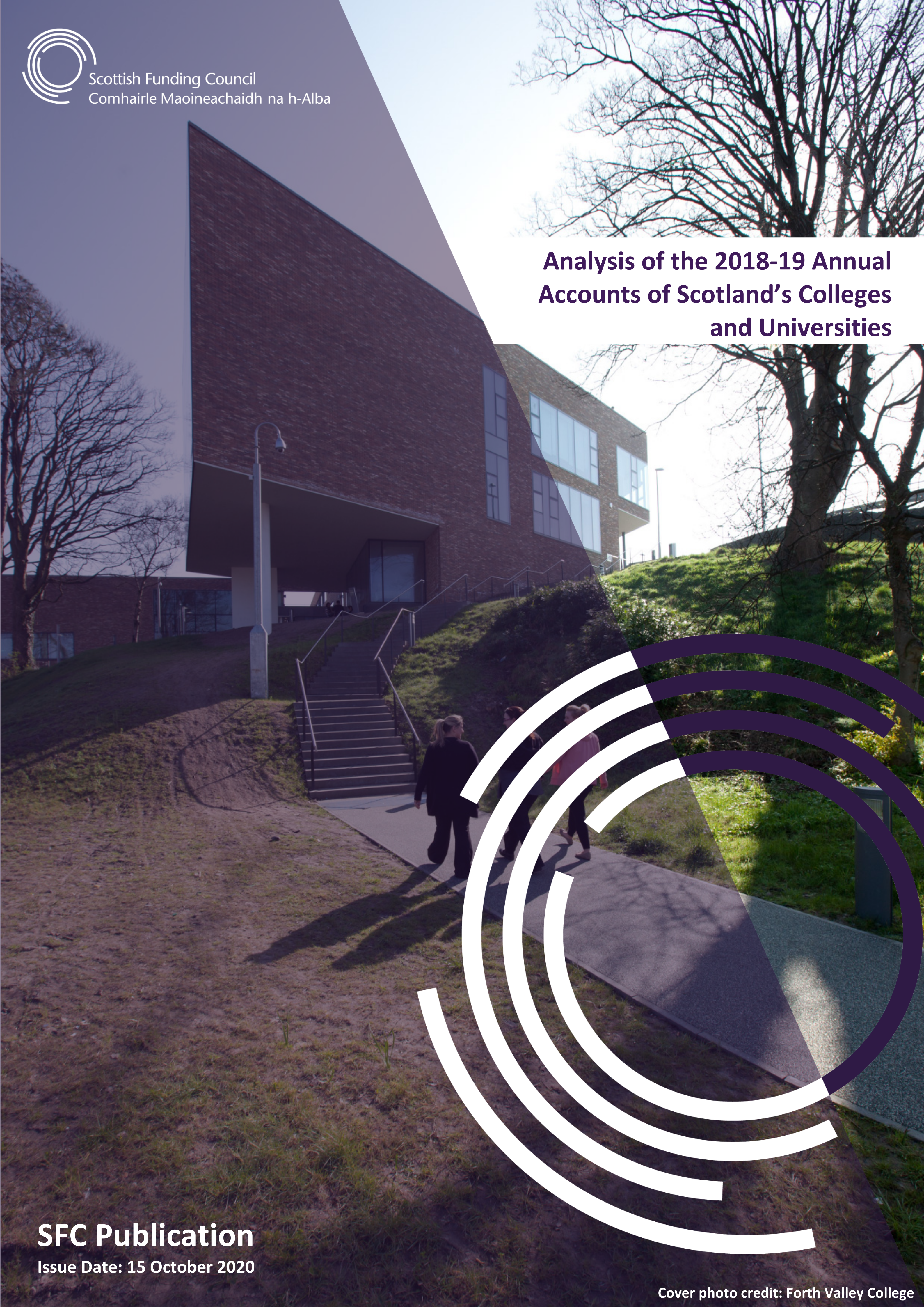
Scottish Funding Council
Comhairle Maoineachaidh na h-Alba

Analysis of the 2018-19 Annual Accounts of Scotland's Colleges and Universities



SFC Publication

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Summary: This publication provides a summary analysis of the 2018-19 annual accounts for the college and university sectors.

FAO: Principals, Finance Directors and Board/Governing Body Secretaries of Scotland's colleges and universities

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1. The Scottish Funding Council (SFC) has a key role in ensuring that the institutions we fund continue to plan and manage their activities in a way which ensures their sustainability and financial viability. This contributes to the success of students and researchers, local communities and the wider Scottish economy. Financial sustainability is, therefore, a condition of grant and is set out in our Financial Memorandum.

2. This report presents an aggregate picture of the financial health of Scottish institutions based on a review of their 2018-19 financial statements. The college sector in Scotland comprises twenty incorporated and six non-incorporated colleges. Eighteen higher education institutions submitted financial statements for the year ending 31 July 2019. While this report presents an aggregate position, there is significant variation in the financial position of individual institutions.

3. Financial management is a dynamic process and the information contained within this report is an update to the information provided in our February publication.

Colleges

Adjusted Operating Position

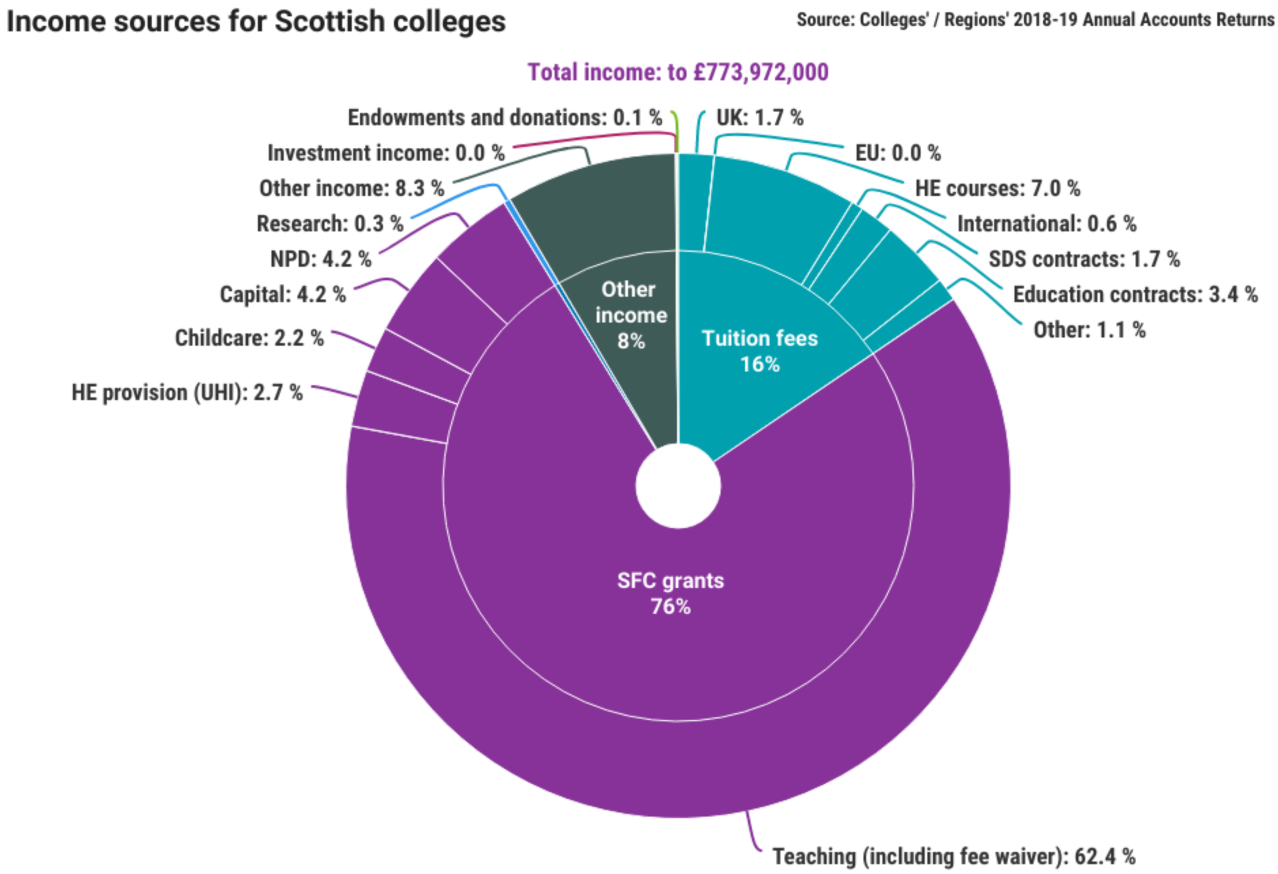
4. The Adjusted Operating Position (AOP), or underlying position, is intended to reflect the financial performance after allowing for non-cash adjustments and other material one-off or distorting items required by the Statement of Recommended Practice (SORP). The AOP is therefore designed to smooth any volatility in reported results arising from the Financial Reporting Standard (FRS) 102 and also to recognise that some of the reported costs do not have an immediate cash impact on the college. This should give a better indication of colleges' operational cash generating capacity.

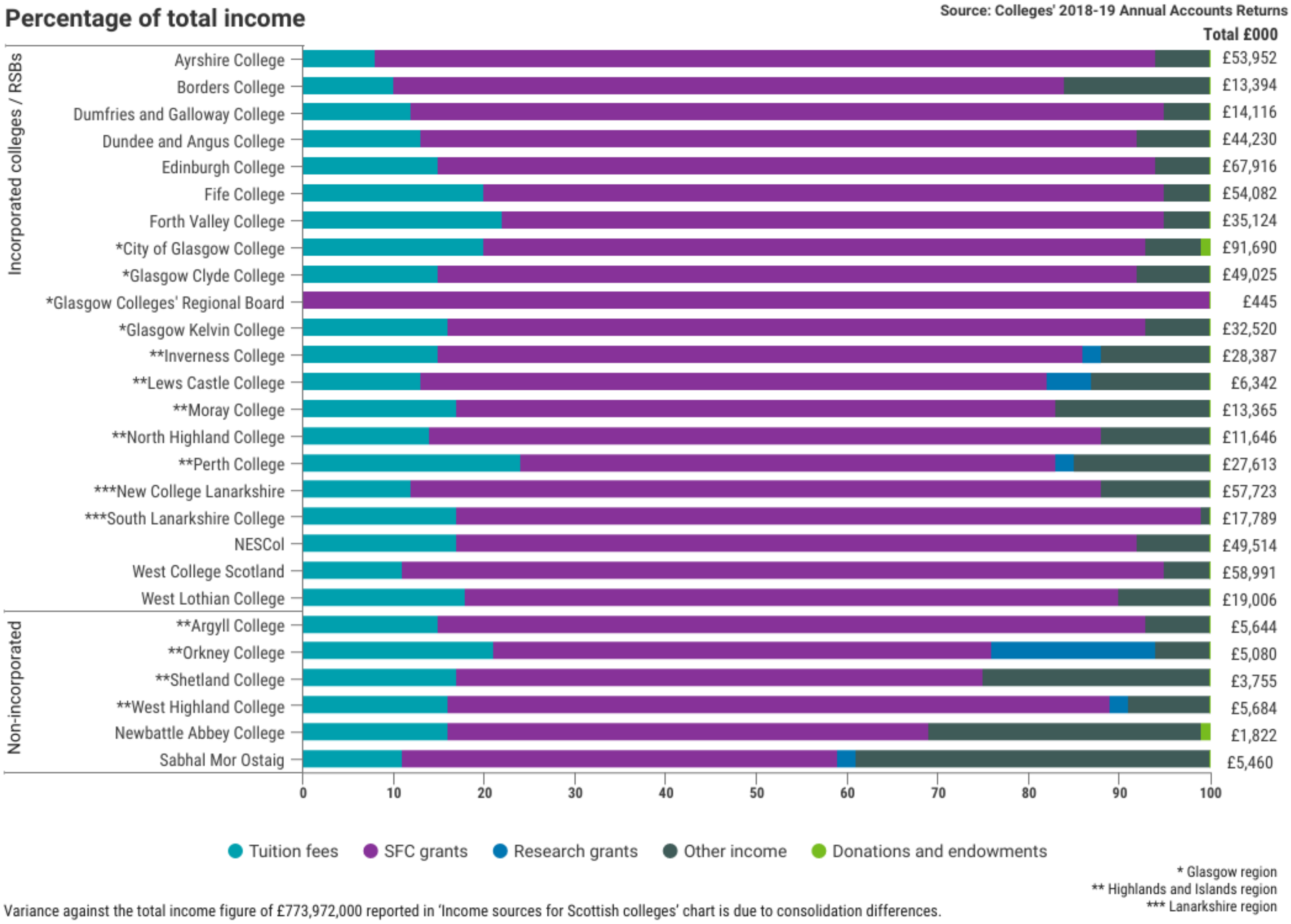
5. The overall AOP for the incorporated colleges, both forecast and actual for 2018-19, and also including the previous year's result, is set out in the following table:

Table 1	2018-19 Actual £000	2017-18 Actual £000	2018-19 Forecast £000
Adjusted Operating Surplus	12,714	3,149	8,200

6. The incorporated colleges' 2018-19 annual accounts show a sector adjusted operating surplus of £12.7 million which represents an improvement on both the previous year's result (£3.1 million surplus) and the forecast (£8.2 million surplus). Only three incorporated colleges reported an adjusted operating deficit in 2018-19. A summary of each college's 2018-19 adjusted operating position, liquidity and borrowing is set out in Annex A.

Sources of Income / Reliance on SFC grants





Variance against the total income figure of £773,972,000 reported in 'Income sources for Scottish colleges' chart is due to consolidation differences.

7. SFC grants accounted for 76% of total sector income in 2018-19. There is, however, a large variation in the reliance on SFC's grant across the sector. In 2018-19, the institution with the lowest reliance on SFC income was Perth College (59%) while Ayrshire College reported the highest reliance, with 86% of its income coming from SFC grants.

8. Other income accounted for only 8% of overall college income due to the limited opportunities for colleges to generate commercial income, and surpluses. It is clear that colleges are heavily reliant on SFC grants to fund most of their activities.

Staff Restructuring

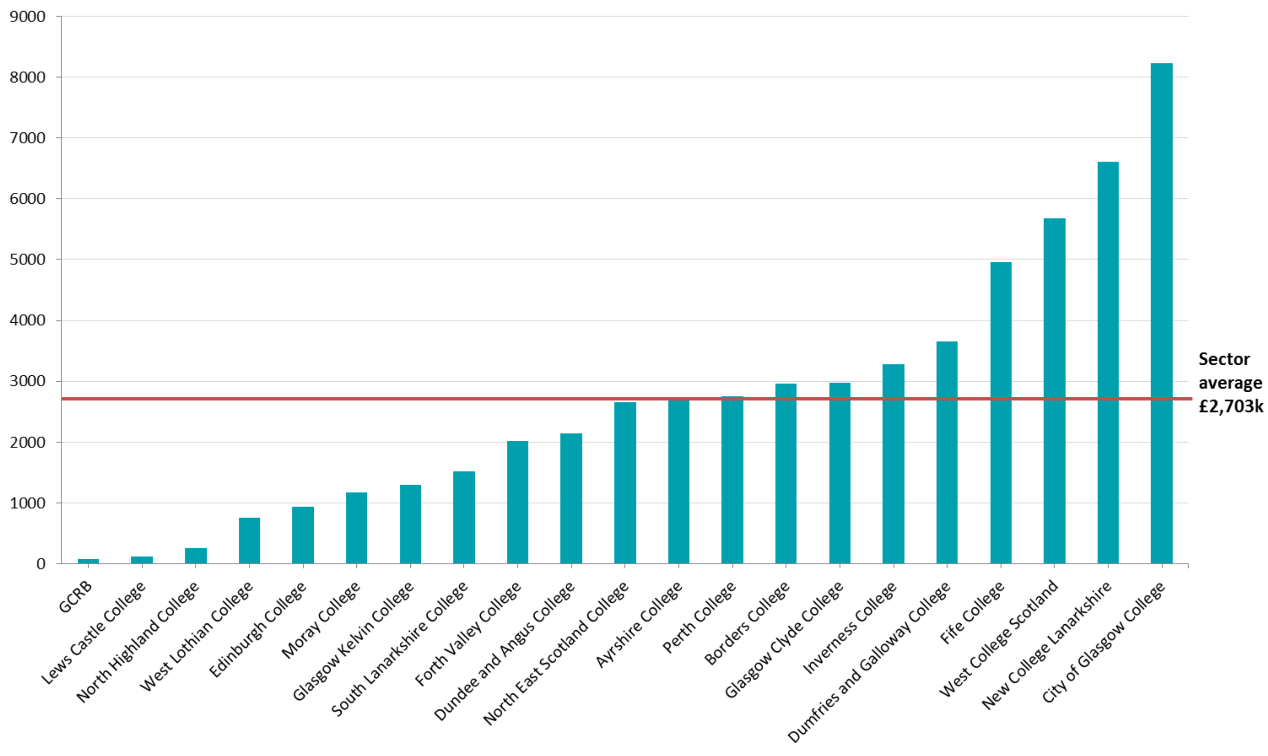
9. For colleges in Scotland, staff costs represent the largest element of expenditure and in 2018-19 made up 64% of total sector costs, ranging from 52% at North East Scotland College to 75% at Moray College. This is reflective of the cost pressures impacting on the college sector, including increased employer contributions to pension schemes and cost of living pay awards. Colleges are, therefore, focusing on staff costs to generate efficiencies in order to deliver a balanced budget, given the sector has in previous years already delivered significant non-staff cost efficiencies.

10. In 2018-19 the college sector spent £5.5 million on staff restructuring costs. This enabled colleges to reduce costs to a level that would allow them to be financially sustainable in future years. Most of the restructuring was addressed through voluntary severance schemes, although there were a small number of compulsory redundancies across two colleges: Perth College and North Highland College.

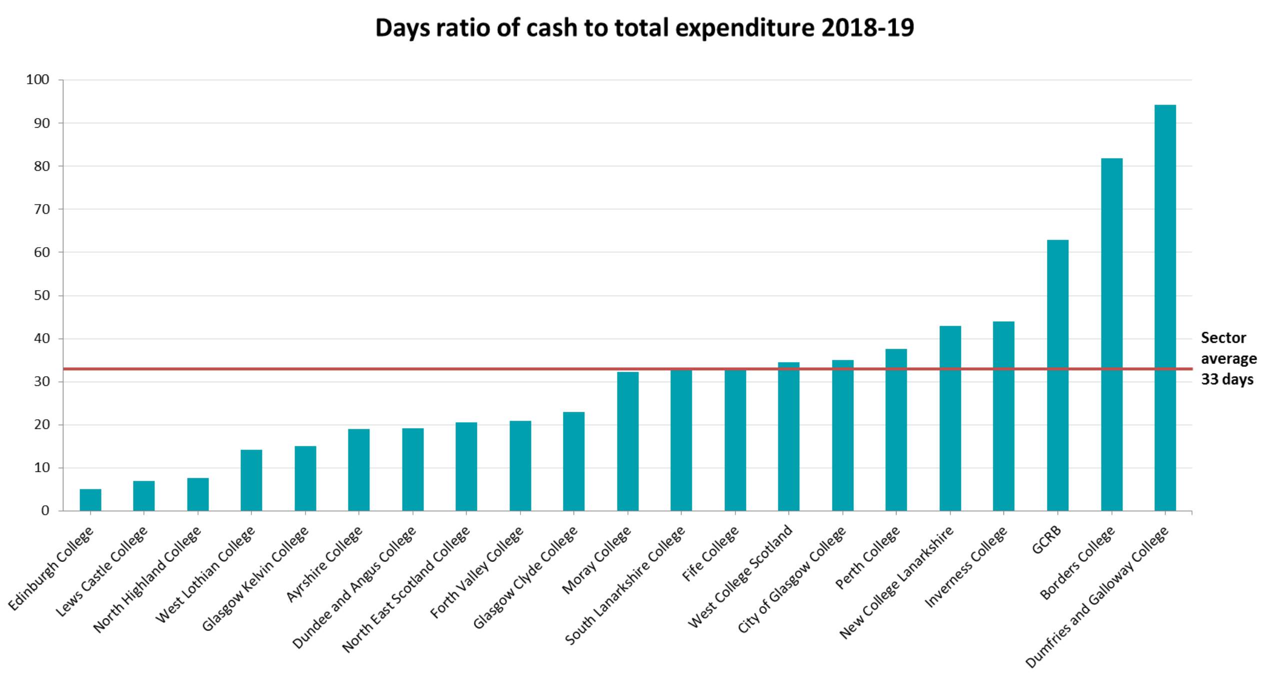
Cash

11. Incorporated colleges' overall cash balances increased from £42 million in 2017-18 to £56.8 million in 2018-19 reflecting the improvement in operating position and favorable working capital movements. Levels of cash at the end of 2018-19 for each incorporated college are shown below:

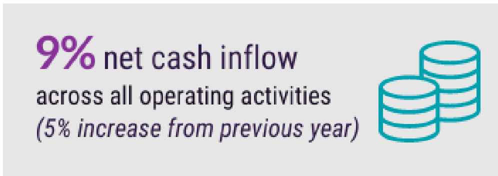
Cash and current asset investments less overdrafts 2018-19 (£000)



12. The graph below shows the number of days of expenditure available in cash:

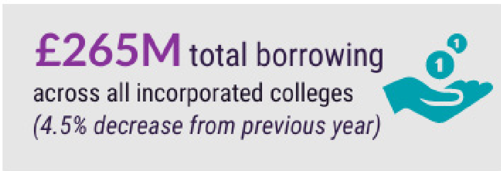


Net Cash Inflow



13. At the end of 2018-19, two colleges reported a negative net cash inflow from operating activities. Across all incorporated colleges, the net cash inflow from operating activities as a proportion of total income increased from 4% in 2017-18 to 9% in 2018-19.

Borrowing



14. Total long-term borrowing (including NPD/PFI commitments) for incorporated colleges decreased from £277.2 million in 2017-18 to £264.8 million in 2018-19. Capital expenditure amounted to £61.1 million in 2018-19.

Non-incorporated colleges

15. The six non-incorporated colleges reported a combined adjusted operating surplus of £173,000 which was a slight improvement on the 2017-18 surplus of £127,000. Two out of the six non-incorporated colleges reported an adjusting operating surplus in 2018-19, whereas four non-incorporated colleges had reported an adjusted operating

surplus in 2017-18. Non-incorporated colleges reported cash balances of £3 million and borrowing of £1.2 million at the end of 2018-19, both slightly down on the previous year's levels.

Ongoing Financial Sustainability

16. We published our early analysis of the potential impacts of COVID-19 in Academic Year 2019-20. While colleges are undertaking detailed scenario planning work and the position on the longer term impact continues to develop, it is clear that they face significant challenges ahead as a result of the COVID-19 pandemic.

17. Generally speaking, these are the most significant risks that could adversely affect colleges' financial performance and sustainability:

- Impact of the COVID-19 pandemic and the potential consequential failure to achieve income targets.
- Changes to the funding model and colleges' ability to deliver regional outcome agreements and Government priorities. This includes the sector's ability to meet the core student activity target of c116,000 FTEs and other key performance measures.
- The impact of cost efficiencies, including reduced staff numbers and frontline student services, on both the quality of student experience and on the health and wellbeing of college staff.
- The UK's exit from the European Union although this impact could be mitigated by the Shared Prosperity Fund.
- Additional staff costs arising from both cost of living pay awards and the outcome of the National Bargaining job evaluation exercise for support staff.
- Increases in employer contributions to the Scottish Teachers Superannuation Scheme and Local Government Pension Schemes.
- Addressing backlog estates maintenance and ICT/digital requirements.
- Challenges of diversifying income and generating additional surplus.
- The balance of portfolio provision and how that impacts on student numbers.
- Meeting student support requirements.

Universities

Operating position

18. The sector reported an operating deficit of £503 million in 2018-19. This represents a substantial increase on the 2017-18 operating deficit of £2.3 million. This was expected, as it reflects the position after accounting for several large items that distort the year-on-year results. These include:

- Universities Superannuation Scheme (USS) provision adjustments.
- The costs of the Glasgow School of Art Mackintosh building stabilisation following the second fire and the costs of business interruption.
- The exceptional staff restructuring costs.

19. Excluding these items, the underlying surplus for 2018-19 is £96.4 million, which is marginally less than universities were forecasting, although it represents an improvement on the previous year's surplus of £32.5 million.

Table 2	2018-19 Actual £000	2017-18 Actual £000	2018-19 Forecast £000
Operating Deficit	(502,671)	(2,264)	(67,468)
Underlying Operating Surplus	96,382	32,508	100,729

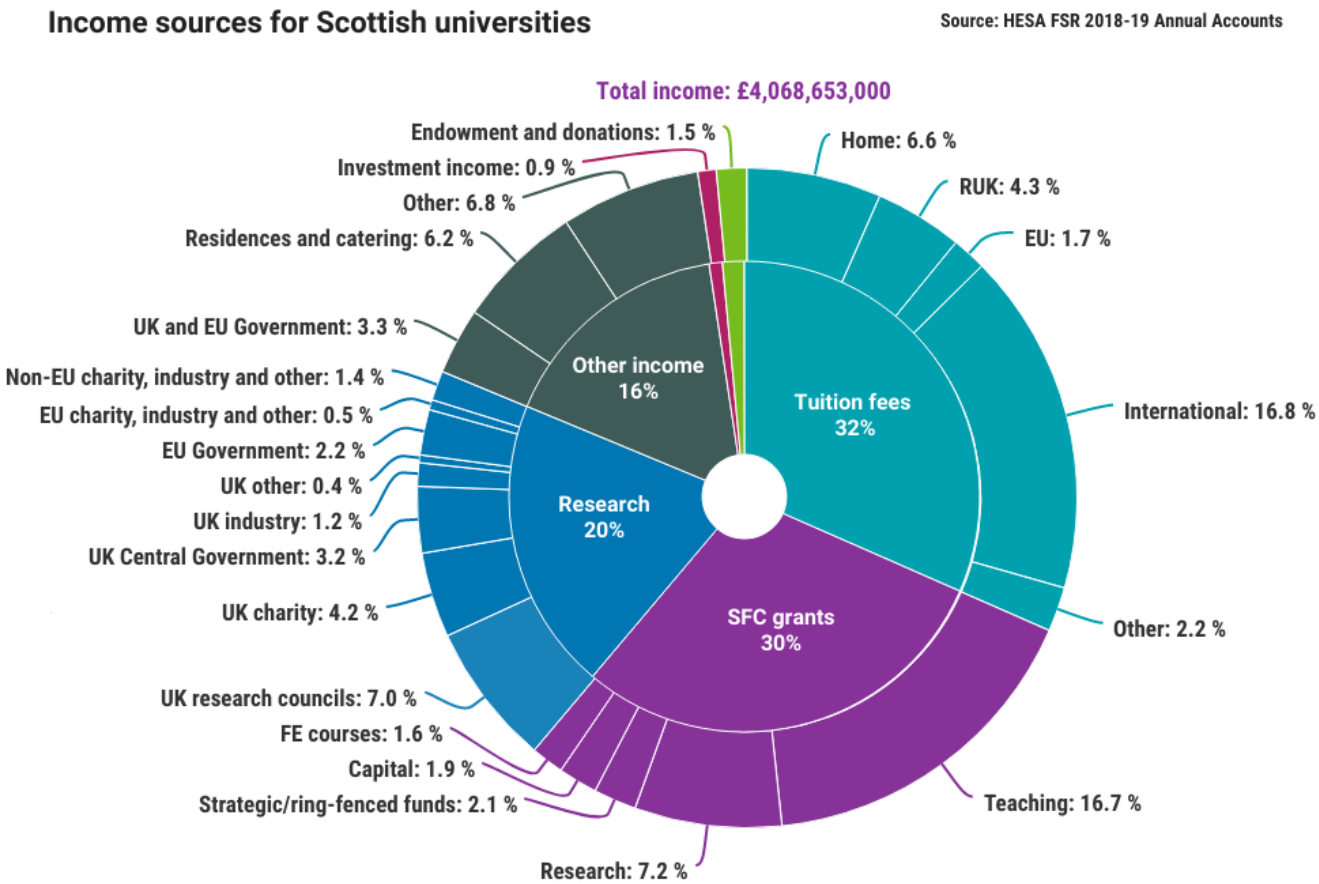
20. The main reason for the significant difference between the forecast operating position (£67.5 million deficit) and the actual result for 2018-19 is that many of the universities did not include a figure for the increase in pension provision for the Universities Superannuation Scheme (USS) at the time of the forecast.

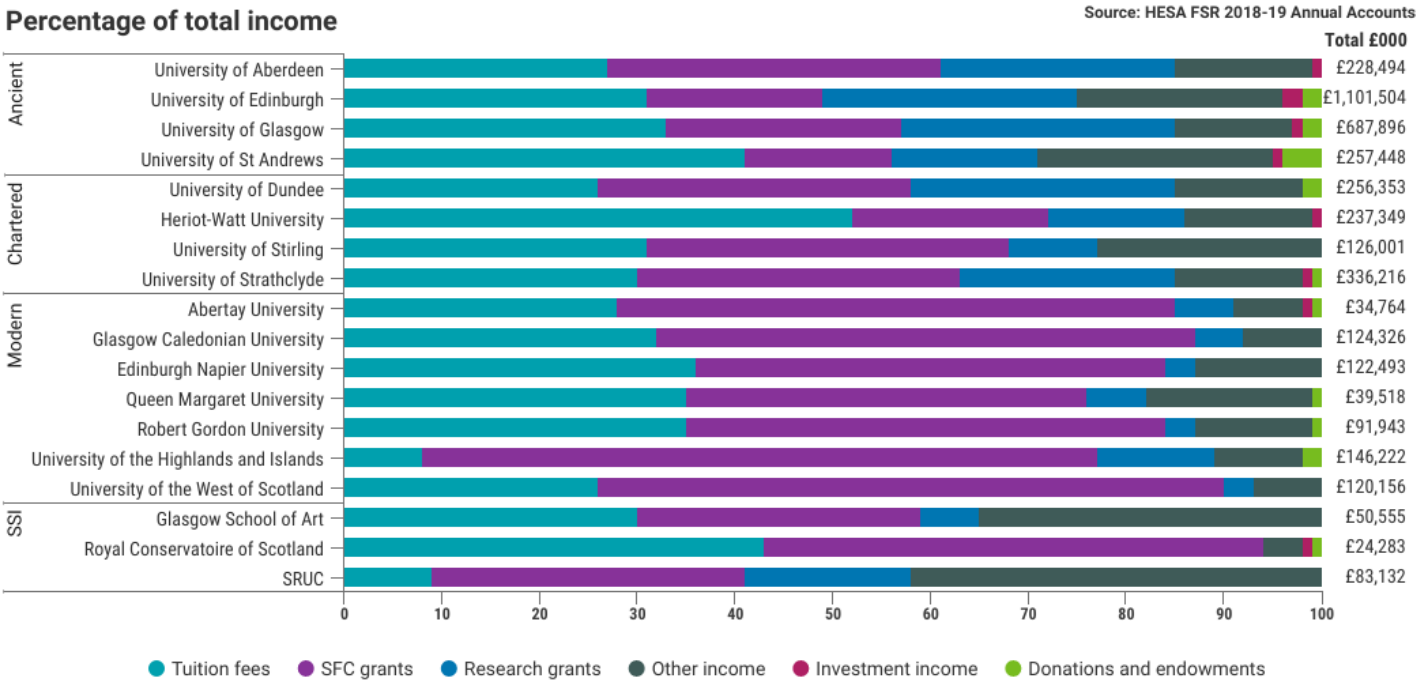
21. The sector's underlying position is skewed by the operating surpluses of the two largest institutions, the universities of Edinburgh and Glasgow. As Table 3 below shows, the sector's position is, therefore, considerably weaker when their results are taken out of our aggregate analysis.

Table 3	2018-19 Actual £000	2017-18 Actual £000
Operating Deficit	(298,929)	(46,973)
Underlying Operating Deficit	(2,905)	(8,027)

22. Nine of the 18 institutions reported underlying operating deficits in 2018-19, in line with the previous year's result. There is significant variation in the financial position of individual institutions. A summary of each university's 2018-19 operating position, underlying operating position, liquidity and borrowing is set out in Annex B, while Annex C sets out the underlying operating position as a percentage of income for each university for the period 2014-15 to 2018-19. It should be noted that some volatility in results is to be expected under the FRS 102 accounting standard, as there may be a mismatch between the reporting of income and related expenses, particularly in relation to capital grants received.

Sources of income





23. Apart from SFC grants, universities receive income from tuition fees and contracts (including international student fees), research activity, commercial income, investment income and donations and endowments. SFC grants amount to 30% of the sector's overall income.

Reliance on SFC grant

24. The majority of SFC grant in 2018-19 related to teaching (17% of overall sector income) while SFC funding for research represented 7% of overall sector income.

25. The larger and older universities are generally not as reliant on SFC funding as other universities. For example, University of St Andrews generated only 15% of its income from SFC funding during 2018-19, whereas University of the Highlands & Islands derived 69% of its income from this source.

Other sources of income (non-SFC)

26. All of the other sources of income come with associated costs and some of the activities can be loss making. Our understanding of the performance of Scotland's universities can be improved by considering income cross flows within an institution, highlighted through the Transparent Approach to Costing (TRAC) data, and the impact they have on financial sustainability and the benefits or issues they create. A summary of how Scotland is performing, based on 2018-19 TRAC data, is published on the SFC website.

27. There are also cost pressures that need to be covered by income. Employer

pension contributions, for example, have increased substantially in recent years and will continue to rise, placing more pressure on the financial sustainability of universities. In addition, the cost of maintaining buildings represents a significant pressure on university budgets.

International student fees

28. In 2018-19, international fees represented 17% of the university sector total income (up by 1% from the previous year). Overall, international student tuition fees increased by 1.9% on forecast in 2018-19. Many universities forecast quite ambitious targets in 2018-19 and exceeded those targets. However, five institutions did not meet their planned levels in 2018-19. One institution forecast a reduction in this income stream in 2018-19 and did not meet the reduced target.

29. The COVID-19 pandemic has demonstrated the exposure universities face to global events beyond their control and the risk inherent in relying on international tuition fee income over the short to medium-term. There is also an impact on this market from UK immigration policy, although it is encouraging that the UK Government has changed its policy of restricting post-study visas for international students and will now offer two year work visas for international students. This came into effect for students starting courses in September 2020, although we are still assessing the likely effect of the COVID-19 crisis on student mobility.

30. However, it is clear at this time that it may be unfeasible for some students to commence studies in location due to travel restrictions and social distancing measures. It is possible some students will start through on-line learning options until they can travel and social distancing measures are eased. Students may also choose to defer their studies or pursue other options in Academic Year 2020-21.

Staff restructuring

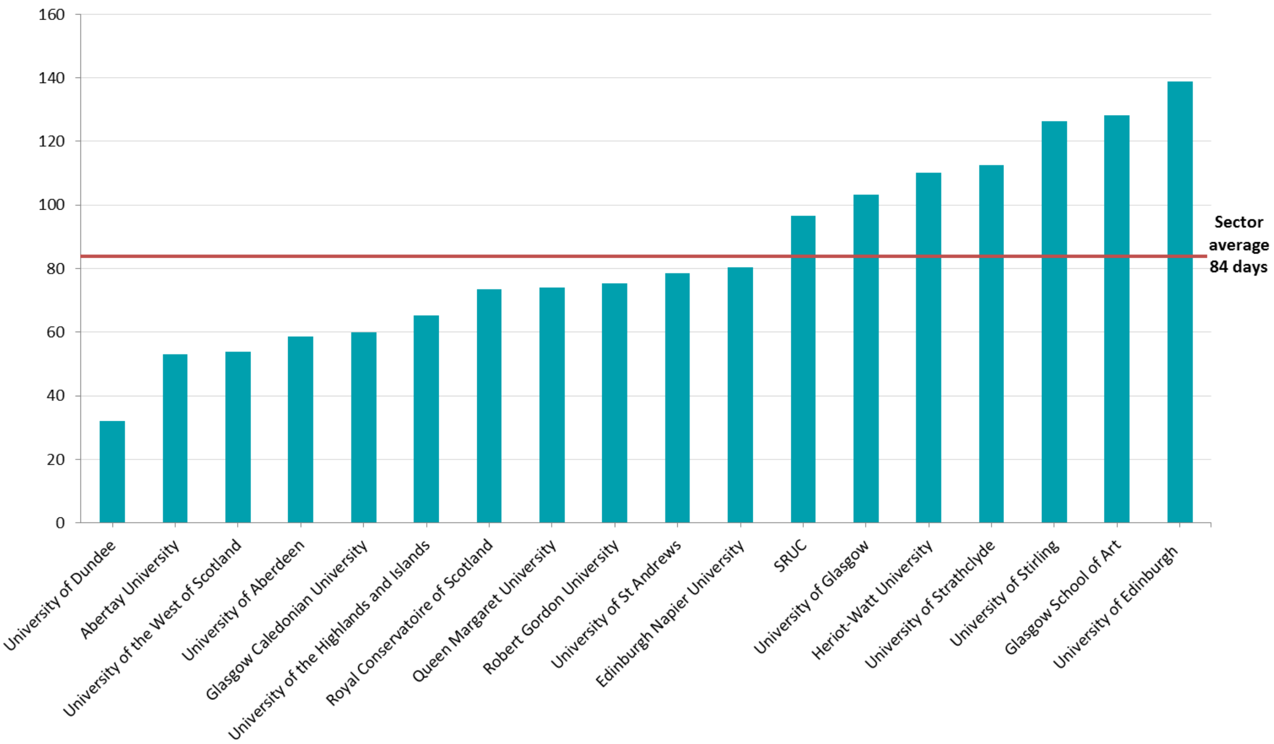
31. Five universities spent a total of £3.8 million on staff restructuring during 2018-19, less than half the amount spent in 2017-18.

Cash

32. The sector reported cash and short-term investment balances of £1,183 million at the end of 2018-19, which is less than forecast but higher than the previous year's balance of £1,153 million. Excluding the universities of Edinburgh and Glasgow, cash and equivalent balances moved from £529 million in 2017-18 to £532 million in 2018-19.

33. The chart below shows the number of days of expenditure covered by cash balances across the sector:

Days ratio of cash to total expenditure 2018-19



34. The average number of cash days across the sector at the end of 2018-19 was 84, which represents a drop from 98 days in 2017-18. Seven institutions were above the sector average in 2018-19. Twelve institutions reported a drop in cash days from the previous year while six institutions reported an increase.

Net Cash Inflow

35. The net cash inflow from operating activities is an important indicator of the financial health of an institution in terms of its day-to-day operations, as it does not include any items of non-cash expenditure (such as depreciation, amortisation and, most importantly, adjustments for pension liabilities), or income from and expenditure on financing activities. It shows an institution's ability to generate sufficient cash to repay debt and for estates investment. The sector figure is £289 million in 2018-19, an increase on the 2017-18 figure of £254 million. Only one institution in 2018-19 reported an overall outflow of cash from operating activities, as a result of exceptional adjustments, including additional deficit recovery contributions to the institution's own pension scheme. There are no immediate concerns about their financial health.

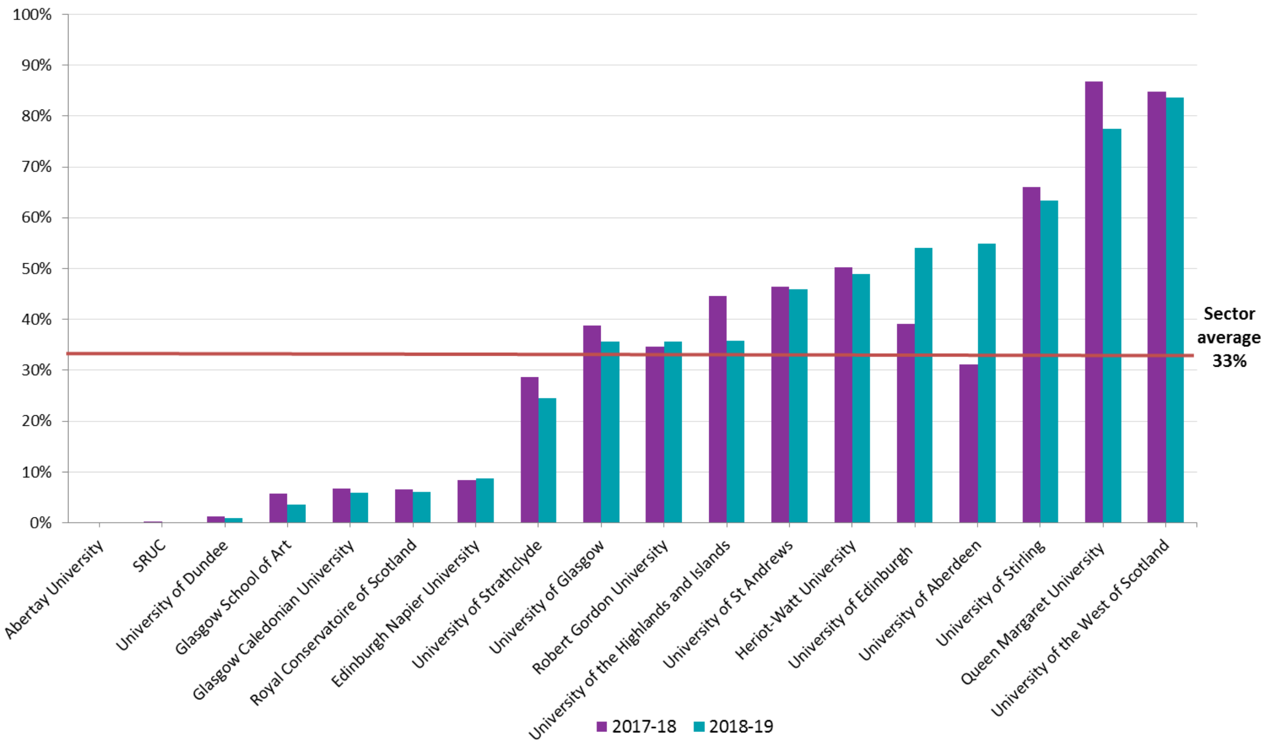
£289M
net cash inflow
(14% increase from previous year)

Borrowing

36. Total borrowing increased from £1,344 million in 2017-18 to £1,646 million in 2018-19 reflecting an increase in capital investment in the sector (£439 million during 2018-19). Borrowing represented 40% of total income in 2018-19 compared to 36% in 2017-18. The average borrowing for the sector is 33% of total income. Ten institutions reported above average borrowing in 2018-19. The scale of borrowing at each institution is shown in the chart below:

£1,646M
total borrowing
(22% increase from previous year)

Borrowing as a % of total income



37. Much of the sector's borrowing is now in the form of private placements due to the very low interest rates available. However, this type of borrowing involves large capital repayments at set points in the future with interest being paid in the intervening years. Out of the total sector borrowing figure of £1,646 million at the end of July 2019, £916 million was in the form of private placements. The universities with this form of borrowing will have to ensure they have the necessary funds to repay at the set points. Therefore, building up cash reserves, through generating ongoing surpluses, is essential to allow them to do this. Three institutions (Robert Gordon University, University of Aberdeen and University of Edinburgh) undertook additional borrowing in the form of private placements during 2018-19.

Ongoing financial sustainability

38. As with colleges, universities are undertaking detailed scenario planning work in relation to the impact of the COVID-19 pandemic. In the round, these are the most significant risks that could adversely affect the universities' financial performance and sustainability:

- Impact of the COVID-19 pandemic and the potential consequential failure to achieve international student recruitment targets.
- The UK's exit from the EU, although this impact could be mitigated by the Shared Prosperity Fund and the nature of the future relationship between the UK and the EU in terms of research and mobility.
- Rise in staff and pension costs.
- Fall in recruitment from the rest of the UK in an increasingly competitive market.
- The UK Government's response to the Review of Post-18 Education and Funding in England, as lower tuition fees in England could have a significant impact on Scottish institutions, and other education policies that may affect Scottish institutions.
- UK visa and immigration regulations.
- Further unanticipated public spending cuts in teaching and/or research income.
- Impact of changes to UK research funding in the Higher Education and Research Act 2017.

Conclusion

39. In what is currently a very dynamic situation, colleges and universities are continuing to explore and implement measures to address the financial impact of the COVID-19 pandemic. We continue to support them in this, monitoring individual institutions for early signs of financial difficulties, and receive regular financial updates as part of that engagement. We have issued a further Call for Information to request colleges' financial forecasts covering the period 2019-20 through to 2022-23. We will report on this shortly.

40. We have also issued a Call for Information to request universities' strategic plan forecasts covering 2019-20 and 2020-21. The forecasts will take account of the additional research funding allocation announced on 12 June as well as use of

the Coronavirus Job Retention Scheme and Government loan support schemes. We will report on this shortly. A further Call for Information will be issued later in the academic year once the position on 2020-21 student recruitment becomes clearer.

Lorna MacDonald
Director of Finance

Summary of colleges’ adjusted operating positions, liquidity and borrowing for 2017-18 and 2018-19

	Adjusted operating surplus/(deficit)		Cash and cash equivalents less overdraft		Total borrowing	
	Actual 2017-18 £000	Actual 2018-19 £000	Actual 2017-18 £000	Actual 2018-19 £000	Actual 2017-18 £000	Actual 2018-19 £000
Ayrshire College	(965)	1,790	1,723	2,705	53,148	50,971
Borders College	200	214	2,544	2,957	146	0
City of Glasgow College	644	1,201	7,048	8,227	148,615	144,249
Dumfries and Galloway College	(69)	54	744	3,660	0	0
Dundee and Angus College	127	2,249	1,172	2,150	5,681	4,114
Edinburgh College	416	708	945	936	10,411	9,692
Fife College	132	208	2,294	4,955	6,865	6,356
Forth Valley College	1,049	1,268	5,249	2,020	3,904	3,737
Glasgow Clyde College	125	107	2,632	2,972	901	410
Glasgow Colleges Regional Board	12	(6)	32	81	0	0
Glasgow Kelvin College	671	(328)	1,433	1,301	668	301
Inverness College	306	329	4,060	3,282	37,471	37,846
Lews Castle College	25	(23)	164	120	0	0
Moray College	161	98	769	1,171	590	494
New College Lanarkshire	531	324	1,008	6,602	1,614	646
North East Scotland College	(1,089)	2,330	2,481	2,651	207	42
North Highland College	48	(419)	402	256	1,335	1,277
Perth College	1	1,274	2,188	2,756	300	0
South Lanarkshire College	639	1,170	612	1,521	0	0
West College Scotland	19	26	3,825	5,677	2,825	2,330
West Lothian College	166	140	729	760	2,527	2,369
Incorporated colleges	**3,149**	**12,714**	**42,054**	**56,760**	**277,208**	**264,834**
Argyll College	(98)	212	1,116	1,701	36	15
Newbattle Abbey College	36	(117)	203	(11)	43	71
SMO	72	(177)	1,349	680	639	590
Shetland College	(21)	(28)	n/a	n/a	n/a	n/a
Orkney College	40	(90)	n/a	n/a	n/a	n/a
West Highland College	98	373	668	581	607	537
Non-incorporated colleges	**127**	**173**	**3,336**	**2,951**	**1,325**	**1,213**
Sector total	**3,276**	**12,887**	**45,390**	**59,711**	**278,533**	**266,047**

Summary of universities' operating positions, underlying operating positions, liquidity and borrowing for 2017-18 and 2018-19

	Operating surplus/(deficit)		Underlying operating surplus/(deficit)		Cash and cash equivalents less overdraft		Total borrowing	
	Actual 2017-18 £000	Actual 2018-19 £000	Actual 2017-18 £000	Actual 2018-19 £000	Actual 2017-18 £000	Actual 2018-19 £000	Actual 2017-18 £000	Actual 2018-19 £000
University of Aberdeen	(7,478)	(44,157)	(7,589)	(1,596)	31,350	40,704	68,323	125,595
University of Edinburgh	27,310	(134,431)	26,644	60,778	416,081	445,907	389,803	609,789
University of Glasgow	17,399	(69,311)	13,891	38,509	207,399	204,595	245,000	245,000
University of St Andrews	23,524	(27,268)	21,262	12,025	54,750	58,214	116,971	118,468
Ancient	**60,755**	**(275,167)**	**54,208**	**109,716**	**709,580**	**749,420**	**820,097**	**1,098,852**
University of Dundee	(9,051)	(55,113)	(9,740)	(13,777)	40,530	25,739	3,261	2,315
Heriot-Watt University	7,355	(28,554)	7,042	7,910	77,365	76,443	114,546	116,224
University of Stirling	(1,004)	(31,873)	(2,030)	(2,879)	63,524	51,663	79,914	79,880
University of Strathclyde	382	(68,486)	3,196	7,346	109,906	114,686	88,257	94,423
Chartered	**(2,318)**	**(184,026)**	**(1,532)**	**(1,400)**	**291,325**	**268,531**	**285,978**	**292,842**
Abertay University	227	(2,466)	1,336	(653)	8,136	5,105	1,076	922
Glasgow Caledonian University	(7,555)	(7,874)	(3,487)	(5,409)	19,402	20,674	8,051	7,387
Edinburgh Napier University	(4,722)	(6,875)	(4,402)	(6,661)	21,878	26,962	10,496	10,734
Queen Margaret University	(5,373)	(6,044)	(4,289)	(3,389)	8,084	8,082	32,259	30,738
Robert Gordon University	(12,606)	(8,135)	(12,606)	(8,135)	18,334	19,115	32,396	32,837
University of the Highlands and Islands	(3,790)	(1,666)	(518)	5,617	17,329	26,021	54,349	62,273
University of the West of Scotland	(3,319)	(8,460)	(2,381)	(7,625)	16,263	16,179	95,287	100,442
Modern	**(37,138)**	**(41,520)**	**(26,347)**	**(26,255)**	**109,426**	**122,138**	**233,914**	**245,333**
Glasgow School of Art	(26,412)	(2,177)	3,326	13,104	23,417	17,826	2,363	1,861
Royal Conservatoire of Scotland	473	533	477	444	4,984	4,597	1,550	1,484
SRUC	2,376	(314)	2,376	773	13,814	19,998	207	5,297
Small Specialist Institution (SSI)	**(23,563)**	**(1,958)**	**6,179**	**14,321**	**42,215**	**42,421**	**4,120**	**8,642**
Sector total	**(2,264)**	**(502,671)**	**32,508**	**96,382**	**1,152,546**	**1,182,510**	**1,344,109**	**1,645,669**

Underlying operating surplus/deficit as % of total income by type of university 2014-15 to 2018-19