FINANCIAL SUSTAINABILITY OF COLLEGES IN SCOTLAND 2020-21 TO 2025-26

Scottish Funding Council
Comhairle Maoineachaidh na h-Alba

Scotland's tertiary education and research authority

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Photo: UHI Perth

Introduction

The Scottish Funding Council (SFC) has a key role in ensuring that the colleges we fund continue to plan and manage their activities in a way which ensures their sustainability and financial viability. This report provides an aggregate picture of the financial health of Scottish colleges, based on their annual accounts for academic years 2020-21 and 2021-22, and the latest forecasts for the period from 2022-23 to 2025-26 academic years. It does not take into account the most recent budget announcement for 2024-25. Incorporated colleges, non-incorporated colleges and Glasgow Colleges' Regional Board are all included in the analysis[1].

The report also considers key risks that could have a significant impact on colleges' financial sustainability. In the context of our assessment of sector finances, we engage regularly with the Scottish Government, sector bodies and auditors.

It is important to note that the 2020-21 position included a full year of the COVID-19 impact, including additional financial support provided to colleges. Colleges were already facing a series of cost pressures prior to the pandemic, including increases in employer pension contributions, the cost of maintaining buildings and withdrawal from the European Union. The COVID-19 crisis heightened those challenges, particularly for colleges with high levels of commercial income. The results for 2021-22 reflected colleges returning to 'normal' business but the financial sustainability of the sector remains challenging.

We have previously reported on the financial sustainability of the college (and university) sectors in SFC/CP/02/2020, SFC/CP/05/2020, The Financial sustainability of colleges and universities in Scotland – Review report in October 2020, Coherence and Sustainability: Financial Sustainability of colleges and universities in June 2021, and SFC/CP/02/2022.

1 Scotland's Rural College (SRUC) is classed as a higher education institution and is covered in the publication Financial sustainability of universities in Scotland 2020-21 to 2024-25.

Photo: Dundee and Angus College

SFC monitoring and engagement

SFC monitors and assesses the financial health (sustainability and viability) of colleges and supports them in making the best use of their resources through regular engagement and analysis of financial returns which colleges are required to submit to SFC each academic year. SFC also considers colleges' individual circumstances and exposure to risk, capacity to respond to financial challenges and other relevant available information.

Financial sustainability is a condition of grant set out in SFC's Financial Memorandum with colleges. Colleges are responsible for their own financial sustainability and are required to notify SFC if they identify material risks to their financial viability or sustainability.

SFC increases levels of engagement and monitoring activity for those colleges facing risks to their financial health. SFC works closely with such colleges to understand and assess the problem areas and requires colleges to develop plans to bring them back to a sustainable position.

Financial health of the college sector

Key messages

Colleges continue to operate in an extremely tight fiscal environment alongside many challenges, such as increasing staff costs, general inflationary pressures, high energy costs and rising interest rates impacting on loan repayments.

The financial position of colleges is deteriorating. The sector reported an adjusted operating surplus of £7.2m in 2021-22 which represents a deterioration against the 2020-21 result (£19.3m surplus). Eight colleges (30%) reported adjusted operating deficits in 2021-22.

The sector is forecasting an adjusted operating deficit of £27.2m for 2022-23. The deterioration reflects flat cash in SFC grants and reduction in tuition fees relating to higher education provision not matched by the same level of reductions in costs. Twenty-four colleges (92%) forecast adjusted operating deficits in 2022-23. Colleges take a cautious approach to forecasting and in recent years the actual results have often shown an improved position against earlier projections.

Adjusted operating deficits are projected to continue over the next three years. Seventeen colleges (68%) are forecasting adjusted operating deficits in 2023-24, reducing to 13 colleges in 2024-25 and 2025-26.

Colleges remain highly reliant on SFC grant which is forecast by colleges to remain at 78% of total income.

Staff costs continue to be the largest element of colleges' spending (just under 70% of total costs) and are the main focus of savings as colleges try to balance their budgets in the current fiscal environment. **The sector reported staff restructuring costs of £6.7m in 2021-22 and forecasts staff restructuring costs of £13.2m in 2022-23 and £8.2m in 2023-24. Based on current forecasts, significant staff reductions of 2,387 FTEs are projected over the period 2022-23 through to 2025-26, equating to the potential removal of 21% of FTE staff employed in the sector.** Staff reductions are expected through a combination of vacancy management (1,130 FTEs), voluntary severance schemes (1,103 FTEs) and compulsory redundancies (154 FTEs). Given the experience to date of industrial relations within the sector, this level of staff reduction is likely to result in widespread industrial action.

The sector reported an aggregate cash balance of £141.4m at the end of July 2022 but cash reserves are forecast to deteriorate to a cash deficit of £4.2m by the end of July 2026 reflecting colleges' weak operating positions. No college reported a cash deficit at the end of July 2022, but four colleges are forecasting a cash deficit by the end of July 2024, increasing to six colleges by the end of July 2026. This projected deterioration in liquidity, particularly in the context of continually challenging budget settlements and continued high government savings expectations, will make it increasingly difficult for SFC to manage cash advances and reprofile grant payments to ensure colleges have sufficient cash to manage their liabilities, as we have done in the past. It will also become increasingly difficult for colleges to self-fund staff restructuring activity and rebalance their cost base as a pathway to sustainability.

Overall sector borrowing reduced from £244.1m at the end of July 2021 to £232.1m by the end of July 2022. Borrowing is forecast to reduce further to £186.4m by the end of July 2026. Most of the sector's borrowing is in the form of NPD/PFI commitments relating to three colleges. The borrowing figures exclude cash deficits projected by many colleges. **The weakening liquidity increases the risk of covenant breaches and heightens the risk of colleges defaulting on debt repayments.**

The position beyond 2023-24 is uncertain. We know that the budget for 2024-25 will be particularly challenging but there remains uncertainty about future year allocations. The assumptions used for these forecasts included flat cash SFC grant, 3.5% annual pay awards in the latter years of the forecast and Office for Budget Responsibility (OBR) forecasts for inflation to non-staff costs (3%-5% p.a.), in line with Scottish Government advice. **Colleges have also provided SFC with alternative scenarios based on more pessimistic planning assumptions which show an even greater deterioration in the sector's financial position.**

It is important to note that:

- the sector is not homogeneous and there is significant variation in the financial position of individual colleges that is not reflected in the aggregate indicators.
- the financial sustainability of the sector remains extremely fluid with assumptions being constantly updated as circumstances change. The results can only be viewed as a snapshot in time and are historic. Forecasts are not a guarantee of future performance returns and are highly likely to change over the planning period.

Photo: Sabhal Mòr Ostaig

Risks to colleges' financial health

Colleges identified many risks in their returns which could adversely affect their financial health and 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 the outcome of the job evaluation exercise for support staff.

Difficulties in meeting activity thresholds due to demographic changes and prospective students securing employment or obtaining places at universities instead of going to college, leading to changes to funded activity levels.

Uncertainty over funding recovery exposure due to lower levels of recruitment across the sector and ongoing discussions with colleges around potential mitigations.

The requirement for colleges to self-fund the staff restructuring costs could substantially diminish colleges' available cash balances following the Scottish Government's withdrawal of £26m transformation funding in 2023-24.

Any further unanticipated in-year reductions in funding which would place significant added pressure on colleges to maintain a sustainable trajectory.

The uncertain macro-economic outlook, with inflation reducing but remaining high by historic standards, and rising interest rates.

Rising energy costs with the centrally negotiated contract for college energy costs ending across 2022-23 to 2023-24 and colleges moving onto a new contract. Changes to government support that helps with colleges' energy bills are also proposed for 2023-24 which are likely to make this support less generous.

The impact of cost efficiencies (including the impact of reduced staff numbers, changes to frontline student services and potential decisions about the future of particular campuses) on the quality of student experience, the health and wellbeing of college staff, and breadth and width of the curriculum offered to students.

The impact of the outcome of the **Independent Review of Skills Delivery** and **Purpose and Principles** on the sector, as the Scottish Government continues to develop its response.

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.

The ability to address **backlog estates maintenance and 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**, with a recent estimate of the cost of achieving net zero targets across the UK FE sector sitting at £6.7bn[2].

The impact of **reinforced autoclaved aerated concrete (RAAC)** on the college estate with potential building closures and expenditure required to make affected buildings safe for use.

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.

2 The Cost of Net Zero | EAUC

Mitigating actions

Colleges remain heavily reliant on SFC grant (78% of total income) and generating commercial income is challenging in the current fiscal environment. This is mainly due to:

- difficulty in competing for contracts against private sector providers that have lower fixed cost bases (especially staff costs);
- weak liquidity limiting the sector's ability to expand their offer because that may require additional investment; and
- the lack of fiscal flexibilities associated with their public body status to exploit further commercial opportunities.

Colleges have provided assurances that they are addressing the risk of not achieving student activity targets through undertaking scenario and contingency planning, proactive budget monitoring, effective curriculum planning and management, developing stronger partnerships (with schools, universities, employers and industry), increased marketing activity, implementation of business process improvement initiatives, and shifting delivery patterns.

From 2023-24, SFC has made changes to the college funding model as a first step towards a more dynamic, forward-looking approach that will help colleges limit their exposure to the risk of funding recovery due to under-delivery in 2023-24. The changes include:

Introducing a reduced credit threshold, while maintaining the same level of funding as in 2022-23.

Providing a 2% tolerance on the reduced credit threshold.

Aligning the required date with universities for claiming credits, meaning colleges can now claim credits for full-time students on courses lasting over 20 weeks if the student is still in active learning after five weeks from the course start date.

Decoupling 20% of the value of credits to take account of college sunk costs, recognising that colleges bear an element of semi-fixed costs even when credits are not delivered.

Staff costs are the main focus of savings. Colleges have indicated that their options for non-staff cost savings are limited because of previous cost reductions and current inflationary pressures. Many colleges have raised the possibility of compulsory redundancies as a last resort or in order to target staff reductions, as they believe their capacity to achieve savings through voluntary severance schemes, while sustaining coherent provision, is reducing. There will be a significant leadership challenge for colleges to ensure that planned staff reductions do not adversely affect a college's reputation, student outcomes (quality, retention and other performance indicators) and the mental health, morale and turnover of remaining staff. Other mitigating actions colleges are actively considering include curriculum reviews and freezing non-essential spending.

It is important that colleges continue to adapt to the challenging fiscal environment and other uncertainties. Financial challenges are likely to affect individual colleges differently and each college should pursue the mitigating actions that are right for its mission and context. We expect colleges to be alert to the risks to their financial health and have scenario planning and contingency arrangements in place to address them. We encourage colleges to constantly review and consider the range of options available to them so they can take corrective action rapidly as risks begin to emerge.

Colleges should continuously review their operating models and consider options for reducing costs and maximising income in this challenging environment of increasing staff costs, inflationary pressures, high energy costs and interest rates, and flat cash settlements.

In our engagement with colleges we are seeing a mix of strategies being adopted, for example:

- Exploring opportunities for strategic collaborations and consolidation with other institutions or appropriate other bodies, including shared services, centralising costs and business process improvements.
- Reviewing estates to ensure the size, structure and design is right for the college. This could include downsizing; looking at how buildings and facilities are used; disposing of surplus buildings; and reducing annual maintenance costs. We recognise this may require some upfront investment. SFC is supporting colleges in this work through the delivery of the College Infrastructure Strategy published in November 2022 (see page 23) and in tri-partite work with the Scottish Government and Colleges Scotland on the reinvestment of capital receipts following disposal.
- Reviewing teaching provision, with a view to consolidating or rationalising curriculum, including the closure of courses that are considered to be financially unsustainable.
- Developing more commercial income streams although we recognise this can be challenging in the current financial environment, especially due to the lack of fiscal levers available to colleges.

Photo: Glasgow Clyde College

It is recognised that achieving further efficiencies will require significant investment over many years. In addition, some of these strategies could have an impact on student choice and experience, staff and local communities, and on the size, shape and capacity of the sector more widely. SFC will continue to work closely with colleges to understand any such impact and provide appropriate support as colleges explore options to remain financially sustainable.

In considering the future policy and funding environment, these key actions could assist colleges on the path to financial sustainability:

Multi-year funding settlements and realistic future funding assumptions, to enable colleges to undertake better planning, adapt business models and collaborative activity.

Continuing to work collaboratively on future funding models.

Reducing the fragmentation of funding streams.

Transformation funding to support the way colleges may need to adapt their provision, structures, approach to collaboration and target operating models.

Providing additional year-end financial management flexibility around the March financial year-end to support the reprofiling of income and expenditure to the end of July, and exploring whether there is potential for enhancing flexibilities for Scotland's colleges within the ONS classification designation.

Recognising the role colleges play, through specific funding and the review of apprenticeship and work- based learning opportunities, in responding to the needs of employers.

Engaging positively with the reform programme for post-16 education and skills so that it takes account of the financial and funding context and supports opportunities for colleges to continue to make a difference as anchor regional institutions, in changing lives, and in creating value for Scotland and local communities.

Supporting national level and efficient infrastructure planning and procurement, for example in relation to estates and digital infrastructure.

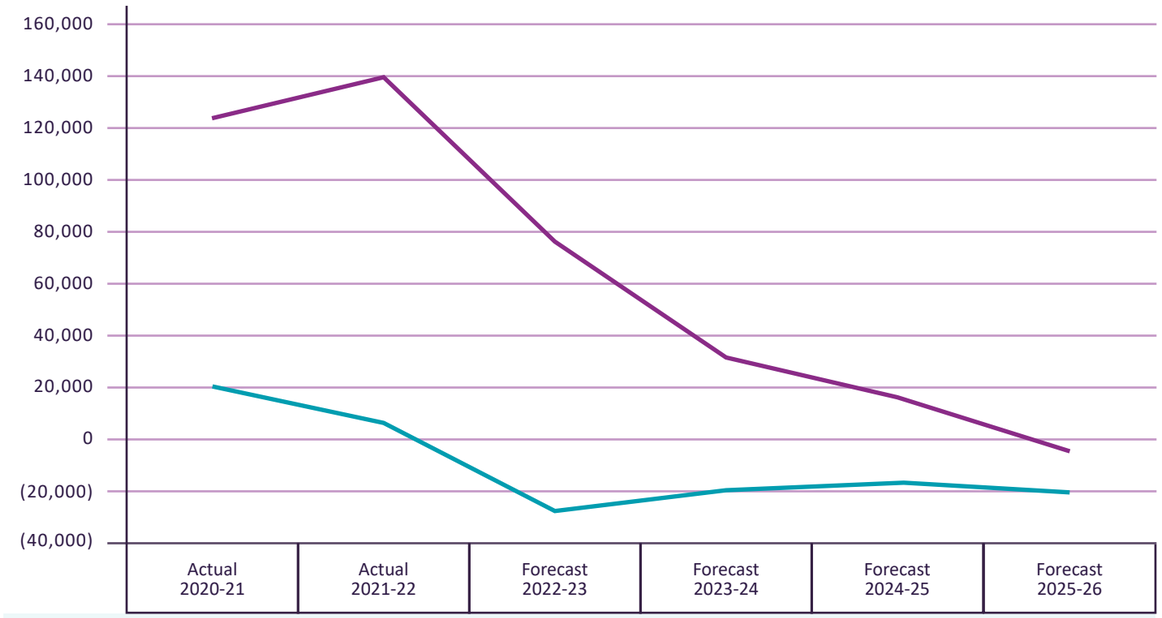
Analysis of financial returns

This section reports on the results of our analysis of data from colleges' 2021-22 annual accounts return (including 2020-21 academic year) and the Financial Forecast Return which provides forecast data for the period from 2022-23 to 2025-26 academic years. The table below provides a summary of key financial information for the college sector over these six years.

Summary of college sector aggregate financial data						
	2020-21 Actual	2021-22 Actual	2022-23 Forecast	2023-24 Forecast	2024-25 Forecast	2025-26 Forecast
Total income (£000)	792,332	830,635	814,908	806,684	806,338	808,933
Total expenditure (£000)	839,745	890,753	861,001	842,918	842,447	850,237
Adjusted operating surplus/ (deficit) (£000)	19,320	7,202	(27,187)	(19,178)	(16,620)	(20,335)
Adjusted operating surplus/ (deficit) as % of total income	2.4%	0.8%	(3.3%)	(2.4%)	(2.0%)	(2.5%)
Cash flow from operating activities (£000)	86,244	57,240	(30,175)	(16,361)	8,949	5,436
Cash flow from operating activities as % of total income	11%	7%	(4%)	(2%)	1%	1%
Net liquidity (£000)	122,907	141,438	76,635	31,709	15,004	(4,170)
Net liquidity days	57	62	35	15	7	(2)
Total borrowing (£000)	244,055	232,186	220,818	209,262	197,534	186,378
Total borrowing as a % of total income	31%	28%	27%	26%	24%	23%

At an aggregate sector level, the table above and the graph that follows show a downward trend in the financial health of colleges as shown by the deteriorating underlying operating position and liquidity.

College sector adjusted operating position and net liquidity (£000)



The 2021-22 financial result represented a deterioration against the 2020-21 outturn and the sector is forecasting a further decline in financial operating performance from 2022-23, with costs increasing at a faster rate than income. Liquidity is also forecast to decline from 2022-23 onwards. There remains a significant variation in financial performance across the sector for all years.

The substantial deterioration in the sector's operating position over the planning period is largely due to increases in staff costs, self-financed severance costs (£27.5m) and other operating costs, reflecting inflationary pressures. It is important to note that a portion of the college cost base is fixed or semi-fixed as it forms part of the infrastructure for curriculum delivery which makes further cost reduction challenging to achieve. Increasing commercial income can also be difficult for colleges, as mentioned earlier in the report.

Financial performance

Adjusted operating position

The adjusted or underlying operating position reflects the financial performance of colleges after allowing for non-cash adjustments and other material one-off or distorting items required by the FE/HE Statement of Recommended Practice (SORP). This smoothes volatility in reported results arising from the implementation of Financial Reporting Standard 102 and recognises that some of the reported costs do not have an immediate cash impact on the college. This gives a better indication of colleges' operational cash generating capacity and a clearer picture of colleges' short-term financial health.

The methodology for calculating the adjusted operating position has been agreed following sector consultation to ensure a consistency of approach in the interpretation of colleges' financial performance (Annex C).

Depreciation and pension adjustments (non-cash items that are beyond a college's immediate control) account for most of the difference between the operating position and the adjusted operating position. Incorporated colleges receive a 'non-cash' budget to cover depreciation, but this additional budget is not recognised under the FE/HE Statement of Recommended Practice (SORP) accounting rules. Annual Managed Expenditure (AME) pension adjustments may also impact on the reported operating position. Consequently, we would expect to see operating deficits reported across the college sector.

The sector reported an adjusted operating surplus of £7.2m for 2021-22, which represents a significant deterioration against the previous year's result (£19.3m surplus) due to increases in staff costs, reflecting the impact of the pay award and some additional recruitment. Other operating costs also increased because of the return to campus activity combined with inflationary impacts. Sector income increased due to increased SFC grant more than offsetting the reduction in one-off COVID funding, and a rise in other income due to the return to campus activity more than offsetting the loss of furlough funding. Tuition fee and education contract income also increased against the previous year's levels.

The 2022-23 forecast shows a sector adjusted operating deficit of £27.2m. The deterioration against the 2021-22 outturn reflects forecast reductions in SFC grants and HE tuition fees and the lack of corresponding reductions in costs. Further substantial deficits of £19.2m, £16.6m and £20.3m are projected in 2023-24, 2024-25 and 2025-26 respectively.

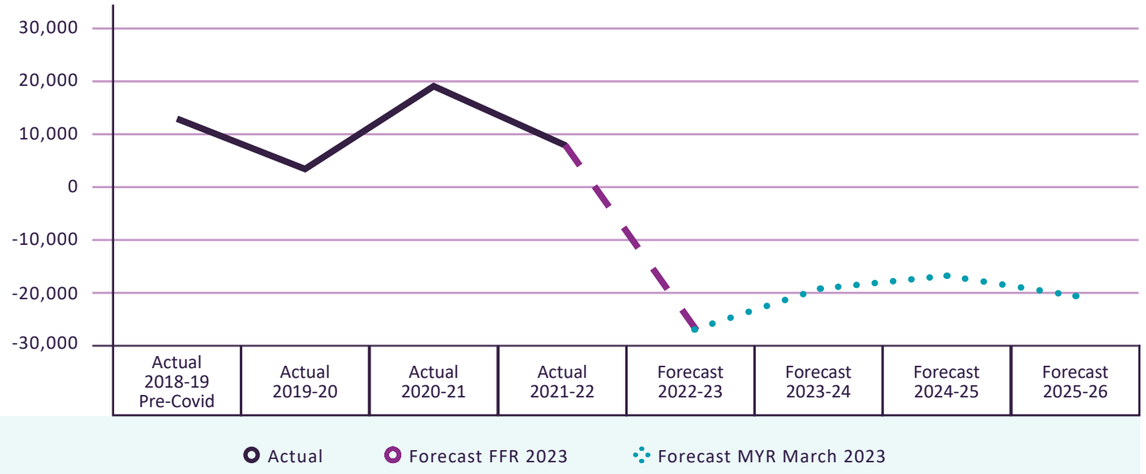
Nine colleges (33%) reported an adjusted operating deficit in 2021-22 compared to three (11%) colleges in 2020-21. A total of 24 colleges (92%) forecast adjusted operating deficits in 2022-23, reducing to 17 colleges (68%) in 2023-24 and 13 colleges (52%) in the final two years.

The number of colleges forecasting adjusted operating deficits is of real concern and it is clear that many colleges are not sustainable on the basis of these forecasts. However, these forecasts do reflect a snapshot in time. Alternative scenarios with more pessimistic planning assumptions show an even greater deterioration in the sector's financial position.

Photo: UHI Perth

The graph below illustrates the marked deterioration in the forecasts[3] against the actual outturns from 2018-19 to 2021-22.

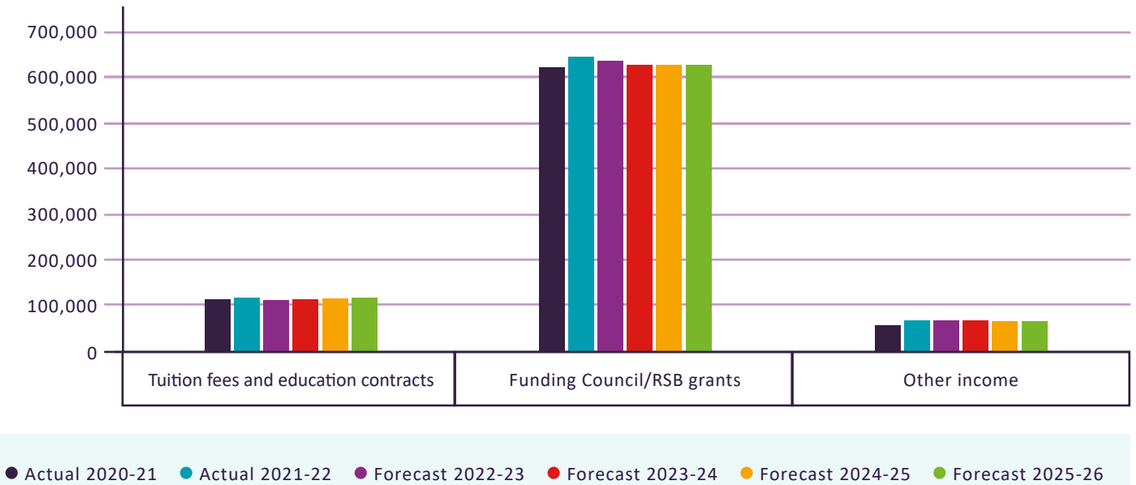
College sector: adjusted operating position 2018-19 to 2025-26



Income

The graph below shows the projected movement in sector income over the period from 2020-21 to 2025-26.

College sector: sources of income (£000)



3 MYR is the Mid-Year Return collected at the end of March which provides a budget update for the current year only against the original budget

Total sector income increased by 4% in 2021-22 but is expected to decrease over the remainder of the forecast period.

Colleges remain heavily reliant on SFC grant which for the purposes of these forecasts was projected by colleges to remain flat and at around 78% of overall sector income throughout the forecast period, although there is some minor variation in grant reliance across the sector. Several colleges do not expect to achieve student activity and other income targets during 2022-23 and some (but not all) have included recovery of SFC grant in their latest forecasts, reducing their projected income further.

The primary source of non-SFC income is tuition fee and education contract income. Other income generating activities include residence and catering income. Several colleges have trading subsidiaries which contribute to commercial income. There has been some recovery in trading subsidiary revenue and catering income in 2021-22 because of the return to on-campus activity after the relaxation of pandemic measures. However, non-SFC income is forecast to remain relatively flat from 2022-23 onwards.

Recruitment challenges

Approximately half of all colleges anticipate they will have under-delivered their student activity in 2022-23 because of the continued impact of the buoyant labour market and competition from universities. This has been reflected in the reduction of higher education fee income in the sector as students opt to go into employment or attend university.

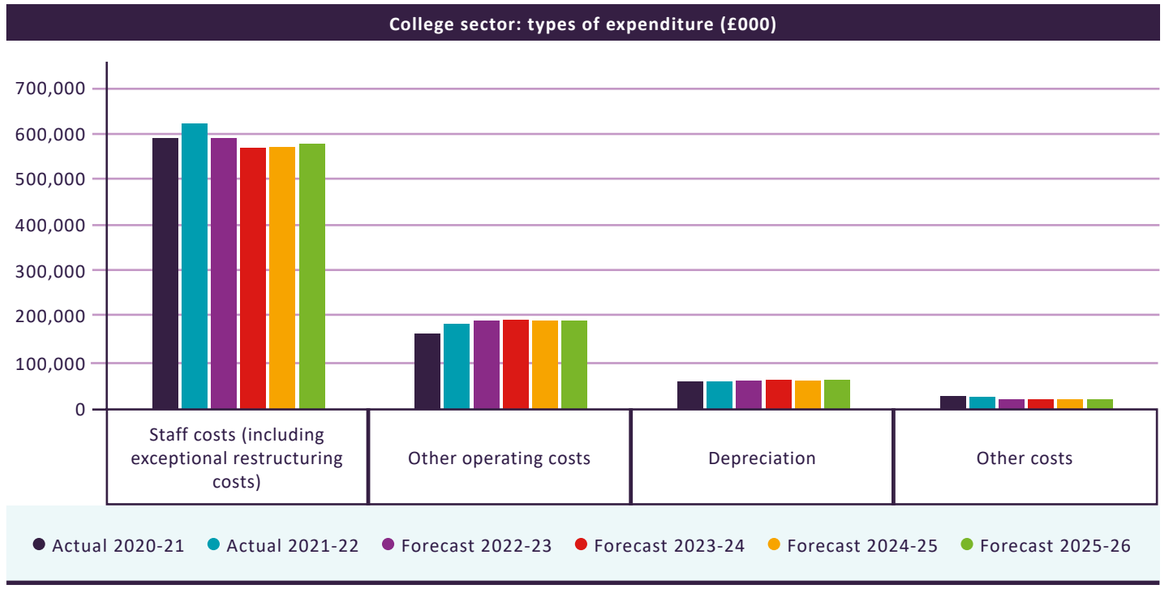
Several colleges have continued to experience recruitment challenges over recent years due to reductions in demand driven by demographic trends, in particular the decline of the population of 16- to 24-year-olds in their regions. Recruitment performance ranges from 90% to 127% against target.

As colleges work to address shortfalls and the data cleansing and audits are finalised, these figures are likely to change. The current level of delivery at the sector level is 98.0%. SFC continues to consider the implications of this shortfall as figures are finalised and arrangements are made for recovery of funding.

Photo: City of Glasgow College

Expenditure

The graph below shows the projected movement in sector expenditure over the period from 2020-21 to 2025-26:



Staff costs represent the largest element of expenditure for colleges at 69% of total costs in 2021-22. The results for 2021-22 reflected increased pay costs and employer contributions to pension schemes. One-off savings from freezes to non-essential recruitment activity have not recurred in 2021-22 though some colleges have reported difficulties in recruiting staff due to tight labour market conditions.

Underlying staff costs, excluding severance and pension costs, are forecast to increase by £14.1m (2.5%) in 2022-23, before decreasing by £15.8m (2.7% reduction) in 2023-24 due to the savings generated from previous severance activity. Colleges have assumed a pay increase of 5% for 2022-23 and 3.5% thereafter in their forecasts, but this could be understated given current inflation and the ongoing negotiations on the pay offer. Staff costs are projected to increase by £5.7m (1.1%) in 2024-25 and by £9.1m (1.6%) in 2025-26, reflecting the continued impact of pay awards.

An additional staff cost pressure which colleges are likely to face from April 2024 is increased employer pension contributions because of changes in the discount rate being applied to the Scottish Teachers Superannuation Scheme. The UK Government intends to provide funding to affected government bodies to meet this additional cost. The Scottish Government provided £7.5m funding to colleges to support the change to the employer contribution rate from September 2019.

Other operating expenses are forecast to increase across the forecast period reflecting the resumption of full campus operations. Utilities costs are expected to rise consistently over the forecast period, increasing from £16.4m in 2021-22 to £27.0m by 2025-26 (64% increase).

Photo: Edinburgh College

Staff restructuring plans

Thirteen colleges spent £6.7m on staff restructuring costs in 2021-22 (2020-21: £6.5m across 12 colleges). Colleges intend to spend a further £27.4m on staff restructuring activity over the forecast period to 2025-26. This is expected to be funded from within colleges' existing resources. Several colleges have indicated that they may have to resort to compulsory redundancies to achieve the level of savings required to rebalance their financial position. In addition to voluntary and compulsory severance, colleges are also generating savings through vacancy management.

Savings tend to be generated in the year after the voluntary severance investment is made due to departures occurring at or near the end of the academic year. Colleges believe voluntary departures are now more difficult to secure due to the volume of severance previously undertaken and the perceived unattractiveness of the terms of schemes to those staff that remain. In some cases, colleges are no longer able to afford voluntary severance. The sector anticipates using compulsory redundancies in future.

Based on colleges' 2023 Financial Forecast Returns, the expected reduction of 2,387 FTE equates to the removal of 21% of FTE staff employed in the sector. Colleges have highlighted the impact of this level of staff reduction on the student experience. This could compromise colleges' ability to deliver both the breadth and quality of provision and there is a risk to maintaining business as usual when undertaking such fundamental restructuring.

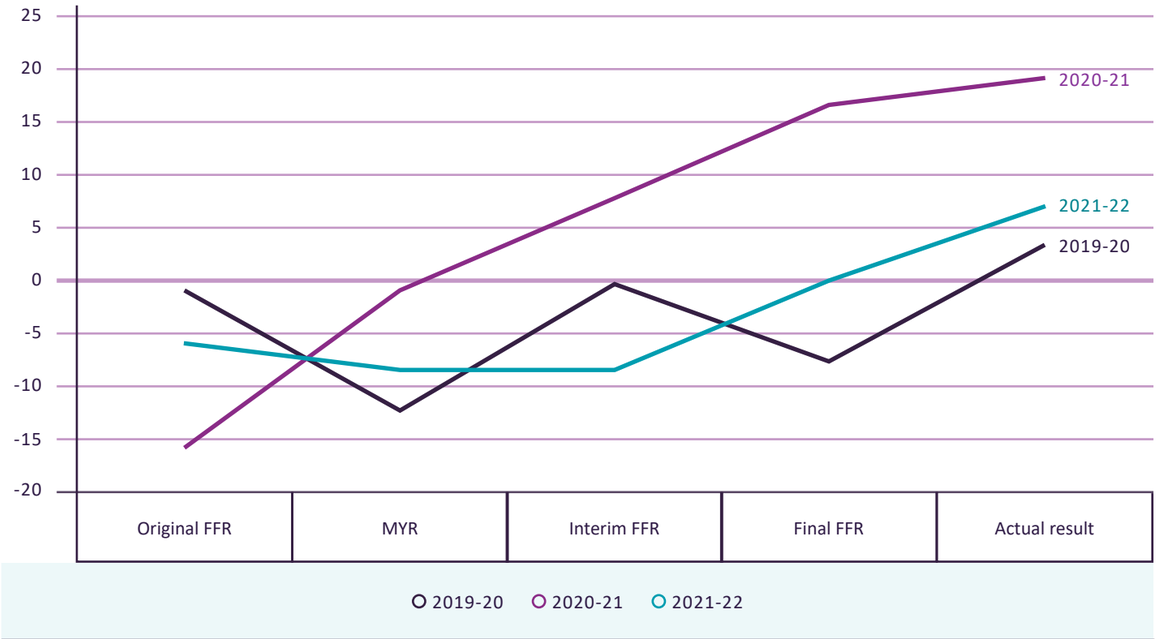
The level of staff reductions, including the potential for significant levels of compulsory redundancies, has already led to industrial relations challenges at several colleges, including ballots for industrial action.

Accuracy of forecasting

For most colleges, movements between actual results and forecast figures can largely be explained by adjustments being made to react to new information. In the last few years, forecasting was difficult due to the uncertainty surrounding the continuing impact of the pandemic, coupled with recent economic uncertainty. To consider the accuracy of forecasting we use historical forecasts and compare them to the actual results. The most recent year of actual results was 2021-22 academic year.

The movements in the adjusted operating position for academic years 2019-20, 2020-21 and 2021-22 are set out in the graph below:

College sector: adjusted operating surplus/(deficit) (£million)



Improvements in actual outturns against forecast have occurred in most years as shown in the graph above. For 2021-22, the initial projected deficits reflected the uncertainty around SFC funding recovery and some uncertainty about the overall impact of the return to campus activities, pay awards and non-pay cost inflation. By the time of the submission of the September 2022 FFR, the positions on some of the above issues had become clearer and this led to colleges forecasting a substantially improved result of £0.2m surplus.

The final outturn reported in colleges' 2021-22 annual accounts was an adjusted operating surplus of £7.2m surplus which represented a favourable variance of £12.9m against the original September 2021 FFR and £7m against the September 2022 FFR forecast. Four colleges reported positive variances against the September 2022 FFR forecast of around £1m which account for most of the overall £7m variance.

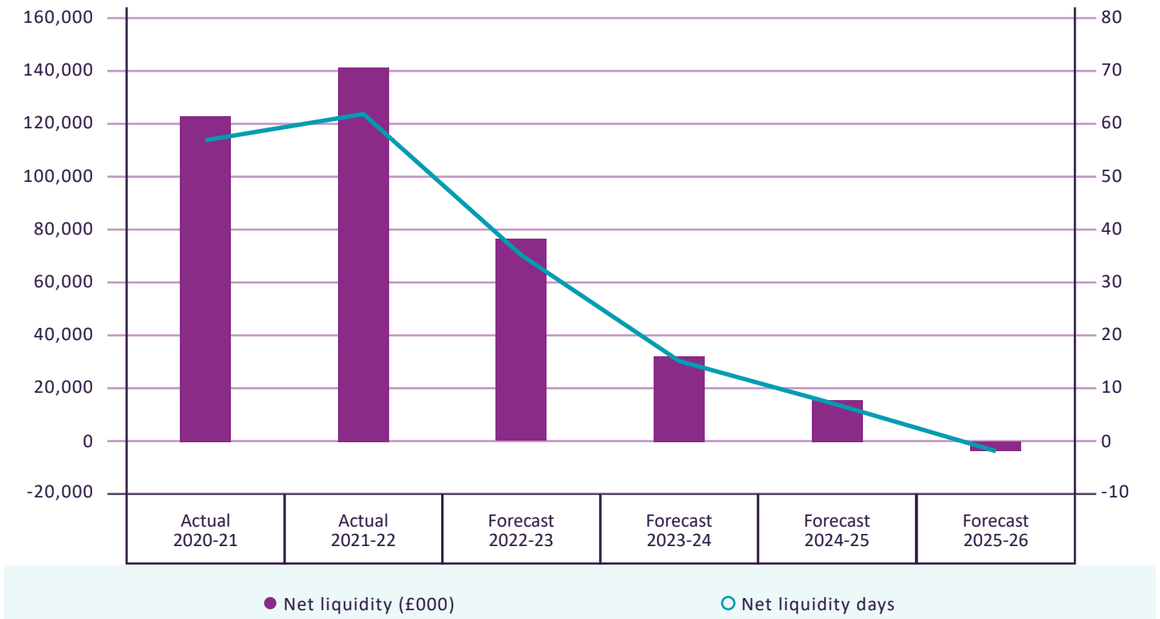
We will continue to work with colleges on the accuracy of forecasting as part of our assessment of financial returns for 2022-23 and the current academic year. While SFC recognises that colleges need to make adjustments to their forecasts as they react to new information, they should ensure that their forecasts are as accurate and dependable as possible in future years.

Financial position – strength and resilience

Liquidity

Cash balances and number of days expenditure held in cash reserves are key performance indicators. The graph below shows levels of sector cash reserves and days ratio of cash to total expenditure over the period from 2020-21 to 2025-26.

College sector: liquidity



The sector reported a cash balance of £141.4m at the end of July 2022. Cash reserves are forecast to reduce by 46% to £76.6m by the end of July 2023 reflecting colleges' weak operating positions. They are projected to further deteriorate to a cash deficit of £4.2m by the end of July 2026 reflecting further weakening of colleges' operating positions and the spend or return of unspent SFC ring-fenced grants (including unspent student support funds and colleges delaying capital works due to COVID-19 and increased construction inflation) which inflated the July 2022 figures.

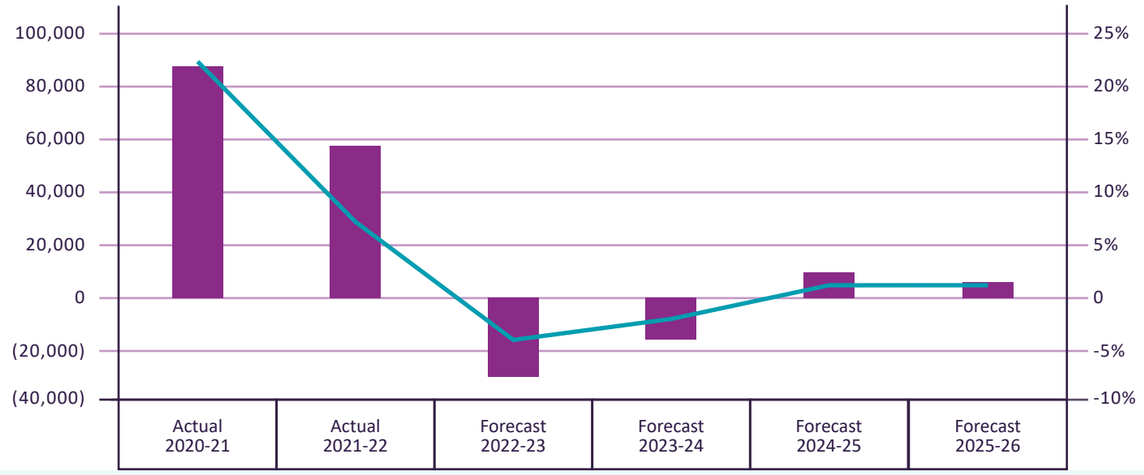
The number of colleges forecasting a cash deficit is expected to increase from one college at the end of July 2023 to four colleges (16%) by the end of July 2024, and to six colleges (24%) by the end of July 2026. It should be noted that the college forecasting a cash deficit at the end of July 2023 subsequently reported a positive cash position, having received a cash advance from SFC prior to the end of the academic year.

The sector cash deficit forecast from 2023-24 onwards is at such a high level that it may become difficult for SFC to manage cash advances through reprofiling grant payments. It would also become increasingly difficult for colleges to self-fund staff restructuring activity. The range of negative cash balances at the end of July 2026 (the year of maximum exposure) sits between £866k to £11.5m.

Cash flow

Net cash inflow from operating activities is an important measure of colleges' financial health as it does not include any items of non-cash expenditure (such as depreciation, amortisation and adjustments for pension liabilities), or income from and expenditure on financing activities. It illustrates an institution's ability to generate sufficient cash to repay debt and for estates investment. The graph below shows the sector's net cash inflow as a percentage of total income over the period from 2020-21 to 2025-26.

College sector: net cash flow from operating activities



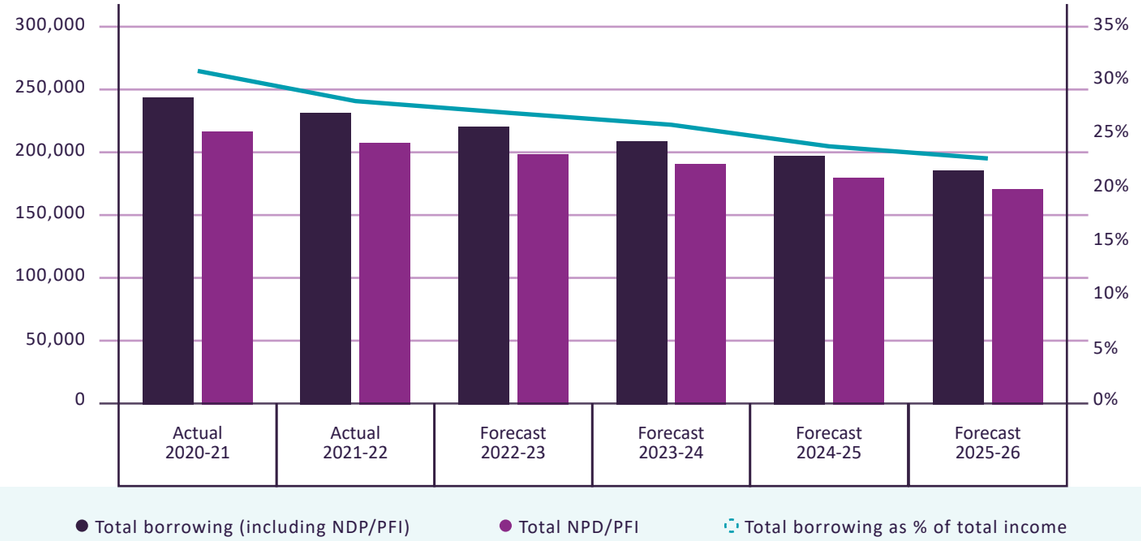
In 2021-22 there was an inflow of operating cash of £57m, equivalent to 7% of total sector income (2020-21: £86m inflow, 11% of income). The forecast for 2022-23 shows a net cash outflow of £30.2 million (4% of total income) with a further net cash outflow of £16.4m (2% of total income) in 2023-24 before returning to positive net cash inflows (1% of income) in the final two years. This reflects the weaker projected operating positions across the forecast period and the impact of high severance costs at the beginning of the forecast period with the savings accruing in later years.

Seven colleges (27%) reported a net cash outflow from operating activities in 2021-22 (2020-21: nil colleges). Twenty colleges (77%) are forecasting net cash outflows from operating activities in 2022-23, reducing to 11 colleges (44%) by the end of the forecast period.

Borrowing

The graph below shows the sector's borrowing and the ratio of borrowing as a percentage of total income over the period from 2020-21 to 2025-26.

College sector: borrowing



Total borrowing (including legacy bank loans, finance leases and NPD/PFI commitments) is expected to reduce by 19.7% from £232.2m at the end of July 2022 to £186.4m at the end of July 2026. Excluding NPD/PFI commitments, borrowing is forecast to decrease by 36% from £23.6m to £15.0m. Twelve colleges (50%) are projecting outstanding borrowing at the end of July 2026 including NPD/PFI debt. It is important to note that the borrowing figures exclude the cash deficit projected by many colleges in the forecast period.

No college reported any breach of bank covenants during 2022-23 or is forecasting doing so in 2023-24. Given the forecast deterioration in the sector's forecast operating and cash positions, there is a heightened risk of colleges breaching their covenants and defaulting on debt repayments in the later years of the forecast.

Capital Expenditure

Sector capital expenditure amounted to £33.0m during 2021-22, 45% higher than the previous year's total of £22.8m. Capital spend of £189.0m is projected over the planning period. SFC capital grants are forecast to fund £178.7m of this capital expenditure with the remainder being financed through a mix of grants from arms-length foundations, non-SFC grants (such as City Deal funding) and reserves.

College Infrastructure Strategy

In November 2022, SFC published the "College Infrastructure Strategy: the approach to delivering Scotland's College Infrastructure Plan". The strategy sets out the collective approach between SFC and colleges to develop an Infrastructure Investment Plan (IIP) for Scotland's colleges covering the period 2024-2034. The plan will identify infrastructure investment needs for the college sector, including investment in net zero, training equipment and digital infrastructure essential for a sustainable college estate.

Working with Colleges Scotland, SFC has developed a delivery plan for the strategy. In collaboration with Colleges Scotland, we have also developed a set of governance, monitoring and reporting arrangements that will ensure the engagement of appropriate stakeholders including colleges, the Scottish Government and Scottish Futures Trust (SFT) in the strategy delivery. These arrangements include:

The Infrastructure Delivery Group (IDG) to support, advise, monitor and report on progress of the delivery plan.

The College Infrastructure Departmental Assurance Group to provide appropriate challenge and support to IDG, and to build consensus across the Scottish Government, SFC and SFT officials for the provision of updates and advice to Scottish Government Ministers.

Pension Liabilities

Nearly all college staff belong to one of the two pension schemes, the Scottish Teachers Superannuation Scheme (STSS) or the relevant Local Government Pension Scheme (LGPS). The STSS is a notional fund and, therefore, colleges are unable to identify and report their share of the underlying assets and liabilities. Pension liabilities reported in colleges' financial statements therefore relate to the LGPS multi-employer defined benefit schemes.

Pension Liabilities				
	2018-19 Actual £000	2019-20 Actual £000	2020-21 Actual £000	2021-22 Actual £000
Sector Pension (Liability)/Asset	(253,165)	(467,984)	(354,477)	74,779

The overall sector liability decreased from a deficit of £354.5m at the end of July 2021 to a surplus of £74.8m by the end of July 2022 due to the improved performance of scheme assets exceeding the scheme liabilities.

Ten colleges (38%) have recognised a pension asset in respect of this improvement in investment performance with nine (35%) reporting improved deficits. Six colleges (23%) reported a nil balance. The difference in disclosure and treatment is because of differences in audit approach which capped the recognition of the beneficial movement in the colleges that reported a nil balance.

Arms-Length Foundations

Arms-length foundations (ALFs) were established to mitigate the impact of the reclassification of colleges in relation to cash reserves and future commercial surpluses. Colleges had the option of establishing a local ALF or participating in the sector 'umbrella' ALF (Scottish Colleges Foundation). Colleges donated a total of £99m to ALFs before they were reclassified on 1 April 2014. This included £25.3m donated to the Scottish Colleges Foundation. This represented cash balances accumulated by colleges over numerous years.

SFC maintains a close overview of ALFs given the magnitude of public funds donated to ALFs and the levels of scrutiny in this area. SFC's Finance Committee receives annual assurance on the stewardship of public funds donated by colleges to ALFs along with details of the inflow and outflow of funds.

In financial year 2021-22 (1 April 2021 to 31 March 2022), ALFs paid grants of £7.9m to colleges. This is a significant (72%) increase on £4.6m in 2020-21. Colleges also donated £460k to ALFs resulting in a net reduction on ALF balances of £7.5m (40%). The remaining balance in the ALFs at the end of financial year 2021-22 was £11.3 million.

The sector provided SFC with forecast movements for 2022-23. ALF balances are expected to have increased by £0.4m (3.5%) to £11.7 million by 31 March 2023. Colleges have donated £2.6m to ALFs and expected to receive £2.1m grant funding from ALFs. SFC will consider and report on the accuracy of these projections in its analysis of ALFs' audited 2022-23 financial statements once these are available.

ALFs are charitable organisations. Their independent nature means that they are accountable to the Office of the Scottish Charity Regulator (OSCR) and Companies House where the legal form of the ALF is a company limited by guarantee. Colleges are required to submit funding applications to ALFs to access funds but there is no guarantee that these applications will be successful. Nevertheless, existing legislation governing charities, companies and contracts, as well as audits and OSCR's wide-ranging powers in the supervision of charities, provide a series of safeguards in terms of the governance and application of these funds.

Photo: Forth Valley College

Annex A: Summary: college sector operating position, underlying operating position, liquidity and borrowing

College sector: operating position, underlying operating position, liquidity and borrowing								
Incorporated colleges	**Operating surplus/(deficit)**		**Adjusted operating surplus/(deficit)**		**Cash and cash equivalents less overdraft**		**Total borrowing**	
	2020-21 Actual £000	**2021-22 Actual £000**	**2020-21 Actual £000**	**2021-22 Actual £000**	**2020-21 Actual £000**	**2021-22 Actual £000**	**2020-21 Actual £000**	**2021-22 Actual £000**
Ayrshire College	(1,082)	(1,479)	2,331	3,232	8,201	12,713	46,272	43,727
Borders College	(697)	(1,711)	307	332	4,018	4,199	0	0
City of Glasgow College	(4,145)	(4,196)	73	(469)	12,250	14,987	134,538	129,290
Dumfries and Galloway College	(1,922)	(2,137)	14	(70)	1,923	2,169	0	61
Dundee and Angus College	(2,172)	(2,054)	2,164	(1,450)	5,853	6,248	3,179	2,726
Edinburgh College	(6,593)	(8,081)	884	(134)	5,289	5,494	8,949	8,408
Fife College	(4,425)	(1,141)	1,609	1,425	11,588	15,234	5,106	3,579
Forth Valley College	(963)	(4,662)	2,217	616	4,420	5,500	3,378	3,185
GCRB	61	(131)	151	4	2,984	2,676	0	0
Glasgow Clyde College	(4,068)	(3,873)	572	787	8,535	10,433	0	0
Glasgow Kelvin College	(2,231)	(1,404)	876	1,092	3,783	4,157	227	227
UHI Inverness	259	(1,474)	1,854	427	6,204	7,496	36,409	35,589
UHI Outer Hebrides	(197)	(1,589)	615	(479)	365	290	0	0
UHI Moray	(852)	(783)	(15)	0	1,795	1,540	302	251
New College Lanarkshire	(7,317)	(6,640)	(1,689)	(1,432)	10,874	7,367	0	0
North East Scotland College	(908)	(2,689)	2,332	468	6,517	9,198	0	0
UHI North Highland	(667)	(1,739)	659	(252)	586	1,132	1,147	1,076
UHI Perth	(1,587)	(2,292)	1,050	309	3,803	3,625	8	4
South Lanarkshire College	356	(1,204)	1,604	1,078	3,473	3,628	0	0
West College Scotland	(5,738)	(6,294)	223	512	8,776	12,826	1,420	1,088
West Lothian College	(1,742)	(2,636)	738	(81)	2,749	2,829	2,211	2,211
Total incorporated colleges	**(46,630)**	**(58,209)**	**18,569**	**5,915**	**113,986**	**133,741**	**243,146**	**231,422**
Non-incorporated colleges								
UHI Argyll	966	377	1,288	908	4,991	5,406	0	0
Newbattle Abbey College	(51)	(101)	108	82	1,361	330	16	0
UHI Orkney	(511)	(784)	37	367	n/a	n/a	n/a	n/a
SMO	101	97	101	97	1,179	888	509	453
UHI Shetland	(973)	(1,863)	(973)	(657)	n/a	369	n/a	0
UHI West Highland	190	365	190	490	1,390	704	384	311
Total non-incorporated colleges	**(278)**	**(1,909)**	**751**	**1,287**	**8,921**	**7,328**	**909**	**764**
Sector total	**(46,908)**	**(60,118)**	**19,320**	**7,202**	**122,907**	**141,438**	**244,055**	**232,186**

Annex B: College Regions

The college sector in Scotland comprises 19 incorporated colleges and five non-incorporated colleges, organised into 13 college regions[4]. Ten of these regions consist of one college. The three remaining regions (Glasgow, Highlands & Islands, and Lanarkshire) have more than one college. The individual colleges in Glasgow and the Highlands & Islands are assigned to the relevant Regional Strategic Body: Glasgow Colleges' Regional Board or University of the Highlands & Islands (UHI)[5]. In Lanarkshire, New College Lanarkshire is the Regional Strategic Body and South Lanarkshire College is assigned to the Lanarkshire Board. Details of all regions and colleges are set out on the next page.

Fundable bodies in the college sector can be incorporated or non-incorporated. Before the Further & Higher Education (Scotland) Act 1992, almost all publicly funded colleges in Scotland were run by local authorities. In 1993, most of these colleges were established with boards of management constituted under the 1992 Act. Colleges with a board of management constituted under the 1992 Act are commonly referred to as incorporated colleges. Incorporated colleges were reclassified as arms-length central government bodies in 2014 and are subject to Government budgeting and accounting requirements and are required to comply with the Scottish Public Finance Manual.

The 1992 Act does not govern the non-incorporated colleges which take a number of different legal forms and/or have differing constitutional arrangements. One non-incorporated college, UHI Orkney, is run by its local authority.

Photo: Glasgow Kelvin College

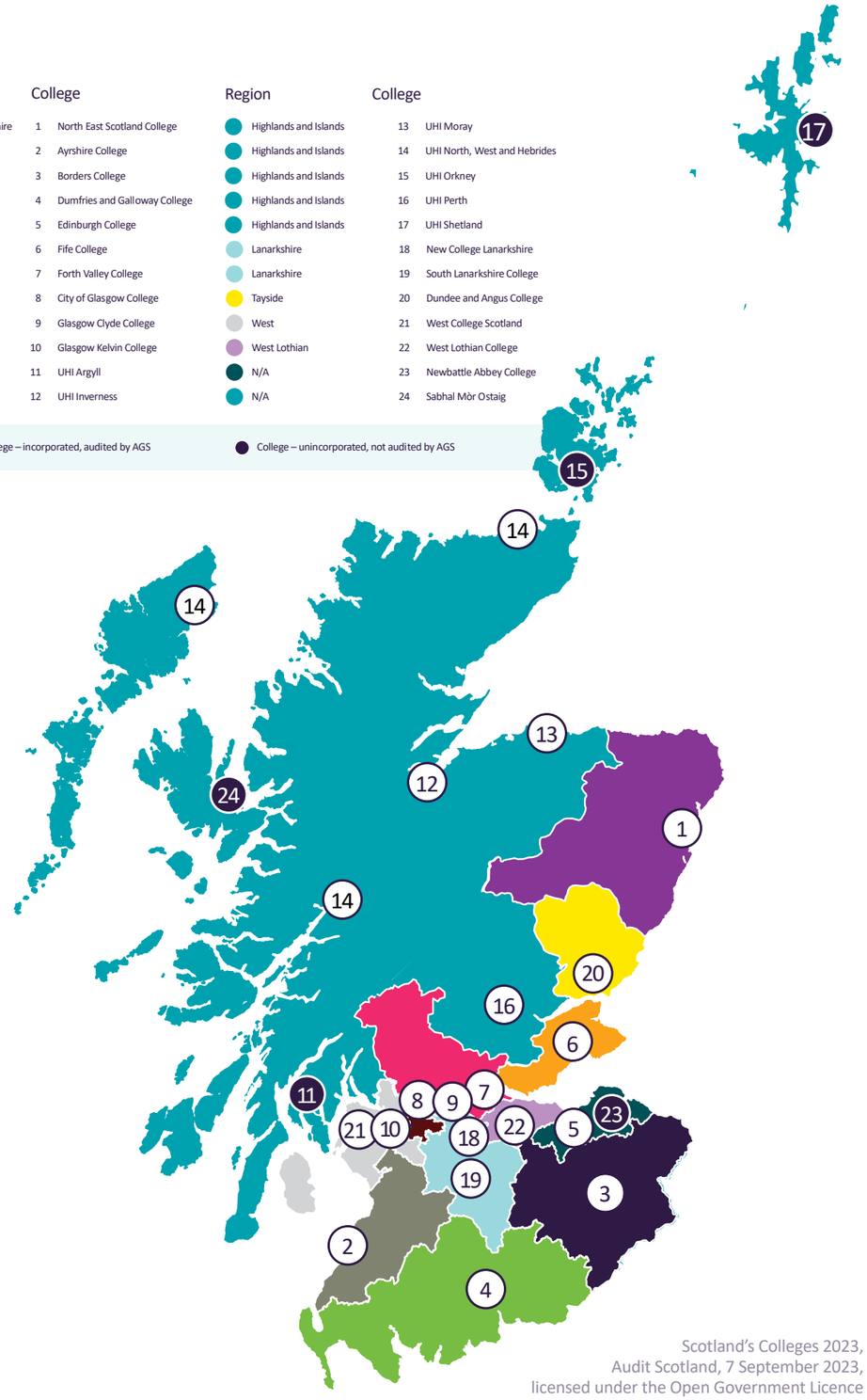
4 UHI Outer Hebrides, UHI North Highland and UHI West Highland merged to become UHI North, West and Hebrides from 1 August 2023.

5 Five colleges (UHI Argyll, UHI Inverness, UHI Moray, UHI Orkney and UHI Perth) are currently assigned to UHI with UHI Shetland and UHI North, West and Hebrides due to be assigned in due course.

Annex C:

Region	College		Region	College	
Aberdeen and Aberdeenshire	1	North East Scotland College	Highlands and Islands	13	UHI Moray
Ayrshire	2	Ayrshire College	Highlands and Islands	14	UHI North, West and Hebrides
Borders	3	Borders College	Highlands and Islands	15	UHI Orkney
Dumfries and Galloway	4	Dumfries and Galloway College	Highlands and Islands	16	UHI Perth
Edinburgh and Lothians	5	Edinburgh College	Highlands and Islands	17	UHI Shetland
Fife	6	Fife College	Lanarkshire	18	New College Lanarkshire
Central	7	Forth Valley College	Lanarkshire	19	South Lanarkshire College
Glasgow	8	City of Glasgow College	Tayside	20	Dundee and Angus College
Glasgow	9	Glasgow Clyde College	West	21	West College Scotland
Glasgow	10	Glasgow Kelvin College	West Lothian	22	West Lothian College
Highlands and Islands	11	UHI Argyll	N/A	23	Newbattle Abbey College
Highlands and Islands	12	UHI Inverness	N/A	24	Sabhal Mòr Ostaig

○ College – incorporated, audited by AGS ● College – unincorporated, not audited by AGS



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Audit Scotland, 7 September 2023,
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Annex D: College adjusted or underlying operating position

The underlying operating position is a better indicator of colleges' operational cash generative capacity.

The adjustments to the operating position to give the underlying operating position for the colleges have two purposes:

- Smooth the volatility in reported results arising from the FRS 102 accounting standard; and
- Recognise some of the reported costs do not have an immediate cash impact.

The reported operating surplus/(deficit) figures have been adjusted for:

- Depreciation net of deferred capital grant (incorporated colleges only).
- Exceptional non-restructuring costs (impairments and lease dilapidation costs).
- Non-cash pension adjustments.
- Donations to arms-length foundations (ALFs) (incorporated colleges only).
- Non-Government capital grant (e.g. ALF capital grant).
- Exceptional income.
- Loan repayments (incorporated colleges only).
- Non-Profit Distributing Project (NPD) income applied to reduce NPD debt.

Cover Photos:

Dundee and Angus College

UHI Perth

UHI Moray

Glasgow Clyde College

Edinburgh College

Scottish Funding Council
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