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

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### Purpose

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

### Recommendations

2. The Finance Committee is invited to **consider** the university sector's financial results for 2021-22 and the updated assessment of institutions' 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 university governance, leadership and management, including financial failure.
5. This risk is mitigated by regular monitoring of institutions. Any institutions facing heightened challenges to their sustainability are subject to a higher level of engagement.
6. Overall, for the university sector, the Executive's assessment of this risk is high.

### Impact assessments

#### Equality and diversity

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

## Carbon reduction

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

## Publication

9. 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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### Purpose

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### Background

12. Universities submit the following financial returns to the Scottish Funding Council (SFC) over the course of the academic year (AY):
  - Financial Forecast Update (FFU) at the end of March for continued monitoring of the forecast outturn for the current AY.
  - Strategic Plan Forecast (SPF) at the end of June, comprising an outturn forecast for the current AY and forecasts for the following two AYs.
  - Annual accounts at the end of December, comprising the audited financial statements for the AY and supporting audit reports by the universities' audit committees, internal and external auditors.
  - Quarterly and monthly returns for universities experiencing heightened challenges to their ongoing financial sustainability.
13. The HESA Financial Statements Return (FSR) 2021-22 data was used to compile the consolidated data for the sector which informs the analysis in this paper.

{1x paragraph}

### Structure of paper

14. This paper comprises key messages, key risks and next steps. The paper is supported by six annexes:

{Annexes withheld}

## Key messages from our analysis of institutions' 2021-22 annual accounts

15. **The sector is forecasting an adjusted operating surplus of £385m for AY 2021-22.** This represents an improvement on both the previous 2021-22 forecast (£370m) and the 2020-21 result (£313m), mainly due to increased international tuition fees, research activity and commercial income. However, the sector position is skewed by the results of the two largest institutions with five institutions reporting underlying deficits during 2021-22. {1x paragraph}
16. **Institutions' dependency on SFC grants reduced** from 31% in 2020-21 to 27% in 2021-22.
17. **The sector cash position is improved on levels reported at the end of July 2021.** This reflects the improved operating position and continued delays in implementing capital programmes and research activity as a result of COVID. Additional loans drawn down but not fully utilised have also contributed to the improved cash position. No institution reported a negative cash balance at the end of July 2022.
18. **Overall sector borrowing reduced slightly during the year ending 31 July 2022.** The majority of the sector's borrowing is in the form of private placements which involve large bullet payments at set points in the future with interest paid in the intervening years. No loan covenants were breached during 2021-22.
19. **It is important to note that the sector is not homogeneous** and there continues to be variation between institutions in terms of financial performance that is not reflected in the aggregate indicators.
20. **The returns can only be viewed as a snapshot in time,** historic and are not a guarantee of future performance. Financial Forecast Updates from institutions will provide an update on their 2022-23 outturn and this will be reported to the Committee in May.
21. **There are no significant governance issues** to bring to the Committee's attention as a result of this analysis.

## Key risks for universities

22. The institutions 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 institutions relate to:
  - Over-reliance on income from international students.
  - Macro-economic outlook has deteriorated, with growth slowing, inflation accelerating and interest rates rising.

- Rise in staff costs including increases in employers' pension contributions, the Universities Superannuation Scheme and industrial action.
- Rising energy costs.
- Shortage of student accommodation.
- Stock market pressures and wider economic challenges that lead to significant drops in regular donations and income from endowments.
- Existing debt levels, increasing interest rates and the management of lender and private placement relationships, including compliance with covenants.
- Future arrangements for funding Graduate Apprenticeships.
- Fall in rUK recruitment in an increasingly competitive market.
- Changes in UK Government policy on Higher Education.
- UK policy relating to visa and immigration regulations.
- Unanticipated public spending cuts in teaching and/or research income.
- Impact of changes to UK research funding and the research funding policies of charities and industry.
- Failure to effectively manage major capital investment programmes and their financial impacts, including construction inflation.

## Next steps

23. 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.
24. SFC will continue to engage closely with particularly vulnerable institutions in addressing financial sustainability challenges. Institutions are continuing to provide SFC with regular financial updates. Financial Forecast Updates (FFUs) 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 institutions' financial forecasts covering the outturn forecast for the current AY and forecasts for the following two years.
25. These financial returns will continue to further develop our understanding of the financial health of individual institutions and enable the provision of further advice to Scottish Government.

## Recommendations

26. The Finance Committee is invited to **consider** the university sector's financial results for 2021-22 and the update on institutions' financial sustainability and governance based on an analysis of the annual accounts returns and supporting audit reports.

{Annexes withheld}