

Scottish Funding Council

Annual Audit Report 2012-13

June 2013



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1. Executive Summary

Introduction

The Auditor General for Scotland appointed Grant Thornton LLP as auditors to the Scottish Funding Council (the Council) under the Public Finance and Accountability (Scotland) Act 2000 for a five year period from 2012. This is the second year of our appointment.. This report summarises the findings from our audit work for the year ended 31 March 2013.

Our responsibilities

It is a condition of our appointment that we meet the requirements of the Code of Audit Practice, which is approved by Audit Scotland and the Auditor General for Scotland. The most recent Code was published in May 2011 and applies to audits for financial years starting on or after 1 April 2011.

The Code of Audit Practice highlights the special accountabilities that are attached to the conduct of public business and the use of public money. This means that public sector audit must be planned and undertaken from a wider perspective than the private sector. We are therefore required to provide assurance, not only on the financial statements and annual governance statement, but also on Best Value, use of resources and performance.

Our Annual Report

This report summarises the findings from our 2012-13 audit of the Scottish Funding Council. The scope of our work was set out in our Audit Approach Memorandum, which was presented to the Audit Committee on 12 December 2012.

The main elements of our audit work in 2012-13 have been:

- the audit of the financial statements, including a review of the annual governance statement
- a review of corporate governance arrangements, internal financial controls and financial systems
- a review of the Council's response to Audit Scotland's national study reports.

The key issues arising from these outputs are summarised in this annual report.

Overall Conclusions

The key findings emerging from each aspect of our work during 2012-13 are detailed on page 4. Overall, the Council is in good financial health with a strong general reserves position of £11.1 million. There have been significant changes within the further education sector with the introduction of Regionalisation. The introduction of outcome agreements has been a fundamental change for both the higher and further education sectors and the Council. In response, the Council has undertaken significant organisational change to align their resources to its strategic priorities and is developing its performance management framework.

Acknowledgements

We would like to take this opportunity to record our appreciation for the kind assistance provided by committee members and officers of the Council during our audit.

Key Findings

Reporting Area	Our Summary
Financial Statements	<ul style="list-style-type: none"> We intend to give an unqualified opinion on both the financial statements of the Council and on the regularity of transactions undertaken for the 2012-13 financial year.
Financial Position	<ul style="list-style-type: none"> The key source of income for the Council is the Scottish Government. In 2012-13, the Council received grant-in-aid totalling £1,675m, an increase of £15m (1%) from 2011-12. There has been a reduction in funding to the college sector and an increase in funding to the higher education sector. The Council has identified running cost savings in excess of £800k, these are off-set in the current year due to voluntary severance costs of £684k. The Council has a general reserves balance of £11.1m, with a reported deficit of £7.8m recorded in the current financial year.
Governance	<ul style="list-style-type: none"> Good progress has been made in agreeing Outcomes agreements for both the HE and FE sectors during the year. In addition, the Council made significant changes to its operating arrangements to better reflect the move to outcome agreements for delivering the government's education priorities and to differentiate funding. Outcome agreements, and the revised administrative arrangements to support them are, however, at the early stages of development and implementation and we expect further refinement of these arrangements in the coming year. The further education sector is in the process of implementing reform to create regional structures and the Council faces a significant challenge in managing and supporting institutions through the merger process. Our audit confirms that the Council has reviewed its arrangements to support this process during the year in line with the Audit Scotland report on managing mergers in the public sector and confirmed that its arrangements comply with good practice requirements.
Performance	<ul style="list-style-type: none"> The Council has completed a self-evaluation of its arrangements for discharging its duty to achieve Best Value in its use of public funds. Our audit confirms that the Council has good arrangements for demonstrating best value. The Council is in the process of developing its performance management framework to better link activities to outcomes to reflect the move to outcome based funding models. We will continue to monitor these arrangements throughout the period of our appointment. We have recommended that the Council should take the opportunity to develop and publish more performance indicator information on its operational performance.

2. Financial Statements

We intend to give an unqualified opinion on both the financial statements of the Council and on the regularity of transactions undertaken for the financial year 2012-13.

Financial Statements Audit

The draft financial statements were of good quality and we identified no significant errors or misstatements. The supporting working papers reflect the standard of the accounts. Our Audit Findings report which we will present to the Audit and Compliance Committee on 11 June 2013 provides our detailed findings.

Audit Adjustments

Our audit identified two minor errors. The draft financial statements were adjusted for one of these errors, relating to an understatement of the pension provision, but not for the other, relating to an element of a rent prepayment, on the grounds of materiality.

In addition to the financial statement adjustments, our audit also identified a small number of presentational and disclosure issues impacting the financial statements. The most significant of these related to an adjustment to the disclosure of voluntary exit packages to ensure consistency with the figures reflected in the main financial statements.

Internal Controls

Overall, the results of our interim testing confirmed that there is a sound system of internal control covering key financial systems operated by the Council. We noted that the development of outcome agreements was at an early stage with compliance and monitoring arrangements for these agreements still in development.

Regularity

We did not identify any instances of irregular expenditure or non-compliance with laws and regulations.

Whole of Government Accounts

The current deadline for completion of the Whole of Government Accounts (WGA) is 12 August 2013. However, there are currently a number of delays in HM Treasury rolling out the new data capture tool and providing guidance on the WGA process for 2012-13. We expect that we will be able to provide our certificate of assurance by the deadline of 4 October 2013.

3. Financial Position

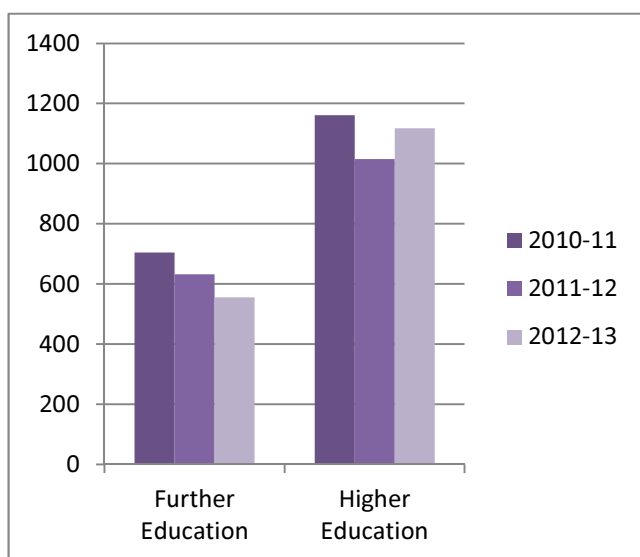
The key source of income for the Council is the Scottish Government. In 2012-13, the Council received grant-in-aid totalling £1,675m, an increase of £15m (1%) from 2011-12. There has been a decrease in funding to the college sector and an increase in funding to the higher education sector. The Council has identified running cost savings in excess of £800k, these are off-set in the current year due to voluntary severance costs of £684k. The Council has a general reserves balance of £11.1m, with a reported deficit of £7.8m recorded in the current financial year.

Key areas of expenditure

The Council approve an annual budget and programme of grant allocations based on direction from the grant-in-aid allocations from the Scottish Government.

During the year there has been a decrease in funding to colleges and an increase in funding to higher education institutions. This is in line with the Council's strategic plan to generate efficiencies through the college regionalisation programme.

Table 1 Grants paid to Colleges and Universities (£ million)



Source: Scottish Funding Council Annual Report 2012/13

The financial period 2012-13 was the first year in which grants have been allocated to institutions on an outcome agreement basis. The funding which is provided to each institution is based on a signed agreement based on strategic priorities agreed with the Council and the institution.

Table 2 Grants paid Universities (£ million)

University Grant	Recurrent	Capital	Total
2012-13	1,067,608	51,163	1,118,771
2011-12	962,953	52,563	1,015,515

Recurrent grant has increased in 2012/13 by 11% from 2011/12.

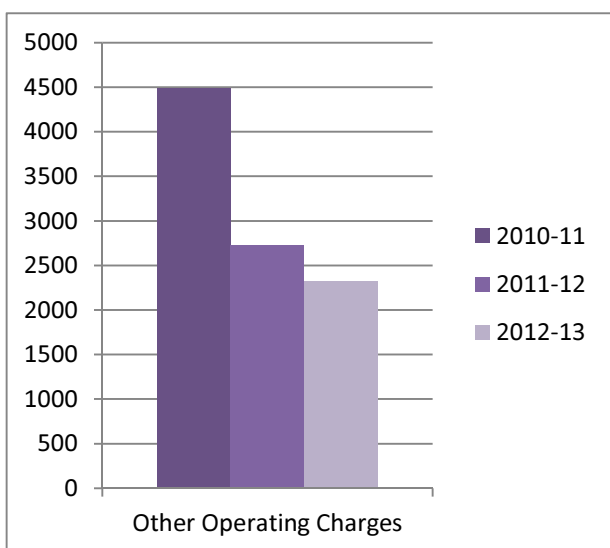
Table 3 Grants paid to Colleges (£ million)

College Grant	Recurrent	Bursary	Capital	Total
2012-13	430,842	97,452	28,009	556,303
2011-12	494,342	86,675	50,361	631,878

There has been a 13% reduction in recurrent funding and a 44% reduction in capital grant to the sector.

Running costs are a key area where the Council can generate savings through efficiencies. The main element of running cost expenditure is staff costs.

Table 4 Other operating charges (£ million)



Source: Scottish Funding Council Annual Report 2012/13

2010/11 saw one off costs for office refurbishment of £471k. Consultancy costs (for professional services in relation to college and university capital projects) have reduced from £1,023k in 2010/11 to £197k in 2012/13.

The Council undertook a review following a reduction in running cost funding of £750k to identify sustainable savings in non-staff and staff costs. Following the review, the reported non-staff cost savings were £439k. There are inflationary pressures going forward on the non-staff costs budget.

The identified staff cost savings are £459k. The Council has generated savings on staff costs through a voluntary severance scheme. The in-year costs associated with this scheme were £684k.

Income for the year

The key source of income for the Council is the Scottish Government. In 2012-13, the Council received grant-

in-aid totalling £1,675m, an increase of £15m from 2011-12. The financial statements also highlight that other income rose during the year by £3.8m. The predominant source of this increase was claw back movement of £2.2m. Claw back in relation to student support funds for academic year 2011-12 had increased to £6.8m.

Financial Position

The Council's statement of financial position reflects a positive financial position with general reserves of £11.1m.

Table 5 Statement of Financial Position

Statement of Financial Position	2013 £'000	2012 £'000
Non-current assets	5,353	6,074
Current assets	12,557	21,103
Current liabilities	(784)	(2,136)
Non current liabilities	0	(103)
Total net assets	17,126	24,938

Source: Scottish Funding Council Annual Report 2012/13

Table 6 Tax Payers Equity

Tax Payers Equity	2013 £'000	2012 £'000	Movement £'000
Grants for distribution	10,745	16,708	(5,726)
Running cost	329	627	(535)
General reserves	11,074	17,335	(6,261)
Institutional advances	6,052	7,603	(1,551)
Total	17,126	24,938	(7,812)

Source: Scottish Funding Council Annual Report 2012/13

There has been a significant downward move in current assets during the year. This was due to a reduction in the trade receivables balance of £10.3m. At the end of 2011-12 there was a large debtor balance (£2.2m) relating to claw back from institutions. Our testing during 2012-13 confirmed that the claw back due in 2012-13 was received by the Council prior to the year end and therefore there was no similar debtor in 2012/13. In addition there was a large value of prepayments made in 2011-12 (£13.2m) which were not made in 2012-13 (£4.8m). The prepayments are based on the payment profile of the grants and therefore are expected to vary year upon year. We have substantively tested the prepayments made.

Further variations in current assets related to the cash balance which had increased significantly compared to prior year (increase of £1.7m). From our discussions with the client we understand this was due to grant funding received by the Council on the last working day of the financial year.

The movement in current liabilities relates to capital projects which were on-going in the prior year at Glasgow School of Art, Glasgow Metropolitan and Shetland College. There was only one equivalent capital accrual at the end of 2012-13 relating to Kilmarnock College.

Looking forward

The Council will face inflationary pressures on running and staff costs in the coming years. A number of saving opportunities have already been exhausted, reducing the scope to further reduce running cost budgets.

The Scottish Government has future planned allocations, for use in paying grants, of £1,609.2m in 2013-14. This will be used to fund the Council's programme of change and reform as outlined in the Strategic Plan 2012-15. The Council aim to achieve this deliverable through the use of outcome agreements.

The further education sector continues to rationalise delivery through collaborative working within regions and re-structuring. Planned revenue budget remains flat for 2013/14 and 2014/15 at £521.7m.

The higher education sector is facing a number of challenges and opportunities in maximising income sources including student recruitment in the Rest of UK and overseas markets. 2014 will see a change in how the quality of research is assessed with the introduction of the Research Excellence Framework.

4. Governance

The Council has made significant changes to its operations in the current financial year. The most significant change is the use of outcome agreements to deliver the government's priorities and differentiate funding. In particular, the further education sector is facing significant structural reform as it moves towards regional structures requiring a number of college mergers. A key challenge for the Council will be to manage and support this structural reform process over the coming year. An Interim Chief Executive and Accountable Officer has been appointed.

Annual Governance Statement

The Annual Governance Statement (AGS) is the key document that records the governance ethos of the Council, and assurances around the achievement of the vision and strategic objectives of the Council. The AGS summarises the governance structures in place, including the internal control framework, arrangements for risk management, financial governance and accountability.

Risk Management

The Council has risk management arrangements in place at corporate, directorate and service level. Risks are reviewed regularly by the Council and the Audit and Compliance Committee.

National Fraud Initiative

The Council have taken part in the National Fraud Initiative data matching exercise 2012/13. We have reviewed the Council's response to the matches identified and have concluded that the Council had appropriate resources in place and there were no matches which were not satisfactorily resolved.

Outcome Agreements

We reviewed the governance arrangements surrounding outcome agreements as part of our interim work on the financial statements. Our interim work concluded that there were robust systems in place for the governance arrangements surrounding the creation of outcome agreements. We noted that there was some development required going forward as to how

performance against the outcome agreement would be monitored. This was raised as part of our interim report and actions agreed at this time.

Regionalisation

The Council has taken an active role in guiding the merger process for colleges. We reviewed the arrangements in place as part of interim audit work however, due to the timing of the mergers, there has been limited opportunity to evaluate the completed mergers. This is an area we aim to follow up on in our 2013-14 audit.

Looking forward

During 2012-13 a decision was taken by the UK Office of National Statistics to reclassify further education colleges so that they are within the scope of central government for budgeting and reporting purposes. This will have financial, governance and operational implications with regard to the interactions between the Council and colleges. Consideration will be required as to how the Council can manage the changes while continuing to support colleges in achieving their objectives in line with the outcome agreements.

5. Performance

Our audit confirms that the Council has good arrangements for demonstrating best value. The Council is in the process of developing its performance management framework to better link activities to outcomes to reflect the move to outcome based funding models. We have recommended that the Council should take the opportunity to develop and publish more performance indicator information on its operational performance.

Strategic Plan

Driven by Scottish Government’s pre-legislative consultation paper, *Putting Learners at the Centre*, the strategic plan 2012-15 was launched in December 2012. The Strategic Plan outlines eight national outcomes and the high-level actions that the Council will undertake to support the attainment of these outcomes.

- Outcome 1: efficient and effective regional college structures
- Outcome 2: access for people from the widest possible range of backgrounds
- Outcome 3: the right learning in the right place
- Outcome 4: high quality, efficient and effective learning
- Outcome 5: a developed workforce
- Outcome 6: sustainable colleges and universities
- Outcome 7: a research base that is internationally competitive and improving its reputation and standing in the world
- Outcome 8: university/industry collaboration and the exploitation of research

Progress with the implementation of the Strategic Plan is reported to the Quality, Equalities and General Purposes Committee (QEGPC) each quarter. A Critical Programme which contains around 30 programmes of work, or major projects, which are critical to the success of the Council, is also reported.

Best Value

Accountable Officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. In addition, the Boards (or equivalents) of relevant public service organisations have corporate responsibility for promoting the efficient and effective use of staff and other resources by the organisations in accordance with the principles of Best Value. During 2012-13, the Council carried out a self-assessment against the characteristics of the seven Best Value themes, the key outcomes from this assessment are summarised in Table 7 below

Table 7 Best value self-assessment

Best Value Theme	Self-assessment of characteristic		
	Well Developed	Under Developed	To Be Developed
Vision and Leadership	9	4	
Effective Partnerships	6	2	
Governance and Accountability	10	2	
Use of Resources	12	5	
Performance Management	5		7
Equality	2	5	
Sustainability	4	2	
Total	48	20	7

Source: Scottish Funding Council, Best Value, September 2012

The key area for development relates to performance management. The Council is currently reviewing its performance management framework, a balance score-card approach which focuses on the perspectives below has been proposed.

Balanced scorecard perspectives:

- Stakeholders
- Outcomes
- Internal processes
- Staff and other resources.

The balanced score card will be used to develop strategy maps. The strategy maps identify key enablers and main activities or outcomes and the links between activities and outcomes. Key performance indicators will be determined based on the strategy maps, the Council should take the opportunity to develop and publish more inward looking performance indicators. We are content that the Council has good plans in place for continuous improvement in line with Best Value guidelines, however, scope remains to improve operational performance reporting. **Action Point 1**

Performance reporting

A selection of the current key performance indicators, which relate to the Council's main statutory duties and responsibilities are reported in the Annual Report and Accounts. The published indicators cover a range of information including Council funded provision, external research income, knowledge exchange income, financial sustainability of institutions, quality of learning provision and efficiency of the councils operations.

Student volume targets have been exceeded every year, however the extent to which the target has been exceeded has reduced over the past few years. The ratio of external research income to Council quality-based research funding has remained static.

Table 8 Financial sustainability ratios

Ratio	Movement - Universities	Movement - Colleges
Operating surplus as a % of total income	↓	↑
Reliance on public sector income as a % of total income	↓	↓
borrowing as % of total income	↑	↑
Liquidity	↑	↑

Source: Scottish funding Council, Best Value, September 2012

The financial sustainability measures show the effectiveness of management of the institutional resources to achieve long-term financial sustainability.

Although there is variability between institutions, in general the sectors are heading in the right direction.

National Studies

Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland.

Audit Scotland ask us to ensure that public sector bodies review the national studies relevant to them and action them accordingly.

The Council has now established a protocol to summarise national reports for the relevant Committee.

During 2012-13, the Council executive considered the following reports and presented their findings to the Audit and Compliance Committee:

- Scotland's Colleges: Current finances, future challenges
- Learning the lessons of public body mergers

Scotland's Colleges: Current finances, future challenges

The Auditor General published her report into college finances in October 2012. The purpose of the report was to identify the financial standing of the college sector immediately before structural reforms and planned public sector spending reductions take effect.

The key messages from the report were:

- The overall financial standing of the college sector in 2010/11 was generally sound but there is variation between individual colleges.
- The college sector faces significant challenges over the next few years with a 24% funding reduction in real terms over the period to 2014/15.
- Structural reforms will bring many benefits but there will be disruption and added cost pressures during the transitional period.
- Strong leadership and collaboration with the Scottish Funding Council and the planned Further Education Strategic Forum will be needed to deliver the efficiency savings needed to ensure the continued financial sustainability of the sector.

The Council Executive provided a report to the Audit and Compliance Committee in December 2012 which provided an assessment of the Council's current status in relation to the recommendations the report made. A summary is included at table 9.

Table 9 Response to recommendations from Scotland's Colleges report

Recommendation: Development of performance management arrangements for the sector that allow the value for money of the public sector funds provided to be demonstrated.

Current action: The move to Outcome agreements has already been made. A full set of outcome measures for 2013-14 has not yet been developed but a core set of measures linked to the Council's priorities have been included within the framework. The Council is in the process of developing a performance management framework.

Recommendation: Develop outcome agreements for the sector which reflect national objectives and priorities for post 16 education.

Current action: In line with the Council's strategic direction, future outcome agreements will have a greater emphasis on colleges' contribution to the Scottish Government's wider objectives.

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

Current action: The Council have a process in place to monitor institutional sustainability. A number of recommendations to improve the reporting and monitoring are being acted upon.

Source: Scottish Funding Council, Audit Scotland Report "Scotland's colleges: current finances, future challenges", December 2012

Learning the lessons of public body mergers

The council's executive considered the report against existing Council processes and procedures and the support and guidance given to colleges and universities going through the merger process.

It was noted that the Council's merger guidance reflected a number of the recommendations and that the move to Outcome Agreements would strengthen the monitoring of institutions post merger.

Scotland's public finances: Addressing the challenges

Scotland's public finances: Addressing the challenges was published by the Auditor General and the Accounts Commission in August 2011. The report provided an overview of the scale of budget cuts expected to be faced by the Scottish public sector in the period 2010/11 to 2014/15, and how public bodies were beginning to respond to the challenges of reducing expenditure. As part of Audit Scotland's national targeted follow up work programme, we will review how the Council is responding to the challenges of public sector budget constraints and the Council's efforts to achieve financial sustainability. We will be specifically looking to address the following questions:

- Does the Council have sustainable financial plans which reflect a strategic approach to cost reduction?
- Do senior officials and non-executive directors demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval?

We will carry out the work in Autumn 2013 and will provide a report on our findings to the Audit and Compliance Committee.

Appendix A: Action Plan

	Issue and risk	Recommendation	Management Response
1	The current published performance indicators focus on the inputs and measures for Universities and Colleges.	The Council should take the opportunity as part of the work on implementing a new performance management framework to develop and publish a broader range of performance indicators including those which report on the Council's own performance.	We are currently recruiting a new Head of Strategic Performance Management Taskforce. This post will report to the Interim Chief Executive and will lead on developing a new strategic performance management system, working through a cross-organisational taskforce. This audit recommendation will be considered as part of that work.



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