Summary financial position of the college sector following analysis of 2015-16 annual accounts

The financial results for the college sector in 2015-16 show significant variations in the financial performance of individual colleges across the sector. Overall the financial health of the sector remains relatively stable but has deteriorated since last year (2014-15).

Background
2015-16 is the first year that colleges reported under the new FRS 102 accounting standard, interpreted for the sector by the FE/HE Statement of Recommended Practice (SORP). The 2014-15 results have also been restated under the new rules to allow a comparison to be made. However there is the added complication that 2014-15 was a 16 month period which is important to note as it makes the income and expenditure lines look inflated for that year when comparing to 2015-16 figures. This summary includes the results of all colleges, incorporated and non-incorporated, where possible.

Income and expenditure
Sector income in 2015-16 was £692 million and expenditure totalled £712 million. The sector reported an operating deficit of £19 million (-2.8% of total income), compared with a deficit of £12 million (-1.4% of total income) in 2014-15.

Following their reclassification as arms-length central government bodies from 1 April 2014, it is expected that most incorporated colleges will report deficits in their published accounts which can arise as a result of the depreciation charge and/or due to other transactions distorting the results.

While budget is allocated to colleges for both cash and non-cash transactions, it is only the cash grant-in-aid that is reflected as income in the accounts. This can result in deficits which relate to non-cash transactions being reported in accounts which have no corresponding income. If colleges spend their entire cash budget on revenue items, this creates a ‘technical’ deficit to the value of the depreciation charge. Government budgeting rules mean colleges have to spend their entire cash budget in that Financial Year.

Audit Scotland has made clear its view that a deficit arising from the use of cash funding originally provided for non-cash depreciation (i.e. a ‘technical’ deficit) does not indicate an underlying financial sustainability concern; therefore this, and other one-off transactions need to be adjusted for in arriving at the underlying operating position. This includes taking account of significant transitional accounting changes which were introduced as a result of FRS 102 e.g. non-Government capital grants are no longer deferred but recognised in full in the Statement of Comprehensive Income and Expenditure when performance conditions are met.

After taking account of adjustments the sector ‘underlying’ operating deficit for incorporated colleges reduces to £8 million. The figures are skewed by the results of a small number of colleges. Where the deficit is of a sufficient level to cause SFC concern, a higher level of engagement is put in place to allow SFC to be supportive of the colleges whilst they are drawing up and implementing a recovery plan to allow them to return to a breakeven or surplus position.

Liquidity
The amount of cash held by colleges has reduced since incorporated colleges were reclassified as public bodies in 2014. Colleges’ cash less overdraft balances reduced from £55.9 million to £45.0 million over the course of 2015-16. Some incorporated colleges have retained a cash ‘reserve’ for the purposes of repaying outstanding loans and other financial commitments therefore their balances will reduce year on year. The remaining movement is due to working capital movements, largely in relation to estates projects, and the weaker operating position of some colleges has also depleted their cash balances. The Council executive closely monitors colleges’ cash balances by means of the monthly cash flow returns.

Total sector borrowing was £132 million at 31 July 2016, this is double the amount of borrowing in the previous year. The increase in overall borrowing is due to Non-Profit Distributing (NPD) Project commitments appearing on the balance sheets of two of the colleges. Other college borrowing decreased from £66.8 million to £58.6 million during 2015-16.

Capital investment
Capital investment in 2015-16 totalled £119 million compared to £46 million in 2014-15. However, it should be noted that the increased level of investment is being driven by two colleges with major capital projects contributing £90 million of the sector’s capital expenditure total in 2015-16. Capital expenditure as a percentage of total income varied considerably at an individual college level with a total of twelve colleges reporting a reduction in capital expenditure from 2014-15 to 2015-16.

Reserves and pension deficits

Reserves are a college's total assets less its liabilities and, in very broad terms, can be used as a proxy for the overall value of a college. These are the accumulated surpluses of a college over its lifetime and are not the same as cash.

Under the new financial reporting framework, reserves are categorised as either restricted or unrestricted. Unrestricted income and expenditure reserves represent the value of the college's accumulated surpluses reported in a college's income statement, where there are no restrictions on the use of funds.

The sector reported unrestricted reserves of £-64.4 million. This represents a deterioration from the previous year, where reported reserves were £-0.7 million. The movement in reserves is largely due to a combination of the operating deficits incurred by colleges and the increase in pension liabilities. Some colleges are now reporting net liabilities due to the reclassification of deferred Government Grant on the balance sheet following the introduction of the new FRS 102-based SORP.

Risks

There are a number of risks that could adversely affect the financial health of colleges. The most significant risk areas for colleges relate to:

- Changes to the funding model and achievement of student activity targets;
- Challenges of diversification of funding;
- European funding;
- Pension costs;
- Staff costs/ National pay bargaining;
- Balance of portfolio of provision and how that impacts on student numbers;
- Maintenance of estates; and
- Student support funding.