The 2015/16 audit of Edinburgh College

Prepared for the Public Audit and Post Legislative Scrutiny Committee by the Auditor General for Scotland

Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000

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Introduction

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

2. The purpose of this report is to draw Parliament's attention to concerns about the financial sustainability of Edinburgh College, and to report to Parliament on progress with issues raised in my 2014/15 section 22 report on Edinburgh College. My report is based on information provided through the 2015/16 audit of Edinburgh College and additional work undertaken by the auditor and Audit Scotland.

The auditor's opinion

3. The auditor issued an unqualified opinion on Edinburgh College's financial statements for 2015/16. However, in his report, he highlighted concerns about the college's current financial position and future sustainability. The college reported a deficit of £7.0 million for 2015/16 and was reliant on additional support from the Scottish Funding Council (SFC) in order to meet its liabilities. Colleges' accounts include technical accounting adjustments that do not reflect actions taken by colleges and are outside their immediate control. These include property asset valuation reductions and pension adjustments. After excluding these items the underlying position for 2015/16 was a £3.6 million deficit. The auditor also highlighted that, at the time of reporting, the college's delivery of credits was behind its activity target for 2016/17. The auditor concluded that the future financial sustainability of the college is dependant on successful delivery of its transformation plan, but that it was too early in the implementation of the transformation plan to make a judgement about whether it will be successful.

Background

4. This is the second consecutive year in which I have reported on Edinburgh College. In my previous report, published in March 2016, I highlighted concerns raised in the auditor's annual report about the college's financial position. The auditor noted that the college experienced financial difficulties in 2014/15, and faced a reduction in forecast cash resources of £3.3 million in 2015/16. As a result the college sought additional financial support from the SFC. In my 2016 report, I highlighted the issues arising from the college's failure to meet its targets for student activity, and concluded that the college would face extreme difficulties without further financial support. I asked the auditor to keep the position under review and also asked Audit Scotland to undertake further work to examine the action being taken by the college to address these concerns.

5. Edinburgh College was formed in October 2012 by the merger of Jewel and Esk, Telford and Stevenson colleges. Edinburgh College is an independent legal body with charitable status as defined by the Further and Higher Education (Scotland) Act 1992 (the 1992 Act). It is governed by a board which is responsible for determining the overall strategy of the college and the proper use of public funds, the quality of provision and appointing the Principal and

other senior staff. In 2015/16, the college had 17,898 registered students and employed 1,164 full-time equivalent members of staff.

6. The college receives approximately 75 per cent of its annual income from the SFC. The majority of this funding is allocated on the basis of the college achieving an agreed target rate of student activity. This activity target is measured in 'credits'.[1] The SFC can seek to recover money from a college if the activity target is not met.

7. The SFC issued revised funding guidance in July 2014. The guidance included a change that set a limit on the use of additionality.[2] Additionality (also referred to as '1+' activity) is the provision of extra learning to students who are already enrolled at the college, such as students completing extra units that better prepare them for the workplace. The change in SFC funding guidance tightened the rules covering the volume of additionality for which a college could claim funding. The practice is now only permitted to specified levels and anything above these levels must be agreed in advance with the SFC.

8. The SFC had previously noted high levels of additionality at Edinburgh College, and the SFC raised its concerns with the college in November 2014, when the college's quarterly data return to the SFC showed a higher level of 1+ activity than was allowed. Despite the new guidance, and the SFC’s efforts to highlight its concerns, the college again reported high levels of additionality in 2014/15.

9. In October 2015, the SFC notified the college that it was likely to recover funds (£0.8 million) as a result of the college failing to reach its activity target for 2014/15. This failure occurred largely because of the college's reliance on 'additionality' to meet its activity targets.

10. Having realised the extent of the college's problems with student numbers, the current Principal, in post since May 2015, approached the SFC to rebase the college's activity target. In December 2015, the SFC wrote to the college, agreeing a six per cent reduction in its target for 2015/16, from 200,258[3] to 186,258. These credits were removed in-year and the associated reduction in funding of £2.8 million, plus a further £0.66 million reduction in European Social Fund funding, placed the college in severe financial difficulty.

11. In December 2015, the college Board of Management approved a 16-point action plan to form the basis of a new transformation plan (referred to in my 2016 report as a "recovery plan").

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

[2] While the SFC guidance specified a limit on additionality of no more than 2.5 per cent of activity, the guidance also indicated that higher levels of additionality might be accepted, but only if colleges agreed those levels with the SFC in advance.

[3] This includes a core credit target of 195,452 and 4,806 additional credits for delivery of programmes supported by the European Social Fund.

The final version of the transformation plan was agreed by the SFC in March 2016, and it was published in April 2016. In February 2016, the SFC notified the college that the Scottish Government had agreed that the college could retain the £0.8 million that the SFC was due to recover, as part of a special payment to support implementation of the transformation plan and on condition that the college implement the plan.

Action taken since the 2014/15 report

Additionality

12. The problems with additionality, and the associated decision by the SFC to pursue recovery of funding, led the new Principal to carry out a detailed review, beginning in November 2015, in order to better understand the reasons for the college's failure to meet its activity targets. The Principal reported to the Board on her findings in February 2016, with a final report presented to the Audit and Risk Assurance Committee in June 2016. On the specific issue of additionality, the Principal's review highlighted that there were problems arising from having two Vice Principals with responsibility for curriculum. Due to a lack of effective joint working within the college, and a potential for blurring of the lines of responsibility between the Vice Principal Curriculum and the Vice Principal Quality, there was a lack of clarity about who was ultimately responsible for making changes to the curriculum. The Principal confirmed that there were problems with lines of accountability at the meeting of the Public Audit and Post-Legislative Scrutiny Committee (PAPLSC) on 17 November 2016.

13. The SFC raised concerns about the college’s use of additionality with the then Depute Principal and both the Vice Principal (VP) Curriculum and the VP Quality on numerous occasions, beginning in August 2014. The Principal concluded that the SFC's concerns about the use of additionality were not adequately addressed, but noted that other members of the Executive Team reported that that they had assumed the matter had been dealt with. The current Chief Operating Officer was the Director of Finance during 2014/15. In evidence to the PAPLSC, he stated that, although he was aware of the change in SFC guidance, neither of the two Vice Principals had raised any concerns with him. He indicated that, as far as he was aware, the levels of additionality had been agreed with the SFC. In her report, the Principal acknowledged that part of the problem arose from the lack of follow-up action from the wider Executive Team to address problems raised with the use of additionality, and underlying problems with the curriculum.

14. The two Vice Principal posts for curriculum and quality were merged in May 2015, as part of a management restructuring exercise, creating a new post of Vice Principal Curriculum and Quality. The then VP Curriculum was matched into the new role. Following the restructuring, the VP Quality applied for and was granted voluntary severance, with a severance payment in line with the terms of the scheme. For the six months between her post being deleted and taking severance, she worked as Director of Strategic Projects until leaving the college in November 2015.

15. On completing her review, the Principal concluded that the primary responsibility for developing the curriculum, and making sure the curriculum frameworks were updated and

compliant with SFC guidance during 2014/15 lay with the then VP Curriculum. In February 2016, the Board agreed that the now VP Curriculum and Quality would undergo a competency hearing to determine if disciplinary action was required. Before the competency hearing was initiated, the VP Curriculum and Quality resigned and left the college in May 2016. He did not receive any severance payment or any other additional payment.

16. Our assessment of all the investigatory material reviewed by the Principal concurs with her findings. We found evidence of concerns and differences of opinion between Management Information Systems (MIS) staff and Heads of Centre over the reliability and robustness of the data being reported to the SFC. Correspondence in October 2014 and March 2015 shows that MIS staff raised concerns with Heads of Centre and with the VP Curriculum about the high levels of additionality. There was evidence of confusion over target and planned activity levels in each of the curriculum areas and a lack of understanding from Heads of Centre about how this information was recorded.

Wider problems with curriculum and recruitment

17. The Principal's review found that the college's over-reliance on additionality was indicative of broader underlying and long-standing problems with the college's curriculum, linked to difficulties in both recruiting and retaining students. While the college had been aware of some of these issues for a number of years, the college's efforts to address the problems were inadequate. The Principal noted that both a 2014 curriculum review and a 2015 curriculum 'health-check' had highlighted problems with student numbers and retention, but the college did not take appropriate action to address the problems. The Principal concluded that there was a lack of leadership on curriculum issues, with no-one at the college taking responsibility for ensuring that the curriculum was updated and compliant with SFC guidance.

18. Our assessment of the evidence concurs with the Principal's conclusion that the college's breach of the SFC's guidance on additionality was symptomatic of deeper issues. The evidence indicates that, while management recognised that the curriculum frameworks needed to be fully reviewed and updated following the merger, the college had not taken effective action to do so.

19. At the PAPLSC meeting on 17 November 2016, the Principal accepted that the college was responsible for the underlying problems. Corporately, the college focused on increasing activity per student as a short-term fix, without addressing the deeper issues with student recruitment and retention.

20. As well as putting the transformation plan in place, the college has now completed a full restructuring of the senior management team to improve lines of accountability. With the exception of the Principal, who joined in May 2015, the current Chief Operating Officer is the only remaining member of the senior team that was in place during 2014/15. The executive team is now smaller, with the Chief Operating Officer and one Depute Principal sitting below the Principal, supported by three Assistant Principals.

Progress with the transformation plan

21. The college developed its transformation plan to help it move to a sustainable financial position, by improving operations and the delivery of core activity. It consists of 19 projects, forming four overarching programmes of work:

- financial sustainability: priority-based budgeting, resource management and estates strategy
- curriculum relevance, regional and coherence with community planning partnerships
- workforce development and structure
- recruitment, retention and productivity.

22. The SFC was supportive of the broad direction of the plan but raised concerns about the volume of work to be undertaken and requested prioritisation of work relating to the core curriculum and financial health issues. In July 2016, the college's internal auditor was jointly commissioned by the SFC and the college Board to undertake a detailed review of the plan. The aim of this review was to assess whether the plan was fit for purpose, and to provide assurance to the SFC and the Board on the extent to which the plan was likely to achieve its objectives.

23. The review was completed in September 2016. The internal auditor concluded that, overall, the plan set out the key challenges facing the college and the improvements the college needed to make to address them. It found that the college had made good progress with certain key areas of the plan, specifically with student recruitment and curriculum planning. However, the review also made 12 recommendations, highlighting areas where there was scope for improvement, particularly in relation to the prioritisation of projects, setting SMART objectives and putting in place more robust and consistent project management processes. It also recommended that the financial plan be regularly refreshed and forecasts shown on a monthly basis. The recommendations were accepted by the college and the Board of Management.

24. A Strategic Programme Board, chaired by the Principal, meets every eight weeks. The Depute Principal acts as the Depute Chair and the Programme leads also sit on the Strategic Programme Board. The Strategic Programme Board provides high level governance of the transformation plan. There are also programme boards for the four transformation plan programmes, each chaired by a senior manager. The programme boards meet between every one to two months, depending on progress with the particular programme. The Policy and Resources Committee provides governance of the transformation plan on behalf of the college's Board of Management, and considers progress reports at every committee meeting. A paper presented to the committee in January 2017 reported that the college was making progress across all four transformation programmes.

25. Following the review of the transformation plan, the college has taken positive steps to act on the internal auditor's recommendations to improve governance and project management processes. It appointed a Head of Corporate Development in November 2016, whose role is to set up and run a Programme Management Office (PMO). The college is in the process of

recruiting further staff for the PMO. The Head of Corporate Development has developed a portfolio improvement plan. This is a high-level action plan, incorporating the internal auditor's recommendations. The college is also refreshing the transformation plan to incorporate the internal auditor's recommendations. It is too early to make an assessment of the impact of the PMO, but the external auditor will continue to monitor progress.

Monitoring and reporting

26. The SFC has put in place effective monitoring arrangements, meeting with the college on a monthly basis to monitor progress. The SFC also attends meetings of the Policy and Resources Committee. At these meetings, the college provides updates on progress with the transformation plan on student activity, curriculum planning, staffing issues and the financial position. The SFC believes the college is making progress, particularly with its approach to curriculum planning. It has required the college to provide more robust evidence to support its reporting on progress, including a weekly update on student activity. Based on regular engagement with the college to secure assurances, the SFC is confident that the college will meet, or slightly exceed, its activity target for 2016/17.

27. The SFC is satisfied that the college has improved its financial forecasting and our review of the management accounts supports this view. The finance report which goes to the executive team and the Board every month provides a good level of detail, with narrative to support forecasts and updates to explain movement and variance.

28. Board members told us that, during 2013/14, it became clear that there were financial problems at the college, but that the root cause of the problems was not clear from the information provided to the Board. Although there was no indication that the financial data being provided to the Board was unreliable, it did not explain why the college was not meeting its credit targets. Board minutes show that during 2014/15, the Board was provided with assurances by the executive team that the college would achieve its student activity target. Minutes during this period also show that the Board raised the need for the development of management information to allow for more effective monitoring of application and enrolment data.

29. The auditor found that the quality of information provided to the Board during 2015/16 had improved, particularly in relation to the management accounts and on student recruitment. Board members told us that they are now more confident that the Board and committees are getting the right information to allow them to assess progress, and that the information provided by the management team is more robust.

30. The college has developed a new approach to curriculum planning. Each department within a faculty is set a credit target based on past performance and projected future demand, and credits by department are monitored and reported on. The Assistant Principal for Curriculum told us that previously, projections were more arbitrary, as it was not possible to work out whether a course was efficient or not. The college has taken steps to better understand the relative value of individual courses under the SFC's funding formula.

31. The college has developed a new curriculum planning tool, which is enabling improved monitoring and analysis. For each course, the planner includes information on:

- projected and actual enrolments
- delivery hours
- credit target
- SFC funding
- FTE staff required
- current staff numbers.

32. The curriculum planning tool provides the college with better information on activity across departments and individual courses, allowing the college to monitor and respond to changes in activity and costs, for example by removing inefficient courses from the curriculum. The staffing information also enables the college to assess which areas should be targeted for the third phase of voluntary severance. The auditor will continue to monitor progress with implementation of the revised curriculum.

33. In January 2017, it was reported to the Policy and Resources committee that the early withdrawal rate is currently at 4.3 per cent, compared to 5.2 per cent in 2015/16.

Current financial position and future sustainability

Financial position and SFC support

34. The college's financial position was weak and worsening by the end of 2015/16. The college reported a deficit of £7.0 million in 2015/16 (compared to £5.6 million in 2014/15), which equates to approximately 11 per cent of the college's total income for the year. After excluding pension accounting adjustments, the underlying position for 2015/16 was a £3.6 million deficit (paragraph 3). The college is forecasting a deficit of £3.814 million for 2016/17, a deficit of £0.546 million for 2017/18, and a small surplus for 2018/19.

35. The college was heavily dependant on SFC support in 2015/16 in order to meet its liabilities, and will continue to be so until at least 2018/19. The SFC has agreed to provide a range of support to the college (Exhibit 1). This includes funding to support the voluntary severance schemes (paragraphs 40-41) and a cash advance of up to £2.9 million to support implementation of the transformation plan. The SFC expects the college to repay this advance. Details of the repayment have not been formally agreed, but the college's financial plan for 2015-19 forecasts a three-year repayment period to 2019/20, subject to affordability.

36. The SFC has acknowledged the scale of change required by the transformation plan and the fact that the college may require further support to meet operating and transformation costs. In November 2016, the SFC provided written assurances to the college that it will continue to support the college through to 2018/19, when the transformation plan is due to be fully implemented.

Exhibit 1

Additional support provided to Edinburgh College by the SFC

Nature of support	Value £ million	Timing of receipt	Subject to future repayment
Additional transformation funding	£1.1m	2015/16	No
Additional transformation funding	£0.8m	2015/16	No
Voluntary severance 1	£0.65m	2015/16	No
Total 2015/16	**£2.55m**		
Cash advance funding	£2.9m	2016/17	Yes
Voluntary severance 2	£0.6m	2016/17	No
Voluntary severance 3 (not yet confirmed)	£1.8m	2016/17	No
Total 2016/17	**£5.3m**		
Voluntary severance 4 (not yet confirmed)	£0.25m	2017/18	No
Total 2017/18	**£0.25m**		
Total non-repayable funding	**£5.2m**		
Total	**£8.10m**		

Source: Edinburgh College Annual Audit Report 2015/16

Performance against activity targets

37. The financial sustainability of Edinburgh College is primarily dependent on its ability to deliver its annual activity target and on the outcome of a series of voluntary severance schemes. The college must also effectively monitor its income, expenditure and cash flows, to ensure its financial forecasts remain on track to achieve a small surplus in 2018/19.

38. The college's rebased activity target for 2015/16 was 186,258 credits (paragraph 10). Subsequently the college missed this target, delivering a total of 180,144 credits. The shortfall of 6,114 credits for 2015/16 amounted to £1.1 million in SFC funding. The SFC clawed back this funding and then re-issued it to the college as non-repayable transformation funding. In addition to the £0.8 million re-issued to the college to replace the clawback for 2014/15, this amounts to a total of £1.9 million of transformation funding in 2015/16.

39. The SFC and the college agreed a core activity target of 184,028 credits for 2016/17, plus 2,000 European Social Fund credits. As at 14 March 2017, the college reports that it had delivered 185,074 credits and that it is on track to meet its 2016/17 target. The college is likely to retain the same credit target in 2017/18, based on the SFC's indicative allocations. The

college plans to seek modest increases to this target from 2018/19 onwards. Growth will be dependent on the availability of funding from the SFC and on successful delivery of the college's new curriculum.

Voluntary severance schemes

40. The college has planned for four voluntary severance schemes from 2015/16 to 2017/18, with a target reduction in FTE staff of around 134. The college anticipates that, in total, these schemes will deliver recurring savings of £4.6 million by the end of 2018/19 (summarised in Exhibit 2). The SFC is providing £3.3 million of support for these schemes.

41. Phases one and two involved mainly administrative support staff. Phase three, which opens in April 2017, will target academic staff following the curriculum redesign. This will be the most challenging scheme to date. The college is aiming to target specific subject areas as far as possible, but, as it is an open scheme, there is a risk that this phase of voluntary severance may not deliver the staff profile required and the associated savings.

Exhibit 2

Voluntary severance schemes

Dates	Number of staff	SFC funding £ million	Cost £ million	Expected savings £ million
May-June 2016	41	£0.65m	£1.14m	£1.12m (audited)
October-November 2016	26	£0.56m	£0.620m	£0.77m
April-May 2017	c.51	£1.85m	tbc	£2.46m
Feb-March 2018	tbc	£0.25m	tbc	£0.35m
Total	**c. 134**	**£3.31m**	**tbc**	**c.£4.7m**

Source: Edinburgh College Financial Plan

Financial monitoring

42. College financial forecasts are based on a number of assumptions underpinning the success of the transformation plan including the adoption of Priority Based Budgeting to align curriculum and staff planning. Cash flow management is a critical component with efforts required to address cost areas where the college has limited control such as pension and energy costs and the outcome from national bargaining. The college is looking for cost savings beyond those from voluntary severance, and its unaudited management accounts at the end of December 2016 report some success so far in 2016/17, with savings on staff vacancy churn and delayed recruitment, professional fees and catering overheads. Looking further ahead, the college plans to make savings in estate management across the four campuses.

43. Management accounts at the end of December 2016 show that year-to-date performance has reduced the projected deficit for 2016/17 by £0.4 million to £3.417 million. Cash flows are dependent on full draw-down of SFC funding of £2.9 million between March and April 2017, with a forecast year-end cash balance of £0.7 million. Finance staff have carried out high-level sensitivity analysis on the budgeted forecasts for the year to determine the potential impact of various events such as reduced income, increased expenditure in the year, or the timing of voluntary severance acceptances by staff. These demonstrate the vulnerability of the college's finances. Any fluctuation in income or expenditure will affect the size of the deficit and may result in the college requiring further financial support from the SFC.

Conclusion

44. The college now understands the underlying issues which led to its current financial position and is making progress to address these through its transformation plan. It has put in place more robust governance arrangements, which should lead to better and more consistent programme and project management, as well as better monitoring and reporting to both the Board and the SFC. The college reports that it has improved performance against activity targets and is on track to achieve its target for 2016/17.

45. While there is an overall picture of progress and improvement, the college's financial position remains challenging and continued progress is dependant on the college fully implementing its curriculum review in time for the 2017/18 academic year. The college is also heavily reliant on voluntary severance to make savings.

46. The SFC has provided written assurances to the college that it will continue to support the college through the implementation of the transformation plan, and made clear that further support is conditional on the continued delivery of the transformation plan. Any adverse fluctuation in income or costs could affect the college's ability to repay the £2.9 million transformation funding to the SFC, and the college could require further support.

47. The auditor will continue to monitor progress.

Appendix 1

Timeline

Date	Event
22 July 2014	SFC issue 2014/15 funding and activity guidance to colleges
August 2014 -October 2015	College monitors and reports on activity to both the SFC and the Board, providing assurances to the Board that targets would be met
November 2014 - April 2015	Interim Principal in post - puts initial development plan in place
May 2015	New college Principal and Chief Executive takes up post
May 2015	VP Curriculum and VP Quality posts merged
10 October 2015	Deadline for submission of 2014/15 data return for funding purposes by the college to SFC. Accompanying audit certificate and report provided by internal audit
Mid-late October 2015	College notified by SFC that it failed to deliver its agreed activity target and that SFC will seek to recover £0.8 million
November 2015	VP Quality leaves the college on voluntary severance
November 2015	Principal initiates review of the college’s activity targets from the point of merger
November 2015	Principal approached the SFC to request rebasing the college's 2015/16 activity target
December 2015	Board agree 16 point action plan that will form basis of transformation plan
December 2015	SFC writes to the college to agree Principal's request to rebase 2015/16 activity target
February 2016	SFC notify the college that it can retain £0.8 million, that it had originally intended to claw back due to failure to deliver agreed activity target
February 2016	Principal reports to the Board on the outcome of her review of the college's activity targets
March 2016	Final version of transformation plan submitted to SFC
April 2016	College formally publish transformation plan
May 2016	VP Curriculum and Quality (former VP Curriculum) resigns and

Date	Event
	leaves the college
June 2016	Report on Principal's review of activity targets presented to the Audit and Risk Assurance Committee
1 July 2016	New senior management structure in place
September 2016	Internal auditor completes review of the transformation plan, commissioned jointly by the college and the SFC