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Llywodraeth Cymru
Welsh Government

Eich cyf/Your ref
Ein cyf/Our ref LF/HL/0619/13

Anne Jones AM
Committee Chair
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Cardiff Bay
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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 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.