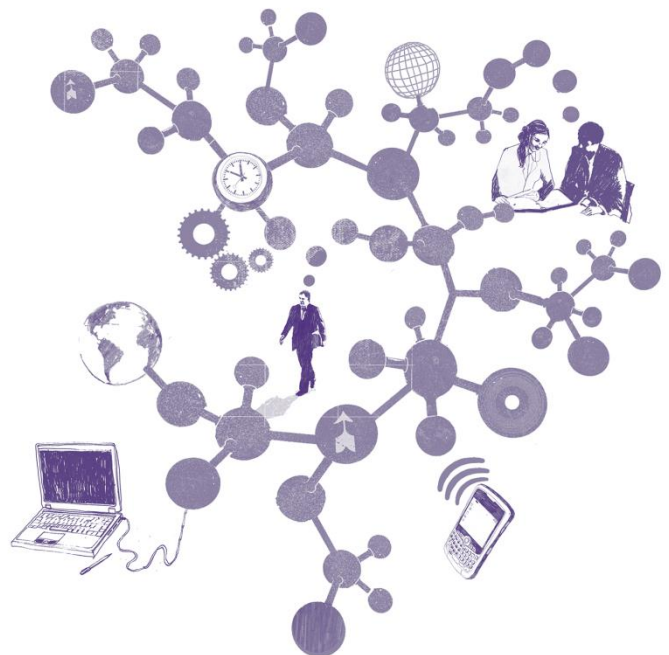


Scottish Funding Council

Annual Audit Report 2013-14

June 2014



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1. Executive Summary

Introduction

The Auditor General for Scotland appointed Grant Thornton UK 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 therefore the third year of our appointment.

This report summarises the findings from our audit work for the year ended 31 March 2014.

Overall Conclusions

We use the table below to highlight the key findings emerging from each aspect of our work during 2013-14.

Overall we continue to observe strong leadership and a well-developed approach to monitoring the performance of colleges and universities. Outcome agreements continue to be a key tool used by the Council to set out requirements for each institution. The outcomes are tailored to ensure achievement of the ambitions set out in the Strategic Plan 2012-15.

There were significant changes in 2013-14 making this challenging period for the Council. Changes included movement within the leadership team and the reclassification of incorporated colleges, for budgeting, reporting and accounting purposes, under the Office for National Statistics.

During 2013-14 a new Chair and Chief Executive were appointed. We noted that during the transitional period effective leadership was maintained and there were adequate induction processes in place to support members in their new role.

The Office for National Statistics reclassification resulted in a significant level of additional work for the Council in 2013-14, in order to prepare incorporated colleges for the change in regulatory environment. This remains a significant challenge for the Council, as they guide the colleges through the first year of operating under central government budgeting and reporting regulations.

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 2013-14 financial year. ■ The draft financial statements and supporting working papers were of a good standard, and as a result there were only minor audit adjustments required following our audit.
Financial Position	<ul style="list-style-type: none"> ■ The Council has reported a relatively stable financial position in the current financial year with moderate increases in resource expenditure matched with an overall increase in grant funding and other income. ■ The Council recorded a deficit of £5,869k in the current financial year, however, the Council has maintained net assets of £11,257. The majority of this relates to cash balances held at the year end to cover additional working capital needs as a result of the Office on National Statistics reclassification of the incorporated colleges. This has been approved by the Scottish Government ■ Running costs are the area the Council has most scope to generate efficiencies. There has been a reduction in running costs of 7%. This is mainly attributable to a reduction in staff costs due to a restructuring programme and voluntary severance scheme in 2012-13.

Governance	<ul style="list-style-type: none"> ■ The Scottish Government has planned to maintain grant-in-aid at close to current levels until 2015/16. The Council will therefore face inflationary pressures and will need to consider how efficiencies can be made.
	<ul style="list-style-type: none"> ■ The Council's governance and risk arrangements continue to operate effectively.
	<ul style="list-style-type: none"> ■ The introduction of outcome agreements continues to progress well with processes firmly embedded in the Council. There is on-going work on the movement to a new simplified needs based funding model for college teaching grants.
	<ul style="list-style-type: none"> ■ Post-merger evaluations in the FE sector have commenced with key messages confirming successful delivery.
	<ul style="list-style-type: none"> ■ The Post-16 Education (Scotland) Act 2013 received Royal assent on 7 August 2013 and has significant implications for the governance arrangements of the Council. This legislation will change duties and responsibilities of the Council and alter the relationships with colleges and universities. The Council has prepared an action plan to address the requirements of the Act.
	<ul style="list-style-type: none"> ■ There continues to be significant reform in the college sector through the Office for National Statistics reclassification. The Council has put robust processes in place to guide colleges through the Scottish Government budgeting regulations. However, as this is the first year of these new regulations and compliance remains an area of significant risk for the Council.
Performance	<ul style="list-style-type: none"> ■ A key issue arising from the revised budgeting regulations applicable to incorporated colleges related to limits over the ability to carry cash reserves and retain future surpluses. The Scottish Government approved the use of arm's length foundations, which can be through an umbrella foundation or at an individual college level. The Council has supported incorporated colleges throughout the process. <p data-bbox="416 1200 1445 1301">A total of £97.9 million has been transferred to arm's length foundations with 25% of this being held within the umbrella foundation. The Council has an on-going role in monitoring the funds transferred between the incorporated colleges and the foundations.</p>
	<ul style="list-style-type: none"> ■ The Council is committed to achieving Best Value and has completed a self-assessment exercise to identify areas for development. Our audit confirms that the Council has good arrangements for demonstrating best value.
	<ul style="list-style-type: none"> ■ The Council is in the final stages of implementing a new performance management framework. This framework is designed to support the achievement of the outcomes outlined in the Council's Strategic Plan 2012-15.

2. Introduction

Introduction

This report summarises the findings from our audit of the Council. The scope of our work was set out in our Audit Plan which was presented to the Audit and Compliance Committee on 25 March 2014.

This report has been prepared for the benefit of discussion between Grant Thornton UK LLP and the Council.

The Council's responsibilities

It is the responsibility of the Council and the Accountable Officer to prepare the financial statements in accordance with the HM Treasury Government Financial Reporting Manual (the FReM).

This means the Council must:

- prepare financial statements which give a true and fair view of the financial position of the Council and its income and expenditure for the year to 31 March 2014
- maintain proper accounting records which are up to date
- take steps to prevent and detect fraud and other irregularities.

The Council is also responsible for putting proper arrangements in place to ensure that:

- public business is conducted in accordance with the law and proper standards
- public money is safeguarded and properly accounted for
- economy, efficiency, effectiveness and Best Value is achieved in the use of resources.

Our Responsibilities

It is a condition of our appointment that we meet the requirements of the Code of Audit Practice (the Code) 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 audits in the public sector 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

The purpose of the annual report is to summarise our opinions and conclusions, and to report any significant issues arising. As part of our audit we assessed the key financial and strategic risks being faced by the Council. The identified risks were summarised in our Audit Plan which was presented to the Audit and Compliance Committee and remained unchanged at the year end.

The main elements of our audit work in 2013-14 have been:

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

Acknowledgements

We would like to take this opportunity to record our appreciation for the kind assistance provided by the Council's Finance Team throughout our audit.

3. 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 2013-14.

Financial Statements Audit

Financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.

We are required to audit financial statements in accordance with statutory requirements and give an opinion on:

- whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
- whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements.

This section provides a summary of our results of our audit on the financial statements. Our Audit Findings report which we will present to the Audit and Compliance Committee on 9 June 2014, provides a more in depth analysis.

Our Review of the Financial Statements

The draft financial statements were of good quality and we identified no significant errors or misstatements.

As part of our work on the financial statements we are required to review the narrative elements of the financial statements (including Chair's Forward, Chief Executive and Accountable Officer's Report, Performance Report, Sustainability Report and the Management Commentary).

We note that the Council has taken action to improve the content within the narrative reporting in the annual accounts to make them more relevant and usable. We provided comments on an early draft of the narrative and we are pleased to note that the narrative sections

provide a balanced overview of the contents of the financial statements, the activities of the Council and performance measures. We note that there may be scope to further develop the Performance Report as the new performance management system becomes embedded.

We have reviewed the narrative commentary against the requirements of the FReM which resulted in only minor areas for improvement.

Audit Adjustments

We identified two proposed adjustments which do not affect the Council's retained surplus position. The changes are due to the recognition of a previously undisclosed claw back of funding from a university and an overstatement of prior year long term debtors. None of the adjustments were above our level of tolerable error and therefore did not require adjustment.

The Council elected leave both balances unadjusted. The rationale behind this was the adjustments were not material and did not have an impact on the operating deficit or reserves in the current year.

The draft accounts recorded a retained deficit of £5,869k and there is no change to the audited figure.

Internal Controls

We used an interim visit to update our understanding and test controls across a number of the Council's key financial systems.

During our interim audit, we conducted testing on the following areas:

- payroll
- operating expenditure
- grants made.

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.

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 receipt of the unaudited Whole of Government Accounts (WGA) pack is 30 June 2014. We intend to carry out the work on this area in July 2014 and will therefore provide our certificate of assurance in advance of the deadline for audit, 15 August 2014.

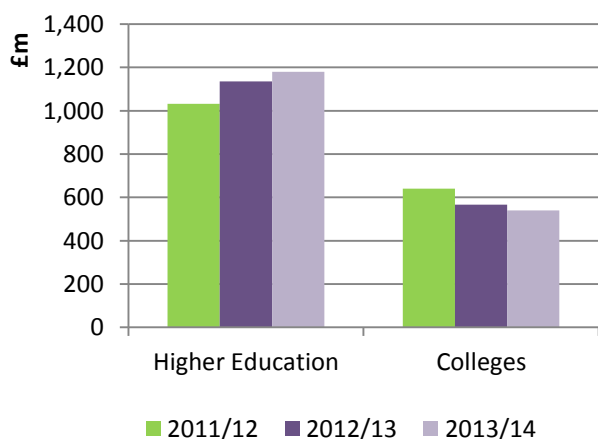
4. Financial Position

The Council has reported a relatively stable financial position in the current financial year, with moderate increases in resource expenditure matched with an overall increase in grant funding and other income. The Council recorded a deficit of £5,869k in the current financial year, however, maintains a strong reserves position of £11,257k.

Grant funding to institutions

The main business of the Council is to award grants to universities and colleges for the provision of education throughout Scotland. For this reason 99% of the expenditure from the Council is in the form of grants made to institutions.

Figure 1: Grants paid to colleges and universities



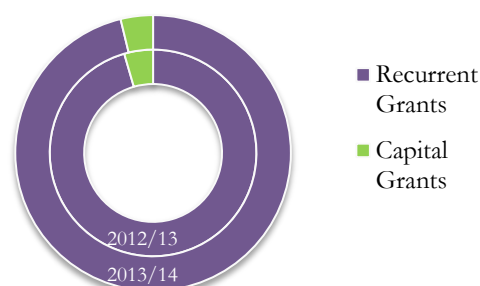
Source: Scottish Funding Council Annual Report and Accounts 2013-14

In 2012 the Council presented the Strategic Plan 2012-15 which set out the objectives for the sectors. This outlined a plan to increase spending in the university sector in order to focus on key outcomes such as widening access and guaranteed articulation (entry to higher education from college with an advanced standing). These strategic objectives are captured within the outcome agreements established for each university.

The college sector has seen a reduction in grants, of £101,512k, approximately 50% of this has been as a result of the regionalisation agenda. This programme generated efficiencies to create an efficient and effective college sector. The remainder of the reduction relates to a planned period of capital investment coming to an end during 2012-13.

The majority of the grants paid to both universities and colleges are in the form of recurrent grants.

Figure 2: Grant funding to universities by type

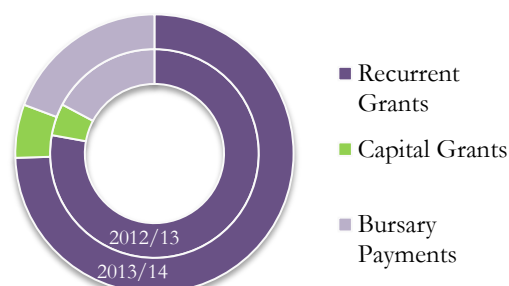


Source: Scottish Funding Council Annual Report and Accounts 2013-14

Recurrent funding in the universities sector consists of the main teaching grants, research and knowledge exchange grants and strategic projects as well as ring-fenced grants related to specific course types.

Capital grants have remained constant at approximately 4% of the total grant funding awarded. All universities are awarded a small amount of funding for capital maintenance purposes. The Council also provides match funding for Business Innovation and Skills (BIS) research capital. The remainder of the grant is for specific capital projects. In the academic year 2013-14 the capital projects supported by grant funding were the Reid building at the Glasgow School of Art and the creation of innovation centres throughout Scotland.

Figure 3: Grant funding to colleges by type



Source: Scottish Funding Council Annual Report and Accounts 2013-14

The recurring funding to the college sector predominantly relates to the teaching grant and fee waiver. This is linked to the achievement of Weighted Student Units of Measurement (WSUMs). The proportion of recurrent grant funding of the total has fallen in the year marginally from 78% to 75%. This is against a backdrop of WSUMs targets increasing by 4% in 2013/14 and shows that the Council is driving efficiencies in this area while protecting access.

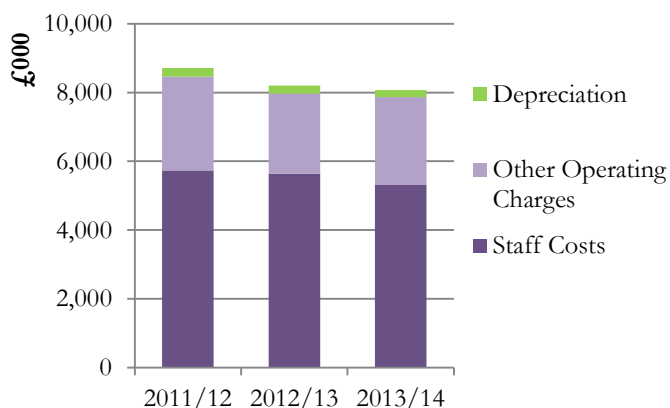
Bursary funding has increased by a small amount (£6,676k). This is demand led and is driven by the number of students at the college who are eligible for bursary funding.

Capital funding at the colleges in the main relates to estates maintenance and has remained constant as a proportion of total grant funding.

Running Cost Expenditure

The running cost expenditure of the Council is a very small proportion of the overall expenditure, however, it is this element that the Council has most control and ability to generate efficiencies.

Figure 4: Running costs at the Council



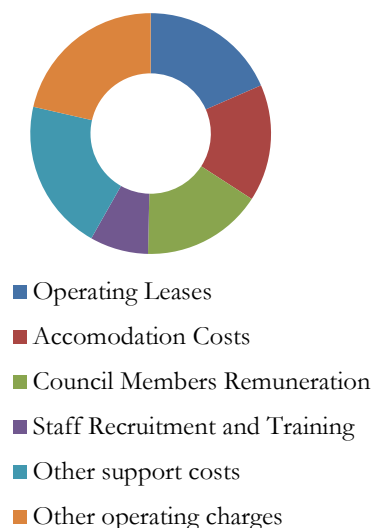
Source: Scottish Funding Council Annual Report and Accounts 2013-14

Like most public sector bodies the Council has been working to reduce the levels of expenditure. A key contributing factor of this was a voluntary redundancy scheme which was run in 2012/13.

Staff costs are the largest area of running cost expenditure. During 2012/13 the Council conducted an internal restructuring exercise in order to make the Council operate more efficiently and part of this was a

voluntary severance programme. This has resulted in staff costs falling by 7% since 2011/12.

Figure 5: Analysis of Other Operating Expenses



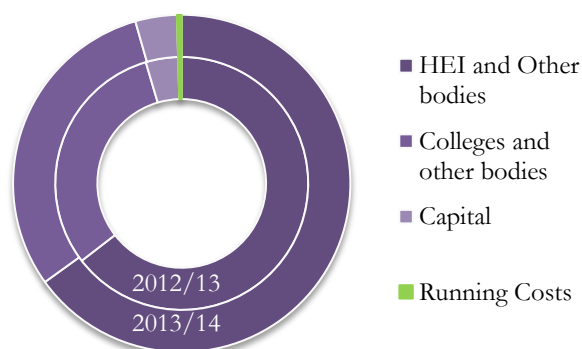
Source: Scottish Funding Council Annual Report and Accounts 2013-14

The other operating charges have remained consistent across financial years with only minor movements. Key areas of expenditure continue to be operating leases and accommodation costs. There has been an increase in year for staff recruitment and training. This is mainly due to a decision made by the Council to invest in training staff, following restructuring and the implementation of outcome agreements. However, an element of this increase also related to the recruitment of a new Chief Executive.

Income for the year

The main source of income for the Council is grant-in-aid received from the Scottish Government.

Figure 6: Grant-in-Aid allocated to the Council



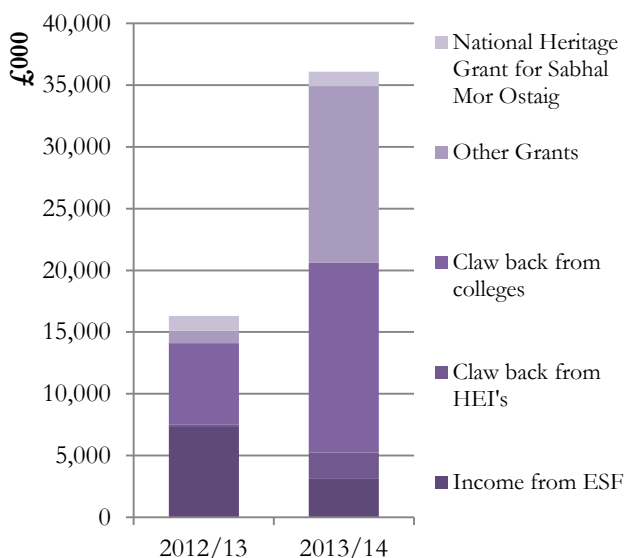
Source: Scottish Funding Council Annual Report and Accounts 2013-14

The grant-in-aid received from the Scottish Government has been stable over the past two years with the majority of expenditure being allocated to fund further and higher education institutions. Funding allocated for running costs for the Council is a very small proportion of the total grant-in-aid, less than 1%.

Looking forward, the Scottish Government plan to maintain the stability of the grant funding awarded to the Council. This is reflected in the planned grant for 2015/16 of £1,632,100k which is broadly in line with current funding levels.

In addition to the grant-in-aid the Council receives income from a variety of sources and this can be used for a number of purposes.

Figure 7: Other Income received by the Council



Source: Scottish Funding Council Annual Report and Accounts 2013-14

As the graph above shows the income from other sources is less consistent than grant-in-aid, with significant fluctuations between years. The main variances relate to claw back from universities and colleges and other grants.

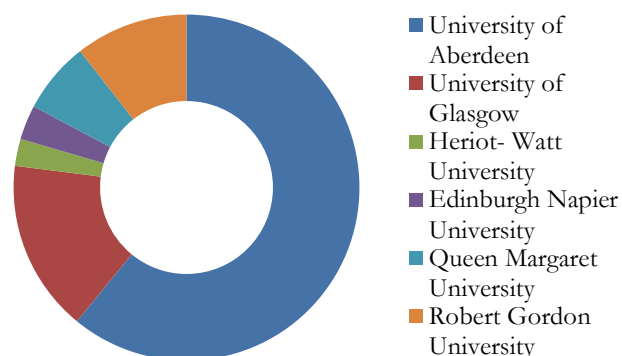
The most significant movement is in the Other Grants figure which has increased by £13,217k in year. This relates to grant funding administered by the Council on behalf of the Higher Education Funding Council for England. This is new funding from the UK Research

Partnership Investment Fund which has been awarded to the University of Strathclyde and University of Dundee for specific research projects.

Claw back from colleges has changed significantly during the current financial year. The increase is £8,770k and predominantly arises from the reclassification of colleges under the Office for National Statistics decision. This decision means that from 1 April 2014 the colleges will have both cash and resource budgets. In order to spend cash colleges must have sufficient resource to cover that spend. Any unspent funding held by the colleges at 31 March 2014 cannot be spent without additional budget cover. In order to prevent the cash balances relating to student support funds being frozen the Council made a decision to claw back the funds and re-allocate during 2014-15 in line with the approved budget cover.

There were further significant movements in the claw back from universities, increasing from £198k to £2,147k. The majority of this increase relates to institutions who have breached the consolidation threshold. In 2012-13 there was only one instance of a university breaching this threshold, this compares to six institutions in 2013-14.

Figure 8: Claw back split by institution



Financial Position

The Council's statement of financial position reflects a positive position with reserves of £11,257k.

Table 1: Statement of Financial Position

	2014	2013
	£'000	£'000
Non-current assets	3,800	5,352
Current assets	10,192	12,558
Current liabilities	2,375	784
Total net assets	11,257	17,126

Source: Scottish Funding Council Annual Report and Accounts 2013-14

The movement in non-current assets relates to the movement in long term debtors relating to recoverable grants. In year, West Lothian College made an increased payment to reduce the balance outstanding on its loan advance and negotiated revised payment terms.

There has been a significant downward movement in current assets. The most significant element of this relates to trade and other receivables which have reduced by £5,305k. A significant factor in the reduction is the receipt of European Structural Funds, which had a debtor of £3,967k in the prior year. During 2013-14 the projects were finalised and there are no further monies due to the Council.

In addition the prepayments to colleges reduced from £2,346k to £353k. This arises from the Office for National Statistics movement as the majority of the prepayments in the prior year related to bursary and student support payments (£1,990k). In the current year no prepayments were made as the college could not hold funds in cash at the year-end without this

impacting their resource budget cover in 2014-15. For this reason the Council made the decision to claw back any unspent funds and did not make prepayments.

This reduction in trade and other receivables is partially offset by an increase in the balance held at the bank which has moved from £2,362k in 2012-13 to £5,301k in 2013-14. This increase in cash balances has been deemed necessary due to the new methodology for disbursement of funds to incorporated colleges which is based on draw down claims submitted from colleges on the basis of need. The Scottish Government has granted approval to maintain an increased cash balance at the year-end.

The increase in current liabilities relates to a number of higher education projects with quarterly payments. There are payments which relate to the 2013-14 payment profile which had not been made at the year end.

Looking forward

The Scottish Government has planned future allocations of £1,632,100k which reflects a relatively stable allocation for the Council. However, inflationary pressures will result in a need for the Council to create efficiencies within its running costs budget.

The college sector has rationalised delivery through the regionalisation programme and the grant funding has reduced since 2011-12. The 2013-14 Scottish Government Budget Act had planned allocations to the college sector of £512 million, before spring and autumn revisions. The equivalent figure for 2014-15 is £522 million showing a commitment from the Scottish Government to increase funding to allow the achievement of outcomes.

The university sector will also see a minor increase in grant-in-aid funding from the Scottish Government in 2014-15. The planned grant-in-aid allocations have risen to £1,061 million in 2014-15, from £1,041 million in 2013-14. There is, however, on-going pressure for universities to maximise income from other sources including student enrolment and specific project grants.

5. Governance

The Council's governance and risk management arrangements continue to operate effectively. Progress has been made on outcome agreements with processes firmly embedded and movement towards a new funding model being underway. Post-merger evaluations have commenced with key messages for successful delivery being identified.

The Post-16 Education (Scotland) Act 2013 received Royal assent on 7 August 2013 and has significant implications on the governance arrangements for the Council. This legislation will change the duties and responsibilities of the Council and alter the relationships with colleges and universities

There continues to be significant reform in the college sector through the Office for National Statistics reclassification. The Council has put robust processes in place to guide colleges through the revised budgeting regulations. However as this is the first year of implementation of this new guidance, and this area remains a significant risk for the Council.

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.

The Council has continued to maintain good procedures for establishing required assurances for the Statement. We reviewed the processes against the requirements of the Scottish Public Finances Manual and found the Council to be compliant. Each Director has contributed to a self-assessment against the Scottish Government's Internal Control Checklist. The checklist was used as the basis for the Statement of Assurance to the Scottish Government and the AGS.

We reviewed the Council's AGS as part of our audit procedures and concluded that the disclosures were in line with our knowledge of the Council.

Compliance with the Scottish Public Finance Manual

Our Audit Plan we noted that we would use the Scottish Public Finance Manual (SPFM) to assess compliance against good practice. We noted in our interim report that we had asked the Council to complete a self-assessment checklist. From this work we concluded that the Council were compliant with the SPFM and demonstrated strong practice in this area.

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.

Prevention and Detection of Fraud and Irregularity

The integrity of public funds is a key concern for the organisation and for auditors. As external auditors, we are required to consider the arrangements made by management for the prevention and detection of fraud and irregularities. Our enquiries of management and the Council's internal auditors found that there were no internal frauds during 2013-14. We conducted testing on journal entries and related party transactions to highlight any unusual transactions. There were no issues arising from this testing.

Outcome Agreements

This is the second year of the use of outcome agreements across all colleges and universities. The Council continue to work with HE and FE bodies in the negotiation and monitoring of outcome agreements. As part of our work conducted at the interim stage of the audit we reviewed the processes surrounding outcome agreements and the funding model. We concluded that the processes in place were appropriate and that progress was being made in developing a needs-based funding model.

We will continue to monitor the use of outcome agreements to monitor and assess performance of institutions and the development of the new funding model as part of our 2014-15 audit work.

Post-16 Education (Scotland) Act

The Post-16 Education (Scotland) Act 2013 received Royal assent on 7 August 2013. This legislation has significant implications for the Council, with significant changes to duties and responsibilities and their relationships with colleges and universities.

There are a range of implications for the Council under this Act including:

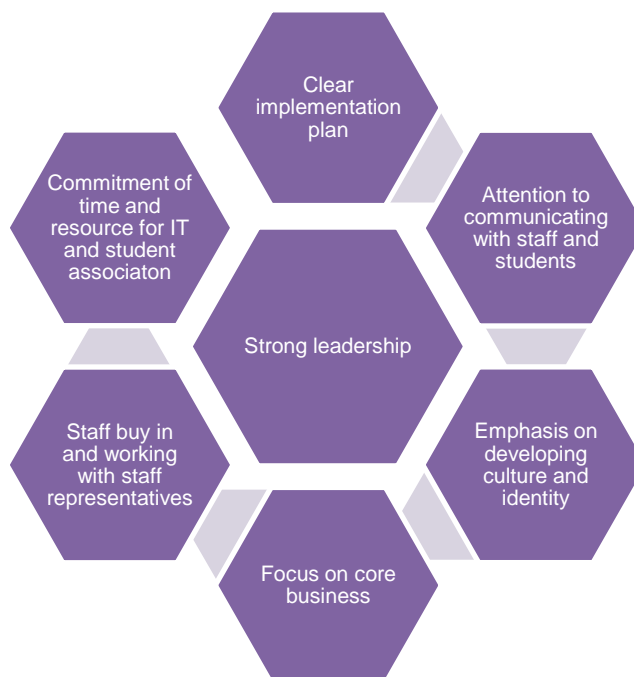
- the Council is required to formally publish a range of reviews including widening access and any reviews on funding or provision
- the legislation allows the Council to impose compliance with governance good practice as a condition of grant
- the introduction of a widening access agreement for universities
- the Council now has a role in the governance structures for Regional Colleges, Regional Strategic Bodies and "Assigned Colleges"
- the Council has a role in employment matters in the college sector for the first time.

The Council has developed an action plan to address the requirements of the Act. We will review this as part of our audit in 2014-15 and evaluate progress.

In anticipation of this legislation, and as a response to the Griggs report, the Council commenced a regionalisation programme for colleges. We reviewed the work the Council had undertaken as part of our review at the interim stage of our audit. As part of this we noted that a post-merger evaluation program was planned.

Following our interim work we reviewed the post-merger evaluation for City of Glasgow College. This review was informed by a self-evaluation by the College, subsequent information requests and a site visit. The Council has concluded the merger was a success.

Figure 8: Critical success factors identified in City of Glasgow college post-merger evaluation



Source: City of Glasgow college: post-merger evaluation paper presented to the Council on 10 May 2013

The review process has identified several critical success factors shown in figure 8. The Council recognised that the areas identified were applicable across the sector and updated their merger guidance accordingly.

The Council has a schedule of eight post-merger evaluations planned for 2014. We will continue to monitor the processes in place and the outcomes of the evaluations.

Financial Health of Institutions

The Council made a commitment in their Strategic Plan 2012-15 that they will deliver colleges and universities that can survive financially and environmentally in the long-term.

The Council monitors the financial position of both colleges and universities through financial returns received at specified points of the academic year. Colleges and universities are required to submit a return in June which comprises an outturn forecast for the current year and forecasts for later years. This is followed by the submission of financial statements and associated documents in December. The Council's Audit and Compliance Committee review the findings from the reports as a standing item on the agenda.

The results from the academic year 2012-13 were discussed at the March 2014 meeting. Ten colleges and one university recorded an operating deficit in 2012-13. This is an improvement on the prior year when thirteen colleges and three universities recorded a deficit position.

Table 2: Financial position for college and university sector

	Year to 31 July 2013	Year to 31 July 2012
	£'000	£'000
College Sector		
Operating Surplus	3,200	1,600
Accumulated Income and Expenditure reserve	216,000	202,000
University Sector		
Operating surplus	94,000	81,000
Accumulated reserves	1,974,000	2,300,000

Source: Financial sustainability reports presented to March 2014 Audit and Compliance Committee

The results of this review show a relatively stable position within the universities sector with all but one institution reporting a surplus and substantial overall reserves.

Although the college sector overall has returned a surplus position there is a degree of variation across the colleges with ten reporting a deficit position. This will be a key area of risk for the Council in 2014-15 due to the reclassification by the Office for National Statistics.

Office for National Statistics Reclassification

The Office for National Statistics made a decision to reclassify incorporated colleges as part of central government, for budgeting, reporting and accounting purposes, from 1 April 2014. This has resulted in increased budgeting restrictions for all colleges to meet the Scottish Government budget targets and regulations regarding drawing down funds in advance of need. The Council has developed new processes to help colleges through this.

From 1 April 2014 the methodology for payment of grant funds has moved to a needs based method. Each month incorporated colleges are expected to submit a claim based on the cash need for the following month. This has resulted in a higher workload for the Council developing cash flow model templates. The colleges are expected to complete quarterly resource projections to show that they are managing within budget and will have a balanced position at the year end. This moves to a monthly projection from January to give the Council more scope to take action where required.

A key risk to the Council is that there are issues with the new processes and a college experiences financial difficulties due to lack of budget cover for expenditure. The Learning, Governance and Sustainability Group and Finance and Corporate Resources Group are working together to monitor the financial sustainability and budget cover position for the colleges.

To date there have been no issues with the new draw down process and colleges are maintaining sufficient funding to ensure there is adequate cover for expenditure.

As this is the first year that colleges will have to meet budgeting targets there remains significant risk of under/ overspend by the sector. Slippage of any key

projects such as voluntary severance schemes could result in an underspend and a loss of available funding.

The Council have taken action to mitigate these risks and have a support team in place for the colleges. We will follow up on this area as part of our 2014-15 audit and evaluate success of the first year.

Arm's length foundations for Colleges

A key issue arising from the Office for National Statistics decision was that incorporated colleges would become subject to Scottish Government budget controls which would limit the ability to carry cash reserves and retain future surpluses. In order to mitigate the impact of the reclassification the Scottish Government approved the following actions:

- establishment of a college sector umbrella foundation
- establishment of separate foundations for each college, as required
- transfer of colleges cash-backed reserves and on-going surpluses to the above foundations.

The Council conducted research around the processes for setting up a trust and contacted Turcan Connell who are acting as the legal advisors in setting up the constitution of the Trust.

The Council has supported incorporated colleges, with regard to setting up their own foundation or making transfers to the umbrella foundation, throughout the year. This support has come through regular guidance notes and discussion groups.

A critical element in establishing the umbrella and college foundations was ensuring they could be shown to be independent of the colleges so transfers of reserves would be outside the Scottish Government budgeting boundary.

At 31 March 2014 all incorporated colleges had made transfers to either the umbrella or their own foundation, with a total of £97.9 million transferred out with the Scottish Government budgeting boundary. Eight incorporated colleges were involved in the umbrella foundation, one of which is on a temporary basis while

the college finalise its arrangements for a local foundation. The total funds held in the umbrella foundation at 1 April 2014 amounted to £24.2 million.

As local foundations and the umbrella foundation will be independent, concerns have been raised over whether the funds transferred from incorporated colleges to foundations will be available and applied in ways in which the Council and Scottish Government may consider appropriate.

The Council has taken action to ensure they provide assurances that the funding will be applied in line with the purposes of the Scottish Government while protecting the independent nature of the foundations. A key action was to ensure the constitution documents for each foundation were set up appropriately. Each foundation should have been set up with a charitable purpose that aligns with that of the college. The Council intend to provide assurance through a review by Turcan Connell of all constitution documents and donation agreements across the sector. This review will be completed in June 2014.

In addition charity law imposes legal duties on trustees to ensure the charity acts in a manner consistent with its purposes and puts the interests of the charity above their own interests or that of others.

The Council continues to monitor the funds transferred to and from the foundations through the financial returns provided by incorporated colleges. The Council requires further disclosure in the incorporated colleges financial statements. The Council will review the financial statements of all foundations in order to reconcile transactions with incorporated college disclosures. This will ensure funds are being used appropriately and are recorded correctly.

6. Performance

The Council is committed to achieving Best Value and has made significant progress on the development of a new performance management framework. This framework is designed to link to demonstrable outcomes in line with the Strategic Plan 2012-15. The Council revised the disclosures in the financial statements so that the performance information was closely aligned to the outcomes identified in the Strategic Plan.

Strategic Planning

The Council approved the Strategic Plan 2012-15 in December 2012. This plan directly supports the Scottish Government's National Performance Framework and strategy for creating a smarter Scotland.

The Strategic Plan is underpinned by eight outcomes which set out the ambitions of the Council:

- Efficient and effective regional college structures
- Access for people from the widest possible range of backgrounds
- The right learning in the right place
- High quality, efficient and effective learning
- A developed workforce
- Sustainable colleges and universities
- Internationally competitive research base
- University/ industry collaboration.

The Council has outlined progress made against the outcomes in the Annual Report through the use of key measures of success. The annual report notes areas for development as follows:

- The Council are currently working towards improving their evidence base for information on the proportion of leavers achieving employment 6 months after completing their course. There is work underway to establish a national leaver destination survey.
- The Council feel they need to do more in both sectors to identify new and effective interventions on carbon emissions. Actions taken in the current year were: investment in three projects as part of a new carbon reduction programme; and engagement with Environmental Association for Universities and Colleges Scotland to implement climate change action plans which all institutions have signed.

Sustainability Reporting

During 2011-12, a new requirement was introduced within the FReM to include a section in the annual report which outlines the economic, social and environmental factors impacting the organisation. This is to be presented in a Sustainability Report.

The Scottish Government prepared guidance on this *Public Sector Sustainability Reporting- Guidance on the Preparation of Annual Sustainability Reports* which outlines the minimum reporting requirements covering areas such as:

- Greenhouse gas emissions
- Waste minimisation and management
- Finite Resources
- Action on Biodiversity
- Sustainable procurement

We reviewed the report in 2013-14 to evaluate disclosures against the reporting requirements. We found that the Council continue to improve disclosures and work towards meeting the minimum reporting. We noted particular improvement in the current year over greenhouse gas emissions and waste management disclosures.

There are still issues around data collection which make it difficult for the Council to meet the minimum required data. Where this has been an issue there is disclosure in the accounts clarifying the Council's position.

Best Value

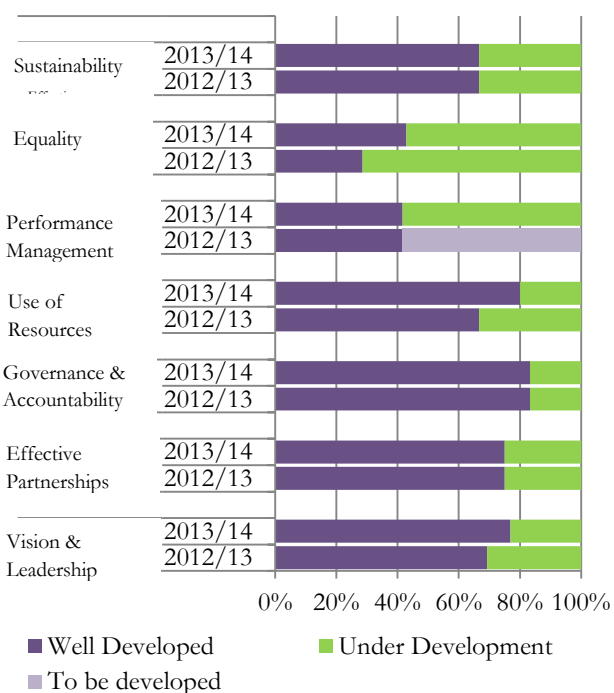
Accountable Officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. In addition, the Boards of relevant public service organisations have corporate responsibility for

promoting the efficient and effective use of staff and other resources by the organisations in accordance with the principles of Best Value.

The Council's Strategic Plan 2012-2015 gives a commitment that the Council will use the resources made available to it efficiently and effectively and will promote the principles of Best Value in its operations.

During 2012-13 the Council carried out a self-assessment against the seven Best Value themes using the 73 characteristics outlined by the Scottish Government. The evaluation assessed how well the Council felt they demonstrated the characteristic and could be classified as well-developed, under development or to be developed. As a result of this exercise the Council identified 19 actions for improvement.

Figure 9: Best Value self-evaluation results



Source: Best Value Implementation Plan: progress report presented to the Audit and Compliance Committee 11 June 2013

In early 2013-14 the Council reported on the progress made against the action plan and a revised assessment of the characteristics of best value. The Council noted an improvement in their performance against the best value principles with 69% being well developed, 31% being under development and no outstanding areas to be developed (2012-13: 63% well developed, 25% under development and 12% to be developed).

The key areas where further progress had been deemed necessary are performance management and equality.

The Council has noted that significant progress has been made in relation to Best Value since June 2013 and that many actions identified in the 2012 action plan are now redundant. For this reason the Council plan to conduct a full self-evaluation in early 2014-15 to create a new baseline. This is a year ahead of the planned schedule of assessments but is deemed appropriate due to the level of change at the Council.

We will continue to monitor the arrangements for Best Value and will conduct a review of the processes underpinning the self-assessment.

Performance reporting

The Council identified a need to improve performance management in 2012-13 and agreed to develop a performance management framework at their meeting in May 2013.

This framework is intended to support the delivery of the strategic plan and drive improvement in the organisation. The Council and executive groups have been involved and consulted regularly throughout the process to ensure the framework is built on the vision and purpose of the Council.

The framework has been developed around four key questions which are deemed to be critical to the success of the Council:

- What has been achieved?
- What has been provided?
- How well have we done?
- How good are we?

Reports have been presented to the Council in both January and March recording key performance information. The Chief Executive has recorded an overall conclusion that at March 2014 the Council were "on track" to deliver the strategy but did note some challenging areas as follows:

- meeting the 2013-14 college activity target
- the Council strategy to reduce carbon emissions in both sectors
- effective delivery of the Scottish Government's target for nursing and midwifery.

The Council is currently taking action on the areas identified and continues to monitor the position through the framework.

Scotland's Colleges

The Auditor General published a follow-up report to the *Scotland's Colleges: Current finances, future challenges* report in August 2013. This follow up report focused on the financial standing of the college sector as a whole and of individual colleges in 2011-12, and the sector's progress towards structural reform.

The key messages from the report were:

- The overall financial standing of the college sector in 2011-12 continued to be generally sound.
- Most colleges are either merging or forming federations with other colleges to create 13 new college regions.
- The college sector faces an overall 11% real terms reduction in revenue grant funding from the Scottish Government between 2011-12 and 2014-15.
- The reclassification of colleges as public bodies from April 2014 will require them to operate within the same annual budget limits as other Scottish Government bodies.
- An increased emphasis on longer courses has led to reductions in the total number of students attending college.

The report states that the Council should:

- monitor the progress in achieving savings and other benefits from mergers to help with financial planning
- monitor the impact of prioritising younger students and full-time courses on learning opportunities for older people
- work with colleges and regions to assess and manage the effect that the reclassification of colleges as public bodies has on their financial planning
- work with colleges to ensure that the lessons from completed mergers are available to

colleges that are currently going through the merger process

- further develop outcome agreements to provide greater focus on the outcomes of colleges' planned contributions to national priorities and objectives for post-16 education
- monitor colleges' progress towards contributing more to community planning.

7. Summary and Conclusions

There were significant changes in 2013-14 making this challenging period for the Council. The Council has performed well under the challenging circumstances and continues to maintain a robust control environment.

Summary

During 2013-14 a new Chair and Chief Executive were appointed. Effective leadership was maintained during the transitional period.

The Council has a well-developed approach to strategic leadership and monitoring the performance of colleges and universities with outcome agreements continuing to develop, but now established as a key monitoring tool for both the college and university sectors.

The Office for National Statistics reclassification resulted in a significant level of additional work for the Council in 2013-14, in order to prepare incorporated colleges for the change in regulatory environment. This remains a significant challenge for the Council, as they guide the colleges through the first year of operating under central government budgeting and reporting regulations.

Looking forward

Looking forward, the key challenges for the Council will be the continued support of colleges and universities through outcome agreements, managing the impact of the Post -16 Education (Scotland) Act 2013 and continuing to monitor how foundation trusts linked to the college sector develop over time.

The Council is well prepared to meet these challenges and continues to perform well overall.

