College Accounts

Learning+Skills Council

Executive Summary

Date: February 2002

Subject: Summary information extracted from college accounts for the year ended 31 July 1999

Intended Recipients: This is of interest to college principals and chairs of corporations

Status: For information

Content: The document is set out as follows:

Summary information on the financial performance of sector colleges for the financial year ended 31 July 1999.

Annex A – Comparative information on key financial indicators for the sector from 1993-94 to 1998-99

Appendix 1 to Annex A – Definitions of financial health groups

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College Accounts

Introduction

1 This report contains summary information extracted from college accounts for the year ended 31 July 1999. Similar information for the financial periods ended 31 July 1994 to 31 July 1998 was included in the Further Education Funding Council (FEFC) circulars 95/30, 96/29, 97/35, 98/43 and 00/10.

2 The publishing of this report was unfortunately delayed due to the transition from the FEFC to the Learning and Skills Council (the Council). A further report in respect of financial information derived from the financial statements for the year ending 31 July 2000 is planned to be produced by the spring of 2002, and subsequent reports will be published directly from data held within colleges' finance records, without prior reference back to colleges. Further information on this will be issued in due course.

3 The financial health of colleges is assessed in relation to their solvency and their ability to implement the financial aspects of their strategic plan. Definitions of financial health groups are given in appendix 1 to annex A.

Financial Health of the Sector

4 An analysis of the data published in respect of financial statements up to 31 July 1997 indicated that the financial health of colleges in the sector deteriorated each year since incorporation. This year (that is 1998-99), for the second time, the audited financial statements indicate an improvement in the overall financial health of the sector compared to the previous year. Some of the figures present a mixed picture however. For example, although the number of colleges in poor financial health has decreased, the amount of overall surplus has fallen to just £1 million and the sector average for solvency (as measured by the current ratio) has fallen slightly from 1.7:1 to 1.6:1.

5 The improvement in the financial health of the sector has resulted in a reduction in the number of colleges assessed as financially weak and which are, or may become, dependent on the goodwill of others (group C). However, there are a considerable number of colleges that are still considered financially weak, and which give cause for concern. The number of colleges in this position reduced from 80 at 31 July 1998 to 70 at 31 July 1999. *However, at the time of writing the number of colleges in financial health group C has increased to over 80. Future reports on the financial performance of colleges may not therefore present such a positive improvement as this report does*.

6 The improvement in the financial health of colleges in the sector is also evidenced by reductions in the number of colleges with operating deficits and negative reserves, and an increase in the level of general reserves held.

7 A number of reasons can be identified for the overall improvement in the financial health of colleges in the sector which include additional resources made available, the rationalisation of the sector resulting in improved efficiencies, the action taken by colleges in weak financial positions to develop and implement recovery plans, and the merger of some financially weak colleges with stronger colleges.

Financial Details

8 A summary of the information extracted from college accounts is attached at annex A to this report.

9 Summary information for college accounts is available on the Council's website (www.lsc.gov.uk). The information can be used to assist colleges in making benchmarking comparisons.

Annex A: College accounts 1998-99

Background

1 Under the terms of the financial memorandum between colleges and the Council, colleges are required to produce audited accounts within five months of the financial year end, that is by 31 December 1999, for the 1998-99 financial year. By the due date the Council had only received 35% of audited returns, although many returns were received in the first week of January 2000. In the 1997-98 financial year 66% of colleges produced audited accounts by the due date (31 December 1998).

2 The Council has now received finance records from 419 colleges from the 433 returns expected, equivalent to 97% return rate. Fourteen colleges are currently in breach of their financial memorandum with the Council.

3 Colleges are required to make their audited accounts available to members of the public. This report and the associated financial information on the Council's website are part of the effort to encourage openness and accountability.

Summary

4 Whilst the financial health of the sector continues to show weakness in some areas, the overall position shows an improvement (albeit small) on the previous year. This is the second year in a row that there has been an improvement.

5 Colleges are asked to carry out a self-assessment of their financial health and to state in which of three financial health groups they believe their college falls. The Council carries out an independent assessment of each college's financial health to verify the college's self-assessment. The key characteristics of the three groups are set out in appendix 1 to this annex. The number of colleges assessed as falling into financial health group C, that is a college that is considered financially weak, has fallen. However, on the basis of 1998-99 finance record data, 16% of colleges are still in financial health group C. An analysis of the financial health assessment of colleges is shown in table 1.

Table 1. Financial health groups of sector

	1994	1995	1996	1997	1998	1999
Group A	309 (70%)	257 (57%)	206 (46%)	197 (44%)	213 (49%)	250 (58%)
Group B	106 (24%)	135 (30%)	148 (33%)	151 (34%)	142 (33%)	113 (26%)
Group C	25 (6%)	60 (13%)	93 (21%)	96 (22%)	80 (18%)	70 (16%)

Source: assessed financial health groups for colleges after the financial statements for the period ending in that year were evaluated.

6 The improvement in the financial health of the sector can be evidenced in the following areas:

- an increase in the proportion of financial health group A colleges from 49% to 58%
- a decrease in the proportion of colleges in financial health group C from 18% to 16%
- an increase in the percentage of income from non Council sources from 28.3% to 29.3%
- a reduction in pay costs (excluding restructuring) from 64% as a percentage of income to 63%
- a reduction in colleges with an operating deficit from 186 to 176
- a increase in the level of accumulated reserves from 14.6% as percentage of income to 16.5%
- a reduction in colleges with an accumulated deficit from 50 to 39
- an increase in cash days from 55 to 64; and
- a reduction in colleges with less than 25 cash days from 109 to 85.

7 However, the above positive factors also need to take into account the fact that:

- the average current ratio has fallen from 1.7:1 to 1.6:1; and
- the number of colleges with current ratios that are less than 1:1 has increased from 79 to 84.

8 Key accounting ratios for the sector have been calculated from the data provided by colleges. These accounting ratios may be used by colleges to compare their performance against the sector and against similar colleges. Comparative data for 1997-98 has been updated to reflect returns made by colleges since FEFC circular 00/10 was published.

Income

9 The total income for the sector for the year ended 31 July 1999 was £4.1 billion. This represents an increase of some £173 million on the 1997-98 financial year.

Grant income

10 Colleges generate the majority of their income from public funds, including those from the Council. The Council remains the major source of income for the sector, providing approximately 71% of total income. Other public sources of income include training and enterprise councils, european funding and local education authorities.

Diversification of Income

11 Colleges are encouraged to increase their income from other sources so that they become less reliant on the Council, the major source of income for the vast majority of colleges.

12 The diversity of income is measured by the income derived from sources other than the Council. The trend since incorporation is shown in table 2.

Table 2. Diversity of income

	1994	1995	1996	1997	1998	1999
Percentage of income from non-Council sources	32.6	30.1	26.7	26.4	28.3	29.3

Source: College Finance Records for each financial period.

13 Table 2 shows that the percentage of non-Council income received by colleges in 1998 increased after successive declines since incorporation. The major reason for the decrease in diversity in the early years following incorporation was as a result of the switch of work related further education funding from training and enterprise councils to the Council. The increase in diversity in later years is a result of increases in income generated from tuition fees and other income generating activities.

14 The diversity of income varies according to the type of institution. Further details on sector diversity are set out in paragraphs 30 to 44 of this annex.

Expenditure

15 Colleges should aim at least to break even at the operating level so that resources can be generated for reinvestment within the college. A college may sustain an operating deficit for one or two years but a prolonged period of operating deficits may lead to a decline in its financial health. Colleges, therefore, need to closely control expenditure so that, as a minimum, it is balanced by income.

Pay

16 For the sector as a whole, the majority of colleges' income is expended on staff resources. Details on the trend of pay costs as a percentage of income since incorporation are shown in table 3 below.

17 Table 3 shows that the percentage expenditure on pay excluding staff restructuring has fallen in 1998-99. This reduction appears to be the result of previous staff restructuring undertaken by colleges and as a result of increases in income without comparable increases in expenditure, that is improved productivity.

Operating Position

18 As indicated in paragraph 15 to this annex, colleges are expected to break even on an operating basis from year to year. Details of the operating position for the sector are shown in table 4.

Table 3. Pay expenditure as a percentage of income

	1994	1995	1996	1997	1998	1999
Including restructuring costs sources (%)	68	71	71	67	64	64
Excluding restructuring costs (%)	66	69	68	65	64	63

Source: College Finance Records for each financial period.

Table 4. Comparison of the operating position for the sector for year ended 31 July

	1994	1995	1996	1997	1998	1999
Total operating surplus/ (deficit) £ million	(6)	(122)	(123)	(29)	34	1
Surplus/(deficit) as a percentage of income %	(0.2)	(3.5)	(3.4)	(0.8)	0.9	0.0
Number of colleges with an operating deficit	204	266	266	207	186	176

Source: College Finance Records for each financial period.

19 Table 4 shows that the sector generated an operating surplus for the second time since incorporation, albeit a very marginal one, and the number of colleges that have generated an operating deficit has also fallen to its lowest level since incorporation. However, 42% of colleges have generated an operating deficit in 1998-99 and this is of continuing concern. It should also be noted that some colleges have not yet submitted finance records for this period and that the above position may be over-stated.

Reserves

20 Whilst the value of general reserves shown in a college's balance sheet is indicative of a college's financial performance over time, it is less meaningful as a measure of a college's financial health. The major factor to consider in assessing a college's financial strength is its solvency, that is, its ability to meet its liabilities as they fall due. A number of colleges have relatively strong reserves, but poor levels of solvency, the principal cause of which is the purchase of fixed assets from working capital.

21 Colleges are encouraged to consider a mix of financing in capital developments to ensure that a sufficient level of working capital is maintained to support ongoing operations and future investments. Over a period of time a college would be expected to generate reserves to fund future investment within the college.

22 The trend for the balance on accumulated general reserves for the sector is set out in table 5.

Table 5. Accumulated general reserves for the sector

	1994	1995	1996	1997	1998	1999
Accumulated balances (£ million)	250	276	309	402	545	644
Accumulated balance as a percentage of income %	7.6	7.9	8.6	10.8	14.6	16.5
Number of colleges with negative reserves	55	73	81	67	50	39

Source: College Finance Records for each financial period.

23 Table 5 shows that the accumulated surpluses within the sector have increased and the number of colleges with an accumulated deficit has fallen to its lowest level since incorporation.

Solvency

24 Two main ratios are used by the Council to indicate a measure of the solvency of the sector and individual colleges. These are the current ratio and the number of cash days in hand.

25 The Council has advised colleges that they should aim for a current ratio of 1.5:1 or above. A ratio of 1.5:1 will provide a margin of security to a college in meeting its liabilities as they fall due. Colleges may be able to operate safely on current ratios below 1.5:1 in some circumstances.

26 The trend for the sector for the current ratio is set out in table 6 below.

27 The current ratio for the sector indicates that the sector's overall solvency remains above 1.5:1, but only marginally. It is disappointing that the previous year's significant reduction in the number of colleges with current ratios below 1:1 has been largely reversed.

28 The number of cash days in hand is a measure of the cash that a college has available to meet its liabilities. A college in financial health group A would normally have at least 25 cash days in hand. The funding profile for colleges is such that July (the month at which the ratio is determined) is likely to be the month with the lowest cash balance for most colleges. The trend for the sector for this ratio, since incorporation, is set out in table 7.

Table 6. Comparison of the current ratio for the sector for the year ended 31 July

	1994	1995	1996	1997	1998	1999
Current ratio for the sector	1.8	1.7	1.5	1.7	1.7	1.6
Number of colleges with ratio below 1:1	53	69	89	86	79	84

Source: College Finance Records for each financial period.

Table 7. Comparison of cash days in hand for the sector for the year ended 31 July

	1994	1995	1996	1997	1998	1999
Cash days in hand for the sector	38	46	42	46	55	64
Number of colleges with less than 25 cash days in hand	98	121	149	129	109	85

Source: College Finance Records for each financial period.

29 Whilst this ratio shows improvement in the solvency of the sector, the number of colleges with fewer than 25 cash days in hand still represents approximately one fifth of the sector. The inconsistency between an improvement in cash days and a decline in the current ratio can be explained primarily by improved cash management regimes within colleges.

Comparison of Sector Types

30 The above tables indicate the financial performance for the sector as a whole. However, an analysis of the data for the various college types within the sector shows that the financial performance across the sector is not consistent. Accounting ratios for the four main college types are shown in table 8.

Table 8. College ratios by type for year ended 31 July 1999

	Agriculture and horticulture	Art, design and performing arts	General FE and tertiary	Sixth form college
Current ratio	2.0	2.0	1.9	3.4
Cash days in hand	40	70	61	88
Operating surplus/(deficit) income %	(1.8)	0.3	(0.3)	1.7
General reserve/income %	22.6	20.0	14.7	26.2
Pay expenditure/income %	55.3	62.4	63.5	70
Income from non-Council sources %	52.2	47.1	28.8	10.2

Source: College Finance Records for each financial period.

31 The table shows that the solvency of sixth form colleges, which are more dependent on the Council for income than the rest of the sector, is the highest whilst agriculture and horticulture colleges have the weakest solvency. One major factor for the lower cash days in hand of agriculture and horticulture colleges is that these colleges maintain considerably higher levels of stock than other types of colleges.

32 Pay expenditure is proportionately lower in agriculture and horticulture colleges as these colleges incur expenditure and generate significant levels of income from the operation of farming and horticultural activities.

33 Details of the trend in accounting ratios for the individual college types, since incorporation, are set out in the following paragraphs.

Agriculture and horticulture colleges

34 Table 9 shows the accounting ratios for agriculture and horticulture colleges since incorporation.

35 Table 9 shows that the financial health, as measured by the solvency ratios, of agriculture and horticulture colleges is still marginally weaker than at incorporation, but that there has been a slight improvement since 1998.

36 One factor that has influenced the financial health of agriculture and horticulture colleges is that they were generally funded at higher than average levels of funding (ALF) compared to the sector as a whole and, therefore, faced much greater reductions in ALF as a result of convergence.

Art, design and performing arts colleges

37 Table 10 shows the accounting ratios for art, design and performing arts colleges since incorporation.

Table 9. College ratios for agriculture and horticulture colleges for year ended 31 July

	1994	1995	1996	1997	1998	1999
Current ratio	2.4	2.0	1.9	1.9	1.9	2.0
Cash days in hand	N/A	43	34	41	35	40
Operating surplus/(deficit) income %	1	(2)	(2)	(2)	(3)	(2)
General reserve/income %	17	20	21	22	23	23
Pay expenditure/income %	51	54	55	55	55	55
Income from non-Council sources %	45	53	52	53	52	52

Source: College Finance Records for each financial period.

Table 10. College ratios for art, design and performing arts colleges for year ended 31 July

	1994	1995	1996	1997	1998	1999
Current ratio	2.0	2.1	2.7	1.7	2.0	2.0
Cash days in hand	N/A	71	79	54	65	70
Operating surplus/(deficit) income %	1	1	(2)	(4)	0	0
General reserve/income %	11	16	11	13	17	20
Pay expenditure/income %	63	64	69	68	64	62
Income from non-Council sources %	44	47	45	42	43	47

Source: College Finance Records for each financial period.

38 The table shows that the financial health of art, design and performing arts colleges has improved in 1998-99. The level of general reserves being held has increased significantly since incorporation. Pay expenditure has reduced over the last three years and diversity of income has also significantly increased. This demonstrates that colleges have taken significant action to properly manage their financial position, despite the fact that only an overall break even position is shown.

39 Art, design and performing arts colleges have faced similar pressures in the reduction in ALF, although not to the same extent as agriculture and horticulture colleges.

General further education and tertiary colleges

40 Table 11 shows the accounting ratios for general further education and tertiary colleges since incorporation.

Table 11. College ratios for general further education and tertiary colleges for year ended 31 July

	1994	1995	1996	1997	1998	1999
Current ratio	1.7	1.6	1.4	1.6	1.9	1.9
Cash days in hand	N/A	44	39	44	52	61
Operating surplus/(deficit) income %	(1)	(4)	(4)	(1)	1	0
General reserve/income %	6	7	7	9	13	15
Pay expenditure/income %	68	72	71	67	64	64
Income from non-Council sources %	34	31	27	27	28	29

Source: College Finance Records for each financial period.

41 Table 11 shows continuing improvements in the financial position of general further education and tertiary colleges, albeit not to the same extent as in 1997-98. These colleges also made a small operating loss in 1998-99.

42 The improvement in the financial health of general further education and tertiary colleges since 1995-96 reflects the trend for the sector. Factors for this improvement include the impact of developing and implementing recovery plans by those colleges in a weak financial position and the merger of a number of institutions with financially healthier colleges.

Sixth form colleges

43 Table 12 shows the accounting ratios for sixth form colleges since incorporation.

44 Table 12 shows that the financial health of sixth form colleges has improved each year and that the reliance on Council income has fallen each year since incorporation. The only exception to this trend is in respect of sixth form colleges' current ratios, where there has been a decrease. However, the overall position of 3.4:1 is still well above the financial health group A threshold.

Table 12. College ratios for sixth form colleges for year ended 31 July

	1994	1995	1996	1997	1998	1999
Current ratio	2.4	2.3	2.5	2.8	3.7	3.4
Cash days in hand	N/A	67	64	68	82	88
Operating surplus/(deficit) income %	2	0	0	0	1	2
General reserve/income %	12	15	17	21	24	26
Pay expenditure/income %	69	74	74	72	71	70
Income from non-Council sources %	6	7	8	8	9	10

Source: College Finance Records for each financial period.

Appendix 1 to Annex A: Definitions of financial health groups

The definitions stated here have been taken from the Council's circular *01/01 Strategic Plans, Including Financial Forecasts and Accommodation Data*. The definitions in use when the financial statements were required to be submitted were included in FEFC circular *99/25 Strategic Plans Including Financial Forecasts*.

Group A

1 Providers that appear to have sufficiently robust finances to implement their strategic plan and to deal with the circumstances which are most likely to occur during the planning period.

2 These providers will normally have:

- a positive cashflow from operations each year
- more than 25 days cash in hand
- a current ratio above 1.5:1
- a positive balance on their general reserve (income and expenditure account)
- an operating surplus year on year; and
- total borrowing less than 50% of their general reserve (income and expenditure account).

3 These providers will also have carried out a rigorous sensitivity analysis and modelled the issues which are most critical to their success. They will also have identified contingency plans to deal with the most adverse variances.

Group B

4 Providers that show signs of financial weakness which might limit their ability to implement their strategic plan if they encounter adverse circumstances during the planning period.

5 Providers in this group are likely to have weaker solvency than those in group A but should still have:

- a positive cashflow from operations each year
- more than 15 cash days in hand
- a current ratio between 1.0:1 and 1.5:1
- a positive balance on their general reserve (income and expenditure account)
- operating position at break even; and
- total borrowing no greater than their general reserve (income and expenditure account).

6 In addition, this group also covers those providers that may appear to have features similar to those for group A but whose assumptions appear either over-ambitious or optimistic. For example, some providers in group B are planning significant efficiency savings without having robust plans to achieve those savings. Some providers may have included income generation without a supporting business plan. In addition, this group also includes providers that are improving from a group C position.

Group C

7 Providers that are financially weak and which are, or may become, dependent on the goodwill of others. This might involve, for example, a loan from their bank for solvency purposes.

8 Providers in this position are likely to have:

- a cash outflow from operations in one or more years
- less than 15 cash days in hand
- net current liabilities (current ratio less than 1.0:1) in one or more years
- an accumulated deficit on their general reserve account
- an operating deficit; and
- total borrowing in excess of their general reserve (income and expenditure account).

Reference REP/0167/02