Shetland Islands Council

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Date: 5 December 2018

Dear Sir/Madam

You are invited to the following meeting:

Special Shetland Islands Council
Council Chamber, Town Hall, Lerwick
Wednesday 12 December 2018 at 10am

Apologies for absence should be notified to Anne at the above number.

Please note that Appendix 4 to item 1 contains EXEMPT information.

Yours faithfully

Executive Manager – Governance and Law

Convener: M Bell
Depute Convener: B Wishart

AGENDA

(a) Hold circular calling the meeting as read.

(b) Apologies for absence, if any.

(c) Declarations of Interest - Members are asked to consider whether they have an interest to declare in relation to any item on the agenda for this meeting. Any Member making a declaration of interest should indicate whether it is a financial or non-financial interest and include some information on the nature of the interest. Advice may be sought from Officers prior to the meeting taking place.

1. Effective and Sustainable Tertiary Education, Research and Training in Shetland Project – Full Business Case
DV-46

2. Scottish LGPS Restructure Review – Consultation Response
F-091

Shetland Islands Council	Agenda Item **1**

Meeting:	**Shetland College Board** **Education and Families Committee** **Policy and Resources Committee** **Shetland Islands Council**	**10 December 2018** **10 December 2018** **11 December 2018** **12 December 2018**
Report Title:	**Effective and Sustainable Tertiary Education, Research and Training in Shetland Project – Full Business Case**	
Reference No:	**DV-46-18**	
Author/Job Title:	Maggie Sandison, Chief Executive	

1.0 Decisions/Action required:

1.1 That the Shetland College Board and Education and Families Committee RECOMMENDS to the Policy and Resources Committee that it RECOMMENDS that the Council RESOLVES to:

a) NOTE (a) the content of the Full Business Case (FBC) for the Effective and Sustainable Tertiary Education, Research and Training in Shetland Project (hereafter referred to as 'the Project'); and (b) supporting documents from the Project's financial and legal advisers confirming that the FBC has been prepared in accordance with best practice and that there are no material obstacles to merger; AND

b) APPROVE the merger of Shetland College, NAFC Marine Centre and Train Shetland.

1.2 Subject to approval of b) above, that the Policy and Resources Committee further RECOMMENDS that the Council RESOLVES to:

c) DELEGATE authority to the Chief Executive (or her nominee) to procure and engage a Project Manager, specialist financial and legal services, and any other specialist services or advice required to implement the merger;

d) DELEGATE authority to the Chief Executive (or her nominee), in partnership with the Chair of SFTCT, and in consultation with the Leader of Shetland Islands Council and the Chairs of the Shetland College Board and the Education & Families Committee, to take any actions and decisions required to establish and resource the recruitment panel for the Principal Designate, as described in the FBC;

e) DELEGATE authority to the Chief Executive (or her nominee) to realise arrangements for property assets resulting in usage of the Council-owned properties for a minimal value transaction to the new college;

f) DELEGATE authority to the Chief Executive (or her nominee), in consultation with the Leader of Shetland Islands Council and the Chairs of Shetland College Board and Education & Families Committee, to liaise with, negotiate, or otherwise engage with the other parties to the merger and with any regulatory, parliamentary, statutory or other bodies and generally to take any action and take any decision necessary to achieve the outcomes of the decision to fulfil the aims of the decision to merge;

g) APPROVE the provision of a guarantee against the pension liability of the merged college to the Shetland Islands Pension Fund (SIPF);

h) AGREE that the delegation of authority granted to the Shetland College Board on 29 June 2016 [Min. Ref. SIC 53/16] to support potential further stages of the Project remains in place until August 2020.

2.0 High Level Summary:

2.1 The efficient and effective delivery of tertiary education, research and training in Shetland is crucial for the delivery of Shetland's community plans, increasing the number of young people accessing learning and ensuring businesses have access to the skilled workforce they require and ensuring people in Shetland can reach their full potential.

2.2 A Colleges Integration Liaison Group, which is made up of Board representatives from the NAFC and College, was set up to provide guidance to the Interim Joint Principal in helping to integrate the activities of Shetland College, NAFC Marine Centre and Train Shetland and provide a more joined up Shetland tertiary education, research and training offering. To this end the Joint Strategic Plan and Operating Plan 2017-19 were agreed. More recently, discussions between the Liaison Group and the strategic and funding stakeholders Scottish Funding Council (SFC) and the University of the Highlands and Islands (UHI), resulted in a commitment to develop a FBC analysis of an effective and sustainable model for tertiary education, research and training in Shetland.

2.3 The FBC concerns the future operating and governance options for the Shetland Tertiary Education, Research and Training sector, and the first step in producing this was the development of a Strategic Outline Case (SOC).

2.4 The purpose of the SOC was to:

- establish the strategic context for the Project
- make the case for change
- identify and agree measureable Critical Success Factors
- identify and agree a long list of options
- review the long list options against the Critical Success Factors
- agree the preferred way forward
- approve the preferred options to be taken forward in the FBC.

2.5 The SOC identified the preferred way forward as being a merger of the services involved in delivering tertiary education, research and training in Shetland. The preferred options to realise this were chosen following an appraisal of shortlisted options against the Critical Success Factors, with each option given a score based on their ability to achieve crucial elements of the CSFs, including financial sustainability, quality management, effective governance and business development.

2.6 The preferred options chosen on the basis of the above process were as follows:

- Option 5 (‘Host’ NAFC) - Independent organisation comprised of operations of Shetland College, NAFC Marine Centre and Train Shetland, which is part of the UHI network, with SFTCT as the ‘host’ organisation;
- Option 6 (New College) - Creation of a new, independent organisation comprised of operations of Shetland College, NAFC Marine Centre and Train Shetland, which is part of the UHI network.

2.7 The purpose of the FBC is to revisit the SOC to ensure the case for change remains robust, to identify the value for money option, to set out the arrangements for realising that option and demonstrate affordability.

2.8 The SOC was presented to Shetland Islands Council on 23 May 2018 [Min Ref. 30/18], following presentation to the Shetland College Board, Education and Families Committee and Policy and Resources Committee in May 2018. The decision of the Council was:

- To approve the merger of tertiary education, research and training services as the preferred way forward as identified in the SOC;
- To note the preferred way forward contains two options; namely the ‘Host’ NAFC option and the New College option;
- To delegate authority to the Chief Executive (or her nominee) to take any action and decisions required to develop the Full Business Case for the preferred option, which will be reported to Committees, Board and Council for a decision in October 2018;
- To delegate authority to the Chief Executive (or her nominee) to procure and engage any specialist legal or other services required to develop and finalise the Full Business Case;
- To agree that the delegation of authority granted to the Shetland College Board on 29 June 2016 [Min. Ref. SIC 53/16] to support potential further stages of the Project remains in place until September 2019;
- To delegate authority to the Director of Development (or his nominee), in consultation with the Chair of Shetland Fisheries Training Centre Trust (SFTCT), to extend the Interim and Joint management arrangements up to the end of the 2018/19 academic term (July 2019).

2.9 SFTCT confirmed at a meeting of their Board on 23 November 2017 that they were committed to the process of planned merger.

2.10 A Project Board was established consisting of the Chief Executive of Shetland Islands Council and the Interim Joint Principal of Shetland College, NAFC Marine Centre and Train Shetland. A Project Initiation Document was drafted and approved, and a Project Manager appointed to establish a team to develop the various workstreams necessary to inform the merger decision.

The workstreams identified were:

- Business Development
- Curriculum
- Estates
- Finance
- Governance
- IT
- Research
- Staffing Structure and HR
- Student Engagement, Support and Marketing
- Vision and Culture

The FBC at Appendix 1 is based on the information generated from the workstreams.

2.9 In addition, external advisors were engaged to provide both financial and legal due diligence. Deloitte LLP and Anderson Strathern have provided assurance that the methodology which underpins the FBC is robust and well prepared, confirm that no material obstacles lie in the path to merger, and have confirmed that the financial modelling developed in the production of the business case is based on sound planning and reasonable assumptions.

3.0 Corporate Priorities and Joint Working:

3.1 The Project is in line with Our Plan 2016-2020, which states:

"A stronger economy which has well-paid jobs available to more people has the potential to produce a more prosperous and fairer society in Shetland. The long-term community plan aim is for Shetland to have good places to live as well as sustainable economic growth with employment opportunities, and for our residents to have the skills they need to benefit from those opportunities."

The Project addresses the following key aims of the Plan:

<u>Economy and Housing</u>

- The tertiary education, research and training project will have created an effective model for providing excellent services to our learners
- We will have an economy that promotes enterprise and is based on making full use of local resources, skills and a desire to investigate new commercial ideas.

3.2 The Shetland Partnership, of which the Council is a key member, is the Community Planning Partnership for Shetland. The Shetland Partnership Plan 2018-2028 reflects the shared vision of the local area and the partner organisations:

"Shetland is a place where everyone is able to thrive; living well in strong resilient communities; and where people and communities are able to help plan and deliver solutions to future challenges."

3.3 A key objective for the Shetland Community Planning Partnership is to develop and implement a ten-year action plan to attract people to live, work, study and invest in Shetland. This plan is predicated on the link between a healthy demographic balance and the ability to sustain communities and services, and compete economically.

The vision of the plan is:

"In 2028 Shetland will:

- *Be an island of opportunity for young people, businesses and investors;*
- *Be a vibrant and positive student destination;*
- *Have a more balanced demographic profile and a growing population underpinned with more private sector jobs."*

In order to achieve this vision, one of the objectives of the plan is:

- Foster an environment that supports entrepreneurship and sustainable learning and research

3.4 A joint strategic plan for the tertiary education services in Shetland, comprising Shetland College, NAFC Marine Centre and Train Shetland, was developed in 2017 as a response to the requirement for a closer integration of services, with a view to integration of management structures in the future. The *Tertiary Education Sector in Shetland: Strategic Plan 2017-2019* describes the following vision:

"NAFC Marine Centre, Shetland College and Train Shetland will work together to help build the future of Shetland through education, training and research".

The joint strategic plan identifies six strategic goals for the period up to 2019:

- Respond to the needs of Shetland
- Deliver high quality learning experiences and successful outcomes for all learners
- Carry out high quality research
- Provide high quality governance, leadership and management structures
- Grow our business
- Build sustainability

4.0 Key Issues:

4.1 The outcome of the FBC and the decisions required presents a number of scenarios which the Council and the Trust could choose to follow. In broad terms these are:

a) Merger of the organisations in line with the FBC;
b) Maintain Status Quo;
c) The Council and the Trust adopt a purely commercial relationship.

The scenarios are described below:

Merger

4.2 The FBC demonstrates that merger of NAFC Marine Centre, Shetland College and Train Shetland can result in a financially sustainable college which will provide high quality learning, teaching, research and training, and which will be governed and managed in line with practices required by the Regional Strategic Body, the Scottish Funding Council and the Scottish Government.

4.3 The core purpose of the new college is to ensure that every learner has access to the right programme at the right place and time and is given options and choices to meet their individual needs, and match their motivation, talents and ability to progress to work or further study. The academic strategies for the new college will underpin the ambition to deliver excellence in learning and teaching and to develop a curriculum portfolio which is dynamic and responsive to local, regional and national needs. Future strategic planning must include strategies for research, business development and marketing which emphasise growth and employer engagement.

4.3 The proposed model for the merger is the creation of a new entity into which the assets of the existing services will transfer. This is the ‘New College’ option.

4.4 Merger will require the creation of a Shadow Board to lead the process of merging the separate organisations, which will then form the new college Board of Management upon vesting date. The responsibilities of the Shadow Board are described in the Management Case. The suggested membership of the Shadow Board is:

- Two members of SFTCT, of which one is the current Chair;
- Chair of Shetland College Board
- Chair of Education and Families Committee;
- Staff member – teaching;
- Staff member – non-teaching;
- Student representative;
- Non-executive members (subject to open recruitment).

Senior officers and relevant Committee chairs, in partnership with the Chair of SFTCT, will require to be proactive in establishing the Shadow Board. This will require the development of a partnership agreement, drafting of terms of reference and ensuring staff, student and non-executive members are recruited. It is expected that a secretariat function will be sourced from UHI and/or SFC.

4.5 The Scottish Funding Council advise that a new Principal should be appointed at the earliest possible date, while recommendations from Audit Scotland state that the chief executive for a merged organisation should be in post “not less than six months before the start of the new organisation” to ensure sufficient time for operational changes to be implemented and for the new Principal to lead the culture change and strategic planning for the new entity.It is recommended that a recruitment panel be established to undertake an open recruitment process for the new Principal. At a minimum, this panel should include:

- Chair, SFTCT
- Chair, Shetland College Board
- UHI representative/FE specialist
- Senior recruitment consultant

4.6 Transfer of staff into the new organisation will have an impact on the Shetland Islands Pension Fund (SIPF). It is intended that the new college will be an Admitted Body to the SIPF. Due to the nature of the changes that are expected, a new SIPF Admission Agreement will be required by the new college at the vesting date.

In determining the basis of transfer from the funding perspective, three alternatives have been considered by the Actuary:

- Fully funded - 'clean slate' option which leaves no liability with SFTCT;
- Share of deficit (of funding level of ceding employer) - at the calculation date - on an ongoing basis.
- Share of deficit (of funding level of active members of the ceding employer) - pensioner and deferred members of ceding employer fully funded at the calculation date - on an ongoing basis.

It is considered that the most beneficial option will be to proceed on the basis of the fully funded option. This will leave no deficit remaining with SFTCT.

There are two major financial considerations resulting from the fully funded scenario:

- This scenario creates a cessation cost trigger to the value of £2.5-3m (based on the estimated position at 31 October 2018), for SFTCT from the liabilities left, which should be paid at point of cessation;
- All new Admission Bodies (new Admission Agreements) will be required to provide some form of security, such as a guarantee, an indemnity or a bond, as set out in the SIPF Regulations. The security is required to cover some or all of the following:
    - the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
    - allowance for the risk of adverse market experience;
    - allowance for the possible non-payment of employer and member contributions to the Fund; and/or
    - the current deficit.

Neither SFC nor UHI can provide the security required due to the provisions of the Further and Higher Education (Scotland) Act 2005. This will therefore require the Council to act as the guarantor for the new college's admission to the SIPF.

4.7 The financial projections for the business case are achievable if the property assets are made available to the new college at a minimal cost. It is proposed that leasing costs in relation to buildings previously owned by Shetland Leasing and Property Ltd. (SLAP) are removed, and that the Council commit to an alternative arrangement which will result in a minimal value transaction. This arrangement will be established in the next phase.

4.8 Approval of merger will require the initiation of the next phase of the Effective and Sustainable Education, Research and Training Project, which will involve implementation of merger proposals. This will require the appointment of a Project Manager, and the seconding of existing staff into Project Team roles to resource workstreams, which will require backfilling, acting up and/or undertaking higher duties. This phase will also require the procurement of specialist legal, financial and other services.

<u>Status Quo</u>

4.9 The Council's auditors are required to consider the Council's arrangements in place to secure Best Value and to ensure value for money, and have been aware that a project was underway in order to achieve this with regards to tertiary education in Shetland. While having previously not commented on the provision of deficit funding to the sector, the auditors would be required under auditing standards to consider the compliance of this arrangement (or any subsequent arrangement) with the Council's statutory duty to secure Best Value and the Code on Following the Public Pound if concerns are raised that the arrangement is non-compliant. This will become particularly relevant if a decision not to merge is taken, as there will no longer be a process in place to achieve Best Value in the tertiary sector in Shetland.

4.10 Current arrangements present a serious risk for the Council, in particular due to the provisions of the Financial Memorandum between the Council and UHI. The FM is the means UHI, as the Regional Strategic Board (RSB) for the Highlands and Islands, uses to ensure each of its academic partners conforms to requirements to deliver to coherent, high quality further and higher learning provision in a sustainable and responsible manner. It is a term and condition of grant that Colleges are required to comply with the FM in return for both HE and FE funding. In the event that an assigned college is found to be in breach of the terms and conditions of the FM, the RSB's Chief Officer can suspend payments of grant to colleges, and demand repayment of funds.

4.11 The existing FM specifically covers arrangements between UHI and SIC; however it states that:

"*Where the Council is responsible for funding another college on behalf of the RSB i.e. NAFC Marine Centre, the Council will use its best efforts to ensure that NAFC Marine Centre are complying with this financial memorandum."*

The Council's responsibilities within the FM include:

"*that public money is safeguarded and properly accounted for and used economically, efficiently and effectively…[and]" and "has …a statutory duty to make arrangements to secure Best Value".*

The FM states that elected Members collectively, and senior officers individually, are responsible for the stewardship of resources and the management of risk. Currently the Council is not only taking on the risk of its own funding, but also that of the NAFC Marine Centre (in excess of £500k per annum).

4.12 With regard to the status quo, the main challenge in ensuring compliance with the FM is the following clause:

"The Council plans and manages the activities of the College to remain sustainable and financially viable. A College is being managed on a sustainable basis if, year on year, it generates sufficient income to cover its costs and allow for maintenance of and investment in its infrastructure (physical, human and intellectual) at a level which enables it to maintain adaptive capacity necessary to meet future demands."

The Status Quo shows that the sector requires a contribution from the Council of more than £2 million per annum to allow it to meet all costs. If the decision is to maintain the Status Quo, i.e. not merge, then it will not be possible to demonstrate that this requirement can be met.

4.13 In the event of a decision not to merge, the Council could not continue with this situation and retain that risk where efforts to merge the entities and create a sustainable body in accordance with the recommendations of an FBC have been rejected. Therefore, in line with the FM:

"The Council must inform the RSB's Chief Officer without delay of any circumstance that is having, or is likely to have, a significant adverse effect on the ability of the College to deliver its education programs, and other related activity … any serious weakness, such as a significant and immediate threat to the College's financial position…"

This would mean that the only option the Council could pursue upon a decision not to merge is to pursue a purely commercial relationship with the Trust and a Best Value review of Shetland College and Train Shetland, which achieves financial sustainability.

<u>Commercial Relationship</u>

4.14 In the event of a decision not to merge, the Council will be required to find a Best Value solution for current arrangements to ensure responsible management of its finances and assets. The Council will also require to immediately undertake a Best Value review of the Shetland College and Train Shetland services. This review will be based on finding a value for money solution for delivery of these services, and will utilise the findings and strategies which have been developed from the FBC process.

4.15 In this scenario, the relationship between the Council and the Trust would become purely commercial, with no financial or strategic responsibility for the NAFC Marine Centre operations attendant to the Council, in order to remove and/or reduce the risk that the Council currently bears. Where appropriate and necessary, reports will be brought to the Council to this effect. The implications of this are:

- The negotiation of a Financial Memorandum between UHI and SIC, which solely concerns delivery of further education through Shetland College UHI, in order to minimise risk to the Council;
- The Council will no longer provide financial support in the form of stability funding or other support to NAFC to ensure stability;
- Following the decision of the Council to purchase the SLAP portfolio, NAFC Marine Centre will be occupying Council-owned premises. This will entail the Council charging the organisation a commercial rental for the premises;
- The relationship between the Council and NAFC Marine Centre in terms of service delivery will be purely a buyer-supplier relationship – the Council may still seek training and/or research requirements from NAFC Marine Centre, but prices and contracts will be sought on a competitive basis to ensure value for money;
- NAFC Marine Centre are an Admitted Body to the SIPF. Current rules of admission to the SIPF require a guarantee or security be provided against the pension liabilities of the Admitted Body. As NAFC Marine Centre does not

currently have such security, the SIPF must review the risk the financial position of the organisation poses to the Fund, and come to an early decision on any further action to take;

- The Council will be required to ensure that any grant funding awarded to NAFC Marine Centre is awarded in line with grant conditions which are expected to be met by other businesses seeking financial assistance – this will require NAFC Marine Centre to demonstrate financial viability and sustainability prior to receiving an award of grant.

5.0 Exempt and/or Confidential Information:

5.1 Appendix 4 of the report has been categorised as containing Exempt information. This arises from the nature of the information contained within it, but also because the Council is subject to a legal agreement and placing that Appendix in the public domain could amount in breach of contract.

5.2 Having acknowledged its Exempt status, if Members then wish to discuss the contents of Appendix 4 they should indicate this to the Chair and the public will be excluded for the time required to consider the aspect that relates to Appendix 4.

6.0 Implications:

6.1 **Service Users, Patients and Communities:**	Formal consultation with students will form part of the merger implementation plan for the next phase of the project. Regional officers from the Highlands and Islands Students Association (HISA) have been involved in the development of workstreams for this phase, and student involvement in work to realise merger will continue, including consultations on naming and branding of the new entity. The merger implementation will follow guidance from the Scottish Funding Council, which recommends that: • Colleges invite their staff and student representatives to contribute to the development of the staff communication and engagement strategy and the student strategy; • Colleges provide regular and consistent opportunities for staff and students to speak to the Principals about the merger proposal and its impacts; • Staff and students are involved in the development of the merger proposal; and • Staff and students are involved in agreeing what needs to be in place for Vesting Day.
6.2 **Human Resources and Organisational Development:**	The identified staffing implications and actions of the merger are as follows: • Recruitment - The Scottish Funding Council advise that a new Principal should be appointed at the earliest possible date, while recommendations from Audit Scotland state that the chief executive for a merged organisation should be in post “not less than six months before the start of the new organisation” to ensure sufficient time for operational changes to be implemented and for the new Principal to

	lead the culture change and strategic planning for the new entity. This will provide strong and sustained leadership from the outset, under the strategic direction of the Shadow Board, in the lead up to the college merger. • Personal Development Opportunities - the new college culture will have high-quality learning and teaching at its heart and offer personal and professional development opportunities to staff. It will also provide opportunities to share best practice in both teaching and support staff from the two colleges. • Communication and Consultation – the Principal, with support, will take the lead in consulting and communicating with trades unions, staff representatives, staff teams and individuals regarding the new culture and staff structure. Staff engagement and involvement is fundamental to a successful merger. The merger implementation will follow guidance from the Scottish Funding Council, which recommends that: o Colleges invite their staff and student representatives to contribute to the development of the staff communication and engagement strategy and the student strategy; o Colleges provide regular and consistent opportunities for staff and students to speak to the Principals about the merger proposal and its impacts; o Staff and students are involved in the development of the merger proposal; and o Staff and students are involved in agreeing what needs to be in place for Vesting Day. Implementation of the merger will be overseen by a Shadow Board who will have strategic responsibility for merger – this will include staff and student representation • TUPE – the Transfer of Undertakings and Protection of Employment Regulations will apply to all those employed by the NAFC and SIC. The regulations aim to protect the employment and terms and conditions of employees when there is a transfer to a new employer. When TUPE applies the new college employer takes on the rights, responsibilities and liabilities of the old employers. All employees employed immediately before the transfer are automatically transferred to the new college and employees are protected against having their terms and conditions changed in connection with the transfer • Pensions – it is intended that the new college will be an Admitted Body to the SIPF, which will ensure current scheme members will be unaffected by the transfer. Members of SPPA will likewise be unaffected by the transfer. • The Council's Organisational Restructure procedure and the NAFC Redundancy Policy will be used in the event that there needs to be a reduction or changes to staff

	numbers and duties for economic, organisational or technical reasons. • Avoiding/reducing the need for compulsory redundancies - in the lead up to any merger, in line with Organisational Restructure policy and good practice ACAS guidelines, consideration needs to be given to the need for the following in order to avoid, where possible, the need for compulsory redundancies: o Reviewing whether a post needs to be filled; o Early restrictions on the recruitment of permanent staff; o Early restrictions on external recruitment; o Voluntary severance/early retirement in the interests of efficiency; o Termination of employment of temporary employees and a restriction on the use of relief staff; o Use of "natural wastage" o Initial ringfencing of suitable internal vacancies to employees at risk; o Redeployment of employees at risk; and o Consideration of requests for part-time working/flexible retirement. • Staff Training and Welfare o Discussions will take place with managers and staff about providing resilience training through workshops to provide staff with the tools to help them deal with change; o The Council's Welfare Officer is available to meet with staff who are need support on an individual basis in relation to the change process.
6.3 **Equality, Diversity and Human Rights:**	The new college will adopt policies which provide specific guidance on ensuring equality of provision – this includes Access and Inclusion, which specifically states: "Our Access and Inclusion Strategy details how we will work to ensure that we are both accessible and inclusive in our approach to delivering learning in Shetland. The landscape of education and training is changing with increasing demand for flexible and inclusive provision. Therefore, it is essential that the Tertiary Education Sector in Shetland is similarly dynamic in order to meet the needs of the Shetland community – ensuring that we put the learner at the heart of our services." Workstream outputs on student engagement and support provide detail on how access to learning will be expanded and how support and guidance to students will be delivered. The proposed governance model for the new college will involve student and staff representatives being full members of the new

	board. This will ensure a range of interests and perspectives are represented. Governance of the new college must meet the provisions of, and the standards set by, Colleges Scotland's Code of Good Governance. This contains specific provisions on corporate social responsibility, including commitment to improving economic, social and cultural wellbeing, and leading on equality and diversity. An Equalities Impact assessment has been completed as part of the development of the preferred option.
6.4 Legal:	The primary legal consideration in reaching a decision on this matter is to ensure Best Value. Section 1 of the Local Government in Scotland Act 2003 states: "(1) It is the duty of a local authority to make arrangements which secure best value. (2) Best value is continuous improvement in the performance of the authority's functions. (3) In securing best value, the local authority shall maintain an appropriate balance among— (a) the quality of its performance of its functions; (b) the cost to the authority of that performance; and (c) the cost to persons of any service provided by it for them on a wholly or partly rechargeable basis. (4) In maintaining that balance, the local authority shall have regard to— (a) efficiency; (b) effectiveness; (c) economy; and (d) the need to meet the equal opportunity requirements. (5) The local authority shall discharge its duties under this section in a way which contributes to the achievement of sustainable development. (6) In measuring the improvement of the performance of a local authority's functions for the purposes of this section, regard shall be had to the extent to which the outcomes of that performance have improved. …..........................." Scottttish Government Guidance for Accountable Officers on Best Value in Public Services states, among other things: "Best Value ultimately is about creating an effective organisational context from which Public Bodies can deliver their key outcomes. It provides the building blocks on which to deliver good outcomes by ensuring that they are delivered in a manner which is economic, efficient, sustainable and supportive of continuous improvement." Section 20 of Local Government in Scotland Act 2003 states: "(1) A local authority has power to do anything which it considers is likely to promote or improve the well-being of— (a) its area and persons within that area; or (b) either of those. (2) The power under subsection (1) above includes power to— (a) incur expenditure, (b) give financial assistance to any person,

	(c) enter into arrangements or agreements with any person, (d) co-operate with, or facilitate or co-ordinate the activities of, any person, (e) exercise on behalf of any person any functions of that person, and (f) provide staff, goods, materials, facilities, services or property to any person. (3) The power under subsection (1) above may be exercised in relation to, or for the benefit of— (a) the whole or any part of the area of the local authority; (b) all or some of the persons within that area. …………….” This provision allows the Council to provide the guarantee specified in the report at section 4.0, Key Issues. Other Legal Matters If merger is approved, there are significant employment, pension, contract, procurement, conveyancing and other legal issues to be planned and addressed. These will be carried out by a combination of in house and external legal provision depending on the nature and extent of the requirements.
6.5 Finance:	The FBC demonstrates that the new college can be financially sustainable. Over the five year period modelled, the proposed new college nets savings of £12.2 million (excluding tax) compared with the status quo, based on 2018/19 budgets. The total cost to the Council of the proposed merged college is summarised as: - Retention of £0.4m of costs currently held within Shetland College and Train Shetland; - Support funding of £0.16m in the first year of operation of the merged college; - Potential additional support funding of £0.19m in the first and second year of operation of the merged college to cover tax costs; - Transition costs of £0.1m to enable the progression of the proposed merger; - Recruitment costs of £0.02m for the principal of the merged college; and - The provision of a financial guarantee for Shetland Islands Pension Fund, currently valued at £4.4m (subject to change by future actuarial valuations). Costs of £0.4 million currently held within Shetland College and Train Shetland will remain with the Council (recharges, Train Shetland building, current pensioner enhancements). The Council will become a customer on a commercial basis of the new college, rather than the deficit funder. To enable the merger, the model demonstrates that £0.16 million additional funding will be required by the merged college

	in year one, with no further gap funding required. This does not include tax implications, which have a provisional cost of £0.19 million (subject to confirmation by Deloitte). These costs will be met from a combination of current STERT budgets within Development Services supported by Council contingency. In addition to the above, it will be necessary at times to provide cash flow funding to mitigate for items such as course fee's which tend to be received in block payments. These arrangements will be further reported to Council. Costs associated with the implementation phase will be met from current STERT budgets in Development Services, supported by Council contingency. However, in previous college mergers, SFC have provided significant one off funding. A detailed bid will be submitted early in the new year. Until these costs are quantified and the SFC funding application approved, it is not possible to be specific about the Council requirement, however an additional budget of £0.1 million will be provided. Recruitment costs in relation to the Principal are £0.02 million, to be met from current recruitment budgets within the Council. The exact arrangements in relation to property costs will be developed in the next phase, but any cost will be nominal in value. A negotiated settlement will be reached to address pension cessation costs, and will be fully paid up on vesting. Part of this arrangement sees the Council take on the Pension Guarantee for the new college, which will be an admitted body within the Shetland Islands Pension Fund. This guarantee is estimated to be £4.4 million, however it will vary from year to year in line with actuarial valuations. Ongoing management costs within the colleges will be met from existing budgets.
6.6 Assets and Property:	To inform the FBC, an Asset Management Statement has been prepared which provides detail on the current estates portfolio occupied by the colleges and identifies issues required to be addressed, and opportunities for future development and delivery of services.
6.7 ICT and New Technologies:	To inform the FBC, an ICT Issues Report has been produced which summarises the consideration for ICT resources during the merger process and beyond.
6.8 Environmental:	None at this stage.
6.9 Risk Management:	Risk Management procedures are described in the Management Case of the FBC.

	A draft Risk Register has been developed which described and profiles key risks of the merger implementation phase and the workstream which should own these risks. This draft Risk Register is attached as Appendix 3 of the FBC.	
6.10 Policy and Delegated Authority:	The decisions in this report fall within the remit of the Council and its Committees, as set out in the Scheme of Administration and Delegations, as follows: **Shetland College Board** Shetland College Board has delegated authority to monitor progress against objectives approved by the Board or which have been set by the Council, including Strategic direction for Shetland College and Train Shetland. Approval of long term plans shall be reserved the Education and Families Committee and thereafter to SIC as a component of its longer term vision and wider strategic remit for learning at all stages of life. **Education and Families Committee** The Education and Families Committee has delegated authority to make decisions on matters within its functional areas in accordance with the policies of the Council, and the relevant provisions in its approved revenue and capital budgets. The Education and Families Committee functional areas include tertiary education and lifelong learning. **Policy and Resources Committee** The Policy and Resources Committee has delegated authority to secure the co-ordination, control and proper management of the financial affairs of the Council, and is responsible for the development and operation of the Council as an organisation in all matters relating to organisational development, staffing and structures. The Committee has referred authority to advise the Council in the development of its strategic objectives, policies and priorities. **Shetland Islands Council** The Council has reserved authority for determining Council priorities, policies or strategies that are of major significance.	
6.11 Previously Considered by:	N/A	

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Appendices:

Appendix 1 – Full Business Case – Effective and Sustainable Tertiary Education,

Research and Training in Shetland Project
Appendix 2 – Anderson Strathern – Legal Due Diligence Summary
Appendix 3 – Deloitte – Financial Assurance Report
Appendix 4 – Deloitte – Taxation **(THIS APPENDIX IS EXEMPT)**

Background Documents: None

Effective and Sustainable Tertiary Education, Research and Training in Shetland

Full Business Case

Version: 1.1

Issue Date: 05 December 2018

1. EXECUTIVE SUMMARY

1.1 Introduction

This Full Business Case (FBC) for the Effective and Sustainable Tertiary Education, Research and Training in Shetland Project forms the final stage of the process to identify the best value option for future delivery of tertiary education, research and training (TERT) in Shetland, which comprises those services currently delivered by Shetland College UHI (including Train Shetland) and NAFC Marine Centre UHI.

The previous stage of the process, the Strategic Outline Case (SOC), presented a detailed assessment of options and identified a preferred way forward. It is the purpose of the FBC to identify the value for money (VFM) option, to set out the arrangements for realising that option and demonstrate affordability. This has been achieved by reviewing the SOC and earlier decisions related to the project to ensure all assumptions and conclusions remain sound and that the case for change remains.

The FBC is not the plan for the future, it is a business case that demonstrates that the preferred option is achievable. The future plan will be development by the Principal and the Shadow/New Board of the merged college.

1.2 Structure and content of the document

This FBC has been prepared using the agreed standards and format for business cases, as set out in the Green Book Guidance issued by HM Treasury. The approved format is the Five Case Model, which comprises the following key components:

- the **Strategic Case** sets out the strategic context and the case for change, together with the supporting objectives for the project;
- the **Economic Case** demonstrates that the organisation has selected the option which best meets existing and future needs;
- the **Commercial Case** outlines the content and structure of the proposal;
- the **Financial Case** confirms funding arrangements and affordability;
- the **Management Case** demonstrates that the project is achievable and can be delivered successfully.

1.3 Strategic Case

1.3.1 The strategic context

The political priorities of the Council, community planning partners and government are clear in placing tertiary education, research and training (TERT) services at the heart of economic policy, given their vital role in delivering improvements to the economy through skills development, training, research and providing varied and high quality options for school leavers. The sector is crucial to the ambitions of the Shetland Partnership Plan and the 10 Year Plan, not least in the targets of creating new private sector jobs, growing the student population and increasing the number of local apprentices.

The development of a sustainable TERT sector should be clearly seen as an investment in the future of Shetland, and one which should be undertaken in partnership with learners, community planning partners, employers and the local community.

Growing the working age population and developing Shetland as a destination of choice to live, work, study and invest are core aims for community planning partners in Shetland. In order to achieve these aims, it is essential to establish and maintain a TERT sector which is financially sustainable, student-focused, delivers a high quality learning experience and which is properly engaged with learners, businesses and communities.

1.3.2 The case for change

The combined TERT sector is currently financially unsustainable. The total funding gap identified on the basis of approved budgets for 2018/19 is £2.1m. Given the continuing pressures on Council budgets, the requirement of local authorities to act in accordance with best value principles, and the need for continuing investment, it is essential that a delivery model be established which allows the sector to thrive and become financially sustainable.

The last few years have seen considerable efforts undertaken to determine the future of the TERT sector in Shetland, specifically with regard to the future governance and operation of Shetland College UHI (including Train Shetland) and NAFC Marine Centre UHI. Currently, services are financially unsustainable and are encumbered with complex governance arrangements – these are issues which must be resolved in order to encourage growth in the sector and secure the benefits which the education, research and training needs to deliver for the future.

In order to grow the student population, to increase income and impact from research and development, and to continue to provide positive impacts to the local population through improving skills, it is necessary to develop a financially sustainable model which is customer-focused, outcomes-driven and responsive to local needs, and which can retain and develop the resources required to deliver high quality learning and research services.

1.4 Economic Case

1.4.1 Critical Success Factors

The Critical Success Factors for this project have been developed to ensure that all key considerations are taken into account for the future of the tertiary education, research and training sector in Shetland. These are described below:

1) Develop a financially sustainable model for delivery of tertiary education, research and training in Shetland
    - Establish the most cost effective way to deliver the services in Shetland
    - Reduce the level of annual subsidy from Shetland Islands Council
    - Ensure the ability of the merged college to achieve assigned status to UHI as the Regional Strategic Body

2) Maintain and enhance quality standards in all aspects of service delivery
    - Ensure ability of services to meet quality requirements set by government and service delivery partners

3) Maximise future income
    - Ability to achieve income targets from students, learners, research and business services
    - Ability to respond quickly to income generating activity

4) Commit to a single clear, consistent and effective voice for the tertiary sector in Shetland
    - Develop a targeted business development and marketing strategy for the sector, with clear targets for growth and engagement
    - One clear, strong and focused voice at regional and national tables

5) Maintain local tertiary education, research and training presence, and build strong relationships with resource enablers and strategic partners
    - Maintain physical presence in Shetland
    - Build strong relationships with external organisations vital to the successful delivery of services

6) Simplify governance arrangements, and ensure the retention and attraction of appropriately skilled staff
    - Ensure appropriate management structure
    - Developed simplified governance structure for the sector

1.4.2 The long list

The long list of options developed as part of the options appraisal were as follows:

Table 1.1 Summary of long list options and findings

Options		Definition
1	Do Nothing	No further action is taken to change governance, management and funding arrangements of Shetland College, NAFC Marine Centre and/or Train Shetland.
2	Status Quo	Maintain existing governance, with joint management posts regularised, joint strategic plan adhered to and joint curriculum developed as per interim arrangements. Requirements for operational efficiencies would continue.
3	Create a single tertiary education, research and training centre within the Council ('Host SIC')	NAFC Marine Centre becomes part of the Council. Employment of staff is transferred, and all assets and liabilities are taken on by the Council.
4	Create a single tertiary education, research and training centre within UHI ('Host UHI')	Shetland College, NAFC Marine Centre and Train Shetland transfer from existing arrangement to organisational and operational control of UHI. Staff, governance and management transfer to UHI.
5	Create a single independent tertiary education, research and training	Creation of independent organisation comprised of operations of Shetland College, NAFC Marine

	centre, which is part of the UHI network (‘Host NAFC’)	Centre and Train Shetland, which is part of the UHI network, with SFTCT as the ‘host’ organisation.
6	Create a single independent tertiary education, research and training centre, which is part of the UHI network (‘New College’)	Creation of a new, independent organisation comprised of operations of Shetland College, NAFC Marine Centre and Train Shetland, which is part of the UHI network.
7	Shetland College and Train Shetland remain within SIC as part of Education & Families Committee; NAFC Marine Centre remains as is	Strategic oversight of Shetland College and Train Shetland is more closely aligned with SIC Children’s Services. NAFC remains as per status quo.
8	Provide only minimum amount of tertiary education, research and training in Shetland	No further investment from SIC in tertiary education, research and training. UHI and SFC fund only basic services.
9	Provide no tertiary education, research and training in Shetland	Disestablishment of Shetland College and Train Shetland by the Council. Core funding to NAFC Marine Centre discontinued.

1.4.3 The short list

A shortlisting assessment was undertaken which measured the capability of each option of achieving the goals of the previously defined Critical Success Factors. From this assessment, the following short list of options emerged (descriptions shortened for brevity):

- **Option 1** Do Nothing
- **Option 2** Status Quo
- **Option 3** Host SIC
- **Option 4** Host UHI
- **Option 5** Host NAFC
- **Option 6** New College

1.4.4 Options appraisal

In order to provide a ranking of options, a scoring mechanism was developed by the project team. This mechanism provided a score of 0 (low)-5 (high) based on the potential ability of each option to deliver against the Critical Success Factors.

Each Critical Success Factor contained two categories against which options were scored (with the exception of CSF2, which was weighted by a factor of 2 to bring the available score in line with the other CSFs).

The outcome of the detailed scoring process was as follows:

Table 1.2 Summary of initial scoring process

	Option					
	1	2	3	4	5	6
	Do Nothing	Status Quo	Host SIC	Host UHI	Host NAFC	New College
CSF1	0	0	3	4	10	10
CSF2	2	8	8	10	10	10
CSF3	2	6	2	8	10	10
CSF4	0	5	8	6	10	10
CSF5	6	6	7	8.25	10	10
CSF6	2	2	5.5	7	9	9
TOTAL	12	27	33.5	43.25	59	59

The scoring process demonstrated that two options from the shortlist were clearly preferable. These were:

- Option 5 – 'Host' NAFC
- Option 6 – New College

In line with Green Book guidance on using the Five Case Model, development of the Full Business Case requires that options appraisals be revisited, and "*the FBC must demonstrate that the conclusions of the economic appraisal…remain valid*." This must take into account where "*new information affecting the ranking of the options may have become available*." For this reason, further information and recommendations arising from legal advice and diligence reports have been considered and factored into the revised options appraisal.

Revisiting the scoring model for Options 5 and 6 on the basis of the revised CSFs produces the following results[1]:

[1] As another scoring factor has been added under CSF1, the weighting to CSF2 applied in the initial scoring process has been removed.

Table 1.3 Summary of revised scoring process

	Option	
	5	6
	Host NAFC	New College
CSF1	10	15
CSF2	5	5
CSF3	10	10
CSF4	10	10
CSF5	10	10
CSF6	9	9
TOTAL	54	59

1.4.5 The preferred option

Conclusion: the preferred option is **Option 6 – New College**, because it has been evaluated as providing the highest chance of achieving the objectives specified by the Critical Success Factors.

Option 5 – Host NAFC provided a high degree of benefits against almost all of the Critical Success Factors; however, it was evaluated to have a high degree of risk with regard to being able to achieve assigned status with UHI, and therefore scored lower than Option 6.

None of the other options were considered to provide a high degree of benefits against the Critical Success Factors, and have therefore been discounted.

1.5 Commercial Case

1.5.1 Required services

The required service to be delivered as part of the proposed deal is a model for delivery of tertiary education, research and training in Shetland which:

- is financially sustainable;
- incorporates a model of governance and management which is appropriate to local conditions and is fit-for-purpose;
- delivers a high quality learning and training experience, maintaining and enhancing current quality standards;
- delivers high quality research services to the benefit of local industry;
- is responsive to local needs and delivers against strategic targets as identified in the Strategic Case;

- is physically located in Shetland;
- consists of a single consistent identity for the tertiary sector in Shetland;
- is capable of delivering a clear business development and marketing strategy emphasising engagement and growth.

The Commercial Case considers arrangements for and delivery of the above services in terms of:

- Governance, Management and Legal
- Academic Benefits
- Student Issues
- Assets and Property
- Marketing, Research and Commercialisation

1.6 Financial Case

1.6.1 Key messages

The financial model demonstrates that the merged college can achieve and maintain a financially sustainable position. This means that not only will it be able to meet its costs in any given year, but that it will be able to plan and invest for the future.

The preferred option is substantially more sustainable than the status quo. Over the five year period assessed the preferred option nets savings of £12.2m compared with the status quo, excluding tax. This saving can be achieved through streamlining and maximising the efficiency of the college structure and curriculum, whilst improving outcomes delivered for students and staff.

1.6.2 Merged College – Projected Income and Expenditure Account

Proposed New Entity - Income and Expenditure Summary (exc VAT)	Year 1 £000	Year 2 £000	Year 3 £000	Year 4 £000	Year 5 £000
Employee Costs	4,559	4,632	4,771	4,915	5,062
Premises Costs	521	532	542	553	564
Operating Costs	1,015	1,036	1,056	1,078	1,099
Grants to Individuals/Organisations	3	3	3	3	3
Marketing	33	34	35	35	36
Professional and Financial Fees	208	214	221	227	234
Travel/Vehicle Expenses	149	152	155	158	161
TOTAL EXPENDITURE	**6,489**	**6,603**	**6,784**	**6,969**	**7,160**
Scottish Funding Council	- 2,567	- 2,727	- 2,891	- 2,977	- 3,065
Tuition Fees, Contracts & Grants	- 1,770	- 1,838	- 1,909	- 1,955	- 2,002
Research Grants and Contracts	- 1,063	- 1,107	- 1,177	- 1,290	- 1,383
Sale of Meals	- 96	- 98	- 100	- 102	- 104
Consultancy	- 153	- 166	- 190	- 210	- 216
Management & Service Fees	- 385	- 405	- 433	- 459	- 472
Other Income	- 296	- 301	- 307	- 314	- 320
Bank Interest	- 2	- 2	- 2	- 2	- 2
TOTAL INCOME	**- 6,331**	**- 6,645**	**- 7,009**	**- 7,307**	**- 7,564**
(Favourable) / Adverse	**158**	**(41)**	**(225)**	**(338)**	**(403)**

1.6.3 Overall Sustainability

The proposed merged college is a more prudent use of resources by Shetland Islands Council compared with the status quo, and it demonstrates sustainability moving forward. It reduces the financial commitment required by the Council by £1.8m.

1.7 Management Case

1.7.1 Project management arrangements

The project will be managed in line with PRINCE2 methodology. As such, the Shadow Board will take on the role of the Project Board in the PRINCE2 management structure, with the co-chairs acting as the Senior Executive.

The Shadow Board will be responsible for appointing the Project Manager. An external Project Advisor resource with experience in college merger will also be appointed to take on the role of Project Assurance.

1.7.2 Benefits realisation and risk management

Proposed arrangements for benefits realisation and risk management are attached.

1.8 Recommendation

This Full Business Case recommends **Option 6 – New College** as the preferred option for the Effective and Sustainable Tertiary Education and Training in Shetland Project.

Signed:

Date:

Senior Responsible Owner Project
Project Team

2. THE STRATEGIC CASE

2.1 Introduction

The purpose of the Strategic Case is to explain how the scope of the proposed project or scheme fits within existing business strategies, and to identify the preferred way forward by providing a compelling case for change, in terms of existing and future operational needs.

2.2 Part A: The strategic context

2.2.1 Organisational overview

Shetland

The 2017 Mid-Year Population Estimates for Scotland estimated Shetland's population at 23,080, spread across 16 inhabited islands, with the main population centre of Lerwick home to roughly 7,000 inhabitants.

Employment in Shetland is dominated by public administration, which accounts for 21.2% of full-time equivalent (FTE) employment. The next largest sectors in terms of employment are wholesale/retail (12.5%) and construction (8.1%)[2].

The most recent economic survey conducted in Shetland found the overall output value of the local economy (based on combined output from all sectors) to be £1,091.4m, of which around £198m can be attributed to public services and £310.5m can be attributed to combined fisheries operations (fish catching, aquaculture and fish processing)[3].

Shetland Islands Council

Shetland Islands Council is the local authority for Shetland, established by the Local Government (Scotland) Act 1973. The Council delivers services including, but not limited to, education, environmental health, roads and ferries, port

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[2] Shetland Employment Survey 2017, Shetland Islands Council

[3] Dyer, G. and Roberts, D. *An Analysis of the Shetland Economy Based on Regional Accounts 2010-11,* p.6

services, planning, community development, economic development and social care.

The Council is structured around five Directorates:

- Children's Services;
- Community Health and Social Care Services;
- Corporate and Executive Services;
- Development Services;
- Infrastructure Services.

The above Directorates encompass the various services the Council operates to deliver on its statutory responsibilities and priorities.

Shetland Fisheries Training Centre Trust

Shetland Fisheries Training Centre Trust (SFTCT) promotes the development of the Shetland fisheries and maritime sectors, including fish catching, fish processing, fish farming, marine engineering, navigation, seamanship, research and all related ancillary activities. It does this through advice, support, training and research.

SFTCT is a registered charity governed by a Board of Trustees; the Board is comprised of representatives of the local seafood industry and a number of independent appointees, and is responsible for operating NAFC Marine Centre UHI.

Shetland College UHI

Originating in 1970 as the Shetland College of Further Education, Shetland College is an academic partner of the University of the Highlands & Islands (UHI) and a part of Shetland Islands Council's Development Services Directorate.

The College offers a wide range of study options, from national certificates to postgraduate degrees, across a variety of subjects, including creative industries, ICT, business & hospitality, health & social care and construction.

Facilities at the College include an Apple Mac suite, video conferencing facilities and construction workshops, as well as the Textile Facilitation Unit, which hosts three Shima Seiki knitting systems and a range of finishing equipment. The College also hosts the UHI Chair in Rural Creativity, and is one of three key locations (including Orkney and Perth Colleges) from which the Institute for Northern Studies operates. Creative courses, including music and film, are delivered in Mareel through a Service Level Agreement with Shetland Arts Development Agency.

Shetland College also includes the Train Shetland service, which comprises two separate functions:

- Short Courses delivers a range of training courses to employers in Shetland across various disciplines, including first aid, business management, ICT, health & safety and construction. The centre is accredited by a number of compliance bodies including Highfield ABC, REHIS and OCR, and is the local Construction Plant Competency Scheme (CPCS) centre. Short Courses provides business and related training as part of the local Business Gateway service, and also operates as an examination centre for professional bodies and further/higher education institutes outside of Shetland.

- Vocational Training co-ordinates Modern Apprenticeships across a range of industries, including construction, business & administration, health & social care, engineering, vehicle maintenance, agriculture, hospitality and services. This is done through an annual delivery contract with Skills Development Scotland.

Shetland College operations are under the authority of the Shetland College Board, while overall strategic authority remains with the Education & Families Committee. Staffing issues are under the authority of the Policy & Resources Committee.

The College employs 31.7 FTE lecturing staff and 26.6 FTE support staff, plus 5 FTE staff in Train Shetland Short Courses and 4.7 FTE staff in Train Shetland Vocational Training.

Shetland College's main campus is located at the Gremista Industrial Estate in Lerwick, with Train Shetland located in an adjacent building. The College also operates rural learning centres in Yell, Unst, Whalsay, Brae and Lerwick.

NAFC Marine Centre UHI

Originating in 1992 as the North Atlantic Fisheries College, NAFC Marine Centre is an educational and scientific institute which supports training and development in Shetland's maritime industries, including the seafood sector. The Centre is an academic partner of UHI and is operated by SFTCT.

NAFC Marine Centre delivers a range of training and qualifications related to maritime industries – this includes qualifications in the engineering, fish catching and aquaculture sectors (including Modern Apprenticeships), and courses to train and qualify seafarers, including the Merchant Navy Cadet Programme.

NAFC carries out a range of applied research and development projects in subjects relevant to the fishing and aquaculture industries, marine spatial planning and the marine environment in general. These include the assessment of shellfish stocks, analysis of fish catching trends, provision of fisheries management advice in support of policy development, and the preparation of the Shetland Islands Marine Spatial Plan and associated guidance. Research can be provided on a contract or consultancy basis.

Facilities at NAFC include a ship bridge simulator, research/teaching laboratories, a marine hatchery and engineering workshops. The NAFC Marine Centre operates a number of vessels for research, survey, training and other purposes – these include a 12m fishing vessel and a 12.5m survey/training vessel which is equipped to carry out seabed and hydrographic survey work and benthic sampling, as well as for nautical training.

NAFC employs 18.2 FTE staff in Marine Sciences, 16.5 FTE staff in Training and 10.1 staff in Central Services.

The NAFC Marine Centre campus is located at Port Arthur in Scalloway.

Tertiary Education Sector in Shetland: Strategic Plan 2017-2019

A joint strategic plan for the tertiary education services in Shetland, comprising Shetland College, NAFC Marine Centre and Train Shetland, was developed in 2017 as a response to the requirement for a closer integration of services, with a view to integration of management structures in the future. The plan describes the following vision:

> *"NAFC Marine Centre, Shetland College and Train Shetland will work together to help build the future of Shetland through education, training and research".*

The joint strategic plan identifies six strategic goals for the period up to 2019:

- Respond to the needs of Shetland;
- Deliver high quality learning experiences and successful outcomes for all learners;
- Carry out high quality research;
- Provide high quality governance, leadership and management structures;
- Grow our business;
- Build sustainability.

The Tertiary Education in Shetland Operating Plan 2017-2019 identifies a series of key actions scoped to deliver against each strategic goal.

A summary of approved budgets for the combined tertiary education services for 2018/19 is provided below:

Table 2.1 Summary of combined SC, NAFC and TS approved budgets 2018/19

EXPENDITURE	**£,000**
Employee Costs	5,115
Premises Costs	1,373
Operating Costs	1,720
Total Expenditure	**8,208**
INCOME	**£,000**
SFC Funding	-2,407
Curricular Income	-1,652
Research Income	-955
Other Income	-1,102
Total Income	**-6,116**
(Favourable)/Adverse	**2,092**

2.2.2 Business strategies

Local

Shetland Islands Council: Our Plan 2016 to 2020

Ensuring inclusive growth through developing the skills of local people and creating well-paid jobs is a core part of the Council's vision. The Council's Plan states:

> *"A stronger economy which has well-paid jobs available to more people has the potential to produce a more prosperous and fairer society in Shetland.*
>
> *The long-term community plan aim is for Shetland to have good places to live as well as sustainable economic growth with employment opportunities, and for our residents to have the skills they need to benefit from those opportunities."*

The Council's Plan highlights the following as priorities for improving the economy and quality of life in Shetland:

- The tertiary education, research and training project will have created an effective model for providing excellent services to our learners;
- There will be opportunities for people with all levels of skills, and there will be a close match between the skills that businesses need and those that the trained workforce have;
- We will have an economy that promotes enterprise and is based on making full use of local resources, skills and a desire to investigate new commercial ideas.

Shetland's Partnership Plan 2018-2028

The Shetland Partnership, of which the Council is a key member, is the Community Planning Partnership for Shetland. The Shetland Partnership Plan 2018-2028 reflects the shared vision of the local area and the partner organisations:

“Shetland is a place where everyone is able to thrive; living well in strong resilient communities; and where people and communities are able to help plan and deliver solutions to future challenges.”

The Shetland Partnership Plan sets out the shared priorities of the Shetland Partnership for 2018-2028, which are as follows:

- People
    - Individuals and families thrive and reach their full potential
- Participation
    - People participate and influence decisions on services and use of resources
- Place
    - Shetland is an attractive place to live, work, study and invest
- Money
    - All households can afford to have a good standard of living.

The following targets will be addressed by maintaining and developing a sustainable TERT sector in Shetland:

- 97% of school leavers will be in positive destinations (education, employment, training, and personal development) in 2021, rising to 98% by 2028 (currently 96.1%);
- No more than 15% of businesses are struggling to fill vacancies due to a lack of local labour in 2021, and no more than 5% in 2028 (currently 20%).

The relevant ten-year outcomes from the Plan are as follows:

- Place
    - People will be accessing employment, education and services in new and innovative ways designed to minimise barriers to involvement for all
    - Shetland will be attracting and retaining the people needed to sustain our economy, communities and services
- Money
    - Everyone will be able to access the support they need to maximise their income potential; including innovative, flexible

and entrepreneurial employment opportunities throughout Shetland

- People
    - The number of disadvantaged people and households in Shetland will be considerably reduced as a result of people being enabled and empowered to address the issues they face and helping others to thrive in the same way.

Securing the future of TERT services in Shetland will contribute to the Shetland Partnership Plan's achievement of the following National Outcomes within Scotland's National Performance Framework:

- We are creative and our vibrant and diverse cultures are expressed and enjoyed widely
- We have a globally competitive, entrepreneurial, inclusive and sustainable economy
- We are well educated, skilled and able to contribute to society
- We have thriving and innovative businesses, with quality jobs and fair work for everyone
- We are open, connected and make a positive contribution nationally.

<u>10 Year Plan to Attract People to Live, Study, Work and Invest in Shetland</u>

A key objective for the Shetland Partnership is to develop and implement a ten-year action plan to attract people to live, work, study and invest in Shetland. This plan is predicated on the link between a healthy demographic balance and the ability to sustain communities and services, and compete economically.

The vision of the 10 Year Plan is:

"In 2028 Shetland will:

- *Be an island of opportunity for young people, businesses and investors;*
- *Be a vibrant and positive student destination;*
- *Have a more balanced demographic profile and a growing population underpinned with more private sector jobs."*

In order to achieve this vision, one of the objectives of the plan is:

- Foster an environment that supports entrepreneurship and sustainable learning and research.

Under this objective, the plan identifies the following key priorities:

- Expansion of Modern Apprenticeship programmes across all disciplines, and access funding from the Apprenticeship Levy;
- Development of FE programmes in developing skills areas, and work with local businesses and community partners to develop a skills investment plan;
- Further develop HE programmes which retain and attract in students e.g. the performing arts programme with Shetland Arts in Mareel;
- Facilitate the provision of student accommodation;
- Provision of short courses for businesses;
- Priority will be given to highly applied, industry specific research that supports sectors of local economic importance;
- A vibrant post-graduate research community will be developed within Shetland.

Regional

University of the Highlands and Islands: Strategic Vision and Plan 2015-2020

The University of the Highlands and Islands (UHI) is an integrated university comprised of 13 academic partners across the Highlands and Islands region of Scotland, which include Shetland College and NAFC Marine Centre.

UHI is the Regional Strategic Body (RSB) for the Highlands and Islands, as established under the Further and Higher Education (Scotland) Act 2005 (amended by the Post-16 Education (Scotland) Act 2013) to support a regional approach to the planning and funding of college provision. As the RSB, UHI is accountable to the Scottish Funding Council (SFC) for the use of public funds which it disburses in the form of grant payments to partner colleges, and must exercise its functions to secure coherent, high quality further and higher education in its colleges, and monitor the performance of these colleges. The relationship between UHI (as the RSB) and the partner colleges is defined by Financial Memoranda, which detail the responsibilities and requirements of each for the stewardship of public funds.

The strategic vision for UHI comprises the following themes:

- The university will act as a force for economic, social and cultural change across the region by connecting and collaborating with businesses, public and third sector partners and communities;
- The university will continue to meet the needs of learners within the region, while targeting growth in our share of young entrants and students from beyond the region;
- The university's research will be recognised internationally, nationally and regionally for its quality and for its contribution to our remit of transforming and enhancing lives, the environment and the economy.

Highlands and Islands Regional Tertiary Outcome Agreement 2017-2020

Through Outcome Agreements, colleges and universities in Scotland set out what they plan to deliver in exchange for funding from SFC. The Highlands and Islands Regional Tertiary Outcome Agreement 2017-2020 details the agreed aims, priorities and outcomes for the delivery of education, research and training through the UHI, and how these will deliver on SFC objectives.

The aims, priorities and outcomes agreed in the Regional Outcome Agreement are:

- Access
  - HE Priority 1: Widening Access – learning that is accessible and diverse attracting and providing more equal opportunities for people of all ages and from all communities and backgrounds;
  - FE Outcome: Access – a more equal society because learning is accessible and diverse attracting and providing more equal opportunities for people of all ages and from all communities and backgrounds.

- High quality learning and teaching
  - HE Priority 2 and FE Priority – an outstanding system of learning that is accessible and diverse where students progress successfully with the ability, ideas and ambition to make a difference;
  - FE Outcome: an outstanding system of learning where all students are progressing successfully and benefitting from a

world-class learning experience in the hands of expert lecturers delivered in modern facilities;
    - Outcome: a more successful economy and society with well prepared and skilled students progressing into jobs with the ability, ideas and ambition to make a difference.

- Research
    - HE Priority 3: World leading research – world-leading universities, nationally and internationally connected with a global reputation for their research.

- Innovation
    - HE Priority 4: Greater innovation in the economy – a national culture of enterprise and innovation leading to a more productive and sustainable economy.

- High performing institutions
    - HE Priority 5: FE Outcome – a coherent system of high-performing, sustainable institutions with modern, transparent and accountable governance arrangements.

Highlands and Islands Skills Investment Plan

In October 2014, Skills Development Scotland (SDS), the Scottish Funding Council (SFC) and Highlands and Islands Enterprise (HIE) launched the *Skills Investment Plan (SIP) for Highlands and Islands*. This was the culmination of discussion, research and consultations on finding the best way to realise the ambitions of the three agencies to position the Highlands and Islands as a region with outstanding skills and the potential for development, in light of emerging economic opportunities.

The Skills Investment Planning approach is intended to bring skills demand and supply closer together, and to contribute to a vibrant economy by supporting individuals to develop the skills needed by industry. The H & I SIP sets out:

- the region's economic performance and sectoral and local assets;
- the performance of the regional labour market and associated demographic challenges;
- skills issues facing employers within the region;

- opportunities and challenges related to future economic and employment growth;
- assessment of current education and training provision.

This extensive and robust evidence base is used as the basis for a framework for future regional action on skills issues. Five key themes were identified as priorities for action with a range of specific interventions and activities identified for each. The themes are:

- Meeting the current skills needs of employers;
- Planning for the future;
- A region for young people;
- People attraction and place attractiveness;
- Strengthening the employer voice in the skills system.

The actions set out in the SIP are intended to have an impact on:

- numbers of young people entering positive destinations on leaving school;
- numbers of young people staying within the Highlands and Islands on leaving school, college and university as a result of good quality education, training and employment opportunities being on offer;
- reducing the number of businesses reporting difficulties accessing skills training;
- increasing the number of businesses reporting growth in their workforce;
- the scale and range of continuing professional development provision available within the Highlands and Islands.

The SIP is helping guide skills planning and investment decision-making within the Highlands and Islands. However, the Highlands and Islands is a large and diverse area, and employment and skills issues are often local in their focus – reflecting the boundaries of local labour markets, and the specifics of local economies.

In response to the above, a local Skills Investment Plan is currently under development.

National

Scotland's Economic Strategy

Scotland's Economic Strategy describes the actions the Scottish Government plan to take to develop the priority of sustainable growth. These include:

"Invest in Scotland's people at all stages of life to ensure that we have a well skilled, healthy and resilient population and an innovative, engaged and productive workforce;

Support the development of highly innovative businesses across the Scottish economy;

Encourage more of Scotland's diverse business base to engage in innovation and research and development as part of their day-to-day activities;

Continue to support the high-impact, world-class research of Scotland's Universities and improve levels of commercialisation of academic research."

Colleges Scotland: Colleges Sector Statement of Ambition (Draft) 2018-2023

The purpose of Colleges Scotland's Statement of Ambition is to set out a vision, mission and set of values for the college sector for the next five years (2018-2023). A set of underpinning ambitions have also been outlined which will support the achievement of the vision by the sector:

"Colleges have a critical role supporting individuals and businesses in Scotland as well as providing community leadership in the regional economies in which we are situated.

Our sector's three ambitions are outlined below:

1. Supporting a successful Scottish economy today and into the future

2. To be at the heart of Scotland's communities

3. For our people: students, staff and partners"

The future

The development of a sustainable TERT sector should be clearly seen as an investment in the future of Shetland, and one which should be undertaken in partnership with community planning partners, learners, employers and the local community.

Growing the working age population and developing Shetland as a destination of choice to live, work, study and invest are core aims for community planning partners in Shetland. In order to achieve these aims, it is essential to establish and maintain a TERT sector which is financially sustainable, student-focused, delivers a high quality learning experience and which is properly engaged with learners, businesses and communities.

The political priorities of the Council, community planning partners and government are clear in placing TERT services at the heart of economic policy, given their vital role in delivering improvements to the economy through skills development, training, research and providing varied and high quality options for school leavers. This sector is crucial to the ambitions of the Shetland Partnership Plan and the 10 Year Plan, not least in the targets of creating new private sector jobs, growing the student population and increasing the number of local apprentices.

Current services are expensive to maintain, and are operated separately in a manner which is not conducive to implementing a cohesive strategy for the local sector. In order to reduce the draw on public finances which support the separate institutions, and to develop a more sustainable, responsive and learner-friendly sector to grow the student population and take advantage of economic opportunities, restructuring is required.

Demand for a more highly skilled workforce is borne out from the results of the Shetland Employment Survey 2017, which showed that 20% of employers cannot fill vacancies due to a lack of local labour, while 23% said that the basic employability of candidates for vacancies is a problem. Further, of those businesses who stated they had plans to invest in the next three years, 28%

said that they have plans to invest in their workforce, while only 27% of local employers said that they were able to source all their training needs in Shetland.

Following the Shetland Employment Survey 2017, a dedicated skills survey was carried out in order to gather information on recruitment and skills issues, in order to inform local skills planning. As part of this survey, employers were specifically asked about experiences with the local tertiary sector, and the draft report makes the following summarised statement:

> *"It was felt both local training providers and SIC could liaise more with industry, to discuss potential future workload, and required skills and training. It was further felt that local training providers could be more proactive in terms of marketing their services to employers. Long waiting periods for training courses locally, cancellation of courses at short notice, irregular running of courses, and minimum numbers required for training were raised as issues. Increased use of IT, web and cloud based services was raised as a major change in recent years."*

Only 24% of respondents to the skills survey stated that they felt communication and consultation between employers and training providers was good, while 68% felt that employers should be involved in curriculum development, suggesting a need for change in the local sector.

Uncertainty over the future of TERT services in Shetland has ongoing negative impacts for the sector, including loss of key staff, inability to invest for the future, difficulties in cultivating and maintaining strategic relationships and the lack of coherent long-term planning. For those reasons it is essential to identify a suitable option for delivery of these services and provide a clear direction of travel for the future.

Context for the Full Business Case

SFTCT confirmed at a meeting of their Board on 23 November 2017 that they were committed to the process of planned merger and would assist fully with the development of a business plan for the whole sector.

At a joint meeting of representatives from Shetland College, NAFC Marine Centre, SFC and UHI on 16 April 2018, it was agreed that a business case be prepared examining options for a restructuring of the organisations involved in delivering tertiary education, research and training in Shetland.

A Strategic Outline Case (SOC) was developed which identified a long list of options, and then refined these options to determine a preferred way forward for the sector.

The SOC was presented to Shetland Islands Council on 23 May 2018 [Min Ref: 30/18]. The decision of the Council was:

- To approve the merger of tertiary education, research and training services as the preferred way forward as identified in the SOC;
- To note the preferred way forward contains two options; namely the 'Host' NAFC option and the New College option;
- To delegate authority to the Chief Executive (or her nominee) to take any action and decisions required to develop the Full Business Case for the preferred option, which will be reported to Committees, Board and Council for a decision in October 2018;
- To delegate authority to the Chief Executive (or her nominee) to procure and engage any specialist legal or other services required to develop and finalise the Full Business Case;
- To agree that the delegation of authority granted to the Shetland College Board on 29 June 2016 [Min. Ref. SIC 53/16] to support potential further stages of the Project remains in place until September 2019;
- To delegate authority to the Director of Development (or his nominee), in consultation with the Chair of Shetland Fisheries Training Centre Trust (SFTCT), to extend the Interim and Joint management arrangements up to the end of the 2018/19 academic term (July 2019).

Following the decision, a Project Board was established consisting of the Chief Executive of Shetland Islands Council and the Interim Joint Principal of Shetland College, NAFC Marine Centre and Train Shetland. A Project Initiation Document was drafted and approved, and a Project Manager appointed to establish a team to develop the various workstreams necessary to inform the merger decision.

The workstreams identified were:

- Business Development;
- Curriculum;
- Estates;
- Finance;
- Governance;
- IT;
- Research;
- Staffing and HR;
- Student Engagement, Support and Marketing;
- Vision and Culture.

The Full Business Case is based on the information generated from the workstreams.

2.3 Part B: The case for change

2.3.1 Project objectives

The last few years have seen considerable efforts undertaken to determine the future of the TERT training sector in Shetland, specifically with regard to the future governance and operation of Shetland College UHI (including Train Shetland) and NAFC Marine Centre UHI. Currently, services are financially unsustainable and are encumbered with complex governance arrangements – these are issues which must be resolved in order to encourage growth in the sector and secure the benefits which the sector delivers for the future.

In order to grow the student population, to increase income and impact from research and development, and to continue to provide positive impacts to the local population through improving skills, it is necessary to develop a financially sustainable model which is business-driven and responsive to local needs, and which can retain and develop the resources required to deliver high quality learning and research services.

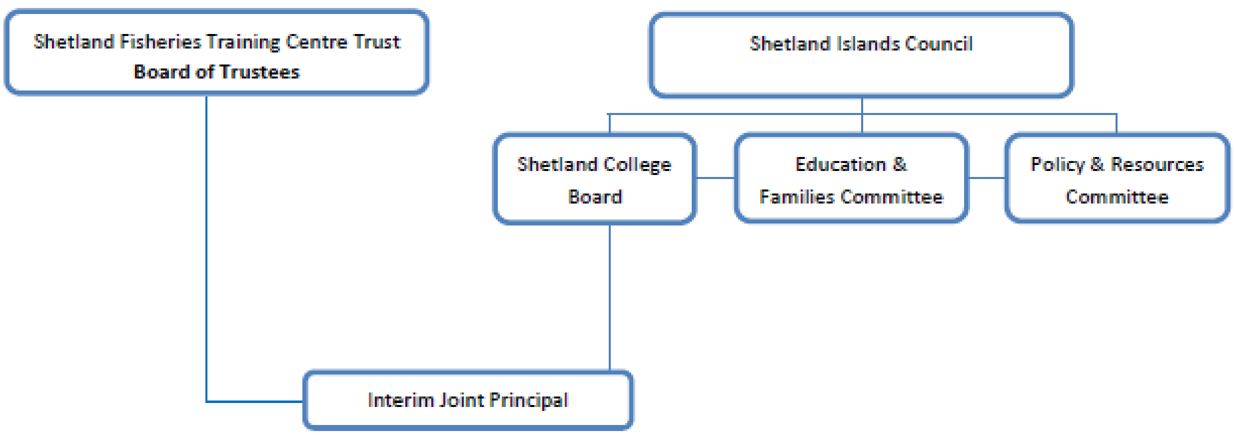
In terms of scale, on the basis of approved budgets the combined cost of operating Shetland College UHI, NAFC Marine Service UHI and Train Shetland for 2018/19 is £8.2m, with a combined income estimated at £6.1m. This results in an estimated funding gap of £2.1m.

2.3.2 Existing arrangements

Shetland College UHI (including Train Shetland) is managed by the Interim Joint Principal and is part of the Council's Development Directorate. The College reports directly to Shetland College Board on operational matters and Education and Families Committee on wider strategic matters. Staffing issues are a matter for the Policy and Resources Committee.

NAFC Marine Centre is also managed by the Interim Joint Principal. SFTCT has overall authority for NAFC Marine Centre.

The Interim Joint Principal reports to both Shetland College Board and SFTCT, as per the following governance structure:



Directly reporting to the Interim Joint Principal are:

- Acting Depute Principal (with responsibility for academic and quality management);
- NAFC Head of Central Services;
- NAFC Joint Heads of Marine Science;
- NAFC Head of Training and Skills (vacant);
- Acting Train Shetland Short Courses Manager;
- Acting Train Shetland Vocational Training Manager (shared post);
- Acting Shetland College Operations Manager (shared post);
- Shetland College Administration Manager.

Finance, legal, human resources and other corporate services for Shetland College are currently managed by the relevant Council departments. These services are managed in-house by NAFC Marine Centre.

2.3.3 Business needs

The combined TERT sector is currently financially unsustainable. The total funding gap identified on the basis of approved budgets for 2018/19 is £2.1m. Given the continuing pressures on Council budgets, and the requirement of local authorities to act in accordance with best value principles, and the need for continuing investment, it is essential that a delivery model be established which allows the sector to become financially sustainable.

Governance arrangements differ across the different services, but the requirements for Shetland College to fit within the Council directorate structure (with authority ultimately coming from Council committees), and the requirement for Council funding to support NAFC Marine Centre, mean that arrangements are complex and not conducive to collaborative strategic planning, timely decision-making or the development of a single 'voice' with which to market and promote the sector. Simplification of governance and management is required to enable a more entrepreneurial, stable and customer-focused environment.

Arrangements at almost all levels of management in the respective services are currently on an interim basis either utilising short term and/or acting up contracts to fill key gaps, or leaving posts unfilled. This must be replaced with a fit-for-purpose management structure with permanent posts.

The ability to deliver on strategic goals for the local sector is hampered by the complexity of current arrangements, the unsustainable financial position, and the overall instability and uncertainty faced by the sector. Delivering the maximum benefit for people and businesses in Shetland, and promoting a high quality, innovative environment to schools, employers and partners with a single voice is essential for the future of the sector and the realisation of economic goals for Shetland. Future strategic planning must include strategies for business development and marketing which emphasise growth and employer engagement.

A single voice is also essential for the maintenance of relationships with key strategic partners and enablers, with particular emphasis on UHI and SFC. UHI is keen that the instability relating to its affiliated partners in Shetland is resolved to the good of the sector and to learners in Shetland, while the SFC has made it clear that the current situation of funding two institutions in Shetland is undesirable and unsustainable, and will not continue to support it. The resolution of this is vital for the future of skills and training delivery in Shetland, while the maintenance of quality standards set by other delivery partners, including the Scottish Qualifications Authority (SQA), SDS (through whom Modern Apprenticeship contracts are managed), Seafish, CSCS, REHIS and others is essential for the current functioning and future development of the services.

<u>The impacts of not proceeding with merger</u>

Current arrangements, with three separate institutions, are not financially sustainable. Without a decision to merge, the ability of services to operate in the future will be in doubt. A number of key resource gaps limiting the ability of the sector to operate effectively, notably in business development, marketing and student support, have been identified and without resourcing these areas the ability of the institutions to grow business and delivery high quality services will be impacted.

The Council's auditors are required to consider the Council's arrangements in place to secure Best Value and to ensure value for money, and have been aware that a project was underway in order to achieve this with regards to tertiary education in Shetland. While having previously not commented on the provision of deficit funding to the sector, the auditors would be required under auditing standards to consider the compliance of this arrangement (or any subsequent arrangement) with the Council's statutory duty to secure Best Value and the Code on Following the Public Pound if concerns are raised that the arrangement is non-compliant. This will become particularly relevant if a decision not to merge is taken, as there will no longer be a process in place to achieve Best Value in the tertiary sector in Shetland.

Given that this process has gone through various iterations over a number of years, staff morale has suffered considerably as a result of ongoing uncertainty. The failure of yet another attempt to resolve this issue will lead to a loss of confidence, further impact on morale and lead to even more uncertainty.

The requirement to maintain multiple management and governance structures will be a lost opportunity in terms of streamlining the services and achieving integration.

Without a TERT sector which is financially sustainable, appropriately managed and governed, and which is capable of sound strategic and operational planning, it is unlikely that many of the goals of the Shetland Partnership Plan and the 10 Year Plan can be achieved. It is also likely that the loss of key services as a result of financial instability will have a negative impact on businesses and individuals who require local access to training and qualifications.

Issues arising from consultation

Between December 2017 and February 2018, consultations were undertaken with staff and students of Shetland College, NAFC Marine Centre and Train Shetland to examine attitudes to proposals for the future of the services. What follows is a summary of the full report.

Staff Consultations

A variety of investigative techniques were used to determine attitudes to the status quo and to proposals for the future of the services. The first table presents the results of an activity in which staff were presented with a series of positively written statements and asked to indicate the extent with which they agreed or disagreed. The table presents the statements and the net agreement score, calculated by subtracting the percentage of those who disagreed from those who agreed.

Table 2.2 Staff consultation – summary of statements and net agreement score

	Net agreement score (-100 to +100)			
Statement	NAFC Marine Centre	Shetland College	Train Shetland	All
My organisation would benefit from closer working with the other post school education organisations in Shetland	+39	+77	+90	+53
The student experience in Shetland could be improved with much stronger joint working amongst NAFC Marine Centre, Train Shetland and Shetland College	+35	+63	+50	+49
There is very good cooperation and collaboration amongst staff within the organisation	+49	+37	+90	+47
There is very good cooperation and collaboration between my organisation and the business community in Shetland	+72	+3	+100	+43
At present I feel very secure about my future employment	-15	-16	0	-14
There is very good cooperation and collaboration amongst NAFC Marine Centre, Train Shetland and Shetland College	-26	-40	+90	-21

Although there is some level of disparity in the responses from the individual organisations, in general responses to this exercise suggest that staff believe that there are benefits to be gained from the tertiary sector working more closely together, and improvements to the student experience could be realised from stronger joint working. There was also general agreement among staff regarding good levels of collaboration and co-operation with the local business community.

However, positive agreement with these statements was offset with disagreement that there is good cooperation and collaboration between NAFC Marine Centre, Shetland College and Train Shetland, and that staff currently feel secure in their employment.

Overall, the responses suggest that staff see potentially significant benefits from closer collaborative working, but that current arrangements have left many staff feeling insecure in terms of future employment.

Staff were also asked to rate the probability of achieving a successful outcome from a number of options under consideration—these were maintaining the status quo, merger of the organisations, or integration with UHI. The table below summarises the responses:

Table 2.3: Staff consultations: outcomes

	Chances of a positive (negative) outcome			
Option	**NAFC Marine Centre**	**Shetland College**	**Train Shetland**	**All**
Status quo	49% (51%)	42% (58%)	66% (34%)	48% (52%)
Merger	61% (39%)	64% (36%)	63% (37%)	63% (37%)
Integration within UHI	46% (54%)	53% (47%)	46% (54%)	49% (51%)

Across all staff respondents, the exercise above reveals that merger was rated as having the highest probability of a positive outcome, and was the only option which was considered to have a probability of success higher than 50%.

Student Views

Discussions in focus group sessions with students suggested broad agreement regarding the merits of merger, and a belief that there is a strong case for merger. Part of the consultation included sessions with student representatives, including class representatives, following which the student body submitted a letter outlining their interests, which included the following key points:

- It can no longer be considered good practice to exclude the student voice from governance arrangements, and students were clear in highlighting legislation that affords students two places on a college board of management;
- There is a consideration that the status quo cannot ensure that students can play a full part in governance arrangements, and that this can only be realised through merger;

- Students value the quality of contact they are afforded by relatively small class sizes;
- Students are keen to see investment in better student accommodation and facilities;
- There is a requirement to ensure much better transport links.

Trades Unions

Discussions were held separately with trade union representatives. A decision to merge will require continued and sustained engagement with trade union representatives on matters pertinent to their members as a consequence of any impacts on staff, HR changes, terms and conditions or other related matters.

2.3.4 Potential business scope and key service requirements

It is essential that the options selected for analysis have been scoped to cover the full extent of the project brief. The long list of options described in the Economic Case capture the most relevant methods of organising tertiary education, research and training provision operation, and include minimum and fully resourced, internal and external methods and maintaining the existing services as is.

The Project Scope includes:

- All existing tertiary education, training and research services operated by the Council as part of Shetland College and Train Shetland;
- All existing tertiary education, training and research services operated by SFTCT as part of NAFC Marine Centre;
- All staffing directly related to the above services;
- All property and assets required for operation of the above services;
- Existing and new contracts with service delivery partners and business customers;
- All academic and vocational accreditations and certifications held by the services in question.

The Project Scope excludes:

- Tertiary education and training operated by the Council as part of SIC Workforce Development or Adult Learning;

- Future plans for development of student accommodation.

2.3.5 Main benefits criteria

The Benefits Criteria are based on the aspects of project delivery which will best achieve the Critical Success Factors, and detailed in the Benefits Realisation Plan, attached as Appendix i.

2.3.6 Main risks

A list of key project risks has been drawn up and profiled using the Council's Risk Management procedure. Risks have been profiled using a scale of Likelihood (1 = Rare; 5 = Almost certain) against Impact (1= Insignificant; 5 = Extreme). Risks with a profile score 12 or higher have been deemed to be 'high' risk. The risks which have been profiled as 'high' are as follows:

Table 2.4 Project risks

Risk
Failure to merge
Failure to transfer existing contracts to merged college
Failure to secure sufficient merger funding from SFC
Failure to establish financial sustainability
Failure to secure favourable response to pensions issue
Failure to secure favourable outcome for estates issues
Failure to agree appropriate governance model
Loss of key staff
Failure to establish an achievable staff transfer plan
Failure to establish harmonisation of staff terms and conditions
Failure to agree on merged College name
Failure to agree on strategic direction
Failure to develop a shared quality culture
Failure to establish merged college identity

Risk management is discussed more fully in the Management Case. A draft risks matrix is attached as Appendix ii.

2.3.7 Constraints

The following have been identified as constraints within which the Project must operate:

- Quality standards of key service delivery partners (e.g. UHI, SFC, SQA);
- Council spending limits;
- Timescales – preferred option required in May 2018 with Full Business Case to be completed in December 2018;
- Provisions of the Further and Higher Education (Scotland) Acts 1992 and 2005;
- Provisions of the Post-16 Education (Scotland) Act 2013.

2.3.8 Dependencies

The main external influence on the project is the requirement to maintain funding from the Scottish Funding Council for tertiary education delivery in Shetland.

The project must remain a strategic and political priority for SIC and SFTCT, and appropriate resources (e.g. staff time) allocated towards this at the direction of the Chief Executive and Interim Joint Principal.

3. THE ECONOMIC CASE

3.1 Introduction

This section of the FBC documents the wide range of options that have been considered in response to the scope identified within the Strategic Case, and the methods used to select the preferred option.

3.2 Critical success factors

The critical success factors (CSFs) for the project were agreed as follows:

1) Develop a financially sustainable model for delivery of tertiary education, research and training in Shetland
    - Establish the most cost effective way to deliver the services in Shetland
    - Reduce the level of annual subsidy from Shetland Islands Council

2) Maintain and enhance quality standards in all aspects of service delivery
    - Ensure ability of services to meet quality requirements set by government and service delivery partners

3) Maximise future income
    - Ability to achieve income targets from students, learners, research and business services
    - Ability to respond quickly to income generating activity

4) Commit to a single clear, consistent and effective voice for the tertiary sector in Shetland
    - Develop a targeted business development and marketing strategy for the sector, with clear targets for growth and engagement
    - One clear, strong and focused voice at regional and national tables

5) Maintain local tertiary education, research and training presence, and build strong relationships with resource enablers and strategic partners

- Maintain physical presence in Shetland
  - Build strong relationships with external organisations vital to the successful delivery of services

6) Simplify governance arrangements, and ensure the retention and attraction of appropriately skilled staff
   - Ensure appropriate management structure
   - Developed simplified governance structure for the sector

The Critical Success Factors are considered to be essential in the context of the project achieving the strategic objectives detailed in the Strategic Case.

3.3 The long-listed options

The long list of options developed as part of the options appraisal were as follows:

Table 3.1 Summary of long list options and findings

Options		**Definition**
1	Do Nothing	No further action is taken to change governance, management and funding arrangements of Shetland College, NAFC Marine Centre and/or Train Shetland.
2	Status Quo	Maintain existing governance, with joint management posts regularised, joint strategic plan adhered to and joint curriculum developed as per interim arrangements. Requirements for operational efficiencies would continue.
3	Create a single tertiary education, research and training centre within the Council (‘Host SIC’)	NAFC Marine Centre becomes part of the Council. Employment of staff is transferred, and all assets and liabilities are taken on by the Council.
4	Create a single tertiary education, research and training centre within UHI (‘Host UHI’)	Shetland College, NAFC Marine Centre and Train Shetland transfer from existing arrangement to organisational and operational control of UHI. Staff, governance and management transfer to UHI.
5	Create a single independent tertiary education, research and training centre, which is part of the UHI network (‘Host NAFC’)	Creation of independent organisation comprised of operations of Shetland College, NAFC Marine Centre and Train Shetland, which is part of the UHI network, with SFTCT as the ‘host’ organisation.
6	Create a single independent tertiary education, research and training centre, which is part of the UHI network (‘New College’)	Creation of a new, independent organisation comprised of operations of Shetland College, NAFC Marine Centre and Train Shetland, which is part of the UHI network.

7	Shetland College and Train Shetland remain within SIC as part of Education & Families Committee; NAFC Marine Centre remains as is	Strategic oversight of Shetland College and Train Shetland is more closely aligned with SIC Children's Services. NAFC remains as per status quo.
8	Provide only minimum amount of tertiary education, research and training in Shetland	No further investment from SIC in tertiary education, research and training. UHI and SFC fund only basic services.
9	Provide no tertiary education, research and training in Shetland	Disestablishment of Shetland College and Train Shetland by the Council. Core funding to NAFC Marine Centre discontinued.

3.4 Short-listed options

Prior to scoring the options against the Critical Success Factors, a brief scoping exercise was carried out against each option. This judged whether or not each option was capable of achieving the basic aims of each Critical Success Factor, how this impacted on achievability and affordability, and whether or not each option could demonstrate a fit with the business needs and strategic objectives as described in the Strategic Case.

The results of the scoping exercise are as follows:

Table 3.2 Summary of scoping exercise

	Option								
	1	2	3	4	5	6	7	8	9
	Do Nothing	Status Quo	Host SIC	Host UHI	Host NAFC	New	E&F	Minimum	No Provision
CSF1	×	×	?	?	?	?	×	?	×
CSF2	?	?	?	✓	✓	✓	?	?	×
CSF3	?	?	?	?	?	?	?	×	×
CSF4	×	×	?	✓	✓	✓	×	×	×
CSF5	×	?	✓	✓	✓	✓	?	×	×
CSF6	×	×	?	✓	✓	✓	×	×	×
Potential affordability	×	×	?	?	?	?	×	?	?
Potential achievability	?	✓	?	?	?	?	✓	?	?
Business need	×	×	?	✓	✓	✓	×	×	×
Strategic fit	×	?	?	✓	✓	✓	?	×	×
Summary	Discounted	Discounted	Possible	Possible	Possible	Possible	Discounted	Discounted	Discounted

Options 3, 4, 5, and 6 could all demonstrate either a potential or direct fit with the Critical Success Factors, potential affordability and achievability, and fit with the Strategic Case. For that reason, these options remained in the process at this stage and were subject to scoring against the Critical Success Factors.

As shown above, Options 7, 8 and 9 were considered to be unable to achieve some or all of the Critical Success Factors, and were unable to demonstrate affordability, achievability or a fit with the Strategic Case. For that reason, these options were discounted at this stage and not subject to the detailed scoring against the Critical Success Factors.

While Options 1 (Do Nothing) and 2 (Status Quo) were also unable to show achievements or fit with the above criteria, these options are important comparators for the remainder of the Business Case process, particularly the Status Quo, against which any preferred option must be judged. For that reason, these options remained in the process at this stage and were subject to scoring against the Critical Success Factors.

3.5 Options appraisal

In order to provide a ranking of options, a scoring mechanism was developed by the project team. This mechanism provided a score of 0 (low)-5 (high) based on the potential ability of each option to deliver against the Critical Success Factors.

Each Critical Success Factor contained two categories against which options were scored (with the exception of CSF2, which was weighted by a factor of 2 to bring the available score in line with the other CSFs).

The outcome of the detailed scoring process was as follows:

Table 3.3 Summary of initial scoring process

	Option					
	1	2	3	4	5	6
	Do Nothing	Status Quo	Host SIC	Host UHI	Host NAFC	New College
CSF1	0	0	3	4	10	10
CSF2	2	8	8	10	10	10
CSF3	2	6	2	8	10	10
CSF4	0	5	8	6	10	10
CSF5	6	6	7	8.25	10	10
CSF6	2	2	5.5	7	9	9
TOTAL	12	27	33.5	43.25	59	59

The scoring process demonstrated that two options from the shortlist were clearly preferable. These were:

- Option 5 – ‘Host’ NAFC
- Option 6 – New College

The preferred way forward identified by the options appraisal is a merger of Shetland College UHI, NAFC Marine Centre UHI and Train Shetland, outwith Shetland Islands Council. Two options were identified which were most suitable to realise this merger.

In line with Green Book guidance on using the Five Case Model, development of the Full Business Case requires that options appraisals be revisited, and "*the FBC must demonstrate that the conclusions of the economic appraisal…remain valid*." This must take into account where "*new information affecting the ranking of the options may have become available*."[4] For this reason, further information and recommendations arising from legal advice and diligence reports have been considered and factored into the revised options appraisal.

When considering an options appraisal, it is essential to ensure that all key considerations have been taken into account. The legal due diligence reports prepared by Anderson Strathern find no legal impediments to merger. However, the choice of governance arrangement leads to the requirement that certain other crucial factors be appraised. One of these crucial factors considered is the ability of the merged college to secure funding from the Scottish Funding Council for Further Education delivery. Anderson Strathern's report on legal due diligence includes the following statement:

> *"One of the key issues is that the college is financially sustainable. It is therefore essential that the new college is able to be funded by the SFC through the RSB."*

On the basis of the foregoing, the Economic Case contained within the Strategic Outline Case has been revisited and expanded, and the Critical Success Factors revised to take account of crucial information. The Critical Success Factors are now as follows (*change in italics*):

1) Develop a financially sustainable model for delivery of tertiary education, research and training in Shetland
    - Establish the most cost effective way to deliver the services in Shetland
    - Reduce the level of annual subsidy from Shetland Islands Council

[4] *Public Sector Business Cases – Using the Five Case Model; Green Book Supplementary Guidance,* p.107

- *Ensure the ability of the merged college to achieve assigned status to UHI as the Regional Strategic Body*

2) Maintain and enhance quality standards in all aspects of service delivery
    - Ensure ability of services to meet quality requirements set by government and service delivery partners

3) Maximise future income
    - Ability to achieve income targets from students, learners, research and business services
    - Ability to respond quickly to income generating activity

4) Commit to a single clear, consistent and effective voice for the tertiary sector in Shetland
    - Develop a targeted business development and marketing strategy for the sector, with clear targets for growth and engagement
    - One clear, strong and focused voice at regional and national tables

5) Maintain local tertiary education, research and training presence, and build strong relationships with resource enablers and strategic partners
    - Maintain physical presence in Shetland
    - Build strong relationships with external organisations vital to the successful delivery of services

6) Simplify governance arrangements, and ensure the retention and attraction of appropriately skilled staff
    - Ensure appropriate management structure
    - Developed simplified governance structure for the sector

It is essential that the merged college will be an ‘assigned college’ – this means that the college will be assigned to a Regional Strategic Body (RSB) for the purposes of delivering further education outcomes. It is through the RSB that assigned colleges receive grant funding from the Scottish Funding Council – the RSB for the Highlands and Islands is the University of the Highlands and Islands. All assigned colleges must comply with a number of requirements, including a Financial Memorandum between themselves and the RSB (which, among other things, requires that colleges must operate on a financially sustainable basis), the 2014 ministerial guidelines on college board membership, and Colleges Scotland's Code of Good Governance. There are a number of factors within each if the elements above which raise questions over the ability of Option 5 to meet the requirements for assigned status, including:

- The lack of student and staff representation on the Board of Trustees;
- The legal status of SFTCT as a Trust, which does not provide limited liability protection for Board members;
- Diversity of membership to include a range of community interests;
- Transparent and open decision-making, including public dissemination of agendas, minutes, decisions and financial information;
- Requirement for specific committee structures, which at a minimum comprise Audit, Remuneration, Finance and Nominations/Appointments.

There would also be a requirement for SFTCT to considerably widen its purpose in order to accommodate the course provision delivered by Shetland College and Train Shetland.

A number of the issues above could be dealt with by SFTCT adopting a new legal form. The implication of this is that, under Scottish charity law, the conversion of a charity from one legal model to another effectively ends the previous charity and creates a new one, so any conversion of SFTCT will require the creation of a new entity, which must be capable of achieving charitable status (e.g. company limited by guarantee, SCIO). This is effectively the New College model.

The legal requirements summary notes a number of considerations relating to New College. This includes that "*the structure of the new organisation should reflect the good governance requirements to ensure that there are no problems with obtaining the consent of SFC to assign the college to UHI*." As the New College model will be a bespoke arrangement designed to achieve the best chance of success, it can be expected that governance arrangements will be designed with this specific goal in mind. The summary also notes that, while the New College model will require complex legal agreements in the form of Transfer Agreements and multiple applications to the Office of the Scottish

Charity Regulator (OSCR), these would be required regardless of the Host or New College model being chosen.

On the basis of the foregoing consideration and the revised Critical Success Factors, the two options identified in the preferred way forward have been revisited and the scoring updated, as follows[5]:

Table 3.4 Summary of revised scoring process

	Option	
	5	**6**
	Host NAFC	**New College**
CSF1	10	15
CSF2	5	5
CSF3	10	10
CSF4	10	10
CSF5	10	10
CSF6	9	9
TOTAL	**54**	**59**

3.6 The preferred option

Conclusion: the preferred option is **Option 6 – New College**, because it has been evaluated as providing the highest chance of achieving the objectives specified by the Critical Success Factors, and provides a compelling case for change against the status quo.

Option 5 – Host NAFC provided a high degree of benefits against almost all of the Critical Success Factors; however, it was evaluated to have a high degree of risk with regard to being able to achieve assigned status with UHI, and therefore scored lower than Option 6.

None of the other options were considered to provide a high degree of benefits against the Critical Success Factors, and have therefore been discounted.

[5] As another scoring factor has been added to CSF1, the weighting for CSF2 has been removed from the revised scoring process.

4. THE COMMERCIAL CASE

4.1 Introduction

The purpose of the Commercial Case is to describe the proposed deal in relation to the preferred option outlined in the Economic Case.

4.2 Required services

The required service to be delivered as part of the proposed deal is a model for delivery of tertiary education, research and training in Shetland which:

- is financially sustainable;
- incorporates a model of governance and management which is appropriate to local conditions and is fit-for-purpose;
- delivers a high quality learning and training experience, maintaining and enhancing current quality standards;
- delivers high quality research services to the benefit of local industry;
- is responsive to local needs and delivers against strategic targets as identified in the Strategic Case;
- is physically located in Shetland;
- consists of a single consistent identity for the tertiary sector in Shetland;
- is capable of delivering a clear business development and marketing strategy emphasising engagement and growth.

The details of the required service, and the actions required to deliver this, are described more fully below:

4.2.1 Governance, Management and Legal

<u>Legal Structure</u>

The new college will be established as a non-incorporated college. This means that the college will not be incorporated under the Further and Higher Education (Scotland) Act 1992. Colleges which are incorporated under this Act are now classified as public bodies following reclassification by the Office for National Statistics in 2014.

SFC and UHI have confirmed that non-incorporation is acceptable for the new college. The process of establishing a non-incorporated college is a much streamlined process in comparison to establishing an incorporated college.

The new college will be an assigned college to UHI, as the Regional Strategic Body (RSB) for the Highlands and Islands. The formal relationship between the UHI (as the RSB) and the new college (as the Assigned College) is established by a Financial Memorandum (FM). The governing body of the new college is responsible for ensuring compliance with the FM, which sets out:

- The relationship between the RSB and the new college, and the responsibilities of each for the proper stewardship of public funds;
- General requirements that apply to the new college, including internal and external audit requirements, student activity and support, tuition fee policy and governance;
- Additional requirements for non-incorporated colleges, including capital finance and contingent commitments.

This will require Scottish Ministers to promote an order to assign the new entity to UHI as regional strategic body (s 7C(1) of the 2005 Act) and potentially a further order to remove Shetland College (as per SIC) s.7(1) (a) of the 2005 Act.

There are currently two independent non-incorporated colleges within UHI, which are Argyll College and West Highland College. The FM for the new college will reflect the agreements with these colleges.

A summary of the legal requirements of merger models identifies that a new company limited by guarantee or Scottish Charitable Incorporated Organisation (SCIO) will require to be established. Staff, assets, liabilities etc. would be transferred by way of a transfer agreement from SIC and NAFC to the new entity on the vesting date.

The new organisation must have charitable status in order for SFTCT to transfer all or part of their assets for no financial consideration (as would normally be the case in a merger). There is a presumption that charitable assets will remain within the charity sector, unless sold at a market rate – if transferred to a non-charitable organisation, the sale of NAFC Marine Centre and associated assets at full market value would be acceptable, but a transfer at a nil or nominal value would not be.

Setting up an unincorporated college will require an application to OSCR seeking consent to enter the new college onto the Scottish charity register and become a recognised charity with a Scottish charity number. This process usually takes 2-3 months to complete, so this would require to be done before vesting date.

Governance

The new college must be governed in accordance with the Code of Good Governance for Scotland's Colleges, which sets out requirements for compliance with the following principles under the Code:

- Leadership and Strategy;
- Quality of the Student Experience;
- Accountability;
- Effectiveness;
- Relationships and Collaboration.

While the new college will be non-incorporated, it will be expected to follow the 2014 ministerial guidance on college sector board appointments as this relates to assigned incorporated college boards. This provides that the college board must:

- Comprise between 13 and 18 members;
- Comprise the following:
  - A chair;
  - The principal of the college;
  - Two elected staff members (one teaching and one non-teaching);
  - Two nominated student members;
  - Non-executive board members[6].

The chair and non-executive members must:

[6] An assigned college board must therefore have between 7 and 12 non-executive board members.

- Adhere to the Nine Principles of Public Life[7] and act at all times in good faith and in the best interests of learners;
- Have significant experience or knowledge of:
    - Further, higher and secondary education or the college student experience; or
    - Industry, commerce, finance, the Third Sector, public service or trade unions; or
    - The region (or a relevant part of it) and its relevant needs.

The college must conduct a fair, open and merit-based recruitment process for appointment of board members, adhering at all times to the 2014 guidance. Taking into account the anticipated opportunities and challenges facing the college, current and future needs of the college board should be identified, including, for example, finance, human resources, legal, estates, etc. A role description for non-executive Board Members is attached as Appendix iii.

In respect of student members of the college board, it is expected that local elected officers of the Highlands and Islands Students Association will be appointed to these positions.

The first step in forming the new board of management will be the establishment of a Shadow Board which will take forward the merger. It is proposed that the Shadow Board is created as soon as possible to ensure that there is clear leadership of the merger process, and that the decisions required for the implementation of merger can be made in a timely manner.

The composition of the Board must ensure that the required skills and experience necessary for the Shadow Board to carry out its duties are represented. Duties and responsibilities of the Shadow Board are described more fully in the Management Case.

The following considerations will apply:

- The role of the Shadow Board will be to take forward the merger process;
- The Shadow Board will be a formal sub-committee of each Board;
- Members of the Shadow Board will remain as full members of their existing Boards until vesting day for the new college;

[7] Selflessness, integrity, objectivity, accountability, openness, honesty, leadership, public service and respect.

- When appointed, the Principal Designate will become a member of the Shadow Board;
- The Shadow Board will keep its composition under review, including the skillset of the overall group, and recruit additional or co-opt new members as required;
- On vesting day, the Board of Management for the new college will be constituted with the members of the Shadow Board.

Management

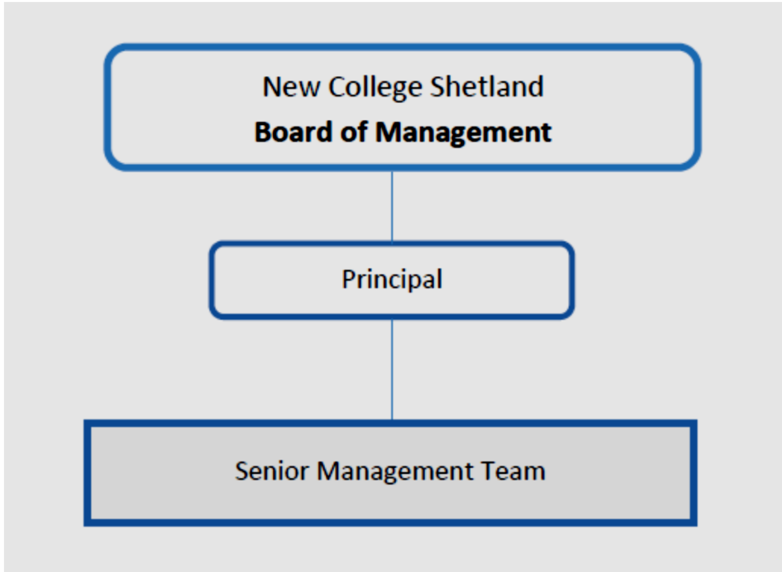
The first appointment which will take place during the merger process will be the Principal Designate, who will take on the role of Principal and Chief Executive of the merged college following vesting date, and will have responsibility for leading the restructure at the direction of the Shadow Board.

The appointment of the Principal will be subject to an open and transparent recruitment process, which will be undertaken by a specially appointed recruitment panel. The recruitment panel will comprise, at a minimum:

- Chair, SFTCT;
- Chair, Shetland College Board;
- UHI Principal (or nominated depute);
- Senior recruitment consultant.

The Scottish Funding Council advise that a new Principal should be appointed at the earliest possible date, while recommendations from Audit Scotland state that the chief executive for a merged organisation should be in post "not less than six months before the start of the new organisation" to ensure sufficient time for operational changes to be implemented and for the new Principal to lead the culture change and strategic planning for the new entity." It is recommended that the recruitment panel membership be finalised and the panel be convened as soon as possible following a decision to merge.

The appointment of a single, independent Board of Management and a Principal and Chief Executive as key officer will create a much simplified governance and management structure:



The key responsibilities of the Principal prior to vesting day will be:

- to provide robust leadership prior to and during the college merger;
- to plan the integration of the new college;
- to lead the culture change required to create the new college;
- develop detailed plans for consultation and regular communication with staff, students and external stakeholders. This will include seeking input from individual staff, staff teams, trades unions and staff representatives regarding the new structure.

Upon appointment, the Principal Designate will be a member of, and be accountable to, the Shadow Board.

At vesting day, the Principal will take over full responsibility for the new college, including line management of the senior management team. In line with good practice it is intended that the first phase of the restructure will provide a senior management team model which will deliver robust strategic leadership and clear operational management.

The composition of the senior management team will be subject to the views of the Principal and consultation with staff. Financial assumptions relating to senior management arrangements for the new college have been informed by benchmarking with comparator colleges within the UHI network.

Pensions

Employees of the Council, and therefore Shetland College and Train Shetland, may be members of one of two separate pension schemes:

- Lecturers may be members of the Teachers' Pension Scheme, administered by the Scottish Government (Scottish Public Pensions Agency); or
- Other staff may be members of the Shetland Islands Pension Fund (SIPF).

Employees of SFTCT are eligible for membership of the SIPF, as SFTCT is an Admitted Body to the Scheme.

It is intended that the new college will be an Admitted Body to the SIPF. Due to the nature of the changes that are expected then a new SIPF Admission Agreement will be required by the new college at the vesting date.

In determining the basis of transfer from the funding perspective, three alternatives have been considered by the Actuary:

- Fully funded – 'clean slate' option which leaves no liability with SFTCT;
- Share of deficit (of funding level of ceding employer) - at the calculation date - on an ongoing basis.
- Share of deficit (of funding level of active members of the ceding employer) - pensioner and deferred members of ceding employer fully funded at the calculation date - on an ongoing basis.

Given the circumstances of transfer, it is considered that the most beneficial option will be to proceed on the basis of the fully funded option. This will leave no deficit remaining with SFTCT or with the new college upon commencement.

There are two major financial considerations resulting from the fully funded scenario:

- This scenario creates a cessation cost trigger to the estimated value of £2.5-3m[8] for SFTCT from the liabilities left, which should be paid at point of cessation;
- All new Admission Bodies (new Admission Agreements) will be required to provide some form of security, such as a guarantee, an indemnity or a bond, as set out in the SIPF Regulations. The security is required to cover some or all of the following:
    - the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
    - allowance for the risk of adverse market experience;
    - allowance for the possible non-payment of employer and member contributions to the Fund; and/or
    - the current deficit.

The provisions of the Further and Higher Education (Scotland) Act 2005 specifically prohibit SFC or UHI from acting as a guarantor in this manner. Therefore, it is recommended that the Council act as guarantor for the pension liabilities of the new college. This will involve the provision of a guarantee to the value of £4.3m, which will be reviewed periodically through triannual valuations.

<u>Legal Due Diligence</u>

A legal due diligence exercise was carried out by Anderson Strathern on behalf of the Project. The diligence exercise reviewed matters relating to:

- Governance issues, legal constitution, powers of governing bodies, partnership board and charity issues;
- Material contracts;
- Property;
- Intellectual property issues;
- Borrowing and funding issues;
- Employment and pensions;
- Litigation and disputes;
- Compliance.

[8] Calculated as at 31 October 2018

The conclusion of the report is that no material issues have been identified which would legally prevent merger.

4.2.2 Academic Benefits

The creation of the new merged college will allow for the enhancement and development of the distinctive, high quality specialisms offered by the partner organisations. The new college will be committed to a comprehensive and varied portfolio with distinct specialist provision across FE and HE.

The Board, management and staff of the new college will ensure that the needs of students will continue to be met and that the portfolio will be under continuous review, in preparation for and after merger, to ensure the curriculum offered is well co-ordinated, relevant and suited to meet the continuing needs of Shetland, the wider Highlands and Islands and Scotland, and upcoming challenges and opportunities.

In doing so, strategies and plans must take into account the priorities for Shetland laid out in the Shetland Partnership Plan, and the 10 Year Plan, and the identification of issues within the local economy, particularly expansions in economic activity (such as decommissioning) and difficulties experienced by local employers in recruiting suitably skilled staff.

As the northernmost partner of the University of the Highlands and Islands, the new college will broaden and strengthen the local connection to the aims of the University, and utilise the resources available through the network to benefit educational opportunities in Shetland, particularly through local access to higher education opportunities.

There is an anticipated growth in continuous professional development activity and part-time learning, and an expectation of modest growth and/or consolidation of high volume activity—such as social care and engineering—as demand for workers in those areas increases. There will be a continued emphasis on those areas which are highly vocational and with clear evidence of employability or study progression routes.

The merged college will ensure the curriculum facilitates synergies in learning, encourages creativity in students and staff, and promotes a flexible approach to the curriculum offer.

The merger proposal anticipates the creation of ‘Schools’ within the merged college, which will focus on the distinctive requirements of particular areas, some of which, such as marine studies and creative industries, are already acknowledged as high quality specialisms with regional, national and international reach.

The new merged college will prioritise inclusivity and diversity. A priority will be ensuring that access to courses and clear progression routes through study areas of choice will be available to all, and new approaches to delivery will be developed in an innovative and flexible manner in order to provide access to as wide a range of learners as possible.

The new college’s curriculum areas will make a vital contribution to the economic and social well-being of Shetland and the wider region. Through merger, the intention is to pool resources, expertise and experience to ensure that the curriculum meets the needs of students and employers, and further meets to strategic priorities of the Shetland Partnership, the University of the Highlands and Islands and the Scottish Government.

The academic strategies for the new college will underpin the ambition to deliver excellence in learning and teaching and to develop a curriculum portfolio which is dynamic and responsive to local, regional and national needs.

Ultimately, the core reason for creating a new college is to ensure that every learner has access to the right programme at the right place and time and is given options and choices to meet their individual needs, and match their motivation, talents and ability to progress to work or further study.

One single point of contact will ensure easier access and enable more coherent developments and links with employers, so that the curriculum portfolio better meets their current and future needs and in turn offers additional opportunities and benefits to students.

<u>Learning and Teaching Strategy</u>

The development of a single learning and teaching strategy for the tertiary sector in Shetland is key to delivering education and training of the highest standard, within an educational environment that is fully inclusive and supportive.

While the component parts of the college will continue to deliver their specialisms, they will do so in an environment of innovation and development, with standardised practice where possible creating a single learning environment under which different disciplines can thrive and grow.

A proposed Learning and Teaching Strategy for the new college has been produced, the primary purpose of which is to ensure that everything that can be done to bring about high quality learning and teaching for all of the college's learners is undertaken and that sufficient and sustained effort is made to maximise the success of learners and their future prospects. The Strategy describes a number of strategic objectives under the following headings:

- Curriculum Design and Assessment;
- Achieving Excellence in Learning and Teaching;
- Achieve High Levels of Learner Success and Progression into Positive Destinations;
- Learner Pathways and Opportunities for Progression;
- Developing Skills for Learning, Work and Life;
- Hearing and Listening to the Learner Voice;
- Developing Creative, Enterprising and Digitally Literate Learners;
- Support for Learning.

Curriculum Development Plan

Insightful and rigorous curriculum development planning is fundamental to the success of the new college, to ensure the portfolio meets community and industry needs. It is essential that the curriculum is evaluated against economic and skills needs and local, regional and national policy drivers.

Through curriculum development planning the new college will seek to provide a relevant and dynamic curriculum at as many levels as possible, delivering programmes from introductory level through to HND, degree and professional workforce development qualifications.

The Board, Senior Management Team and Curriculum Teams must have in place the means which provide for regular and efficient consideration to be given to the existing and prospective curriculum.

The proposed Curriculum Development Plan for the new college contains the following aims:

- to develop a curriculum that is demand-led, of the highest quality, and which makes a significant contribution to Shetland's society and economy;
- to ensure that the curriculum is inclusive and aligned to meet the needs of employers, communities and individuals in Shetland, but also one that reflects regional and national priorities;
- to ensure that curriculum planning is closely aligned to the planning arrangements and mechanisms of Shetland Partnership and of the University of the Highlands and Islands.

Quality Assurance and Enhancement Policy

It is the ambition of the new college to be renowned as an organisation where the highest standards of quality are achieved and are integral to everything we do.

Considerations relating to quality permeate other policies, including Learning and Teaching, Curriculum Development, Research and Student Engagement.

However, in an environment where there is an increasing expectation on colleges to self-evaluate, it is essential to establish a policy which ensures the college takes a wide-ranging and coherent view of its approach to managing quality.

The proposed Quality Assurance and Enhancement Policy details the following requirements:

- To have in place a set of arrangements that are aimed at enhancing the quality of all aspects of the college's operations;
- To ensure that self-evaluative and reflective activity, and the gauging of the college's quality performance, is well-informed by current and comprehensive data and that the analysis is routinely acted upon;

- To have in place effective internal verification and audit processes;
- To have in place a course and unit approval process that assures the quality and sustainability of the college curriculum and which is aligned to the University of the Highlands and Islands processes in respect of higher education qualifications.

4.2.3 Student Issues

Student Support Services

A review of current student support services across the sector was carried out in order to identify gaps in current provision, explore best practice, develop a student support plan for merged college and to identify resources required. The scope of this work package included support for learning, student health and wellbeing, front line student support; guidance and employability, and student funding and finance. Issues reports arising from reviews of student support and wider support requirements identified key issues which are summarised below:

- Increased health and wellbeing support staff hours are required to ensure identified gaps in service are resourced adequately;
- To avoid confusion amongst students, PAT (Personal Academic Tutor) could be the term used for all students (FE and HE). Meanwhile, academic staff should have confidence in student support provision and be able to refer timely and efficiently so that their PAT and academic role is focussed on what it should be;
- PAT roles could be more effectively shared amongst team members within departments to avoid reliance on one individual;
- Student support services should be accessible, student friendly and outcome focussed with a 'Triage' model of delivery adopted. This would ensure front line staff are equipped with the right information and skills;
- Student support services are there to support the individual;
- Student support service information must be clearly communicated. Forms and support should be readily available to all on our website. The intranet or network drives should be avoided for student support guidelines, forms, etc. to make it accessible to all;
- UHI Single Policy Environment Project noted with relevant policies and procedures adopted to date. There will be a requirement to update and refresh applicable policies and procedures. Our support policies and

procedures should be published on our website rather than the Intranet to help improve communication and accessibility;

- No changes to Support for Learning Services suggested. However, 'Triage' delivery approach could result in improved administrative support for that existing role;
- Students should be able to access support anytime the college is open. Clear emergency signposting should be in place for times when the college is not open;
- Need to improve transition support in all areas including care leavers as well as school transition for learners with additional support needs;
- The Access and Inclusion Strategy highlights the need for further work to be done. This is seen as a priority area to focus on;
- Changes to bursary and student funding arrangements may be necessary for new college;
- Student support services should be accessible for all learners, ensuring the tertiary nature of our business is reflected in how we meet learner support needs;
- UHI Single Policy Environment Project noted;
- No changes to Library Services suggested, with current arrangements highlighted as being effective;
- No changes to facilities services arrangements apart from centralising room bookings;
- Need to ensure Student Registry service delivery is adequately resourced within support staff structure;
- GDPR, data handling as well as contract compliance could be combined;
- SITS to be integrated into all applications/enrolments to avoid manual data entry practices;
- Finance and course bookings systems should integrate with SITS;
- Current Train Shetland CRM procedures recommended for adoption for all admin/front line staff to ensure consistent approach.

There is an acknowledgement in assumptions that skills and experiences of existing staff must be utilised effectively in delivering student support services in the future, and that student support services have been under resourced and must be addressed. Financial assumptions have therefore been based on ensuring that student support services are open during college opening hours with necessary additional hours of staff time factored into costings, and ensuring that the following areas of responsibilities within services are adequately resourced:

- Engagement and international learning;
- Mental health and wellbeing;
- Student health;
- Schools liaison and transitions support;
- Guidance, careers and employability;
- Opportunities (e.g. internships, volunteering);
- Support for learning (non-academic – e.g. admin, support with completing PLSPs);
- Student funding.

Student Engagement

In February 2017, students from NAFC Marine Centre UHI and Shetland College UHI agreed to unite the local student voice for the benefit of all students, whilst maintaining their unique respective identities. The Local Student Partnership Agreement for 2018/19 was signed by Highlands and Islands Student Association (HISA), the Chair of Shetland Fisheries Training Centre Trust and the Chair of the Shetland College Board in August 2018.

A review of student engagement provision was undertaken to highlight relevant issues that may arise through merger. An issues report on student engagement identified the following as key issues for future developments, to ensure meaningful on-going engagement and dialogue with students:

- re-organise student representation and ensure fair representation for all students
- re-structure local HISA Officer positions;
- ensure student representation on College Board and College committees;
- review College feedback mechanisms;
- continue to develop our international educational opportunities programme;
- encourage initiatives and support students in improving ‘Student Community’.

4.2.4 Assets and Property

Estates

In order to inform future usage of estates and assets, a review was initiated to investigate estates issues which may impact on the proposed merger. The review generated an Asset Management Statement, which illustrates the challenges and opportunities that the proposed merger of estates may present for the current entities and a newly invested entity. It sets out the criteria for the required estates strategy that needs to be implemented post review on incorporation of a new entity.

It is vital that an Estates Strategy for a merged entity is produced. This must ensure that the existing estate and its facilities are utilised to their maximum potential and meet the college's strategic objectives while promoting:

- Sustainability;
- Accessibility;
- Environmental stewardship; and
- Safety.

Strategic objectives identified as part of the review are:

- ensure robust management of the college estate and its facilities across the multiple campuses and delivery points;
- ensure that the facilities are utilised efficiently and deliver value for money;
- create an environment for students and communities that inspires learning and prepares students for real work environments;
- be flexible and adapt to the changing requirements of curriculum delivery;
- create an inclusive, accessible environment that promotes equality and facilitates progression and achievement;
- support technological innovation;
- ensure that facilities are safe, healthy environments that are fit for purpose;
- appropriate investment which enhances the financial and physical sustainability of the College;

- ensure the college meets its responsibility for the stewardship of its public assets; and
- enable the delivery of sustainable, effective and relevant courses and activities that contribute to our quality of life.

The colleges utilise an extensive and diverse property estate spread over two geographically distinct areas in Lerwick and Scalloway. Most of the property portfolio involves direct and indirect provision of teaching, learning and research. However, the portfolio also contains office, catering, student accommodation and maritime infrastructure.

The financial projections for the business case are achievable if the property assets are made available to the new college at minimal cost. It is proposed that leasing costs in relation to buildings previously owned by Shetland Leasing and Property Ltd. (SLAP) are removed, and that the Council commit to an alternative arrangement which will result in a minimal value transaction. This arrangement will be established in the next phase.

It is assumed within the financial projections that the building currently occupied by Train Shetland will not form part of the new college estate.

ICT

In order to inform future integration systems and processes, a review was initiated to investigate ICT issues which may arise during the proposed merger.

The purpose of the review was to investigate issues relating to the transfer of ICT services from existing arrangements to merged college, including:

- Issues relating to existing corporate services functions;
- ICT resource requirements for merged college;
- Transfer of Train Shetland staff from existing (SIC) network to new (UHI) network;
- Continuing functionality of CRM and management systems (e.g. Learnsmarter, FIPS).

The scope of the review included: staff; service delivery and support; operating costs; capital costs; ICT hardware, systems and software; web presence; corporate systems; printing; telephony; virtual server environment; backup and replication; local network provision. UHI top sliced costs associated with certain services have been excluded from scope.

It is assumed that the merged college will be using the UHI network and Wide Area Network (WAN) links as its primary backbone, and that core services such as Active Directory, Domain Name System, etc. will be provided through the UHI.

The review established that:

- There are no major issues relating to the transfer of Train Shetland staff to the UHI network;
- There are no major issues relating to the continued use of CRM and management systems currently used by Train Shetland after the merger, however there may some minor issues relating to branding, and further investigation is required to determine whether the existing systems will meet the requirements of the merged college;
- Issues relating to corporate service functions such as finance, payroll and HR will have to be addressed prior to the merger. It is recommended that a separate project or work stream is initiated to fully research and procure suitable systems should the merger go ahead;
- Integration of the two existing Active Directory UHI partner sites into the merged college site will require an ICT led project to deliver the desired outcome;
- Integration of the two existing number plans on the UHI telephony system will require an ICT led project to deliver the desired outcome. This can be combined with the Active Directory project using the same ICT teams.

There will be many strategic, operational and technical requirements relating to ICT that need to be considered prior to, and after the merger. These include, but are not limited to:

- Developing an ICT strategy for the new college;
- Developing a single website for the new college;
- Rolling equipment upgrade programme;
- Existing software licensing and subscriptions to new organisation.

4.2.5 Research, Marketing and Commercialisation

Business Development

In order to achieve the goals, aims, themes, priorities and targets it is essential to establish and maintain a business development function within the TERT sector in Shetland which is co-ordinated, effective, responsive, proactive, inclusive, well-informed and operated and forward looking, with the ability to foster an entrepreneurial environment and seek financially sustainability. It must also focus on the development of the merged college and be properly engaged, both internally within the college, and with strategic partners, learners, and businesses. A Business Development Plan was produced which articulates the proposed approach to these issues.

Both a proactive approach and the ability to react quickly to potential business development opportunities are required. This may be at an individual staff member, sectional, cross-sectional or overall organisational level. It is therefore suggested that an open door policy in relation to business development is adopted, and that in addition an annual consultation be held with all staff, to gather suggested business development ideas or proposals. These changes will have to be driven from the top down, both at Principal and Board level.

With regard to implementing change in relation to business development the College will:

- Implement cultural change to facilitate business development;
- Establish a business orientated philosophy from both Principal and Board level down.

With regard to internal communication and engagement in relation to business development the College will:

- Ensure that communication flow across the college both to and from the business development function is effective, appropriate, clear, concise and timeous;
- Establish a business development forum involving all areas of the college operation;
- Establish a regular meeting schedule between BDS and other sections of the college;

- Establish an open door policy in relation to business development proposals;
- Consult with staff annually about potential business development proposals;
- Develop a proactive approach to business development, with the ability to react quickly to business development opportunities where required;
- Support and encourage cross-sectional and team working within and across the College to ensure delivery of its business development vision, goals and objectives.

With regard to implementing effective external communication and engagement the new college will:

- Engage with current and potential funders, partners and clients, in terms of market intelligence, networking and partnerships, funding and business development opportunities, feedback on services and service improvement.

It is envisaged that service provision by the BDS, in addition to the internal and external engagement detailed above, in pursuit of the strategic goals relating to business development within a merged college i.e. to respond to the needs of Shetland; carry out high quality research; grow our business, and build sustainability, will include but may not be limited to:

- Market intelligence, monitoring and information services including the pursuit of business development opportunities, both within and outwith the college;
- Securing business development opportunities, preparing bids for funding and tenders, lobbying and project monitoring;
- Screening of business development proposals particularly in terms of viability and realism;
- Marketing the business development aspects of the college;
- Obtaining feedback, collation, analysis and distribution of this information to relevant areas of the college.

Research and Knowledge Exchange Strategy

The new college will undertake high quality research and knowledge exchange which develops and enhances Shetland and its environment, history, culture and industry. There is considerable potential for development of Shetland's niche specialisms, particularly in the area of marine research but also in the creative sector. The proposed Research and Knowledge Exchange Strategy states that vision of the new college is:

- Undertake high quality, impactful academic and commercial research relevant to Shetland, including its environment, history, culture and industries;
- Reach out to collaborate with the University of the Highlands and Islands, and other universities at national and international level, in pursuit of excellence in research;
- Increase activity in knowledge exchange for the benefit of Shetland's economy and communities, maintaining clear links between knowledge exchange and research activities;

In pursuit of the aforementioned vision, the new college will aim to:

- Sustain the level of research activity in Shetland and maintain the knowledge, expertise and capacity in research that exists within the current organisations;
- Continue to meet local research needs, but not be constrained to only meeting those needs;
- Develop and expand research activity in Shetland by building on existing knowledge, expertise and capacity, and by taking full advantage of the opportunities offered by Shetland's location, characteristics, expertise and facilities;
- Promote Shetland to researchers from other universities and organisations as a place to conduct research.

Marketing

A paper on marketing issues was produced to inform the Full Business Case. This purpose of this paper was to:

- Review marketing requirements for merged college;
- Identify resource requirements for marketing plan.

The following issues were identified:

- There is an urgent need for dedicated and professionally skilled marketing resources in support of branding, positioning and marketing requirements, from decision to merge through to vesting date and beyond;
- There is a requirement to ensure that web presence and public booking systems are compatible with UHI website and systems;
- All courses for FE and HE must be set-up for online applications in order to be fully compliant with GDPR;
- Branding will adhere to UHI Branding guidelines and will take account of ongoing UHI Branding and Positioning project;
- The Communications Strategy must be updated to ensure students, staff and stakeholders are informed throughout next phase;
- The merged college must implement one virtual front door, and rationalise social media presences to dedicated pages/groups managed by the marketing team, with editorial rights granted where applicable.

The following goals have been identified for marketing activity, from decision to merge onwards:

Financial goals

- Establish a dedicated marketing development budget (including staff) which includes provision allowance for branding and additional work in year to vesting date;
- Work towards generating a minimum of 20% additional income against the annual marketing salary costs;
- Identify new funding streams and reduce reliance on public funding.

Non-Financial goals

- Create a strong identity and brand for the new College, in line with UHI branding;
- Launch one virtual front door, with all activity and delivery available to book online with full integration to UHI systems (including SITS);
- Establish programme of market research activities and establish clear CRM procedures;
- Develop a programme of events and campaigns which inspire interest and engagement in learning opportunities available in Shetland;
- Adopt a more targeted approach to marketing delivery;
- Improve industry and schools links.

A Marketing Development Plan for the colleges sector was developed in 2018.

Communications Strategy

Clear, relevant and timely communications are an essential component of any change process, and must be delivered in combination with the vision, direction and rationale for change.

The purpose of the Communications Strategy is to co-ordinate consistent communications about the merger process to staff, students and all stakeholders, including the general public. The following communications objectives apply:

- Devise and deliver a programme of public relations to support the aims and objectives of the merger process through existing and new communications channels, internally and externally;
- Identify, analyse and monitor stakeholder engagement;
- Develop and review key messages.

To ensure the success of this strategy, it is suggested that the following policies for communication are adopted by the Shadow Board:

- We are committed to open and timely two-way communication with all staff and learners;
- We will take time and effort to deliver high-quality, proactive communication that ensures stakeholders are informed about board activity, aims and objectives, and know how they impact upon our collective success;
- We will use a combination of traditional methods and innovative technologies to reach a culturally and geographically diverse audience and will put stakeholder need at the core of all communication;
- We will value feedback, listen to and involve people in our activity and we will recognise the link between strong, effective communication and organisational success, adhering at all times to the principles of openness, transparency and accessibility.

4.3 Personnel implications (including TUPE)

Integrating staff from two disparate organisations—one a charitable trust, one a local authority—is a challenging process, but one which will be undertaken in an open and transparent manner at all stages.

The success of the new institution will rely on the development of a new culture, and a curriculum which reflects the strengths and specialisms of the partners, and the current and future needs of the local, regional and national economy.

A new staffing structure for the merged college will be developed by the Principal Designate in a spirit of co-operation and consultation, and will adhere to the following principles:

- The structure must support a diverse, vibrant and flexible curriculum which is coherent and offers progression;
- The new staffing structure will address areas of support service delivery which are currently under resourced, such as student support, marketing and business development;
- The structure must be efficient, effective and sustainable, and incorporate opportunities for individual and professional career development and progression;
- The volume and level of provision of FE Education will be designed to deliver on the Regional Outcome Agreement and the UHI Strategic Plan, as well as local strategies and priorities;
- The appropriate restructure policies and procedures will be used during any staff restructure;
- Consultation with trades unions and staff will take place during the restructure process in line with restructuring procedures including SIC's Organisational Restructure and NAFC's Redundancy policies and procedures;
- Significant change can only be delivered successfully with the commitment and engagement of staff. Support for staff will be provided through a range of workforce development and well-being strategies. Human Resources will work with the trades unions and managers to provide advice on the restructure process to all employees affected by the restructure.
- The new college must be sustainable in its own right;
- All staff transferring to the new college will have their terms and conditions of employment protected in line with TUPE regulations.

4.4 Implementation timescales

Draft implementation milestones for the project are detailed in the draft Project Plan described in the Management Case.

5. THE FINANCIAL CASE

5.1 Introduction

The purpose of this section is to set out the forecast financial implications of the preferred option (as set out in the Economic Case) and the proposed deal (as described in the Commercial Case).

5.2 Key messages

The financial model demonstrates that the merged college can achieve and maintain a financially sustainable position. This means that not only will it be able to meet all of its costs in any given year, but that it will be able to plan and invest for the future.

The ability to demonstrate sustainability is a key requirement for assigned status to the Regional Strategic Body, and therefore to secure income from the Scottish Funding Council.

The preferred option is substantially more sustainable than the status quo. Over the five year period assessed the preferred option nets savings of £12.2m compared with the status quo, excluding tax. This saving can be achieved through streamlining and maximising the efficiency of the college structure and curriculum, whilst improving outcomes delivered for students and staff.

Achieving a financially sustainable position for the tertiary sector allows Shetland Islands Council to meet its corporate vision to "work[s] well with our partners to deliver sustainable services for the people of Shetland".
Delivering this change for the community in Shetland is in line with the Council's statutory duty to achieve Best Value, which requires the Council's to commit to improvement across services and the to ensure that such improvement is appropriately prioritised and progressed.

The Council's Medium Term Financial Plan 2018/19 – 2023/24 requires recurring savings of £15.6 million per annum by 2023/24, to allow the Council to live within its means, as previously approved by the Council. This proposal can provide approximately 15% of that ongoing revenue saving requirement.
Failure to progress with the proposed merger will result in these savings being required elsewhere – amounting to in excess of £2.4m per annum. The Council

has to date been unable to identify which services would be able to provide this level of saving.

5.3 Key assumptions (Revenue)

The financial model is based on key assumptions which were developed within the various project work-streams. The main assumptions are detailed below:

5.3.1 Pensions

- A negotiated position will be found to address cessation costs, and no liability will remain;
- Shetland Islands Council will provide the pension guarantee for the new entity; and
- Pensioners and deferred members will transfer into the Shetland Islands Pension Fund.

5.3.2 Employee Costs

- Employee numbers reduce from 113 to 99 FTE;
- NRPA has been applied to all lecturing posts;
- TUPE will apply to all staff transferring to the merged college;
- Single Status has been applied to all support posts;
- Staffing levels and remuneration and structure of Senior Management have been informed by external specialists;
- Curriculum costs have similarly been informed by external specialists and current teaching staff; and
- Instructors will be used to deliver some non-certificated activity.

5.3.3 Premises

- Train Shetland building will no longer be used;
- Alternative use for Port Arthur House has not been established and quantified, as such upkeep costs only have been built into the model; and
- Leasing costs are removed and the Council will commit to an alternative arrangement, resulting in a nominal value transaction.

5.3.4 Operating Costs

- Estimated VAT provision is not included in the financial model, but we will be in a position to advise at the meeting; and
- Additional provision for Marketing and Events Development is included.

5.3.5 SFC Income

- No SFC funding will be applied to commercial courses; and
- HE funding is applied according to the UHI RAM.

5.3.6 Curricular Income

- Detailed curriculum modelling was carried out through consultation with lecturing staff and a relevant external specialist;
- Minimum numbers will be applied to classes (8 for exclusively taught and equivalent for shared classes);
- Growth in commercial course income – with increases in per head spend and total number of local employers accessing training locally – has been assumed in line with the Shetland Employment Survey carried out by the Council; and
- National course fee charges will be applied where appropriate.

5.3.7 Research Income

- Niche specialisms – e.g. marine spatial planning – will be prioritised for development;
- Collaboration and partnerships within UHI will improve;
- Community focused research will be further developed; and
- Projected income is based on historical levels of research income achieved by the existing colleges, adjusted to align with comparable organisations (SAMS and Aberdeen University) based on staffing levels.

5.4 Summary of Model Achievements

The table below shows the value of changes to the Income and Expenditure between the status quo and the proposed model, once full implementation has been achieved.

Table 5.1 Income and Expenditure Modelling Impacts

Income & Expenditure Modelling Impacts (exc VAT)	Status Quo £000	New College £000	(Favourable) / Adverse £000
Employee Costs	5,115	4,468	(647)
Premises Costs	1,373	521	(851)
Operating Costs	1,102	1,015	(86)
Grants to Individuals/Organisations	4	3	(1)
Marketing	18	33	16
Professional and Financial Fees	447	208	(239)
Travel/Vehicle Expenses	149	149	
TOTAL EXPENDITURE	**8,208**	**6,398**	**-1,809**
Scottish Funding Council	-2,407	-2,728	(322)
Tuition Fees, Contracts & Grants	-1,652	-1,820	(169)
Research Grants and Contracts	-955	-1,169	(213)
Sale of Meals	-96	-96	
Consultancy	-148	-193	(45)
Management & Service Fees	-452	-421	31
Other Income	-404	-296	109
Bank Interest	-2	-2	
TOTAL INCOME	**-6,116**	**-6,724**	**-609**
(Favourable) / Adverse	**2,092**	**(326)**	**(2,418)**

It should be noted that £1.97 million of the above saving relates to the implementation of merger, and the remaining £0.45 million can be achieved regardless.

5.5 Financial Due Diligence (Financial Model)

The Council's external audit is wider in scope than a financial statements audit. As part of their 2018/19 audit and requirement to consider the Council's arrangements for achieving Best Value and demonstrating value for money, Deloitte have reviewed the finance work-stream, and their scope includes:

1. Reviewing the methodology and modelling used to produce the financial forecasts;
2. Providing a first and final check on the completed financial projections, with specific reference to the assumptions used in their production; and
3. Providing assurance to decision makers, through the preparation of a report that the plans are robust and based on a sound methodology.

While this work has been carried out as part of the wider scope audit for Shetland Islands Council and the report and assurance is addressed to them, written agreement of the scope was obtained from the Interim Joint Principal on behalf of the Chair of SFTCT prior to any work being undertaken.

The auditors commented that:

"The Effective and Sustainable Tertiary Education, Research and Training in Shetland Project, is an example of where Shetland Islands Council is looking to identify best value options ..."

Deloitte's financial assurance report concludes that:

- The methodology and modelling used to produce the financial forecasts for the proposed merged college are reasonable and appropriate, as they:
    - consider all the work-streams which would be anticipated to be considered based on current budgets and comparable colleges;
    - have been developed by relevant specialists and sense-checked by appropriately qualified finance staff;
    - include appropriate assumptions; and
    - have been appropriately reflected in the financial model.
- The assumptions used in the financial modelling – whilst including an inherent element of uncertainty and being subject to decisions made by the Principal and Board of the new college – are supportable, reasonable and appropriate.
- Following adjustments to the financial modelling and additional work carried out arising from this review, which identified amendments of £0.22m, the auditors are satisfied that the financial projections and associated financial model is robust.

5.6 Taxation

The main issues in relation to tax are:

- The status of the charitable entity;
- Consideration needs to be given as to whether or not it would be prudent to establish a trading subsidiary to carry out any non-primary purpose trading activities;
- The transfer of activities should fall out-with the scope of UK VAT (transferred as a going concern), however there will be a need to demonstrate that all conditions can be met;
- A non-statutory clearance from HMRC is recommended; and
- A new VAT Registration number is recommended to ensure that no liabilities transfer from the SFTCT.

The taxation implications of the proposed merger were reviewed by Deloitte taxation specialists, independent of the audit team.

5.7 Merged College - Projected income and expenditure account

The following table summarises the combined income and expenditure of the merged college, per the financial model, over a period of 5 years

. **Table 5.2 Proposed New Entity – Income and Expenditure Summary**

Proposed New Entity - Income and Expenditure Summary (exc VAT)	Year 1 £000	Year 2 £000	Year 3 £000	Year 4 £000	Year 5 £000
Employee Costs	4,559	4,632	4,771	4,915	5,062
Premises Costs	521	532	542	553	564
Operating Costs	1,015	1,036	1,056	1,078	1,099
Grants to Individuals/Organisations	3	3	3	3	3
Marketing	33	34	35	35	36
Professional and Financial Fees	208	214	221	227	234
Travel/Vehicle Expenses	149	152	155	158	161
TOTAL EXPENDITURE	**6,489**	**6,603**	**6,784**	**6,969**	**7,160**
Scottish Funding Council	- 2,567	- 2,727	- 2,891	- 2,977	- 3,065
Tuition Fees, Contracts & Grants	- 1,770	- 1,838	- 1,909	- 1,955	- 2,002
Research Grants and Contracts	- 1,063	- 1,107	- 1,177	- 1,290	- 1,383
Sale of Meals	- 96	- 98	- 100	- 102	- 104
Consultancy	- 153	- 166	- 190	- 210	- 216
Management & Service Fees	- 385	- 405	- 433	- 459	- 472
Other Income	- 296	- 301	- 307	- 314	- 320
Bank Interest	- 2	- 2	- 2	- 2	- 2
TOTAL INCOME	**- 6,331**	**- 6,645**	**- 7,009**	**- 7,307**	**- 7,564**
(Favourable) / Adverse	**158**	**(41)**	**(225)**	**(338)**	**(403)**

Deloitte advised that detailed sensitivity analysis on the financial model is not necessary, as the assumptions upon which it is based are considered supportable, reasonable and appropriate. However, to provide additional assurance, it was recommended that a high-level sensitivity analysis was carried out.

Income: The table below shows the impact of 2.5% and 5% adverse changes in income. This excludes SFC funding as there is the potential for the merged college to receive additional rurality funding, and the Scottish Government in their Medium Term Financial Strategy confirmed that education is a key priority for the coming five years and is therefore likely to be protected from significant cuts in funding.

Expenditure: The table below also shows the impact of 2.5% and 5% adverse changes in expenditure. This excludes employee costs as pay increases have been factored in in line with Scottish Government proposals for public sector staff. It also excludes premises costs as the Council is assumed to commit to a nominal value rental and it is not anticipated that this position will change in the medium term.

It is important to note that these adverse changes from Year 2 – Year 5 are *in addition to* the inflationary impacts already factored into the financial model.

Table 5.3 Summary of revised scoring process

Sensitivity Analysis- Impact on Outcome	Year 1 £000	Year 2 £000	Year 3 £000	Year 4 £000	Year 5 £000
5% Increase in Costs (exc Employee & Premises)	229	31	(151)	(262)	(327)
5% Decrease in Income (exc SFC)	346	154	(19)	(121)	(178)
2.5% Increase in Costs (exc Employee & Premises)	193	(5)	(188)	(300)	(365)
2.5% Decrease in Income (exc SFC)	252	57	(122)	(229)	(291)

The sensitivity analysis demonstrates that reductions in income have a greater impact than increases in cost on the sustainability of the entity. However, where income is affected, it is likely that associated costs would reduce to mitigate the impact. Given the improved starting position, even where adverse conditions present themselves, the merged college will be better able to respond.

5.8 Status Quo – Projected income and expenditure

The status quo position is approximately £2.4 million more expensive than the proposed new entity per annum (Table 1.4). The following table shows the income and expenditure position for NAFC Marine Centre UHI, Shetland College UHI and Train Shetland, on the basis of the status quo position.

Table 5.4 Status Quo – Income and Expenditure Summary

Status Quo - Income and Expenditure Summary	Approved Budget for 2018/19					
	Shetland College	Train Shetland	NAFC (inc PAH)	NAFC (SIC)	STERT	Total for Sector
	£000	£000	£000	£000	£000	£000
Employee Costs	2,471	355	2,288			5,115
Premises Costs	439	71	461	401		1,373
Operating Costs	450	335	317			1,102
Grants to Individuals/Organisations	4					4
Marketing	7		11			18
Professional and Financial Fees	191	35	198	6	18	447
Travel/Vehicle Expenses	31	65	53			149
TOTAL EXPENDITURE	**3,593**	**861**	**3,328**	**408**	**18**	**8,208**
Scottish Funding Council	-1,644		-763			-2,407
Tuition Fees, Contracts & Grants	-605	-282	-765			-1,652
Research Grants and Contracts			-955			-955
Sale of Meals	-96					-96
Consultancy			-148			-148
Management & Service Fees	-18	-340	-94			-452
Other Income	-91		-242			-404
Bank Interest			-2			-2
TOTAL INCOME	**-2,453**	**-622**	**-3,041**			**-6,116**
(Favourable) / Adverse	**1,140**	**240**	**287**	**408**	**18**	**2,092**

A five year model has also been developed for the status quo to show the anticipated impact of inflation on the annual outturn position. Inflation has been taken per the Bank of England forecast, except for employee costs which are assumed to rise 3% per annum in line with recent Scottish Government guidance. The funding gap between the status quo and the proposed new entity at year five grows from £2.4 million to £2.9 million (21% increase).

Table 5.5 Status Quo – Future Years Income and Expenditure Summary

Status Quo - Future Years Income and Expenditure Summary	Approved Budget for 2018/19					
	Shetland College £000	Train Shetland £000	NAFC (inc PAH) £000	NAFC (SIC) £000	STERT £000	Total for Sector £000
Year 2	1,187	248	316	416	18	**2,185**
Year 3	1,236	257	346	424	19	**2,281**
Year 4	1,287	265	377	433	19	**2,381**
Year 5	1,340	275	409	441	19	**2,485**

The above table demonstrates that the status quo is unsustainable. This is demonstrated for NAFC Marine Centre within their Annual Accounts as at 31 March 2018, which makes the following statement:

"A material uncertainty exists that may cast significant doubt on the charity's ability to continue as a going concern".

The risks associated with this include a lack of ability of the sector to invest in the future, respond to customer requirements, and to ensure that outcomes delivered for students and the wider community improve.

5.9 Investment in the Future

The status quo position allows for no planned investment in capital, though each organisation has a list of requirements, ranging from high priority health and safety items, including Port Arthur House in Scalloway (currently closed), to 'nice to haves', and low priority items.

The proposed new entity will be in a position to utilise anticipated surpluses as shown in the financial model to fund capital and improvement works. It is also assumed that being in a more financially sustainable position and existing outwith the Council structure will enable the merged college to apply for additional loan or grant funding.

5.10 Balance Sheet

5.10.1 Status Quo

The NAFC Marine Centre's Balance Sheet as at 31 March 2018 shows that it had net liabilities of £0.82 million (including a pension liability of £3.1 million). It had a cash position of £1.08 million.

Shetland College and Train Shetland are included within Shetland Islands Council's Balance Sheet.

5.10.2 Merged College

It is assumed that all items contained within the NAFC Marine Centre Balance Sheet will be completed or transferred into the new entity, with the exception of the pension liability (assumed to be cleared on cessation). There will be no pension liability at initiation, as it is assumed a negotiated position will have been reached to address cessation costs (£3.1 million on the Balance Sheet).

Shetland Islands Council will maintain ownership of its land and buildings. Equipment with a net book value as at 31 March 2018 of £0.095m in the Council's Balance Sheet will transfer at nil cost, as these items were funded by European or SFC grant, for Shetland College, and will continue to be utilised for their original purpose.

5.11 Overall Sustainability

The proposed merged college is a more prudent use of resources by Shetland Islands Council compared with the status quo, and it demonstrates sustainability moving forward. It reduces the financial commitment required by the Council by £1.8m per annum.

The Scottish Funding Council have provided strategic funding to meet one off costs associated with transition in previous college mergers, and are currently in negotiation with the Council in regard to funding the pension liability at NAFC Marine Centre.

A detailed bid for further support cannot be completed until a commitment to merger has been made. It is intended that a bid will be prepared early in the next stage to cover other one off costs associated with merger, such as external advice and early retirement/voluntary redundancy support.

Shetland Islands Council will be required to provide cash support in the short to medium term to allow the new entity to operate and meet its commitments on a daily basis.

6. THE MANAGEMENT CASE

6.1 Introduction

This section addresses the 'achievability' of the project; it sets out in more detail the actions that will be required to ensure the successful delivery of the project in accordance with best practice.

6.2 Project management arrangements

Shadow Board

In line with best practice for college mergers, a joint committee will be established consisting of representatives from each of the partner organisations, to work towards realising the merger proposal. This is known as the Shadow Board.

The Shadow Board will be established in line with, and will reflect, the 2014 ministerial guidance on college board governance and in line with the Post-16 Education (Scotland) Act 2013.

Establishment of the Shadow Board is a transitional step towards the creation of a Board of Management which will be the governance mechanism from vesting day. Membership of the Shadow Board will consist of the following representatives:

- Chair, Shetland Fisheries Training Centre Trust;
- Chair, Shetland College Board;
- Chair, Education and Families Committee
- Staff representative – teaching;
- Staff representative – non-teaching;
- Trustee, Shetland Fisheries Training Centre Trust;
- Student representative;
- UHI representative;
- Independent board members to be recruited[9].

[9] In line with para 4.2, there would require to be 7 to 12 independent members.

The project will be managed in line with PRINCE2 methodology. As such, the Shadow Board will take on the role of the Project Board in the PRINCE2 management structure, with the chair (when selected) as the Senior Executive.

A Project Manager will be appointed and will be responsible for the day-to-day management of the Project, including responsibility for identifying the project tasks. The Project Manager will assemble and co-ordinate the Project Team, who will carry out the project tasks.

An external Project Advisor resource with experience in college merger will also be appointed to take on the role of Project Assurance.

6.2.1 Project roles and responsibilities

The Chair of the Shadow Board (when selected) will act as the Senior Executive for the Project. The Senior Executive is the single point of accountability for the Project.

The Shadow Board are responsible for ensuring that the needs of key stakeholders are represented and that their needs and requirements are met by the Project. The Board consists of political, trust, staff and student stakeholders. The prime responsibility of the Shadow Board is to ensure that all requirements for the merged college, in relation to the governance of the institution, are in place, such as the committee structure, standing orders, scheme of delegated authority and principal office holders. The Shadow Board should also be in a position to endorse and implement the new college's strategic plan from vesting date. The Shadow Board must have delegated authority to:

- provide strategic direction on the merger process prior to vesting day;
- provide an overview of the Principal Designate's activities in relation to the merger process;
- approve the staffing structure for new college;
- approve arrangements for voluntary severance taking account of the approved staffing structure of the new college. The Shadow Board will liaise with the partner Boards with regard to any subsequent voluntary severance requests which arise as a consequence of the implementation of the approved staffing structure;
- approve the draft budget for new college;
- approve policies and procedures for new college;

- approve the name for the new college;
- provide strategic direction on the development of a Communications and Staff Engagement strategy to the Principal Designate.

The Project Manager runs the Project on a day-to-day basis and will be responsible for the Project on behalf of the Shadow Board. The Project Manager will be responsible for communication and reporting, procuring services, planning and monitoring and other key project tasks.

The Project Manager's responsibilities will include:

- Support to the Shadow Board;
- Support to the Governing Bodies and corporate/executive teams of the merger partners as required;
- Development of an overall plan and high level timetable for implementation of the merger;
- Communication of the plan to the Governing Bodies, Scottish Funding Council, University of the Highlands and Islands, and the Scottish Government as appropriate;
- Establishment of internal workstreams and/or development of existing workstreams required for delivery of merger, including development of initial terms of reference and agendas, reporting and communications;
- Provision of information to all required stakeholders;
- Formation of a Project Team and merger support groups to deliver the internal workstreams;
- Definition of activities and outputs required for workstreams, including identification of staff resources required for delivery;
- Programme management to enable development of workstream plans, agreement of initial budgets and delivery of milestones;
- Delivery of status reports and troubleshooting in problem areas;
- Cultivation of business relationships vital to the merger success.

Project Assurance will provide an independent and objective oversight of project functions, and will specifically ensure that the project management is delivering the required information and outputs as specified by the Project Board.

6.2.2 Project plan

The Outline Project Plan below provides a broad outline of the milestones for the merger process:

Table 6.1 Outline Project Plan

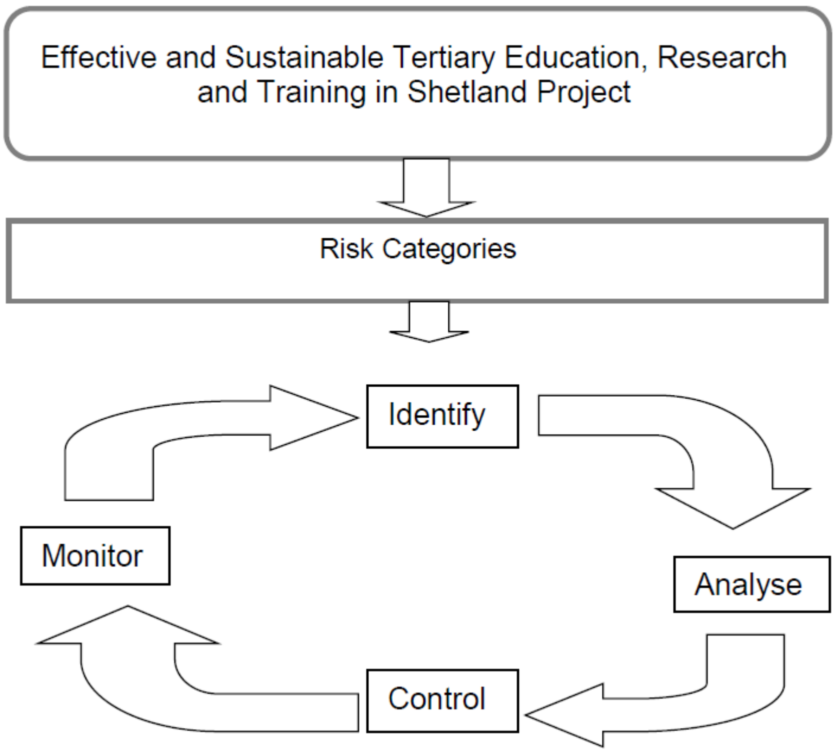
Milestone Activity	Timescale
Full Business Case	
Shetland College Board	Week beginning 10 Dec 2018
SIC Education & Families Committee	
SIC Policy and Resources Committee	
Shetland Fisheries Training Centre Trust	
Shetland Islands Council	
Approval of Full Business Case	
Merger Initiation	
Establishment of Shadow Board	Jan 2019
Appoint Project Manager	Jan 2019
Appoint Project Assurance	Jan 2019
Develop Project Plan	Jan 2019
Establish workstreams and project team	Jan 2019
Submit bid to SFC for strategic funding	Jan/Feb 2019
Consultation and Due Diligence	
Formal consultation – staff, students, UHI, external stakeholders	Mar-May 2019
Due diligence	TBC
SFC evaluation visit	Jun 2019
Application to OSCR	TBC
Recruitment	
Establish recruitment panel	Jan 2019
Recruitment panel training	Jan/Feb 2019
Undertake recruitment for Principal Designate	Feb-Apr 2019
Appoint Principal Designate	May-Jun 2019
Restructure and appointment of senior management team	TBC
Approval of restructuring plan by Shadow Board	TBC
Parliamentary and Ministerial Approval	
SFC advice to Scottish Government and Cabinet Secretary	TBC
Scottish Government consultation process	TBC
Analysis of consultation responses	TBC
Submission to Ministers	TBC
Ministerial approval	TBC
Public announcement	TBC
Parliamentary Process to approval	TBC
Vesting Date	**Aug 2020**

6.3 Outline arrangements for benefits realisation

The Benefits Realisation Plan is attached as Appendix i.

6.4 Outline arrangements for risk management

The Project will follow Shetland Islands Council's Risk Management Strategy, utilising the following risk management process:



Shetland Island's Council's Risk Management Policy sets out the risk tools, processes and methodologies and defines the Council's risk appetite. These tools and processes will be applied as per standard practice for the Project.

A Risk Register has been set up on the RiskWEB system, with the likelihood and severity estimated using the risk matrix.

A draft risk register for the merger has been attached as Appendix ii. Risks have been grouped by workstream, or assigned to the project as a whole, and graded for likelihood and severity.

6.5 Outline arrangements for post project evaluation

The outline arrangements for post implementation review (PIR) and project evaluation review (PER) have been established in accordance with best practice and are as follows.

6.5.1 Post implementation review (PIR)

The review will ascertain whether the anticipated tangible and intangible benefits have been delivered. The review will be conducted 12 months following merger.

The following Key Performance Indicators have been proposed to determine the success or otherwise of aspects of the merger:

Table 6.2 Proposed Key Performance Indicators

KPI	Measurement
Improved quality of teaching and learning	Post-merger Education Scotland report
	Academic Quality Assurance protocol in place
	Curriculum Development and Planning process in place
	Student satisfaction survey
New governance arrangements	Agreed by milestone date
New SMT structure	Agreed by milestone date
New staffing structure	Agreed by milestone date
Merged college – culture change	Staff viewpoint survey – buy-in established
Harmonisation of terms and conditions (including TUPE)	Majority achieved within first year of vesting date
Improved staff confidence and morale	Staff viewpoint survey – views on new direction
Increased income	Outturn figures in first full trading year following merger
College branding	New college brand established
	Business development strategy established and resourced

Business development, research and marketing strategies	Research strategy established and resourced
	Marketing strategy established and resourced

6.5.2 Project evaluation reviews (PERs)

PERs appraise how well the project was managed and delivered compared with expectations and are timed to take place 6 months following full implementation of the preferred option.

The PER will be undertaken by a small team of staff from the Council and the merged college, and will:

- Review project management and documentation
- Note any lessons learned for future projects
- Identify areas of good practice or areas of improvement
- Provide the Project Board with a report assessing project management performance.

Signed:

Date:

Senior Responsible Owner
Project Team

Appendix i - Benefits Realisation Plan

Purpose

The purpose of this document is to propose arrangements for the identification of potential benefits, their planning, modelling and tracking. It includes a framework that assigns responsibilities for the actual realisation of those benefits.

The importance of clear objectives and measurable benefits

The core of any business case is the identification of specific objectives. The preferred option, which becomes the scheme to be delivered, is selected on the basis that it meets the project's objectives in a way that represents the best value for money and is both affordable and deliverable.

The need to have clear objectives from the outset of a project, along with robust arrangements to ensure that they are delivered, is self-evident. However it is important to note that weaknesses in these areas are commonplace. For example the National Audit Office and the Office of Government Commerce have identified the first cause of project failure as "lack of clear links between the project and the organisations strategic priorities, including agreed measures of success."

Types of benefits

Benefits typically fall into four main categories, and are analysed in this way in 5-case model business cases:

- Cash releasing benefits (CRB): These benefits reduce the costs of organisations in such a way that resources can be re-allocated elsewhere. This typically means that an entire resource is no longer needed for the task for which it was previously used. This can be staff or materials/assets.
- Financial but non-cash releasing benefits (non-CRB): This usually involves reducing the time that a particular resource takes to do a particular task; but not sufficiently to re-allocate that resource to a totally different area of work.
- Quantifiable benefits (QB): These benefits can be quantified, but not always easily. The extent to which QBs are measured will depend on their significance. However as a general rule every effort should be made to quantify benefits financially wherever possible and proportionate to do so.
- Non-quantifiable benefits (non-QB): these are qualitative benefits, which are of value to the public sector that cannot be quantified.

Benefits Register

The Benefits Register sets out the defined benefits of the project, the category of each benefit (in economic terms), how they will be measured and quantified, who benefits and who is responsible for their realisation. The benefits are as outlined in the relevant sections of the business case. This document focuses on the key benefits which the project is intended to deliver, rather than providing a comprehensive list of all benefits.

This register is a management tool which addresses specific benefits achieved as a result of the merger of Shetland College, NAFC Marine Centre and Train Shetland.

As outlined in the Management Case, an evaluation will be undertaken to review and assess the success of the project against its original objectives and success criteria. The achievement of these benefits will form the basis of that review. The initial review will be undertaken within two years of the merger vesting date.

	Specific Measurables	Timescale	Source of data	Lead responsibility	Beneficiaries	Type of benefit
1	**Financial**					
1.1	Financial sustainability	Tbc	College financial reporting	Principal	College Wider community and industry	CRB
2	**Organisational**					
2.1	Simplified governance for tertiary sector	Vesting date	College constitution	Board	College	Non-QB
2.2	More efficient management structure	Vesting date-6 months following merger	College operational plan	Board Principal	College Staff Students Wider community and industry	CRB
3	**Operational**					
3.1	Improved responsiveness and decision-making for customer queries	12-24 months following merger	College operational Plan Customer surveys	Senior Management Team	Students Service users	QB
3.2	Improved and enhanced student support arrangements	12-24 months following merger	College operational Plan Student satisfaction survey	Senior Management Team	Students	Non-CRB

3.3	Improved marketing reach through single brand identity and marketing strategy for whole tertiary education, research and training sector	Vesting date	College Marketing Plan Customer surveys	Student Engagement and Marketing Function	College Students Service users	CRB
3.4	Improved Curriculum Development and Planning approach	Vesting date- 12 months following merger	HMI Inspection Reports	Senior Management Team Academic Lead	Students Service users	QB
3.5	Improved access and progression routes	Vesting date- 12 months following merger	College operational plan Cross-college committees HMI Inspection Reports	Senior Management Team Academic Lead	Students Service users Wider community and industry	Non-CRB
4	**Strategic**					
4.1	Enhanced ability to deliver on local (Shetland Partnership Plan) and regional (UHI Strategic Plan, H & I Skills Investment Plan) strategic aims and objectives	Vesting date	College Strategic Plan Strategic partnerships	Board Principal	Wider community and industry Community Planning Partners	QB

Appendix ii – Proposed Risk Register

Workstream	Risk	Risk Profile
Finance	Failure to transfer existing contracts to merged college	High
Finance	Failure to secure sufficient merger funding from SFC	High
Finance	Failure to establish financial sustainability	High
Finance	Failure to secure favourable response to pensions issue	High
Finance	Failure to secure favourable outcome for estates issues	High
Governance	Failure to agree appropriate governance model	High
Project	Failure to merge	High
Staffing Structure and HR	Loss of key staff	High
Staffing Structure and HR	Failure to establish an achieveable staff transfer plan	High
Staffing Structure and HR	Failure to establish harmonisation of staff terms and conditions	High
Vision and Culture	Failure to agree on merged College name	High
Vision and Culture	Failure to agree on on strategic direction	High
Vision and Culture	Failure to develop a shared quality culture	High
Vision and Culture	Failure to establish merged college identity	High
Staffing Structure and HR	Negative impacts on staff morale from merger	High
Staffing Structure and HR	Failure to maintain effective communications with staff and trades unions	High
Business Development	Failure to establish clear strategic direction for commercialisation and business development	Medium
Curriculum	Failure to establish clear curriculum planning process	Medium
Curriculum	Failure to establish learning and teaching strategy	Medium
Finance	Failure to resource corporate services (HR, legal, finance)	Medium
Governance	Failure to ensure suitably qualified governing body	Medium
Project	Failure to maintain current standard of service	Medium
Project	Failure to establish and implement suitable merger timetable	Medium
Staffing Structure and HR	Failure to meet TUPE obligations	Medium
Staffing Structure and HR	Failure to establish clear staffing structure	Medium
Staffing Structure and HR	Failure to undertake staff and student consultations during merger process	Medium
Student Engagement, Support and Marketing	Failure to maintain effective communications with students	Medium
Student Engagement, Support and Marketing	Failure to maintain effective communications with external stakeholders	Medium
Student Engagement, Support and Marketing	Poor public/media relations leading to negative public profile	Medium
Student Engagement, Support and Marketing	Negative impact on the quality of the student experience	Medium
Vision and Culture	Failure to establish clear brand identity for merged college	Medium
Finance	Failure to establish resourcing plan for services arising from new strategies (e.g. business develop	Low
ICT	Failure to ensure proper and timely transfer of ICT services	Low
Project	Failure to reach agreement with accrediting and/or funding bodies	Low
Project	Failure to undertake appropriate legal and financial due diligence	Low
Project	Negative or adverse reporting during due diligence	Low
Research	Failure to establish strategic direction for research	Low
Student Engagement, Support and Marketing	Failure in safeguarding (e.g. PVG, Corporate Parenting)	Low
Student Engagement, Support and Marketing	Failure to establish access and inclusion plan	Low
Student Engagement, Support and Marketing	Impacts on ability of the college to promote equalities	Low
Student Engagement, Support and Marketing	Failure to establish effective student representation	Low

Appendix iii - Board of Management – Independent Member Role Description

The Independent members of the College Board of Management are appointed by the Regional Strategic Body. An independent member is responsible for:

- Contributing to the business of Board meetings, following established and agreed procedures
- Contributing to one or more of the Board committees by membership or chairmanship
- Engaging effectively at board meetings and working collaboratively with other members
- Observing the *Nine Principles of Public Life (*selflessness, integrity, objectivity, accountability, openness, honesty, leadership, public service and respect) in all Board business.

The Independent members shall contribute to the Board in:

- articulating the vision of the College as an academic partner and assigned college of UHI
- maintaining and developing the ethos of the College
- setting corporate objectives in line with local outcome agreement with UHI
- assessing the performance of the Principal and Chief Executive
- establishing high standards of integrity in the conduct of Board business
- monitoring the financial health and compliance of the College in line with the Local Financial Memorandum agreed with UHI
- Monitoring the college's achievement of its agreed outcome measures
- Working effectively with the FE Regional Board

The Members shall seek to promote the best interests of the College wherever possible, be its ambassador, and if call upon to do so, represent it at meetings, presentations and conferences.

Performance of the Board and individual Board members

Each Member:

- should contribute to establishing performance indicators against which to measure its performance
- should discuss his or her contribution and development needs with the Chair of the Board at least annually
- is expected to contribute to critical self-assessment of Board performance and processes and make an active contribution to the annual performance assessment of the governance of the College

- shall ensure regular attendance at board meetings.

Anderson Strathern

Shetland Islands Council

and

Shetland Fisheries Training Centre Trust

1. **Scope of the report**

1.1. This report has been prepared on behalf of Shetland Islands Council and Shetland Fisheries Training Centre Trust for the purpose set out in the brief and for no other purpose or person. It cannot be relied on for any other purpose or by any other person and if it is so used, it is used at that person's own risk.

1.2. This report is based on the information provided to us. We have not sought to establish the reliability of the information and therefore we cannot be held liable in the event that any information is untrue, inaccurate or incomplete.

1.3. It is also based on our understanding of the importance of certain matters as explained to us.

1.4. We appreciate the hard work which goes into pulling together all of the information for a diligence exercise particularly when this is in addition to keeping the service operating. We would like to take this opportunity to thank the Project Manager and all of the staff in respect of the work they did to make the process as easy as possible for us. We could not have completed this report without that assistance.

2. **Introduction and overview**

2.1. A review has been ongoing in Shetland for some time in relation to tertiary education, research and training provision. The Shetland Tertiary Education, Research and Training (STERT) Project initially established a STERT Partnership Board to consider how best to deliver the services and functions carried out by

2.1.1. Shetland Islands Council (SIC) through

2.1.1.1. Train Shetland; and

2.1.1.2. Shetland College (UHI) (Shetland College)

2.1.2. Shetland Fisheries Training Centre Trust (SFTCT) using the operating name NAFC Marine Centre (UHI) (NAFC Marine Centre).

2.2. Shetland College and NAFC Marine Centre are members/academic partners within the University of the Highlands and Islands (UHI).

2.3. As part of the STERT Project, initial due diligence was carried out in relation to NAFC Marine Centre, Shetland College and Train Shetland. Following the due diligence exercise, SIC and SFTCT agreed to work together and appointed a joint Principal in respect of both colleges and Train Shetland was integrated into the reporting structure of Shetland College.

2.4. During this period of closer working, a Strategic Outline Case was developed in respect of the future of the tertiary education, research and training provision, which identified merger as the preferred way forward. The Strategic Outline Case also narrowed down the potential merger options to: either a host or phoenix model. SIC and SFTCT agreed to proceed to a Full Business Case for merger of Shetland College, NAFC Marine Centre and Train Shetland, prior to a final decision being made towards the end 2018. As part of the decision making process, it was also agreed in view of the passage of time, to revisit the legal due diligence exercise carried out previously.

2.5. As a result we have undertaken a legal due diligence exercise. We have been provided with a number of documents for each organisation. These have been reviewed in the context of the potential merger options and also the practical and legal issues in delivering each of the options.

2.6. We have provided detailed due diligence reports for both SIC and SFTCT. However as the detailed reports include information which is commercially sensitive and which would include personal data, we have provided this summary report to enable circulation.

3. Models and Legal Process for the relevant Model

3.1. The two key merger models of Host or Phoenix have a number of issues which are associated with them:

Host Model	**Council Host**	As the Council is not a charity, SFTCT could not transfer any assets to the Council at nil and the Council would require to pay full market value if they were to be the Host.
	SFTCT Host	NAFC Marine Centre has objects relating to the advancement of education and training, the courses offered by SC and TS have a far more diverse educational remit than those provided by NAFC Marine Centre whose services are relevant to the maritime industry only. If NAFC Marine Centre is used as the host model, it would be necessary for the objects and remit of SFTCT to be considerably widened to make provision for this. The new college would require either (i) to be a fundable body or (ii) assigned to the Regional Strategic Body (RSB) in order to avoid any issues with continued funding. As a result the Scottish Ministers would require to consult with the Scottish Funding Council (SFC) under section 7 of the Further and Higher Education (Scotland) Act 2005 (the "2005 Act") (Fundable Body) and Section 7C of the 2005 Act (Assigned College). The SFC will review whether there are suitable provisions for (amongst others) the governance and management of the body which would include the application of the Code of Good Governance. There is an expectation that there should be student representatives and staff members on the board. As a result of this and the widened remit which would come about as a result of any merger we would strongly recommend that SFTCT considered updating its legal form to become a body with limited liability protection given the wide remit it would have, such as a charitable company limited by guarantee or a Scottish Charitable Incorporated Organisation or SCIO.
Phoenix	**Incorporated College**	The Scottish Ministers could promote an order under section 13 (1) of the Further and Higher Education (Scotland) Act 1992 (the "1992 Act") in respect of Shetland College which states that on the appointed date Shetland College would cease to be under the management of Shetland Islands Council (SIC). The order promoting the

		transfer of Shetland College would also establish, with effect from such date as the Secretary of state would prescribe a “Board of Management of” the new college and also apply such other provisions (subject to modifications) as are appropriate in respect of the transfer to the new college. This new college would be an incorporated college. An incorporated college would be considered as being a general government public sector body by the Office for National Statistics (ONS). The reason for this classification is the control held by Scottish Ministers over the corporate policy within the Colleges. In particular the fact that (i) an incorporated college would need consent from Scottish Ministers in order to borrow and (ii) the Scottish Ministers can remove the board, close of merge colleges has resulted in that classification. The impact of this classification means that incorporated colleges have had to align their budgeting, reporting and accounting practices to the practices which apply to non-departmental government departments. This includes that colleges have to control their expenditure so it does not exceed pre-set limits, even if expenditure is financed from borrowing it would still require “budget cover” which would mean that it would still be included within the Scottish Government budget and colleges cannot carry forward surplus funds to future years. This has a fundamental impact on the operation of a college.
	Unincorporated College	An unincorporated college can take a number of different forms including a company limited by guarantee or Scottish Charitable Incorporated Organisation (SCIO). Whilst the Further and Higher Education (Scotland) Act 1992 and the 2005 Act do not apply to the establishment of the board, the structure and governance of the new organisation should reflect the good governance guidelines to ensure that there are no problems with obtaining consent from the SFC to the assignation of the new college to UHI as regional strategic body. The new body would apply to OSCR as registration as a charity.

3.2. When carrying out the due diligence exercise we have considered the risks based on the preferred models.

3.3. In order to adopt each of the models there is a very different process. In many previous college mergers, the route used was for the Scottish Ministers to promote the necessary orders using the powers under 3(1) (c), 25(1), (1A), (2) and (5) and 60(3) of the 1992 Act to transfer the staff, assets, rights and liabilities to the host and dissolved the other College(s) (Transfer order). However, it should be noted that sections 3(1) (c) and 25(1) apply to incorporated colleges and would not apply to SFTCT. As a result, no matter which model is adopted, the process will be novel for the SFC and also the Scottish Government and therefore we would recommend that there is early engagement with the SFC and Scottish Government in respect of the proposed merger model and also the merger proposal itself sets out the suggested process.

4. **Key Issues – Governance Issues, Legal Constitution, Powers of Governing Bodies, Partnership Board and Charity Issues**

From the information we have been provided, we have not identified any key issues in respect of Governance Issues, Legal Constitution, Powers of Governing Bodies, Partnership Board and Charity Issues which would legally prevent merger. However, we have identified a number of issues which would have (i) a potential impact on the structure or (ii) would require to be actioned to successfully merge.

4.1. As set out in relation to the merger models above, it is not recommended that a Scottish charity such as SFTCT transfers all/ part of its assets to a non-charitable entity for no financial consideration (or even for a nominal consideration) whether it takes place under a merger or under some other form of business transfer agreement. This is due in part to the nature of the duties and responsibilities that the trustees of SFTCT have under charity law. This includes a duty to safeguard and maximise the assets of SFTCT and to retain the independence of SFTCT. Therefore the only way for an SIC host model to work would be the sale of NAFC Marine Centre (UHI) to SIC at full market value. For these reasons, this makes it difficult from a Charity law perspective for SIC to be the host.

4.2. In respect of SFTCT being the host, whilst it has objects relating to the advancement of education and training, the courses offered by Shetland College have a far more diverse educational remit than those provided by NAFC Marine Centre whose services are predominantly relevant to the maritime industry. If SFTCT is used as the host, it would be necessary for the objects and remit of SFTCT to be considerably widened to make provision for this widened remit. SFTCT may also wish to consider amending their name to reflect their new role. Any amendment to the objects or name would require the prior approval of the Office of the Scottish Charity Regulator (OSCR). The trustees of SFTCT would also need to be satisfied that on balance having considered the business case in full and after taking all relevant advice, they consider that it is in the best interests of SFTCT to take on these wider activities which would necessitate SFTCT moving into some new areas, albeit that they are still connected to their current educational remit.

4.3. Whilst UHI could potentially seek to fund elements of an unassigned college, the basis of such funding is narrower and therefore in order to continue to be funded through UHI as the RSB in respect of all of its activities, the merged entity would require either (i) to be a fundable body or (ii) assigned to UHI as the RSB. As a result the Scottish Ministers would require to consult with the Scottish Funding Council (SFC) under section 7 of the Further and Higher Education (Scotland) Act 2005 (the "2005 Act") (Fundable Body) and Section 7C of the 2005 Act (Assigned College). The SFC will review whether there are suitable provisions for (amongst others) the governance and management of the body which would include the application of the Code of Good Governance. There is an expectation that there should be student representatives and staff members on the board. Therefore the constitution of SFTCT would require to be amended to ensure that the constitution was considered by SFC as complying with the application of the Code of Good Governance.

4.4. The SFTCT as a trust governed by a trust deed does not have the same separation as a legal "entity" in the way that a SCIO or company limited by guarantee is. For example, leases/formal contracts have to be entered into in names of trustees. Legal proceedings cannot be taken by the trust but only by individuals representing it and similarly, legal proceedings would be taken against the trustees rather than the organisation. Trustees could be personally liable for debts if the organisation were unable to meet its debts and liabilities out of its own resources. Whilst protections may be in place, we consider that this structure would be unattractive to staff and students to participate in. As a result of this and the widened remit which would come about as a result of any merger we would strongly recommend that SFTCT updates its legal form to become a body with limited liability protection given the wide remit it would have, such as a charitable company limited by guarantee or a Scottish Charitable Incorporated Organisation or SCIO.

4.5. In the event that SFTCT was to update its legal form, in effect it would change its legal status and would for the purpose of the process of merger become a phoenix.

4.6. If however SFTCT wished to continue with narrowed objects adopting the phoenix model from the outset may facilitate this option. In these circumstances the new phoenix college should be set up and an application would be made to OSCR at least three months in advance of intended vesting date of the new college to ensure that the phoenix has charitable status to facilitate the transfer from NAFC Marine. This approach would also allow for the organisation to be set up and the board/shadow board to be put in place. The process of setting up an unincorporated college would necessitate making an application to OSCR seeking their consent to enter the phoenix college onto the Scottish charity register and become a recognised charity with a Scottish charity number.

4.7. Consideration would need to be given to the information to be provided to OSCR as part of the application to set up the charity to justify both the business case and in order to meet both the charity test and public benefit test of setting up another college within the small geographic area of Shetland. OSCR would need to be satisfied that this would be of considerable public benefit.

5. Key Issues - Material Contracts

From the information we have been provided, we have not identified any material issues in respect of Material Contracts which would legally prevent merger. However, we have identified a number of issues which would require to be actioned to successfully merge.

5.1. Any contracts that are in place between SIC and SFTCT and third parties in respect of the delivery of aspects which extend beyond the vesting date (i.e. the date when the new College will come into existence) would require to be transferred to the Host (except for the host's own contracts) or alternatively to the phoenix or be terminated.

5.2. Having reviewed the contracts, in the event that these contracts are to be assigned, the consent of the other party is required.

5.3. This leads to the potential risk that:

5.3.1. a third party could refuse to transfer; and/or

5.3.2. the third party could seek to use the requirement for consent to seek to revise the commercial terms.

5.4. As set out above, generally in College Mergers, the Scottish Ministers would promote an order using the powers under 3(1)(c), 25(1), (1A), (2) and (5) and 60(3) of the 1992 Act to transfer the staff, assets, rights and liabilities to the host and dissolved the other College(s) (Transfer order). The effect of the Transfer Order is to change the contracts so that the new college would be treated as if they had always been a party to the contract in lieu of the old college. As a result, the contracts could be transferred without first obtaining consent.

5.5. However, it should be noted that sections 3(1)(c) and 25(1) apply to incorporated colleges and whilst there are provisions within the 1992 Act and the 2005 Act which would allow a Transfer Order to be promoted in respect of SIC, this would not apply to SFTCT. Therefore the contracts will require to transfer by way of agreement. As a result, consent will be required. Therefore where contracts are continuing you should seek to obtain consent in good time prior to vesting date.

5.6. We would also recommend in order to mitigate risk that any new contracts which are entered into between now and full merger the following should be considered:

5.6.1. that when SIC procures goods/services, there may be the potential of procuring/setting up frameworks which the college could also use as this would ease the burden on the new college and still allow economies of scale.

5.6.2. include provisions which enable the contracts to be assigned to any successor bodies to whom the functions of the relevant body are vested/transferred.

5.6.3. allow a no fault break clause in favour of SIC (if possible although we appreciate that these can be difficult to negotiate) which would allow the contracts to be terminated at your behest on merger.

5.6.4. check the change of control provisions (if any) to ensure that these would not permit/restrict a change of control envisaged by a merger situation; and

5.6.5. the parties agree to set parameters that they would consult with each other before entering into a contract for a specified period or above a particular amount to enable the parties to enable any potential future requirements of a combined college to be discussed and fed into the requirements.

6. **Key Issues – Property**

From the information we have been provided, we have not identified any material issues in respect of Property which would legally prevent merger. However, we have identified a number of issues which would require to be actioned to successfully merge.

6.1. The position in respect of the properties is complex. Any properties which are owned or leased by Colleges would require to be transferred to the host or alternatively to the phoenix.

6.2. Shetland College/Train Shetland currently operate out of separate premises. In Shetland College, Phases 1 and 2 are currently subject to leases from Shetland Leasing and Properties (SLAP) with Phase 3 (being the link building) we are advised being in the ownership of the Council. The Train Shetland Building is also subject to a lease from SLAP. In the event that the leases are still in place at the vesting date, consent of SLAP would be required to transfer the leases. The overall property costs across the three institutions are high and high property costs could have an impact on the financial sustainability of the college.

6.3. The position in relation to the property occupied by SFTCT is very complicated. However this complication is not brought about by the merger but relates to pre-existing issues.

6.4. From the information provided we understand that the SFTCT currently occupies North Atlantic Fisheries College, Port Arthur. We understand that the main building and hatchery at North Atlantic Fisheries College are (i) sub-leased to Shetland Islands Council ("SIC") and (ii) owned by SIC although we have not seen their heritable title to verify this. SFTCT are occupying this site in accordance with a Management Agreement (unsigned version).

6.5. The Crown Estate Scotland (Interim Management) (CES) own the sea bed which is leased for a period of 25 years to SFTCT under a lease dated 4 December 2015 and 12 January 2016. CES would require to provide consent to any assignation. Early dialogue with CES would be recommended.

6.6. We understand that the properties currently leased/transferred to SLAP have now been transferred back to the Council. On that basis, for the properties which are occupied by Shetland College/Train Shetland and NAFC Marine where SLAP was the landlord, SIC would now be in the position to grant a lease to the new college on new terms if SIC considered that appropriate.

7. Key Issues - Intellectual Property Issues

From the information we have been provided, we have not identified any material issues in respect of Intellectual Property Issues which would legally prevent merger. However, we have identified a number of issues which would require to be actioned to assist with the successful merger.

7.1. We note that we have received limited responses to our due diligence questionnaire and we have identified areas that may require further investigation. We have provided some suggestions regarding intellectual property issues which you may wish to consider once the new college entity has been created.

7.2. We would recommend that a review should be undertaken of the parties intellectual property issues to determine how the parties would like to deal with their respective intellectual property matters after the merger has taken place and to ensure the necessary steps are taken to facilitate this.

7.3. Following the merger, we would recommend that trade mark protection be sought to protect the new entity's brand and reputation.

7.4. The parties should decide what to do with all old branding and branded goods and if they will continue to be used. The strategy going forward will depend on the model chosen and the branding chosen, following which the appropriate assignations should be put in place to assign the relevant assets to the new entity that is created.

7.5. There do not appear to be any website terms and conditions on a number of the websites and we would recommend putting these in place.

7.6. To ensure ownership of copyright in works created for NAFC or SIC by contractors, employees, students and third parties, NAFC should ensure that the related contractual agreement clearly sets out the arrangements in terms of ownership.

7.7. In moving forward to the new college, the new college should set up clear contractual agreements/policies to ensure that works created for the new college by contractors, employees, students and third parties are owned by the new college as follows:

7.7.1. Third parties: contractual arrangements should provide for the assignation of copyright in any works created by third parties failing which a perpetual transferable licence to be granted.

7.7.2. Employees: although copyright in works created by employees in the course of employment automatically vests in the employer, this should be set out expressly in contracts of employment.

7.7.3. Students: ownership of IP created by students should be addressed in an appropriate policy document or in the student contract.

7.7.4. Contractors: SIC should ensure that its contractual arrangements with contractors provide for the assignation to it of copyright in any works created for it.

7.8. Finally, we would recommend that SIC and SFTCT compile and maintain an inventory of IP assets including unregistered IP. This will assist in drafting any transfer agreement moving forward.

8. Key Issues - Borrowing and Funding Issues

From the information we have been provided, we have not identified any material issues in respect of Borrowing and Funding Issues which would legally prevent merger. However, we have identified a number of issues which would require to be actioned to assist with the successful merger.

8.1. At this stage in the exercise there are a number of material issues which require further consideration.

8.2. In terms of banking facilities Train Shetland and Shetland College do not have any separate banking facilities – it is the Council's facilities which are used. It is likely that the banking facilities for any new organisation moving forward would require to be reviewed.

8.3. One of the key issues is that the college is financially sustainable. It is therefore essential that the new college is able to be funded by the SFC through the RSB. This will be most likely achieved by the new college becoming an assigned college. See comments above in relation to governance. We would recommend that you seek to continue to engage with the SFC and UHI as their support will be required to ensure that any new body will be assigned.

9. **Key Issues – Employment and Pensions**

From the information we have been provided, we have not identified any material issues in respect Employment and Pensions Issues which would legally prevent merger. However, you should continue to work to manage any potential pensions liability.

9.1. As is inevitable with such mergers, there is some disparity in the pay and benefits across the organisations that could create some difficulties post-merger.

9.2. Whichever model is taken forward, the TUPE Regulations will apply.

9.3. Experience tells us that one of the most significant factors for the successful project management of a merger such as this, is a well thought out and considered communication strategy. The more open and transparent the process is, the easier it is for staff and therefore the more positive and supportive staff and the trade unions are likely to be.

9.4. The LGPS is a funded multi-employer occupational pension scheme and is understood to be currently in deficit.

9.5. There is the potential that employees transferring to the new college would trigger a cessation valuation which may lead to a cessation payment of its share of the scheme deficit. In these circumstances the trigger is the date on which an employer ceases to employ a member of the LGPS. Depending on the model, this would potentially affect one or both of the Colleges. We recommend that there is ongoing dialogue with LGPS in order to identify and/or mitigate any payments due.

10. **Key Issues - Litigation and Disputes**

From the information we have been provided, we have not identified any material issues in respect of Litigation and Disputes Issues which would legally prevent merger.

10.1. We have not identified any material legal obstacles in the context of our review of the information made available to in respect of Litigation and Disputes.

10.2. There is one matter in respect of SIC and one in respect of SFTCT which we would hope would be resolved before the vesting date and therefore would be unlikely to be a liability moving forward.

11. **Key Issues - Compliance**

From the information we have been provided, we have not identified any material issues in respect of Compliance Issues which would legally prevent merger.

11.1. We have not identified any material legal obstacles in the context of our review of the information made available to in respect of Compliance.

11.2. However there are a number of steps in respect of licences which would require to be taken to ensure that the relevant licences transferred.

12. **Conclusion**

We have not identified any material issues which would legally prevent merger. There are however a number of actions to be taken to manage the risks between a decision being taken to merge until the vesting date.

Deloitte.

Shetland Islands Council

Appendix 3

Shetland Islands Council – Effective and Sustainable Tertiary Education, Research and Training in Shetland Project

Issued on 3 December 2018 for Shetland Islands Council meeting on 12 December 2018

Contents

01 Our report

Effective and Sustainable Tertiary Education, Research and Training in Shetland Project (continued)

Background

Code of Audit Practice

As we will set out in our annual audit report, public audit in Scotland is wider in scope than financial audit. The Code of Audit Practice sets out four audit dimensions which, alongside Best Value in the local government sector, set a common framework for all the audit work conducted for the Auditor General for Scotland and for the Accounts Commission.

A key theme of the Best Value audit is the **use of resources**, which overlap with three of the four audit dimensions, namely: financial management; financial sustainability; value for money. Whilst Shetland Islands Council is not scheduled for a full Best Value review during 2018/19, we are required to consider elements of this in each of the five years of our appointment.

In considering how effectively a Council demonstrates value for money (VfM) in key decisions, the following points should be considered. Where VfM is to be demonstrated, there should be evidence of a transparent option appraisal process when reviewing how services will be delivered in the future.

- How open is the Council to considering all possible options to reduce the cost, and improve the quality and effectiveness of the services provided?
- How does the Council learn from previous changes and the experiences of other organisations when identifying and considering options?
- Does the Council make good use of cost information and understand its cost drivers?
- Has the Council taken difficult decisions to ensure VfM?
- Are options appraisals and business cases developed to support key decisions?
- Are business cases subsequently reviewed to ensure that the planned advantages and justifications are being realised?

The ***Effective and Sustainable Tertiary Education, Research and Training in Shetland Project*** is an example of where Shetland Islands Council is looking to identify best value options for future delivery of tertiary education, research and training.

As part of our 2018/19 audit, Deloitte performed a review of the Finance Workstream of this project. Specifically, we reviewed the methodology and modelling used in the financial forecast.

This report sets out the results of our review.

Background (continued)

The Project

Shetland Islands Council (SIC) and Shetland Fisheries Training Centre Trust (SFTCT) have agreed to examine options for merging tertiary education, research and training services in Shetland. The merger would include NAFC Marine Centre UHI (operated by SFTCT), Shetland College UHI and Train Shetland (both operated by SIC).

- The SFTCT promotes the development of the Shetland fisheries and maritime sectors, including fish catching, fish processing, fish farming, marine engineering, navigation, seamanship, research and all related ancillary activities. It is a registered charity governed by a Board of Trustees. The Board is responsible for operating NAFC Marine Centre UHI.
- The NAFC Marine Centre is an education and scientific institute which supports training and development in Shetland's maritime industries. It carries out a range of applied research and development projects including the assessment of shellfish stocks, analysis of fish catching trends, and the preparation of the Shetland Islands Marine Spatial Plan.
- Shetland College UHI is one of the few remaining colleges under the control of a local authority (SIC), where it is managed through the Development Directorate. Shetland College UHI offers a wide range of study options, from national certificates to postgraduate degrees, across a variety of subjects, including creative industries, ICT, business and hospitality, health and social care and construction. The College services include Train Shetland, which offers a range of short training courses for local industry and co-ordinates Modern Apprenticeships in Shetland across a range of industries.
- Both the NAFC Marine Centre UHI and Shetland College UHI are partners of the University of the Highlands and Islands (UHI), and are funded primarily through Further Education (FE) and Higher Education (HE) funding which is based on credits awarded for courses offered to students, and SIC support.
- The funding gap has fluctuated in recent years, with an average between 2015/16 and 2018/19 of £2.18m. The funding gap was £2.89m in 2015/16; £2.16m in 2016/17; £1.57m in 2017/18, and is forecast to be £2.09m in 2018/19. The funding gap is met by additional funding provided by SIC.
- The NAFC Marine Centre UHI's main campus is in Scalloway, whilst both Shetland College UHI and Train Shetland are based in Lerwick.
- The sector currently employs 113 full time equivalent ('FTE') staff, with additional corporate support provided by the SIC.

In May 2018, following the development of a **Strategic Outline Case** which identified a merger as the preferred way forward for the sector, SIC and SFTCT agreed to proceed to a Full Business Case for merger, prior to a final decision being made which would initiate the merger process.

It is essential that the Full Business Case provides the necessary information and assurance that will allow Members of SIC and Trustees of the SFTCT to make decisions on the future with confidence. A number of workstreams have been identified which will examine key issues relating to the merger and the future of the tertiary sector, and which will generate the information necessary to inform the Full Business Case.

As part of the Finance Workstream, the Project Team (including members of staff from each of the entities) undertook a comprehensive financial review, considering key areas for the proposed merged college.

Effective and Sustainable Tertiary Education, Research and Training in Shetland Project (continued)

Scope of review

The scope of this review, as agreed with the Project Manager at Shetland Islands Council, was as follows:

- review the methodology and modelling which will be used to produce the financial forecasts for the proposed merged services;
- provide a first check on the completed financial projections produced by the Project Team, with specific reference to the assumptions used in their production; and
- undertake a final check on the completed financial projections, providing through the preparation of a report, assurance to decision makers that plans are robust.

It was agreed that this review would not include:

- a forensic review of the model and an assurance on the construct and build of the underlying document as it is generally not possible to test a model to the extent that it can be assured that all errors have been detected and accordingly we give no such assurance;
- an audit or detailed testing of the input data;
- an assessment on the effectiveness of management's actions and / or control framework in place to implement, execute and realise any of the projected results shown in any prospective scenarios; and
- Deloitte taking responsibility for the validity of the assumptions, the accuracy of the computations or the reasonableness and achievability of any projections comprised in the financial planning tool.

Effective and Sustainable Tertiary Education, Research and Training in Shetland Project (continued)

Key findings

- The Finance Workstream has considered 12 distinct areas, consisting of 22 sub streams, as shown in the financial model. These consider both income and expenditure.
- The various areas have been department-led rather than led by the Project Team. The work has been developed by relevant specialists from each department and the approach has been to identify what the merged college *should* do, rather than what it *can* do. We are satisfied that this approach is appropriate.
- Cost savings of £1.81m have been identified. Additional income of £0.61m has been identified. The net impact is an improvement in financial performance of £2.42m. The impact of the changes suggests that the merged college will have a surplus of £0.33m, if all savings are realised prior to or immediately on vesting. Deloitte consider the Project Team assumption that 80% of these savings will be realised prior to or immediately on vesting is reasonable.
- It is important to note that £1.97m of this improvement is specifically linked to progression of the merger. It is possible to achieve £0.45m of the net savings within the existing structure.
- The financial impact on SIC will be an ongoing annual cost of £0.39m. This compares with a cost of £1.57m in 2017/18 and £2.09m in 2018/19, as SIC provides additional funding to close the funding gap each year, discussed on page 4.

Expenditure

- The costs can be combined into four key areas: staff costs; premises costs; operating costs, and professional fees. These four areas account for 97.9% of costs within the colleges at present. From review of comparable colleges, we have not noted any significant areas which have not been considered within the areas covered by the Finance Workstream. Minor amendments were made to services bought in following our review.
- Savings of £0.78m with regards to premises costs have been assumed. It is important to note that £0.49m of this assumes that there will be *no ongoing lease costs* associated with the properties used by the colleges. This is subject to a decision by the Council. Any movement from a £nil lease charge will reduce the level of savings which will be achieved by the college. The remainder of the savings - £0.29m – do not have this uncertainty.
- Savings of £0.19m have been identified from the removal of internal recharges levied by SIC, offset by the need to source external services such as payroll, legal, HR, staff welfare, insurance and audit. These services have been benchmarked against comparable colleges and SIC charge out rates and the assumptions are reasonable.
- Savings of £0.65m in staff costs have been assumed. This factors in a reduction in staff numbers from 113 FTE to 99 FTE and assumes that all lecturing staff are on the national lecturer pay scale. The proposed staffing structure is considered reasonable and appropriate by comparison to other colleges. Given the historical level of staff turnover, it is reasonable to assume that this reduction in staff can be achieved by managing turnover and recruitment prior to vesting of the merged college, currently planned for August 2020. Fundamentally, the staffing structure of the merged college is a decision for the Principal and Board of that college and any deviations from the structure considered by the Finance Workstream will impact on the savings which can be achieved.

Key findings (continued)

Income

- Additional FE and HE income of £0.42m can be achieved by streamlining and updating the curriculum offered to students without the need to substantially increase student numbers. This curriculum also assumes that commercial courses will be paid for by industry, rather than through the credit system. As with staffing, this income is subject to uncertainty as the new college may offer a different curriculum to that considered by the Finance Workstream.

- Additional income from research activities of £0.3m has been identified. This can be generated by improving the investment in and focus on research in Shetland specialisms, such as marine spatial planning and creative industries. It is important to note that this level of research income is substantially higher than comparable colleges but has been considered reasonable given the existing high level of research income earned by the colleges. The financial model assumes that 26% of income will be research-derived, as opposed to 23% at present. However, this is subject to a high level of uncertainty as research income is project based and difficult to forecast with certainty.

Other

- The remaining net savings of £0.08m relate to marketing, ICT and the costs associated with the tertiary review. The first three of these account for 65% of the remaining savings and have been verified as reasonable and appropriate, subject to limited assumptions and estimation uncertainty.

- This report does not consider the impact of tax, as the tax due diligence was not complete at the time of issuing this report. When considering the quantitative findings in this report, it is important to consider these in conjunction with tax considerations which are highlighted in a separate report.

Overall conclusion

Our key conclusions from undertaking this review are:

- The methodology and modelling used to produce the financial forecasts for the proposed merged college are reasonable and appropriate, as they consider all the workstreams which would be anticipated to be considered based on current budgets and comparable colleges; have been developed by relevant specialists and sense-checked by appropriately qualified finance staff; include appropriate assumptions, and have been appropriately reflected in the financial model.
- The assumptions used in the financial modelling – whilst including an inherent element of uncertainty and being subject to decisions made by the Principal and Board of the new college – are supportable, reasonable and appropriate.
- Following adjustments to the financial modelling and additional work carried out arising from this review, which identified amendments of £0.22m, we are satisfied that the financial projections and associated financial model is robust.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to help Shetland Islands Council discharge their governance duties.

Our report includes the results of our work on the following:

- review of the methodology and modelling which will be used to produce the financial forecasts for the proposed merged services;
- provide a first check on the completed financial projections produced by the Project Team, with specific reference to the assumptions used in their production; and
- undertake a final check on the completed financial projections, providing through the preparation of a report, assurance to decision makers that plans are robust.

We welcome the opportunity to discuss our report with you and receive your feedback.

What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to the Council.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

We make suggestions and observations in the context of our review, however our review did not include:

- a forensic review of the model and an assurance on the construct and build of the underlying document as it is generally not possible to test a model to the extent that it can be assured that all errors have been detected and accordingly we give no such assurance;
- an audit or detailed testing of the input data;
- an assessment on the effectiveness of management's actions and / or control framework in place to implement, execute and realise any of the projected results shown in any prospective scenarios; and
- Deloitte taking responsibility for the validity of the assumptions, the accuracy of the computations or the reasonableness and achievability of any projections comprised in the financial planning tool.

This report has been prepared for the Shetland Islands Council, as a body, and we therefore accept responsibility to you alone for its contents.

We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

for and on behalf of Deloitte LLP
Glasgow

3 December 2018

Deloitte.

Shetland Islands Council

Agenda Item

2

Meeting(s):	**Shetland Islands Council**	**12 December 2018**
Report Title:	**Scottish LGPS Restructure Review – Consultation Response**	
Reference Number:	**F-091-F**	
Author / Job Title:	**Jamie Manson, Executive Manager- Finance**	

1.0 Decisions / Action required:

1.1 That the Council consider the consultation response to the Scottish LGPS restructure review (Appendix A)

1.2 That the Council RESOLVES to approve that the consultation response be sent to the Pensions Institute.

2.0 High Level Summary:

2.1 The Local Government Pension Scheme Advisory Board (SAB), at the request of the Scottish Government Cabinet Secretary for Finance and Constitution is carrying out a consultation on the future of the Scottish Local Government Pension Scheme (SLGPS).

2.2 The consultation seeks to establish the views of employers and employee representative groups on whether outcomes for the members and sponsors of the SLGPS can be improved by altering the structure of the scheme.

2.3 The consultation asks employers and employee representative groups to consider the advantages and disadvantages of four options ranging from the current structure to consolidating the functions of the Scottish 11 funds by collaboration or pooling or full merger.

2.4 The consultation is predominately focussing on the investment area of the Pension Fund and not at present the administration side. The consultation also has questions on SLGPS investing in infrastructure projects.

2.5 Employer and employee representative organisations are asked to respond to the set specific questions in the form accompanying the consultation report and email responses to the Pensions Institute by Friday 7 December 2018. The Council has until the 12 December 2018 to respond.

2.6 The Council received an initial background report on the SAB consultation on the 31 October 2018. A final proposed response has now been prepared to the consultation in line with the preferred option of the meeting on the 31 October 2018, which was to retain the current SLGPS structure. The final proposed response to the consultation from the Shetland Islands Council is attached as

Appendix A. The response has been prepared in consultation with the Leader as per the decision of the meeting on 31 October 2018 (minute ref: 52/18).

2.7 The Pension Fund Committee and Pension Board received an initial report on the SAB consultation on the 8 October 2018. From that meeting the Pension Fund Committee agreed to respond to the consultation with a view to retaining the current structure in Scotland. The response went up to the Pension Fund Committee and Pension Board for approval on the 5 December 2018.

3.0 Corporate Priorities and Joint Working:

3.1 The report links to the Council's corporate priorities, defined in its Corporate Plan, specifically in relation to assisting the Pension Fund in ensuring that financial resources are managed effectively.

4.0 Key Issues:

4.1 The Scheme Advisory Board consultation document on the future of the SLGPS is basically a number of questions on four future proposed options. The four options proposed for consideration in the consultation are:

- Retain the current structure with 11 Local Authority Pension Funds
- Promote cooperation in investing and administration between the 11 funds
- Pool investments between the 11 funds
- Merge the 11 funds into one or more funds

4.2 The questions in the consultation follow a similar pattern for each of the four options. The questions cover certain areas which the SAB have identified as significant challenges for Pension Schemes. These significant challenges are:

- Cost of investing
- Governance
- Operating Risk
- Infrastructure investment

4.3 The deadline for responses from all employer and employee groups to the consultation is the 7 December 2018. We have asked for a short extension to their timescale to enable the Council to consider its points at its meeting on 12 December. The Council now has until the 12 December 2018 to respond to the questions.

4.4 Responses go to the Pensions Institute for analysis and review before going onto the SAB for further evaluation. The results will then be presented to the Scottish Government Ministers in 2019 to decide on any future course of action.

4.5 Further information on the SAB consultation on the future of the SLGPS is attached as Appendix B.

5.0 Exempt and/or confidential information:

5.1 None

6.0 Implications :	
6.1 **Service Users, Patients and Communities:**	The report provides the stakeholders with information on the current SAB consultation on the future of the Pension Scheme. The outcome of the consultation could have wide ranging implications on the operation of the Pension Fund, which could have implications for the Council as an employer and staff who are Pension Fund members.
6.2 **Human Resources and Organisational Development:**	Currently the SAB consultation is gathering comments from employee and employer groups. Depending on which future option is preferred from the results of the consultation there could be changes to the local operation of the Pension Scheme, and possible implications for staff working with the Pension Scheme.
6.3 **Equality, Diversity and Human Rights:**	None
6.4 **Legal:**	There are no direct legal implications arising from this report however, legal advice and legal remedies will be sought and used whenever this is appropriate.
6.5 **Finance:**	Any changes to the operation of the Pension Scheme could affect the Council's employer contributions. The pooling option would take away partial control of investing the Pension Fund, and the full merger option would take away all control of the Pension Fund from the Council. Both of these situations would impact on the Council's employer contributions, and be out with the Council's control.
6.6 **Assets and Property:**	Long term investments are assets of the Pension Fund and represent money given to fund managers to manage on its behalf for long term benefit. The SAB consultation is looking specifically at the future management structure of these assets, with four options for consideration, from maintaining the current structure to more cooperation, pooling and complete merger of the 11 Scottish Pension Schemes.
6.7 **ICT and new technologies:**	None
6.8 **Environmental:**	Currently all of the Pension Fund managers are signed up to the United Nations Principles on Responsible Investment. No matter which option is eventually proposed by the SAB any Pension Fund structure must as a minimum require all fund managers to be signed up to the United Nations Principles on Responsible Investment. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, and therefore must be given

	appropriate consideration by investors, if they are to fulfil their fiduciary (or equivalent) duty. The principles provide a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices, and so better align their objectives with those of society at large.	
6.9 Risk Management:	There are no risk implications from the report but the SAB consultation is looking at the future investment structure of the SLGPS, and depending on the results from the consultation there may be changes to the risk profile of the Pension Fund. All investments carry risk. Risks, such as market risk are mitigated and actively managed through diversification of fund managers, asset classes, markets, size of holdings and through performance monitoring against benchmarks.	
6.10 Policy and Delegated Authority:	The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administrating authority for the Shetland Islands Council Pension Fund (the Pension Fund) in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013. The Pension Fund Committee are going to respond to the SAB consultation. The Council as an employer can also respond to the SAB consultation, as per the consultation document and having regard to the distinction which might be made in separate responses, as described in paragraph 1.13 in Appendix B to this report.	
6.11 Previously considered by:	None	

Contact Details:
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Appendices:
Appendix A: Shetland Islands Council Consultation Response
Appendix B: Information on the Scheme Advisory Board Consultation on the Future of the Scottish Local Government Pension Fund

Background Documents:
Scheme Advisory Board consultation and response document, *http://lgpsab.scot/consultation2018/*

END

Review of the Structure of the Scottish Local Government Pension Scheme

CONSULTATION RESPONSE FORM

Instructions
Responses in this form should be drafted in conjunction with the accompanying consultation report. To respond, please complete the **respondent details** and as many of the **consultation questions** your organisation wishes to complete and return the form via email to the Pensions Institute at consultation@pensions-intitute.org no later than **Friday, 7 December 2018**.

This consultation is being conducted in electronic form only, so **responses must be emailed**; hard copy posted or delivered responses cannot be received. Any queries about the consultation should be addressed to Matthew Roy, Fellow, Pensions Institute at matthew.roy@pensions-institute.org.

RESPONDENT DETAILS

Name of responding organisation(s) Please list the full name of each organisation participating in this response.	**Organisation type** Is your organisation an administering authority, employer, or employee group? Please record for each responding organisation.
Shetland Islands Council	Employer

Authors Please list any people that wish to be recorded as authors of this response, including name, job title and organisation.	**Consent** Please confirm each author consents to their information being retained for analysing the consultation responses by writing ‘confirm’ by their name.
Jamie Manson, Executive Manager – Finance, Shetland Islands Council	Confirm

Date
Please date the response.

date

Covering information
If you wish to include covering information with your response, please include the text here. The text can wrap onto additional pages if needed.

Shetland Islands Council is the Administering Authority for the Shetland Islands Council Pension Fund.

Key figures for the Shetland Islands Council Pension Fund as at the 31st March 2018 are as follows:

Membership

Membership	2017/18
Employee members	3,358
Pensioners	1,851
Deferred members	2,044
Total Membership	**7,253**

The population of the Shetland Islands at the 31st March 2017 was 23,200. The membership of the Shetland Islands Council Pension Fund is therefore equivalent to around 31% of the population.

Employers

There are 12 employers in the Fund with active members, this includes scheduled bodies and admitted bodies.

Funding

At the March 2017 triennial valuation the Fund had a calculated 90% funding level.

The Shetland Islands Council as the main employer within the Fund pays a contribution rate of 20.8%. This rate was set at the 2017 triennial valuation and remains the same up to 2020/21.

Investment Assets

The Fund had a value of £459 million at the 31st March 2018. The Fund is invested in a diversified global strategy using five fund managers. All of the Fund's managers have signed up to the United Nations Principles on Responsible Investment as required by the Fund's Statement of Investment Principles.

The Fund's investment strategy is invested as follows:

Asset Class	Allocation %
Global Equities	40
Diversified Growth Fund	20
UK Equities	18
UK & European Property	12
Alternative Bonds	10

Investment Performance

3 years 7.1% p.a.

5 years 7.4% p.a.

10 years 6.2% p.a.

Fund Manager Fees

The current average level of fund manager fees for the Shetland Islands Council Pension Fund is 0.27% of the value of assets under management.

The consultation questions follow.

CONSULTATION QUESTIONS

Question 1: Retain the current structure with 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- *How well informed do you feel about the investment costs in your fund? What information do you rely on to specify and measure these?*

The Shetland Islands Council Pension Fund complies fully with the disclosure of investment costs as per CIPFA guidance in its Annual Report and Accounts.

All investment costs are reconciled from the fund manager's records on a quarterly basis and analysed between the different costs.

All investment costs are agreed at the initial set up of an investment management agreement with a new fund manager, and the new Code of Transparency requires further disclosure of fund manager's transaction costs.

All of the Shetland Islands Council Pension Fund investment fund managers are signed up to the Code of Transparency.

- *How well does the current system manage investment costs?*

Investment costs are discussed with investment consultants at the initial outset of an investment strategy review project. When interviewing prospective fund managers during a tender for a new mandate, the fund managers are questioned on their investment costs using the competitive situation to try and reduce costs.

An Investment Management Agreement with a fund manager always includes a section on investment costs so it is clear from the outset. There are other types of daily fund manager trading costs from purchasing and selling assets. Again these are reviewed against the turnover of investments to ensure this is appropriate for the agreed mandate.

- *How would you improve the measurement and management of investment costs in the current system?*

There have been recent developments in this area with the new Code of Transparency for LGPS asset managers, requiring them to provide cost collection templates. The FCA has also convened a working group to develop the existing cost templates further.

The competitiveness in the fund management industry has brought down costs over the past few years and the Code of Transparency is increasing the disclosure of costs, these measures by themselves are improving the measurement and management of investment costs.

b) Governance:

- *How well informed do you feel about the governance of your fund? What information do you rely on to measure this?*

In line with LGPS legislation the Fund established a Pension Fund Committee which discharges all functions and responsibilities in relation to the governance of the Fund, along with a Pension Board to assist with the compliance of scheme regulations and the requirements of the Pensions Regulator. The Pension Fund Committee and Pension Board meet at least quarterly to review all aspects of the fund's investments and administration. Both of these bodies are supported by Shetland Islands Council officers, investment consultants, actuaries, the custodian along with the Council's internal audit service and other Council committees such as the Audit Committee that can review, check and scrutinise all aspects of the Pension Committee's work.

The Pension Fund produces an Annual Report and Accounts which is an externally audited document. This includes an Annual Governance Statement which documents the governance arrangements for the Fund. The statement also evaluates these governance arrangements against the Code of Corporate Governance to ensure compliance with best practice and to identify any areas that require improvement. If any governance issues were found these would also be reported in the external auditors report on the Annual Report and Accounts.

http://www.shetland.gov.uk/finance/Pensions.asp

- How well is the current system governed?

The governance of the Scottish LGPS was reviewed and enhanced recently with new legislation and regulations, which resulted in the requirement to produce separate externally audited Annual Report and Accounts, and the establishment of a Pension Fund Committee and Pension Board which has both employer and union representation, for each Scottish LGPS.

No significant issues have been highlighted by Audit Scotland which in itself suggests there are no significant governance issues with the individual Scottish Funds.

The governance of the Scottish LGPS is further supported by Council officers with external Independent Auditors who review and scrutinise all aspects of the Fund's operations. The Pension Fund takes advice from external advisors who have extensive experience of the LGPS throughout the whole of the UK, and therefore helps the Pension identify best practice.

- *How would you improve governance of the current system?*

The recent regulatory changes have improved the overall governance of the Scottish LGPS to a high standard, but ongoing review is to be welcomed. This could perhaps be best conducted by an independent audit to not only ensure all Scottish LGPS are compliant with the regulations but to assist and help with any areas of improvement.

Pension Boards were set up under recent legislation and these include employer representation but the Board does not have voting or decision making ability. This could be reviewed to allow the Board to have more capabilities.

- *How important is it to maintain a local connection with respect to oversight and strategy?*

It is imperative for accountability of decision making to maintain a local connection with respect to oversight and strategy. If Full Merger of Funds was decided, resulting in a Single Fund for LGPS Scotland, the local connection between the Fund's performance and the Employer contributions to the Fund would be lost.

The Council is the main employer into the Pension Scheme and it is Council officers that maintain and operate the Pension Fund to ensure members receive a good service but also an efficient and well run Pension Fund will help to keep employer contributions at an appropriate level. This maintains a high level of accountability and scrutiny with a good service for the members while there is overall community responsibility by the local authority.

The local approach to the Scottish LGPS combines the benefit to scheme members within the community to the cost of the scheme to the local employers. This level of accountability and oversight would be lost with a merger option as employer contributions would be disconnected with local pension members. Any meaningful oversight by the scheme members and the employers would then be very remote.

The investment strategy is integral to the financial position of the pension fund and is specifically designed and implemented for the benefit of employers and employees. This is put together in conjunction with the contribution/funding strategy which is also set locally, as contributions are paid by the Council and other local employers. It would seem appropriate that there is a strong level of local accountability for the risk appetite inherent in the investment and contribution strategies combined, since these fall on the local employers.

The local scrutiny of the strategy by employers and employees through the current governance arrangements allows direct questioning at all stages of the strategy process. The increased disconnection of a merged Scottish fund could not allow this level of employer and employee scrutiny therefore lessening governance of the key interested parties.

The membership of the Shetland Islands Council Pension Fund in total is equivalent to about 31% of the population of the Shetland Islands. This shows how important to the local economy the pension fund is, and how important that there is a local connection to the oversight and strategy of the Pension Fund. The Fund sets its investment and contribution strategies locally, using a risk management framework which is appropriate to its local employers, and subject to local scrutiny: this approach has served the SLGPS well to date.

- *How would you determine if the benefits of a local connection in governance outweigh the benefits of scale?*

It seems logical that local governance of the Shetland Pension Fund which is important to the local community is better served by local interested parties monitoring and deciding on issues. Removing a local connection makes it no less important to that community, and the level of importance and scrutiny cannot be replicated in any other type of organisation that is remote from the community.

Evidence of any other type of Scottish LGPS model is unknown and not tested, it is therefore difficult to quantify any costs or benefits as these could not be estimated with any real accuracy. Only the current Scottish LGPS position can actually be evaluated, and there is no evidence to suggest that the current model requires change, indeed all of the Scottish LGPS funding positions are very healthy irrespective of their scale, which is a direct output from good long term local governance.

c) Operating risks:

- *How well informed do feel about the operating risks of your fund? What information do you rely on to specify and measure these?*

The Shetland Islands Council Pension Fund has a risk register that is reviewed regularly.

External auditors undertake an annual assessment of the internal controls as part of their audit process. Furthermore, our external advisors work with us, providing specialist expertise drawing on extensive experience elsewhere in the UK LGPS, to help us maintain best practice in this area.

- *How well are operating risks managed in the current system?*

Both internal and external audit have not identified any significant issues in the Pension audits they have undertaken.

Operating risks are managed in all areas of the Fund, from internal and external audit reviews to having business continuity plans. Investment risks are paramount within the setting up of an investment strategy from the use of investment consultants, through to the diversification of fund managers and the independence of the custodian. Internally within the Council there are segregation of duties with all cash movements, and the reduction of key man risk through the involvement of various Council officers at all levels.

The Pension Fund has the backing of Council staff and its operating controls which are also externally audited to ensure all operating risks are managed throughout all of the Pension Fund's operations.

All internal and external use of risk control is used to mitigate all possible risk and safeguard assets, which is reflected in the external auditors clean audit report.

- *How would you improve the measurement and management of operating risks in the current system?*

Due to the complexity of the LGPS and other associated regulations, it's imperative to undertake continual staff development/training to ensure all pension administering staff are fully trained and multi-skilled so as to ensure key man risk is mitigated. Operating risks have been significantly improved now that all 11 Scottish Pension Administering Authorities are using the Heywoods Altair Pension Administration System. We are also making greater use of our external advisors to reflect the greater focus on these issues.

d) Infrastructure:

- *How well informed do you feel about your fund's investments in infrastructure? What information do you rely on?*

The Shetland Islands Council Pension Fund does not currently have any investments in infrastructure.

All investments are compared and analysed by our investment consultant before deciding which assets best fits into the Fund's investment strategy. The current investment strategy was agreed in 2014 and a review of this strategy has just been initiated with our investment consultants, with the intension to have a new investment strategy in place during 2019. This strategy may include infrastructure investments as it will be compared again to other asset classes during the consultant's analysis.

- *How do you rate the current system's ability to invest in infrastructure?*

Infrastructure will be evaluated against all other asset classes by investment consultants, when they look at compiling the new investment strategy.

Infrastructure investing does have different governance characteristics, is more expensive to invest into, relatively illiquid and there are supply constraints. This does mean that investing directly into infrastructure requires specialist knowledge but there are different options to direct investing that could be utilised if the asset class was perceived to be a good investment for the fund's strategy, through to pooled vehicles already available and established in the pension investment universe.

- *How would you increase investment in infrastructure in the current system?*

Any investment into infrastructure would have to be recommended initially by the investment consultants and believed to be a good addition and diversifier within the investment strategy, relative to alternative investment options.

Infrastructure is not treated differently from of any other asset class when comparing investment options: the aim of the Fund is to balance risk and return for the benefit of participating employers, ensuring the payment of benefits to all our members.

If there were a greater number of attractive infrastructure vehicles available it would increase the potential appeal of investment in this area. This is possibly where greater collaboration between the LGPS could assist with looking at prospective infrastructure products and assisting with the due diligence requirements.

e) Do you have any additional comments about this option?

To restructure the Scottish LGPS simply to secure additional investment in Scottish infrastructure could be a hugely costly mistake. If the Government's aim is to increase infrastructure investment, then it would be best achieved from the supply side (i.e. making suitable projects available for Funds to invest in) rather than mandating a demand for a limited number of opportunities.

The 11 Scottish LGPS Funds are all in a healthy position with good funding levels approaching or above 100%. This shows that the current system, with 11 Local Authority Pension Funds, is achieving security and protection over their member's future pension payments. This is the aim of a pension scheme and the Scottish Funds are achieving that aim. The saying of "if it isn't broken then don't fix it" appears relevant as the current Scottish LGPS Funds are in a good funding position. In particular, the consideration of pooling and greater focus on infrastructure in England and Wales has been borne partly out of a much poorer funding position south of the border than we experience in Scotland: importing solutions from other parts of the UK which are in very different situations is not necessarily appropriate for the Scottish Funds.

A restructure of the Scottish LGPS would be appropriate if the 11 Scottish Funds were in a very different situation with much lower funding levels, but given the current situation it is difficult to see what the overall benefit a change would make. There are many challenges for the Pension industry but these are being dealt with through proper governance and careful investment management, delivered by local decision-makers, as the results show.

If it is believed that infrastructure is a good long term risk/return asset class for the Scottish LGPS then it requires to be made more accessible and attractive for investment. This could be achieved through increased collaboration, such as the type of infrastructure product that Lothian has put together.

Question 2: Promote cooperation in investing and administration between the 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- *What impact do you think promoting agreements between funds would have on investment costs?*

Certainly any agreement between funds in relation to a joint procurement exercise would save costs and duplication of work. Any agreed investment, could also save time on due diligence work and save fund manager fees, given the cost structure that fund managers adopt which is based on overall investment size.

Some investment classes could become more accessible to the smaller Scottish LGPS Funds such as infrastructure, where due diligence work and ongoing governance could be covered by the joint agreement.

Costs are important but it is investment return net of costs which is the real measure.

- *What would be the positive impacts?*

Saving of costs and officer time in procurement and ongoing investment fees. An increased universe of possible investable asset classes.

- *What would be the negative impacts?*

Setting up and drafting the initial agreements between various Funds, could be time consuming and expensive and may be difficult to achieve agreement.

There could also be significant costs, delays and administration involved with getting revised investment processes put in place.

b) Governance:

- *What impact do you think promoting agreements between funds would have on governance?*

Initially introducing a new layer of cooperation and setting up agreements with other Scottish LGPS Funds would involve added governance at officer and committee level due to the new nature of the agreements and its complexity.

Once the agreements are in place and operating it would depend on the agreement itself but collective governance could actually reduce individual fund governance.

- *What would be the positive impacts?*

A collective approach to governance could improve the general governance of the investment, and help spread knowledge.

- *What would be the negative impacts?*

Initial discussions on the various aspects of any agreement would be a time consuming process. This process could be onerous and issues difficult to resolve due to the complexity of any agreement and the number of parties involved. All agreements need to be maintained, updated, reviewed etc.to everyone's satisfaction.

c) Operating risks:

- *What impact do you think promoting agreements between funds would have on operating risks?*

A new contract or agreement between funds will involve, at the outset, new operational controls and risks. This will require additional work initially but after that there should not be any difference to the ongoing operational risk, if anything there should be an improvement to operational risk, in particular key man risk.

The Scottish LGPS already has a good networking arrangement in place for the sharing of information, which includes the IGG and SPLG groups. These groups meet on a quarterly basis along with attending other group meetings such as the Heywoods Pension System bi-annual meetings (i.e. CLASS User Group).

More collaboration with the Funds can only be a positive thing by learning more from each other and would go some way to eliminating duplication of effort, in particular with regard to administration matters.

- *What would be the positive impacts?*

It depends on what the collective agreement is and how it is set out, but a collective management of risk must benefit operational risk.

- *What would be the negative impacts?*

A collective agreement will bring at its outset additional issues and work to satisfy risk management. Once the agreement is in operation it will require to be maintained and reviewed which will also require additional resources.

d) Infrastructure:

- *What impact do you think promoting agreements between funds would have on funds' ability to invest in infrastructure?*

An agreement between Scottish Funds on an infrastructure product would certainly be beneficial for most funds, as it would remove certain barriers that have prevented them from investing, such as lack of expertise in this area, the increased due diligence, governance required and the level of investment. An agreement would certainly give

Scottish Funds the ability and opportunity to invest if it was as seen as an appropriate investment within their investment strategy.

- *What would be the positive impacts?*

It would give the opportunity for many of the Scottish Funds to invest in another asset class. There may also be benefits with scale to reduce management costs.

- *What would be the negative impacts?*

There is an increased collective risk and reduced diversification if many of the Scottish Funds invested in the same agreement with the same fund manager; if the returns were poor all of the funds would suffer. This is a greater risk the fewer opportunities there are.

e) Do you have any additional comments about this option?

Significant co-operation between the Scottish LGPS Funds and the wider LGPS network already exists. The introduction of the LGPS 2015, and the associated member and employer communications, was a successful large-scale collaborative exercise between all the Scottish LGPS Funds.

A collaborative agreement between Scottish Funds on infrastructure would open up this type of investment to many of the Scottish Funds that could not invest in this asset class individually.

Scottish LGPS Funds have worked together before on projects, so an agreement on an infrastructure product is certainly a realistic option, which would allow some of the Funds to get access to an infrastructure investment.

Question 3: Pool investments between the 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- *What impact do you think pooling investments between funds would have on the cost of investing?*

It is difficult to quantify costs as there is no evidence to suggest that large Funds have lower costs than smaller Funds. With the combination of past efforts by Scottish Funds, and the cost transparency developments, it would seem that the SLGPS is already in a good place

The initial setting up of the pool would be a costly and time consuming project, and it could take many years to recoup the set up and reorganising costs. This is evident from the experience in England and Wales. There would be an economy of scale benefit on costs when investing but any savings would be dependent on the type of investment, as all investments have different cost levels. There are also the significant ongoing costs of the staff managing the pool to be considered.

Reducing investment costs does not guarantee increased returns, so the effect on net-of-fees returns could quite possibly be minimal and out of proportion to the work and upheaval required to establish the Pools.

Pooling therefore looks to be costly to set up and manage which could take many years to recover. Some English & Welsh Funds will not reach break-even point for at least 10 years, and others will actively be worse off as a result of pooling, due to their positive starting point.

The costs involved with pooling will hit employers contribution levels which will have knock on effects to the Council's own budgets and level of service. This is a concern given the actual situation which is happening in England and Wales.

It appears there is no argument for pooling of Funds when the funding levels of the Scottish LGPS Funds are already good and fee levels are generally quite competitive.

- *What would be the positive impacts?*

A wider mix of asset classes could be available for investment due to the pool size. Investment strategy would remain under local control, which is crucial as identified above.

- *What would be the negative impacts?*

Costs from the initial set up of the pool could be very expensive. The time required to decide how the pool will actually be formed and function could run into many years, as England and Wales have found.

This will take up Council officer time adding strain to the Pension service, along with additional Pool costs that will filter through to employer's contributions which will affect the Council's services.

Large transaction costs to disinvest and reinvest, reduced selection of fund managers to achieve economies of scale, and possible unavailability of suitably qualified staff for the Pools, would increase investment risk. There is no evidence that a large Fund will save costs, and no guarantee of better investment returns.

- *If asset pooling were possible, under what circumstances should a fund consider joining an asset pool?*

If a Fund had a high level of fund manager fees, staffing issues and a poor funding level the merits of joining a pool structure might be considered.

- *Under which circumstances should the SLGPS consider directing funds to pool?*

It would require a situation where a fund was basically failing and not achieving its aims, and required outside help. An assessment of the fund's situation would need to be conducted to see if it would be beneficial for the fund to join a pool. However Government should take great care before forcing a Fund down a particular course of action which may increase a Fund's costs in excess of the potential benefits achieved.

b) Governance:

- *What impact do you think pooling investments between funds would have on governance?*

Pools would create another layer of governance and therefore further remove Pension Fund Committees and Pension Boards from the investments and fund managers. This adds to the complexity of the structure and reduces the Pension Committee's control and governance over the fund and its investment performance.

Pooling investments would remove employers further from the Pension Fund's investments and the management and oversight of those investments. This is in complete contrast to the recent legislation that gave employers more responsibility by including them on the Pension Boards.

- *What would be the positive impacts?*

It is not clear what benefits there would be on governance from pooling investments. It is sometimes argued that the removal of investment manager decisions from local decision-makers would improve matters by focusing their attentions on the more important issue of investment strategy: however this brings into question why significant work is needed to address the lower risk issue of manager selection.

- *What would be the negative impacts?*

The work and time required to setup the initial pool would require additional resources of governance. Any structure that adds additional management layers such as a pool will increase the governance complexity and time allocated to the governance function.

The recent legislation which improved governance through the set-up of the Pension Board that included employer and Union representation, would see their role significantly reduced regarding the governance of the actual investments and the fund managers.

Reduced ability to deal with poor-performing managers could be an issue: if the Pool is the designated manager but under-performs, how would a Fund remedy this situation?

c) Operating risks:

- *What impact do you think pooling investments between funds would have on operating risks?*

It is unlikely that there would be any impact on the operating risk with the investments as these would be invested with fund managers as per the current situation. If anything there could be a negative impact due to the potentially limited availability of asset classes: the Funds would be restricted to choose from what the Pool had on offer.

It is unclear how the pools would tender for or select fund managers, and what level of choice of fund managers per asset class the Pension Committee would have.

- *What would be the positive impacts?*

It would depend on how the pool operated but due to the size and variety of the investments it may give an additional level of due diligence and risk control over the investments.

- *What would be the negative impacts?*

Pooling will decrease the choice of investment managers and asset classes, so increasing the concentration of the investments with the chosen fund managers. This will have a negative impact on investment risk and operational risk.

The changing governance responsibilities of the Pension Board and the Pension Fund Committee would create uncertainty of roles with the pool which could have possible operational issues increasing risk.

d) Infrastructure:

- *What impact do you think pooling investments between funds would have on funds' ability to invest in infrastructure?*

Pooling investments would give an additional size to the overall pool allowing it to consider offering an investment vehicle in infrastructure to the funds. Any fund considering an investment in infrastructure would still have to compare it to other investments and decide if it fits into their particular investment strategy.

Some of the Scottish LGPS Funds are already invested in infrastructure, so pooling may not achieve any sizeable change to the overall investment in infrastructure.

- *What would be the positive impacts?*

Pooling could offer an infrastructure vehicle which some Scottish LGPS Funds have not had the size or expertise to be able to invest into.

- *What would be the negative impacts?*

Setting up a pool for investments is a very expensive proposition to try and achieve an increase in infrastructure investment. This could be achieved more easily through the collaboration approach or simply investing in an existing investment pool or insurance contract.

e) Do you have any additional comments about this option?

The current Scottish LGPS structure is a success with all funds close to and exceeding a 100% funding level. To change this structure and introduce a pooled investment structure will create large initial set up costs, costs to reorganise investments plus the continued operational costs of the pool. Agreement on how this structure would operate is unknown, as are the costs.

England and Wales have reorganised the LGPS into eight large pools, which has been under construction for a few years, and still has no known outcome on costs, investment returns or even actual agreements on some of the pool's structures. This does not set a good example to follow, especially when the Scottish LGPS position is well funded.

Fund manager fees in Scotland have reduced over the past couple of years making further savings through a pool more difficult.

Changing a structure will only add benefit if net returns after costs are improved, which is very unclear from the position in England and Wales.

There are 11 Scottish LGPS Funds all investing specifically for their Pension Funds using many different fund managers in different assets, which creates a very low risk diversified structure. A pool would reduce the diversification of fund managers and asset classes, significantly increasing investment risk through concentration of investment. Pooling investments would create another tier of bureaucracy and would muddy governance responsibilities which in turn would increase operational risk.

As the main employer in the Fund, pooling looks as if it will increase costs, as has been witnessed in England and Wales. This will only increase employer's contributions unless investment returns are higher and there is no evidence for this. This could continue to be the case for many years with a long term cumulative effect on the Council's budget and ability to maintain services. Given the current good position of the fund with stable employer contributions the option of moving to a pooled structure does not make sense.

Question 4: Merge the funds into one or more new funds

The text can wrap onto additional pages.

a) Cost of investing:

- *What impact do you think mergers between funds would have on the cost of investing?*

It is difficult to quantify cost savings as there is no evidence to suggest that large funds have lower costs than smaller Funds.

There may be cost savings with investing larger amounts but it depends on which asset classes, for example passive equities have seen fees slashed in recent years so any cost savings would be minimal. Some asset classes have an oversupply of investment so would be unwilling to cut fees.

Cost is only part of the investment picture as it is the investment performance return less costs that is important.

Reducing investment costs does not guarantee increased returns.

- *What would be the positive impacts?*

There is no evidence to suggest that larger funds have lower costs than smaller funds.

- *What would be the negative impacts?*

A reduction in costs does not guarantee an increase in investment return.

A merger would involve large set up costs plus disinvestment and reinvestment costs of funds being reorganising to go into a merged fund. These costs are unknown but are costs that are not incurred at present so they will be a drag on all of the funds positions for a long time, due to the great upheaval of arranging such a merger.

Scottish LGPS Fund costs are not excessive and the funding positions are good. Any merger would immediately add set up and reorganisation costs, with no evidence that the merged fund will improve costs or investment return.

The costs of restructuring would be significant and could be a drag on fund performance for many years, this would immediately affect funding levels and could lead to increased employer contributions.

- *If merging were possible, under what circumstances should a fund consider a merger?*

Any options available to a fund should be considered but a fund would only consider alternative options such as merging with other funds if its analysis of that option proved to be a better outcome for that fund and its members. It is difficult to envisage such a situation given the known costs and delays in the short term, and the unknown (and possibly unavailable) cost savings in the longer term.

- *Under what circumstances should the SLGPS consider directing funds to merge?*

This step could only be considered if a fund was failing and required help. An assessment of the fund's situation would need to be conducted to see if it would be beneficial for the fund to merge.

b) Governance:

- *What impact do you think mergers between funds would have on governance?*

There would be a loss of governance over the fund, as local control and accountability would be diminished or completely removed depending on the merger model.

The role of the Pension Board with employer and Union representation which was set up a few years ago to improve governance would disappear. This local governance model which allowed the employers and employees to be involved and assist with the operation of the scheme would be lost with no known future model of governance. This would take governance away from representatives of the people the fund is actually meant to be for.

What would be the positive impacts?

Saving on time and any costs relating to the governance of the fund at local level due to the decrease or ceasing of this function. This would only be a positive if the fund was ultimately in a better funding position with lower contribution rates and/or greater investment returns.

- *What would be the negative impacts?*

Governance of the merged funds would be further removed losing accountability from the fund employers and members. . The Funds assess contribution and investment strategies using a risk management framework which is appropriate to their local employers, and is therefore subject to local scrutiny and accountability: this would be lost under a merged arrangement.

The current governance arrangements were enhance only a few years ago through the introduction of separate accounts, Pension Fund Committees and Pension Boards. This close level of governance would be lost in a merged situation.

c) Operating risks:

- *What impact do you think mergers between funds would have on operating risks?*

With a merged fund you would have a greater concentration of investment which would create increased operating risk. Poor performance by a fund manager would have a larger impact on the overall fund.

The merged structure and its governance arrangements would be paramount in managing operating risk, to ensure as a minimum that the current standards were maintained.

The larger merged structure would have more staff and resources to rely on, with more advanced risk analysis, to help control the greater mix and size of investments in monitoring operational risk.

- *What would be the positive impacts?*

More staff and resources available to check, monitor and review the investments, with more advanced risk analysis models, to help control the operational risk of the larger more complicated fund.

- *What would be the negative impacts?*

Greater range of asset mix will increase operational risk. Larger investments will have a greater concentration of risk, as well as breaking the local accountability link which currently serves the SLGPS well.

The changes required to implement the new structure will be onerous, and from the outset there will be increased operational risk during the changes and with the initial operation of a new larger structure.

d) Infrastructure:

- *What impact do you think mergers between funds would have on funds' ability to invest in infrastructure?*

A merged fund may not offer an infrastructure investment. This would have no impact on the Scottish funds that do not at present have this investment but would remove the ability of any Scottish funds currently invested in infrastructure.

The increased size of a merged fund would increase the probability of having an infrastructure investment vehicle as part of its investment strategy, which would open up this investment to the smaller Scottish LGPS.

Some of the larger Scottish LGPS are already invested in infrastructure so merging may not achieve any sizeable change to the overall investment in infrastructure.

Whether it is a few funds merging together or all of the Scottish LGPS merging, the merits of investing in infrastructure would be reviewed against other investments, to see if it would be included in the investment strategy.

- *What would be the positive impacts?*

The merger of some funds or all of the Scottish LGPS could offer a direct infrastructure vehicle which was not available to some of the Scottish LGPS.

- *What would be the negative impacts?*

Some of the Scottish LGPS already invest in infrastructure so a merger would make little difference to their infrastructure investments.

The merging of different infrastructure investments would be very difficult and could ultimately increase concentration risk. Restricted options made available by the merged Fund may give rise to a negative impact for those Funds which would require a change in their infrastructure investment.

e) Do you have any additional comments about this option?

A merger of any of the Scottish LGPS Funds would not actually improve funding levels, as the merged position would simply be the sum of the current constituent positions: this is a major issue with this option.

The high funding levels of the Scottish LGPS Funds give reassurance to employers and members that the funds are currently being well governed and able to pay current and future pensions without requiring excessive contributions overall. This is paramount, and any change to this structure would need very good sound evidence to prove that the current good position could be improved for all interested bodies.

The current structure has been in place for many years and has proved that it works and can achieve its objectives. Any change from a successful structure is dangerous without being sure of the outcomes.

The pooling option has proved to be a very difficult and costly option from the experience witnessed in England and Wales. A merger of some or all of the Scottish Funds takes pooling to another level where all functions of the Pension Scheme are merged. This will therefore involve greater costs and changes than was seen with pooling, involving many more unknown outcomes. This will have a negative effect for employers through increased contribution levels which will have a knock on effect to the Council's budgets and other services.

Any form of merger that included the Shetland Island Council Pension Fund would need to be Island Proofed. This brings in an islands awareness into the decision to ensure that any impact of the change does not harm the interests of the Shetland Community.

Question 5: Preferred and additional options

The text can wrap onto additional pages.

a) Which option does your organisation prefer? Please explain your preference.

Out of the four options in the consultation the Shetland Islands Council would prefer Option 1 to “Retain the current structure with 11 funds”.

The Shetland Islands Council Pension Fund at the last actuarial valuation in March 2017 had a calculated funding level of 90% on a prudent basis, which maintains a good ability to cover current and future pensions. This level of funding along with strong governance shows that the fund is well placed for the future.

When you add up all the fund’s current members, deferred members and pensioners the total comes to about 31% of the population of the Shetland Islands. The fund is therefore very important to not only the members, but for the future income and benefit of the Shetland community. Local employers pay the required contributions and bear the investment risk, all under a framework of local scrutiny. Any option to remove local control of the pension fund would require very strong evidence to show that it would be beneficial to the fund and its membership and employers. The options proposed to pool and merge funds have many issues which have unknown outcomes, and they do not have the level of evidence or assurance to make them viable alternatives.

The Council as the largest employer in the Shetland Pension Fund and has played a major role in the Pension Fund from operating and managing the Fund to contributing through employer’s contributions. This along with external legislation, external audit scrutiny and reporting to the Pension Board has resulted in a Fund with a good funding position. This is replicated throughout Scotland and is not a structure in need of major reform.

The Fund has benefitted from the already significant cooperation between the Scottish Pension Funds and it would be good to see this continue with further collaboration on issues relating to both investment and administration, which would help enhance the fund’s position.

b) What other options should be considered for the future structure of the LGPS?

The 11 Scottish Pension Funds have good funding positions and have proved to be a long term success but there are many challenges within the pension domain. This is not an unusual situation and does not require any sudden changes to the scheme but the cooperation between Funds could be enhanced with more collaboration on some of the more challenging issues. A recent example of this would be the joint collaboration on infrastructure investment between Lothian and Falkirk.

c) What would be the advantages and disadvantages of these other option for funds’ investment costs, governance, operating risks and ability to invest in infrastructure?

A collaborative approach on specific pension issues between the Scottish Funds would allow their combined knowledge and understanding of the issues to be discussed and solutions worked out to the benefit of the Funds and their members. This type of joined approach would always discuss the long term costs, governance and the operational risks.

The ability to invest in infrastructure is again a choice of each fund, based on the merits of that investment against other investments. The collaboration of certain Scottish Funds has already witnessed an instance where the ability to invest in infrastructure was realised.

d) Are there any other comments you would like to make?

The consequences of a large change could have long term detrimental effects to the Scottish pension position, the members and many employers. With a lack of evidence for any change and many unknown outcomes the options to pool and merge appear to present little positive benefit but significant potential costs, upheaval and risk.

Major changes to the operation of the Scottish LGPS should only be considered if there were large problems with the current situation. This is clearly not the case as the Scottish LGPS have good controls in place and have strong funding levels, which this consultation will demonstrate.

The consultation questions end.

Appendix B

Information on the Scheme Advisory Board Consultation on the Future of the Scottish Local Government Pension Scheme

1.0 A review of the SLGPS was agreed with stakeholders and Scottish Government Ministers when the changes to the scheme and the new Scheme Advisory Board were introduced in 2015.

1.1 The SAB proposed carrying out this review beginning in 2016. The SAB commissioned research pieces by Mercer (investment consultants) in 2016 and Iain Clacher at Leeds University in 2017, as well as setting up a working party comprising employers, trade unions and fund advisors. From this research the SAB released its own report in 2017.

1.2 The research concluded that Scottish pension schemes face a number of significant challenges and, as a result, the current structure of the scheme in Scotland which has 11 Local Authority Pension Funds should be reviewed. A selection of these significant challenges include: the deficit; investment management costs and their transparency; investment performance; volatile investment markets; low interest rates; a maturing scheme membership and the consequences of implementing investment preferences in respect of certain assets, such as fossil fuels and infrastructure.

1.3 Based on this research the SAB report identified four options for the future of the local government pension scheme in Scotland.

1.4 The four options proposed are:

- Retain the current structure with 11 Local Authority Pension Funds
- Promote cooperation in investing and administration between the 11 funds
- Pool investments between the 11 funds
- Merge the 11 funds into one or more funds

1.5 The four proposed options were presented to Scottish Government Ministers in May 2017. In January 2018, SAB received a letter from Derek Mackay MSP, Cabinet Secretary for Finance and the Constitution seeking a consultation with SLGPS employers and employee membership bodies on the four options.

1.6 The SAB has commissioned the Pensions Institute to manage the consultation process on the structural review of the SLGPS. The consultation invites employers and employee representative groups to give their views on each of the four options. The consultation was launched during June 2018.

1.7 The SAB’s 2017 report sets out the four main options for the local government pension scheme and the consultation questions focus on four criteria in relation to each option:

- Cost of investing: This is the biggest outlay by each fund in the SLGPS and research suggest even small reductions in investing costs and, in particular, investment manager fees could have a significant impact on fund performance.

- Governance: Numerous studies show that improving governance produces significantly better outcomes over the long-term and that most pension funds in both the private and public sectors have room to improve in this area.

- Operating risks: Believed to vary significantly among public and private sector pension funds depending on the effectiveness of the governance processes of each fund and the quality of the executive resources available to individual funds.

- Infrastructure investment: There is an increasing political desire that SLGPS funds be able to invest pension assets in infrastructure should they decide it to be in the interest of members and employers.

1.8 The cost of investing, governance and operating risk are all issues which pension schemes consider and review. Infrastructure investment is rather different as it is an actual investment sector, one of many that would be considered by pension funds when setting an investment strategy. The foreword to the consultation is by Derek Mackay MSP, and it states “The Scottish Government is ambitious for greater investment by local government funds in Scotland’s infrastructure.”

1.9 The consultation is open to SLGPS employers and employee representative groups only. To have their views heard, they should respond to the questions no later than Friday 7 December 2018. We have asked for a short extension to their timescale to enable the Council to consider its points at its meeting on 12 December. The Council now has until the 12 December 2018 to respond to the questions.

1.10 Responses gathered from the consultation will be analysed by the Pensions Institute and then forwarded onto the SAB for evaluation, before being presented to Scottish Government Ministers in 2019 for a decision on any future course of action. As well as this consultation, Ministers will also take into consideration a governance review of public sector pensions being undertaken by the Scottish Public Service Pensions Agency.

1.11 The four options proposed in the SAB report which employee and employer groups are asked to consider could have very different impacts upon the Shetland Islands Council Pension Fund:

- Retaining the current 11 Scottish Local Authority Pension Funds. This is the status quo option, and there would be no change to the present governance, operation and investment of the Pension Fund.

- Promoting cooperation in investing and administration between the 11 Funds. The administration officers and the investment officers of the 11 Funds already meet quarterly and share information. This would increase the current cooperation, in certain specific areas where beneficial between the Scottish Funds. This would involve having a closer working relationship with the other 11 Pension Funds.

- Pooling of investments between the 11 Funds. This is following on from England and Wales where 89 funds combined into eight large pooled funds. This option for Scotland would see the 11 funds made into one Scottish Pool, involving the setting up of a new committee and officer operation to look after the Scottish investment pool.

  Shetland's Pension Fund would be removed from any dealings with fund managers as the selection, monitoring and reviewing would be dealt with by the pool's officers. Shetland's Pension Fund investment strategy would still be set by the Pension Fund Committee but it would only be able to invest in the selection of fund managers that the pool recommended. Costs and benefits would be unclear with this arrangement until the pool structure was operating, but it would add another layer of governance between the Fund and the fund manager, with a reduced fund manager investable list.

- Merging the 11 Scottish Funds into one or more funds. This would remove all local control and involvement in the Pension Fund from the Council. The new Scottish Fund would have responsibility for all of Scotland's pension investments. There would be no requirement for a Pension Fund Committee or Pension Board, no involvement in the investments and there may be staff issues if administration was included. The Council would no longer have any local control of the Pension Fund. The Council would be told by the new Scottish Fund what the Council's employer contribution would be with no obvious control over the situation.

1.12 The last two options, pooling or merger, would have the largest impact on the current operation of the Pension Fund. These two options would ultimately reduce or take all control of the Pension Scheme away from the Council. The Pension Fund is important to Shetland as pension fund members, admitted bodies and pensioners in Shetland combine to create an overall total of 7,253 members at the 31 March 2018, which represents around 31% of Shetland's population.

1.13 The Council's Pension Fund Committee acts on the full delegated authority on all matters representing the Council as administering authority for the Shetland Islands Council Pension Fund. Its activities are overseen by a

Pension Board on which there are representatives of other bodies who participate in the Pension Scheme (admitted bodies) and by employee representatives through union participations. The individual members of the Committee and the Pension Board act under a fiduciary duty to the Pension Fund and the terms of reference of the Committee and the board respectively are attached as Appendix C to this report. Given their fiduciary duty, it is entirely appropriate for the Pension Committee to submit a response aligned to its functions and it must do so having regard to the interests of all participants in the scheme. Although any response the Pension Committee might be minded to make is likely to be similar to one endorsed and submitted by the Council, it is also within the gift of the Council as a separate employer to make its own response. In that manner, the Council might wish to make other strategic or political comments having regard to its status as the largest employer and thus a major contributor to the existing fund.

1.14 All employers and employee groups can respond to the consultation. The Council is the largest employer within the Shetland Islands Council Pension Fund and would be affected the most by any changes to the Pension Fund, not only with a possible loss of staff but also in regard to the employer's contribution level. It would therefore add to Shetland's voice in this matter if the Council as an employer in the Pension Scheme were to submit a formal response.