserve deficits in 2010/11 totalling £11.6 million. In two of these colleges, with a combined I&E reserve deficit of £10.0 million, the deficit can largely be attributed to repayable advances by the SFC to help support the colleges' estates development programmes. Our analysis of West Lothian College's and Forth Valley College's accounts for 2009/10 and 2010/11 suggests their underlying financial health is reasonably robust and they appear capable of eliminating the I&E reserve deficit and repaying the advance from their own resources. However, at Lews Castle College, one of Scotland's smallest and with limited financial reserves, the SFC provided additional grant support of £0.5 million in 2008/09. This is to help enable the college repay to the SFC £0.8 million over the next five years, following its submission of incorrect Extended Learning Support claims in 2007/08 and 2008/09.[7]

Pension reserves had an overall deficit of £60 million at the end of 2010/11

28. Colleges' pension reserves reflect their share of the assets and liabilities of the Local Government Pension Schemes. These are defined-benefit schemes in which employers and employees contribute to pension funds. A net surplus on the pension reserve means that the value of investments funded from pension contributions exceeds the anticipated pension costs of former and current non-teaching staff.[8] A net deficit is sustainable in the short term because not all liabilities will be due simultaneously. However, unless investment returns increase, pension scheme administrators may need to take longer-term action to address the deficit, for example by increasing contribution rates.

29. Overall, the college sector reported a pension reserve deficit of £59.8 million at the end of 2010/11. Despite recent increases in contribution rates, the deficit has risen roughly sixfold since 2006/07, when it stood at £10.8 million. Reasons for this deterioration include projected increases in the cost of pensions because of the longer life expectancy of retirees, and reduced income from financial investments. Conversely, the UK-wide move from the Retail Prices Index to the Consumer Prices Index as the basis for indexing the value of pensions has had the effect of reducing their costs. A total of 31 colleges reported pension scheme deficits for 2010/11, ranging from £0.5 million (South Lanarkshire College) to £6.6 million (Forth Valley College).[9]

Case study 1

Dundee College

The college reports its deficit in 2010/11 was largely associated with the cost of restructuring.

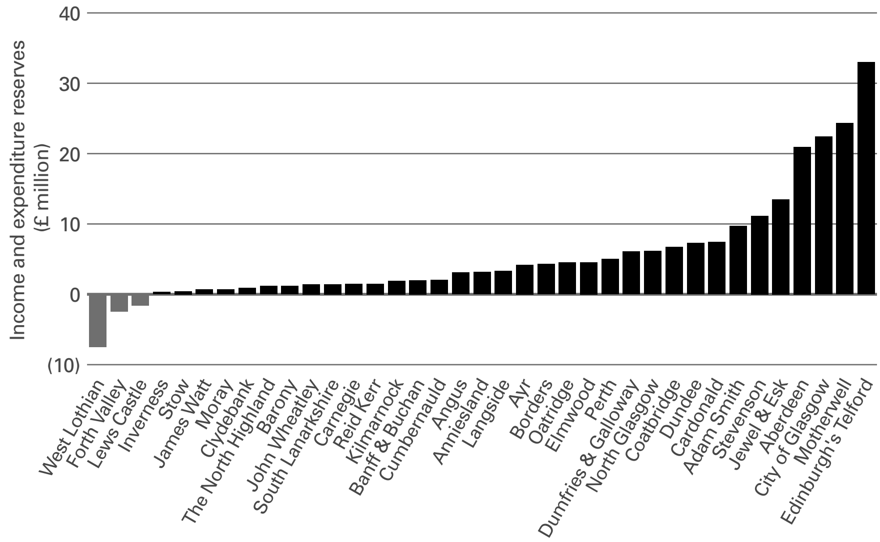
In 2010/11, Dundee College reported income of £30.8 million and expenditure of £33.3 million, leading to a deficit of £2.5 million. The deficit was partly due to the refurbishment of its Gardyne Campus (£0.7 million), as part of a long-term estates strategy to move from five campuses to two. In addition, exceptional restructuring costs, including voluntary severance costs and other pension contributions, related to the early departure of over 100 staff (£1.6 million). The college is forecasting a surplus of £0.1 million in 2011/12, after a further £0.8 million of restructuring costs. The college expects to generate annual savings of around £4.9 million in pay costs and a further £1.5 million in non-pay costs in subsequent years from the restructuring and the fulfilment of its estates strategy.

Source: Dundee College

Exhibit 5

Colleges' income and expenditure reserves in 2010/11

34 colleges reported having a surplus on their I&E reserve at the end of 2010/11.



Source: Colleges' audited accounts for 2010/11

7 Extended Learning Support is an SFC grant which colleges use to provide specialised support for individual students with particular educational support needs.
8 College teaching staff are normally members of the Scottish Teachers' Superannuation Scheme (STSS). As the STSS is an unfunded, defined benefit scheme under which colleges make contributions on a pay-as-you-go basis, the assets and liabilities of the scheme are not reflected in the accounts of individual colleges and are underwritten by the Scottish Government.
9 The 2010/11 accounts of the other six colleges, all members of the North East Scotland Pension Fund, had no pension reserves because actuaries are unable to identify the colleges' share of the pension scheme's assets. The colleges treat the scheme as if it was a defined contributions scheme and make contributions according to actuarial valuations.

Most colleges have significant amounts of cash to meet short-term commitments

30. Colleges' balance sheets indicate they had a total of £204.7 million of cash and cash equivalents (CCE) at the end of 2010/11, representing an increase of £10.6 million on 2009/10.[10] The SFC considers it is good practice for colleges to have not less than 60 days of cash available to meet their immediate financial commitments.[11] Overall, colleges had sufficient CCE on 31 July 2011 to pay for 97 days of expenditure, significantly more than the figure of 78 days at the end of 2006/07.

31. While the sector overall had a significant amount of CCE as at 31 July 2011, this does not necessarily mean that all colleges have large amounts of uncommitted cash which could readily be diverted to other purposes. Colleges need to have sufficient CCE to pay their creditors but the CCE could be falsely inflated as a result of planned payments falling a few days after the financial year-end (31 July) when the CCE position is calculated. Similarly, there may be temporary inflation of a college's CCE position if expenditure is delayed because a construction project is behind schedule.

32. The CCE position as at 31 July 2011 also varied widely among individual colleges, with some having little cash in relation to the scale of their average daily expenditure:

- Carnegie College was the only one to report a CCE deficit (£1.2 million). The college had bank loans and overdrafts totalling £1.6 million at the year-end, which were used to finance exceptional restructuring costs of £0.5 million during 2010/11. The college expects to have reduced its overdraft by £70,000 in 2011/12.
- Five other colleges had insufficient cash to meet 60 days of expenditure, ranging from Reid Kerr with less than one day (£30,000 CCE) to John Wheatley with 47 days (£1.3 million CCE).
- The other 31 colleges had a year-end CCE surplus that was sufficient to meet at least 60 days of expenditure. In these colleges, CCE ranged between £2.0 million (Cumbernauld College) and £26.8 million (City of Glasgow College), and included 12 colleges whose CCE surplus was sufficient to meet at least 120 days of expenditure (Exhibit 6).

Some colleges appear more financially sustainable than others

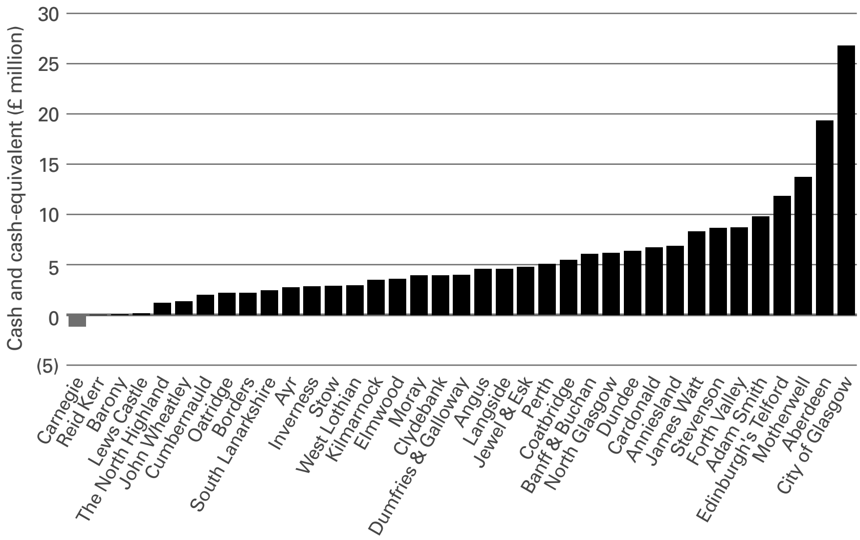
33. Our analysis of colleges' accounts suggests that the sector's financial standing in 2010/11 was generally sound overall, although the financial standing of individual colleges varies widely (Appendix 2). In many cases, colleges' annual operating performance appears sensitive to small differences between actual and planned performance because they rarely plan to achieve operating surpluses which exceed five per cent of their total income. As a result, relatively small changes in activity, or other factors, can reverse a small planned surplus into an actual deficit. There are also some colleges, such as Aberdeen College and Motherwell College, which appear more financially secure because of their accumulation over time of significant I&E reserves and CCE balances.

34. A college's annual accounts help to provide an indication of its financial standing but additional information may be necessary to provide a more complete picture. For example, a college's deficit in one year may be due to it incurring set-up costs for an

Exhibit 6

Colleges' cash and cash equivalents for 2010/11

Cash and cash equivalents at 31 July 2011 varied widely between individual colleges.



Source: Colleges' audited accounts for 2010/11

10 Cash equivalents include assets, such as short-term investments, which can readily be converted to cash.
11 We calculate the number of days' cash available by dividing an organisation's cash balance at the end of the financial year by its daily operating expenditure, ie annual operating expenditure divided by 365.

initiative that will generate income in subsequent years. The SFC therefore supplements colleges' audited accounts with other information, such as financial forecasts, to help provide a more risk-based and rounded view of the sector's financial performance.

35. In particular, the SFC regularly reports to its Audit and Compliance Committee on the financial standing of colleges, including any which require more careful monitoring. This can happen, for example, where the SFC has concerns about the ability of colleges to generate sufficient cash to meet their short-term commitments.

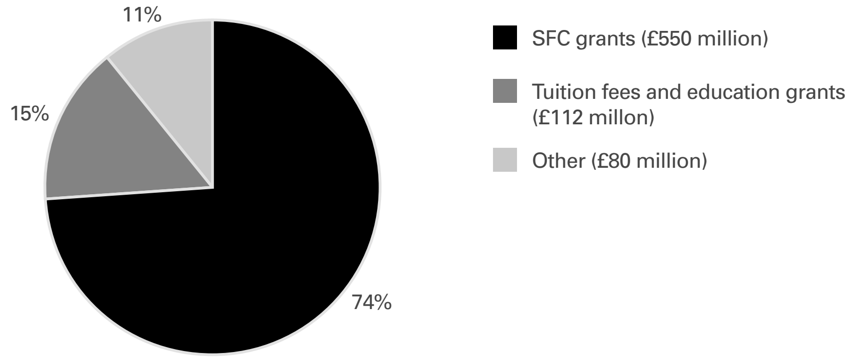
Colleges face significant financial challenges in the years ahead

36. Public sector spending constraints mean that colleges' income will reduce over the next few years and colleges also face a number of other cost pressures, such the rising cost of energy. In addition, planned reforms of the sector, including regionalisation and restructuring (see Part 3), will have cost implications for individual colleges, although these are not fully clear at this stage.

Recent increases in Scottish Government funding are likely to be reversed

37. Between 2006/07 and 2010/11, colleges' total income increased by £88.5 million from £653.1 million to £741.6 million (3.3 per cent increase in real terms). The increase was almost all as a result of increased Scottish Government funding, which rose by £85.9 million from £463.6 million to £549.5 million over the same period (7.8 per cent in real terms). In 2010/11, the Scottish Government, via the SFC, provided the college sector with 74 per cent of its combined income (Exhibit 7).

Exhibit 7
Colleges' income in 2010/11
The SFC provided almost three-quarters of the college sector's total income in 2010/11.



Source: Audit Scotland analysis of colleges' 2010/11 audited accounts

38. All colleges rely heavily on the SFC for their income, with John Wheatley College the most reliant in 2010/11 (89 per cent of its total revenue income) and Oatridge and Barony Colleges the least reliant (both 53 per cent of their total revenue income). Scottish Government funding for the college sector is due to fall over the next few years as public sector spending is reduced. As part of the Scottish Spending Review 2011, in September 2011, the Scottish Government proposed to be reduced its revenue grant funding for the sector from £544.7 million in 2011/12 to £470.7 million in 2014/15 in cash terms, which equates to a real-terms fall of 24.1 per cent (Exhibit 8).[12]

39. Similarly, combined Scottish Government funding for colleges' and higher education institutions' capital projects will reduce from £91.0 million in 2011/12 to £56.4 million in 2014/15, a real-terms reduction of 45.5 per cent. The Scottish Government has subsequently announced additional revenue grant funding of £17.0 million for the college sector in 2013/14, comprising £11.0 million for student support and £6.0 million to provide additional college places, but the outlook beyond 2011/12 remains one of significant reductions in the public sector's funding to colleges.[13]

Colleges' income from other sources may also decline

40. Colleges' income from other sources may also fall over the next few years:

- Income from tuition fees charged to students who do not normally live in Scotland and from other education contracts rose from a combined £104.0 million in 2006/07 to £112.1 million in 2010/11 but colleges expected this to fall to £107.0 million in 2011/12. The continuing economic downturn means that fewer people from the rest of the UK who have to pay their course fees may be able to do so. Similarly, constraints on immigration may also limit colleges' ability to attract fee-paying, non-EU students.

12 *Scottish Spending Review 2011 and Draft Budget 2012–13*, Scottish Government, September 2011.
13 *Scottish Draft Budget 2013-14,* Scottish Government, September 2012.

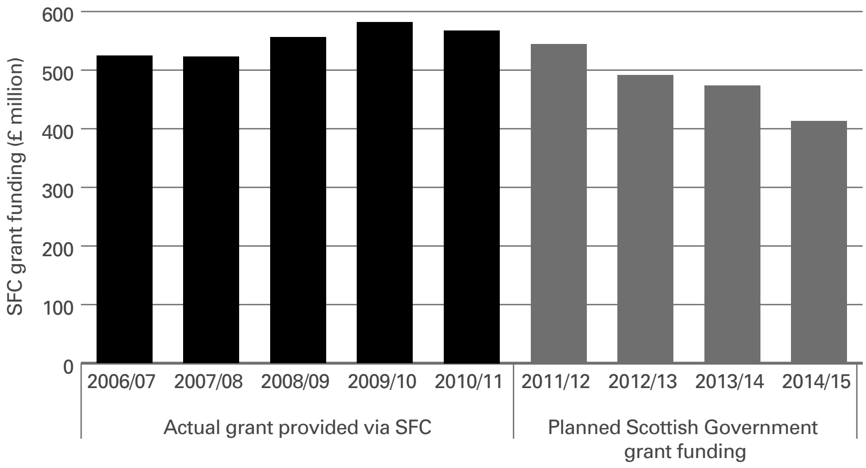
Colleges generated income of around £10.6 million from the 6,000 non-EU students who studied in Scotland during 2010/11.

- Colleges' other sources of income decreased from £85.8 million in 2006/07 to £80.3 million in 2010/11 and were expected to reduce by another £15.9 million to £64.4 million in 2011/12 (33.3 per cent in real terms). A significant proportion of this income is from EU grants but this reduced from £22.3 million in 2006/07 to £13.5 million in 2010/11 (44.9 per cent in real terms). The 2004 and 2007 expansions of the EU and the planned expansion to include Croatia in 2013 may result in further reductions in EU income as many of the newly admitted countries have higher overall levels of social deprivation than Scotland.

Exhibit 8

SFC grant funding for colleges

Revenue grant funding is planned to fall by £131.1 million in real terms between 2011/12 and 2014/15



Note: The chart shows revenue grant funding in 2011/12 prices as this was the base year used by the Scottish Government in its Scottish Spending Review 2011.

Source: Colleges' audited accounts (actual grant provided) and Scottish Government (planned grant funding)

Increased demand for college places may generate extra costs

41. The current economic climate and high unemployment levels are encouraging more people in Scotland to study in a college. While the SFC does not record the numbers of people applying to attend college, the volume of learning activity provided by colleges rose by 5.5 per cent between 2009/10 and 2011/12. However, public sector spending reductions mean that the level of SFC grant support per student is likely to be reduced. Extra demand for places will create pressure on colleges to manage that demand within existing or diminishing resources.

42. In Scotland around 70,000 people aged 16–24 are not in employment or full-time education (16.2 per cent of 16–24 year olds).[14] The Scottish Government has therefore asked the SFC to ensure colleges have resources to contribute to the national policy objective, that all 16–19 year olds not otherwise in employment are guaranteed an education or training place. This may generate, however, additional cost pressures for colleges. In November 2011, Scotland's Colleges, the national body that represents the views of colleges, gave evidence to the Scottish Parliament's Education and Culture Committee. It said that, based on current cost models and configurations, if colleges 'took on one in four 16–19 year olds not in employment, education or training, and continued to service 18–24 year olds to the same level, there would be no funded provision left for older learners who make up over half of learners over 16 years of age'.[15]

Staff costs may continue to rise

43. Between 2006/07 and 2010/11, colleges' staffing costs rose by 4.6 per cent in real terms. In 2010/11, staff costs accounted for 63 per cent of the college sector's overall expenditure (Exhibit 9, overleaf).

44. Each college conducts its own negotiations with its staff about pay, terms and conditions. While some colleges have introduced pay freezes for their staff in recent years, the pay freeze only applies to annual cost of living rises but not incremental increases between pay scale points. Staff pay costs may therefore be expected to increase, although this has been offset over the last few years by most colleges reducing their staff numbers.

14 *Youth Unemployment Statistics (16–24 years) Summary Briefing*, Scottish Government, August 2012.
15 *Supplementary Evidence to the Scottish Parliament's Education and Culture Committee on the Draft Budget and Spending Review proposals*, Scotland's Colleges, November 2011.

Building maintenance and energy costs may increase

45. Since 2001/02, colleges have either newly built or undertaken major refurbishments of 24 campuses. Some 30 per cent of the college property estate is now in 'as new' condition but 37 per cent is either at serious risk of breakdown, or requires major repair or replacement over the next three to five years.[16]

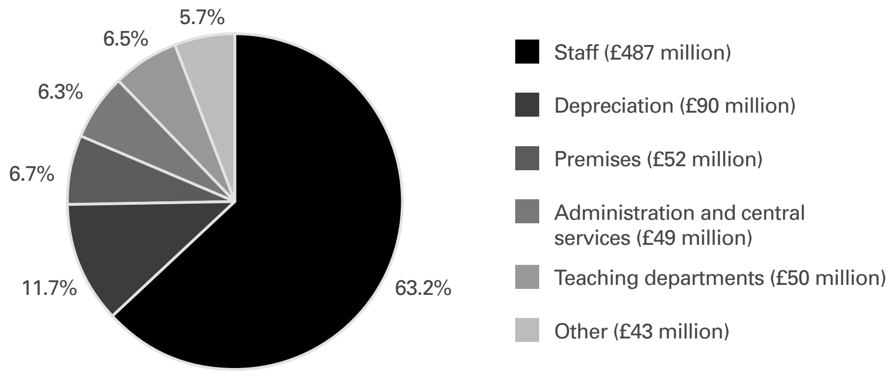
46. The reductions in public sector capital funding available to colleges over the next three years mean that colleges are unlikely to be able to sustain the same level of new-build campuses as in recent years. Older buildings are likely to continue in use for longer and to require more costly maintenance. While new buildings may require less maintenance in the short term, it is important that colleges continue to invest in their maintenance so that costly maintenance backlogs do not develop. Colleges' expenditure on property maintenance fell by 5.2 per cent from 2009/10 to 2010/11, from £16.2 million to £15.4 million.

47. Modern buildings are usually more energy efficient than older ones. Between 2006/07 and 2008/09, public sector spending on energy rose by 21 per cent in real terms to £322 million. Electricity and gas prices rose by an average of 28 and 30 per cent respectively over these three years. Although energy prices fell in 2009/10, forecasts say they will rise again over the next decade.[17] Energy costs are therefore likely to continue to be a significant financial pressure on colleges. However, their declining budgets may mean colleges will find it difficult to introduce energy efficiency measures, because of the upfront spend-to-save investment which may be required.

Exhibit 9

Colleges' operating expenditure in 2010/11

Staffing costs accounted for 60 per cent of the sector's total operating expenditure in 2010/11.



Source: Audit Scotland analysis of colleges' 2010/11 audited accounts

16 *Annual Report and Accounts 2011/12*, Scottish Funding Council, June 2012.
17 Policy impacts on prices and bills: question and answer tool, Department for Energy and Climate Change, www.decc.gov.uk

Part 3. Current developments

The college sector faces significant structural reform.

Key messages

- Current developments include the creation of 13 college regions by 2013 and a reduction in the number of colleges from 37 to no more than 23. The structural reforms will require careful handling, and management of the reform process will demand strong leadership at national, regional and local level. For example:
  - further work is needed to identify and articulate the costs and benefits of regionalisation, including restructuring
  - regional outcome agreements will need further development to allow government to assess more accurately the sector's contributions to national objectives for education and learning
  - boards will need to move quickly to develop strategic planning for education provision, in their regions, that contributes to the achievement of national objectives while at the same time meeting the local needs of students and employers
  - existing colleges will need to manage mergers and federations well, to deliver the efficiency savings that are necessary because of reduced public sector funding.
- Regionalisation and the development of outcome agreements have the potential to bring a more strategic approach to managing the sector. However, there are opportunities for the SFC to review how it monitors and supports the financial sustainability of the sector.

The Scottish Government is planning significant structural reforms

There are plans to reform post-16 education

48. In September 2011, the Scottish Government published *Putting Learners at the Centre: Delivering our Ambitions for Post-16 Education (Putting Learners at the Centre)* setting out its proposals to reform post-16 education provision. The paper emphasised the Scottish Government's view of the importance of colleges in contributing to the development of a highly educated and skilled workforce. Its objectives included:

- placing more emphasis on the student, with the 'learner journey' being better tailored to meet the needs of the individual
- widening access to post-16 education so that, for example, it is more open to people with disabilities and those who come from the most deprived areas
- better aligning of the provision of learning and skills with the needs of employers and the economy.

49. In particular, *Putting Learners at the Centre* sets out the Scottish Government's desire for more effective and sustainable delivery of learning and skills through college regionalisation and restructuring; greater sharing of services and partnership working; and rationalisation of courses, for example where they do not meet the needs of the labour market or where there is unnecessary duplication. The Scottish Government also plans to introduce a more robust approach to performance management by setting clear outcomes that institutions must deliver in return for their public sector funding.

50. In July 2011, the Scottish Government appointed Professor Russel Griggs to conduct a review of college governance. The *Report of the Review of Further Education Governance in Scotland* (the Griggs Review) was published in January 2012.

The sector is moving to a regional basis, with mergers the preferred option

51. In February 2012, the Scottish Government announced that, in future, colleges will be organised in 13 regions. Ministers chose not to exercise their statutory powers to compel mergers between colleges, but the Scottish Government has emphasised its expectation that colleges in each region should consider the potential for mergers to achieve financial efficiencies and better outcomes for students. The Scottish Government has also welcomed other forms of collaboration between colleges in a region, such as federations.

52. Mergers are likely to reduce the number of incorporated colleges from 37 to no more than 23 by August 2013. The 13 regions will be of greatly different geography, staffing levels and expenditure (Appendix 3). There are currently plans for the regions to comprise:

- Nine regions with one college, including four that already contain one college (Ayrshire, Borders, Central, Dumfries & Galloway, Edinburgh, Fife, Tayside, West, West Lothian).
- Two regions comprising federations of colleges (Aberdeen & Aberdeenshire, Lanarkshire).
- One region which will see some existing colleges merging, and then acting in federation with others (City of Glasgow).
- One region comprising the colleges making up the University of the Highlands and Islands.

Outcome agreements will hold regional boards to account

53. The Scottish Government plans to introduce legislation to establish regional boards responsible for strategic oversight of each of the 13 regions. Ministers have invited a number of individuals (some of whom currently chair a college board) to lead strategic planning and structural change in each region. In single-college regions, either the existing college board, or the college board created from the merger of two or more colleges, will be the regional board. In multi-college regions, there will be a new regional board, with the board of the University of the Highlands and Islands becoming the regional board for that area.

54. The Scottish Government plans to introduce a Bill in the current Parliamentary session. If passed, legislation may result in the new regional boards formally coming into effect during the 2013/14 academic year. The Scottish Government expects that regional boards will be responsible for:

- entering into a regional outcome agreement with the SFC, detailing how the region will contribute to the Scottish Government's policy objectives for college-based education. Regional boards in multi-college regions will also develop local outcome agreements that define the contribution of individual colleges to the region's outcomes
- deciding how funding received within the region should be distributed. For single-college regions, this means determining the allocation of budgets between individual college departments and activities. In multi-college regions, this will involve determining the funds provided to each college in accordance with its local outcome agreement
- strategic planning of the education provided by each college in the region
- providing a focal point for engagement with regional partners, such as local authorities and community planning partnerships.

55. In multi-college regions, individual college boards will be responsible for managing the college but the regional board will hold them to account for the delivery of their local outcome agreement. In single-college regions, the regional board will be responsible for managing the college. All regional boards will be held accountable to the SFC for the delivery of regional outcome agreements.

56. The SFC has now agreed outcome agreements with each college for 2012/13 covering five overarching outcomes (Exhibit 10). In 2012/13, colleges in each region will have joint responsibility for the region's performance but once established, regional boards will be accountable for the delivery of outcomes. The outcome agreements currently focus on planning and

Exhibit 10
Outcome agreements in the college sector
The detail of each outcome agreement may differ between regions but all will cover five key areas.

Outcome	Purpose
Efficient regional structures	The outcome agreement should set out plans for agreeing and facilitating structural change, to enable the delivery of future efficiencies.
Right learning in the right place	The outcome agreement should set annual targets for learning delivered by the region. These include any national specialisms offered, and the maintenance of access to further learning for pupils who attended, or are still attending, schools where a high proportion of former pupils do not advance to education, training or employment.
High-quality and efficient learning	The outcome agreement should set out how the region will maintain and enhance quality; improve attainment; and deliver efficient progression from national qualifications through to articulation to with degree-level study. The regional grouping of colleges should establish a regional baseline of recent performance in order to assess progress.
A developed workforce	The outcome agreement should set out how the regional grouping of colleges will improve engagement with employers, employability and the progression of learners into employment within the region. In the future, regions should set targets for the number of students supported into employment and other positive destinations.
Sustainable institutions	The outcome agreement should set out how the college will manage itself in a sustainable manner and comply with good governance practice.

Source: *Delivering college outcome agreements AY 2012-13*, Scottish Funding Council, June 2012 other steps needed to implement structural change. They will need to be developed in future to better reflect the outcomes expected from colleges' education and training activities (see paragraphs 62 to 64).

Reforms will require careful management

57. The college sector is facing significant change over the next few years as colleges restructure and public sector funding reductions take effect. These changes present a number of risks.

The expected benefits and costs of the Scottish Government's reform plans are unclear

58. The Scottish Government has not yet published a quantified assessment of the overall costs of the reform of the college sector and the expected benefits. Regionalisation can promote a more strategic approach to the delivery of education by the sector as a whole, and the reforms, including college mergers, have the potential to deliver efficiency savings and economies of scale. This will require the Scottish Government to make clear the intended benefits and costs of reform, and how these will contribute to its strategic objectives for the sector as set out in *Putting Learners at the Centre*.

59. To inform its scrutiny of draft legislation, the Scottish Parliament requires a financial memorandum to be attached to each Bill, setting out the likely cost of the policy objectives that the Bill addresses. While the Scottish Government has contributed an extra £15 million to support regionalisation in 2012/13, it has also underlined that colleges will need to draw on their own resources when preparing for regionalisation.[18] It is important, therefore, that the financial memorandum for the Bill establishing regional boards provides a detailed assessment of the benefits and costs of regionalisation, including the funding of merger costs.

Regional boards need to hit the ground running

60. The establishment of regional boards depends on the successful conclusion of the Government's legislative proposals. The new regional leads, working with existing college boards, have an important role in providing leadership in the merger of colleges and the establishment of federations, and in supporting complex change management. Equally, college leaders will need to ensure that their strategies for course provision reflect both the Scottish Government's priorities, including the education and learning outcomes it expects, and demands from learners and employers in their region.

61. In particular, the college sector will need to develop effective links with community planning partnerships (CPPs) to ensure that the education and learning that colleges provide integrate with the wider needs of the region. This may be especially challenging given that the geographic boundaries of the new college regions are not all coterminous with local authorities or other partners. As a result, the same regional board could be represented on more than one CPP. These regions will need to develop a clear understanding of the effect that different spending options will have on their relative contribution to the education and learning objectives of each CPP.

62. The Audit Scotland report *The role of boards* is also relevant to the college sector.[19] The report highlighted that board members need to scrutinise effectively their organisation's risks, financial management and performance and also need to be able to make decisions based on clear evidence about performance and priorities. Successful arrangements depend on having boards with a mix of people with the right skills and expertise, and an effective appointments process to ensure this.

Outcome agreements need to develop further

63. Performance management systems need to be able to demonstrate value for money and progress against national strategic objectives and priorities for education and learning. The development of outcome agreements for the sector has the potential to achieve this but the pilot outcome agreements will need further refinement.

64. The first set of outcome agreements, published in October 2012, concentrate on input measures such as the amount of learning delivered by each region, and process measures such as the development of plans for agreeing and facilitating structural change. This approach is understandable in the short term, as structural reform is implemented. But it is important that the outcome agreements continue evolving to provide a greater focus on colleges' contribution to the development of a highly educated and skilled workforce.

65. It can take several years before the outcomes of public sector policy implementation can be determined, and the SFC will need to think carefully about whether some interim indicators are necessary to chart progress towards the outcomes. The SFC will also need to consider what data collection systems it needs to assess performance.

Managed well, mergers have the potential to deliver savings

66. Mergers can be costly, complex and time-consuming but, as the City of Glasgow College merger demonstrates (Case study 2), they can also generate efficiency savings and other benefits.

18 Presentation by the Cabinet Secretary for Education and Lifelong Learning to the annual conference of the Association of Scotland's Colleges, June 2012.
19 *The role of boards*, Audit Scotland, September 2010.

67. Audit Scotland recently reported on 18 public sector mergers that occurred between 2008 and 2011.[20] The report's conclusions and recommendations provide useful advice to colleges in managing their own mergers and a number of its key messages apply equally to the regionalisation process. For example:

- strong, resilient leadership is vital from the outset to drive the process forward. The absence of permanent leaders early in the planning and implementation stages risks delaying decision-making and the development of key elements such as the long-term vision, objectives and structure of the new body

- colleges should be objective and realistic about the academic and financial benefits that change can generate, and the timescale over which benefits will become evident. It is important to establish a bank of evidence about the position prior to any change in order to benchmark the performance improvements and other benefits planned from the merger process

- colleges should not confine merger planning to the period leading up to the vesting date for the new college. Some issues may take several years to resolve, such as introducing a common set of staff terms and conditions and developing a shared culture for the new organisation. It is important that colleges develop a clear strategy for ensuring that business-as-usual continues after the creation of the new organisation. Plans should be in place for subsequent organisational development to focus on delivering improvements to the quality of education provided to students

- keeping staff regularly informed about the development of the new organisation and seeking feedback on key issues can help merged bodies to assess performance, demonstrate change, or identify what service improvements are needed. Members of staff are likely to experience a variety of emotions in the run-up to mergers but it is important that they feel engaged with the new organisation and the services they deliver.

Case study 2

The creation of the City of Glasgow College

The college was created in September 2010 from the merger of Central College Glasgow, Glasgow Metropolitan College and Glasgow College of Nautical Studies. It has a portfolio of over 2,600 courses and around 40,000 students.

The merger cost £8.6 million, mainly in voluntary severance costs. By March 2012, 113 staff had accepted voluntary severance out of the 1,101 people who transferred to the new organisation. The college plans to reduce staff numbers further, to 930 by 2012/13.

The college estimates the merger will generate recurrent annual savings of £5.8 million. Of this £4.6 million arises from reduced staff costs, with the balance being generated from course rationalisation and reduced volumes of teaching.

The college considers that educational benefits will include a comprehensive curriculum with more employment-focused, interdisciplinary subjects; a better learning environment with more accessible learning resources and well-resourced support services; and better use of technological innovation. The college plans to start building a new £200 million campus in 2013.

The college's main learning points relate to the substantial management time required to plan and carry through the merger, and the need for regular and open communication with staff about progress. It has written a report on its merger experience, submitting it to the Cabinet Secretary for Education and Lifelong Learning.

Source: City of Glasgow College

68. In September 2012, the SFC published its own guidance on managing structure change in the college sector, including the management of mergers and federations. The report draws on Audit Scotland's mergers report and should be a useful information source for colleges.[21]

69. Ensuring the sustainability of the college sector is essential. Our analysis of 2010/11 accounts indicates that the overall financial standing of colleges is generally sound. But the scale of public sector funding reductions means that they, and the SFC, will need to address some significant challenges to ensure the continued financial sustainability of the sector.

70. Unprecedented spending cuts will require colleges to think seriously about how to reduce their costs. Colleges will need to take a strategic approach to assessing the quality and

20 *Learning the lessons of public body mergers: good practice guide*, Audit Scotland, June 2012.
21 *Guidance on mergers and federations*, Scottish Funding Council, September 2012.

quantity of education they are able to deliver for the money available. This will require colleges to have a clear understanding of their costs, and how they differ with changes in activity.

71. The number of full-time equivalent staff employed by the sector fell from 13,087 in 2009/10 to 12,612 in 2010/11 (3.6 per cent). Staff costs are on average about 60 per cent of annual expenditure, so it is likely that colleges will need to make savings through reducing staff numbers, based on a clear assessment of the workforce numbers and skills needed in the future. Our report *Scotland's public finances: addressing the challenges*, however, noted that a number of other public bodies have lost senior staff recently, taking with them significant corporate knowledge and experience which will be difficult to replace in the short term.[22]

72. Since their incorporation, the SFC has generally overseen colleges on a college-by-college basis, providing additional support to individual colleges when necessary. Regionalisation and the development of outcome agreements have the potential to bring a more strategic approach to managing the sector, including the management of resources.

73. The SFC has the potential to play a more proactive role in monitoring and supporting colleges' efforts to achieve financial sustainability in the years ahead. In particular, there are opportunities for the SFC to look again at how it monitors the financial performance of existing colleges to consider whether other indicators, such as the condition of college buildings, would help identify regions whose financial sustainability is most at risk. The SFC should use this analysis to help determine the allocation across the sector of any additional public sector funds to support regionalisation and mergers.

The remit of the Further Education Strategic Forum has still to be determined

74. Ministers have accepted a recommendation by the Griggs Review that it set up a Further Education Strategic Forum to provide leadership and strategic guidance to the sector. The Scottish Government has still to confirm the precise remit of the forum but it is important that its aims and objectives are clear, and that it complements the SFC's role in providing guidance and oversight to the college sector.

22 *Scotland's public finances: Addressing the challenges*, Audit Scotland, August 2011.

Appendix 1.

Glossary of terms

Term	Meaning
Accounting year	In the college sector, this runs from 1 August to 31 July. This is also the same period as colleges' academic year. This is different from the financial year used by the SFC (1 April to 31 March).
Accumulated surplus/(deficit)	Generally, this refers to the surplus/(deficit) shown in the college's income and expenditure (I&E) reserve.
Annual accounts	The annual accounts of a college provide the financial position for a financial year. The main elements of the accounts include: • an income and expenditure statement for the year • a balance sheet as at the financial year end showing the college's assets and liabilities • a cashflow statement • the auditor's opinion on the accounts.
Association of Scotland's Colleges	The Association, whose trading name is Scotland's Colleges, is a charity that supports, represents and promotes colleges.
Break-even	Where the college's income equals expenditure.
Capital grants	Payments by the SFC to colleges for securing or improving assets (eg, buildings or IT equipment).
Cash terms	The value of money at the time income or expense was incurred (see Real terms overleaf).
Financial Forecasting Return	Every college completes this and returns it to the SFC by 30 June each year. It duplicates the format of the annual accounts and includes the forecast year-end position for the current year and the next three years.
Financial security	The SFC defines a financially secure college as one that, on a continuing basis, is able to generate modest operating surpluses reliably, and accumulate a reasonable level of financial reserve. The college must also generate sufficient cash to finance its operations and meet its liabilities.
Governance	The framework of accountability to users, stakeholders and the wider community, within which the organisations take decisions, and lead and control their functions, to achieve their objectives.
Income	For colleges this is generally of two types: grants from the SFC or funds that the college has earned from its own activities.

Term	Meaning
Income and expenditure reserve	The surplus (or deficit) produced by a college at the year-end is transferred to the income and expenditure reserve. In effect, this represents the accumulated position for the college from all of its years in existence. A positive amount indicates that the college is able to finance any operating deficit and remain a going concern. A negative amount could indicate financial problems.
Income and expenditure statement	One of the primary financial statements produced by every incorporated college. It lists the main income and expenditure items.
Incorporated college	The colleges that are incorporated under the Further and Higher Education (Scotland) Act 1992 operate as independent organisations, each with their own board of management. The unincorporated colleges which the SFC funds differ from incorporated colleges as they have no separate legal identity, being either privately owned, or run on behalf of trustees or the local authority.
Operating deficit	Where the college's expenditure is greater than its income in a financial year.
Operating surplus	When a college's income is greater than its expenditure in a financial year.
Real terms	Figures that have been adjusted for changes in the purchasing power of money over time. We calculated real terms values in this report taking 2011/12 as the base year, and using factors published by HM Treasury (See Cash terms on previous page).
Restructuring costs	Costs incurred by a college when undergoing a fundamental change in the way it conducts its business. A significant element of restructuring costs is often voluntary severance costs and other pension contributions relating to reductions in staff numbers.
Revenue grant	Grants given by the SFC to colleges to pay for recurring costs such as staff pay.

Appendix 2.

Financial performance of colleges 2010/11

College	Operating surplus/ (deficit) (£ million)	Operating surplus/ (deficit) as percentage of income (%)	Cash and cash equivalents (£ million)	I&E reserve (£ million)	Pension reserve (£ million)
Aberdeen	0.791	2.0	19.350	20.950	Nil
Adam Smith	1.039	3.0	9.809	9.706	(3.808)
Angus	0.090	0.7	4.584	3.090	Nil
Anniesland	0.149	0.9	6.855	3.162	(0.850)
Ayr	(0.046)	-0.3	2.757	4.195	(0.705)
Banff & Buchan	0.001	0.0	6.055	2.042	Nil
Barony	(0.219)	-4.0	0.060	1.192	(0.521)
Borders	0.491	4.0	2.222	4.326	(4.406)
Cardonald	1.997	8.7	6.728	7.411	(0.498)
Carnegie	(0.577)	-2.6	(1.174)	1.506	(1.985)
City of Glasgow	(34.385)	-49.7	26.818	22.421	(2.928)
Clydebank	(0.204)	-1.1	3.941	0.898	(1.578)
Coatbridge	1.539	11.2	5.455	6.672	(0.884)
Cumbernauld	0.152	1.4	1.979	2.027	(1.026)
Dumfries & Galloway	0.017	0.1	3.982	6.082	(1.805)
Dundee	(2.532)	-8.2	6.365	7.277	Nil
Edinburgh's Telford	1.188	3.4	11.849	32.981	(3.539)
Elmwood	0.543	5.1	3.606	4.559	(0.780)
Forth Valley	(2.427)	-7.7	8.715	(2.484)	(6.550)
Inverness	(0.694)	-4.2	2.851	0.307	(4.084)
James Watt	(0.519)	-1.3	8.319	0.685	(2.907)
Jewel & Esk	0.580	3.0	4.767	13.457	(2.100)
John Wheatley	0.155	1.5	1.336	1.426	(0.841)
Kilmarnock	0.299	2.0	3.468	1.919	(1.803)

College	Operating surplus/ (deficit) (£ million)	Operating surplus/ (deficit) as percentage of income (%)	Cash and cash equivalents (£ million)	I&E reserve (£ million)	Pension reserve (£ million)
Langside	0.101	0.6	4.594	3.297	(0.849)
Lews Castle	(0.024)	-0.4	0.148	(1.572)	(1.125)
Moray	(0.160)	-1.4	3.930	0.687	Nil
Motherwell	0.889	2.8	13.711	24.326	(1.232)
North Glasgow	(0.288)	-2.0	6.179	6.147	(0.526)
Oatridge	0.292	4.5	2.220	4.524	(0.596)
Perth	0.204	1.0	5.065	4.980	Nil
Reid Kerr	0.222	0.9	0.030	1.512	(1.854)
South Lanarkshire	0.028	0.2	2.440	1.438	(0.495)
Stevenson College	1.103	4.1	8.656	11.152	(2.416)
Stow	0.049	0.4	2.902	0.428	(2.127)
North Highland	(0.032)	-0.2	1.185	1.169	(3.373)
West Lothian	0.738	5.3	2.950	(7.520)	(1.599)

Appendix 3.

College regions

By August 2013, colleges will be organised around 13 regions of greatly different geography, staffing levels and expenditure.

Proposed structural reform[1]	Region	Current colleges	Staff (FTE in 2010/11)	Expenditure (£m in 2010/11)
Four regions already contain one college and will be unaffected by mergers	Borders	Borders	208	11.8
	Central	Forth Valley	627	33.9
	Dumfries & Galloway	Dumfries & Galloway	237	13.1
	West Lothian	West Lothian	248	13.1
Single colleges will be created from mergers in five regions	Ayrshire	Ayr Kilmarnock James Watt (Kilwinning campus)[2]	820	45.9
	Edinburgh[3]	Edinburgh's Telford Jewell & Esk Stevenson	1,059	77.7
	Fife	Adam Smith Carnegie Elmwood (non-land based courses only)[2]	1,126	61.2
	Tayside	Angus Dundee	851	46.2
	West	Clydebank Reid Kerr James Watt Inverclyde campus[2]	1,088	66.2
Two regions will comprise federations of colleges	Aberdeen & Aberdeenshire	Aberdeen Banff & Buchan	759	52.5
	Lanarkshire	Cumbernauld Motherwell South Lanarkshire Coatbridge	1,203	64.9

Proposed structural reform[1]	Region		Current colleges	Staff (FTE in 2010/11)	Expenditure (£m in 2010/11)
The Glasgow region will comprise three colleges formed from mergers which will then act in federation with each other	Glasgow	City Centre	City of Glasgow	1,084	103.5
		North-East	John Wheatley North Glasgow Stow	636	38.6
		South-West	Anniesland Cardonald Langside	928	54.5
		Total		2,648	196.6
One region will comprise the five incorporated colleges and 13 other colleges and research institutes that make up the University of the Highlands and Islands	The Highlands and Islands		Inverness Lews Castle Moray North Highland Perth	1,261	70.5

Notes:
1. Barony, Elmwood and Oatridge Colleges merged with the Scottish Agricultural College on 1 October 2012 to form Scotland's Rural University College, a new higher education institute focused on rural and land-based education.
2. In February 2012, the SFC provided colleges with indicative grant figures for 2012/13 which included a break-down for those colleges which are expecting to be split and merged with others. We have apportioned staffing numbers and 2010/11 figures using the same percentage splits.
3. Edinburgh's Telford, Jewel and Esk and Stevenson Colleges merged on 1 October 2012.

Scotland's colleges
Current finances, future challenges

If you require this publication in an alternative format and/or language, please contact us to discuss your needs.

You can also download this document in PDF, black and white PDF or RTF at:
www.audit-scotland.gov.uk

AUDIT SCOTLAND

Audit Scotland, 110 George Street, Edinburgh EH2 4LH
T: 0845 146 1010 E: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk

ISBN 978 1 907916 75 5 AGS/2012/6

RECYCLED
Paper made from recycled material
FSC® C023105

This publication is printed on 100% recycled, uncoated paper