

# THE FEFC FUNDING MODEL AND SKILLS ACCOUNTS: A CONSERVATIVE PARTY CONSULTATION DOCUMENT

## Executive Summary

Detailed study of the history of skills funding in England suggests the following conclusions should inform our model:

### **The FEFC Funding model**

- The FEFC's tariff based funding formula has been remarkably resilient and has survived under the LSC.
- The main problem with the FEFC's funding model was that it failed to provide a suitable mechanism to fund expansion and new provision.
- The LSC addressed these problems through a return to planning; however this has resulted in greater bureaucracy, a loss of local autonomy and other unintended consequences which have been addressed through even more centralisation.

### **Lessons for our new FEFC**

- If we attempt to establish a system based on the FEFC's tariff system plus national, sectoral and regional priorities then **we risk recreating the LSC**.
- An alternative approach is drive the efficient allocation of resources **not from above but from below** by making colleges more accountable to individuals and their communities. Life-long learning accounts are one important way of increasing provider responsiveness.

### **Life-long Learning Accounts**

- The fraud associated with Individual Learning Accounts (ILAs) can be avoided by adopting a system of registered providers similar to that used in Scotland where Learning Accounts continue to operate.
- There are various ways of rationing demand. The most effective would be to use accounts as a way of **activating money** allocated under an FEFC funding model. This would be a way of ensuring that providers respond to individual demand.

**These reforms would enable a significant reduction in the number of bodies and processes involved in skills funding.**

## **Introduction**

In our skills Green Paper, published in 2008, we made a commitment to structural changes in the way public funding is provided for training. The task is now to provide more detail about how these new arrangements will work in practice. In particular, the Green Paper outlined two significant changes that require attention if they are to be implemented successfully:

- The paper stated that *‘funding will be administered through a slimmed-down Further Education Funding Council for England’*.
- Secondly, the paper stated that support for workplace training would *‘be delivered through new Lifelong Learning Accounts.’*

This paper outlines how both these objects may be achieved in practice. It draws on various sources, including wide ranging discussions with college principals, the AOC and the 157 Group of Colleges conducted by David Willetts, John Hayes and David Evennett, as well as academic research, papers prepared by the House of Commons Library, conversations with former FEFC staff and two papers prepared by John Stone, Director of the Learning and Skills Network and a former college principal.

## **1. The FEFC Funding model**

Our discussions with college principals indicate that they favour a return to the years of college autonomy which followed incorporation in 1992.

The Further Education Funding Council for England (FEFC) was a non-departmental public body of the Department for Education and Skills in the United Kingdom which distributed funding to Further Education and Sixth Form Colleges in England between 1993/94 and 2000/01.

Until August 1992 colleges had been funded directly by local authorities. Different authorities had developed different approaches. The Council therefore inherited a wide variety of systems and also of rates payable.

The Further Education Council ‘Tariff’ funding methodology following a period of debate and consultation. The consultation indicated overwhelming support for ‘Option E’ which funded colleges through a system of ‘tariff units’ reflecting the three ‘programme elements’ Entry, On Programme and Exit (Achievement).

The main features are outlined in the table below.<sup>1</sup>

Programme Element	Scope	Indicative evidence
Entry	Covering the process of enrolment, induction and production of the student learning plan	Student learning agreement
On programme	Reflecting the costs of delivery through assessing the number of ‘guided learning hours’ provided <i>or</i> for the most common programmes (eg A level or GNVQ) determining a set tariff irrespective of the number of hours delivered to the student.	Enrolment record and course registers
Exit	Reflecting the costs of assessment but also providing a performance related element to the methodology	Examination results

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<sup>1</sup> Source: Letter from John Stone, 19/10/09

Money was allocated on a per-capita basis and records were to be maintained at individual student level (the ‘Individual Student Record’ or ISR) and made available to the Council to substantiate each college’s funding claim. All claims were subject to independent external audit, the costs of which were met by the institutions themselves.

The level of support could differ enormously between different types of qualification. For example the final FEFC funding guidance contains the following two examples of the allocation of funding units.<sup>2</sup>

	<b>Entry</b>	<b>On programme</b>	<b>Achievement</b>
<b>EDEXCEL National</b>			
<b>Diploma</b>	8	144	31
<b>NVQ or GVQ unit</b>	4	3.8	0.9

The use of units provided a single currency for measuring activity in colleges but it also created incentives to expand programmes and earn more units, at the cost of spending more per student on fewer students. The LSC made two significant changes to the formula to deal with these problems:

- In 2003, the LSC removed the concept of units to create a link between the cash calculated by the formula and a target number of students.
- In 2008, the LSC introduced a new volume measure in the form of Standard Learner Numbers, which is a measure of weighted full-time equivalent numbers (1SLN = 450 guided learner hours).<sup>3</sup>

### **1.1 Other key features of the Council’s approach included:**

- A core and margin approach to unit allocations with colleges guaranteed 90% of their previous allocation while bidding for additional units through the production of a strategic plan.

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<sup>2</sup> FEFC, *Guidance on further education funding eligibility and rates*, 2001/2. Weighting factors have been removed from these examples which are intended for illustrative purposes only. The entry element was determined in relation to the basic on-programme units (bopu). For example, in 2001/2 3.8 or more bopu’s were worth 4 units while 10 or more were worth 8.

<sup>3</sup> Information provided by the AOC.

- In year flexibility: once allocated colleges were free to vire units between eligible provision without reference to the Council, subject to the presumption that their offer remained ‘broadly in line’ with that initially proposed.
- Variable funding rate: although the tariff system provided a robust methodology for comparisons of activity between institutions, the amount paid per unit to each institution was determined by the Council and initially at least varied considerably between institutions.
- Cost Weighting Factors: The differential costs of delivering different specialisms was reflected through ‘Cost Weighting Factors’ which multiplied the tariff units drawn down for more expensive provision (eg Humanities = 1.0; Science = 1.2 etc).
- Additional Learning Support (ALS) funding (e.g. for dyslexia) was funded outside the tariff system on the basis on an individual student claim.

## **1.2 The development of the methodology**

The FEFC funding methodology has proved remarkably resilient and is still recognisable in the 16-19 and ‘Adult Responsive’ funding mechanisms still used by the LSC.

The main issues and developments since 1994 include:

## **1.3 The ‘demand led element’ (DLE)**

In retrospect an extraordinary development in which the FEFC offered an open-ended commitment to fund above target performance at a marginal rate of £6.50 per unit. The offer was probably designed to fund the marginal costs of taking on additional students through increasing class sizes and other small-scale initiatives.

The main impact however was to stimulate a torrent of low-cost schemes which unleashed unprecedented growth and drove down average unit costs contributing to an ‘efficiency gain’ in the sector which reached 7% per annum over a four-year period.

The main uses of DLE was in setting up neighbourhood IT centres and ‘franchised’ provision in community locations and on employers’ premises.

The lag between contracting and gathering data for claims was such that the Council (and the Treasury) were unaware for the full extent of such activity. When this became apparent the tap was turned off abruptly leaving a number of contractual complications in its wake.

In November 1996, the FEFC sent a report to the DFEE for £82 million of additional grant aid due to extra activity generated by the DLE, much higher than the Government had anticipated. When it was announced that DLE would not be forthcoming in the future, it sparked a financial crisis for colleges.<sup>4</sup>

#### **1.4 Franchising**

The FEFC methodology allowed colleges to pass on funding to third-party providers, the principal of the college remaining accountable to the FEFC as accounting officer. Franchising became the favoured mechanism for institutions seeking to achieve rapid growth or make up for an under-target performance during the year. Franchising proved to be an effective mechanism for achieving cost-effective growth, promoting innovative forms of delivery, stimulating employer engagement in training and widening participation.

There were however serious drawbacks.

There were a number of high-profile audit failures as some colleges failed to maintain effective checks on delivery in off-site locations.

College franchising activity was not at first restricted to the local area. This led to vocal complaints from colleges who found other institutions indulging in what was termed ‘wasteful competition’ on their patch. Others complained that institutions were neglecting their local community and by driving down costs through marginal activity were denying increasingly scarce resources for the core mission of the college sector. The rules and audit regime became increasingly tighter until franchising all but disappeared under the LSC.

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<sup>4</sup> N. Lucas, J. McDonald and D. Taubman: ‘The Impact of FEFC Funding, Further Evidence from Fourteen Collges’, NATFHE, Institute of Education, 1999.

## **1.5 Widening participation**

Following the publication of the Helena Kennedy report “Learning Works”, commissioned in 1996 by the FEFC and a campaign by colleges in inner-city areas, colleges recruiting students from disadvantaged backgrounds were compensated for the additional costs of supporting such students through the tariff system. This was achieved through multiplying the tariff by a ‘disadvantage uplift’ linked to the level of disadvantage recorded against that student’s postcode.

## **2. The LSC and the return of planning**

The FEFC funding methodology was designed for free-market operation. Planning was at institutional level and colleges were, by and large, free to move funding units to areas where the demand was greatest. If a college failed to meet its target, funds were clawed back and were in principle available for redistribution. With the change of government in 1997 there was some support for the return of an element of central planning. The LSC took over from the FEFC with explicit planning powers included in its remit.

The return of planning had the impact of significantly increasing the level of funding complexity and resulted in unintended consequences that necessitated even more central direction.

### **2.1 16-18 year old students**

Following the realisation that England was falling behind other countries in the proportion of 16-18 year olds continuing in full-time education, funding for 16-18 year olds was separated out from that for adults. Each funding line continued to operate under a form of the tariff methodology, except that higher rates were paid for 16-18 than for 19+ students. Funds available for growth were largely focused on the 16-18 target group. Colleges were allowed to vire funds from adults to 16-18 year olds but not vice versa.

The policy succeeded in driving up 16-18 participation but predictably significantly reduced the emphasis on adult skills. Arguably, this contributed to the dissatisfaction felt by employers over FE's responsiveness which provided the rationale for counter initiatives, such as Train to Gain, as 'employer responsiveness' moved back up the policy agenda.

It is striking that the problem of youth unemployment and inactivity are now, in many respects, as acute for 19 to 24 year olds as for 16 to 18 year olds.

### **2.2 Accredited provision**

The emergence of OECD comparisons of international qualification rates as the main driver for skills policy encouraged the Government and the LSC to focus more on

accreditation. Qualifications were characterised as a close proxy for skills. Provision therefore needed to be accredited with strong emphasis on the subset of qualifications deemed to contribute to national targets. In due course there was pressure from regional partners to take account of regional skills priorities. These demands were accommodated through the introduction of a **provision matrix** for each institution.

	High regional priorities	Intermediate priorities	Low Priorities
Provision contributing to targets			
Accredited & not contributing to targets			
Non-accredited provision			

Encouraged by the allocations methodology colleges were required to rebalance their provision towards the top left. **The bottom right became known in some quarters as ‘the naughty corner.’** The provision matrix has subsequently been replaced by a more complicated system.<sup>5</sup>

The unintended consequences of this approach included:

- Reduction in flexibility at local and sub regional level
- Large reductions in priority areas where accreditation was unavailable or inappropriate. This led to reductions in funding for courses for adult learners, disabled learners and NEETs
- The rationale for identifying an area as high or low priority was not always clear

Despite being originally designed as a market-oriented flexible funding mechanism, the tariff methodology survived the change to a planning-based system relatively unscathed.

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<sup>5</sup> Information provided by the AOC

### **3. Lessons for a new FEFC**

It would be relatively straightforward to return to the principles of the FEFC tariff system by removing the provision matrix and its emphasis on accreditation and centrally determined targets. The main challenge for a new funding model is to identify an alternative way of prioritising the funding of new provision efficiently and effectively. The above discussion shows that the use of the DLE and franchising under the old model failed to do this effectively.

These problems are particularly important as we would want a new FEFC to fund both colleges and private training providers. **Any model would need to determine how to fund new entrants into the market.**

One possibility would be to establish priorities through consultation with regional and sectoral bodies. **However, the danger with such an approach is that we would simply recreate the LSC.** It is central planning, not funding methodology which provides the main contrast between the FEFC and the LSC.

Another alternative would be to drive the efficient allocation of resources **not from above but from below** by making colleges more accountable to their communities.

#### **3.1 Proposed model**

Each college or provider would be given a historic allocation based on a number of students at a set price per student. Some would overshoot their allocation and some undershoot. To ensure value for money the FEFC would undertake to claw back any unused numbers at the end of the year. However, there also needs to be a mechanism that encourages an efficient and flexible response to changes in demand.

Underperforming colleges would be allowed to trade their unwanted numbers and the associated funds with other providers, possibly online. These would be offered at a marginal rate so that these colleges have a financial cushion to manage downsizing (smaller class sizes) and would enable successful colleges with the mechanism to fund in-year expansion at a marginal rate.

For each institution, the following year's allocation would be based on the student numbers actually delivered creating a new baseline. **New providers would be able to enter the market and get a foothold to gain baseline funding in the following year.**

The FEFC would have a market regulation function, the volumes and prices being traded would provide management information on what providers were prepared to deliver and at what price. **This could potentially drive efficiency gains over time.** There would probably have to be more than one type of funding unit with premium rates for disadvantage and high-cost provision. These should be kept to a minimum with the mechanism for college accountability (see below) also ensuring that provision meets community need.

An informal trading system had begun to emerge in the mid-1990s, but was shut down by the FEFC which needed to claw back funds to balance the books and meet its obligations under the open-ended 'demand-led element'.

### **3.2 College accountability under an FEFC**

We envisage an FE sector that has the flexibility and agility to respond to the changing needs of the local economy but also serves the wider needs of the community. However, it may be possible under a unit-based funding system for colleges to exploit their virtual monopoly position and run a successful business without regard to large sections of the community who may not cross their door or be easy to reach. It has been partly in response to these potential problems that the extensive national structure of regulation, planning and quality assurance has been erected. But there are other systems of accountability which do not require such bureaucratic structures.

### **3.3 Self-evaluation**

Effective self-evaluation would be based on the following elements:

- Benchmarked assessment of the quality of teaching and learning
- Peer review of teaching and learning
- Benchmarked data comparisons covering student success rates, attendance and student destinations

- Employer, student and staff perceptions and complaints register
- Periodic External Inspection
- External audit of governance and mission

A recent UKCES report has advocated a similar system with a balanced public scorecard based on a profile of ‘*aggregate outcomes/destinations, customer satisfaction levels and quality*’, enabling individuals and employers to take informed decisions about which provider to use for training.<sup>6</sup>

### 3.4 New Providers

Where provision is insufficient or inadequate the FE system could be opened up to new institutions to apply for state funding. **These could be part of the public, private or voluntary sectors.** They could operate from FE buildings held in trust where previous management arrangements have failed. There could be similar arrangements for FE providers to those for schools with academy status.

### 3.5 Mission statements and public accountability

Each institution should have responsibility for its own mission, expressed by a statement from the governing body. This statement would be a precise and detailed account of those communities, commercial sectors and special interests (NEETs, special needs etc) the college wishes to serve and how it proposes to do so.

The mission statement would be public and include a strategic plan. The FEFC and the local community would be formally invited to comment on the statement and make representations should there be significant omissions. Where such gaps are not addressed, it would be open to the FEFC to make alternative provision available.

The college would document the main messages to have emerged from consultation and demonstrate how it has taken account of these in its allocation of resources within its strategic plan. It would formally assess the impact of such measures and include an assessment in its annual report. The UKCES has advocated a similar approach. Ways of

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<sup>6</sup> UKCES: ‘*Towards Ambition 2020: skills, jobs, growth*’, 2009.

strengthening college government may be examined to ensure that strategic plans are acted on.

These arrangements would not be introduced as additional burdens on institutions. Colleges are enthusiastic about the role they play in their community. It may be possible for large colleges to play the role of ‘lead provider’ and take on the responsibilities of mission statements and public accountability for smaller providers.

**Our package would give significant freedoms to colleges which would be held to account via local structures and mechanisms and through commercial pressures and increased competition.**

### **3.6 One funding body, one audit regime, one improvement body**

This approach would enable us to consider the abolition of a whole range of bodies and mechanisms designed to ensure provision matches local need. The recent White Paper commits the Government to the abolition of Regional Skills Partnerships but we would also consider the role of RDAs, Multi-area agreements and Employment and Skills Boards. It would mean the end of multiple funding streams, including 16-18 funding. It would require one single funding body.

It would only require a single monitoring and audit requirement across all budgets and programmes.

It would also enable us to significantly rationalise the system of publicly-funded improvement organisations in the sector. The UKCES has recommended that all such improvement organisations: the Learning and Skills Improvement Service, BECTA, Standards and Verifications UK and the non-SSC elements of Lifelong Learning UK, should be merged into one body.<sup>7</sup>

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<sup>7</sup> UKCES: Op Cit.

#### **4. Lifelong Learning Accounts**

The training needs of individuals outside the workplace are currently funded through adult-responsive provision. The Government intends for all of this provision to be delivered via Skills Accounts by 2015.

Although Individual Learning Accounts (ILAs) were discontinued after reports of widespread fraud, there is evidence that they had a positive impact on individual engagement in education and training. A LSDN study found that the experience of ILAs suggests that there is *‘a substantial untapped market for learning.’*<sup>8</sup>

However, pilots of the new Skills Accounts give little indication that the scheme will make any significant difference to the way adult learning is funded. A recent Cabinet Office inquiry into social mobility and access to the professions concluded that *‘this money will not be truly demand led: individual ‘entitlements’ will in reality operate through existing supply-driven training schemes, such as the Government’s Train to Gain model.’*<sup>9</sup>

If Skills Accounts do not enable individuals to access training in a way that is not significantly different to the current entitlements it is difficult to see how they will help reach a new market for learning. According to the principal of a large FE college *‘Skills Accounts are not developing, they are not real money and as a result do not mean very much to people, particularly adults.’*

It should be possible to conceive of a new system of learning accounts which is structured to avoid many of the problems experienced. Fraud can be avoided by ensuring that funds can only be used to access training offered by accredited providers.

For example, Skills Accounts have continued to operate in Scotland, with fraud avoided through a system of registered providers. Registered ILA Scotland learning providers must, as a minimum requirement, meet one or more of the following quality standards stipulated by Skills Development Scotland (SDS):

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<sup>8</sup> *Research Findings: Impact of Individual Learning Accounts*, 2002 Learning and Skills Development Agency

<sup>9</sup> *Unleashing Aspiration; The Final Report of the Panel on Fair Access to the Professions*; Cabinet Office, 2009

- Scottish Funding Council recognition of good standing regarding Quality Assurance Agency (QAA) for Higher Education and/or recognition of good standing regarding the requirements of HM Inspectorate of Education (HMIE)
- Scottish Qualifications Authority (SQA) approval as an SQA-approved centre
- Approved learndirect Scotland branded learning centre.

Questions remain, however, as to how the calls on public funds can be managed should learning accounts become the universal skills funding system. There are at least four possible approaches, all with their own strengths and weaknesses:

#### **4.1 Restricting their size and scope.**

There are two obvious routes to controlling expenditure on accounts: setting limits on the value of accounts and restricting access to accounts.

The scheme in Scotland has both of these characteristics: accounts are limited to £200 per person, or £500 for people studying a part-time higher education or professional qualification equivalent to 40 or more Scottish Credit and Qualifications Framework credits.<sup>10</sup> The scheme is limited to those earning £18,000 or less, rising to £22,000 or in the 2009-10 academic year.<sup>11</sup> Mean testing would require a significant allocations bureaucracy.

The early Train to Gain experience gives us an example of the possible negative impact of such limitations. Initially the demand for full level 2 qualifications was so limited that even a 100% subsidy was insufficient to ramp up demand. This approach, however hardly represents an encouragement to train.

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<sup>10</sup> ILA Scotland, <http://www.ilascotland.org.uk/ILA+Homepage.htm>

<sup>11</sup> <http://www.scotland.gov.uk/Topics/Education/skills-strategy/progress/sg/economicimprovement/ILA200>

## 4.2 First Come First Served

The total sum available is cash limited. Rationing is therefore either on a first come first served basis, this would introduce a bias towards better motivated students. A limit of 100,000 accounts was a feature of the original ILA scheme in Scotland.<sup>12</sup>

## 4.3 Variable Value Accounts

Here the number of accounts available in any given month is flexible, but the amount of subsidy varies according to demand. The total pot is constant and profiled monthly. Individuals could apply one month ahead and receive an on-line estimate of the value of the account. If this were relatively generous more would apply driving down the rate. The market would therefore find its own level of acceptable subsidy. The amount could also be proportionate to the investment made by the individual and/or enhanced in cases of disadvantage etc.

## 4.4 Plug-in accounts

Here virtual funds are allocated to all account holders but the funds are not activated until the account is 'plugged' into a provider with suitable provision on offer. The rationing is at provider level with each provider receiving an allocation of 'virtual tariff' units which would only be drawn down if matched with a learning account. This allocation would be determined using the funding model proposed in the first part of this paper.

This form of rationing is similar to the Maximum Aggregate Student Number (MASN) system used in HE to keep an otherwise open ended entitlement to student support within acceptable limits. Unused virtual tariff units could be traded on-line between institutions to allow popular provision to expand and maximize the number of funded places on offer.

### **In the case of apprenticeships, employers would also be able to access this funding.**

Where employers do not wish to provide the training themselves they would be able to direct funding to a private training provider, FE college, or a Group Training Association. This would give employers much greater control over funding than at present.

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<sup>12</sup> Scottish Parliament Information Centre, Research Note RN01/108, *Individual Learning Accounts: Progress since Introduction*, 23 November 2001, [http://www.scottish.parliament.uk/business/research/pdf\\_res\\_notes/rn01-108.pdf](http://www.scottish.parliament.uk/business/research/pdf_res_notes/rn01-108.pdf)

## **5. Next Steps**

The approach set out in this paper is intended to free FE colleges and other providers so they can deliver education and training which meets the needs of individuals and employers. We intend that our approach should be informed by the knowledge and experience of those from within the sector and we intend to consult widely on these proposals.

### **5.1 Consultation questions**

1. Is a tariff based funding formula the best way of funding provision? Should we consider other models?
2. Is a trading system the best way for adjusting for underperformance?
3. Does consideration need to be given to the structure of college governance? Are there specific examples of best practice we should examine?
4. Which of models outlined in this paper for Lifelong Learning Accounts offers the best way forward?
5. Should we encourage individual and employer contributions to accounts? How could we encourage contributions?

Please send your responses to us by Friday, 15 January 2010.

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**November, 2009**