House of Commons

Committee of Public Accounts

Overseeing financial sustainability in the further education sector

Thirteenth Report of Session 2015–16

HC 414

House of Commons

Committee of Public Accounts

Overseeing financial sustainability in the further education sector

Thirteenth Report of Session 2015–16

Report, together with formal minutes relating to the report

Ordered by the House of Commons to be printed 9 December 2015

HC 414
Published on 16 December 2015
by authority of the House of Commons
London: The Stationery Office Limited
£0.00

The Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine "the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit" (Standing Order No. 148).

Current membership

Meg Hillier (*Labour (Co-op), Hackney South and Shoreditch*) (Chair)

Mr Richard Bacon (*Conservative, South Norfolk*)

Harriett Baldwin (*Conservative, West Worcestershire*)

Deidre Brock (*Scottish National Party, Edinburgh North and Leith*)

Chris Evans (*Labour (Co-op), Islwyn*)

Caroline Flint (*Labour, Don Valley*)

Kevin Foster (*Conservative, Torbay*)

Mr Stewart Jackson (*Conservative, Peterborough*)

Nigel Mills (*Conservative, Amber Valley*)

David Mowat (*Conservative, Warrington South*)

Stephen Phillips QC (*Conservative, Sleaford and North Hykeham*)

Bridget Phillipson (*Labour, Houghton and Sunderland South*)

John Pugh (*Liberal Democrat, Southport*)

Karin Smyth (*Labour, Bristol South*)

Mrs Anne-Marie Trevelyan (*Conservative, Berwick-upon-Tweed*)

Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No. 148. These are available on the Internet via www.parliament.uk.

Publication

Committee reports are published on the Committee's website at www.parliament.uk/pac and by The Stationary Office by Order of the House.

Evidence relating to this report is published on the inquiry page of the Committee's website.

Committee staff

The current staff of the Committee are Stephen McGinness (Clerk), Claire Cozens (Committee Specialist), James McQuade and George James (Senior Committee Assistants), Sue Alexander (Committee Assistant) and Tim Bowden (Media Officer).

Contacts

All correspondence should be addressed to the Clerk of the Public Accounts Committee, House of Commons, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 4099; the Committee's email address is pubaccom@parliament.uk

Contents

Summary

The declining financial health of many further education colleges has potentially serious consequences for learners and local economies, but the bodies responsible for funding and oversight have been slow to address the problem. Too often, they have taken decisions without understanding the cumulative impact that these decisions have on colleges and their learners. Oversight arrangements are complex, sometimes overlapping, and too focused on intervening when financial problems have already become serious rather than helping to prevent them in the first place. The Department for Business, Innovation & Skills and the Department for Education appear to see area-based reviews of post-16 education as a fix-all solution to the current problems, but the reviews do not cover all types of provider and it is not clear how they will deliver a robust and financially sustainable sector.

Introduction

Further education is formal learning outside of schools and higher education institutions, covering academic and vocational courses and training for apprenticeships. The further education sector in England receives around £7 billion of public funding each year, to educate and train around 4 million learners. The Department for Business, Innovation & Skills funds adult learners via the Skills Funding Agency, while the Department for Education funds learners aged 16 to 19, primarily via the Education Funding Agency. Around 240 further education colleges teach more than half of the sector's learners. Around 700 providers are commercial or charitable bodies, teaching most of the remaining learners. Colleges are independent of government and manage their own affairs, with external intervention occurring only where a college is failing. The sector is subject to oversight from several bodies: The Department for Business, Innovation & Skills is responsible for the overall regulatory framework and policy; the Skills Funding Agency monitors financial health and management; and Ofsted inspects the quality of provision, including the effectiveness of leadership and management. The Further Education Commissioner—a role established in 2013—intervenes in the most poorly performing colleges.

Conclusions and recommendations

1. **The declining financial health of many colleges is potentially damaging for learners and local economies, but the funding and oversight bodies have been slow to address emerging financial and educational risks.** The Skills Funding Agency deemed 29 colleges to be financially 'inadequate' in the 2013/14 academic year. The Agency's latest estimates, produced in May 2015, suggest that there could be around 70 colleges in this position by the end of 2015/16. Declining financial health in a college can affect the life chances of its students and limit skills development in the local economy. College principals explained to us the practical impact of financial strain, including: difficulty in recruiting and retaining quality staff; closure of courses; and inability to properly invest in facilities or online learning that would benefit students. Until recently, the departments have followed a largely hands-off approach in the face of mounting financial pressures. The departments need to demonstrate that the actions they are now taking are effective in placing the further education sector on a financially sustainable footing.

   Recommendation: ***We expect the departments to report back to us on their progress in understanding the risks facing colleges and efforts to address these within 12 months, including progress against the specific recommendations we set out below.***

2. **While the introduction of the Further Education Commissioner has been a positive development, oversight of the sector is overly complex, leading to confusion over who is responsible for intervening and in what circumstances.** There is a plethora of different oversight and intervention bodies, and questions remain over the rationale for having separate funding agencies for learners of different ages. The Skills Funding Agency's formal intervention is often ineffective in prompting a timely resolution of problems. As a result, the Agency has had to provide emergency loans to support colleges in extreme difficulty, some of which has then had to write-off. The Further Education Commissioner's intervention and advice has been well-received since he took up post in November 2013, and he appears to prompt swift remedial action in the colleges he reviews. But despite taking on additional advisers, the Commissioner may still lack the resources to address the number of colleges expected to be in difficulty in the near future.

   Recommendation: ***The departments should review and simplify the oversight and intervention arrangements for colleges, making them as streamlined and effective as possible. They should also ensure that the Further Education Commisioner has adequate resources to intervene when colleges are struggling and before they reach crisis point.***

3. **The departments and funding agencies sometimes make decisions without properly understanding the impact on learners, nor the impact on colleges' ability to compete with other education providers.** Colleges face a number of substantial external challenges, some of which are exacerbated by the actions of the departments and their funding agencies. These include: very late funding decisions, including a funding cut only days before the start of the 2015/16 academic year; overly complex funding arrangements, whereby funding comes from many sources for different students attending the same course; and instances where colleges

are seemingly treated differently from other education providers offering similar services, for example in relation to VAT rules. Some colleges are also still struggling with large debts associated with capital funding decisions made by the funding agencies' predecessor, the Learning and Skills Council, a matter on which on the Committee of Public Accounts has previously reported.

Recommendation: ***The departments should routinely assess the impact of potential decisions on colleges and learners particularly considering the impact of short term year by year funding allocations, including the ability of further education colleges and other education providers to compete fairly with each other.***

4. **The Department for Business, Innovation & Skills and the Skills Funding Agency are not doing enough to help colleges address risks at an early stage.** The Skills Funding Agency, in particular, has been too reactive to emerging risks, allowing colleges to get into trouble before acting. The Agency's Chief Executive told us that he intends to act more quickly in future, and is keen to learn lessons from other bodies with similar oversight responsibilities, such as Monitor in the health sector. But more detail is needed on how the Agency plans to help colleges prevent emerging financial difficulties from becoming serious. The funding departments have also not been sufficiently proactive in supporting colleges to manage the emerging challenges. Potential support might include sponsoring the development of better commercial and change-management skills, drawing upon the experience of the best performers among other colleges and elsewhere.

   Recommendation: ***The departments and the Skills Funding Agency should be much more proactive in helping further education colleges improve their capacity to manage the significant financial challenges they face in the likely event of further funding cuts.***

5. **It is unclear how area-based reviews of post-16 education, which are limited in scope, will deliver a more robust and sustainable further education sector.** The departments appear to see the national programme of area-based reviews, which they announced in July 2015, as a fix-all solution to the sector's problems. But the reviews have the potential to be haphazard, and it is too early to speculate on whether they will lead to significant improvements in local provision. Each review only covers further education and sixth form colleges, and does not include school and academy sixth forms or other types of provider. If a review concluded, for example, that there was over-provision of education for 16- to 19-year-olds in an area, it is not clear that this conclusion would have any influence over decisions regarding provision by local schools and academies. The departments also lack effective powers in cases where college governors do not accept, or will not implement, a review's recommendations.

   Recommendation: ***The departments need to demonstrate that the area-based reviews are taking a sufficiently comprehensive look at local provision taking into account all FE providers and school sixth forms, that they are fair, and that they result in consensus on sustainable solutions to meet local needs.***

1 Funding and support

1. On the basis of a report by the Comptroller and Auditor General, we took evidence from the Department for Business, Innovation & Skills (BIS), the Department for Education and the Skills Funding Agency.[1] We also took evidence from the principals of three further education colleges: Hackney Community College, Heart of Worcestershire College and Central Sussex College.

2. Further education (FE) is formal learning outside of schools and higher education institutions, covering academic and vocational courses and training for apprenticeships. Around 4 million people learn in the sector each year, including young people continuing their academic or vocational learning outside school; adults and young people seeking basic skills; and others who want to develop skills or get formal qualifications. The FE sector in England receives around £7 billion of public funding each year. The Skills Funding Agency, which BIS sponsors, provides £3.8 billion for adult learners and apprentices, and for apprentices aged 16 to 19, while the Education Funding Agency, which the Department for Education sponsors, provides £3.0 billion for learners aged 16 to 19.[2]

3. In England, there are more than 1,000 FE providers, of which around 240 are FE colleges teaching more than half of the sector's learners. Around 700 providers are commercial or charitable bodies, teaching most of the remaining learners. FE colleges have an important local presence, since FE students traditionally learn relatively close to home. However, they may find themselves in competition with other types of provider–for example, the commercial and charitable providers, school and academy sixth forms in the case of younger learners, and higher education institutions in the case of adult learners.[3]

4. The financial health of FE colleges is particularly important because of the public investment in their facilities and infrastructure. But under the Further and Higher Education Act 1992, FE colleges are financially independent, with powers to own assets, employ staff and enter contracts. As a result, they may make financial surpluses or deficits. The Education Act 2011 furthered colleges' freedom and responsibility to manage their own affairs, with external intervention occurring only where a college is failing.[4]

5. The FE sector is subject to oversight from a plethora of bodies: BIS is responsible for the overall regulatory framework and policy; the Skills Funding Agency monitors financial health and management; and Ofsted inspects the quality of provision, including the effectiveness of leadership and management. The Education Funding Agency, on behalf of the Department for Education, is involved in joint decision-making about intervention. The Skills Funding Agency is responsible for some direct intervention, but the most poorly performing colleges are now referred to the FE Commissioner—an independent adviser to the Secretary of State for Business, Innovation & Skills and the chief executives of the funding agencies—who took up his role in late 2013.[5]

1 C&AG's report, Overseeing financial sustainability in the further education sector, Session 2015-16, HC 270, 20 July 2015
2 C&AG's report, paras 1.1 and 1.7
3 C&AG's report, paras 1.3, 1.5 and 2.12
4 C&AG's report, paras 1.6 ,1.10 and 1.12
5 C&AG's report, para 1.11 and Figure 1

6. The Skills Funding Agency collects financial information from colleges each year, based on audited accounts and forecasts, which it uses to allocate an overall financial health rating to each college. An 'inadequate' rating means there is a significant risk of the college being unable to fulfil its contractual obligations because of weak financial health. In recent years, the Agency has taken a light-touch approach to offering advice or intervening where a college's financial health rating is not yet formally 'inadequate'.[6]

7. According to analysis by the Skills Funding Agency, at an aggregate level the FE colleges in England were in deficit for the first time in 2013/14. Some 110 colleges recorded an operating deficit, which is more than double the number with a deficit in 2010/11.[7] The Agency gave 29 colleges an 'inadequate' financial health in 2013/14, up from 12 in 2010/11.[8] The Agency explained that the number of financially inadequate colleges could have since risen to the high 30s, and that the number might be around 70 in 2015/16 according to a projection based on standard assumptions.[9]

8. The college principals told us that they had experienced a real-terms funding cut of 27% in the last 5 years, combined with some significant cost increases, for example relating to pensions, national insurance contributions and redundancy payments.[10] They explained how declining financial health can force them to make decisions that affect the life chances of their learners and limit skills in the local economy. For example, they had: closed whole classes, including modern foreign languages and English language provision for those who may lack the linguistic skills to find work; dropped specific types of qualification, including some A-levels; and been unable to upgrade their buildings or invest in online learning. The principals explained that these decisions may also affect college staff. For example, they had paid teachers in lieu of notice, because last-minute changes in course provision left insufficient time to make them formally redundant in the normal manner.[11]

9. A range of external factors can affect colleges' financial health. For example, the principals explained that funding is allocated on a year-by-year basis, which makes it difficult for colleges to plan ahead effectively.[12] The Skills Funding Agency told us that funding for 16 to 19-year-olds should be relatively predictable, because each year's allocation is based on student numbers from the previous year. The Agency conceded that the amounts allocated under the Adult Skills Budget are less predictable, but said it tries to provide details of each college's allocation for the academic year beginning in August by the end of March.[13]

10. However, the principals drew attention to particular problems in summer 2015, when further cuts to the Adult Skills Budget were announced only days before the start of the academic year.[14] We challenged the funding bodies about why this had happened. They explained that BIS was asked to make in-year spending reductions of £450 million, of which £60 million was to come from skills-related expenditure. Detailed discussions about

6 C&AG's report, paras 2.3 and 3.13, and Figure 3
7 Q 1; C&AG's report, para 2.2 and Figure 2
8 Q 118; C&AG's report, para 2.2 and Figure 4
9 Qq 118-119
10 Q 2
11 Qq 2, 6, 9 and 45
12 Q 2
13 Qq 79-80
14 Q 2

where the reductions should fall took some time, which meant that the Skills Funding Agency officially informed colleges of the outcomes in late July.[15]

11. We also heard from the college principals about the challenge presented by the complexity of colleges' funding streams, requiring them to secure public money from different pots, provided on different bases by different government agencies. The Skills Funding Agency told us that some elements of the Adult Skills Budget had been too complex in the past, and that plans are ongoing to simplify the budgets for 2016–17 and 2017–18.[16]

12. We challenged the departments on whether they treat colleges fairly compared to other education providers offering similar services. The Department for Education explained that it had levelled the playing field by equalising the basis for funding all 16–19 year olds. But the Department also conceded that colleges are required to pay Value Added Tax, and therefore have a higher cost base than schools and academies which can reclaim this tax. This has meant, for example, that the average sixth-form college is losing around £318,000 per year compared to school sixth forms.[17]

13. Some colleges also face serious problems arising from the historic *Building Colleges for the Future* programme—a topic on which the previous Committee of Public Accounts reported.[18] When the programme was suspended, 79 capital project applications had been approved in principle by the former Learning and Skills Council, but only 22 subsequently received final approval. Reductions in funding since then have left some colleges with new premises that are under-used, or large debts that they are struggling to repay.[19] The Skills Funding Agency told us that it has since tried to take account of such problems when making capital allocations. But the responsibility for capital funding now sits with Local Enterprise Partnerships, whose role in this regard is to allocate remaining funds in line with local economic needs.[20]

14. The departments and the Skills Funding Agency agreed that they need to do more to help colleges address financial risks at an earlier stage, and we were told that the finance teams of the Skills Funding Agency and Education Funding Agency are being joined up for this purpose. The Skills Funding Agency, in particular, plans to feed back a greater proportion of the data it gathers, so that colleges can understand their financial context more clearly. It is important to go beyond the pure financial health indicators, which tend to be backward-looking, in order to produce intelligence that can help colleges to address emerging risks. The Skills Funding Agency is planning a series of events in spring 2016, in order to present the results of its more preventative approach to college governors. The Agency also explained that it is taking steps to learn lessons from Monitor, the health service regulator, and from those who fund and oversee the 5,000 academies.[21]

15. College principals and other stakeholders have reported shortages in the change-management skills that colleges need in order to adapt to a rapidly changing environment. The FE Commissioner's reviews have identified similar common issues in management

15 Qq 73-81
16 Qq 3, 80, 120-121
17 Qq 65-71
18 Committee of Public Accounts, Renewing the physical infrastructure of English further education colleges, Forty-eighth Report of Session 2008-09, HC 294, July 2009
19 Qq 39, 148-150; C&AG's report, para 2.14
20 Q 150
21 Qq 122-123

and governance among colleges that are struggling.[22] Evidence submitted to us by the 157 Group, which represents 26 of the largest colleges, emphasised that college leaders must become more skilled at developing a long-term pipeline of income, and more effective at networking with potential funders. The Group suggested that BIS might use its sponsorship of the Education and Training Foundation to create 'leadership development' activities which address these skills shortages.[23]

16. The Department for Education emphasised that 15 colleges had emerged from a financially 'inadequate' rating, as a result of intense support for the colleges' leadership. The Department also suggested that colleges in serious financial difficulty invariably face problems which have already been tackled successfully by other colleges. As such, it believes that the FE Commissioner has a key role to play in sponsoring the development of better commercial and change-management skills, by feeding back the lessons from the cases he examines more widely.[24]

22 C&AG's report, para 3.7

23 Written evidence submitted by the 157 Group, November 2015

24 Qq 122-123

2 Intervention and wider structural review

17. When the Skills Funding Agency assesses a college as having 'inadequate' financial health, it issues a 'Notice of Concern'. The college must then produce a recovery plan, describing how it will address its financial difficulties, along with a timeframe for action. Colleges have expressed concerns about the effectiveness of the Notice of Concern process, which can be limited by their own ability to make the necessary changes and the capacity of the Skills Funding Agency to properly assess whether a recovery plan will produce a sustainable solution.[25] We challenged the Agency as to what the Notice of Concern process was intended to deliver. The Agency conceded that the key to achieving an impact in these cases is often to refer the college to the FE Commissioner.[26]

18. The Skills Funding Agency has historically offered financial advances to some struggling colleges, but the colleges are expected to repay the sums advanced to them. In September 2013, the value of outstanding advances stood at £49 million. Over the following year, the Agency wrote off advances worth £40 million, most of which was with one college, by converting them to grants. By February 2015, the outstanding amount had grown again, to £45 million.[27] The Agency explained that it always seeks to maximise the proportion of the financial support to colleges that can be converted into long-term loans, as part of the new arrangements implemented in late 2015. These arrangements state that the Agency should automatically issue a Notice of Concern to colleges receiving such loans, and that it should also refer their case to the FE Commissioner.[28] BIS also emphasised that this financial support is awarded only in exceptional circumstances, on a case-by-case basis, because the funding comes out of the adult skills budget.[29]

19. We asked the college principals about the impact of the FE Commissioner. The Principal of Central Sussex College told us that the Commissioner's involvement had been productive and helpful. In her view, it was important to have an additional level of intervention in serious cases.[30] BIS agreed that the Commissioner was a very experienced FE college leader, whose advice was helping colleges to make difficult decisions. BIS explained that the role was created because in 2012–13 it became apparent that earlier intervention and support was required, and that the Commissioner's resources had increased significantly over the course of 2015. The Commissioner now has a team of 24 or 25, but further advisers are being recruited in order to deal with the expected steep rise in the number of colleges with serious financial problems.[31]

20. The National Audit Office concluded in its report that the FE sector lacked a process for making joined-up decisions about local provision in a particular geographical area.[32] We were therefore interested to hear about the programme of area-based reviews which the departments announced shortly after the National Audit Office had published its report.

25 C&AG's report, paras 4.2 and 4.4
26 Q 145
27 Qq 151, 154-155; C&AG's report, para 4.5
28 Q 151; C&AG's report, para 4.6
29 Q 156
30 Q 11
31 Qq 112-114
32 C&AG's report, para 4.14

The programme of reviews is due to have covered the whole country by March 2017.[33] The Skills Funding Agency explained that the starting point of each review is to consider what type of FE provision is needed for learners, communities and businesses, and then to determine what pattern of local providers can best meet that need.[34] The funding bodies will not be obliged to financially support colleges in order to ensure that they survive, but they may choose to do so in order to safeguard the provision of education or protect public investment.[35]

21. The area-based reviews will cover FE colleges and sixth form colleges, but not school and academy sixth forms or other types of provider. The departments explained that this scoping decision had been made for two reasons: firstly to focus on the type of provision perceived to have the greatest need of restructuring; and secondly to keep the reviews manageable in scale. Therefore, while Regional Schools Commissioners will be involved in the reviews' steering groups in order to inform them of any gaps or problems in school sixth form provision, no changes in school provision will be made as a result of the reviews.[36] Furthermore, if a review concludes that there is over-provision for 16-19 year-olds in a particular area, this will not influence the decisions made in response to any local schools or academies that might apply to expand their sixth form provision around the same time.[37]

22. We were concerned that, with so many parties involved in running the reviews, there may be no clear process for making difficult decisions on the future of individual colleges. The departments explained that they expect steering groups—which include representatives of the community, local authorities and businesses—to present a consensus on the needs of the area, and to generate fully agreed recommendations. All parties should then work together to produce the desired outcome.[38] However, if a college governing body disagrees with the steering group's recommendations, ministers will need to decide whether that disagreement is reasonable. If the ministers conclude that the governing body is not being reasonable, the funding bodies could impose some additional funding conditions in an attempt to secure cooperation.[39]

33 Q 123
34 Q 50
35 Q 52
36 Q 53
37 Q 62
38 Q 142
39 Q 138-141

Formal Minutes

Wednesday 9 December 2015

Members present:

Meg Hillier, in the Chair

Mr Richard Bacon	David Mowat
Chris Evans	Steven Phillips
Kevin Foster	Mrs Anne-Marie Trevelyan

Draft Report (*Overseeing financial sustainability in the further education sector*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 22 read and agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Thirteenth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 14 December at 3.30 pm

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry web page.

Monday 19 October 2015

Question number

Sarah Wright, Principal, Central Sussex College, **Stuart Laverick**, Principal, Heart of Worcestershire College, and **Ian Ashman**, Principal, Hackney Community College — Q1–45

Martin Donnelly, Permanent Secretary, Department for Business, Innovation and Skills, **Peter Lauener**, Chief Executive, Skills Funding Agency/Education Funding Agency, and **Chris Wormald**, Permanent Secretary, Department for Education — Q46–174

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page. FSE numbers are generated by the evidence processing system and so may not be complete.

1 157 Group (FSE0005)

2 Association of Colleges (FSE0002)

3 Education Funding Agency and Skills Funding Agency (FSE0004)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the Committee's website at www.parliament.uk/pac.

Session 2015–16

First Report	Financial sustainability of police forces in England and Wales	HC 288
Second Report	Disposal of public land for new homes	HC 289
Third Report	Funding for disadvantaged pupils	HC 327
Fourth Report	Fraud and Error Stocktake	HC 394
Fifth Report	Care leavers' transition to adulthood	HC 411
Sixth Report	HM Revenue & Customs performance 2014-15	HC 393
Seventh Report	Devolving responsibilities to cities in England: Wave 1 City Deals	HC 395
Eight Report	The Government's funding of Kids Company	HC 504
Ninth Report	Network Rail's: 2014-2019 investment programme	HC 473
Tenth Report	Care Act first-phase reforms and local government new burdens	HC 412
Eleventh Report	Strategic financial management of the Ministry of Defence and Military flying training	HC 391
Twelfth Report	Care Quality Commission	HC 501
First Special Report	Unauthorised disclosure of draft Report in the previous Parliament	HC 539