Pecyn dogfennau cyhoeddus

Y Pwyllgor Plant a Phobl Ifanc

Cynulliad Cenedlaethol Cymru
National Assembly for Wales

Lleoliad:
Ystafell Bwyllgora 4 - Tŷ Hywel

Dyddiad:
Dydd Mercher, 3 Gorffennaf 2013

Amser:
09:15

I gael rhagor o wybodaeth, cysylltwch â:
Deddfwriaeth: Steve George
Clerc Deddfwriaeth
Polisi: Claire Morris
Clerc y Pwyllgor
029 2089 8148 / 029 2089 8242
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Agenda
Preifat

Yn ei gyfarfod ar 19 Mehefin, cytunodd y Pwyllgor i gynnal y cyfarfod heddiw yn breifat, yn unol â Rheol Sefydlog 17.42.

1 Cyflwyniad, ymddiheuriadau a dirprwyon

2 Y Bil Addysg Bellach ac Uwch (Llywodraethu a Gwybodaeth) (Cymru) (Tudalennau 1 - 32)

Papurau atodol:

- CYP(4)-20-13(p.1) - Llythyr gan y Cadeirydd at Leighton Andrews AC - 20 Mehefin 2013
- CYP(4)-20-13(p.2) - Cadeirydd at Weinidog Addysg a Dysgu Gydol Oes yr Alban - 20 Mehefin 2013
- CYP(4)-20-13(p.3) - Llythyr at y Cadeirydd gan Weinidog Addysg a Dysgu Gydol Oes yr Alban - 26 Mehefin 2013
- CYP(4)-20-13(p.4) - Llythyr gan y Cadeirydd at y Gweinidog Addysg a Sgiliau newydd, Huw Lewis AC - 27 Mehefin 2013
- CYP(4)-20-13(p.5) - Ymateb gan y Gweinidog Addysg a Sgiliau newydd, Huw Lewis AC i'r llythyr gan y Cadeirydd
- CYP(4)-20-13(p.5) - Atodiad

3 Ymchwiliad i Bresenoldeb ac Ymddygiad - trafod yr adroddiad drafft (09.35-10.15)

Y Pwyllgor Plant a Phobl Ifanc
Children and Young People Committee

Cynulliad Cenedlaethol Cymru
National Assembly for Wales

Leighton Andrews AM
Minister for Education and Skills
Welsh Government
Tŷ Hywel
Cardiff Bay
Cardiff
CF99 1NA

20 June 2013

Dear Minister

The Further and Higher Education (Governance and Information) (Wales) Bill

Thank you for attending the Children and Young People Committee's meeting yesterday to answer Members' questions about the above Bill.

You agreed to share with the Committee information on the changes that you will be making to grant conditions for Further Education Corporations (FECs) to ensure that they address concerns from the Office for National Statistics' (ONS) that legislative controls are not replaced with non-legislative controls.

You also agreed to reflect on the proposed abolition of the power to regulate higher education courses in the further education sector (Section 7 of the Bill). Our understanding is that this power only applies to Wales and that it may not be a prerequisite for ONS reclassification of FECs. Although your official, Mr Clark, explained that this power has never been used in Wales, Members asked whether now was an appropriate time to seek its abolition, given wider changes that are in prospect in the sector.

Members also asked whether you had considered approaching the Treasury to agree an uplift to the capital delegated expenditure limit (DEL) for the Welsh Government to the level of planned spend by FECs, which was suggested as an option in the Bill's Explanatory Memorandum. In the memorandum you estimated that this approach was only likely to have a 10%

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chance of being successful as a long-term option. (Although you also indicated that it had a much greater chance of being successful as a short term measure.) However, Members were somewhat surprised that you have apparently decided against even approaching the Treasury on this point. The Committee will be writing to the Scottish Education Minister to seek further clarification on the approach being adopted in Scotland but it was also somewhat surprising that you had decided not to establish whether a joint approach from the Welsh and Scottish Governments (and possibly Northern Ireland Ministers) could be made and whether this might have a greater chance of success than approaching the Treasury alone. I would be grateful for your comments on these matters.

Changes made by the Charities Act 2006 (now contained in the Charities Act 2011) require that exempt charities (such as FECs) are regulated by a Principal Regulator or lose their exempt status and register with the Charity Commission. Simon Thomas asked you about the Welsh Government's proposal that the Welsh Ministers should be prescribed as Principal Regulator for FECs in Wales. Is this likely to have any effect on the ONS reclassification? Could you let us have further information on what practical difference it will mean if the Welsh Government becomes the Principal Regulator?

I am copying this letter to Jocelyn Davies as the Finance Committee also has an interest in some of the matters raised by the Bill. I am also copying it to the Minister for Finance, Jane Hutt, so that she can consider whether she needs to respond in relation to the question about the capital DEL.

Yours sincerely

Ann Jones AM
Chair

Y Pwyllgor Plant a Phobl Ifanc
Children and Young People Committee

Cynulliad Cenedlaethol Cymru
National Assembly for Wales

Michael Russell MSP
Cabinet Secretary for Education and Lifelong Learning
St. Andrew's House
Regent Road
Edinburgh
EH1 3DG

20 June 2013

Dear Mr Russell

The Further and Higher Education (Governance and Information) (Wales) Bill

The National Assembly's Children and Young People Committee is currently considering the above Bill.

The Bill seeks to enhance the autonomy and decision making abilities of Further Education Institutions (FEI) by removing and modifying existing legislative controls on them. In doing this, the Bill seeks to remove various statutory controls that the Welsh Ministers exercise over FEIs in Wales and that led to the Office for National Statistics (ONS) reclassifying them as part of central government for the purposes of the National Accounts. I understand that the ONS has made a similar decision in respect of Scottish Further Education bodies.

According to the Bill's Explanatory Memorandum, the effect of the reclassification has negative impacts for the FE sector in Wales that will lead to changes to the way financial information from colleges is collected and monitored and impact on how FEIs manage their internal affairs. The changes have significant implications for FEIs including:

- any surpluses generated by colleges would be accounted for as Welsh Government funds;
- FEIs would be unable to retain a surplus in order to build reserves for future projects; and

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- additional financial and accounting requirements.

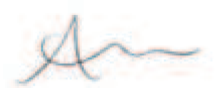
If the Bill is passed, the Welsh Government intends to seek the reclassification of FEIs in Wales by the ONS as ‘Non-profit Institutions Serving Households’, which it believes will mitigate the implications outlined above.

The Committee understands that the Scottish Government has decided to take a different policy approach and will not seek ONS reclassification but will instead seek to mitigate the effects in other ways. The Committee would be grateful for any information you can provide about the approach you are taking. In particular, has the Scottish Government considered approaching the Treasury to see if there is scope to change central government accounting arrangements to help mitigate the effects of the reclassification?

This approach appears to have been ruled out by the Welsh Government, which does not believe it has a realistic chance of success. The Committee would be very grateful for your view on this and whether a joint approach by the Scottish and Welsh Governments and the Northern Ireland Assembly would offer a better chance of convincing the Treasury to agree the necessary changes.

I am copying this letter for information to Leighton Andrews AM the Minister for Education and Skills in the Welsh Government. I’m afraid the time available to the Committee to consider the Bill is very limited and I would, therefore, be grateful for an early reply, if at all possible.

Yours sincerely



Ann Jones AM
Chair

Rùnaire a' Chaibineit airson Foghlaim agus Ionnsachadh Fad-bheatha
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The Scottish Government
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LEGACY 2014
XX COMMONWEALTH GAMES
SCOTLAND

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Chair of Children and Young People Committee
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26th June 2013

Thank you for your letter of 20 June. I very much appreciate the opportunity to engage on the issue of college reclassification, and contribute to your consideration of the Further and Higher Education (Governance and Information) (Wales) Bill.

Your letter confirms that this legislation seeks to remove various statutory controls Welsh Ministers exercise over Further Education Institutions (FEIs), given those controls have led to the Office of National Statistics (ONS) reclassifying FEIs as part of central government. In Scotland, those colleges incorporated under the Further and Higher Education (Scotland) Act 1992 are also subject to reclassification.

ONS' decision to reclassify colleges is both unhelpful and unwelcome in Scotland, coming at a time of substantial change as we implement a programme of reform to Post 16 education.

Our reforms are informed by the independent Griggs Review of Further Education Governance in Scotland, published in January 2012. That review highlighted the need for greater democratic accountability for the significant funding we allocate to colleges. In response, Scottish Ministers have developed policy which is both appropriate and builds on existing arrangements. We are clear that Ministerial controls, enhanced as proposed in our Post 16 Education (Scotland) Bill, are the right solution for Scotland.

We cannot support any suggestion that accounting rules, such as those proposed through ONS' decision, should determine our policy, or that democratic accountability should be sacrificed as a result of that decision.

Since 2010, the Scottish Government has been engaged in an extensive period of negotiation with HM Treasury on the basis for ONS' decision, the timing of implementation and the scope for mitigating the implications. While we continue to believe it is within power of HM Treasury to mitigate this decision, it has regrettably chosen not to do so. We continue to disagree with the HMT position. Indeed, we now believe there could be an inconsistency in the treatment of Scottish colleges and continue to press this point with HMT.

In taking its position, HM Treasury has sought to use the distinctive nature of our response as a means to avoid fully reflecting the budgetary impact of ONS' decision in Scotland. I would therefore welcome the development of a joint approach with other devolved administrations to HM Treasury in pursuit of fairness, parity and increased flexibility.

I believe there is much to be to gained and learned from a shared approach on this issue. My officials will continue to engage with their counterparts in Wales and are happy to provide further advice, while also exploring the options contained within the legislation you are considering.

I attach a full briefing note on the ONS decision and its ramifications in Scotland, which has been shared with key stakeholders including affected colleges. It includes details of our proposed mitigations. We are working collaboratively with our colleges to develop these into practical solutions which will maintain the effectiveness and valuable contribution of the college sector, from within central government.

Yours ever,

MICHAEL RUSSELL

Office of National Statistics reclassification of incorporated further education colleges

Introduction

1 This paper provides an initial overview of the background to the UK's Office of National Statistics' reclassification of incorporated colleges, the consequential impacts and the steps that are being taken to manage the transition and ensure the successful delivery of the post-16 reform programme.

2 This paper has been prepared for the use of the college chairs and principals and therefore, as far as possible, has been written in non-technical language. Consequently, it does not describe the precise technical arrangements for government budgeting and reporting. Such detail can be found in the documents to which links have been provided.

3 The paper has eight sections:

- Executive Summary
- Background
- Overview of government financial budgeting and financial reporting arrangements
- How incorporated colleges' income and expenditure is treated within UK-wide government budgeting arrangements
- Potential Mitigating Actions
- The UK-wide arrangements for the setting, monitoring and control of government budgets
- Financial reporting requirements
- Project board

Executive summary

4 In October 2010 the UK Office of National Statistics (ONS) decided to reclassify incorporated further education colleges throughout the UK so that they would be treated as part of central government for financial budgeting and reporting purposes. The UK ONS's reclassification decision is the consequence of the current level of Ministerial control

and does not relate to the plans for improved governance that feature in the Post-16 Bill. Scottish Ministers have argued the case against these changes but the UK Treasury have refused to change their approach.

5 Scottish Ministers want to work closely with incorporated colleges to implement the changes in a way that is least unsettling for the colleges. To that end, a Project Team is being established with representation from college experts, and the college representative body, to help manage the changes. The Scottish Government and the Project Team are therefore exploring a range of mitigating actions in relation to:

- Generation and retention of income
- Generation and retention of surpluses (reserves)
- Use of existing reserves
- Access to capital funding and commercial borrowing

6 None of this affects the Scottish Government's commitment to provide a floor in college funding of £522m in 2013-14 and 2014-15.

7 The first stage of implementation takes effect on 1 April 2014 when incorporated colleges will need to:

- Move to an April to March financial year
- Manage their expenditure within the wider Scottish Government financial budgeting and reporting arrangements.

Background

8 In October 2010 ONS decided to reclassify incorporated further education colleges throughout the UK so that they would be treated as part of central government for the purposes of reporting government income, expenditure, finances and associated matters. Previously incorporated colleges were treated as being outwith central government for these purposes. The UK Government has taken a direction of travel on colleges that has allowed them to avoid reclassification so far but recent announcements regarding the FE Commissioner south of the border has created a perception of inconsistency of treatment of the sector by the UK Treasury.

9 The UK ONS's reclassification decision is the consequence of the current level of Ministerial control and does not relate to the plans for improved

governance that feature in the Post-16 Bill. Scottish Ministers are clear that those controls, as enhanced by the Bill, are the right solution for Scotland and are appropriate given the very significant public investment in colleges.

10 As described in the rest of this paper, the impact of the UK ONS's reclassification goes well beyond statistical reporting of government income, expenditure and finances. Following clarity from HM Treasury on the position of the Scottish Government's budget following reclassification, Ministers have been conducting detailed negotiations since Autumn 2012 exploring possible flexibilities in implementation. Unfortunately, HM Treasury has only offered some limited additional resource budget support and it is insisting that the changes to incorporated colleges' financial budgeting and reporting are implemented from 1 April 2014.

Overview of government financial budgeting and financial reporting arrangements

11 Up until now what has counted as government expenditure relating to incorporated colleges has essentially been the money allocated by government to colleges (most of which flows through the Scottish Funding Council). From now on it will be what colleges actually spend that is included in the Scottish Government's total expenditure figures. If colleges' only expenditure was that funded by their income from government and their expenditure was consequently very predictable, this change would make little difference. However, a significant amount of college activity is funded from other sources and therefore colleges' income and expenditure levels do fluctuate because of changes in business activity.

12 Given the close interest that is taken in measures such as total public expenditure and the public sector borrowing requirement, all the main aspects of government finance have to be monitored closely. Further, because the control of government finance is focussed on the balance of income and expenditure within an individual year, there is only very limited scope to manage financial resources across different years.

13 In the following sections these features are described in more detail, as follows:

- How incorporated colleges' income and expenditure is treated within UK-wide government budgeting arrangements

- The UK-wide arrangements for the setting, monitoring and control of government budgets

- Financial reporting requirements

How incorporated colleges' income and expenditure is treated within UK-wide government budgeting arrangements

14 For the purposes of HM Treasury budgeting, incorporated colleges will be classified as 'Arms-Length Bodies' (ALBs). The budgeting requirements this places on them is analogous to that for NDPBs. The detailed arrangements are set out in chapter 9 of HM Treasury's *Consolidated budgeting guidance*:

- http://www.hm-treasury.gov.uk/d/consolidated_budgeting_guidance_201213.pdf

15 The key points to note from that document are as follows:

- Incorporated colleges' own 'resource consumption' (i.e. their recurrent expenditure) and their own capital expenditure will be counted as part of the Scottish Government's spending. Therefore, since there is an annual ceiling placed on each area of government expenditure (referred to as 'Departmental Expenditure Limits' or 'DEL'), incorporated colleges will also have to control their expenditure so that it does not exceed pre-set limits.

- Even if expenditure is financed from incorporated colleges' own reserves or borrowing, it is still included as part of overall government expenditure and therefore has to be allocated an equivalent amount from the Scottish Government's overall budget (even though the Scottish Government would not actually have to pay for or fund the expenditure). This is referred to as 'budget cover'.

16 With regard to the year-to-year position, the Scottish Government's expenditure is controlled on an annual basis with only very limited scope to manage any under or over spent budget beyond the financial year end. From 1 April 2014 the incorporated college sector will be subject to the same annularity, including limitations on end year flexibility. The Budget Exchange Mechanism (BEM) offers the Scottish Government some ability to manage funds over the year end. The limits of this are 0.6% of the total Scottish Government resource budget and 1.5% of the total capital budget. This equates to around £150m of resource and £50m of capital for the whole of the Scottish Government. Any future

college budget management across the year end will have to be managed within these narrow limits.

17 Essentially what all this means is that:

- All income and expenditure by incorporated colleges, including that funded from either reserves or borrowing, counts as part of the Scottish Government's own income and expenditure

- All expenditure by incorporated colleges (net of income) requires budget cover from within the Scottish Government's own budget limits

- From 1 April 2014 onwards, any expenditure funded from incorporated colleges' own reserves would be considered as additional within the context of the Scottish Government's budget, and require corresponding budget cover. From 1 April 2014 there will only be limited scope for incorporated colleges to carry forward surpluses to future years.

18 The following sections describe how the foregoing will impact on:

- Generation and retention of income

- Generation and retention of surpluses (reserves)

- Use of existing reserves

- Access to capital funding and commercial borrowing.

19 The paper then describes how some of these impacts might be mitigated.

Generating and retaining income

20 Incorporated colleges will still be able to engage in activities to generate other income – indeed Ministers expect this drive to continue to support direct public investment. Projected additional external income will effectively be matched against the additional expenditure which it supports, leaving the net amount of expenditure that is supported by SFC grant and similar income. There is no intention to revisit previously indicated levels of college funding in light of reclassification. There are already Central Government bodies that successfully generate large proportions of their funding through commercial activity (such as

Historic Scotland, the Scottish Qualifications Authority and the National Collections).

Ability to generate and retain surpluses

21 Any surplus is treated as an underspend against the budget limit and any underspend rolled forward requires additional budget cover to allow it to be spent (deficits are effectively overspends). The Scottish Government has very limited flexibility (under the BEM) to roll forward underspends across year ends.

Ability to spend existing surpluses

22 As already noted, from 1 April 2014, spending of accumulated reserves will also require budget cover from within the Scottish Government's overall budget limit.

Access to capital and commercial borrowing

23 As now, the college sector has access to Scottish Government capital funding along with all other public sector bodies. However, from 1 April 2014 onwards they will not be able to augment that capital funding by using reserves or commercial borrowing without the requisite budget cover from the Scottish Government.

Non-profit distributing projects

24 Careful consideration will be required on the use of college reserves and other sources of income in terms of the affordability of the projects and their unitary charges. However, Ministers remain fully committed to all three college projects , and will work to mitigate any risks to affordability. In particular Ministers are committed to securing the continued use of accumulated reserves for the purpose defined within the college business cases

Potential Mitigating Actions

25 There are a number of ways in which the impact of having to follow Consolidated Budegt Guidance on reserves may potentially be managed.

Protection of reserves

26 It may be possible to protect reserves as at 31 March 2014. This could be achieved by paying over the relevant reserves to the Scottish Government before 1 April 2014, on the understanding that these would

then be made available as and when required. The Scottish Government BEM could potentially then be used to shelter these reserves until required. However, it is again worth noting that the BEM limits are small relative to the size of the total Scottish Government budget. Ministers have to date needed to allocate **all** their BEM flexibility to managing existing spending priorities and it may not be possible to accommodate all college reserves within the limits available. Ministers have indicated that they would be unlikely to commit to allocating a proportion of the BEM to the incorporated college sector as a whole, but could allow the use of the BEM to support specific investment plans for reserves where other mechanisms are not available. Year end flexibility and the BEM are discussed further below.

Aggregating incorporated colleges' surpluses and deficits for Scottish Government financial reporting purposes

27 As already noted, Scottish Government budgets will be impacted by the net movement in reserves across the sector from year to year. However, there will be off-setting movements between individual colleges and the net year-on-year movement will usually be small at whole-sector level. These net whole-sector movements may therefore be manageable within the overall Scottish Government budget control limits, although the net amount would have to be very small (say, £1M to £3M) because, as explained above, the Scottish Government's overall flexibility is very limited. To be clear, this would **not** involve cash or budget transfers between colleges. (It should also be noted that individual incorporated colleges will be able to retain a certain level of working capital, therefore maintaining a certain level of reserves.)

Separate charitable trusts

28 Some other bodies have utilised separate charitable trusts to accumulate funds (reserves/donations) outside of the limits described above, where they can then be deployed as and when required on individual projects. In order to be successful this mechanism would require such a trust to be established as a separate independent organisation, which brings its own risks and considerations. Significant further work is required to establish the extent to which this may (or may not) be a possible mechanism for sheltering reserves and future surpluses for incorporated colleges. This would include consideration of whether one trust for the sector/per region/per individual college would be best.

The UK-wide arrangements for the setting, monitoring and control of government budgets

29 The UK-wide arrangements for government 'budgeting' include processes for monitoring and control, as well as budget setting. These monitoring and control aspects are in addition to the financial reporting requirements (e.g. annual accounts) described in paragraphs 30 to 40 below. Special arrangements will be developed to reflect the unique characteristics of the college sector and the role of the Scottish Funding Council. The following is therefore only an indication of how these processes will operate.

Prior to the start of each financial year (some of which will also be required in the run up to 1 April 2014)

- Individual incorporated colleges prepare draft full budgets by July for the following April to March year

- Scottish Funding Council prepares a collated position and ensures it is consistent with current information about the budget position for the relevant year, before submitting to the Scottish Government

- Scottish Parliament considers draft Scottish Government budget between September and February for the following April to March year

Monthly throughout the year

- Incorporated colleges will prepare a projection of their likely income, expenditure and cash requirements.

- The projections will be collated by the Scottish Funding Council for reporting to the Scottish Government.

- The Scottish Funding Council will pay individual incorporated colleges their cash requirement for the month ahead.

Mid-year Scottish Government budget updates

- Enhanced returns will be required in July and November to feed into the Scottish Government's budget revision processes. The November return is particularly important since it represents the Scottish Government's last opportunity to adjust all budgets across its portfolio and ensure there is adequate 'budget cover' in place for all planned expenditure.

Prior to the year-end

- Incorporated colleges will prepare an updated projection of any under or over-shoot of their previously agreed net expenditure limits by the end of February.

- These projections will also be collated by the Scottish Funding Council and will be used to determine whether the total position will be within acceptable limits.

- As long as the total position is within acceptable limits, the Scottish Funding Council may also use that information to manage underspends and overspends at individual college level.

Financial reporting requirements

30 As well as bringing colleges within the Scottish Government budgeting boundary, the reclassification will also have an impact on existing accounting practice. Whilst these changes will not have the same potential financial impact on the sector, there will be considerable administrative and technical issues to be managed, which are briefly set out below. The intention is that colleges will be supported through the implementation of changes.

Change to the financial year end

31 Strictly speaking, incorporated colleges could continue to prepare annual accounts on an August to July basis. However, they would also need to prepare separate accounts for Scottish Government and HM Treasury purposes on an April to March basis. In practice, therefore, incorporated colleges will need to move towards an April to March financial year. It is recognised that this will impose a transitional burden on colleges and introduce an imbalance between financial and academic year. The reclassification implementation project will seek to find ways of minimising the negative impact of that mismatch.

Financial reporting framework

32 Central Government bodies are required to follow the Government Financial Reporting Manual (FReM) available at:

- http://www.hm-treasury.gov.uk/frem_index.htm

33 This is essentially a version of International Financial Reporting Standards (IFRS), adapted for the government sector. It is anticipated that this will operate in conjunction with the HE/FE Statement of Recognised Practice (HE/FE SORP). The expectation is that accounting would follow the FReM unless contradicted by the HE/FE SORP, in which case **the SORP would take precedence**.

34 The current financial reporting framework for incorporated colleges, the HE/FE SORP, is based on UK Generally Accepted Accounting Principles (UK GAAP). Government accounts (and the FReM) are prepared under International Financial Reporting Standards (IFRS) and incorporated colleges' accounts will ultimately have to be consistent with IFRS.

35 The HE/FE SORP is intended to be revised in line with IFRS for 2015-16, one year after the impacts arising from the ONS reclassification of incorporated colleges is meant to take effect. However, it is currently anticipated that financial reporting for the sector will **continue to follow the HE/FE SORP throughout** and therefore:

- IFRS compliance is likely to be for 2015-16 financial year onwards
- The changes to incorporated colleges' financial reporting framework will essentially only be those which were going to happen anyway.

36 However, it should be noted that this position still needs to be accepted by HM Treasury. Also, it may be that the budgetary impact of IFRS compliance will need to be assessed for 2014-15 as part of the ONS reclassification implementation exercise dependent on the outcome of on-going HM Treasury negotiations.

Summary of financial reporting changes

37 Bringing together the change in year end and the move to the new HE/FE SORP, the annual accounts which will be prepared throughout this period, for colleges not involved in mergers, are expected to be as follows.

- **1 August 2012 to 31 July 2013** (twelve months), using the **current** HE/FE SORP
- **1 August 2013 to 31 March 2014** (eight months), using the **current** HE/FE SORP

- **1 April 2014 to 31 March 2015** (twelve months), using the **current** HE/FE SORP (and also taking account of the FReM, where necessary).

- **1 April 2015 to 31 March 2016** (twelve months), using the **new** HE/FE SORP. This will also require revised comparative figures to be prepared for:

    - 1 April 2014 to 31 March 2015

    - Opening balance as at 1 April 2014 (which might also require some associated reworking of prior year income and expenditure)

- **1 April to 31 March** for each subsequent year, using the new HE/FE SORP.

38 With the exception of the move to a 1 April to 31 March reporting period, **all the above would have taken place anyway**, as a result of the implementation of the new HE/FE SORP.

Financial reporting changes for colleges involved in mergers

39 Again, with the exception of the move to a 1 April to 31 March reporting period from 1 April 2014 onwards, all the financial reporting changes that might impact on the accounts preparation processes of colleges involved in mergers were already going to happen. The following table uses an example of a merger with a 1 November 2013 vesting date.

Current arrangements		**Revised arrangements**	
College which will be the host	**The other colleges in the merger**	**College which will be the host**	**The other colleges in the merger**
1 August 2012 to 31 July 2013 (twelve months), using the current HE/FE SORP		1 August 2012 to 31 July 2013 (twelve months), using the current HE/FE SORP	
1 August 2013 to 31 July 2014 (twelve months), using the current HE/FE SORP and incorporating the 1/8/13-31/10/13 results of the other colleges in the merger	No accounts prepared	1 August 2013 to 31 March 2014 (eight months), using the current HE/FE SORP and incorporating the 1/8/13-31/10/13 results of the other colleges in the merger	No accounts prepared

Current arrangements		Revised arrangements	
College which will be the host	**The other colleges in the merger**	**College which will be the host**	**The other colleges in the merger**
1 August 2014 to 31 July 2015 (twelve months), using the <u>current</u> HE/FE SORP		1 April 2014 to 31 March 2015 (twelve months), using the <u>current</u> HE/FE SORP	
1 August 2015 to 31 July 2016 (twelve months), using the <u>new</u> HE/FE SORP		1 April 2015 to 31 March 2016 (twelve months), using the <u>new</u> HE/FE SORP	

40 However, it needs to be emphasised that the accounting for 1/8/2013 to 31/10/2013 or similar periods for non-host colleges will be subject to agreement between the relevant colleges and their auditors.

Project board

41 A project team and Project Board is currently being established.

42 The Project Board's proposed membership is:

- The project's 'Senior Responsible Officer'
- A Regional Lead
- College sector – college principal
- College sector – college finance director
- Scottish Government post-16 programme team representative
- Scottish Government Finance
- Audit Scotland
- Scottish Funding Council - Finance
- Scottish Funding Council - Learning, Governance & Sustainability

43 The Project Board has effectively already met twice in workshop mode and the product of its initial thinking is reflected in this document.

Y Pwyllgor Plant a Phobl Ifanc
Children and Young People Committee

Cynulliad Cenedlaethol Cymru
National Assembly for Wales

Huw Lewis AM
Minister for Education and Skills
Welsh Government
Tŷ Hywel
Cardiff Bay
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27 June 2013

Dear Minister

The Further and Higher Education (Governance and Information) (Wales) Bill

Can I firstly offer you my sincere congratulations on your appointment as the new Minister for Education and Skills. I am sure other Members of the Committee will wish to join me in offering you their congratulations and are, like me, looking forward to working with you constructively to help create the opportunities our children and young people need to thrive and achieve their full potential.

As you may be aware the Committee is currently at stage 1 of considering the Further and Higher Education (Governance and Information) (Wales) Bill. Following his attendance at our meeting last week, I wrote to your predecessor to follow up a number of points about the Bill. I attach a copy of my letter for information.

One of the issues I raised was your predecessor's decision not to pursue with HM Treasury alternative ways of mitigating the effects of the Office for National Statistics' (ONS) classification of Further Education Colleges (FECs) as part of central government. Members were somewhat surprised that your predecessor had apparently decided against approaching the Treasury on this point.

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The Committee was also aware that the Scottish Government appeared to be taking a somewhat different policy approach and had approached the Treasury to agree mitigating measures, which would allow Scottish FECs to stay within the public sector and continue to be subject to more direct government control.

So I also wrote to the Scottish Education and Skills Minister, Michael Russell MSP, to clarify the position in Scotland. Mr Russell has now replied and I attach a copy of both my letter and his reply for information. You will note that Mr Russell has said that he would welcome a joint approach to the Treasury with the other devolved administrations and that he believes there is much to be gained from a shared approach on this issue.

The Committee will consider Mr Russell's letter at its meeting on 3 July. It would be very helpful if you could let the Committee have, before then, your views on whether Mr Russell's offer is one that you would consider and whether this might have any impact on the timetable for the Bill?

As with my previous letter, I am copying this to Jocelyn Davies, the Chair of the Finance Committee, and to the Minister for Finance, Jane Hutt.

Yours sincerely

Ann Jones AM
Chair

Huw Lewis AC / AM
Y Gweinidog Addysg a Sgiliau
Minister for Education and Skills

Llywodraeth Cymru
Welsh Government

Eich cyf/Your ref
Ein cyf/Our ref LF/HL/0619/13
Anne Jones AM
Committee Chair
Children and Young People Committee
Cardiff Bay
Cardiff
CF99 1NA

2 July 2013

Dear Anne

CHILDREN AND YOUNG PEOPLE COMMITTEE - STAGE 1 SCRUTINY OF THE FURTHER AND HIGHER EDUCATION (GOVERNANCE AND INFORMATION) (WALES) BILL

I note your letter of 27 June regarding the Further and Higher Education (Governance and Information) (Wales) Bill (the Bill). Firstly, thank you for your best wishes, I am looking forward to working with you and members during the scrutiny of the Bill.

I understand my predecessor advised the Children and Young People Committee that Treasury rules are very clear and that he did not think anything would be changed by a conversation with Treasury. He was very emphatic about that.

I have read the letter from Mike Russell MSP, Scottish Education and Skills Minister, with great interest. To my mind, the content of the letter supports my predecessor's views on Treasury rules. In particular, Scotland have been engaged in 'an extensive period of negotiation with HM Treasury on the basis of ONS' decision', but that Treasury has chosen not to 'mitigate' its decision to not give extra budget cover to FEIs.

The Scottish Government has publicly stated that "to introduce legislation would not be compatible with our policy priorities"; policies which include enhancing Ministerial controls, as set out in the Post 16 Education (Scotland) Bill. It is a decision by the Scottish Government to accept the ONS re-classification and try to mitigate the fiscal implication, looking at the costs and benefits against their policies.

The reclassification of FEIs as public sector bodies for the purpose of national accounts would have a significant negative impact on the Welsh Government's budget. It could also de-incentivise the sector to increase income streams outside of Government funding and

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manage to FEIs as efficiently as they do now, which would not be of benefit to the learners of Wales. Please see attached at **Annex A** the written evidence to the Finance Committee.

In Wales, partnership working has been the bedrock in delivering government priorities, which I expect to continue into the future. The Transformation programme is, I believe, an excellent example of partnership working, where 20 colleges have been reduced to 12 colleges through mergers that have been achieved on a partnership basis.

Scottish policy is now starting its journey to deliver what we have already achieved in Wales.

In terms of a joint approach with other devolved administrations to HM Treasury, I do not consider this to be a viable option for two reasons. First, we have carefully considered the relevant Treasury guidance but note that the circumstances of the re-classification by the ONS would not trigger a right to compensation for the Welsh Government. This is because the reclassification has arisen from a re-assessment of the existing position rather than any change of circumstances. In effect, the ONS position is that FEIs should always have been classed as General Government and therefore as part of the public sector.

If the decision to reclassify them is not reversed, then FEIs accounts will need to be consolidated within the National Accounts and all transactions by FEIs would need to be included in the DfES departmental budgets. This would discourage good financial management by individual institutions since:

a. Any surpluses generated by FEIs would lead to under spends in the DfES budget and would need to be managed within the overall position;
b. Similarly, any deficits generated by FEIs would lead to over spends in the DfES budget which would need to be managed within the overall position; and
c. FEIs would not be able to retain any surpluses to build reserves to fund future large revenue or capital projects as DfES is not permitted to carry forward any surpluses to match an increase in expenditure in any one year.

Should the Bill not be passed, we would seek to negotiate with HM Treasury to manage the impact of the reclassification as far as possible through transitional arrangements. However, the underlying issues in relation to sound financial management, and the ability to manage funding flexibly and to best effect would remain and as such, this is not our preferred option. This is not based on what civil servants in England have decided, but on our own Welsh Government considerations.

Second, a joint approach from the devolved administrations would be an extensive exercise with no guarantee of a successful outcome.

As requested in your letter of 20 June, I have attached for your information the written evidence submitted to the Finance Committee (**Annex A**).

Finally, in your letter of 20 June, you invited my predecessor to reflect on retaining the legislative powers to control **higher education courses delivered by FEIs without Welsh Ministers' approval.**

Essentially we are removing powers that are not being used. We are not aware of any issue presently that would result in those powers being used. They were very much intended to be used as a last step.

Those FE institutions which are directly funded by HEFCW to deliver full-time HE courses are subject to the **same arrangements as HE institutions** in respect of fee plans, fee caps and student number controls. For example directly funded FE institutions which seek to charge tuition fees in excess of £4,000 are required to have an approved fee plan in force and to meet the conditions of that plan in the same way as HE institutions in Wales.

Those FE institutions which deliver HE courses under franchise arrangements with HE institutions are subject, via agreements with their partner HE institutions, to the terms and conditions of funding which HEFCW imposes on the HE institution.

Many FE institutions deliver part-time higher education courses. In Wales the fees of part-time higher education courses are not currently regulated and as such are not subject to fee plan requirements. We will be looking at options for the regulation of part-time higher education and when the time is right both FE and HE institutions delivering part-time provision will be subject to the same controls.

We do not foresee any implications associated with the removal of these powers and our intention is that in future FE institutions in Wales delivering higher education courses will be subject to the **same controls as HE institutions**. Those controls are currently the subject of the HE (Wales) Bill Technical Consultation.

On the matter of the ONS and Section 57A of the Further and Higher Education Act 1992, I will copy my response to you once it has been issued.

I hope this letter provides the Committee with the necessary information to aid its scrutiny of the Bill. I look forward to your report and recommendations which I will consider in detail and will respond to outstanding matters during Stage 2 scrutiny.

Huw Lewis AC / AM
Y Gweinidog Addysg a Sgiliau
Minister for Education and Skills

Evidence Paper - Finance Committee

Purpose

1. To provide an evidence paper for the Finance Committee on the implications of the Further and Higher Education (Governance and Information) Bill, including accountancy rules, the ONS classification process, Welsh Government budgets and financial issues arising.

Accountancy rules

2. The UK National Accounts are produced under internationally agreed guidance and rules set out principally in the European System of Accounts 1995 (ESA 95), and the accompanying Manual on Government Deficit and Debt (MGDD).

3. These rules apply to all countries in the European Union, and the UK is legally required to produce the National Accounts on an ESA '95 basis.

4. In the UK the Office for National Statistics (ONS) is responsible for the application and interpretation of these rules.

5. The UK Government has chosen to base its departmental budgeting rules and fiscal statistics on National Accounts principles. As a consequence, ONS decisions on how organisations are treated in the National Accounts for budgeting purposes also inform the public sector boundary used in the production of Whole of Government Accounts (WGA).

6. Classification decisions also feed into a wide range of ONS economic statistics - the National Accounts themselves, public sector employment, etc.

7. If an organisation is classified as being part of the National Accounts then all of its transactions are included in the relevant Government department budgets.

ONS Classification

8. Under ESA 95, all institutional units operating within an economy are classified by ONS to one of six sectors. The sectors are:
    - General Government;
    - Non-Financial Corporations;

- Financial Corporations;
- Households;
- Non-Profit Institutions Serving Households (NPISH); and
- Rest of the World.

9. The “Public Sector” includes all units within General Government, as well as bodies classified as public non-financial corporations (for example, Royal Mail plc) or public financial corporations (such as the Bank of England or the Royal Bank of Scotland). NPISH, which is often known as the third sector, is included in the private sector.

10. Classification decisions for National Accounts purposes are taken by the National Accounts Classification Committee within ONS.

11. Further Education Institutions when established in 1993 were classified as Non – Profit Institutions Serving Households (NPISH). The ONS reclassified them in 2010 (dating back to incorporation) as General Government and therefore within the public sector.

12. The ONS, in determining the classification of bodies for the purposes of national accounts looks at various indicators of control, and the decision by the ONS to reclassify FEIs in Wales was the result of various statutory controls that Welsh Ministers exercise over FEIs in Wales. The indicators for any type of organisations are:
    - Ability to determine aspects of how the body delivers its outputs.
    - Ability to have a final say in sale/ acquisition of fixed assets.
    - Be entitled to a share of proceeds of asset disposals that goes beyond the repayment of previous government support for capital formation.
    - Ability to close the body.
    - Ability to prevent the body from ending its relationship with the public sector.
    - Ability to veto any takeover.
    - Ability to change the constitution of the body, or veto changes to it.
    - Ability to decide what sort of financial transactions the body can undertake, or limit them.
    - Ability to prevent the body from receiving certain types of income from other resources.
    - Ability to exert numerous minor controls over how the body is run.
    - Ability to exert financial control (NB. this is different from funding) as part of a general system of controlling public expenditure.
    - Ability to control dividend policy.
    - Ability to set pay rates.

- Ability to (for non regulatory reasons) approve acquisitions.

Background on Further Education Institutions in Wales

13. There are currently 18 further education institutions in Wales (excluding Merthyr Tydfil College which is part of the University of South Wales) with a total income in 2011/12 of £467m. Of this, the recurrent grant from the Welsh Government was £293m and other Welsh Government grants and contracts were £75m.

14. There are a number of mergers planned for completion over the next few months, which while reducing the number of institutions will not diminish the overall size of the sector.

Impact on Welsh Government budgets if the ONS classification is reversed

15. If the ONS classification is reversed and Further Education Institutions in Wales are returned to the NPISH category for National Accounts purposes then there will be no additional impact on Welsh Government budgets. The Welsh Government will continue to account for revenue grant funding given to FEIs from near cash budgets and capital grants from capital budgets, as they do now.

Impact on Further Education Institutions if the ONS classification is reversed

16. There will be no additional impact on colleges from a financial perspective if the classification is reversed.

17. There will be a change to some of the conditions of the financial memorandum; the approvals that need to be sought from Welsh Government for borrowing and sale of assets will be removed.

18. FEIs will still have to show to lenders that they can afford repayments of any loans. They will also still need the approval of the Governing Body for loans or for the sale of assets and the use of those funds.

19. The level of monitoring of financial health of FEIs by DfES will not change. The forecasts and returns that FEIs provide include analysis of loans that are planned and any sale of assets. Guidance is also currently given on the level of gearing that is acceptable for the sector. This guidance will continue.

Impact on Welsh Government budgets if the ONS classification is not reversed

20. If the ONS classification is not reversed, all income and expenditure in FEIs in Wales will have to be accounted for from within Welsh Government budgets, rather than just Welsh Government funding given to the sector. This will impact all categories of budgets.

Capital budgets

21. The total capital spend by a FEI in any year would count against DfES' capital budget, not just the capital grant that we give them as is currently the case. This includes any cash reserves that they spend on an asset or any loans that they take out to fund an asset.

22. It is unlikely that the WG could negotiate with Treasury an uplift to the capital budget in the long term due to the current Treasury attitude to public sector borrowing and pressures on budgets.

23. Any repayments of borrowing in a year or any grant income from other organisations would be counted as income and net off this figure. Grants from elsewhere are minimal and loan repayments in any year are small compared to the loans taken out as they are spread over 15 -25 years.

24. In effect the budgeting treatment is the same as DfES giving a 100% grant, which at present is usually 50%. This means that the capital budget available to schools and FEIs would be reduced.

25. The table below shows the loans and use of cash reserves in the sector over the last five years:

Year	**11/12**	**10/11**	**09/10**	**08/09**	**07/08**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Loan	6,680	3,671	3,484	1,504	3,335
Cash reserves	21,836	15,868	13,783	12,665	16,747
Total impact on DfES capital budget	**28,516**	**19,539**	**17,277**	**14,169**	**20,082**

26. On average there would be a reduction of £20m available from the DfES capital budget, which is between 10-13%.

Non cash budgets

27. Any depreciation of assets of FE sector assets would count against Welsh Government non cash budgets; this is circa £22m per year. This extra requirement would need to be met from within the DfES budget in the first instance, before looking at the wider WG budget. The WG could apply to Treasury for an increase in the non cash budget, however there is no guarantee that this would be given.

Annually managed expenditure budgets

28. Any movement in the Local Government Pension Scheme (LGPS, for non teaching staff) deficits year on would count against Annually Managed Expenditure Budgets. Movements in pension scheme deficits are extremely difficult to forecast as they are calculated by actuaries at the end of each year, based on assumptions including life expectancy, inflation and market conditions. The charge for 2011/12 was £3.6m, but for 2009/10 £8.0m.

29. Again this would need to be met from within the DfES budget in the first instance, before looking at the wider WG budget. The WG could apply to Treasury for an increase in the annually managed expenditure budget, with no guarantee that this would be given.

30. The Teachers Pension Scheme (TPS) assets and liabilities are not separately identifiable by institutions therefore the deficit within this scheme cannot be accounted for in the same way as the LGPS.

Near cash budgets

31. On average, 21% of FEI income comes from sources other than the Welsh Government, including for example, student fees, ESF and commercial enterprises such as nurseries and training restaurants.

32. When taken into the Welsh Government budgets, this FEI income would be included as Welsh Government income. Conversely, the total expenditure of an institution would also need to be included. Any of this income and expenditure not covered in other budget lines noted above would fall to near cash.

33. The FEI results would need to be managed within the DfES budgets.

34. This means:
    a. Any surpluses generated by FEIs would lead to under spends in the DfES budget and would need to be managed within the overall position;
    b. Any deficits generated by FEIs would lead to over spends in the DfES budget; and
    c. It would be difficult for FEIs to retain any surpluses to build reserves to fund future large revenue or capital projects as this would cause significant swings in expenditure to be managed against DfES budgets year on year. DfES cannot carry forward any surpluses to match an increase in expenditure in any one year.

35. The sector has made surpluses/deficits in the last five years that would count against DfES near cash, non cash, annually managed expenditure or capital budgets as follows:

Year	11/12	10/11	09/10	08/09	07/08
	£'000	£'000	£'000	£'000	£'000
Surplus / (Deficit)	5,128	9,576	8,992	(1,090)	1,602

36. Given the budget cuts received so far from the UK Government, together with further cuts expected from the spending review on the 26 June it is expected that these surpluses will reduce significantly in the future.

DRC budgets

37. There would be additional impacts for the Welsh Government in terms of assessing the budgetary impacts in-year, reviewing consolidation packs (see paragraph 43 below) that would be submitted by FEIs and completing the actual consolidation. This would need an increase in staff time in the DfES and central finance teams.

Impact on Further Education Institutions if the ONS classification is not reversed

38. The FE sector would lose on average £20m of capital funding a year as the full cost of capital spend would be counted against DfES budget rather than the 50% grant contribution to projects that is currently made. As noted in paragraph 22 above an increase in the budget is very unlikely.

39. This would significantly impact the facilities available for learners, for example current projects and the total estimated costs include:
   - Cardiff and Vale College - new FE Cardiff City Centre Campus, £40m;
   - Coleg Ceredigion - transformation technology centre, £3.3m;
   - Coleg Llandrillo - university centre at Rhos on Sea, £4.9m;
   - Coleg Llandrillo - Dolgellau Skills centre phase 1 & 2, £4.5m; and
   - Yale and Deeside College - rebuild of Block B Bersham Road, £12m.

40. Currently the sector benefits from its own good financial management, it can build up surpluses via reserves to fund investment projects for provision and estates which subsequently enhances the learner experience and quality of provision.

41. The sector on average has 79% of funding from the Welsh Government, including the work based learning contracts. They generate the other 21% from other sources as a way of increasing income diversity and widening the student experience. For example attracting international students, providing training provision for businesses, running commercial training enterprises in areas such as hairdressing or travel. This also enables the sector to

supplement surpluses from good financial management of Welsh Government funding and increase the amount available to reinvest into learning provision.

42. If colleges are not able to use the surpluses they build up the incentive to diversify income streams and continually improve financial management will be gone. Any surpluses made would have to be spent in the year that they were made, which may mean that the funds are not put to best use or used in the most efficient way.

43. If FEI are classified as General Government FEIs would need to complete a consolidation pack, known as a 'C-pack' to be submitted to the Welsh Government. A comprehensive form that captures the financial information of an organisation for the year to 31 March and enables any transactions between bodies in the consolidation to be identified and eliminated.

44. The year end for the sector is the 31 July, this may need to be changed to the 31 March. If it was not there would be a significant amount of work for FEIs to complete the C-pack.

45. The C-pack would need to be prepared under International Financial Reporting Standards (IFRS) until 2015/16, whilst the annual accounts would be prepared under UK Generally Accepted Accounting Principles (accounting standards), as the Further and Higher Education Statement of Recommended Practice (SORP) Board has stated that early adoption of IFRS is not an option as the new revised SORP, based on IFRS does not come into force until 2015/16.

46. The C-pack would need to be audited which would carry an additional cost.

47. It is estimated that the minimum completion and audit of the C-pack would cost the sector about £53k per year. If the year end date was not changed this could be significantly more.