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Stewart Maxwell MSP  
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Edinburgh  
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11<sup>th</sup> January 2016

Dear Stewart,

**HIGHER EDUCATION GOVERNANCE (SCOTLAND) BILL: CLASSIFICATION OF SCOTTISH HIGHER EDUCATION INSTITUTIONS (HEIs) BY THE OFFICE FOR NATIONAL STATISTICS (ONS)**

In the Committee's Stage 1 Report on this Bill, it asks the Scottish Government to "*publish, before the Stage 1 debate, the full analysis it has undertaken on this issue*".

Some higher education sector stakeholders have suggested that provisions in this Bill could lead to re-classification of Scottish HEIs as public sector bodies. Principally, this view arises from a perception that the Bill increases Ministerial control of autonomous institutions.

This is not an analysis that the Scottish Government agrees with. We aim to enable HEIs to improve the transparency and inclusivity of governance arrangements themselves, rather than seek any level of control. Indeed, re-classification of Scottish HEIs as public sector bodies is an outcome that we would always actively seek to avoid.

Following my letter of 5 October to the Convenor of the Finance Committee, sharing a summary of relevant analysis conducted prior to introduction of the Bill, I am happy to expand on our consideration of this important matter. I hope that the detailed treatment of the issue set out in this letter will be helpful to members of the Committee, and those on the Finance Committee, to whom the letter has been copied.

## Scottish Government Analysis

As noted in my letter of 5 October, in classifying bodies as either public or private, the fundamental question for ONS is “*does government exercise significant control over the general corporate policy of the unit?*” The ‘Eurostat’ European System of Accounts guidance (ESA 2010) defines control as the ability to determine general corporate policy. This can be exercised, for example, through the appointment of directors, control of over half of the shareholders’ voting power, through special legislation, decree, or regulation. The difference between the public and private sectors is determined by where control over the organisation lies, rather than by “ownership”.

Whether or not such government control exists is assessed by considering a number of “*indicators of government control*” set out in the published ONS guidance<sup>1</sup>. As explained in my letter in October, the Scottish Government considered each of the indicators in turn and how they relate, or not, to the provisions in the Higher Education Governance Bill. Rather than simply outline our analysis against each indicator again, I have attached the letter of 5 October to this letter for ease of reference. The analysis in the letter focuses on the main indicators of control; however, all other relevant sections of the ESA 2010 guidance were examined in forming our assessment. In summary, the Bill presents Ministers with no powers to:

- appoint, remove or approve a majority of officers, board of directors;
- appoint, remove or approve a majority of appointments for key committees;
- own a majority of the shares or voting interest (within an HEI);
- appoint or remove key personnel;
- rights under special shares and options;
- rights to control via contractual agreements;
- rights related to borrowing/financing;
- control via regulation (e.g. restriction on ceasing activities or from diversifying activities).

The various provisions in the Bill do not impose any direct Ministerial control over individual appointments to the governing bodies or academic boards of any institution. Instead, the Bill simply allows regulations to be made to set out consistent processes to be followed for appointment of a chair as well as setting out a minimum composition of governing bodies and academic boards. In addition to these (primary) indicators of control, ESA 2010 guidance sets out 5 indicators of control specific to classification determinations focused on not for profit (NPI) institutions in the private sector (such as HEIs). Guidance expanding on interpretation of each of these 5 indicators is set out in the accompanying Manual on Government Deficit and Debt (MGDD) updated in 2014. This material was also reviewed prior to introduction of the Bill in June. Each indicator is set out below with commentary extracted from

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<sup>1</sup> <http://www.ons.gov.uk/ons/guide-method/classifications/na-classifications/the-ons-classification-process/index.html>

the MGDD guidance, followed by Scottish Government analysis of risk proposed by the provisions in the Bill at introduction:

*a) **The appointment of officers** - The government may have the right to appoint the officers managing the NPI either under the NPI's constitution, its articles of association or other enabling instrument.*

**SG Assessment:** The Bill does not give Ministers the right to appoint officers managing the NPI, both in the sense of staff employed or members of the institution's governing body or any other governance structure. The Bill does provide for processes of appointment and specific categories of membership to be represented on particular governance structures. However, Ministers have no ability to appoint or remove any individual.

*b) **Other provisions of the enabling instrument** – If, statutorily, the functions, objectives and operating provisions (of the NPI) are already determined by government, the appointment of officers would become of secondary importance. But control by government would result if government would have the right to revoke staff and to approve budget or financial arrangements. An NPI would be considered to be controlled by government if approval of government would be required to change the statute of the entity (or the type of activity carried out by the entity), or if the entity could not dissolve itself or terminate any relation with government without such approval.*

**SG Assessment:** The Bill does not give Ministers the right to revoke any appointment, either of staff or representatives on any HEI governance structure. In addition, Ministers are afforded no new ability to approve budget or financial arrangements. In relation to changes to the statute of an entity, the Bill does not provide that government approval is required for changes to the governing statute (or instruments) of the body. Scottish HEIs must seek the approval of the Privy Council for such changes at the current time. The Bill does not provide Scottish Ministers with any new power altering current arrangements in this regard.

*c) **Contractual agreements** - Some NPIs may enter into contracts with government units in order to perform tasks defined by government, acting as a specialised operator, notably in social areas. When such contracts are the main, if not total, part of the activity of the NPI, it is clear that government would be able to influence the general policy of the NPI. However, control should be assessed if the approval of government would be required for exiting from contracts with government.*

**SG Assessment:** The Bill does not give Ministers any new powers relevant to contractual agreements. The current outcome agreements formed between Scottish HEIs and the Scottish Funding Council are not contractual agreements as envisaged by the MGDD guidance. That guidance emphasises the performance of contractual 'tasks defined by government' and the approval of government being required for institutions to 'exit' contracts. The outcome agreements arise from discussions between the Scottish Funding Council and individual HEIs. The agreements seek to measure the impact, in terms of outcomes, of the activity of an HEI, assisted by public investment, rather than direct any of the discrete activities underpinning that impact. Essentially, outcome agreements set out the aims and ambitions of

autonomous HEIs in assisting achievement of overall governmental strategic objectives.

**d) Degree of financing-** *an NPI that is mainly financed by government may be controlled by government. “Mainly” must be as at least over 50%. The control would be assessed if such financing would be permanent (and not on temporary basis) and/or if it would result in a narrow monitoring of the use of the funds and a strong influence from government on the general policy of the entity.*

**SG Assessment:** The Bill does not give Ministers any new powers to monitor the use of funds. It should be noted that the updated MGDD from 2014 notes that many educational units (including HEIs) are non-profit institutions and are generally largely funded by government. The guidance notes “...as a matter of principle, the mere financing of the educational unit should not be, as such, a determining criterion in classifying government-supported educational units”. Further, the guidance notes “...by application of the general rule, if government appoints the managers (or approves their appointment or holds a revocation right) or gives instructions related to the everyday management of the school (sic), thus leaving restricted decision-making capacity to educational unit’s officers, the unit should be classified in the general government sector”. The Bill does not provide Scottish Ministers with any new power to influence or control HEIs in that way.

**e) Risk exposure - government** *“exposed to all, or a large proportion of, the financial risks associated with an NPI’s activities.” In this case, the arrangement would constitute government control. Financial risks refers to ex-ante commitments taken by government on some liabilities incurred by the NPI, on possible disruptions of other sources of revenue apart from those received from government, etc.*

The provisions in the Bill are not directly relevant to this indicator. As autonomous organisations, the Scottish Government is not exposed to the form of risk described.

#### Guidance from HM Treasury

Treasury guidance from 2013 sets out a further 14 indicators of secondary control that ONS may refer to in making classification determinations. These were also considered by Scottish Government officials prior to introduction of the Bill, with a view to assessing whether planned provisions might propose any risk (of re-classification). The guidance asks, can the public sector:

1. determine aspects of how the body delivers its outputs;
2. have a final say in sale/acquisition of fixed assets;
3. take a share of proceeds of asset disposals that goes beyond the repayment of previous government support for capital formation;
4. close the body;
5. prevent the body from ending its relationship with the public sector;
6. veto any takeover (except in the case of an conventional special share);
7. change the constitution of the body, or veto changes to it;

8. decide what sort of financial transactions the body can undertake, or limit them;
9. prevent the body from receiving certain types of income from other sources;
10. exert numerous minor controls over how the body is run;
11. exert financial control (N.B. this is different from funding) as part of a general system of controlling public expenditure;
12. control dividend policy;
13. set pay rates; or
14. approve acquisitions (for non-regulatory reasons).

In summary, the Scottish Government concluded that the Bill did not propose any additional risk of re-classification, with specific reference to these secondary indicators of control. However, I am aware that legal advice procured from Anderson Strathearn by Universities Scotland raises concerns relevant to, at least, point 7 in this list. Specifically, these concerns relate a sections in the Bill, as introduced, featuring regulation making powers to enable Ministers to oblige variation of, for example, the composition of governing bodies or academic boards (sections 8 and 13).

Overall, we do not agree with the conclusions reached in the advice provided by Anderson Strathearn, on what is primarily a matter of statistical classification. However, we have taken careful note of all evidence shared with both the Finance Committee and the Education and Culture Committee. In light of this, I plan to lodge a number of Scottish Government amendments at Stage 2 of the Bill's consideration. A number of these are relevant to the points made in the Committee's Stage 1 report. Specifically, the Scottish Government will consider removal sections 8 and 13 in the Bill.

In my view, this is a discrete and focused Bill seeking to improve the transparency and inclusivity of higher education governance in Scotland. In summary, we do not view the Bill as affecting any existing level of assessed risk relevant to the current classification of Scottish HEIs not for profit, private sector bodies. Indeed, the Scottish Government has been clear that if there was any indication that this status may be altered, and we assess little likelihood of that, we would remove relevant legislation as required in order to avoid that outcome.

I, or my officials, would be happy to provide any further information that might be helpful to the Committee. Throughout the passage of this Bill I have made it clear that I want to listen to all ideas and constructive suggestions in order to make this legislation as impactful as possible in improving the governance of our higher education institutions.

**ANGELA CONSTANCE**