Summary financial position of the college sector: Analysis of 2017-18 financial statements

Summary

The college sector in Scotland comprises twenty incorporated and six non-incorporated colleges. SFC received consolidated accounts for the year ended 31 July 2018 for both the Glasgow and Lanarkshire regions, including the results of their assigned colleges, and their results are reported in this paper on a consolidated basis[1]. The other fifteen incorporated colleges and six non-incorporated colleges[2] also submitted financial statements for the year ended 31 July 2018[3].

Overall, the sector is in improving financial health based on the review of the 2017-18 financial statements, however, this position varies on an individual institution basis.

The introduction of the FRS 102 accounting standard in 2015-16 resulted in greater volatility in the annual operating position of institutions which makes it more difficult to look at trends in operating position over the years. The 'adjusted' operating positions aims to mitigate against this by making certain adjustments to colleges' outturn position which are outwith their control.

The sector continues to face significant cost pressures including the impact of pay awards, increases in employers' contributions to pension schemes, estates maintenance issues and general inflation. In light of the uncertain environment they now operate in, colleges need to ensure that their long-term financial planning includes adequate contingency measures. A list of key risks is included at the end of this paper.

Definition of incorporated and non-incorporated colleges

Following the implementation of the Further and Higher Education (Scotland) Act 1992, most colleges established their own corporate body and boards of management who took over responsibility for the financial and strategic management of the organisation. These colleges are known as incorporated colleges and produce accounts which are subject to audit by the Auditor General for Scotland. The remaining six colleges are known as non-incorporated colleges.

[1] Glasgow region incorporates Glasgow Colleges' Regional Board, City of Glasgow College, Glasgow Clyde College and Glasgow Kelvin College. Lanarkshire region comprises New College Lanarkshire and South Lanarkshire College.

[2] Argyll College, Newbattle Abbey College, Orkney College, Sabhal Mor Ostaig, Shetland College and West Highland College

[3] Orkney College and Shetland College form part of their local authorities and reported to 31 March 2018.

The following analysis is split into a section on incorporated colleges and one on non-incorporated colleges.

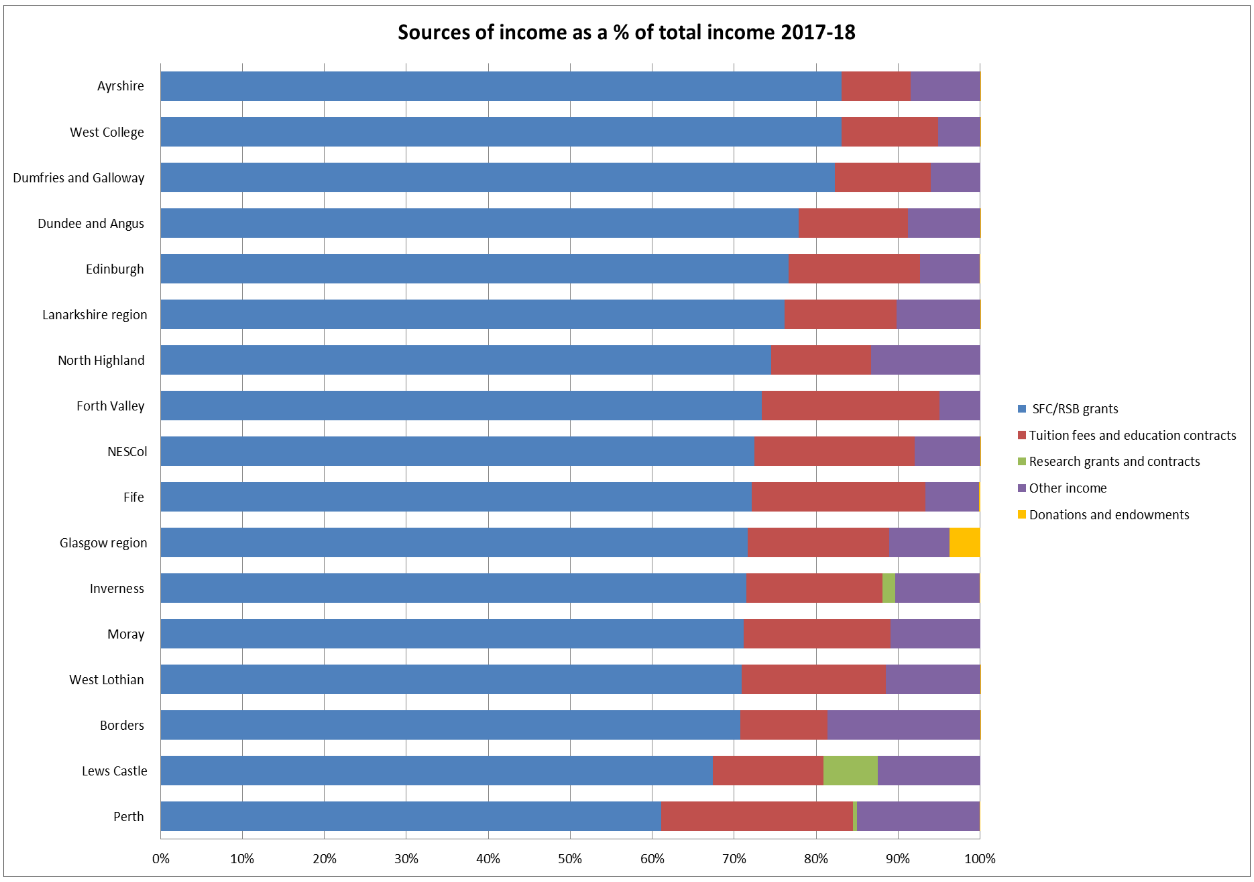
Incorporated colleges

Summary of Key Financial Indicators

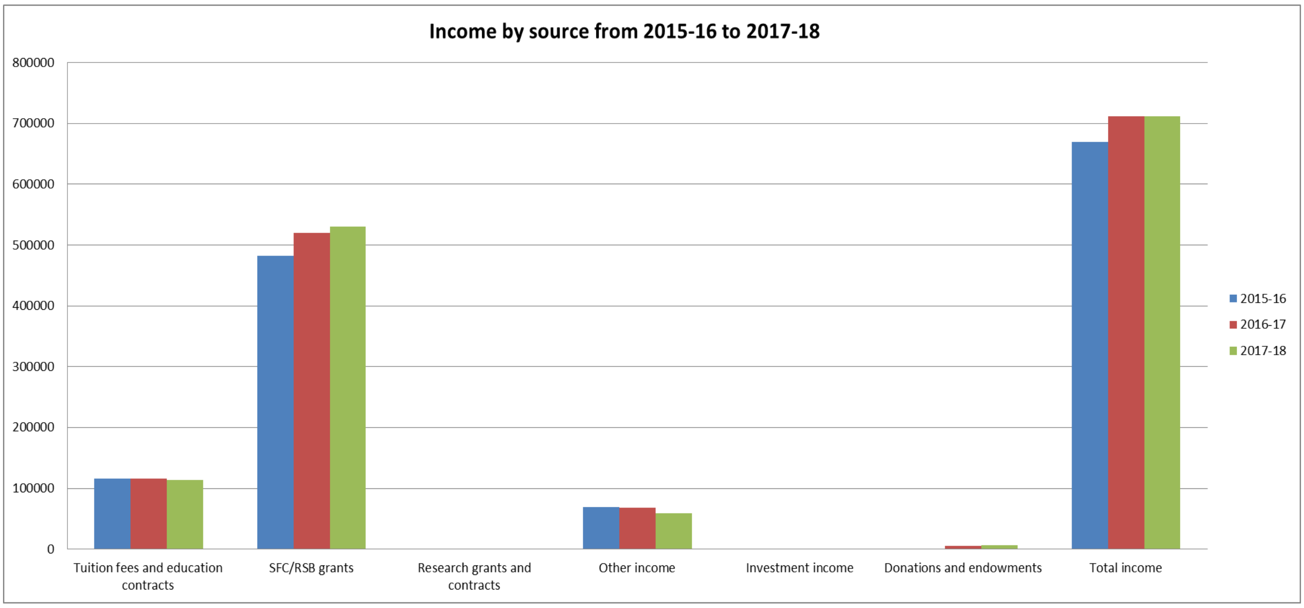
Key financial performance indicators	Actual 2017-18 £000	Actual 2016-17 £000
Total income	711,358	711,474
SFC grant as a % of total income	75%	73%
Adjusted operating surplus/(deficit)	3,066	290
Adjusted operating surplus/(deficit) as a % of total income	0.4%	0.1%
Net operating cash flow	27,700	43,916
Net operating cash flow as a % of total income	4%	6%
Cash and cash equivalents net of overdrafts	42,053	48,659
Cash days	22	26
Borrowing	277,208	290,116
Borrowing as a % of total income	39%	41%

Income

Overall sector income remained static between 2016-17 and 2017-18. The sector receives 75% of its income from the Scottish Funding Council (SFC). The graph below provides a view of sources of income as a percentage of total income by institution and varies between 61% and 83%.



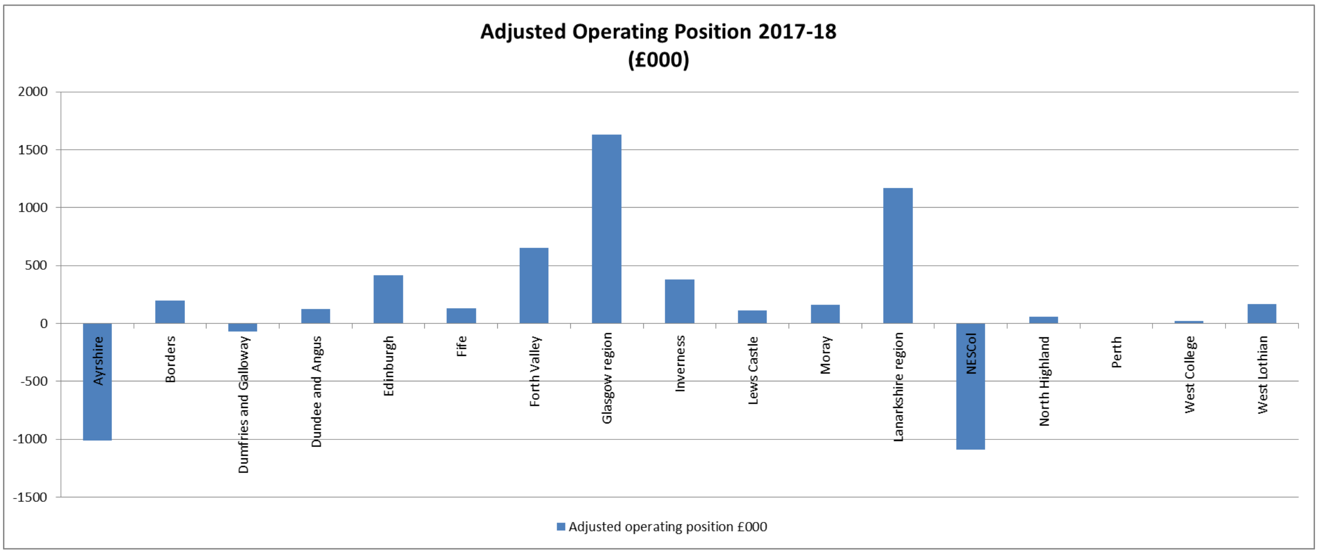
The graph below shows that the main sources of income have remained fairly constant over the past three years.



Adjusted operating position

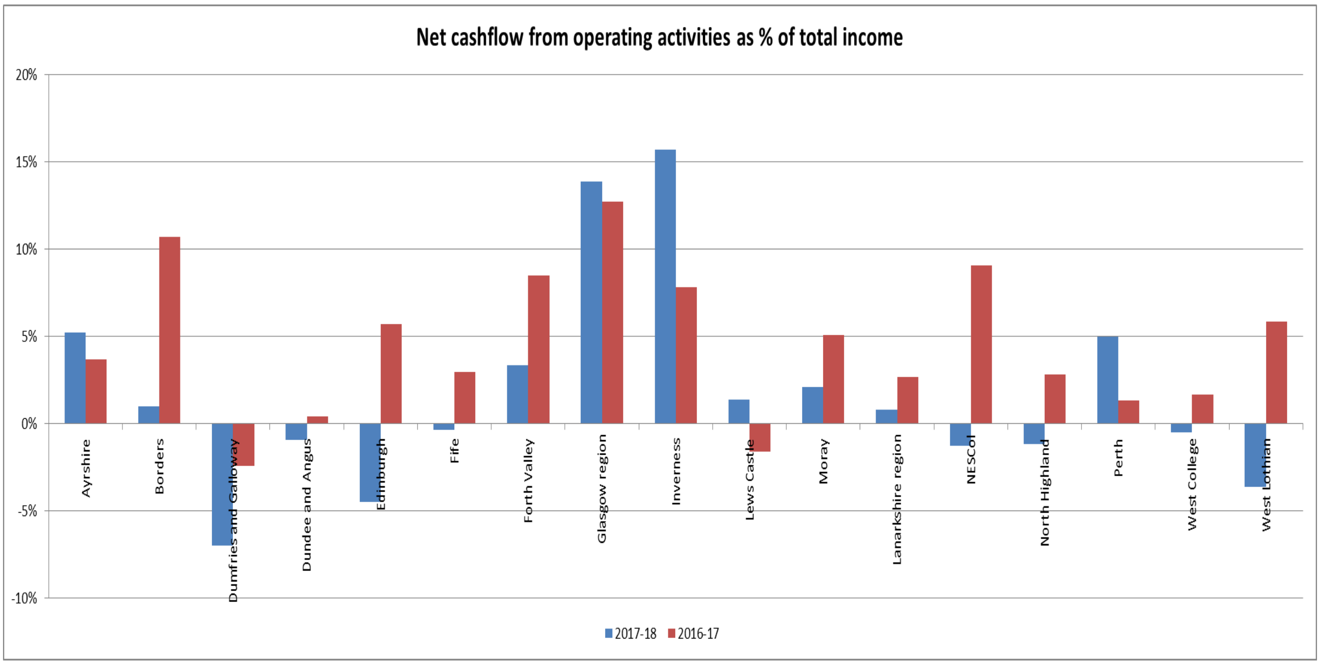
To remove the effect of accounting and other items outwith the sector's control, SFC and Audit Scotland have agreed a methodology for arriving at an 'adjusted' operating position for incorporated colleges.

The twenty incorporated colleges recorded an overall operating deficit of £29.8 million in 2017-18 with the sector 'adjusted' operating surplus sitting at £3.1 million, a significant improvement on the normal operating position. The result also represents an improvement on the sector 'adjusted' operating surplus of £290,000 recorded in 2016-17.



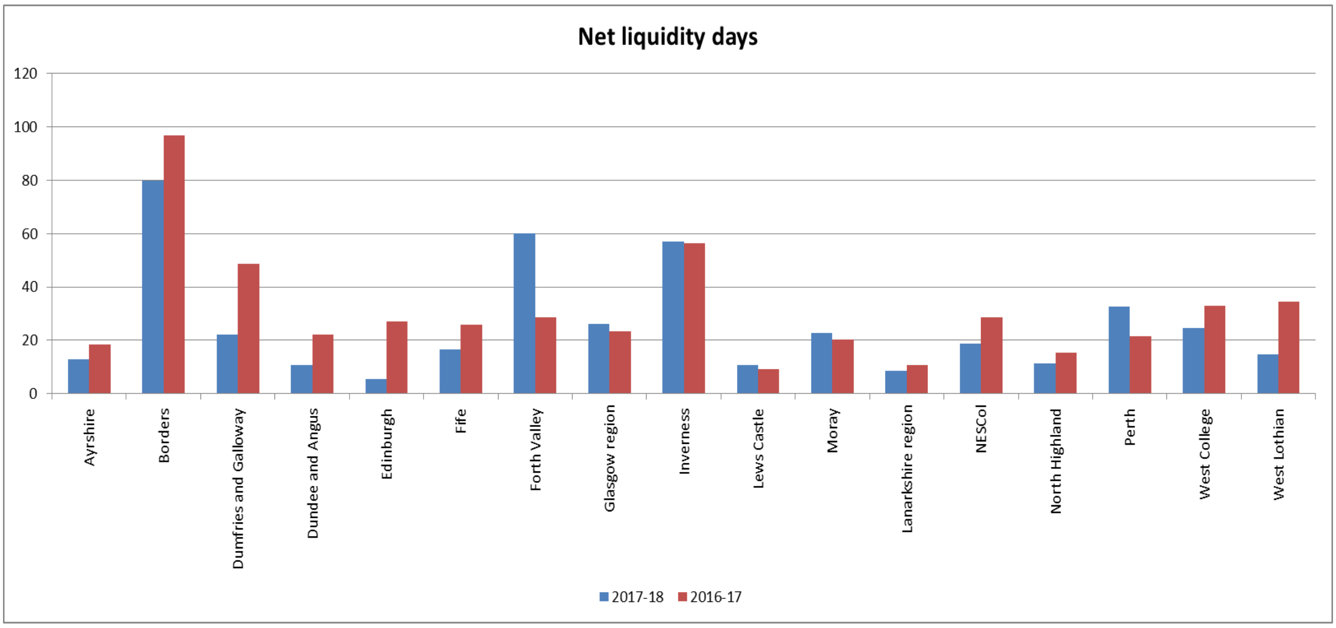
Balance sheet performance

Incorporated colleges' cash and short-term investments less overdraft balances decreased from £48.7 million to £42.1 million over the course of Academic Year 2017-18. The main reasons for the decrease are that some colleges had held funds for the College Energy Efficiency Pathfinder (CEEP) project at the end of 2016-17 which were spent in early 2017-18 while there has also been a reduction in unspent student support funds. There has been a small improvement in colleges' net current liabilities position, the sector figure reducing from £33.9 million to £31.3 million during 2017-18.

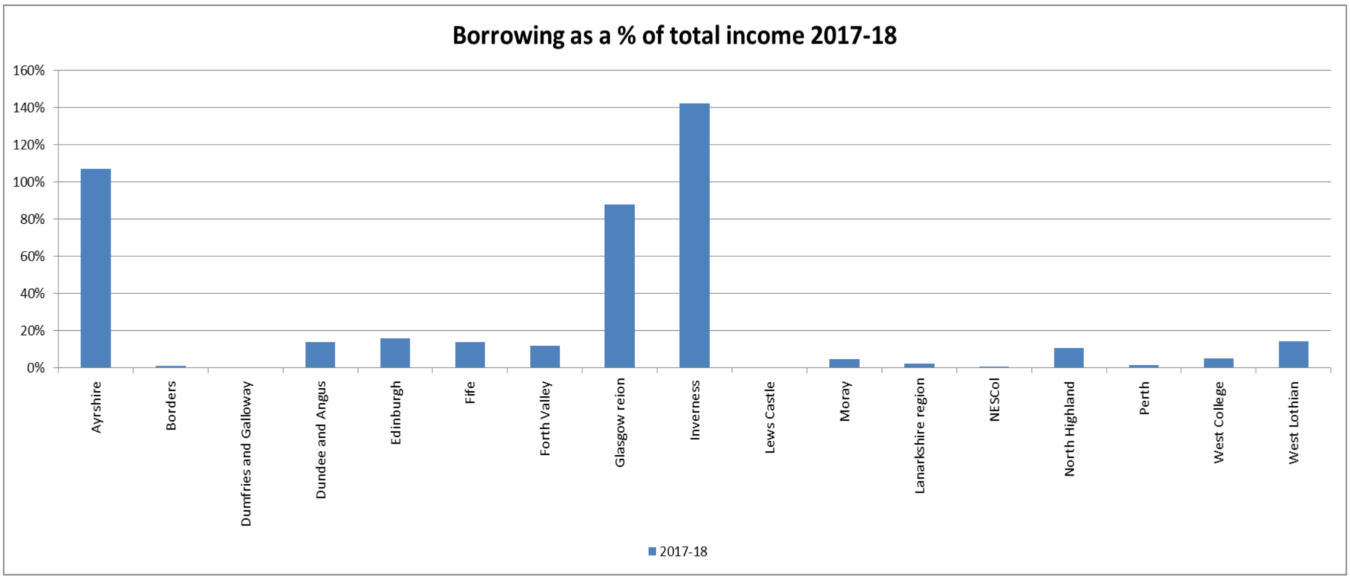


During 2017-18, the sector reported a net cash inflow from operating activities (surplus for the year adjusted for non-cash items and financing/investing activities) of £27.7 million and the 'days ratio of cash to total expenditure' reduced from 26 to 22.

Some colleges have retained a cash 'reserve' for the purposes of repaying Lennartz liabilities therefore their cash balances will reduce year on year. The remaining movement is due to working capital movements, largely in relation to estates projects, and the weak operating position of some colleges has also depleted their cash balances. SFC closely monitors colleges' cash balances by means of monthly cash flow returns.



College borrowing decreased over the course of 2017-18 from £290.1 million to £277.2 million with Non-Profit Distributing Project (NPD) and Private Finance Initiative (PFI) commitments for three colleges accounting for the bulk of the borrowing (£239.2 million). Other college borrowing reduced from £44.2 million to £38.0 million during 2017-18.



Non-incorporated colleges

Summary of Key Financial Indicators

Key financial performance indicators	Actual 2017-18 £000	Actual 2016-17 £000
Total income	25,404	24,283
SFC grant as a % of total income	58%	60%
Adjusted operating surplus/(deficit)	104	82
Adjusted operating surplus/(deficit) as a % of total income	0.4%	0.3%
Net operating cash flow	1,248	1,368
Net operating cash flow as a % of total income	5%	6%
Cash and cash equivalents net of overdrafts	3,356	3,748
Cash days	46	58
Borrowing	1,325	1,473
Borrowing as a % of total income	5%	6%

The six non-incorporated colleges recorded an overall operating deficit of £171,000 in 2017-18 with an 'adjusted' operating surplus of £104,000. Net liquidity remains reasonably strong despite a reduction in the number of cash days held.

Key risks to financial sustainability

There are a number of risks that could adversely affect the financial performance and sustainability of colleges and the negative consequence of this could be a reduction in areas of activity which are important for the Scottish economy e.g. vocational skills training. 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 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.

The level of risks facing the sector highlights the need for long term planning and the need to take timely mitigating action.