

Cylchlythyr | Circular

Financial position of higher education institutions in Wales: 2015/16 financial results

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Principals of directly-funded further education colleges in Wales
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This circular provides an overview of the financial position of higher education institutions in Wales. The analysis covers the financial results for the year ended 31 July 2016.

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Introduction

1. This circular provides an overview of the financial position of higher education institutions in Wales. The analysis covers the financial results for the year ended 31 July 2016 (2015/16). The information in this circular has been presented in a similar format to the Financial Health report published by the Higher Education Funding Council for England (HEFCE) for the higher education sector in England and the financial information presented in the tables within this circular are comparable to the equivalent tables published by HEFCE.

Background

2. Financial Reporting Standard (FRS) 102 is the new financial reporting framework for higher and further education providers for reporting periods starting on or after 1 January 2015, and introduces some significant changes in the way financial performance is reported.
3. The financial results for 2015/16 presented in this circular are consistent with the new standard and the comparative financial information for 2014/15 has been restated under FRS102. The new financial reporting framework makes it difficult to compare financial results between institutions and against historical trends. Transitional changes reflected in the restated 2014/15 results also make this an atypical year.
4. It is apparent, from the latest financial forecasts received in July 2017, that a number of institutions and the sector overall are anticipating financial deficits until the funding expected from the implementation of the recommendations of the Review of Higher Education and Student Finance Arrangements in Wales (led by Sir Ian Diamond) starts to be received by institutions from 2019/20 onwards. This, and the increased volatility of financial reporting of income under FRS102, show significant variability in surpluses / deficits, both in the results for 2015/16 and throughout the forecasts. These forecasts will not reflect the Welsh Government's decision not to increase Full-Time Undergraduate Fees above £9,000.

Financial results

5. The financial results for the higher education sector in 2015/16 show a financially mixed position overall. Annexes A to C present the financial information for the Welsh Higher Education Institutions in more detail.
6. The sector reported a surplus before other gains and losses and the share of surplus or deficit in Joint Ventures and associates of £74.8 million (5.0 per cent of total income), compared with a deficit of £(5.5) million ((0.4) per cent of total income) in 2014/15. The sector surplus for 2014/15 as reported under the previous financial reporting framework (UKGAAP) was £60.9 million.

7. Some significant transitional accounting changes were introduced as a result of FRS102, such as the increase in pension provisions for the sector's multi-employer pension schemes that reduced sector surpluses in 2014/15 by £35 million. If these transitional changes were excluded, the underlying increase in 2015/16 surpluses would be much lower. In addition the impact of the changes in income recognition for Capital grants introduced by FRS102 have significantly increased the sector surplus in 2015/16 by £54.7 million and which will influence the forecasts for future years; however, the amount of capital grant income reported for 2015/16 is not expected to be maintained in future years.
8. At an institutional level, the financial performance for 2015/16 results ranges from a deficit of 7.3 per cent of total income to a surplus of 17.5 per cent of total income.
9. Three institutions reported deficits in 2015/16, compared with four institutions in 2014/15. Three institutions reported surpluses of 5% or more of total income. These surpluses were increased due to significant capital grants recognised as income in the year. The capital grants for these institutions contributed £48.8 million to the sector surplus.
10. Cash flow from operating activities increased from 7.1 per cent in 2014/15 to 7.7 per cent of total income in 2015/16. However, unrestricted reserves fell from £878 million (61.2 per cent of income) to £854 million (56.7 per cent of total income) and total net assets fell from £1,562 million to £1,519 million.
11. Total income from research grants and contracts fell 5.5 per cent in 2015/16 compared with 2014/15. However, 2014/15 income was boosted by an estimated £15 million from Research and Development Expenditure Credits from HM Revenue and Customs, which fell to £2 million in 2015/16, with the 2015/16 figure relating to residual claims following closure of the scheme to universities (see Annex A Paragraph 14). Excluding this, the data shows that overall research income remained almost static at £206.7 million in 2015/16.
12. Total fee income from overseas (non-European Union (EU)) students amounted to £150 million in 2015/16; 4.5 per cent higher than the level reported in 2014/15. This fee income from overseas (non-European Union (EU)) students accounted for 10 percent of total income in 2015/16. Increasing competition from other countries and proposed changes to student immigration rules suggest that maintaining this level of income growth from overseas students may be difficult.

Student recruitment 2016-17 and 2017-18

13. Data from the Higher Education Students Early Statistics (HESES) survey for the 2016/17 academic year indicates a 6.0 per cent increase in the

number of FT undergraduate/PGCE entrants (home and EU). 2016/17 HESES data also indicates a continuing decline in part-time undergraduate total registrations (23,924 to 21,903).

14. For the 2017 cycle, the UCAS application data (Applications to Welsh institutions at the June Deadline 2017) highlights a 5 per cent decline in Welsh applications, an 8 per cent decline in other UK applications and a 5 per cent decline in EU applications, relative to the same point in the previous cycle.
15. UCAS application data for the 2017 cycle indicates that overseas applications have reduced by 5% compared to the same point in the previous year's cycle.
16. In July 2016 the sector forecast an increase in overseas students between 2015/16 and 2016/17. However, the data and indicators taken together suggest an overconfidence by the sector in student number forecasts

Capital investment

17. Cash flow expenditure on fixed assets in 2015/16 totalled £150.8 million, a decrease of 17.4 per cent compared with 2014/15. It should be noted that the bulk of this investment was driven by four institutions which contributed 84 per cent of the sector's capital expenditure. Three institutions reported lower expenditure in the period.
18. Capital expenditure as a percentage of total income varied considerably at an institutional level, ranging from 0 to 13.6 per cent.
19. Whilst capital investment overall is forecast to continue to grow in response to the requirements of the student experience and research and innovation infrastructure, the latest estimate for all the Wales institutions is that they still need to invest £168 million¹ in their non-residential estate to restore it to a sound baseline condition. Inflationary pressures on the cost of construction are likely to push this figure higher.
20. In order to fund the forecast capital expenditure the Welsh Higher Education Institutions (HEIs) committed to new borrowing of £353 million during 2015/16, approximately £300 million of which was raised by Cardiff University through a bond issue. Capital grant receipts of £54 million were reported in 2015/16 (2014/15: £18 million). Including service concessions and obligations under finance leases, long-term borrowings have risen in the year from 21.8% of income to 47.4% of income, with significant increases recorded at Cardiff University (see above), Bangor University, Swansea University and the University of Wales Trinity Saint David.

¹ HESA Estate Record

21. Without increased surpluses and continued government support, there is a risk that Welsh HEIs will be unable to maintain the scale of investment required to meet rising student expectations, build capacity for growth and ensure that they can remain internationally competitive. Government support also fosters confidence among other investors to continue to invest in the sector, including banks' willingness to lend money. Welsh HEIs' capacity to lever in funding from other sources, including additional borrowing, is limited and may not be sufficient on its own to meet the sector's long-term investment needs.

Liquidity and borrowing

22. Long-term external borrowings and obligations under finance leases and service concessions have increased by 228 per cent; from £312 million at 31 July 2015 to £714 million at 31 July 2016. This is a significant increase and equates to a borrowing level of 47.3 per cent of income. Long-term borrowings alone were £511 million at 31 July 2016 (£199 million at 31 July 2015), which was 33.9% of income (Long-term borrowings for the HE sector in England were 31.2% of income at 31 July 2016). As highlighted above, Cardiff University's bond issue accounts for £300 million of this increase. There was also an increase in the liquidity days' ratio, which increased from 120 days of expenditure to 194 days over the same period. Again, much of this increase was due to the fact that Cardiff University received the entire bond proceeds during the year but had spent only £69m on capital projects by the end of July 2016. Most other institutions reported modest increases in liquidity days, with two institutions showing a small reduction. The Welsh HEIs' net cash position (liquid funds less borrowing) fell from £128.7 million at 31 July 2015 to a net debt position of £(21.0) million at 31 July 2016.
23. The liquidity data is taken as a snapshot of bank and investment balances, as at 31 July. The main period of capital spending at most institutions happens during the summer months, after 31 July; therefore the available cash, not committed to future capital spending, is likely to be much lower.

Reserves and pension deficits

24. Reserves are an HEI's total assets less its liabilities and, in very broad terms, can be used as a proxy for the overall value of an institution. These are the accumulated surpluses of an institution over its lifetime and most of these surpluses have been invested in fixed assets used by the University such as land, buildings and capital equipment. Reserves are not the same as cash, although an institution could dispose of an asset if it was surplus to operational requirements (thereby converting it to cash).
25. Under the new financial reporting framework, reserves are categorised as either restricted or unrestricted. Unrestricted income and expenditure reserves represent the value of the institution's accumulated funds through

surpluses reported in an HEI's income statement, where there are no restrictions on the use of funds.

26. After taking into account pension liabilities, the sector reported unrestricted reserves of £854 million, equivalent to 56.7 per cent of total income. This represents a fall from the previous year, where reported reserves were £878 million (61.2 per cent of total income). The aggregate position masks a significant spread and a concentration of large unrestricted reserves in a small number of institutions, with four institutions reporting 84 per cent of the Welsh HEIs' total reserves.
27. Under FRS102, reported pension deficits are much higher, with liabilities relating to the deficit recovery plans for the sector's multi-employer pension schemes now reflected in institutional balance sheets. As a result of the transition to FRS102, pension liabilities reported by the sector rose from £275 million (under the UK GAAP, the previous financial reporting standard) to £397 million (under FRS102) at 31 July 2015.
28. Reported pension liabilities increased significantly again in 2015/16 to reach £541 million at 31 July 2016 (a rise of 36.1 per cent). The pension provision was also 44.2 per cent higher than pension liabilities forecast by the sector last year, indicating that earlier projections underestimated the scale of increased pension deficits.
29. The sector's largest multi-employer pension scheme is the Universities Superannuation Scheme (USS), with the great majority of current staff working in HEIs that were universities before 1992 being members of this scheme.
30. A complex mix of factors is contributing to the growing pension deficits across the sector, not least the prevailing economic conditions and the performance of asset investments. The latest interim valuation of the USS scheme shows that the scheme ended the year with a net deficit of £12.6 billion (as at March 2017), compared with the previous year, where the deficit was valued at £10.0 billion (as at March 2016), demonstrating the significant level of volatility in these valuations. The next full triennial valuation was due in 2017.
31. The results of the revaluation of Local Government Pension Schemes (LGPS) as at 31 March 2016, are also expected to show an increase in the LGPS deficit. With nearly 20 per cent of the sector's employer contributions paid to these LGPS schemes, an increase in the deficit may lead to increases in employer costs, placing significant financial pressures on HEIs participating in these schemes too.

Financial outlook

32. The Welsh HEIs have had to adapt to a more competitive and uncertain environment, but there are significant challenges ahead.

33. The growing uncertainties and increased competition faced by the sector will inevitably lead to a greater focus from investors on the underlying financial strength of individual HEIs. Consequently, any fall in confidence levels could restrict the availability of finance in the sector and put significant elements of the investment programme at risk. Falling confidence levels are also likely to lead to a rise in the costs of borrowing.
34. Based on the financial results for the year ended 31 July 2016 our view is that the sector's financial position is currently sound overall but with increasing variability in the performance of individual HEIs. However, risks are growing in relation to EU, international and home recruitment and in relation to inflationary cost pressures such as rising construction costs. Pension liabilities also look set to rise across the sector following outcomes of triennial reviews of two of the sector's major pension schemes: USS and LGPS. The sector faces some significant uncertainties arising from Britain's forthcoming exit from the European Union, the full impact of which is not yet known. We expect the Welsh HEIs' financial results for the next financial year 2016/17, and forecasts for subsequent years, to reflect lower financial surpluses, and deficits in some cases, as well as lower future fee income growth projections.

Further information / responses to

35. For further information, contact Ewen Brierley (tel 029 2085 9713; email ewen.brierley@hefcw.ac.uk).

Annex A**Detailed analysis of financial results 2015/16**

1. This annex provides an overview and analysis of the financial health of Higher Education Institutions in Wales (Welsh HEIs). This analysis does not include information about further education colleges or other providers of higher education in Wales.

Data sources and financial reporting standards

2. The data used in this paper comes from the following sources:
 - a. Unless stated otherwise, all financial data up to and including 2015/16 is from financial statements of the institutions for 2015/16, and the Higher Education Statistics Agency (HESA) Finance Statistics Record, which is completed by higher education institutions (HEIs) each year and is derived from audited financial statements.
 - b. Student number data is from the HESA Student Record.
3. All financial information is presented in academic years (ending 31 July).
4. Financial Reporting Standard (FRS) 102 is the new financial reporting framework for higher and further education providers for reporting periods starting on or after 1 January 2015. All 2014/15 data quoted in this report is restated under FRS102.
5. The new standard makes it difficult to compare 2015/16 results between institutions and against historical trends, because the new rules have introduced significant changes in the way financial performance is reported. Some transitional changes reflected in the restated 2014/15 results also make this an atypical year.

2015/16 financial results

6. The financial results for the Welsh HEIs in 2015/16 show a financially sound position overall. It should be noted, however, that significant variations continue in the financial performances of individual institutions across the sector, with the main financial strength remaining in a small number of institutions.
7. Results for 2015/16 show that the gap between the lowest- and highest-performing institutions continues to grow.
8. Table 1 provides the key headline data from the financial information for 2014/15 (restated under FRS102) and 2015/16.

Table 1: Summary of key financial indicators

	Actual	
	2014/15 (restated)	2015/16
Total income	£1,434M	£1,508M
(Deficit)/ Surplus ²	(£5.5M)	£74.8M
(Deficit)/ Surplus as % of total income	(0.4%)	5.0%
Cash flow from operating activities	£102M	£116M
Cash flow from operating activities as % of total income	7.1%	7.7%
Net liquidity as number of days' expenditure	120	193
External borrowings as % of total income	22.4%	48.4%
Unrestricted reserves ³ as % of total income	61.2%	56.7%

9. The remainder of this report looks at different aspects of the financial results reported by Welsh HEIs in 2015/16.

² This is the deficit/surplus reported in the 'Statement of comprehensive income', before other gains and losses and the share of surplus or deficit in joint ventures and associates.

³ This is the unrestricted income and expenditure reserve reported in the Consolidated and Institution Balance Sheet.

Income

10. Total income reported by Welsh HEIs in 2015/16 was £1,508 million, an increase of 5.1 per cent in cash terms compared with 2014/15. Table 2 provides a breakdown of sector income for the last two years.

Table 2: Breakdown of total income for Welsh HEIs

	Actual		Change	
	2014/15 (restated) £Million	2015/16 £Million	£Million	Percentage
Funding council grants ⁴	186.4	183.4	-3.0	-1.6%
Tuition fees and education contracts (home and European Union)	599.9	648.1	48.2	8.0%
Research grants and contracts	220.9	208.6	-12.3	-5.5%
Overseas fee income	143.6	150.1	6.5	4.5%
Other income*	272.4	302.5	30.1	11.1%
Investment income	4.6	8.9	4.3	93.4%
Donations and endowments	6.3	6.3	0.0	00.0%
Total income	1,434.1	1,507.9	73.8	5.1%

* Other income includes capital grants received of £18.3M for 2014/15 and £54.7M for 2015/16. Excluding the impact of capital grants the increase in total income year on year in cash terms reduces to 2.6%.

⁴ Funding Council grants include funding received from the Welsh Government Department for Education and Skills for FE provision of £37,412 for 2014/15 and £38,540 for 2015/16.

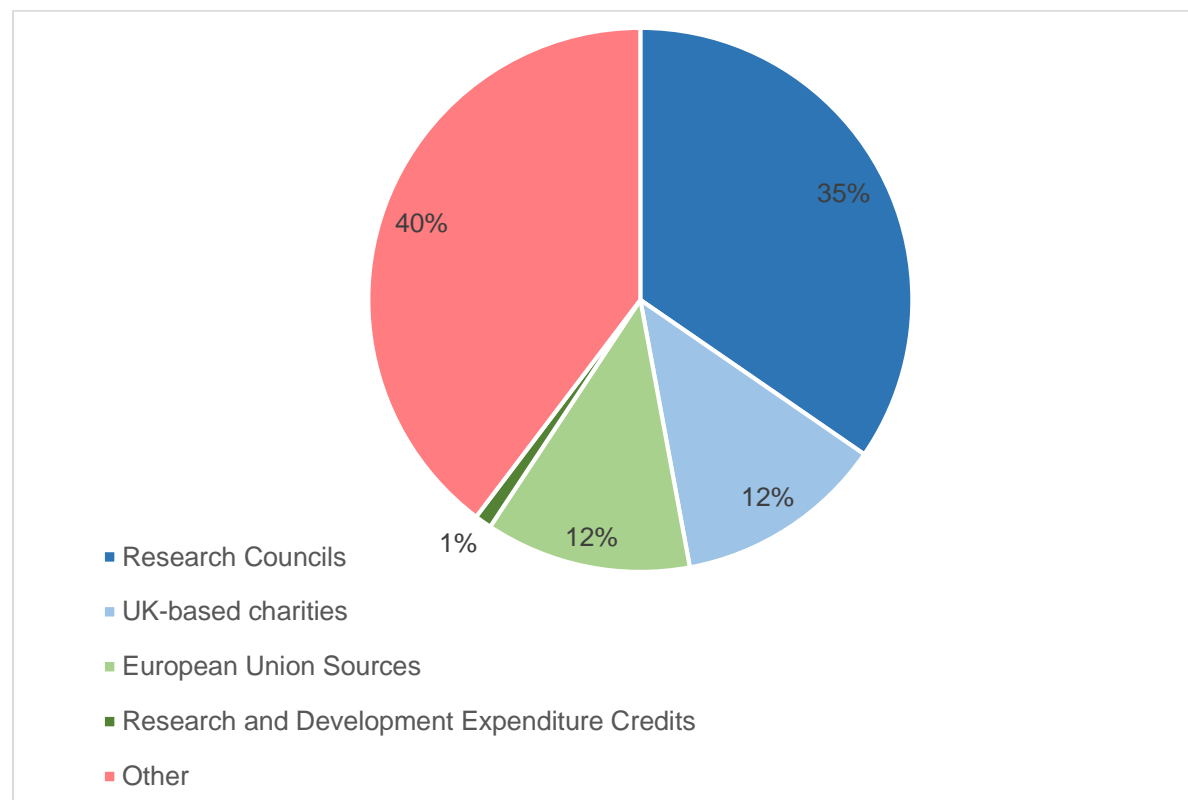
11. Table 3 provides a breakdown of tuition fee income received in 2015/16 compared with 2014/15.

Table 3: Breakdown of home and EU tuition fee income 2014/15 and 2015/16

	Actual		Percentage change
	2014/15 £Million	2015/16 £Million	
Full-time undergraduate	491.3	528.0	7.5%
Full-time postgraduate	26.8	24.0	(10.5%)
Part-time undergraduate and postgraduate	19.7	19.6	(0.5%)
Other fees and support grants	62.1	76.5	23.2%
Total home and EU fee income	599.9	648.1	8.0%

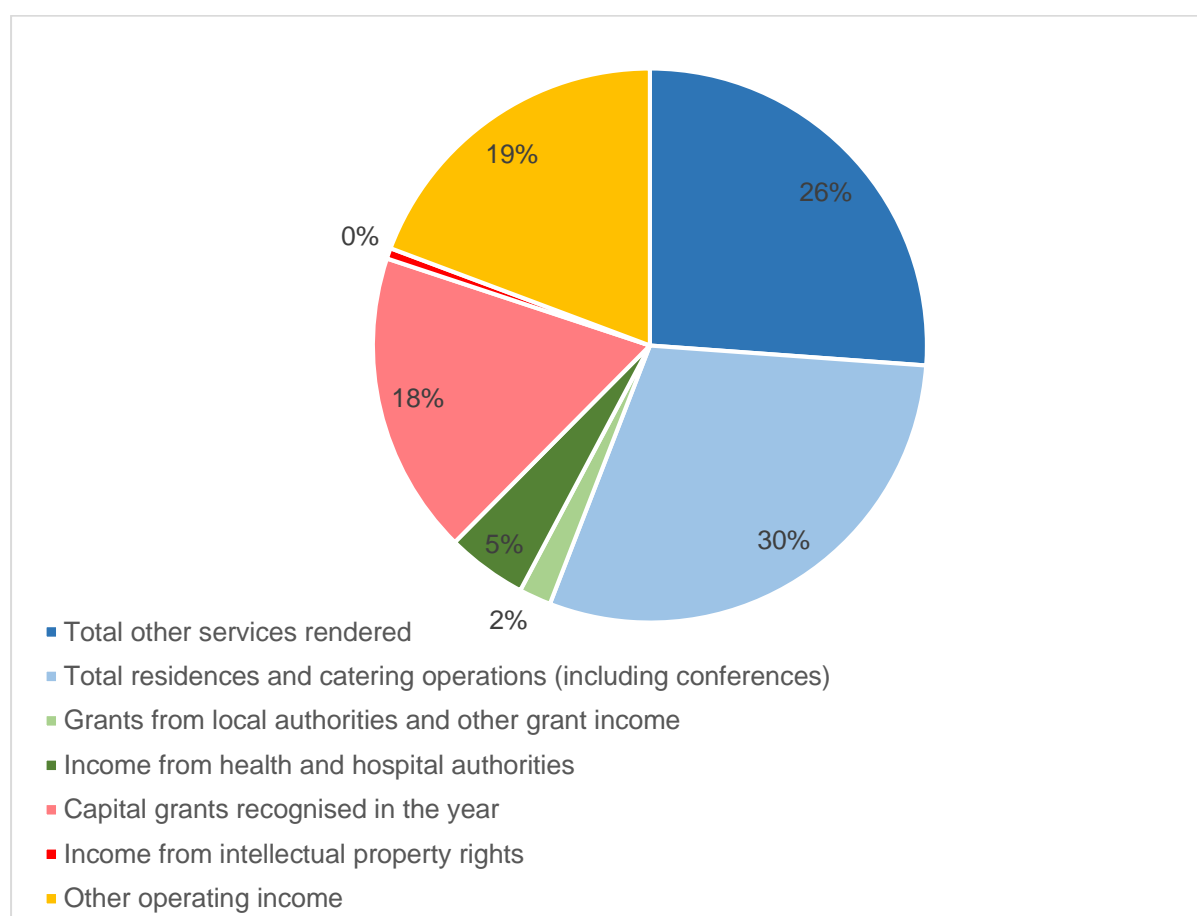
Source: 2015/16 financial statements

12. 2015/16 data from the HESA student record indicates that there was an increase of 2 per cent in home and EU full-time undergraduate students (expressed as full-time equivalents (FTEs)) from 67,010 in 2014/15 to 68,515. This indicates that much of the corresponding increase in income is due to the increase in student fees from 2012-13 replacing the reduced government funding as opposed to increased student numbers.
13. Income from research grants and contracts fell by £12.3 million to £208.6 million in 2015/16, a 5.5 per cent decrease compared with 2014/15. However, 2014/15 income from research grants and contracts was boosted by the receipt of £15.1 million of Research and Development Expenditure Credits (RDEC) from HM Revenue and Customs. RDEC receipts in 2015/16 was much lower at £2.1 million. Without RDEC, research income would have remained almost static in the year. A breakdown of research and contracts income for 2015/16 is provided below at Figure 1.
14. RDEC credits related to a scheme introduced by the UK Government via the Finance Act 2013, to offer tax incentives to large companies to encourage greater investment in research and development. This scheme has since been amended through legislation so that universities and charities will be unable to claim RDEC in future.

Figure 1: Breakdown of research and contracts income (2015/16)

Source: HESA Finance Record

15. The sector reported an increase in 'other income'; from £272.4 million (19.0 per cent of total income) in 2014/15 to £302.5 million (20.0 per cent) in 2015/16. The significant factor in the increase was the reporting of capital grant income received, which increased from £18.3 million in 2014/15 to £54.7 million in 2015/16. A breakdown of other income for 2015/16 is provided below at Figure 2.

Figure 2: Breakdown of other income (2015/16)

Source: HESA Finance Record

Overseas fee income (non-EU)

16. The HESA student record data shows that, in 2015/16, total overseas (non-EU) student numbers (FTEs) decreased 12.8 per cent compared with 2014/15, decreasing from 15,350 to 13,385 FTEs.
17. Table 4 shows the change in overseas students broken down by mode and level of study between 2014/15 and 2015/16.
18. In 2015/16 the sector reported fee income from overseas students of £150.0 million, an increase of £6.5 million and equivalent to a rise of 4.5 per cent compared with 2014/15. In 2015/16 this made up 10.0 per cent of total income across the sector, unchanged from the previous year.
19. A significant risk to Welsh HEIs as well as the UK HE sector is the impact that a decline in overseas students would have on associated fee income and the longer-term financial sustainability of institutions. Areas of potential risk currently facing the sector include the tightening of UK immigration policy, a downturn in the global economy, including that of the UK, and increasing competition from worldwide markets for outwardly mobile students.

Table 4: Breakdown of overseas student FTEs by mode and level of study

	FT UG	FT PGR	FT PGT	PT UG	PT PGR	PT PGT	Total FTEs
2014/15	7,585	1,025	5,700	130	140	765	15,350
2015/16	7,345	1,030	4,235	130	160	485	13,385
% change	-3%	1%	-26%	0%	15%	-37%	-13%

Student recruitment 2016-17 and 2017-18

20. Data from the Higher Education Students Early Statistics (HESES) survey for the 2016/17 academic year indicates a 6.0 per cent increase in the number of undergraduate entrants compared with 2015/16.
21. 2016/17 HESES data also indicates a continuing decline in part-time undergraduates (23,924 to 21,903) total registrations.
22. UCAS data⁵ at June 2017 indicates a 6 per cent decline in applications for the 2017 cycle. This includes a 5 per cent decline in Welsh applications, an 8 per cent decline in other UK applications and a 5 per cent decline in EU applications. Overseas applications have decreased by 5 per cent.
23. The changes in student recruitment highlighted by the latest data raise questions over the sector's ability to maintain the income growth that has been achieved to date and to achieve the ambitious growth targets that have previously been forecast and potentially brings into focus the significant uncertainty facing the sector. The impact of these risks is still fully to play out across the sector and it is anticipated that Britain's forthcoming exit from the European Union, increasing global competition in the higher education market, reduced HEFCW funding in 2016/17 and 2017/18, changes to funding arrangements and a volatile economy both in the UK and internationally will impact on future income and the financial stability of HEIs across the sector.

Expenditure

24. In 2015/16, the sector reported total expenditure of £1,433.1 million, a decrease of 0.6 per cent in cash terms compared with 2014/15 and equivalent to 95% per cent of total income. Table 5 shows a breakdown of the sector's expenditure in 2014/15 and 2015/16.

⁵ See www.ucas.com/corporate/data-and-analysis/ucas-undergraduate-releases/2017-cycle-applicant-figures-june-deadline-0.

Table 5: Breakdown of expenditure

	2014/15 £Million	2015/16 £Million	% change
Staff costs as a % of total income	844.3 58.9%	828.6 54.9%	-1.8%
Other operating expenses as a % of total income	485.4 33.8%	470.8 31.2%	-3.0%
Depreciation as a % of total income	75.5 5.3%	95.3 6.3%	26.2%
Fundamental restructuring costs as a % of total income	6.3 0.4%	0.7 0.1%	-88.9%
Interest and other finance costs as a % of total income	28.2 2.0%	37.7 2.5%	33.7%
Total expenditure as a % of total income	1,439.7 100.4%	1,433.1 95.0%	-0.6%

25. The sector's largest expenditure relates to staff costs, which totalled £828.6 million in 2015/16, equivalent to 54.9 per cent of total income. While this represents a decrease of £15.7 million on the level reported in the previous year, 2014/15 staff costs were higher because of transitional changes introduced as a result of FRS102. In particular, the requirement for HEIs to recognise provisions for liabilities relating to the deficit recovery plans for the sector's multi-employer pension schemes increased staff costs by £35 million in the transitional year (2014/15).
26. Table 6 provides a breakdown of staff costs in 2014/15 under both the old and new financial accounting standards, alongside staff costs for 2015/16. This information is based on 2015/16 financial statements and shows the effect of the transitional change to pension provisions under FRS102.

Table 6: Breakdown of staff costs

	2014/15 £Million	2014/15 (FRS102) £Million	2015/16 (FRS102) £Million	2015/16 change	
				£Million	%
Salaries and wages	640	656	653	-3	-0.5
Social security costs	50	50	55	5	10.0
Employer pension costs	100	103	112	9	8.7
Changes to pension provisions	(0.3)	35	8	-27	-77.1
Other staff related costs	3	7	2	-5	-71.4
Total staff costs	793	851	830	-21	-2.5

Surpluses

27. Welsh HEIs' total surplus⁶ increased from a deficit of (5.5) million in 2014/15 to a surplus of £74.8 million in 2015/16. Whilst the increase in surplus in 2015/16 is significant, it should be noted that some significant transitional accounting changes were introduced as a result of FRS102, such as the increase in pension provisions for the sector's multi-employer pension schemes which reduced surpluses in 2014/15 and resulted in a deficit for Welsh HEIs. £54.7 million of the surplus for 2015/16 relates to capital grants recognised in accordance with the new accounting standard. The underlying increase in 2015/16 surpluses (excluding these transitional changes) is much lower.
28. At institutional level, results range from a deficit of 7.3 per cent to a surplus of 17.5 per cent. This demonstrates the significant level of variation in the financial performance of individual institutions across the sector.
29. Three institutions reported surpluses of over 5 per cent in 2015/16, compared with none in 2014/15. The high surpluses recorded by two of these institutions were due to one-off income injections capital grants and research income recognition.

Liquidity and cash flow

30. At the end of 2015/16 the Welsh HEIs had net liquidity equivalent to 194 days' expenditure. This is considerably higher than the level reported at the end of 2014/15, which was 120 days. It is due largely to the £300m bond proceeds received by Cardiff University in the year, a large proportion of which was still held as cash and short-term investments at the year end. No institution had liquidity of less than 33 days, compared with one in 2014/15.
31. The liquidity data is taken as a snapshot of projected bank and investment balances, as at 31 July. The main period of capital spending at most institutions happens during the summer months, after 31 July; therefore the available cash, not committed to capital spending, is likely to be much lower.
32. As charities, HEIs are obliged to ensure that they remain sustainable and do not expose themselves to undue risk. Strong liquidity is particularly important given current levels of uncertainty and risk in the sector, and as part of our accountability process, we continue to monitor liquidity levels, to assess whether HEIs are able to maintain sufficient cash levels to manage their risks effectively.

⁶ Total income less total expenditure, excluding other gains or losses (from investments and fixed asset disposals) and the share of surplus or deficit in joint ventures and associates.

33. Cash flow from operating activities rose from £102.1 million in 2014/15 to £116.1 million in 2015/16, equivalent to 7.7 per cent of total income.
34. One institution reported negative cash flow in 2015/16 (compared with three HEIs in 2014/15).

Capital expenditure and borrowing

35. Welsh HEIs are continuing to make a substantial investment in infrastructure to maintain and enhance the academic and student facilities. In 2015/16, capital additions totalled £252 million, an increase of 16.8 per cent compared with 2014/15.
36. Estate Management Statistics data, as at 31 July 2016, showed that the sector still needed to invest approximately £168 million to bring its non-residential estate up to a sound and operationally safe condition. This cost reflects the investment required to restore the estate to a sound baseline condition not to achieve the standard required to satisfy rising student expectations. This latter investment is essential for enabling HEIs to compete in the increasingly competitive domestic and global market.
37. With no capital grants available from HEFCW and significantly reduced levels of publicly funded capital grants, Welsh HEIs will need to generate surpluses and operating cash inflows to sustain the level of capital investment needed to attract students and staff, and ensure their long-term sustainability. Increased surpluses provide the positive cash flow needed to fund future investment and meet finance costs including the repayment of borrowings.
38. HEIs will inevitably reassess their capital investment plans in the light of economic uncertainty, changing building costs (occurring as a result of inflation and the weakening of sterling) and their ability to fund planned investment levels by generating additional cash or increasing borrowing. A reduction in capital investment could lead to under-investment, with institutions that fail to invest sufficiently in infrastructure finding themselves in a weaker market position and at higher risk of financial instability.

Borrowing and obligations under finance leases and service concessions

39. At the end of July 2016, the sector reported external long-term borrowings of £ 511 million (equivalent to 33.9 per cent of income). This is £312.3 million higher than the level reported at the end of 2014/15, and is due mainly to the issue by Cardiff University of its £300m bond. Under FRS102 all HEIs were required to bring onto their balance sheets the financial assets and liabilities relating to obligations under finance leases and other service concession arrangements (e.g. for student residences). At the end of 2014/15 these liabilities totalled £113.4 million for Welsh HEIs, and increased to £202.9 million by the end of 2015/16.

40. As borrowing rises in the sector, interest payments will increase. This rise in 'fixed costs' could put pressure on any institution that fails to constrain other costs or to increase income sufficiently.
41. The cost of increased borrowing has to date largely been mitigated by the exceptionally low interest rates available to the UK HE sector. However, a rise in interest rates could add significant costs, placing increasing financial burden on individual institutions' sustainability if not well managed.
42. In 2015/16, Welsh HEIs reported interest and other finance costs of £37.7 million (2014/15: £28.2 million), although some of this increase was due to the recognition of interest costs relating to pension deficit recovery plans and changes in the fair value of financial instruments. This finance cost is forecast to increase as a result of the increase in borrowings committed to during 2015/16.

Reserves and pensions

43. Reserves are an HEI's total assets less its liabilities and, in very broad terms, can be used as a proxy for the overall value of an institution. These are the accumulated surpluses of an institution over its lifetime and most of these surpluses have been invested in fixed assets used by the University such as land, buildings and capital equipment. Reserves are not the same as cash, although an institution could dispose of an asset if it was surplus to operational requirements (thereby converting it to cash).
44. Under the new financial reporting framework, reserves are categorised as restricted or unrestricted. Restricted reserves apply where there are restrictions on how an institution can use the funds, such as endowments and donations designated for a specific purpose. Unrestricted reserves⁷ represent the value of the institution's accumulated funds through surpluses reported in its income statement, on whose use there are no restrictions.
45. After taking into account pension deficits, the latest financial data shows that unrestricted reserves fell from £878.1million as at 31 July 2015 (equivalent to 61.2 per cent of total income) to £864.3 million at 31 July 2016 (56.7 per cent of total income). However, the aggregate sector position masks a significant spread and a concentration of large unrestricted reserves in a small number of institutions.
46. Under FRS102, pension deficits are much higher, with liabilities relating to the deficit recovery plans for the sector's multi-employer pension schemes now reflected in institutional balance sheets. As a result, pension liabilities

⁷ This is the unrestricted income and expenditure reserve reported in the Consolidated and Institution Balance Sheet.

reported as at 31 July 2015 increased from £275 million (under the previous financial reporting standards) to £397 million under FRS102.

47. The latest financial data shows that reported pension liabilities increased by £143.6 million in 2015/16, to reach £541.1 million at 31 July 2016 (equivalent to a rise of 36.1 per cent). These were also 44 per cent higher than the level of pension liabilities projected by Welsh HEIs last year, suggesting that actuarial pension deficits had been underestimated.
48. The sector's largest multi-employer pension scheme is the Universities Superannuation Scheme (USS), with the great majority of current staff working in HEIs that existed before 1992 being members of this scheme.
49. A complex mix of factors is contributing to the growing pension deficits across the sector, not least the prevailing economic conditions and the performance of asset investments. The latest interim valuation of the USS shows that the scheme ended the year with a net deficit of £12.6 billion (as at March 2017), compared with the previous year, where the deficit stood at £10 billion (as at March 2016), demonstrating the significant level of volatility in these valuations⁸. The next full triennial valuation was due to commence in 2017.
50. The results of the revaluation of Local Government Pension Schemes (LGPS) as at 31 March 2016, are also expected to show an increase in the LGPS deficit. With nearly 20 per cent of the sector's employer contributions paid to these LGPS schemes, an increase in the deficit may lead to increases in employer costs, placing significant financial pressures on HEIs participating in these schemes.

Disclaimer

51. This report, which is based on information provided by HEFCW-funded higher education institutions, has been prepared for the benefit of HEIs and their stakeholders in general terms. HEFCW cannot reasonably foresee the various specific uses that may be made of this report, and therefore no responsibility is accepted for any reliance any third party may place upon it.

⁸ See www.uss.co.uk/how-uss-is-run/running-uss/annual-reports-and-accounts.

Annex B

Welsh HEIs consolidated statement of comprehensive income

	2014/15	2015/16
	restated	
	£k	£k
INCOME		
Funding Council grants	186,412	183,494
Home & EU Tuition fees and contracts FTUG	491,376	528,096
Overseas student fee income	143,633	150,090
Other fee and education contract income	108,543	120,045
Research grant and contract income	220,891	208,611
Other income	272,334	302,396
Investment income	4,636	8,862
Donations and endowments	6,310	6,339
Total Income	1,434,135	1,507,933
EXPENDITURE		
Staff costs	844,329	828,576
Fundamental staff re-structuring costs	6,292	723
Other operating expenses	485,413	470,835
Depreciation	75,463	95,263
Interest and other finance costs	28,166	37,733
Total expenditure	1,439,663	1,433,130
Surplus/(deficit) before other gains/(losses) and share of surplus/(deficit) joint ventures and associates	(5,528)	74,803
Gains/(losses) on disposal of fixed assets	1,026	(6,029)
Gains/(losses) on investments	(11,670)	10,024
Share of operating surplus/(deficit) in joint venture(s)	(210)	(1,145)
Share of operating surplus/(deficit) in associate(s)	(205)	(177)
Surplus/(deficit) before tax	(16,587)	77,476
Taxation	(3,338)	(454)
Surplus/(deficit) for the year	(19,925)	77,022
Unrealised surplus on revaluation of land and buildings	0	0
Actuarial gains(losses) in respect of pension schemes	(17,798)	(119,935)
Change in fair value of hedging financial instruments	46	118
Total comprehensive income for the year	(37,677)	(42,795)

Welsh HEIs consolidated balance sheet

	2014/15	2015/16
	Restated	
	£k	£k
NON-CURRENT ASSETS		
- Intangible assets	27	515
- Fixed assets	2,095,787	2,228,925
- Heritage assets	8,230	8,263
- Investments	53,885	93,199
- Investment in joint venture(s)	3,535	17,014
- Investment in associate(s)	327	150
Total non-current assets	2,161,791	2,348,066
CURRENT ASSETS		
- Stock	3,371	2,962
- Trade and other receivables	152,524	149,082
- Investments	182,444	347,442
- Cash and cash equivalents	268,758	362,821
- Other (e.g. assets for sale)	0	0
Total current assets	607,097	862,307
CREDITORS – amounts falling due within one year		
- Bank overdrafts	616	1,167
- Loans repayable to funding council	0	0
- Bank loans and external borrowing	7,237	9,723
- Obligations under finance leases and service concessions	2,438	6,275
- Other (including grant claw-back)	363,990	303,512
Total creditors (amounts falling due within one year)	374,281	320,677
Share of net current assets /(liabilities) in associate	0	0
Net current assets /(liabilities)	232,816	541,630
Total assets less current liabilities	2,394,607	2,889,696
CREDITORS – amounts due after more than one year		
- Loans repayable to funding council	0	0
- Bank loans and external borrowing	198,863	511,151
- Obligations under finance leases and service concessions	113,369	202,903
- Other (including grant clawback)	110,501	102,596
Total creditors (amounts falling due within one year)	422,733	816,650
PROVISIONS		
- Pension provisions	397,504	541,087
- Other provisions	12,808	13,191
Total provisions	410,312	554,278
Total net assets	1,561,562	1,518,768
RESERVES		
Restricted reserves		
- Income and expenditure reserve – endowment reserve	95,855	102,816
- Income and expenditure reserve – restricted reserve	7,348	7,575
Unrestricted reserves		
- Income and expenditure reserve – unrestricted reserve	878,146	854,319
- Revaluation reserve	580,213	554,058
Total reserves	1,562,562	1,518,768

Welsh HEIs consolidated statement of cash flow

	2014/15	2015/16
	restated	
	£k	£k
Cash flow from operating activities		
- Surplus for the year (after taxation)	(19,925)	77,022
Adjustment for non-cash items		
- Depreciation	74,675	88,760
- Amortisation of intangibles	794	6,503
- Amortisation of goodwill	12,220	4,000
- Loss/(gain) on investments	(628)	(7,852)
- Decrease/(increase) in stock	(57)	408
- Decrease/(increase) in debtors	(4,796)	1,654
- Increase/(decrease) in creditors	21,525	(64,662)
- Increase/(decrease) in pension provisions	69,364	22,357
- Increase/(decrease) in other provisions	(8,740)	384
- Share of operating (surplus)/deficit in joint venture	210	1,145
- Share of operating (surplus)/deficit in associate	205	177
- Other	(3,870)	(4,812)
Adjustment for investing or financing activities		
- Investment income (entered as negative)	(4,636)	(8,862)
- Interest payable	16,129	23,380
- Endowment income (entered as negative)	(1,192)	(3,006)
- Loss/(gain) on disposal of fixed assets / other FA disposals	(956)	366
- Capital grant income (entered as negative)	(48,227)	(20,874)
Net cash inflow from operating activities	102,095	116,088
Cash flows from investing activities		
- Proceeds from sale of fixed assets	6,808	19,428
- Proceeds from sale of intangible assets	0	0
- Capital grants receipts	46,965	22,999
- Disposal of non-current asset investments	8,612	15,487
- Withdrawal of deposits	1,164	15,522
- Investment income	4,657	8,874
- Payments to acquire fixed assets	(182,514)	(150,806)
- Payments to acquire intangible assets	(6)	(51,667)
- New non-current asset investments	(9,583)	(55,748)
- New deposits	(34,684)	(168,633)
Total cash flow from investing activities	(158,581)	(344,544)
Cash flows from financing activities		
- Interest paid	(12,075)	(17,596)
- Interest element of finance lease and service concession paymtns	(4,170)	(6,734)
- Endowment cash received	1,023	1,647
- New secured loans	20,000	23,034
- New unsecured loans	2,328	329,776
- Repayments of amounts borrowed	(8,736)	(6,867)
- New long-term creditor	14,310	0
- Capital element of finance lease and service concession paymtns	(747)	(1,292)
Total cash flow from financing activities	11,933	321,968
Increase/(decrease) in cash and cash equivalents in the year	(44,553)	93,512
Cash and cash equivalents at beginning of year	312,695	268,142
Cash and cash equivalents at the end of the year	268,142	361,654

Annex C

Total income

	2014/15	2015/16
	Restated	
	£k	£k
University of South Wales	197,429	190,907
Aberystwyth University	130,328	123,176
Bangor University	144,226	143,442
Cardiff University	482,958	511,753
University of Wales Trinity Saint David	103,291	104,650
Swansea University	236,248	296,292
Cardiff Metropolitan University	97,260	98,260
Wrexham Glyndŵr University	42,395	39,453
Sector total	1,434,135	1,507,933

Surplus /(deficit) before gains /(losses) and share of surplus/(deficit) in joint ventures and associates

	2014/15	2015/16
	Restated	
	£k	£k
University of South Wales	5,292	13,701
Aberystwyth University	(4,093)	(5,106)
Bangor University	(5,781)	(10,422)
Cardiff University	1,929	27,078
University of Wales Trinity Saint David	(6,986)	(3,738)
Swansea University	4,345	51,873
Cardiff Metropolitan University	1,811	550
Wrexham Glyndŵr University	(2,045)	867
Sector total	(5,528)	74,803

NOTE: under FRS102 the sector deficit for 2014/15 included capital grant income of £18.35m; the surplus for 2015/16 included £54.68m of capital grant income

Surplus /(deficit) before gains /(losses) and share of surplus/(deficit) in joint ventures and associates as % of total income

	2014/15	2015/16
	Restated	
	%	%
University of South Wales	2.75	7.18
Aberystwyth University	(3.14)	(4.15)
Bangor University	(4.01)	(7.27)
Cardiff University	0.40	5.29
University of Wales Trinity Saint David	(6.76)	(3.57)
Swansea University	1.84	17.51
Cardiff Metropolitan University	1.86	0.56
Wrexham Glyndŵr University	(5.82)	2.20
Sector total	(0.39)	4.96

Surplus /(deficit) after gains/(losses) and share of surplus/(deficit) in joint ventures and associates

	2014/15	2015/16
	Restated	
	£k	£k
University of South Wales	(7,229)	8,478
Aberystwyth University	(4,157)	(2,509)
Bangor University	(5,519)	(10,073)
Cardiff University	1,061	32,114
University of Wales Trinity Saint David	(7,084)	(3,646)
Swansea University	4,136	51,695
Cardiff Metropolitan University	4,250	550
Wrexham Glyndŵr University	(2,045)	867
Sector total	(16,587)	77,476

Total comprehensive income for the year (after actuarial gains/(losses) in respect of pension schemes)

	2014/15	2015/16
	Restated	
	£k	£k
University of South Wales	(17,173)	(10,531)
Aberystwyth University	(94)	(12,964)
Bangor University	(3,893)	(15,942)
Cardiff University	(4,982)	10,581
University of Wales Trinity Saint David	(11,330)	(18,329)
Swansea University	4,417	32,158
Cardiff Metropolitan University	84	(19,583)
Wrexham Glyndŵr University	(4,706)	(8,185)
Sector total	(37,677)	(42,795)

Total expenditure

	2014/15	2015/16
	Restated	
	£k	£k
University of South Wales	192,137	177,206
Aberystwyth University	134,421	128,282
Bangor University	150,007	153,864
Cardiff University	481,029	484,675
University of Wales Trinity Saint David	110,277	108,388
Swansea University	231,903	244,419
Cardiff Metropolitan University	95,449	97,710
Wrexham Glyndŵr University	44,440	38,586
Sector total	1,439,663	1,433,130

Staff costs

	2014/15	2015/16
	Restated	
	£k	£k
University of South Wales	109,601	108,064
Aberystwyth University	73,398	70,050
Bangor University	87,591	83,967
Cardiff University	284,210	283,321
University of Wales Trinity Saint David	70,963	69,190
Swansea University	137,348	129,601
Cardiff Metropolitan University	56,335	60,939
Wrexham Glyndŵr University	24,883	23,444
Sector total	844,329	828,576

Staff costs as percentage of total income

	2014/15	2015/16
	restated	
	%	%
University of South Wales	55.51	57.37
Aberystwyth University	56.32	56.87
Bangor University	60.73	58.54
Cardiff University	58.85	55.36
University of Wales Trinity Saint David	68.70	66.12
Swansea University	58.14	43.74
Cardiff Metropolitan University	57.92	62.02
Wrexham Glyndŵr University	58.69	59.42
Sector total	58.87	54.95

Interest payable (excluding pension interest)

	2014/15	2015/16
	restated	
	£k	£k
University of South Wales	3,703	3,594
Aberystwyth University	2,398	3,204
Bangor University	4,933	4,865
Cardiff University	1,169	5,448
University of Wales Trinity Saint David	28	2,077
Swansea University	2,380	4,777
Cardiff Metropolitan University	1,504	1,481
Wrexham Glyndŵr University	15	12
Sector total	16,130	25,458

Net assets

	2014/15	2015/16
	restated	
	£k	£k
University of South Wales	72,950	62,419
Aberystwyth University	162,712	149,748
Bangor University	229,829	213,887
Cardiff University	696,887	707,468
University of Wales Trinity Saint David	145,260	126,931
Swansea University	137,463	169,621
Cardiff Metropolitan University	92,784	73,202
Wrexham Glyndŵr University	23,677	15,492
Sector total	1,561,562	1,518,768

Net liquid assets

	2014/15	2015/16
	restated	
	£k	£k
University of South Wales	89,151	98,180
Aberystwyth University	39,666	42,385
Bangor University	19,006	21,970
Cardiff University	171,452	412,453
University of Wales Trinity Saint David	45,143	32,523
Swansea University	58,566	72,403
Cardiff Metropolitan University	26,797	25,879
Wrexham Glyndŵr University	805	3,303
Sector total	450,586	710,263

Net cash inflow from operating activities

	2014/15	2015/16
	restated	
	£k	£k
University of South Wales	18,485	27,463
Aberystwyth University	5,976	7,290
Bangor University	12,714	10,345
Cardiff University	35,779	47,658
University of Wales Trinity Saint David	(1,036)	171
Swansea University	23,334	11,597
Cardiff Metropolitan University	7,605	9,011
Wrexham Glyndŵr University	(762)	2,553
Sector total	102,095	116,088

Liquidity ratio (days of expenditure)

	2014/15	2015/16
	restated	
	Days	Days
University of South Wales	181	215
Aberystwyth University	117	132
Bangor University	50	56
Cardiff University	136	328
University of Wales Trinity Saint David	157	115
Swansea University	97	117
Cardiff Metropolitan University	106	100
Wrexham Glyndŵr University	7	33
Sector total	120	194

Long-term external borrowings and obligations under finance leases and service concessions

	2014/15	2015/16
	restated	
	£k	£k
University of South Wales	70,713	67,860
Aberystwyth University	55,277	55,982
Bangor University	61,264	96,334
Cardiff University	17,893	310,220
University of Wales Trinity Saint David	283	17,538
Swansea University	77,801	137,708
Cardiff Metropolitan University	28,762	28,302
Wrexham Glyndŵr University	239	110
Sector total	312,232	714,054

Long-term external borrowings and obligations under finance leases and service concessions as % of total income

	2014/15	2015/16
	restated	
	%	%
University of South Wales	35.82	35.55
Aberystwyth University	42.41	45.45
Bangor University	42.48	67.16
Cardiff University	3.70	60.62
University of Wales Trinity Saint David	0.27	16.76
Swansea University	32.93	46.48
Cardiff Metropolitan University	29.57	28.80
Wrexham Glyndŵr University	0.56	0.28
Sector total	21.77	47.35