

Written evidence submitted by Audit Scotland (USC0002)

Background

1. Audit Scotland welcomes the opportunity to respond to the Scottish Affairs Committee call for evidence, to help inform its inquiry into universities and Scotland.
2. Audit Scotland is the independent public sector audit agency undertaking the external audit of the majority of public sector bodies in Scotland. We do this on behalf of the Auditor General for Scotland (AGS) and the Accounts Commission (for local government). Public audit provides independent assurance that public money is spent properly and is providing value for money. We carry out this work through the annual audits of public bodies and performance audits on specific themes and subjects.
3. Audit Scotland is responsible for the audit of the Scottish Funding Council (SFC) on behalf of the AGS. The AGS has powers to undertake performance audits in bodies funded by the SFC, including universities.
4. Audit Scotland has published two reports on universities on behalf of the AGS. An [audit of higher education in Scottish universities \(July 2016\)](#) assessed how higher education was funded and delivered, how well it contributed to the national strategic priorities and how well equipped the sector was to deal with future financial challenges. [Finances of Scottish universities \(September 2019\)](#) built on some of the key financial aspects of the 2016 audit. We recognise that the environment in which universities are operating has changed significantly since these reports were published, as a result of the Covid-19 pandemic. However, the reports include findings and recommendations that remain relevant.
5. Our response focuses on the area that is most relevant to our remit (funding for universities) and draws from our previous audit work. Our submission highlights the challenges and opportunities for universities in light of Covid-19 and reiterates some of our previous recommendations.

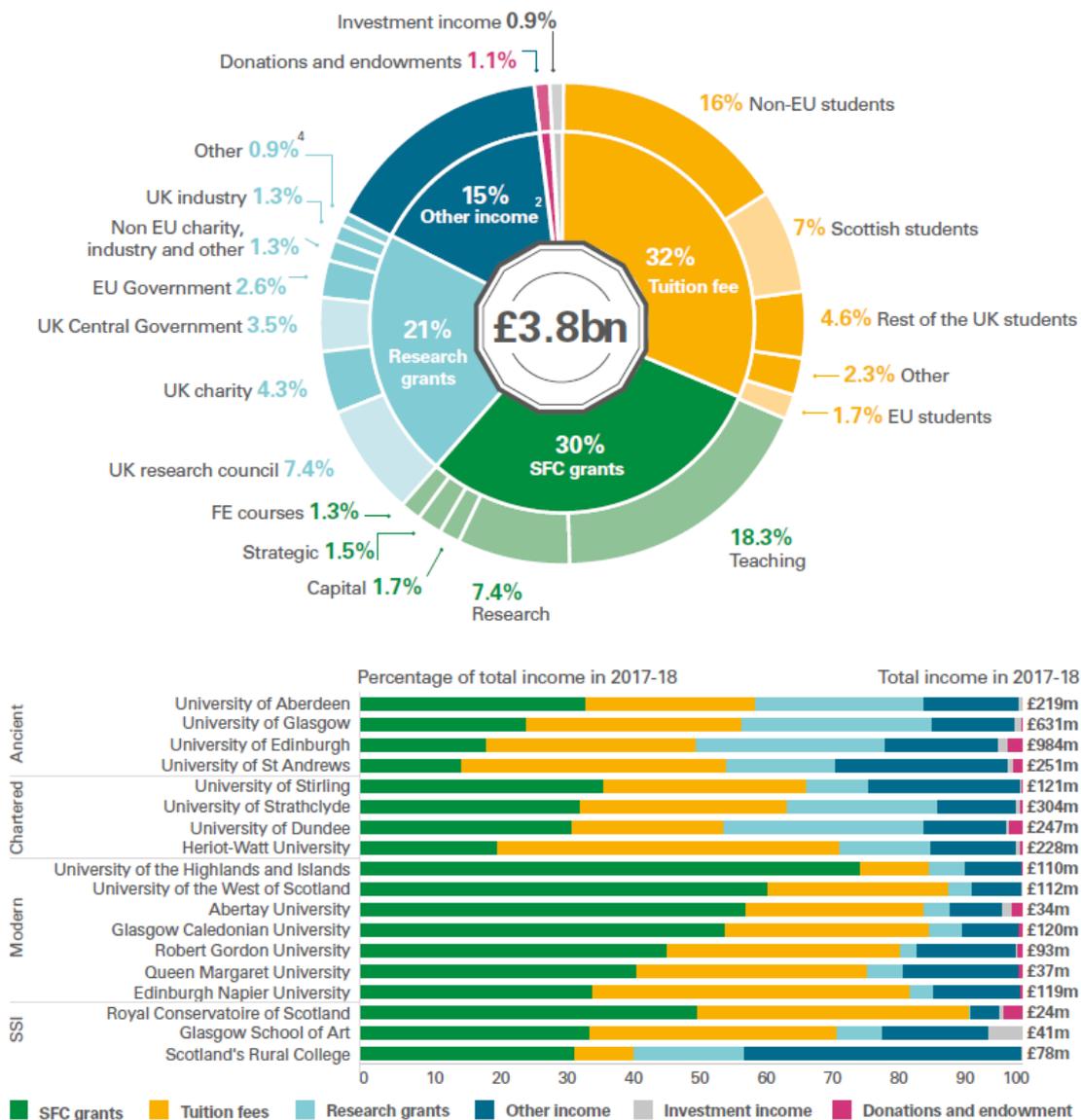
The scale and nature of challenges and opportunities around funding for Scottish universities including funding models, deficits, overseas and EU students' fees

6. Universities make an important contribution to the Scottish economy and wider society as providers of higher education, major employers and centres of research and innovation. They contribute to national outcomes in the Scottish Government's National Performance Framework and to policy priorities, such as inclusive and sustainable growth and reducing inequalities.
7. Universities are expected to play a central part in supporting Scotland's economic recovery following the Covid-19 pandemic. To enable them to fulfil this important role, they will need to work together and with partners to mitigate and manage the risks presented by Covid-19.
8. Some of the challenges and pressures facing institutions are new and others have been exacerbated by the pandemic. Covid-19 has significant implications for the finances and operation of Scotland's universities, and for outcomes for students, both in the short and

longer term. The response to the pandemic provides an opportunity to take stock of what is working well in the provision of higher education and what could be improved, and to identify lessons for the future.

9. The income profile for the university sector in 2017-18 is shown in Exhibit 1.

Exhibit 1 - Income profile for the university sector in 2017-18



Notes:
 1. Lighter shading in the pie chart indicates public funding largely sourced from the Scottish or UK governments.
 2. 'Other income' includes income from services to industry and public bodies, consultancy work and student residences.
 3. Figures exclude income for research undertaken by UHI's partners.
 4. 'Other' research grants includes income from EU charities and industry as well as other UK sources.

Source: Audit Scotland using Higher Education Provider Data: Finance, Higher Education Statistics Authority, March 2019, and university financial statements (2017-18).



In 2017-18, tuition fees replaced SFC grants as the biggest source of income for universities

10. Tuition fees, particularly non-EU student fees, are an essential element of the current funding model for universities. In September 2019, we highlighted that SFC funding to the sector had reduced by seven per cent since 2014-15 to £1.1 billion in 2017-18. Despite this, total income for the sector increased, from £3.7 billion in 2014-15 to £3.8 billion in 2017-18, with tuition fees replacing SFC grants as the single largest source of income for the sector in 2017-18. Between 2014-15 and 2017-18, fee income increased by £200 million (22 per cent), to £1.2 billion (32 per cent of total income). Fee income increased for all but four universities. A notable threat of Covid-19 is the potential reduction of non-EU student fee income.

Universities are subsidising research and publicly funded teaching activity with income from other sources

11. We highlighted in our September 2019 report that, prior to Covid-19, universities were already operating within an increasingly tight financial environment and faced financial pressures and uncertainties (including pensions costs, estates costs and EU withdrawal). The sector now faces a loss of income from sources including non-EU student fees, accommodation, catering and other commercial activity, as well as additional costs to support the move to online teaching and learning and making campuses safe for students and staff to return.
12. The latest [SFC analysis](#) of Transparent Approach to Costing (TRAC) for 2017-18 details that, on average, Scottish universities recovered 95.7 per cent of the full cost of all activities (98.6 per cent in 2016-17). Funding for both publicly funded teaching and research does not always cover the full costs for delivery and in 2017-18, on average, universities recovered:
 - 91.1 per cent of the full economic cost of publicly funded teaching (92.4 per cent in 2016-17), including the teaching of Scottish, rest of UK and EU students
 - 77.8 per cent of the full cost of research activities (80.1 per cent in 2016-17).
13. Universities rely on being able to generate 'cross-flows' of funding between activities. For example, to maintain and improve their position, research-intensive universities will usually have to increase income from other activities, such as non-publicly funded teaching, to cover the full economic cost of their research activity. In 2017-18, on average, Scottish universities recovered:
 - 140.4 per cent of the full cost of non-publicly funded teaching (138.2 per cent in 2016-17), mainly for teaching non-EU students
 - 126.3 per cent of the full cost of other activities (144.2 per cent in 2016-17), for example, commercial activities, residences and conferences.
14. The recruitment of non-EU students is important and has been a growing source of other income for most universities. It is one way in which universities have been responding to cost pressures.

The Scottish Government provides funding for universities through a number of different streams

15. In addition to the core revenue and capital funding provided to the SFC, and Scottish and EU student tuition fees via Student Awards Agency Scotland (SAAS) (£213 million in 2017-18), the Scottish Government provides funding for universities in the form of:
- Financial transactions: Since 2016-17 the SFC has offered low interest loans (financial transactions) to support university proposals for spend-to-save projects, the strategic development of estates and, in 2020/21, the Covid-19 University Support Fund. Universities compete for financial transactions funding by applying to the SFC. The Scottish Government made £60 million available for 2020-21 (£55.5 million in 2019-20).
 - Funding from other Scottish Government directorates: The Scottish Government does not routinely calculate its total funding for universities, beyond what is provided via the SFC and SAAS, but has estimated this to be around £92 million in 2018-19. In our September 2019 report we recommended that the Scottish Government should routinely monitor and publish details of its total investment in the sector.

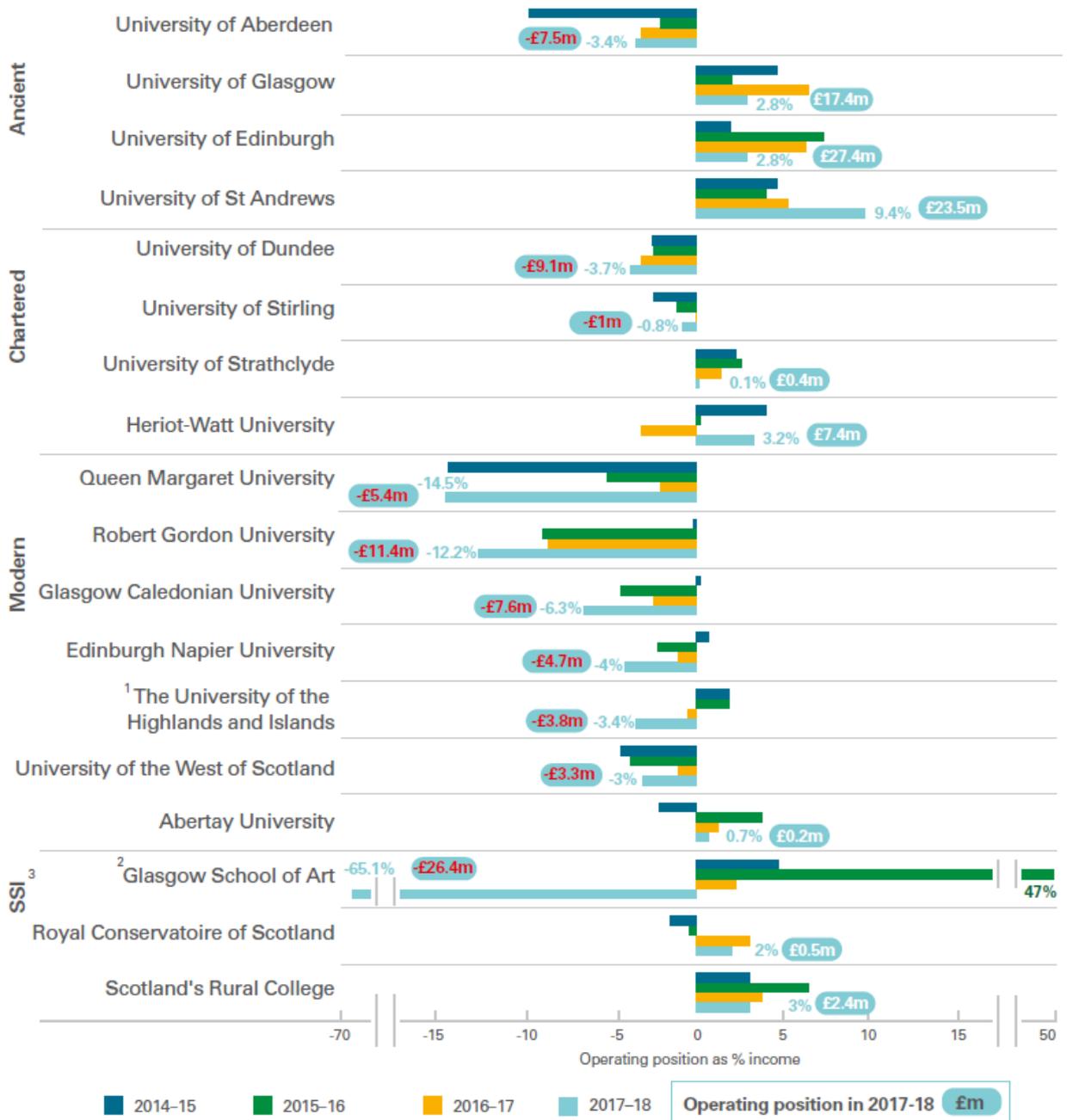
The SFC's funding models provide universities with a degree of stability but strategic funding has reduced

16. The formula-based funding models for the core grants for teaching and research are widely accepted by the sector because they provide transparency, understanding and are perceived by the sector to be fair. However, there is little scope for the SFC to adjust funding to individual universities to reflect specific circumstances.
17. In our September 2019 report we noted that strategic funding had reduced by 46 per cent in real terms, from £69 million in 2014-15 to £37 million in 2017-18. The reduction in strategic funding means that less funding is available to support new developments or to respond to specific circumstances or issues that arise. In the Scottish Government's [letter of guidance](#) to the SFC of July 2019, the Minister for Further Education, Higher Education and Science emphasised the need for projects funded from strategic funds to be self-sustaining where appropriate, asking the SFC to reduce universities' reliance on strategic funds and to integrate and mainstream such funding arrangements where possible.

More than half of all universities were in deficit in 2017-18 and the position was worse than in 2014-15 for most modern and chartered universities

18. In September 2019, we reported that for the year ending 2017-18 while the sector overall was in good financial health, it masked significant variation across universities, and many sector-level indicators were disproportionately affected by the financial results of three of the four ancient universities. At an aggregate sector level, the operating position remained broadly stable between 2014-15 and 2017-18, but six universities reported deficits every year. Exhibit 2 highlights each university's operating position as a percentage of income between 2014-15 and 2017-18. This highlights the varied financial positions of universities, illustrating the potential for the Covid-19 crisis to have differing levels of financial impact across the sector.

Exhibit 2 - Operating position as a percentage of income by university, 2014-15 to 2017-18



Notes:

1. Figures for the University of the Highlands and Islands (UHI) excludes income and expenditure for research undertaken by UHI's partners.
2. Glasgow School of Art's surplus in 2015-16 is due to insurance income from the fire in 2014. Its deficit in 2017-18 is due to damage and reconstruction costs relating to the fires in 2014 and 2018.
3. Small and specialist institutions (SSI)

Source: Audit Scotland using Higher Education Provider Data: Finance, Table 1, Higher Education Statistics Authority (HESA), March 2016 to March 2019, and university financial statements, (2014-15 to 2017-18).



19. In April 2020, [the SFC](#) estimated that for the academic year 2019-20, Scottish universities will face a loss of around £72 million due to Covid-19. At the Education and Skills Committee in September 2020, Richard Lochhead, Minister for Further Education, Higher Education and Science, advised the estimated deficit for universities for the coming academic year 2020-21 could be £191 million.
20. The latest [Universities and Colleges Admissions Service](#) (UCAS) clearing analysis up to 10 September 2020 shows an eight per cent increase in undergraduate applicants being given a place at a Scottish university from the previous year, including increases in non-EU students. This will be seen as good news for Scottish universities at a time of uncertainty amidst the global Covid-19 pandemic. However, final entrant figures for all students, including postgraduate students, and the impact of Covid-19 will not be known until later in the academic year 2020.
21. The Scottish and UK Governments have outlined several measures to financially support the sector:
 - The Scottish Government has provided one-off funding of £75 million for research, to combat the financial impact of Covid-19.
 - The UK Government has provided a UK-wide £280 million research and innovation fund for universities and research organisations impacted by Covid-19, along with some availability of grant funding and low interest loans.
 - The Scottish Government has announced that free EU tuition fees will come to an end after the academic year 2020-21 and universities will be able to charge EU students international fees for the academic year 2021-22. The Scottish Government estimates that £19 million that would have previously funded EU students for 2021-22 will stay in the sector to fund places for Scottish students.
 - In August 2020 the Scottish Government confirmed that it would revert to teacher gradings for the exam results of students in years S5 and S6. Following this decision, it is anticipated that a further 2000 to 3000 Scottish domiciled and EU students will be eligible to study at universities in Scotland. The Scottish Government announced that it will fund the additional 2020-21 entrants to university for the duration of their four or five-year degree.
 - Universities have been eligible for the coronavirus jobs retention scheme.
22. Universities have been facing financial pressures and operating in a tight financial environment for a number of years. Covid-19 will have a significant impact on universities for the foreseeable future, adding to these existing pressures. In response to Covid-19, the SFC is carrying out a [review](#) of the coherent provision and sustainability of further and higher education, which will consider any changes needed to existing funding, operations and accountability frameworks.
23. The longer-term impact of Covid-19 on universities is not yet clear. Audit Scotland will continue to monitor the implications and report on this through our annual audits and performance audit work, where appropriate.

October 2020