Item 14a
For Discussion and Noting

Scotland's colleges 2023

A briefing paper

AUDITOR GENERAL

Prepared by Audit Scotland
September 2023

Key messages

1. Scotland's colleges are vital to learners and local communities. Risks to the college sector's financial sustainability have increased since we reported in 2022. Rising staffing costs are colleges' biggest financial pressure.

2. The Scottish Government's funding for the sector has reduced by 8.5 per cent in real terms between 2021/22 and 2023/24, while the sector's costs have increased. Effective, affordable workforce planning is now a greater than ever priority and challenge for colleges.

3. Significant changes to how the college sector operates have been recommended by recent reviews. However, the Scottish Government and the Scottish Funding Council urgently need to build on their ongoing work to help colleges plan for change now, and make best use of available funding so that they are sustainable for the future.

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Scotland's colleges have a vital role

Colleges provide valuable learning and facilities, support economic growth and help people achieve wider outcomes

1. Scotland's colleges offer academic and vocational courses to develop people's skills and knowledge for work, continued study or general interest. Students can choose to study full-time, day release, evenings, block release or on an open learning basis. The courses that college students undertake contribute not only to their own development but also to Scotland's sustainable economic growth. Colleges are valuable hubs whose facilities may also be used for local community purposes, including as meeting spaces and sports venues.

There are different types of colleges

2. Of the 24 colleges in Scotland, 22 sit in college regions that have one or more colleges. Nineteen colleges are classed as 'incorporated' and are public bodies that are subject to audit by the Auditor General for Scotland (AGS). As public bodies, incorporated colleges are not permitted to retain reserves at the end of their financial year. The five unincorporated colleges (shown in bold in Exhibit 1 (page 4)) are not audited by the AGS and have a range of constitutional arrangements. Two establishments are outside colleges' regional arrangements. Sabhal Mòr Ostaig offers further and higher education opportunities through the medium of Scottish Gaelic. Newbattle Abbey College is an unincorporated residential college that caters largely for students returning to education in adulthood. In addition, Scotland's Rural College is a higher education institution that contributes to the national target for colleges.

3. On 1 August 2023, UHI North Highland and UHI Lews Castle, both of which were incorporated, merged with each other and with UHI West Highland, which was previously unincorporated. The new, merged college is known as UHI North, West and Hebrides. It is expected to be assigned to the University of the Highlands and Islands (UHI) and incorporated. This merger is designed to create an institution of scale which will improve sustainability and create benefits for students, staff and stakeholders across a wide region of Scotland.

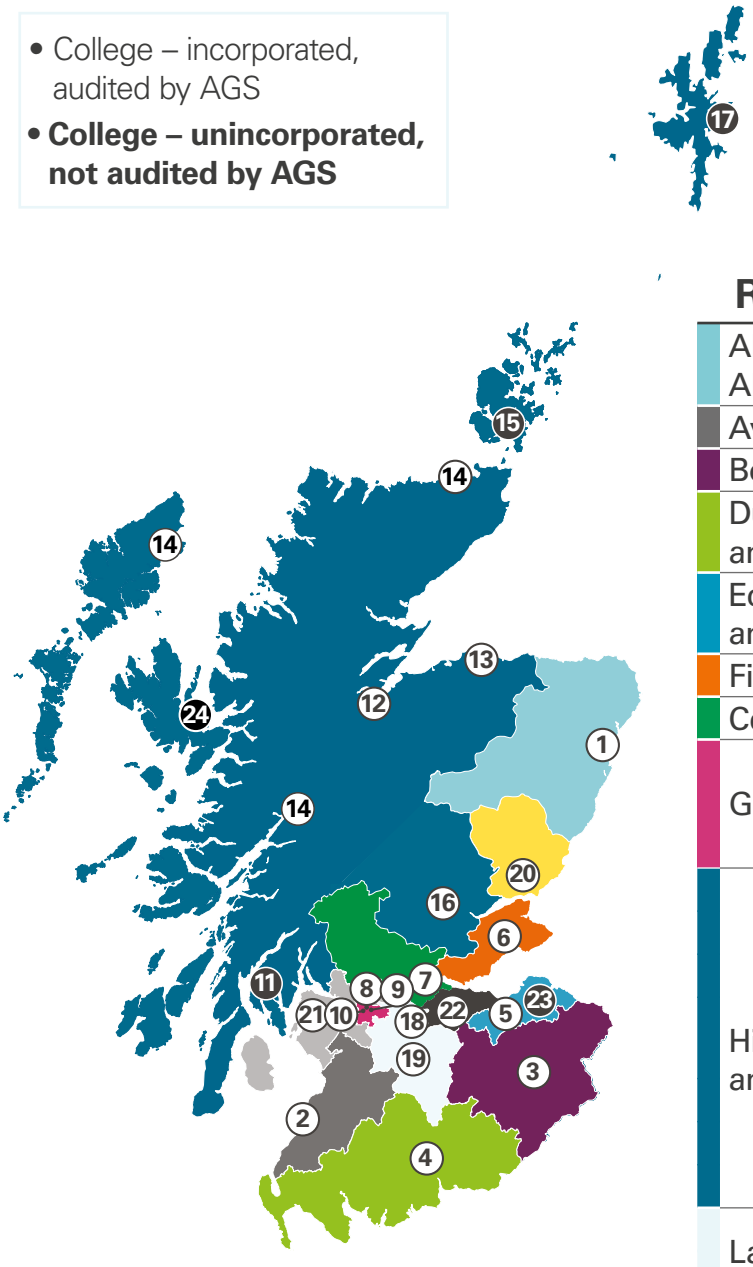
4. This briefing paper draws on our analysis of auditors' annual audit reports (AARs) about incorporated colleges.

Exhibit 1.

Scotland's colleges as at 1 August 2023

The colleges not listed in bold are subject to audit by the Auditor General.

- College – incorporated, audited by AGS
- **College – unincorporated, not audited by AGS**



Region		College
Aberdeen and Aberdeenshire	1	North East Scotland College
Ayrshire	2	Ayrshire College
Borders	3	Borders College
Dumfries and Galloway	4	Dumfries & Galloway College
Edinburgh and Lothians	5	Edinburgh College
Fife	6	Fife College
Central	7	Forth Valley College
Glasgow	8	City of Glasgow College
	9	Glasgow Clyde College
	10	Glasgow Kelvin College
Highlands and Islands	**11**	**UHI Argyll**
	12	UHI Inverness
	13	UHI Moray
	14	UHI North, West and Hebrides
	15	**UHI Orkney**
	16	UHI Perth
	17	**UHI Shetland**
Lanarkshire	18	New College Lanarkshire
	19	South Lanarkshire College
Tayside	20	Dundee and Angus College
West	21	West College Scotland
West Lothian	22	West Lothian College
n/a	**23**	**Newbattle Abbey College**
n/a	**24**	**Sabhal Mòr Ostaig**

Source: Audit Scotland

The Scottish Government has a central role in setting policy and funding the college sector

5. The Scottish Government sets national policies for learning and provides over three quarters of the college sector's funding, through its financing of the Scottish Funding Council (SFC). It does this in financial years (FY) that run from April to March.

6. The SFC works with colleges to set thresholds for the amount of course provision that colleges should deliver and provides the funding to each college, or regional strategic body in multi-college regions. It does this to fit with the college sector's academic year (AY) from August to July. A regional strategic body allocates funding to the colleges within its area. The SFC holds colleges and regions to account for what they deliver through Outcome Agreements. These set out what colleges plan to deliver in return for their funding from the SFC. Its Outcome Agreement Managers work with each college to develop their individual Outcome Agreement.

Risks to the college sector's financial sustainability have increased

In 2022, we reported that change was needed to ensure the sector's financial sustainability in the long term

7. Scotland's colleges 2022 drew on colleges' accounts for AY 2020-21 and concluded that it will be difficult for colleges to balance delivering high-quality learning at the volume expected while contributing to other Scottish Government priorities. We said change was needed to ensure more students are successful; and also that the Scottish Government and the SFC should support colleges to plan for change now to make best use of available funding and ensure the sector is financially sustainable in the long term.

Risks to the sector's financial sustainability have increased since then

8. Auditors' AARs on incorporated colleges for AY 2021-22 highlighted sustained risks to colleges' financial sustainability, and an increased level of risk in most of them.

9. The SFC requires a college to report its adjusted operating position (AOP), to reflect its underlying operating performance after allowing for material one-off or distorting matters outside its control. This helps to assess a college's underlying financial strength and to provide figures which are readily comparable among colleges.

10. The sector reported an adjusted operating surplus of around £8 million in AY 2021-22. The SFC has not yet concluded its assessment of the sector's finances for AY 2021-22. While early analysis indicates that the sector's adjusted operating surplus is slightly better than forecast, the surplus for AY 2021-22 is likely to be considerably less than its surplus of £19.3 million for the previous year.

11. The anticipated reduction in the surplus is partly due to increases in staff costs, reflecting the impact of the sector's pay award in AY 2021-22 and some additional recruitment as well as rising inflation, fuel costs and other pressures. Other operating costs increased by around £10 million (six per cent) on AY 2020-21 levels. The return to campus activity – following

the impact of the Covid-19 pandemic – saw an increase in teaching, teaching support and administration costs plus increased catering, student residence and utilities costs. More colleges reported an adjusted operating deficit in AY 2021-22 than in AY 2020-21.

Rising staffing costs are colleges' biggest financial pressure

12. Staff costs accounted for more than two thirds (around 70 per cent) of the sector's expenditure in AY 2021-22. Changes to their staffing are one of the main levers for colleges to manage their costs. Staff pay awards remain a pressure on college finances. Trade unions are continuing to pursue their pay claim for AY 2022-23. Employers' pension contribution costs are increasing. The outcome of a job evaluation exercise for support staff will also increase staff costs when completed.

13. Colleges have already sought voluntary redundancies to reduce their staff costs. While final figures for the sector are not yet available, we know that many colleges have spent money on staff restructuring costs – that mainly involve voluntary redundancies – to help save money in the longer term. The SFC reported that there were no compulsory redundancies during AY 2021-22. Some colleges anticipate the need for further, significant staffing reductions which could severely erode their ability to deliver a viable curriculum.

14. Glasgow Kelvin College has indicated that it may need to reduce its workforce by 21 per cent from AY 2022-23 to AY 2024-25. Ayrshire College, in preparing its 2022 financial forecast, also calculated a set of financial projections using an alternative, more pessimistic planning scenario (compared to the planning assumptions provided by the SFC). This scenario found the college may need to lose 70 per cent of its staff over a five-year period – a scenario in which it could no longer function.

15. All colleges provided updated financial forecasts to the SFC at the end of June 2023 along with additional planning scenarios that they considered appropriate for their operating environment and circumstances. The updated forecasts and additional planning scenarios supersede the 2022 equivalents. These are currently being reviewed by the SFC.

16. The strategic workforce pressures facing the college sector are more challenging than before, as colleges seek to reduce their costs. Some colleges have said that they are considering implementing compulsory redundancies. In June 2023, the Minister for Higher and Further Education and Minister for Veterans informed the Scottish Parliament's Education, Children and Young People Committee that he had written to all college principals to 'reiterate the importance the Scottish Government places on the use of fair work practices in the college sector …My officials are engaging with the SFC to build a picture of the scale of redundancies facing the sector and whether there is any impact on provision.' In July 2023, the Minister wrote to the Committee, indicating that colleges should only seek compulsory redundancies as a last resort and should notify the SFC of such intentions.

Colleges also have other pressures

17. Without investing in maintenance, colleges risk their estate becoming a worsening environment for learning. Scotland's colleges 2022 noted that capital funding for the college sector was £321 million short of requirements for lifecycle and backlog maintenance, and that capital funding from the Scottish Government, administered through the SFC, had consistently fallen short of the level colleges have needed.

18. The SFC developed the College infrastructure strategy for 2023-33 in consultation with the sector and it recognises the urgent need for significant investment in the college estate. The Scottish Government increased the sector's capital funding from £74.7 million in FY 2022/23 to £82.4 million in FY 2023/24. After taking account of inflation, this represented an increase of 7.6 per cent in real terms. Recognising the increasing number of urgent calls for assistance on repairs/works of a health and safety or business continuity nature, the SFC set aside £4.7 million in AY 2023-24 to support the sector. The SFC received expressions of interest to a value of approximately £20 million and is currently triaging these to a shortlist to fit the budget. Emerging issues around Reinforced Autoclaved Aerated Concrete will only add to this pressure.

19. Numerous colleges have highlighted impacts from the Covid-19 pandemic on their financial position and sustainability. These include reductions in their non-SFC income sources in AY 2021-22 due to pandemic-related restrictions, such as constraints on pursuing commercial opportunities. Other risks are summarised in Exhibit 2.

Exhibit 2.

Significant areas of risk for colleges

This is a cross-section of the numerous risks affecting colleges.

- Inflation, interest rates and energy costs.
- The investment required to achieve public sector net zero targets, especially in relation to the college estate.
- Investment required to invest in digital.
- Difficulties in attracting and retaining students and staff.
- The requirement for colleges to self-fund staff restructuring and voluntary severance package costs.
- Competition from private sector training providers.
- Competition from some universities.
- The challenges of raising income from non-teaching activities.
- The impact of cost efficiencies on staff wellbeing and the student experience.

Source: Scottish Funding Council, Audit Scotland

Colleges rely heavily on Scottish Government funding

20. The Scottish Government's budget works in financial years (FY) that run from April to March, such as April 2022 to March 2023. The Scottish Government has budgeted revenue funding for the college sector comprising £675.7 million in each of 2021/22, 2022/23 and 2023/24. After taking account of inflation, this represents a reduction in real terms of 8.5 per cent from 2021/22 to 2023/24.

21. The SFC uses the Scottish Government's funding to provide grants to colleges within their academic year (AY) that runs from August to July. This means that a college year spans two years of the Scottish Government's budget. For example, the college sector's AY 2022-23 year spanned the Scottish Government's financial years FY 2022/23 and FY 2023/24. The SFC has set a college revenue budget for AY 2022-23 of £675.3 million, a reduction of £36.5 million (5.1 per cent) from AY 2021-22.

22. Grant funding provided via the SFC accounted for around three quarters of the college sector's total income in AY 2021-22. One college relied on the SFC for less than half its income (Sabhal Mor Ostaig). All other colleges relied on the SFC for more than half their income, including seven that obtained over three quarters of their income from the SFC. Colleges' main source of non-SFC income was tuition fees and education contract income, with other income-generating activities, including catering, making up the bulk of the balance.

Significant changes lie ahead

The Scottish Government recognises that changes are needed

23. Several national reviews have recently recommended major changes that would affect the college sector, and these sit alongside other significant developments (Exhibit 3). They all bring both challenges and opportunities for the Scottish Government. There are questions about what can realistically be achieved in the short term and what may require a longer timescale, possibly involving new legislation.

Exhibit 3.

Recent major developments affecting the college sector

These bring challenges and opportunities.

29 June 2021	The SFC's review of tertiary education and research included a recommendation to the Scottish Government that there should be more flexibility in how colleges are funded.
7 June 2023	The Withers review of the post-school learning system urged the Scottish Government to think creatively about how to secure the sustainability of the post-school skills delivery system. It included a recommendation that the Scottish Government should redesign the process for how funding of all learning and training provision, including apprenticeships, is allocated to ensure it is prioritised to deliver strategic outcomes and best value for public investment. It also recommended the establishment of a single funding body and parity of esteem between colleges and universities.
22 June 2023	The Hayward review of qualifications and assessment will have implications for the qualifications that colleges consider when selecting students and employees, and for the courses that colleges provide.
28 June 2023	The Scottish Government's Purpose and Principles for post-school education, research and skills includes a target outcome that the system is 'financially and environmentally resilient; trusted to deliver, and subject to effective governance'. The programme of reform, signalled through the Scottish Government's Initial priorities for implementation and the Purpose and Principles, outlines the key actions that the Scottish Government will be taking forward to deliver on the vision and outcomes it has set for the system.

Source: Scottish Government

24. In May 2023, the Scottish Parliament's Education, Children and Young People (ECYP) Committee concluded that 'If additional funding is unavailable, and flexibility within current funding arrangements is also not forthcoming, then the Scottish Government and the Scottish Funding Council need to provide colleges with a clear steer on what they should be prioritising.'

25. In June 2023, the Scottish Government took some initial steps in response to these developments:

- It advised the Scottish Parliament's ECYP Committee that it had 'heard loud and clear the calls for reform and won't shy away from decisions which will deliver better services for learners and employers and simplify the operating environment for our colleges, universities and training providers.'
- It advised the ECYP Committee that it is considering ways to give colleges more financial flexibility. It also asked the SFC to play an active role in helping colleges to use their funding allocations more flexibility; and to intervene in the sector where necessary.
- It announced that it plans to take over national responsibility for skills planning, and that there will be a new national model of public funding for all colleges, universities, apprenticeships and training.

26. The SFC has introduced a new funding distribution model and associated guidance for AY 2023-24. This is to provide colleges with enhanced flexibility and greater opportunity to decide how best to respond to local, regional and national needs. The Scottish Government is exploring the potential for further changes in colleges' funding arrangements.

The Scottish Government and the SFC urgently need to build on their ongoing work with colleges and help them become sustainable now, while structural arrangements at a national level evolve

27. Overall, 25.5 per cent of school leavers went into further education at college in AY 2021-22, compared to 35.6 per cent from the most deprived areas (Scottish Government statistics, February 2023). These figures exclude school leavers undertaking a higher education course in a college. Colleges therefore play a vital role in providing people, particularly those from more disadvantaged areas, with the training, qualifications and life-skills that can help them to succeed in life and make a valuable contribution to society. More widely, colleges also contribute to achieving the Scottish Government's three national 'missions':

The Scottish Government's three missions

1. **Equality:** tackling poverty and protecting people from harm.
2. **Opportunity:** a fair, green and growing economy.
3. **Community:** prioritising our public services.

28. A significant reduction in a college's range of courses, student capacity, or its closure altogether could have an unequal impact on students from more deprived areas, plus ramifications for the wider community. In many rural, remote and island communities, there is no alternative college nearby.

29. Policy and structural changes by the Scottish Government have the potential to improve colleges' operating environment but colleges face daunting challenges now to their business models and finances. For example, colleges need to maintain and, if possible, enhance the learning they provide and improve outcomes for their students. At the same time, they are managing complex change across the college sector and considerable strain on their finances.

30. Addressing the challenges facing the college sector cannot be avoided or postponed. While recognising the role of college leadership teams in managing their finances, it is also critical for the Scottish Government to work with the SFC during AY 2023-24 to support colleges in planning for change now and making best use of available funding. This should help to secure colleges' future while the Scottish Government considers its response to the reviews featured in Exhibit 3 (page 10), and the funding it allocates to the sector.

Next steps

31. We report annually on the audits of Scotland's incorporated colleges. We will continue to monitor and report on developments across the sector as their impacts become clearer.

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A briefing paper

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