
Financial Sustainability and Governance of the College Sector: Analysis of the 2021-22 Annual Accounts

Purpose

1. The purpose of this paper is to summarise the college sector's financial results for 2021-22 and to update our assessment of colleges' financial sustainability and governance. This is based on our analysis of the colleges' annual accounts returns and supporting audit reports received at the end of December 2022.

Recommendations

2. The Finance Committee is invited to **consider** the college sector's financial results for 2021-22 and the updated assessment of colleges' financial sustainability and governance based on an analysis of the annual accounts returns and supporting audit reports.

Financial Implications

3. There are no specific programme fund or running cost implications arising from this paper that are not already allowed for in the Council's programme fund or running cost budgets.

Risk Assessment

4. There is a risk to the achievement of the Council's strategic plan priorities and/or a risk of reputational damage from failures in college governance, leadership and management, including financial failure.
5. This risk is mitigated by regular monitoring of colleges. Any colleges facing heightened challenges to their sustainability are subject to a higher level of engagement.
6. Overall, for the college sector, the Executive's assessment of this risk is very high.

Impact Assessments

Equality and diversity

7. There are no equality and diversity issues associated with this paper.

Island communities

8. The paper discusses the financial sustainability of island colleges but makes no recommendations in relation to them.

Carbon reduction

9. There are no carbon reduction issues associated with this paper.

Publication

10. This paper will be published on the Council website in edited format (to remove references to specific institutions or forecast information) as it includes information which, if disclosed, would be prejudicial to the effective conduct of public affairs (Freedom of Information (Scotland) Act 2002, Section 30).

Further Information

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Background

2. Colleges submit the following financial returns to the Scottish Funding Council (SFC) over the course of the academic year (AY):
 - Mid-Year Return (MYR) at the end of March for continued monitoring of the forecast outturn for the current AY.
 - Interim FFRs have been collected at the end of June annually during the COVID pandemic. Full FFRs will be brought forward to be collected at the end of June meaning that interim FFRs are no longer required.
 - Full FFRs brought forward to the end of June (previously September), comprising an outturn forecast for the current AY and forecasts for the following five AYs.
 - Annual accounts at the end of December, comprising the audited financial statements for the AY and supporting reports by the colleges' audit committees, internal and external auditors.
 - Monthly cash flow returns (incorporated colleges only) for Scottish Government budgeting and accounting requirements on a Financial Year basis.
 - Quarterly and monthly returns for colleges experiencing heightened challenges to their ongoing financial sustainability.

Structure of paper

3. This paper comprises key messages, key risks and next steps. The paper is supported by six annexes:
 - **Annex A:** Detailed analysis of annual accounts returns.
 - **Annex B:** Provisional college and regional strategic body performance against 2022-23 credit targets.

- **Annex C:** Trend of colleges' adjusted operating position, liquidity and borrowing 2018-19 to 2021-22.
 - **Annex D:** Comparison of 2021-22 results with forecast returns.
 - **Annex E:** Heat Map based on 2021-22 results.
 - **Annex F:** Engagement framework and rationale for the categorisation of colleges' engagement assessment.
4. At the time of writing this report, final sets of 2021-22 accounts and supporting audit reports had not been received from three colleges.

{4x paragraphs}

Key messages from our analysis of the annual accounts returns to 31 July 2022

5. **Colleges continue to operate in an extremely tight fiscal environment** alongside many challenges such as increased staff costs, high energy costs, other inflationary pressures and rising interest rates impacting on loan repayments.
6. **The sector reported an adjusted operating surplus of £7.9m in 2021-22.** This is an improvement on forecast (£191k surplus) due to a combination of increases in all sources of income and lower than expected costs. This is despite costs being significantly increased on the previous year's levels which accounted for the deterioration against the 2020-21 result (£19.3m surplus). Eight colleges reported adjusted operating deficits in 2021-22.
7. **Colleges remain highly dependent on SFC grant** which amounted to 78% of total income for the sector in 2021-22.
8. The sector reported staff restructuring costs of £6.7m in 2021-22, in line with both forecast (£7m) and the previous year (£6.5m), reflecting the activity colleges are undertaking to rebalance their financial position.
9. **The sector reported cash balances of £141.1m at the end of July 2022, improved from £122.9m at the end of July 2021.** The increase reflects the favourable operating position and unspent balances of 'ring-fenced' SFC monies. No colleges reported a negative cash position at the end of July 2022.
10. **Overall sector borrowing reduced from £244.1m at the end of July 2021 to £232.1m by the end of July 2022.** Most of the sector's borrowing is in the form of NPD/PFI commitments relating to three colleges. No loan covenants were breached during 2021-22.

{1x paragraph}

11. **It is important to note that the sector is not homogeneous** and there continues to be variation between colleges in terms of financial performance that is not reflected in the aggregate indicators.
12. **The returns can only be viewed as a snapshot in time**, are historic and are not a guarantee of future performance. Mid-Year Returns from colleges will provide an update on their 2022-23 outturn and an analysis of these returns will be reported to the Committee in May.

Key risks for colleges

13. Colleges identified several risks in their returns which could adversely affect their financial performance and sustainability as well as ability to achieve student activity and other income targets. The most significant risk areas for colleges relate to:
 - Increasing **staff costs** due to cost of living pay awards which are still to be negotiated, increases in employer contributions to pension schemes and national insurance, and the outcome of the job evaluation exercise for support staff.
 - Difficulties in meeting activity targets as a result of **demographic impacts**, prospective students securing employment or obtaining places at universities instead of going to college crystallising in 2022-23 (see **Annex B**) and leading to changes to funded activity levels for 2023-24.
 - **Uncertainty over recovery** in 2022-23 due to the lower levels of recruitment experienced across the sector and of the impact of 2021-22 recovery due to ongoing discussions with colleges around potential mitigations.
 - The requirement for colleges to self-fund the cost of **staff restructuring programmes** unless these are funded from the strategic change fund.
 - The impact of further in-year reductions in funding as a result of measures taken by the Scottish Government as it continues to look for additional **in-year savings** for 2023-24.
 - **Macro-economic outlook** is uncertain with inflation remaining historically high although being forecast to reduce and rising interest rates.
 - Colleges are coming off the centrally negotiated contract for **energy costs** in 2022-23 or 2023-24 which is when price increases will have their largest impact as colleges move onto a new contract coupled and changes to government support are proposed for 2023-24 which are likely to make this support less generous.
 - Future changes to the SFC **funding model** including the establishment of a strategic change fund of £26m identifying 2023-24 as a transitional year for the sector.

- The **impact of cost efficiencies**, including reduced staff numbers, frontline student services and potential closure of campuses, on both the quality of student experience and on the health and wellbeing of college staff.
- The impact of the outcome of the **Independent Review of Skills Delivery** on the sector when it reports later this year.
- The uncertainty of the **UK Government's policies** designed to mitigate the effects of leaving the EU, in particular the development of the Shared Prosperity Fund.
- Addressing **backlog estates maintenance** and ICT/digital requirements to deliver a 21st Century learning and teaching environment.
- The requirement for colleges to invest in the achievement of public sector **net zero targets**.
- Challenges of diversifying income due to **increased competition** from external providers reducing colleges' ability to generate commercial surpluses.
- Delivering against fragmented funding streams and programme requirements.

Next steps

14. Work is ongoing to finalise funding allocations for AY 2023-24 and it is anticipated that final allocations will be announced towards the end of May. SFC does not have any information on future years' budgets beyond 2023-24 and will continue to provide advice to Scottish Government on the financial sustainability of the sector and engage appropriately in the budget process.
15. SFC will continue to engage closely with particularly vulnerable colleges in addressing financial sustainability challenges. In the first instance, we will ensure that all colleges have sufficient cash to meet their liabilities. SFC will work closely with colleges and, where relevant, Regional Strategic Bodies to ensure that they remain on a sustainable trajectory.
16. Colleges are continuing to provide SFC with regular financial updates. Mid-Year Returns (MYRs) will provide an update on the forecast for the current AY and our analysis of these returns will be reported to the Committee's meeting on 30 May. We will also issue a further Call for Information nearer the summer to request colleges' financial forecasts covering the outturn forecast for the current AY and forecasts for the following five years.
17. These financial returns will continue to further develop our understanding of the financial health of individual colleges and enable the provision of further advice to Scottish Government.

Recommendations

18. The Finance Committee is invited to **consider** the college sector's financial results for 2021-22 and the updated assessment of colleges' financial sustainability and governance 2021-22 based on an analysis of the annual accounts returns and supporting audit reports.

{Annexes withheld}