

Audit Committee Meeting

Date of Meeting	Friday 11 March 2016
Paper Title	Audit Scotland report on the college sector
Agenda Item	15
Paper Number	AC2-I
Responsible Officer	Martin Fairbairn, Interim Chief Officer
Status	Disclosable
Action	For approval

1. Report Purpose

- 1.1. Consider the Audit Scotland report, *Scotland's colleges 2015*, a copy of which is included as an annex to this paper.

2. Recommendations

- 2.1. The Committee is invited to:

- **note** the key messages as set out in the Audit Scotland report; and
- **agree** that GCRB management should bring forward a report to the Committee's next meeting setting out how GCRB has addressed Audit Scotland's recommendations.

3. Summary of the report

- 3.1. Audit Scotland based its work on:

- an analysis of information held by the Scottish Funding Council (SFC) including performance and activity data and documentation with regard to the structural reforms;
- fieldwork interviews at Ayrshire, Dundee and Angus, Edinburgh and Glasgow Clyde colleges;
- a review of the fieldwork against the Learning the Lessons of Public Body Mergers published in 2012. (This report is available at http://www.audit-scotland.gov.uk/work/all_national.php?year=2012); and
- an analysis of college annual accounts and Scottish Government budget documentation.

- 3.2. The financial figures used in the report are in real terms.

- 3.3.** The report has two sections, one dealing with College Reform and the second on College Finances.
- 3.4.** The report acknowledges that colleges have faced a period of considerable change in recent years including:
- the reduction in the number of incorporated colleges from 37 in 2011/12 to 20 in 2014/15;
 - reductions in funding of 12.3% in real terms between 2011/12 and 2013/14;
 - the decision by the Office of National Statistics to reclassify incorporated colleges as public bodies;
 - a reduction of 48% in part-time students as a consequence of Scottish Government policy;
 - a reduction of 41% in the number of students aged over 25 years between 2008/09 and 2013/14;
 - the introduction of regional outcome agreements; and
 - a reduction in staff numbers of 9.3% between 2011/12 and 2013/14.

4. Audit Scotland Recommendations

- 4.1.** The report makes a series of recommendations and these are set out below:

Colleges

- 4.2.** Colleges should continue to review workforce plans in the light of reductions in staff, and as part of curriculum reviews, to identify any gaps in skills, knowledge and the resources required to deliver high quality learning.

Regional Bodies

- 4.3.** Regional Bodies should work with colleges in their region to develop appropriate accountability structures to ensure effective governance of the use of public money and management of the performance of the colleges.

College Boards

- 4.4.** College Boards should:
- comply with existing Scottish Government and SFC requirements and guidance, and wider good practice when considering and approving senior staff severance. In particular, they should base their decisions on full business cases to support governance proposals, and clearly record how they have considered and taken decisions on those proposals;
 - monitor student participation and satisfaction to help them plan future provision;

- complete the remaining merger activities including standardising terms and conditions of service for all staff, curriculum reviews and integration of ICT systems; and
- work towards developing ten year financial plans.

5. Risk Analysis

- 5.1.** Consideration of this report contributes towards management of risks associated with GCRB's governance arrangements.

6. Legal Implications

- 6.1.** There are no specific legal implications arising from this paper.

7. Financial Implications

- 7.1.** There are no specific financial considerations arising from this paper.

8. Regional Outcome Agreement Implications

- 8.1.** Through the conditions of grant associated with the Regional Outcome Agreement, GCRB and the assigned colleges are required to conduct their affairs in accordance with the expected standards of good governance, which includes account being taken of relevant audit reports.

Scotland's colleges 2015



Prepared by Audit Scotland
April 2015

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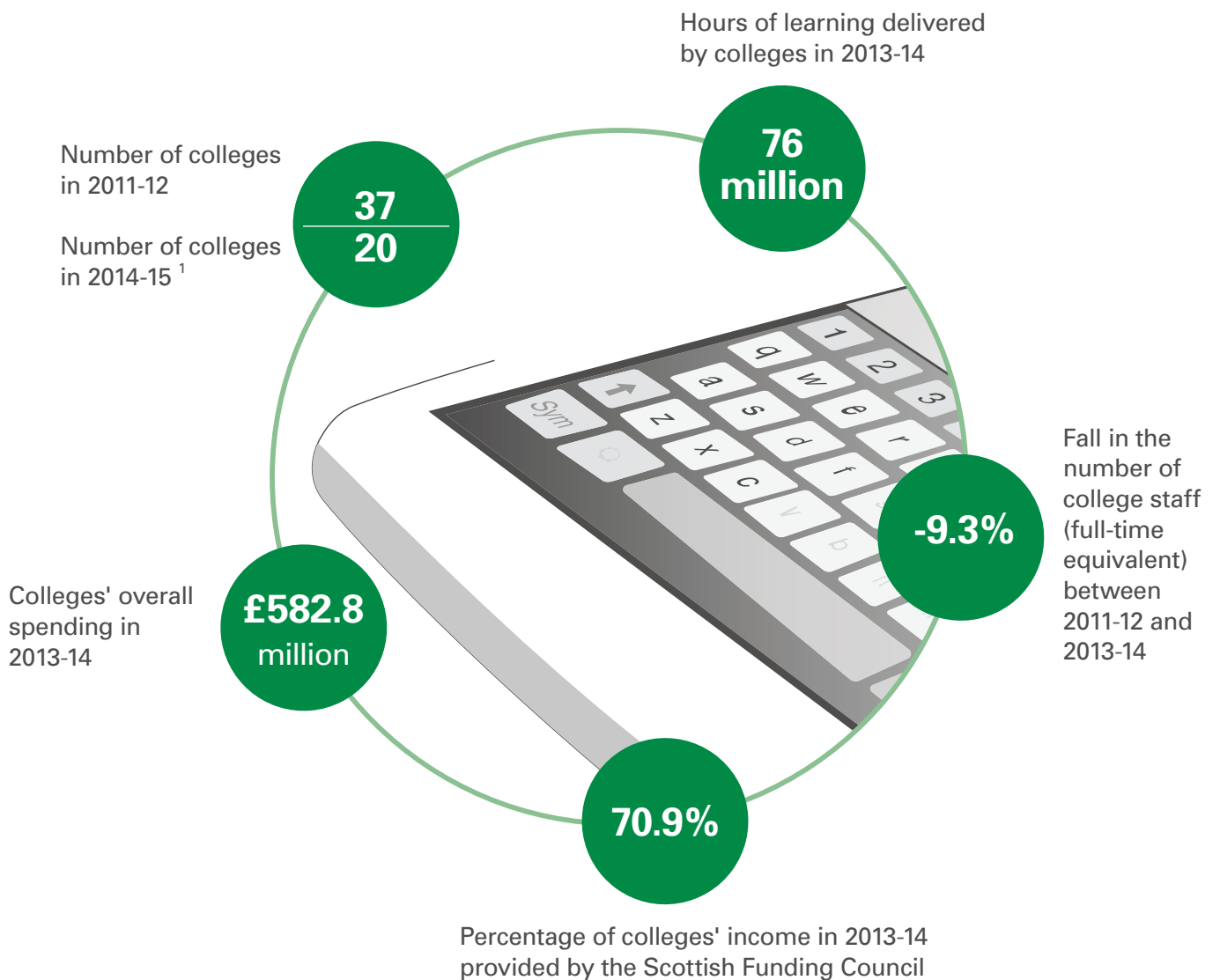
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Exhibit data

When viewing this report online, you can access background data by clicking on the graph icon. The data file will open in a new window.

Key facts



Note: 1. This figure relates to colleges incorporated under the Further and Higher Education (Scotland) Act 1992. There are a further six colleges not incorporated under the Act: Argyll College, Newbattle Abbey College, Orkney College, Sabhal Mòr Ostaig, Shetland College and West Highland College.

Summary



Key messages

- 1** Scotland's colleges have faced significant changes over the last few years that have had implications for funding, the provision of learning and how colleges are run, managed and scrutinised. In addition to the reduction in budgets that most public bodies have had to deal with, colleges have had to manage reforms and other changes. Many of the effects of these changes are still taking place, including standardising terms and conditions of service for staff and integrating ICT systems.
- 2** The reform programme has led to the number of incorporated colleges decreasing from 37 in 2011-12 to 20 in 2014-15. Planning for mergers was generally good and all of the merged colleges were established on time. The Scottish Government identified that mergers would deliver £50 million of efficiency savings each year from 2015-16, along with other benefits, such as reduced duplication and better engagement with employers. While mergers have contributed to significant efficiency savings, the Scottish Government and the Scottish Funding Council (SFC) have not specified how they will measure some of the expected wider benefits. This makes it difficult to assess whether the reform programme is achieving all of its aims.
- 3** The decision by the Office for National Statistics (ONS) to reclassify colleges as public bodies has led to greater accountability for the use of public money in the college sector through additional financial reporting and reduced autonomy for colleges. Reclassification also led to the formation of arm's-length, independent foundations to protect colleges' financial reserves. Colleges transferred £99 million to these foundations in 2013-14. As the foundations are independent, there is no guarantee colleges will be able to access the transferred funds. However, the foundations' Articles of Association limit the activities that they can fund and any transferred funds must be spent on supporting further education in Scotland.
- 4** The changes to date have had minimal negative impact on students. Historically, the Scottish Government has required colleges to deliver agreed amounts of learning activity in return for the funding it provides. Colleges continued to meet targets for learning, delivering around 76 million hours of learning in 2013-14. Colleges need to continue to monitor the effects of ongoing changes to the sector on students and address any issues of concern. The Scottish Government continues to prioritise younger students and has reduced funding for very short-term courses (under ten hours) and those courses which do

not lead to a recognised qualification. There has been a reduction of 48 per cent in part-time students and a reduction of 41 per cent in the number of students aged 25 or older between 2008-09 and 2013-14.

- 5** The development of outcome agreements for the sector has seen an ongoing shift to a focus on outcomes, with an associated change in the approach to funding. However, improvements are needed in how the SFC reports colleges' progress against outcomes to support effective scrutiny of performance.
- 6** Scottish Government funding to colleges fell by 12.3 per cent in real terms between 2011/12 and 2013/14 but colleges' finances continued to be generally sound. The sector reported a deficit of £95.2 million in 2013-14 but adjusting for transfers to arm's-length foundations would result in an overall surplus of £3.8 million (just under one per cent of total income) in 2013-14.
- 7** Recent changes have made it more challenging for colleges to plan and forecast their longer-term financial position. However, colleges need to develop longer-term financial planning to ensure they consider, and plan for, the future needs of their region. The mergers and funding reductions have led to reductions in expenditure, mainly in recurring staff costs. Staff numbers decreased by 9.3 per cent between 2011-12 and 2013-14. The reductions in staff costs were delivered mainly through voluntary severances. While most severance was managed in accordance with good practice, auditors found significant weaknesses in how two colleges processed senior staff severance payments, while another four fell short of good practice.

Recommendations

The Scottish Government and the SFC should:

- specify how they will measure and publicly report progress in delivering all of the benefits that were expected from mergers
- publish financial information on the costs and savings achieved through the merger process
- encourage college board members to attend, and monitor take-up of, the training on severance that is being developed by the SFC and the College Development Network
- monitor colleges' compliance with requirements, guidance and good practice relating to severance arrangements.

The SFC should:

- publish a clear and concise annual summary of colleges' progress against outcome agreements.

Colleges should:

- continue to review workforce plans in the light of reductions in staff, and as part of curriculum reviews, to identify any gaps in the skills, knowledge and resources required to deliver high-quality learning.

Regional bodies should:

- work with colleges in their region to develop appropriate accountability structures to ensure effective governance of the use of public money and management of the performance of the colleges.

College boards should:

- comply with existing Scottish Government and SFC requirements and guidance, and wider good practice when considering and approving senior staff severance. In particular, they should base their decisions on full business cases to support severance proposals, and clearly record how they have considered and taken decisions on those proposals
- monitor student participation and satisfaction to help them plan future learning provision
- complete the remaining merger activities, including standardising terms and conditions of service for all staff, curriculum reviews and integration of ICT systems
- work towards developing ten-year financial plans.

About the audit

1. This report comments on the various reforms under way in the college sector and how well they have been managed and delivered. It also provides an update on the financial standing of the sector between 2011-12 and 2013-14. It is based on:

- An analysis of information held by the SFC including performance and activity data, and documents relating to the structural reforms.
- Fieldwork interviews and review of relevant documentation at four colleges: Ayrshire; Dundee and Angus; Edinburgh; and Glasgow Clyde. We undertook the fieldwork to examine how the merger process is being managed locally. All college mergers were different, but selecting four (out of the nine mergers that have taken place since 2012) gave us a broad basis on which to draw wider conclusions. We chose these particular colleges as they were all at different stages of the merger process and to ensure a geographical spread. We also wanted to include a college that forms part of a multi-college region (Glasgow Clyde College).

- A review of how the four fieldwork sites complied with the recommendations in our 2012 report [Learning the lessons of public body mergers \[PDF\]](#). The key recommendations in that report were:
 - appoint the chair and chief executive at the earliest possible opportunity (ideally at least six months before the start date of the new organisation) to allow them to progress important decisions and contribute to establishing a clear and strong vision, structure and plan for the new organisation
 - identify the skills, knowledge and expertise needed to lead the new organisation and, with merging bodies, use this to assess, and if necessary supplement, board and senior management capability
 - identify, when planning the merger, the specific improvements it expects each merged body to deliver and the criteria it will use to assess this
 - develop robust cost and savings estimates for future mergers and, with merging bodies, regularly review and revise these as necessary as the merger proceeds.
- Analysis of relevant Scottish Government budget documentation and colleges' audited annual accounts and auditors' reports covering the financial periods ending:
 - July 2013 (12-month period for all colleges)
 - July 2014 (12-month period for the University of the Highlands and Islands (UHI) colleges.
 - March 2014 (eight-month period for non-UHI colleges).
 - These financial periods differ due to changes in the accounting arrangements for the sector resulting from the reclassification of colleges as public bodies.

2. These periods differ from the Scottish Government's financial year which runs from 1 April to 31 March. To help provide clarity, we use the convention '2013-14' when referring to figures from the colleges' accounts, or relating to the academic year, and '2013/14' when referring to funding allocations made in the Scottish Government's financial year.

3. Our report reflects mainly the most recent college year (2013-14), unless there are any particular issues arising from the 2012-13 financial year, or where it would be helpful in comparing financial years. The shorter financial period for non-UHI colleges in 2013-14 means it is not always appropriate to compare 2013-14 figures with previous years.

4. Unless we state otherwise, all financial figures in the body of this report are in real terms, that is, allowing for inflation. Figures and exhibits relating to colleges' audited accounts are for incorporated colleges only. Until 1992, all publicly funded colleges were run by local authorities. Under the Further and Higher Education (Scotland) Act 1992, most of these colleges established their own corporate body and boards of management. The boards of management took over responsibility for the financial and strategic management of the colleges. These colleges are referred to as incorporated colleges and produce accounts subject to audit by the Auditor General for Scotland. The remaining six colleges are generally referred

to as non-incorporated colleges. Scottish Government budget information and statistics relating to student activity within this report refer to both incorporated and non-incorporated colleges.

5. Three former further education colleges are now classed as part of the higher education sector. Barony College, Oatridge College and Elmwood College (land-based courses) merged with the Scottish Agricultural College on 1 October 2012 to form SRUC (Scotland's Rural College), a higher education institution. We have adjusted the financial figures to allow comparison between years, but include current and past information on students undertaking further education at SRUC.

6. The 2013-14 accounts for Edinburgh College, Fife College and Glasgow Kelvin College were not laid by the statutory deadline of 31 December 2014. This was a result of the need to complete a number of administrative processes within the Scottish Government. The delay did not affect any of the figures, findings or messages in this report.

7. The 2013-14 accounts and external audit for Coatbridge College were not concluded at the time of preparing our report. This meant that the accounts were not able to be laid in the Scottish Parliament by the statutory laying deadline of 31 December 2014. The delay has been due to difficulties experienced by the auditor in securing the information needed to conclude the audit work, and the need to consider and reflect a number of significant concerns relating to severance arrangements for senior staff. The Auditor General plans to prepare a separate statutory report on these issues. The auditor provided us with a set of draft accounts and we have used those figures for our analysis. Details of further likely changes to the Coatbridge College accounts are outlined in [paragraph 73](#) and we are satisfied that these changes would have no significant effect on the sector figures or messages in this report.

Part 1

College reform



Key messages

- 1** Scotland's colleges have faced significant changes over the last few years, which have had implications for funding, delivery and how colleges are run, managed and scrutinised. It is too early to fully assess how these will affect how colleges perform and the quality of learning, as many of the changes are still taking place.
- 2** The Scottish Government's reform programme has led to college mergers, and the number of incorporated colleges reduced from 37 in 2011-12 to 20 in 2014-15. Planning for mergers was generally good and all of the merged colleges were established on time. All colleges involved in mergers developed appropriate merger proposals and financial business cases, and the SFC provided guidance, support and challenge. Work is ongoing at individual colleges to standardise terms and conditions for staff, review and revise curricula, and integrate ICT systems.
- 3** The Scottish Government and the SFC expect the reform programme to deliver a number of high-level benefits, including reduced duplication, improved engagement with employers, better outcomes for students and financial savings of about £50 million each year from 2015-16. A large proportion of the savings have come from reductions in staff, with the biggest reduction being teaching staff costs. However, it is unclear what savings have been achieved in addition to reduced staffing costs and what the full costs of the merger process are as there are no systems in place either at individual colleges or centrally to collect this information. It is also unclear what progress there has been in achieving some of the wider benefits expected from the mergers.
- 4** The ONS reclassification of colleges as public bodies has led to greater accountability for the use of public money in the college sector through additional financial reporting and reduced autonomy for colleges. Delays in deciding which accounting period to use for financial statements created uncertainty for colleges. Reclassification also led to the formation of arm's-length foundations, intended to protect colleges' financial reserves. Colleges made significant transfers to these foundations of £99 million in 2013-14. The foundations' Articles of Association limit the activities that they can fund and any transferred funds must be spent on supporting further education in Scotland. The SFC reports that colleges have secured nearly £20 million from the foundations since they were established.

colleges
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years

5 Colleges continued to meet targets for learning, providing around 76 million hours of learning in 2013-14. Regular student surveys and SFC merger evaluation feedback indicate that the changes to date have not adversely affected students. The Scottish Government continues to prioritise younger students and has reduced funding for very short-term courses (under ten hours) and those courses which do not lead to a recognised qualification. There has been a reduction of 48 per cent in part-time students and a reduction of 41 per cent in the number of students aged 25 or older attending college between 2008-09 and 2013-14.

Colleges have gone through significant reforms

8. Colleges are the main providers of further education in Scotland. They also deliver a significant volume of higher education. Scotland's colleges play an important role in helping to achieve sustainable economic growth by contributing to the development of a highly educated and skilled workforce. In 2013-14, around 238,000 people attended colleges to pursue a variety of qualifications.

9. The college sector has been through significant change over the last few years ([Exhibit 1, page 12](#)). In addition to the reduction in budgets that most public bodies have had to deal with, the college sector has faced significant reforms:

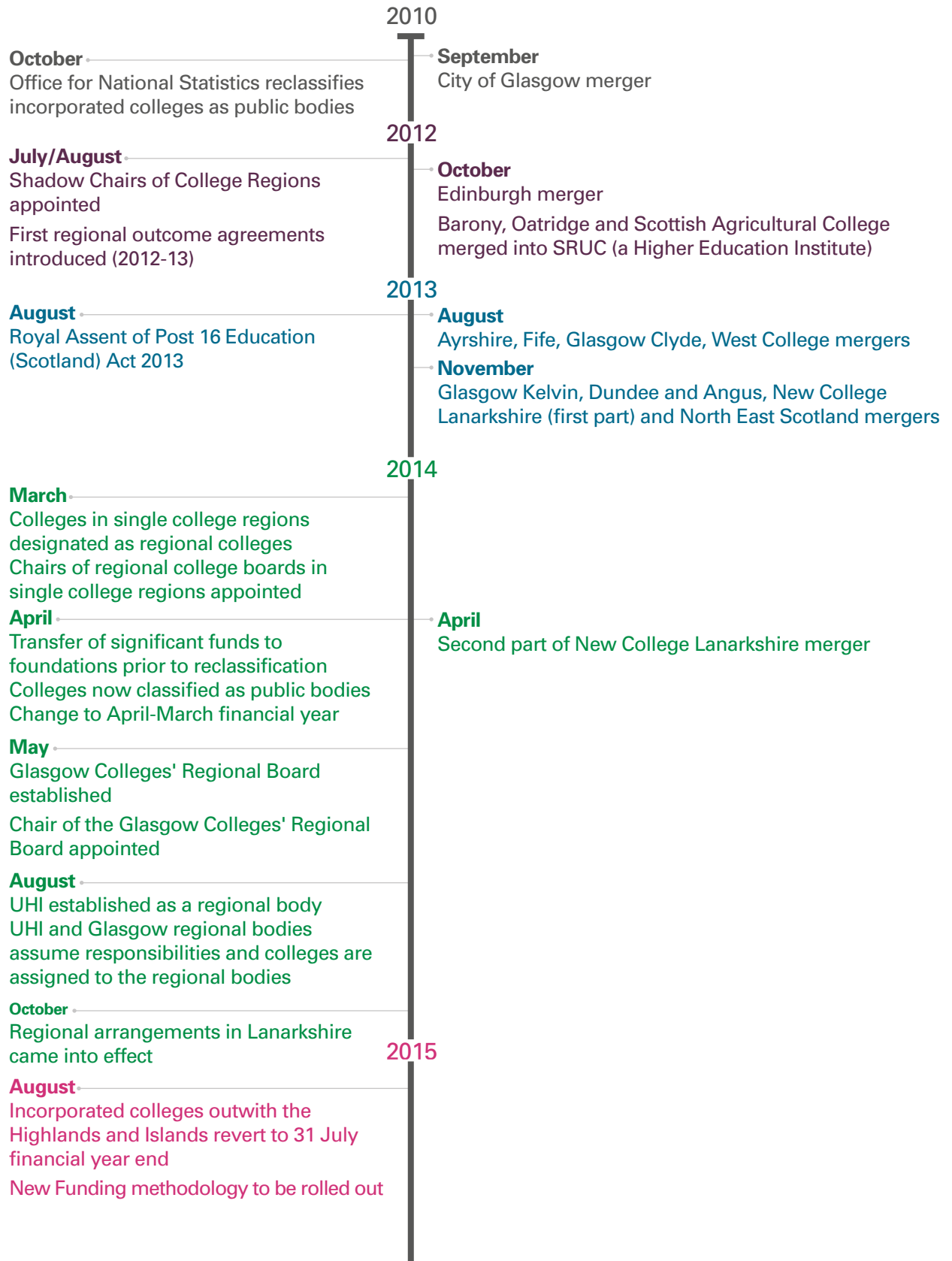
- The number of colleges has decreased from 37 in 2011-12 to 20 in 2014-15. Since October 2012, 25 colleges have merged to form nine colleges. There are a total of ten colleges formed through mergers, with City of Glasgow College having formed in 2010. This audit focuses on the nine more recent mergers ([Supplement 1: College mergers](#)).
- Three former further education colleges are now classed as part of the higher education sector ([paragraph 5](#)).
- The Post-16 Education (Scotland) Act 2013 included provisions to support the reform of the sector into 13 regions, including arrangements for how the merged colleges were to be run.
- The SFC introduced outcome agreements in 2012-13, which set out what colleges need to deliver in return for SFC funding.
- The Office for National Statistics (ONS) reclassified colleges as public bodies in October 2010. This had implications for the way that colleges managed and reported their finances from April 2014.

10. Further changes are planned for the college sector. The Scottish Government established the Commission for Developing Scotland's Young Workforce in January 2013, asking it to make recommendations that would help Scotland to produce better qualified, motivated young people who are ready for work. The Scottish Government's response in December 2014 outlined the early progress that has been made and the additional work proposed to implement the Commission's recommendations. Colleges will play a central role in implementing many of the Commission's recommendations.

Exhibit 1

Changes to the college sector

Since 2010, significant changes have affected how colleges are structured and managed.



11. The SFC has an important role in supporting colleges and securing the delivery of high-quality learning in Scotland ([Exhibit 2](#)). The changes detailed in [Exhibit 1 \(page 12\)](#) have also resulted in additional work for the SFC in terms of supporting the sector, and monitoring funding and activity.

Exhibit 2

The role of the SFC

The SFC has various functions to ensure colleges provide high-quality learning.

The SFC has statutory duties in relation to both Scottish colleges and universities. Its main duty is to secure coherent, 'high-quality further education and higher learning provision'. The SFC works with colleges, universities and its partners to lead and support change in further and higher education, to improve the life chances of learners and to support jobs, growth and sustainability.

The SFC's *Strategic Plan 2012-15* specifies a number of outcomes that it wants to achieve, including: efficient and effective regional college structures; high-quality, efficient and effective learning; and a developed workforce.

Each year, the Cabinet Secretary for Education and Lifelong Learning also issues the SFC with a 'letter of guidance', which sets out the Scottish Government's strategic objectives for the year. The letter of guidance specifies what the Scottish Government expects colleges to achieve in that year and what support the SFC will provide. In the 2014-15 letter of guidance, for example, the Cabinet Secretary highlighted the SFC's expected role in responding to the Commission for Developing Scotland's Young Workforce, the development of a new funding model for colleges and continued support for colleges as they adapt to the requirements of being reclassified as public bodies.

Source: *Strategic Plan 2012-15*, Scottish Funding Council; *2014-15 Letter of Guidance*, Scottish Government

The Scottish Government and the SFC have not specified how they will measure all of the benefits expected from mergers

12. The Scottish Government expects college mergers to support delivery of the following high-level benefits:

- efficiencies through reduced duplication and unnecessary competition
- improved engagement with local employers to better understand their needs
- better outcomes for learners.

13. The Scottish Government and the SFC have not specified the measures they will use to assess progress in delivering all of the expected benefits of the mergers. Neither could they provide us with details of the expected level of change required for mergers to be considered successful. The lack of baseline information for some of the expected benefits will also make it difficult to fully assess and report on improvement. The Scottish Government indicated that it will draw on existing data sources, including financial data and college performance indicators, to assess progress.

14. The Scottish Government and the SFC also intend to assess how effectively the college sector responds to student and employer needs and national programmes such as Developing Scotland's Young Workforce. While it should be possible to extract information on savings and student outcomes from existing data sources, it is not clear how the Scottish Government and the SFC will measure the wider benefits, such as reduced duplication and improved engagement with employers. Reviewing course availability and participation, and seeking the views of employers, are examples of ways in which they could assess achievement of these expected benefits.

15. Although colleges outlined expected benefits from the mergers in individual business cases, they have not detailed how they will measure these benefits. The SFC has indicated that its two-year post-merger evaluations will include a review of whether mergers are achieving benefits ([paragraph 22](#)).

Planning for mergers was generally good and all college mergers took place as planned

16. In February 2012, the Cabinet Secretary for Education and Lifelong Learning announced that colleges would be organised in 13 regions. The Scottish Government's preferred option was for mergers between individual colleges to create a single college in each region. Ministers did not compel colleges to merge and colleges in each region worked together to identify the best approach.

17. Colleges discussed and agreed their expected merger dates with the SFC. All mergers took place within the planned timescales, with most colleges merging in August or November 2013. Cumbernauld College and Motherwell College merged in November 2013 to form New College Lanarkshire, with Coatbridge College joining in April 2014.

18. As a result of these changes, the number of incorporated colleges in Scotland decreased from 37 in 2011-12 to 20 in 2014-15. These colleges are now spread across 13 regions in Scotland ([Exhibit 3, page 15](#)).

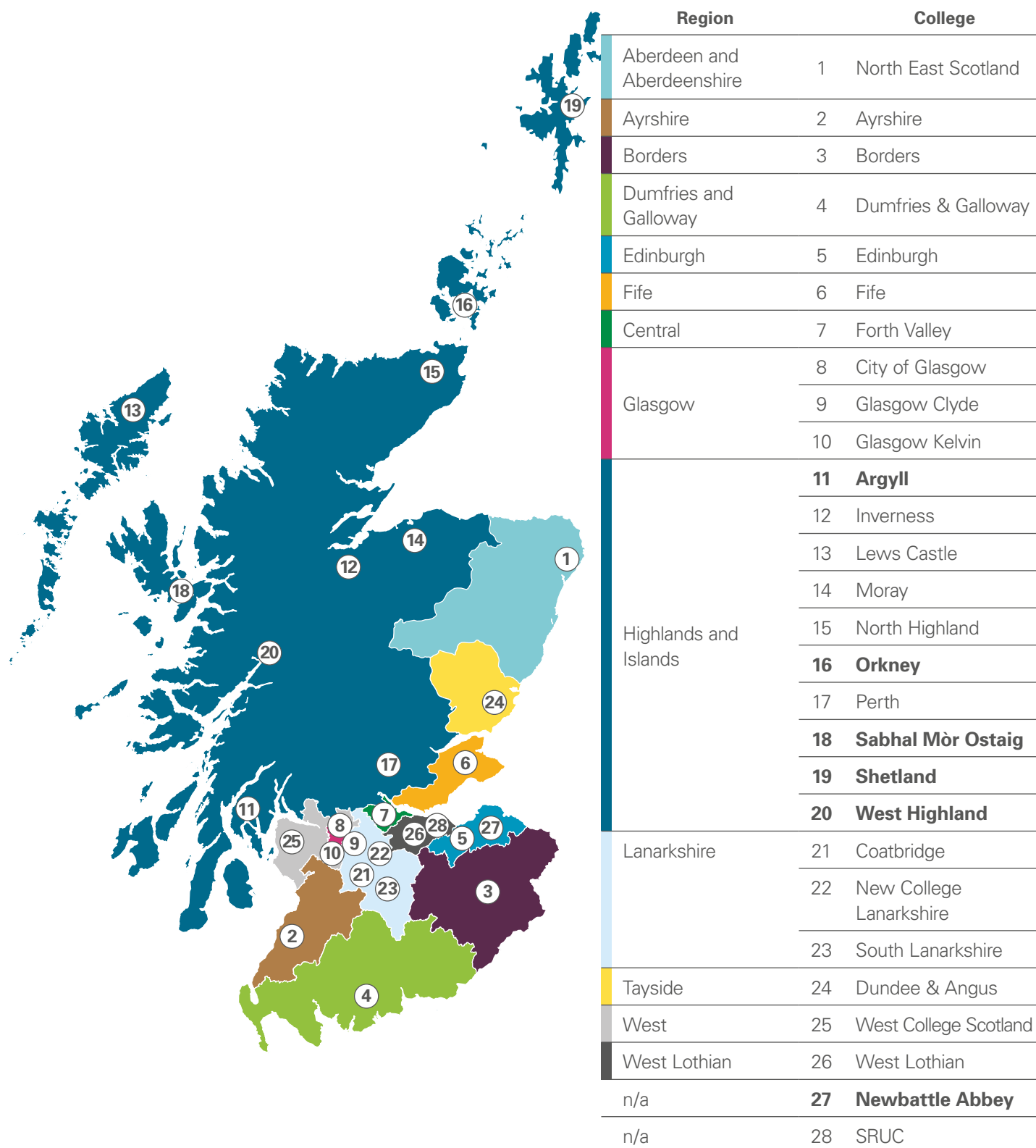
19. We reviewed merger arrangements for four merged colleges ([paragraph 1](#)) and refer to these as 'fieldwork colleges' in the rest of the report. Planning for these mergers was generally good. Each of the four colleges did the following:

- prepared merger proposal documents. These documents covered all important elements of the proposed merger, including the aims and objectives, the expected benefits and the governance and management arrangements for the merger process
- prepared financial business cases, which included all the relevant and appropriate information required such as financial plans, risks, costs and planned actions
- established partnership boards to oversee how each merger was being planned and implemented. The partnership boards comprised appropriate representation from each college involved in the merger, and included both staff and student representatives
- gathered views and managed concerns from staff and students

Exhibit 3

Scotland's colleges


Scotland's college regions, in 2013-14. In electronic versions of this report, key facts about each of Scotland's 21 colleges in 2013-14 are available within the exhibit data.



Note: The map shows the 21 incorporated colleges, the six non-incorporated colleges in Scotland (in bold) and further education student numbers from SRUC during 2013-14. On 1 April 2014, Coatbridge College merged into New College Lanarkshire. From this date forward there were 20 incorporated colleges. Please note that the total number of students differs from the 238,000 quoted in paragraph 8 as students may attend more than one college. We define teaching staff as staff members classified as teaching staff and teaching support staff within colleges' audited 2013-14 annual accounts.

Source: Audit Scotland's analysis of colleges 2013-14 accounts and student number information from the SFC's infact database

- appointed project managers to coordinate the merger process
- developed merger plans that specified tasks and responsibilities leading up to, and following, the planned merger date
- prepared regular monitoring reports, which outlined progress and any issues to be resolved. Partnership boards regularly considered these reports, along with a project manager's update and a risk register, setting out all issues that could pose a risk to achieving the merger. They also resolved issues and areas of concern.

20. While fieldwork colleges were aware of merger guidance from Audit Scotland and the SFC, they did not always follow the guidance. Our 2012 good practice guide [Learning the lessons of public body mergers \[PDF\]](#)  highlighted the importance of appointing the leaders of a new organisation as early as possible.¹ Ideally this should be at least six months before the organisation's start date. Two fieldwork colleges were in line with this good practice. Dundee and Angus College, formed on 1 November 2013, appointed its Principal designate eight months before the merger; and Glasgow Clyde College, formed on 1 August 2013, appointed its Principal designate seven months before the merger. For the remaining two fieldwork colleges, Ayrshire College, formed on 1 August 2013, appointed its Principal designate five months before the merger date; Edinburgh College was formed on 1 October 2012, and our guidance was not available six months before this date. However, Edinburgh College appointed its Principal designate only one month before its formation, and subsequent mergers have shown that an earlier appointment of a Principal designate should have been possible.

The SFC and the Scottish Government provided a range of support and funding to merger colleges

21. The SFC and the Scottish Government provided a range of support to merger colleges. This included dedicated staff for advice and guidance, and SFC staff attending partnership board meetings. The SFC also provided over £52 million between 2011-12 and 2013-14 to support college mergers. It plans to provide a further £6 million in 2014-15. Merger colleges used most of this funding to pay for voluntary severance. We discuss voluntary severance in more detail later in the report. The SFC also provided increased funding to support students' associations and to encourage student involvement in the merger process. Previously, the majority of college students' associations received annual funding of £10,000 or less. As part of the merger process, regional colleges will receive around £100,000 for the two or three years during and directly after the mergers took place.

22. In accordance with Audit Scotland's good practice guide for mergers, the SFC planned two post-merger evaluations at each of the nine merged colleges: an initial evaluation after six months and a full evaluation after two years. The evaluations focus on the following aspects of the merger process:

- communications and engagement with staff and students
- implementation of the mergers and the governance processes put in place to oversee the mergers

- planning and staff development
- integration of systems such as ICT, administration and payroll.

23. The SFC has completed eight out of nine initial evaluations. The six-month evaluation for New College Lanarkshire was not completed in time to be included in this report. The first full evaluation (of Edinburgh College) was due to be completed by the end of 2014, however this has been delayed due to the change in Principal. The evaluation is scheduled to be completed by April 2015. All of the other full evaluations are due to be completed in the autumn of 2015. We include findings from the initial evaluations at relevant parts of this report.

Colleges adopted an appropriate approach to prioritising merger changes, with a number of changes still taking place

24. Following agreement to merge, colleges focused on factors they considered critical to their business continuity, namely:

- strategic and financial planning
- appointing the Principal and senior management
- reviewing critical business systems and policies such as finance systems and HR policies.

These factors were all important in supporting and maintaining the provision of learning to students as the merger process was implemented.

25. Standardising terms and conditions of service for all staff should contribute to developing a single identity and culture for a new college. Delays in completing this process can compromise or delay a merger. Two fieldwork colleges, Dundee and Angus College and Glasgow Clyde College, have new terms and conditions in place for all teaching and support staff. Ayrshire College has introduced new terms and conditions for the majority of staff, however ten per cent of teaching staff at one campus have chosen to remain on previous terms and conditions. Edinburgh College has finalised new terms for teaching staff and is finalising standard contractual terms for support staff. These new terms came into effect from February 2015. At Glasgow Clyde College, staff and management highlighted difficulties in standardising terms and conditions as a significant issue that has delayed finalising the new staffing structure, particularly for teaching staff. While it is understandable that it may take time and resources to negotiate terms and conditions following a merger, it is important that all merged colleges continue to work towards achieving this. In addition to standardising terms and conditions at a regional level, work is under way to introduce national bargaining which may result in further changes to terms and conditions for college teaching staff.

26. Curriculum reviews can help a college to respond better to the needs of learners and employers in the area and provide an opportunity to reduce duplication and improve consistency, contributing to the high-level aims of the reforms. Ayrshire College and Dundee and Angus College completed curriculum reviews during 2013-14 which considered various factors, including:

- meeting the needs of key stakeholders, including employers

- how the college could broaden opportunities and improve student outcomes
- identifying any existing areas of unnecessary course overlap or duplication
- ensuring consistency of quality and qualifications across the college.

27. Glasgow Clyde College is reviewing its curriculum as part of a larger project looking at the curriculum for the entire Glasgow region. Following a consultation, the Glasgow Colleges' Regional Board has endorsed a regional curriculum review with the details of changes for individual colleges in Glasgow being considered from 2015-16 onwards. Edinburgh College is conducting a review of its curriculum for academic year 2015-16 onwards.

28. Integrating ICT systems is critical to improve services for students in areas such as enrolment, student funding and quality assurance. All four fieldwork colleges indicated that integrating systems was a priority. The cost of integrating systems can be significant and individual colleges were expected to meet most of these costs. This expense, and need to ensure business continuity, will often result in the phased introduction of new systems. The fieldwork colleges had made variable progress in integrating systems, with three colleges (Dundee and Angus, Glasgow Clyde and Edinburgh) experiencing difficulties implementing changes. ICT system issues at Edinburgh College initially resulted in problems identifying course availability, which caused delays in the admissions process. At Dundee and Angus College, initial problems with integrated systems resulted in some system problems only being resolved after the end of academic year 2013-14, presenting some difficulties for staff during the first year of the new college. At Glasgow Clyde College, there were some problems in ensuring staff were fully prepared for changes to ICT systems.

It is not clear how much mergers have contributed to the savings achieved so far

29. The Cabinet Secretary for Education and Lifelong Learning issued his 2013-14 letter of strategic guidance to the SFC in October 2012. Among other things, he asked the SFC to make £18 million efficiency savings in the college sector in 2013-14, rising to £33 million in 2014-15. In determining the scale of the savings expected from each college region, the Scottish Government requested that the SFC took account of the size of the college regions, location of colleges and the scope to make savings through mergers. This letter was superseded by revised guidance in March 2013 when the SFC was asked to limit the amount of savings any one college would have to make to 3.5 per cent. The SFC then categorised colleges according to size and rurality and identified a percentage reduction that each category should achieve.

30. In preparation for the more recent mergers, the SFC identified that the sector would make efficiency savings of £50 million from 2015-16. The SFC explained that it used an analysis of the savings achieved by the City of Glasgow merger and from early merger business cases to identify the expected efficiency savings.

31. Our merger good practice guide highlights the importance of measuring, monitoring and controlling all of the costs and savings resulting from a merger. While all colleges undertook an initial analysis of merger costs when developing their business cases, ongoing monitoring of costs and efficiency savings has

been limited. None of the fieldwork colleges could provide detailed information on merger costs and efficiency savings. Only information on the larger merger costs and efficiency savings, such as voluntary severance payments and reduced staffing costs, were available. While this represents three-quarters of the total estimated costs of the mergers, a significant proportion of costs was not separately identified as direct merger costs by individual colleges.

32. The SFC stated that it would request evidence of systems in place within the new colleges to identify, monitor and report the merger costs and efficiency savings as part of its evaluation of college mergers. However, the evaluations do not refer to merger costs and savings in detail and do not provide assurance that these systems are in place. Fieldwork colleges highlighted that it is difficult to separately identify merger costs and efficiency savings, due to the reduction in funding that has taken place over a similar time period. The SFC expects colleges to produce real terms (allowing for inflation) annual efficiencies by maintaining, or increasing, activity with less funding. While this will indicate the level of efficiency savings the sector achieves, it does not clearly indicate the specific contribution that the merger process has made.

Colleges' early concerns about the creation of regional bodies need to be managed

33. College reforms have led to the creation of 13 college regions. Ten regions contain a single college, and the others contain more than one college. The governance structure for the college sector is shown at [Exhibit 4 \(page 20\)](#). The board at each college continues to be responsible for the governance, financial management and operation of the college. In single college regions, the college boards have been designated as regional college boards. In the three regions where there is more than one college, other arrangements have been put in place. A stand-alone regional board has been created as the regional strategic body in Glasgow, while in Lanarkshire and the Highlands and Islands, existing boards were designated as the regional strategic bodies. We use the term 'regional bodies' when referring to these regional structures in multi-college regions.

34. In March 2014, Scottish ministers appointed ten regional college chairs (chairs in each of the single college regions). Regional college boards and regional bodies were operating in all 13 college regions by October 2014. In single college regions, the constitutions of existing college boards were amended to allow them to function as the regional college board and they have also been expanded in size.

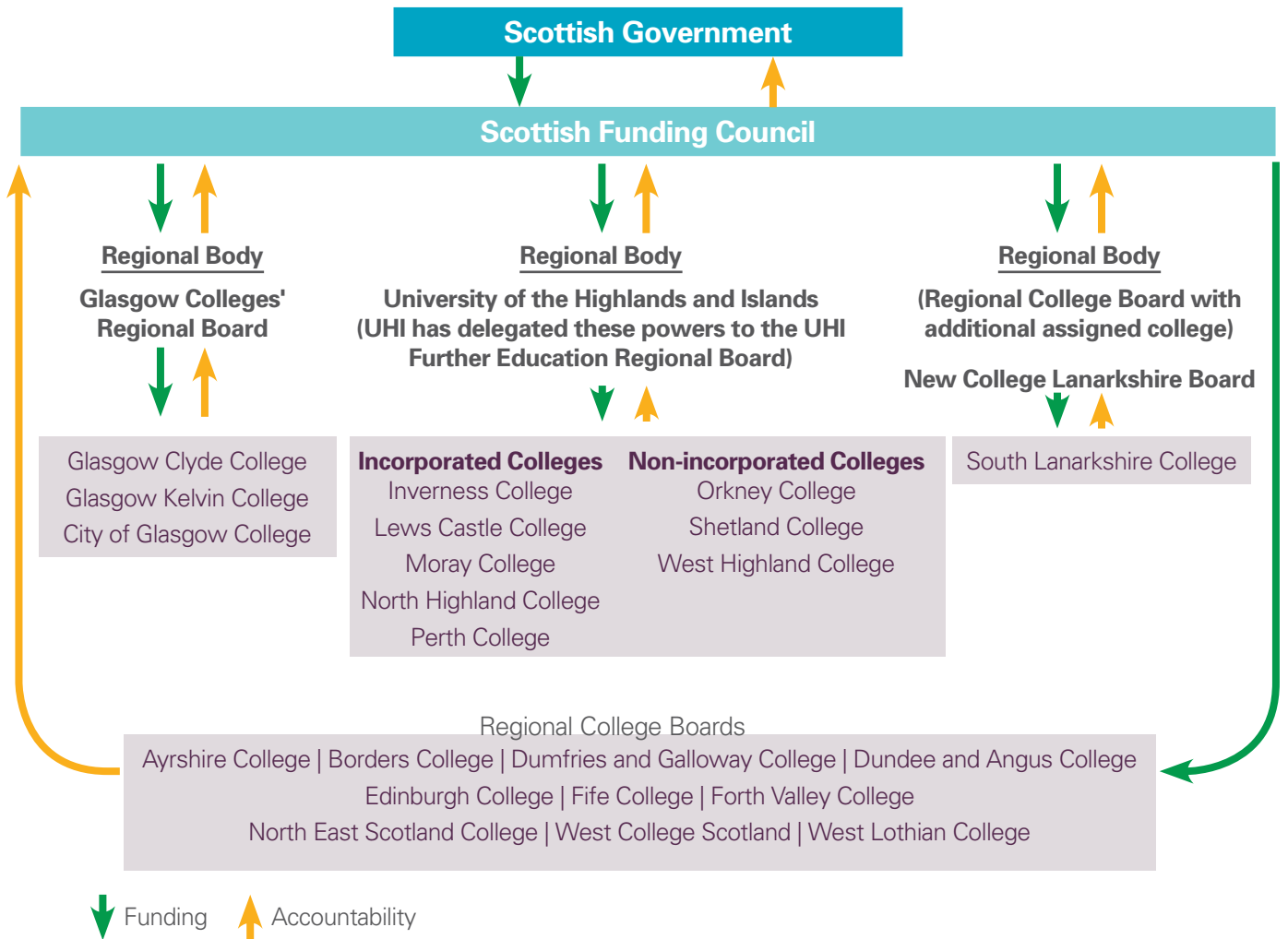
35. Regional college boards and the regional bodies in multi-college regions are responsible for:

- negotiating the annual funding provided by the SFC
- allocating funding within the region
- planning what learning the college, or colleges, provide within the region
- achieving outcomes set out in regional outcome agreements
- monitoring how the college, or colleges, in their region are performing.

Exhibit 4

Colleges are accountable to the body that provides their funding

In multi-college regions, the colleges are funded by, and accountable to, the regional body.



Source: Audit Scotland

36. Introducing regional bodies has resulted in a complex framework of accountability where regional college boards are directly accountable to the SFC but the boards of colleges in multi-college regions are accountable to their regional body, a separate board. Colleges in multi-college regions also continue to maintain direct accountability to the SFC for a number of areas such as financial reporting. This has implications for the autonomy of the boards of the colleges in multi-college regions. They are now responsible to the regional body for how they are contributing to achieving the regional outcome agreement and using public money, rather than to the SFC. This means that the college board may receive direction from its regional body on how it delivers its contribution to the regional outcome agreement. The regional body is then accountable to the SFC.

37. Until April 2014, colleges were largely autonomous bodies, and operational matters were fully a matter for individual college boards. Reclassifying colleges as public bodies, and creating regional bodies as part of the reform programme, has altered accountability. This has implications both for college autonomy and for the SFC's role.

38. It is too early to assess whether the regional bodies have improved governance and accountability. But individual colleges have expressed concerns that regional bodies will affect their autonomy. This has the potential to cause tensions and confusion between the respective roles of college boards assigned to a regional body and the associated regional bodies. Both regional bodies and individual assigned college boards will need effective leadership, communication and close working to establish good working arrangements.

Reclassifying colleges as public bodies has increased accountability and reduced their autonomy and flexibility

39. In October 2010, the Office for National Statistics (ONS) reclassified Scottish incorporated colleges as public bodies. The ONS decision followed an assessment of the levels of ministerial control over colleges. Following the announcement, the UK Government's Department for Business, Innovation and Skills reviewed the effect of reclassification on further education and sixth-form colleges in England, Wales and Northern Ireland. The Scottish Government reported that HM Treasury awaited the outcome of this review, prior to implementing the changes required as a result of reclassification. Following completion of the UK Government review, the Scottish Government entered into discussions with HM Treasury between May 2012 and December 2012 to identify the implications and timescales for reclassification. The Scottish Government confirmed to colleges in May 2013 that the budgetary and other requirements associated with being reclassified as a public body would come into effect from 1 April 2014, and outlined the impact and how the transition would be managed. The SFC then arranged a series of briefings, seminars and workshops with college staff.

40. Reclassification means that colleges will operate within the same annual budget control limits as other public bodies and be treated as part of central government for financial purposes. Colleges must comply with the Scottish Public Finance Manual and this has implications for budgeting, reporting and financial accounting, including:

- One of the most significant implications is that colleges must now break even, in resource terms, within each Scottish Government financial year. This means colleges can no longer plan to report surpluses or deficits without considering the need to break even at 31 March, or use reserves accumulated in previous years to fund current or future spending.
- Colleges must make additional disclosures in their annual accounts to comply with the Government Financial Reporting Manual (FReM) and Statement of Recommended Practice (SORP) for Further and Higher Education.
- Colleges should hold the minimum level of cash to allow the efficient running of the college and to meet any relevant liabilities at the end of the college financial year. Colleges can also no longer use cash to subsidise student support funding, such as bursaries and hardship funds, without reducing expenditure in other areas.
- Colleges must now account for some items differently which may result in more volatile year-end financial positions. For example, from 1 April 2015, non-government capital grants must be recognised as income when a

college receives them and this could lead to large under-spends being reported against capital budgets if grants are not used within the year. Colleges will also no longer be able to use these grants in future years to fund depreciation expenses and this could result in future deficits. This is significant due to the requirement for colleges, and the sector overall, to break even in resource terms each year.

- Colleges are now required to submit additional financial reports to HM Treasury and the SFC. For example, colleges must now submit additional quarterly resource returns and monthly cash flow returns to the SFC and, from 2015, colleges will be required to prepare Whole of Government Accounts returns for HM Treasury.
- Colleges must now seek approval from the SFC for specific categories of spending, for example procurement of goods and services over certain thresholds.
- There will also be future changes to banking and insurance arrangements.

41. These changes to the financial reporting arrangements increase colleges' accountability for the use of public funds and reduce their autonomy and flexibility in relation to how these funds are managed.

Delays in deciding the period to be used for financial statements created uncertainty for colleges

42. Another significant issue arising from reclassification was uncertainty about the period that financial statements would have to cover. HM Treasury confirmed to the Scottish Government in May 2012 that retaining a 31 July year-end for colleges was not possible and recommended that colleges would need to move to a March financial year-end to align their financial year with the rest of the public sector. The SFC informed colleges in May 2013 that their financial year-end would be changing to March from 2014. In November 2013, HM Treasury offered the option for colleges to retain the academic year (August to July) for financial reporting. However, this required additional negotiations between HM Treasury and the Scottish Government, and consultations between the SFC and colleges, which were not concluded until June 2014. As a result, colleges were required to prepare accounts covering only an eight-month period, from 1 August 2013 to 31 March 2014. This did not apply to all colleges. UHI colleges continued to use a year-end of 31 July, and produced full-year accounts for the year ended 31 July 2014. This was to ensure alignment of their financial year with UHI and other academic partners. In 2014-15, non-UHI colleges will again use a different accounting period (16 months). Changes in financial year-end dates require colleges to alter their internal financial monitoring arrangements and can make it difficult for them to plan and forecast their financial position. It also limits the scope to analyse trends.

43. The Scottish Government and the SFC have indicated that the decision to revert to a 31 July year-end will not result in colleges having to provide additional information. Colleges' monthly financial returns will be sufficient. Work is under way to determine the associated audit requirements.

Colleges transferred £99 million to arm's-length foundations

44. With reclassification, colleges are no longer able to accumulate reserves to use across financial years. Using reserves after the date of reclassification to fund spending would result in the Scottish Government reducing its funding for colleges by this amount. This is because the amount colleges spent from reserves would count towards the Scottish Government budget limit that is set by HM Treasury and would be deducted from the Scottish block grant. To avoid this, colleges, working with the SFC, established arm's-length foundations. These are independent bodies outside of the government accounting boundary. The foundations are distinct, charitable organisations and independent trustees are appointed to the foundation boards.

45. The SFC helped to establish a central foundation, the Scottish Colleges Foundation. This is available for all colleges to use and has been structured in a way that allows it to hold funds in groupings that reflect the college regions. Some colleges have also set up their own local foundations.

46. In 2013-14, 18 out of the then 21 colleges transferred a total of £99 million into foundations. Coatbridge, Lews Castle and West Lothian colleges did not transfer any funds into foundations in 2013-14. Six colleges transferred £25.3 million into the central foundation, and 13 colleges transferred £73.7 million into local, geographically specific foundations. City of Glasgow College transferred funds into both a local foundation and the central foundation (£10 million and £11.7 million respectively).

47. These transfers represent a significant amount of funds that now sit outside public sector control. The conditions for using the transferred funds require any organisation that applies for funding to spend the money on supporting further education in Scotland. There is no guarantee that these funds will be returned to the college sector as this would raise concerns about the independence of the foundations. Other organisations such as schools, voluntary sector organisations or private sector educational providers can also apply for funding held by these foundations. However, the foundations' Articles of Association limit the activities they can fund. As colleges are the main providers of further education, it is likely that they will be the main bidders for funds. The SFC reports that colleges have secured nearly £20 million from these foundations since they were established. The foundations are not subject to audit by the Auditor General for Scotland but need to prepare audited annual accounts to be submitted to the Office of the Scottish Charity Regulator (OSCR).

The changes to date have had no significant detrimental effects on students

48. While colleges have faced significant changes, and significant reductions in funding, early indications are that colleges have maintained performance and minimised the effect on students.

49. Education Scotland is responsible for monitoring the quality of teaching by Scotland's colleges as part of a four-year cycle of reviews. Education Scotland agreed to review all newly merged colleges. While the reviews did not specifically evaluate the mergers, the quality framework that Education Scotland used contains indicators that relate to the merger process. These include: planning for, and managing, change; motivating and engaging staff; and managing and responding to changing environments.

50. So far, Education Scotland has completed three reviews of the more recent merged colleges (Edinburgh, Glasgow Clyde and Dundee and Angus colleges). It reported that colleges had effective learning and teaching in place which met the needs of learners. It also highlighted good practice in a number of areas, as well as strong links with employers to inform the design of curricula and to improve student employability. But it also noted that there was evidence that staff were resistant to the changes brought about by the merger process, and that merged colleges needed to focus more clearly on achieving their strategic aims. The Edinburgh College report also highlighted that the college had difficulties in some curriculum areas as new processes and management structures were implemented. The SFC and Education Scotland are working together to develop and trial new methods for assessing and monitoring the quality of teaching. It is important that these new methods also allow colleges and the SFC to identify any significant issues resulting from the reform of the college sector.

51. The National Union of Students (NUS) reported that it is generally supportive of the mergers and regionalisation, provided that there are clear student and educational benefits. However, it has noted a concern that merged colleges might centralise learning within regions. This would mean some students having to travel further, potentially resulting in fewer students participating in learning. Colleges need to monitor participation within geographical areas and consider this when deciding on any changes to how they provide learning locally.

52. The SFC met students as part of its six-month post-merger evaluations to discuss issues such as changes to learning and teaching, enrolment and access to the college. Feedback indicated that there had been little adverse effect on students. Some students highlighted benefits including improved resources, greater choice of courses and better progression and employment opportunities. However, some students raised concerns about potential campus changes and delays in the recruitment and admissions process. It will be important that colleges respond to student concerns, and that colleges and the SFC continue to seek student views as part of ongoing monitoring and evaluation.

53. Colleges regularly carry out student surveys and all four fieldwork colleges gathered student feedback. The colleges did not request specific feedback on the impact of the merger as part of these surveys, but a fall in satisfaction in areas such as enrolment, campus location and quality of teaching could indicate concerns about the merger. Of the four fieldwork colleges, only Dundee and Angus College provided us with survey results covering more than one year. The other fieldwork colleges had not analysed trends in survey results covering their merger periods. The Dundee and Angus College results indicated that overall satisfaction, as well as satisfaction ratings on specific topics, including enrolment, induction and the college experience, decreased marginally between 2013 and 2014, but still remained largely positive. Colleges, the SFC and Education Scotland should continue to monitor student feedback to ascertain if college reforms have adversely affected students. The SFC reported that it is working in partnership with colleges to develop a national survey of student satisfaction and engagement in colleges. The SFC expects the survey to be piloted in a number of colleges during April 2015, before being rolled out for the academic year 2016-17.

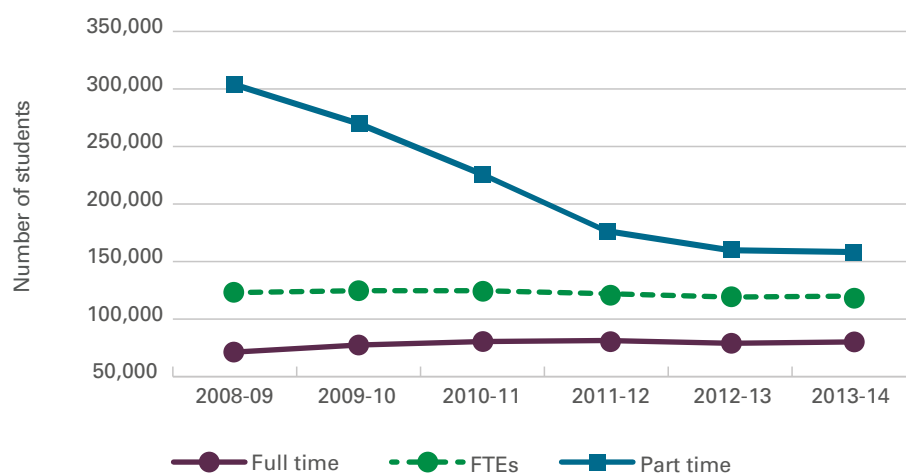
A continued emphasis on full-time courses has led to reductions in total student numbers

54. In 2013-14, about 238,000 people (headcount), attended college, around 19,500 fewer than in 2011-12 (7.6 per cent). This is 36 per cent lower than in 2008-09 and reflects changes in Scottish Government policy. In August 2009, the SFC issued guidance to colleges to reduce the number of courses that did not lead to a recognised qualification or that lasted less than ten hours.² As a result, since 2008-09, the number of part-time students has fallen by 48 per cent. Full-time equivalent (FTE) numbers remained relatively stable between 2008-09 and 2011-12 due to slight increases in full-time students. In the past two years, there have been decreases in both part-time and full-time students (decreases of 10.4 per cent and 1.5 per cent respectively). This has resulted in a fall of approximately 3,000 FTE (2.5 per cent) between 2008-09 and 2013-14 ([Exhibit 5](#)).

Exhibit 5

Students attending Scotland's colleges, 2008-09 to 2013-14

The number of part-time students has decreased significantly. FTEs remained at similar levels until 2011-12 but, since then, there has been a small decrease in FTEs.



Source: *Scotland's colleges: A Baseline Report for Academic Year 2013-14*, Scottish Funding Council, January 2015

55. The percentages of male and female students attending college has remained broadly similar in recent years. However, significant differences remain within individual subjects. The Scottish Government, as part of its strategy on Scotland's youth employment, has asked the SFC to work with partners to develop a plan to address gender imbalance on college courses. Implementation of the plan is scheduled for 2016-17, with the SFC to report annually on progress.

56. There have been greater changes in the ages of individuals attending college between 2008-09 and 2013-14:

- In 2008-09, around 68,000 people under 16 attended college but this had reduced to around 48,000 in 2010-11. In 2011-12, the SFC reduced


funded college places for school students below S3 as these students are expected to study full-time at school. This is reflected in the number of people under 16 attending college further reducing. In 2013-14 around 19,800 people under 16 attended college, a reduction of over 70 per cent since 2008-09.

- The Scottish Government has committed to providing a place in learning or training for all 16-19 year olds who are not in employment. This means that any reduction in the number of people in this age group will mainly reflect the shift in policy focus from part-time to full-time courses, and the reduction in the number of individual college places. The number of students in this age group fell by 15 per cent, to around 72,000 in 2013-14.
- The number of students in the 20-24 age group, again a grouping that is prioritised by Scottish Government policies, fell by nine per cent to around 40,000 in 2013-14.
- The number of people aged 25 or older who attend college has decreased significantly, with almost 74,000 (41 per cent) fewer learners in this age group attending college in 2013-14 compared to 2008-09. This has implications for those adult learners who wish to access college courses to participate in further education.

57. Between 2008-09 and 2013-14, the fall in the number of students aged 16-24 accounts for only 12 per cent of the total reduction of college attendees. Reductions were mainly in the 25 and over (53.5 per cent of the total) and under 16 (34.5 per cent of the total) categories. This has resulted in the percentage of people attending college who are aged 16-24 increasing from 34 per cent in 2008-09 to around 47 per cent in 2013-14.

Outcome agreements provide a new basis for measuring college performance, but SFC reporting of progress needs to improve

58. The SFC introduced outcome agreements for individual colleges in 2012-13, linking college provision to Scottish Government themes such as Opportunities for All. These agreements set out what contribution each college will make to the Scottish Government's strategic aims and national priorities for post-16 education, in return for an agreed amount of funding. Outcome agreements cover a three-year period, and are refreshed annually. Previously in multi-college regions, outcome agreements were negotiated with each of the colleges in the region. Each individual college was held jointly responsible for the delivery of the region's outcome agreement. Now that regional bodies have been established, the SFC negotiates outcome agreements with the ten regional college boards and three regional bodies (the regional college or regional body). This means that in multi-college regions, a single body can be held to account for the delivery of the outcome agreement. Regional bodies will in turn hold colleges to account for their contribution to the delivery of the outcome agreement. The SFC may consider financial penalties if a region fails to meet agreed outcomes. Any penalties would be in proportion to the failure to meet agreed outcomes and would be negotiated as part of the outcome agreement process. The SFC imposed one penalty of £0.4 million in 2012-13 (Edinburgh College) and three penalties of £0.6 million in 2013-14 (Ayrshire College, Fife College and West College Scotland).

59. The format and scope of outcome agreements have developed over time. Outcome agreements for 2012-13 focused mainly on providing agreed amounts of learning activity and on the reform process. Outcome agreements for 2013-14 were slightly more detailed and the SFC measured progress using indicators linked to its, and the Scottish Government's, national priorities. These were: efficient regional structures; right learning in the right place; high-quality and efficient learning; a developed workforce; and sustainable institutions. A similar approach, mapping performance indicators against national priorities, has been undertaken for 2014-15 ([Supplement 2: Performance measures used in 2014-15 outcome agreements \[PDF\]](#) )

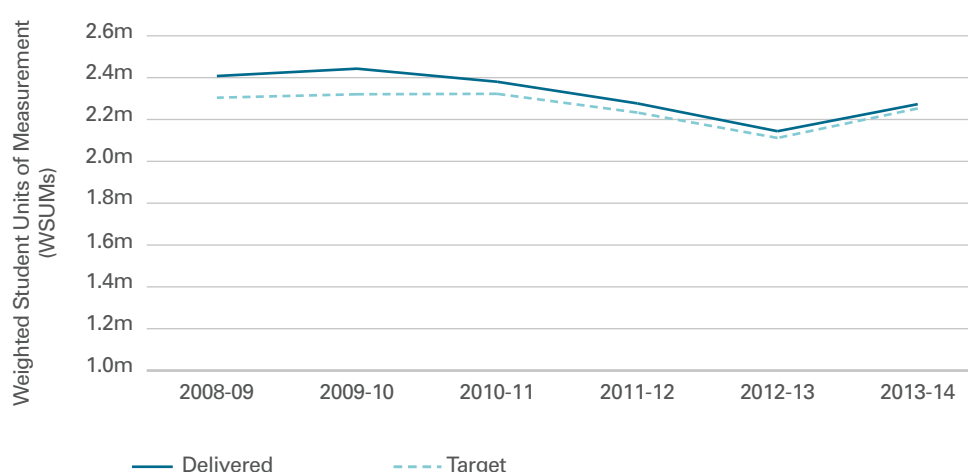
60. The SFC funds colleges based on the amount of learning activity that colleges provide rather than the number of students attending courses. Learning activity is measured by weighted student units of measurement (WSUMS) where one SUM means 40 hours of classroom-based learning and one Scottish Qualifications Authority credit. The SFC weights (W) these units by subject to reflect the differing costs of teaching different subjects. Each year it provides funding to colleges to deliver a specific volume of WSUMs in order to meet national performance targets. Then, through the outcome agreement negotiation process, it seeks to ensure that the totals it negotiates with the sector meet this national target. The SFC performance targets in 2013-14 included:

- a commitment for the sector to deliver 2.252 million WSUMS, an increase of seven per cent on the 2012-13 target. Colleges have, as a whole, exceeded these targets every year since 2008-09 ([Exhibit 6](#))

Exhibit 6

Colleges' delivery of WSUMs, 2008-09 to 2013-14

Colleges have exceeded delivery targets every year since 2008-09 but targets reduced between 2010-11 and 2012-13 before increasing in 2013-14.



Source: *Scotland's colleges: A Baseline Report for Academic Year 2013-14*, SFC, January 2015

- a commitment from all college regions to target 16 to 24-year-olds, with a specific national aim that 70 per cent of provision would be aimed at this age group. In 2013-14, colleges delivered 70.5 per cent of WSUMs to

students aged 16-24. In our previous report, we recommended that the Scottish Government and the SFC should monitor the impact of prioritising younger students and full-time courses on learning opportunities for older people. The SFC provided no evidence of what impact this policy is having on older people

- an increase of 1,000 full-time college students successfully completing their further education courses. The sector as a whole met this target with 66 per cent of full-time students studying further education level courses leading to a recognised qualification following successful completion, an increase of around 1,800 from 2012-13.

61. The SFC reports on some outcome agreement targets, such as student attainment levels, as part of its annual reports on performance of the sector. Individual colleges' performance against indicators in their outcome agreements could also be derived from a variety of sources. Scrutiny of progress against outcome agreements could be enhanced by the SFC producing an annual report which summarises progress at college, regional and national levels.

62. Outcome agreements for 2014-15 employ a new needs-based funding model, where colleges and the SFC identify each region's needs, such as economic needs, and the age profile of the population. This information is used to target prospective students, and to determine the number of places and funding required to meet regional needs. The SFC is making further changes to the funding model for 2015-16. These changes may affect the level of funding that some college regions receive, but the SFC has agreed to limit any changes in funding to one per cent during the first two years of implementing the new model.

63. This analysis suggests that the changes to date have not significantly affected students. However, it is too early to provide a comprehensive assessment as some aspects of the merger process are still under way. Most of the remaining merger activities, such as curriculum review and integrating ICT systems, will directly affect students. It is critical, therefore, that colleges continue to minimise any negative impact on students as these activities progress.

Part 2

College finances



Key messages

- 1** College finances continued to be generally sound. In 2013-14, colleges reported an overall deficit of £95.2 million. This was due mainly to transfers of £99 million to arm's-length foundations. Adjusting for transfers to arm's-length foundations would result in an overall surplus of £3.8 million (just under one per cent of total income) in 2013-14.
- 2** The mergers, and a reduction in SFC funding of £26.1 million in real terms between 2011-12 and 2012-13, have led to reductions in spending, mainly recurring staff costs. These decreased by four per cent, from £421.2 million in 2011-12 to £404.2 million in 2012-13. Staff numbers reduced from around 11,300 in 2011-12 to 10,250 in 2013-14. Staff have expressed concerns about the loss of skills and increased workloads.
- 3** The reductions in staff costs were delivered mainly through voluntary severance. The SFC provided funding and guidance, and most severance was managed in line with good practice. But auditors found weaknesses in how some colleges had authorised, approved and reported severance payments for senior staff. The Scottish Government and the SFC have taken a number of steps to strengthen the governance of severance for senior staff in colleges.

college
finances
continued to
be generally
sound

Scottish Government funding is expected to decrease by over three per cent, in real terms, between 2013/14 and 2015/16

64. As outlined in our previous report, Scottish Government revenue funding for the college sector was projected to fall in cash terms (that is, without taking inflation into account) from £545 million in 2011/12 to £494.7 million in 2013/14. The Scottish Government subsequently announced a range of proposed budget increases totalling £132.5 million between 2011/12 to 2015/16, changing the revenue funding available to colleges in each individual year.

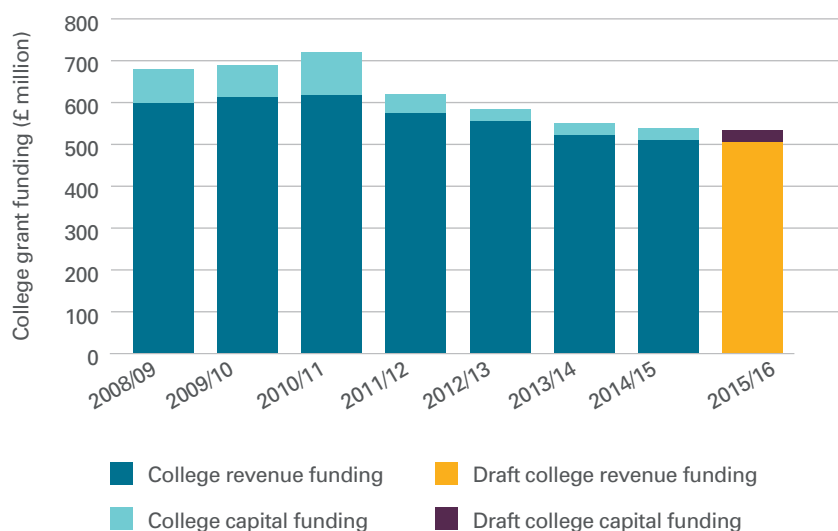
65. These subsequent changes mean that Scottish Government revenue funding to Scotland's colleges decreased, in real terms, by £53.7 million (nine per cent) between 2011/12 and 2013/14. Scottish Government funding to colleges is expected to decrease by a total of £15.4 million (three per cent) between 2013/14 and 2015/16. This represents a 12 per cent decrease in revenue funding compared with 2011/12.

66. Colleges also receive capital funding to maintain and improve buildings and equipment. Following a period of sustained investment up to 2010/11, capital funding has decreased significantly. Between 2011/12 and 2013/14, capital funding for colleges fell by £23.8 million in real terms (46 per cent) to £28 million. Further decreases totalling £3.4 million are planned between 2013/14 and 2015/16, resulting in capital funding of £24.6 million in 2015/16 ([Exhibit 7](#)).

Exhibit 7

Scottish Government funding to colleges, 2008/09 to 2015/16

Total college funding is planned to decrease by 3.4 per cent, in real terms, between 2013/14 and 2015/16.



Source: Scottish Government budget publication

67. Current allocations are partly used to pay for ongoing maintenance costs and to buy equipment, and not just for major capital works, such as new buildings. New college developments are generally being financed through Non Profit Distributing contracts (a form of Public Private Partnership). Currently three major capital developments will be funded using NPD contracts: at Ayrshire College, Inverness College and the City of Glasgow College. These capital projects have a combined value of around £300 million. NPD contracts are still relatively new to the college sector and auditors are monitoring them as part of their ongoing audit work.

Reductions in Scottish Government funding contributed to colleges' income falling by four per cent in 2012-13

68. Scottish Government funding, provided through the SFC, makes up the majority of the income received by the college sector (70.9 per cent in 2013-14). However, the percentage of colleges' total income from SFC funding varies by region. For example, SFC funding made up 82 per cent of Ayrshire College's total income and 59 per cent of Perth College's total income in 2013-14. This means that any changes to SFC funding will have a greater impact on those colleges where SFC funding makes up a larger proportion of their total income.

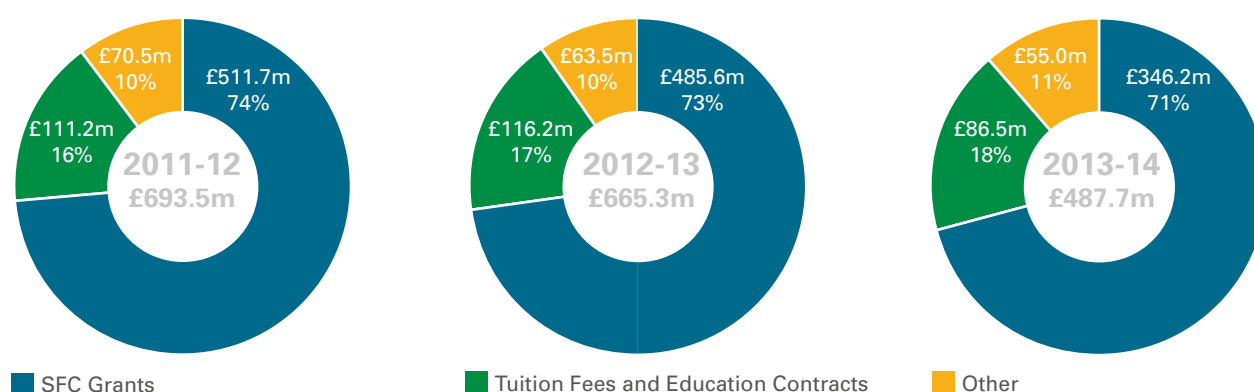
69. Colleges' overall income totalled £665.3 million in 2012-13, around four per cent less than 2011-12. This is mainly due to a fall in SFC funding. These figures do not include around £104 million in bursaries and other student support funds that were provided to individual students in 2012-13 which appears as Notes to the Accounts in colleges accounts.

70. Since most colleges' accounts covered a shorter financial period, colleges' total income was £487.7 million in 2013-14. The sources of this income were broadly similar to previous years, with around 71 per cent of colleges' income coming directly from the SFC ([Exhibit 8](#)).

Exhibit 8

Colleges' total income, 2011-12 to 2013-14

The percentage of income from differing sources has remained broadly the same.



Note: 2011-12 figures have been adjusted for institutions that are no longer part of the sector and all figures are in real terms, that is, taking inflation into account.

Source: Audit Scotland analysis of colleges' 2011-12, 2012-13 and 2013-14 audited accounts

Adjusting for the transfer of reserves to arm's-length foundations would result in an overall surplus of almost £4 million in 2013-14

71. In 2012-13 (full year), colleges' income totalled £653.2 million in cash terms and their spending totalled £650.4 million in cash terms. This resulted in an overall surplus for the sector of £2.8 million (0.4 per cent of total income). Colleges' income was £487.7 million in 2013-14 (an eight-month period for most colleges), and spending was £582.8 million. This spending includes the £99 million transferred to arm's-length foundations as colleges prepared to be reclassified as public bodies. As a result of the way in which these transfers are accounted for, the sector reported an overall deficit of £95.2 million. However, this does not indicate any concerns relating to the financial sustainability of the college sector. If transfers to arm's-length foundations were excluded from their expenditure, colleges would have generated a surplus of £3.8 million (0.8 per cent of their total income).

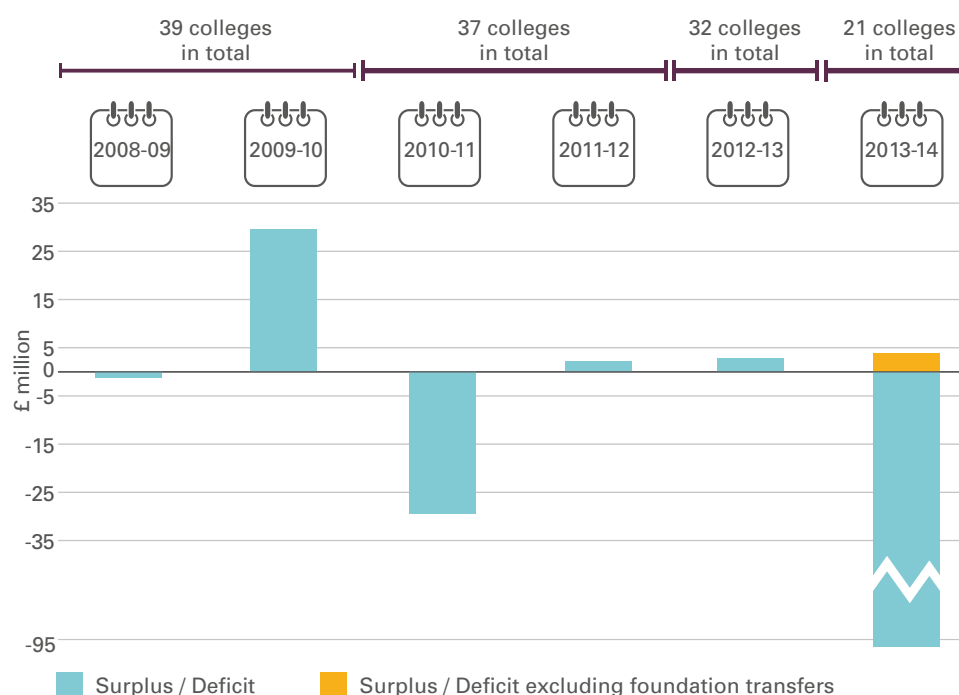
72. Colleges operate within narrow financial margins, where relatively small changes can turn planned surpluses into deficits and deficits into surpluses.

The surplus and deficit position for the sector from year to year remains inconsistent. Three colleges (Edinburgh, Forth Valley and Langside colleges) that reported deficits in 2011-12 then reported surpluses in 2012-13, and four colleges (Carnegie, Dundee, North Highland and Stow) that reported surpluses in 2011-12 then reported deficits in 2012-13. The college sector has reported a surplus in three of the last six years ([Exhibit 9](#)).

Exhibit 9

Colleges' operating surpluses and deficits since 2008-09

The college sector has reported a surplus in three of the last six years.



Source: Colleges' audited accounts 2008-09 to 2013-14

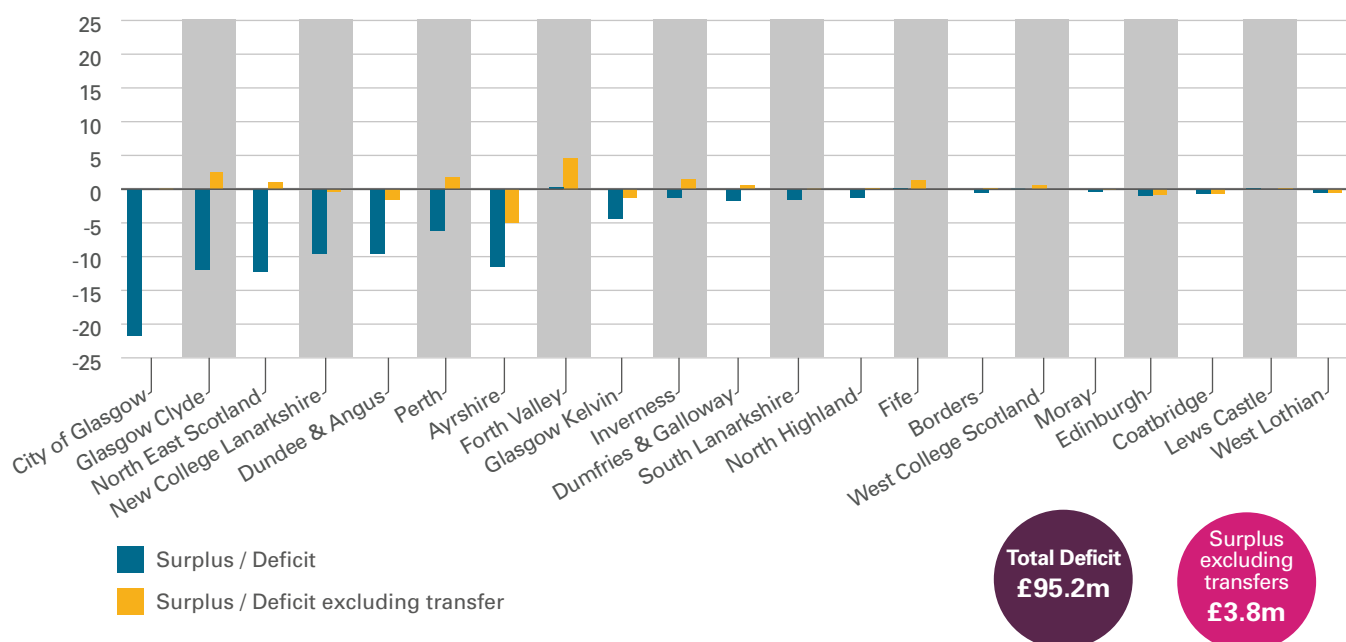
73. In 2013-14, four out of 21 colleges reported surpluses for the year (Forth Valley, Fife, Lews Castle and West College Scotland). If transfers to foundations were removed, 13 colleges would have reported a surplus. There were, therefore, eight colleges with deficits that were not caused by transfers to foundations. These were Ayrshire, Coatbridge, Dundee and Angus, Edinburgh, Glasgow Kelvin, Moray, New College Lanarkshire and West Lothian colleges ([Exhibit 10, page 33](#)). Five of these deficits would have been around five per cent or more of the college's income and four of these five were generally in line with the colleges' forecast positions:

- Ayrshire College (£4.9 million, 14.6 per cent of income): a variety of factors contributed to the deficit. These included the impairment of the current Kilmarnock campus by £8.8 million to reflect the decreased useful life of this site to the college, due to its imminent replacement. Without this impairment charge, and excluding the transfer to the foundation, Ayrshire College would have reported a surplus for the year.

Exhibit 10

Colleges' financial position in 2013-14 with and without transfers to foundations

Four out of 21 colleges reported surpluses.



Source: Audit Scotland analysis of colleges' 2013-14 audited accounts

- Dundee and Angus College (£1.5 million, 5.3 per cent): the deficit was primarily due to unbudgeted voluntary severance costs arising from the merger of Dundee College and Angus College. The college became aware of these and adjusted forecasts accordingly early in 2013-14.
- Glasgow Kelvin College (£1.2 million, 4.9 per cent): the college originally forecast a greater deficit than this within its original merger business case. Costs associated with the merger process, approximately £0.5 million, contributed significantly to the final deficit.
- West Lothian College (£0.5 million, 4.9 per cent): the college did not transfer any funds into an arm's-length foundation and had forecast a small surplus for the year. The deficit was mainly due to voluntary severance costs and the decision to recognise costs for untaken holidays.
- Coatbridge College (£0.7 million, 7.9 per cent as per draft accounts): the college did not transfer any funds into an arm's-length foundation and had forecast a small surplus for the year. The deficit was largely due to grant income being less than forecast (£0.2 million) and unfunded voluntary severance costs (£0.4 million). Costs associated with a recent legal claim made against Coatbridge College, the details of which are being finalised, may increase expenditure by approximately £0.3 million, if the claim is not covered by the relevant insurance policy. This, in turn, would increase the deficit to over £1 million (in excess of ten per cent of income).

74. As well as affecting the reported surplus or deficit position of colleges, transferring funds from colleges to arm's-length foundations had wider effects on the finances of the college sector in 2013-14. The transfers contributed to significant reductions in reserves, specifically accumulated income and expenditure reserves, from £216.9 million in 2012-13 (cash terms) to £135.9 million in 2013-14. The levels of cash held by colleges also decreased, from £183.1 million (cash terms) in 2012-13 (103 days' cash) to £58.8 million in 2013-14 (37 days' cash), reflecting the transfers to foundations and in line with the requirement to reduce the level of cash held.

Colleges need to work towards long-term financial planning

75. Colleges provide Financial Forecasting Returns to the SFC. These generally cover a three-year college financial period, but this has varied in recent years. For example, in 2013-14 the SFC only required colleges to provide information for the current year due to reclassification (eight months for non-UHI colleges). Our fieldwork colleges highlighted that the lack of clarity around the process of reclassification limited their ability to do longer-term financial planning. This included management of cash and use of capital funds post-reclassification, as well as more general planning such as forecasting income and expenditure in order to set annual budgets.

76. The SFC has indicated that the financial return for 2014-15 is again likely to cover a three-year period. As colleges adjust to the new requirement for the college sector to break even in resource terms in each Scottish Government financial year, they may find it more difficult to carry out longer-term financial planning (defined here as a minimum of ten years) as colleges will need to match their expenditure to their income, and be unable to utilise reserves. However, a short-term approach to financial planning may result in colleges taking decisions to manage immediate pressures rather than for longer-term benefits.

77. To ensure that overall Scottish Government budget limits are not breached, it is important that colleges provide accurate financial forecasts to inform SFC funding decisions and to ensure that there is appropriate budget available to be allocated to the colleges. Reflecting these new requirements, in-year adjustments to individual colleges funding may be required, with funding being reallocated from other colleges. Within the SFC's Financial Memorandum with colleges, the SFC reserves the right to make in-year adjustments to grant payments, and this may lead to a renegotiation of outcome agreements.³ Any SFC grant funding that a college does not require within the Scottish Government financial year will not be available to the college in future years, unless the college reaches prior agreement with the SFC. Without effective, longer-term financial planning, colleges may find it difficult to inform the SFC of funding requirements and, therefore, to access all available funds.

The overall deficit in colleges' pension reserves has increased significantly in 2013-14

78. College teaching staff are usually members of the Scottish Teachers' Superannuation Scheme (STSS). Other staff can join the Local Government Pension Scheme (LGPS). Colleges' pension reserves reflect their share of the assets and liabilities of the LGPS. College staff represent a small proportion of the overall membership of these schemes. As a result, colleges have limited control over aspects of how pension funds are managed, for example setting how much individual scheme members contribute.

79. Pension fund assets and liabilities are determined through actuarial valuation. This is a complex process that takes account of factors such as life expectancy, salary levels and length of service, and annual pension increases. The UK Government has also introduced reforms to public sector pension schemes. We have outlined the process for revaluing public sector pensions and upcoming reforms to the schemes, including the LGPS and other public sector schemes, in previous reports.⁴

80. Between 2012-13 and 2013-14, college pension deficits increased by 75 per cent, from £82.3 million to £143.8 million in cash terms. This represents a significant deterioration and is primarily due to changes in the assumptions used by the LGPS actuaries, such as changes in forecast market conditions and life expectancy. Changes in how North East Scotland College accounts for the LGPS have resulted in a pension deficit of £14.5 million being identified on its balance sheet for the first time, contributing to the overall increase in the pension deficit. At seven other colleges pension deficits increased by over £2.5 million: City of Glasgow (£3.4 million), Dundee and Angus (£3.1 million), Edinburgh (£6.6 million), Fife (£4.5 million), Forth Valley (£3.0 million), Inverness (£2.6 million) and West College Scotland (£4.9 million).

81. A net pension deficit is sustainable in the short term because the liabilities will become payable over a long period. Nevertheless, pension costs are a significant proportion of total public sector spending that the Scottish Government needs to continue to monitor.

Colleges reduced their spending by about four per cent in 2012-13, mainly by reducing staff costs

82. Colleges have responded to the recent reduction in income by reducing their costs. Between 2011-12 and 2012-13, colleges reduced their spending by around four per cent to £662.4 million. Colleges' total spending in 2013-14, a shorter period, was £582.8 million. However, the areas of spending were proportionately similar to earlier years if transfers to foundations are removed ([Exhibit 11, page 36](#)).

83. Staff costs make up around 60 per cent of college spending, after removing transfers to arm's-length foundations. Colleges spent about £428.4 million on staff costs in 2012-13. This included £404 million on recurring staff costs and about £24 million on exceptional staff costs, mainly staff severance payments.

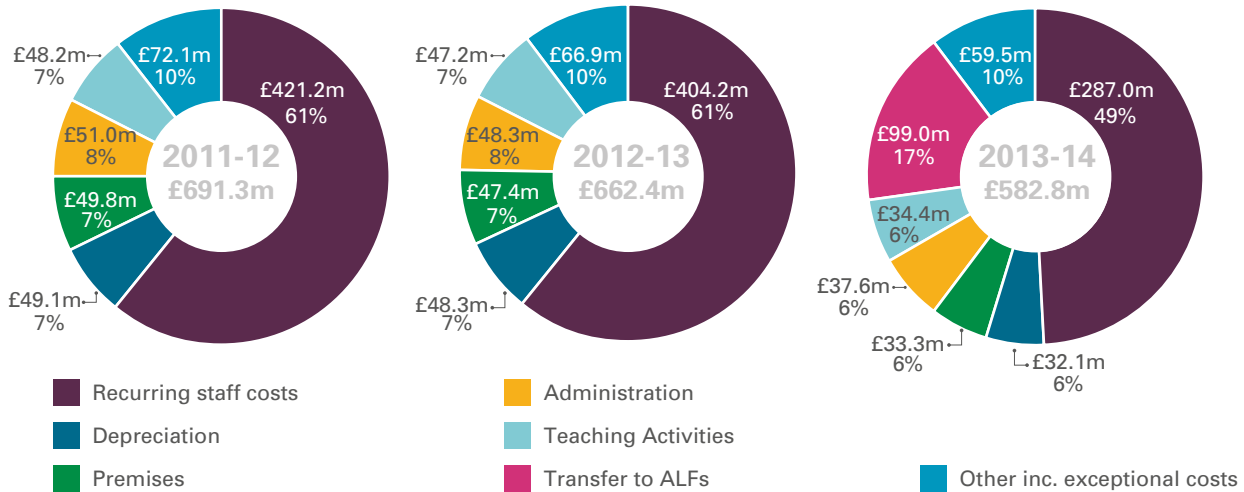
84. Recurring staff costs, excluding those colleges that have left the sector, were about £17 million lower in 2012-13 compared with 2011-12. The reduction in staff costs accounted for 59 per cent of the overall reduction in spending. Exceptional staff costs, including severance payments, increased by £2.1 million.

85. As in 2011-12, reductions in teaching staff accounted for the majority of the overall staff reductions although, proportionately, staff reductions were greater in other staff groups. Teaching staff costs account for around 70 per cent of recurring staff costs. These decreased by 3.5 per cent between 2011-12 and 2012-13. In 2013-14, a shorter period, total recurring staff costs were £287.0 million and teaching staff costs were £201.7 million (70.1 per cent).

Exhibit 11

Colleges' expenditure from 2011-12 to 2013-14

Excluding transfers to foundations, categories of spending have remained broadly the same.



Note: 2011-12 figures have been adjusted for institutions that are no longer part of the sector and all figures are in real terms, that is, taking inflation into account.

Source: Audit Scotland analysis of colleges' 2011-12, 2012-13 and 2013-14 audited accounts

86. Costs other than recurring staff costs also reduced between 2011-12 and 2012-13, including:

- administration costs, for example office supplies and equipment, payroll and personnel services. These decreased by around 5.4 per cent (£2.8 million)
- other costs, including exceptional costs, which reduced by around seven per cent as a whole (£5.1 million). This was mainly due to exceptional costs, the category that includes staff severance payments, reducing by 12 per cent and residences and catering costs reducing by nine per cent.

87. Following a reduction in FTE staff to around 11,300 in 2011-12, the number of FTE staff reduced to around 10,700 in 2012-13. In 2013-14, the number had decreased further, to around 10,250. Overall, this represents a 9.3 per cent reduction in FTE staff numbers since 2011-12. Almost all the reductions in staff numbers have come from colleges that merged. Teaching and administration staff account for the greatest proportion of reductions ([Exhibit 12, page 37](#)).

College staff have expressed concerns about additional work pressures

88. As part of its six-month post-merger evaluations, the SFC gathered feedback from staff on a range of issues. These included the general impact of the merger, the culture of the organisation and the progress made with finalising staffing structures. While there was some evidence of staff highlighting the positive results of the mergers, a number of areas of concern were raised, including increased workloads and the loss of staff with key skills and knowledge.

Exhibit 12

College staffing, 2011-12 to 2013-14

Teaching and administrative staff account for the greatest proportion of reductions.

Staff group	Number of FTE staff in 2011-12	Number of FTE staff in 2013-14	Variance	Variance as percentage
Teaching departments	5,708.6	5,195.0	-513.6	-9.0%
Teaching support services	1,202.2	1,081.0	-121.2	-10.1%
Total teaching staff	6,910.8	6,276.0	-634.8	-9.2%
Other support services	110.0	87.0	-23.0	-20.9%
Other income generating activity	118.5	87.0	-31.5	-26.6%
Premises	585.0	579.0	-6.0	-1.0%
Administration and central support (including Senior Management Team)	2,842.8	2,539.0	-303.8	-10.7%
Other staff	723.2	670.0	-53.2	-7.4%
Total non teaching staff	4,379.5	3,962.0	-417.5	-9.5%
Total	11,290.3	10,238.0	-1,052.3	-9.3%

Source: Audit Scotland analysis of colleges' 2011-12, 2012-13 and 2013-14 audited accounts

89. In our last report on colleges, we recommended that colleges identify the risks associated with reduced staff numbers and take appropriate steps to mitigate their effects. Only one fieldwork college (Edinburgh) did not include loss of skills and knowledge on its register of merger risks. Colleges took a number of actions to reduce the effects of this risk, including sharing information across merging colleges to identify potential skills gaps and the effects of staff reductions.

90. Our 2013 report on early departures highlighted the need for organisations to ensure that they retain sufficient skills and experience before authorising applications for voluntary severance. Two out of the four fieldwork colleges (Ayrshire College and Dundee and Angus College) confirmed that they took decisions based on business needs when they were approving voluntary severance, to minimise the risk of losing key skills and knowledge. However, Edinburgh College reported that it approved most applications for voluntary severance during the early stage of the merger process; and Glasgow Clyde College reported that it approved all applications for voluntary severance in the year leading up to its merger. This allowed these colleges to make early progress on achieving the financial savings expected through the mergers.

91. While reductions in staff could affect service delivery, there is no evidence of any overall deterioration. We did note that, for three colleges, changes in finance staff affected the preparation of financial statements. In only one of the cases (Coatbridge College) was the impact significant.

92. With all mergers now complete, the number of future staff departures is likely to be lower than in the past three years. However, given many colleges will be completing curricula reviews there is potential for further departures. Colleges need to ensure that any further staffing reductions take account of the skills mix required in the college and the workloads of remaining staff.

There were weaknesses in how some colleges managed and approved senior staff severance arrangements

93. Our previous reports [Managing early departures from the Scottish public sector \[PDF\]](#) and [Managing Scotland's public sector workforce \[PDF\]](#) highlighted the importance of planning for staff departures. Those reports also highlighted that:

- board members and senior management have an important role in considering and approving senior staff severance
- any severance arrangements must go through the appropriate approval process.

94. Auditors identified six colleges where the way severance arrangements for senior staff were handled fell short of good practice. In two colleges, there were significant shortcomings in reporting and governance. The Auditor General prepared a separate statutory report on North Glasgow College and plans to prepare one on Coatbridge College ([Exhibit 13, page 40](#)). Auditors identified shortcomings at four other colleges ([Exhibit 14, page 41](#)).

95. There was also one case where the lack of clear guidance from the SFC led to colleges meeting more of the expected severance costs than they had anticipated. In its initial guidance to John Wheatley, North Glasgow and Stow colleges, the SFC indicated that it would fund severance only where the payback period did not exceed one year. However, the SFC also indicated that it would be willing to apply some flexibility. Stow College based its initial calculation of severance costs on the arrangements used by John Wheatley College, which included some flexibility and had been agreed by the SFC. However, the SFC subsequently specified parameters for its flexibility and recovered some funding from John Wheatley College. The SFC also did not provide all of the funding needed for the Stow College proposals, and the college had to draw on reserves to meet the final costs.

96. Responsibility for decisions about severance arrangements lies with college boards. However, the SFC provided significant sums to help pay for college severance arrangements and should have assured itself that colleges had the right processes in place and used the money in line with its guidance. The SFC issued guidance in 2000 on how colleges should deal with severance for senior members of staff but did not remind colleges of this guidance before the programme of mergers began. The SFC has acknowledged the shortcomings identified by auditors and a number of changes should increase the level of awareness and control over college severance arrangements:

- From 1 April 2014, colleges were required to comply with the Scottish Public Finance Manual. This requires central government bodies to seek approval both for severance schemes and for any exceptional payments.

- The SFC, in the Financial Memorandum it issued to colleges in December 2014, set out a series of key requirements for how colleges should process severance payments.
- It is clear from our discussions with senior staff in the sector that statutory reports on severance arrangements have helped to emphasise the responsibilities of both management and boards in ensuring good practice is as followed.
- The SFC is working with the College Development Network (an organisation that supports and facilitates the sharing of good practice) to develop and promote specific guidance and training on severance to college board members.
- Ministers appoint the chairs of college boards, creating a more direct line of accountability to ministers.
- The SFC has the power to call to account anyone who has not applied good practice and, where appropriate, to recover funds from the college.

97. Although it is too early to say whether all of these changes will be effective, they do indicate that the SFC and the Scottish Government have taken steps to minimise the risks associated with senior staff severances.

Colleges will continue to face challenges in the future

98. The college sector will face ongoing challenges as it continues to implement and embed the required changes as a result of the reforms. Colleges will also have a significant role in responding to the recommendations of the Commission for Developing Scotland's Young Workforce.

Exhibit 13

Statutory reports about issues relating to severance arrangements

Coatbridge College and North Glasgow College did not follow good practice in managing and approving severance arrangements for senior staff.

Coatbridge College

The 2013-14 accounts and external audit for Coatbridge College were not concluded at the time of preparing our report ([paragraph 7](#)). However, the auditor identified a number of significant concerns in relation to the way that severance arrangements for senior staff were processed. The Auditor General is preparing a separate report on the issues.

North Glasgow College

On 1 November 2013, North Glasgow College merged with John Wheatley College and Stow College to form Glasgow Kelvin College.

In the 2012-13 annual audit report for North Glasgow College, the auditor highlighted that:

- the college did not provide evidence that the severance arrangements for two senior members of staff, the Principal and Vice-Principal, had been subject to appropriate consideration and approval
- the college did not provide evidence that the costs associated with the severance had been assessed as providing value for money
- the college's initial calculation of severance costs was incomplete.

The Auditor General prepared a report on these issues, which was considered by the Scottish Parliament's Public Audit Committee in May 2014 and again in November 2014. It sought further evidence from the SFC and the Scottish Government and was continuing to consider the matter at the time of this report.

In the 2013-14 annual audit report on Glasgow Kelvin College, the auditor reported that one further senior staff severance arrangement relating to the 2012-13 year had not been subject to appropriate approval by North Glasgow College's Board. When the merged college became aware of this case, it convened a meeting of its Remuneration Committee to consider, and subsequently approve, the business case. The auditor has confirmed that Glasgow Kelvin College has appropriate arrangements in place for any future severance.

Source: Audit Scotland analysis of colleges' 2012-13 and 2013-14 audited accounts and annual audit reports; and information from the auditor of Coatbridge College about the 2013-14 audit.

Exhibit 14

Issues identified by auditors where severance arrangements fell short of good practice





Four colleges fell short of good practice.

College	Issue or issues identified
Banff and Buchan College (subsequently merged into North East Scotland College)	The auditor identified gaps in the documented process for considering and approving senior staff severance applications. Following additional work, the auditor concluded that, while record keeping should have been better, there was enough evidence that board members had appropriately considered and approved severance proposals.
City of Glasgow College	The auditor reported that the college did not have a severance policy in place in 2013-14. The auditor confirmed that the college did have a clear and effective severance scheme that was open to scrutiny, and applications went through a rigorous approval process. The college was developing its policy and expected to present this to the next Staff, Students & Equalities Board meeting in March 2015.
Carnegie College (subsequently merged into Fife College)	At Carnegie College, the Principal was offered a compulsory severance package after a new Principal was identified for the newly merged college (Fife College). The college Chairs' Committee delegated the final terms of the package to the chair of the Carnegie College board. However, it did not agree any limits or guidance on what the package could include and the Principal was offered an enhancement of three months' salary as part of the package. Senior managers at the college told the auditors that the board considered the enhancement was necessary to ensure the Principal took the package. This, in turn, helped the transition to the new management structure go smoothly. However, there was no record of the Chairs' Committee considering and approving this detail and there was no record of the final terms being reported back to the board or the Chairs' Committee.
Cardonald College (subsequently merged into Glasgow Clyde College)	Cardonald College's initial calculations of potential severance costs were incomplete. The initial calculations did not include an estimate of the costs associated with the additional strain that would be placed on the pension fund as a result of the staff severances. These costs can be significant; in a few individual cases, the strain costs more than doubled the total severance cost of the employee. While the board was informed of the full costs of severance once the strain costs were identified, the college should have highlighted and considered this element of cost prior to considering any potential offers to staff.

Source: Audit Scotland analysis of colleges' 2012-13 and 2013-14 audited accounts and annual audit reports

Endnotes



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- ◀ 1 [Learning the lessons of public body mergers: Review of recent mergers \[PDF\]](#)  Audit Scotland, June 2012.
 - ◀ 2 Scottish Funding Council circular SFC/26/2009.
 - ◀ 3 *Financial Memorandum with Fundable Bodies in the College Sector*, Scottish Funding Council, December 2014.
 - ◀ 4 [Scotland's colleges 2013 \[PDF\]](#)  Audit Scotland, October 2013.
[NHS in Scotland 2013/14 \[PDF\]](#)  Audit Scotland, October 2014.
[Developing financial reporting in Scotland \[PDF\]](#)  Audit Scotland, July 2013.

Scotland's colleges 2015

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Audit Scotland, 110 George Street, Edinburgh EH2 4LH

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