Summary financial position of the college sector: Analysis of 2016-17 financial statements

Purpose

This report summarises the college sector's financial results for 2016-17.

Background

Financial health monitoring framework

Incorporated colleges are required to make the following financial returns to the Scottish Funding Council (SFC) in the course of the year:

- Financial forecast return (FFR), submitted at the end of June and prepared on an Academic Year (AY) basis (to 31 July), comprising an outturn forecast for the current year and forecasts for the following five years.
- The annual accounts, submitted at the end of December, comprising the audited financial statements (also prepared on an AY basis) and supporting reports by the college's audit committee, internal and external auditors.
- Quarterly resource (monthly in the final quarter)[1] and monthly cash flow returns prepared on a Financial Year (FY) basis (to 31 March) to ensure they balance their books on a resource basis and in order that cash is not paid out in advance of need.

Non-incorporated colleges are only required to provide SFC with FFRs and annual accounts.

Financial statements analysis

The financial health and governance analysis is based on a review of:

- The audited financial statements for 2016-17.
- Issues raised in external auditors' management letters, internal auditors' annual reports and the annual report of audit committees to boards of management, which may impact on colleges' ability to maintain or achieve financial sustainability.

Incorporated colleges submitted accounts for the twelve month period to 31 July 2017. The analysis also considered the results of the five non-incorporated colleges[2].

[1] The requirement to complete the resource return has been discontinued from Financial Year 2018-19
[2] Newbattle Abbey College, Orkney College, Sabhal Mor Ostaig, Shetland College, and West Highland College

The year-end for both Orkney College and Shetland College is 31 March as they operate as part of the local Islands Councils.

Financial health summary

The main outcomes from the analysis of the 2016-17 results are set out below:

Incorporated colleges

Operating position

The 20 incorporated colleges recorded an overall operating deficit of £17.8 million in 2016-17. After taking account of FRS 102-based adjustments, exceptional non-restructuring costs, donations to Arms-Length Foundations, exceptional income, revenue funding allocated to loan repayments and other capital items, and spend of depreciation funds, the sector 'underlying' operating surplus sits at £290,000, a significant improvement on the normal operating position.

SFC has been working closely with Audit Scotland to agree the adjustments to arrive at the 'underlying' operating position and to ensure that a consistent approach is adopted and reported in Audit Scotland's Overview Reports.

Balance sheet performance

Incorporated colleges' cash and short-term investments less overdraft balances increased from £42.9 million to £48.7 million over the course of Academic Year 2016-17. The main reasons for the increase are that some colleges are holding unspent student support funds while several colleges held funds for the College Energy Efficiency Pathfinder (CEEP) project which were spent in early 2017-18.

During 2016-17, the sector reported a net cash inflow from operating activities (surplus for the year adjusted for non-cash items and financing/investing activities) of £47.6 million. SFC closely monitors colleges' cash balances by means of monthly cash flow returns.

There has been an increase in overall borrowing in 2016-17 of £157 million bringing the total to £290 million. The increase is due to £46.9 million Non-Profit Distributing Project (NPD) commitments appearing on the balance sheet of two colleges for their new campuses. Other college borrowing reduced from £133 million to £128 million during AY 2016-17.

Non-incorporated colleges

The five non-incorporated colleges recorded an overall operating surplus of £178,000 in 2016-17. There are no underlying operating adjustments for these colleges.

Key risks to financial sustainability

The most significant risk areas for colleges are:

- 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.
- Student support funding.
- Impact of the UK exiting from the EU.