

January 2006/01

Core funding/operations

**Report on outcomes**

---

This report is for information.

This document gives financial projections for the higher education sector covering 2004-05 to 2008-09, and summarises the sector's annual monitoring statements for 2004-05.

# Financial forecasts and annual monitoring statements

## Outcomes for 2005

## Contents

Executive summary	2
2005 Financial forecasts	5
2005 Annual monitoring statements	14
List of abbreviations	17

## Annexes

(see Excel download)

Annex A	Income and expenditure account for the sector
Annex B	Comparison of surplus and deficit levels to total income over the period
Annex C	Frequency distribution of historical cost surpluses over the forecast period
Annex D	Balance sheet for the sector
Annex E	Comparison of the level of borrowing and net liquidity to total income over the period
Annex F	Cash flow forecasts for the sector

# Financial forecasts and annual monitoring statements

Outcomes for 2005

---

To	Heads of HEFCE-funded higher education institutions Heads of universities in Northern Ireland
Of interest to those responsible for	Finance, Planning, Management
Reference	2006/01
Publication date	January 2006
Enquiries to	<b>Financial forecasts</b> HEFCE finance advisers  <b>Annual monitoring and corporate planning statements</b> HEFCE higher education advisers

---

## Executive summary

### Purpose

1. This report gives financial projections for the higher education sector covering 2004-05 to 2008-09 and summarises the sector's annual monitoring statements for 2004-05. The outcomes are based on information provided by higher education institutions (HEIs) in July 2005.
2. In line with our policy of reducing institutions' accountability burden, we requested significantly less information for 2005 than in previous years. We have consulted on our future plans for accountability (HEFCE 2005/41) and details of the final agreed process will be published early in 2006.

### Key points

#### Financial forecasts

3. The operating position for the sector, before exceptional items, is forecast to fall from a surplus of £205 million (1.5 per cent of total income) in 2003-04 to a small deficit of £41 million (0.3 per cent of total income) in 2005-06. Future years then show annual increases to £427 million (2.3 per cent) in 2008-09.
4. Total HE student numbers (FTEs) are forecast to increase by 10.5 per cent from 2004-05 to 2008-09.

5. Overseas (non-EU) student numbers are forecast to increase by 24.5 per cent over the period. Although the sector has previously exceeded ambitious plans in overseas growth (a 76 per cent real terms increase in overseas fee income from 1999-2000 to 2003-04) this target provides added risks to the sector. Some recent indications show growth in overseas recruitment slowing down and in some cases recruitment is reducing, so some forecasts seem optimistic.
6. The sector's dependence on income from the Funding Councils is forecast to reduce from 37.8 per cent of total income in 2003-04 to 34.0 per cent in 2008-09. During the same period the proportion of total income coming from fees is set to increase from 25.1 per cent to 31.3 per cent.
7. Net liquidity is forecast to fall from £2,319 million at 31 July 2004 to a low of £1,742 million at 31 July 2007. Liquidity, expressed as the number of days' expenditure cover, will fall below 50 days after 2004-05, its lowest position since 2000-01. Borrowings are forecast to increase by £1,284 million to £3,950 million by July 2008, which represents a substantial investment for the sector.
8. Capital expenditure from 2004-05 to 2008-09 will total £9,739 million across the whole sector, of which £4,373 million will be financed by capital grants.
9. The major risk identified by institutions remains the under-recruitment of students (both home and overseas students). Other key risks include salary increases above inflation and the management of capital programmes.
10. While recognising that the forecasts provided are confidential, we have produced schedules for individual institutions so that they can compare their position against financial health indicators for the sector. Institutions can download their own schedules through the HEFCE extranet, <https://extranet.hedata.ac.uk>.

## **Annual monitoring**

11. Our analysis of the 2004-05 annual monitoring statements (AMSs) focused on four key areas of HEFCE strategic funding (learning and teaching, business and the community, rewarding and developing staff, and research capability). Race equality continues to be monitored as part of our obligations under the Race Relations (Amendment) Act 2000.
12. Institutions were also asked to submit a corporate planning statement (CPS). The CPS is a general update of the institution's progress during 2004-05 against its corporate plan and strategic priorities. HEFCE regional teams have analysed the CPSs and will continue to use these in their discussions with institutions.
13. Informal feedback on the new AMS process has been positive. Almost all institutions have adopted the Committee of University Chairmen (CUC) Governance Code of Practice (HEFCE 2004/40a). Therefore, the lighter touch process was applied to the vast majority of institutions without the need to seek further information. Most institutions assured us of their

delivery and spending for 2004-05 in those areas where they receive HEFCE special initiative funding.

### **Action required**

14. None: this report is for information.

## 2005 Financial forecasts

15. In HEFCE 2005/20 we asked higher education institutions (HEIs) to provide us with financial forecasts covering the period 2004-05 to 2008-09. These forecasts, as in previous years, were prepared on assumptions reflecting current funding announcements and the prevailing economic climate. The forecasts take into account the Department for Education and Skills (DfES) announcements in December 2004 on the funding to be provided for higher education for the financial years 2005-06 to 2007-08.

16. Generally the forecasts appear to have been prepared on reasonable assumptions, although for some institutions these may be challenging or unduly optimistic. The financial strength of the sector is satisfactory, and forecast to improve after 2006 when viewed in aggregate, but a small number of HEIs are facing significant financial constraints.

### Income and expenditure

17. The actual results each year have tended to confirm the reliability of the sector's short- to medium-term forecasting, with variance being less than 1.2 per cent of total income. Longer-term forecasting is subject to greater uncertainty and tends to be more prudent. The actual sector outturn for 2003-04 was a historical cost surplus<sup>1</sup> of £447.6 million (3.2 per cent of total income), which was proportionally the largest surplus since 1997-98. The financial forecasts predict the outturn for 2004-05 (£282 million) will be better than forecast in 2004 but that there will be a small deterioration in 2005-06 and 2006-07. In total the results forecast in 2005 are, on average, £20.1 million per annum less than those forecast in 2004.

18. The forecast income and expenditure account for the sector as a whole is at Annex A, and summarised in Table 1. This shows that total income for the sector is forecast to grow by 28.6 per cent over the five-year period 2004-05 to 2008-09, with the greatest growth being forecast in 2006-07, partly due to the introduction of variable fees. The prospect of variable fee income has given HEIs greater confidence in income growth towards the end of the forecast period than shown in previous years. Historical cost surpluses are forecast to be between 0.8 per cent and 2.8 per cent of total income over the period.

19. Exceptional items have affected the level of surpluses, especially over the three-year period 2002-05. Although a number of institutions are forecasting negative exceptional items (for example, due to restructuring or losses on property transactions), the sector as a whole is expecting gains from exceptional items. This mainly arises from the gains on property transactions, with other items such as the sale of intellectual property rights and the sale of spin-out companies being included. The impact of exceptional items was particularly significant in 2003-04 and comprised large sums arising from six institutions, with each having exceptional gains in excess of £10 million from the sale of properties. In 2003-04 these six institutions accounted for 95 per cent of the exceptional items total. In 2004-05 another six institutions were

---

<sup>1</sup> Operating surpluses include higher depreciation charges following revaluation of assets. Historical cost surpluses reduce the depreciation charges to reflect the historical cost of assets.

each expecting the sale of properties to provide exceptional gains in excess of £10 million, which accounts for nearly all the exceptional item total in that year.

**Table 1: Income and expenditure**

	<b>Actual 2002-03 £M</b>	<b>Actual 2003-04 £M</b>	<b>Forecast 2004-05 £M</b>	<b>Forecast 2005-06 £M</b>	<b>Forecast 2006-07 £M</b>	<b>Forecast 2007-08 £M</b>	<b>Forecast 2008-09 £M</b>
Total income	12,723	13,881	14,621	15,490	16,581	17,733	18,797
% increase on previous year		9.1%	5.3%	5.9%	7.0%	6.9%	6.0%
Total expenditure	12,547	13,676	14,550	15,531	16,527	17,471	18,370
% increase on previous year		9.0%	6.4%	6.7%	6.4%	5.7%	5.1%
Operating surplus (before exceptional items)	176	205	70	(41)	54	261	427
Surplus as % of total income	1.4%	1.5%	0.5%	(0.3%)	0.3%	1.5%	2.3%
Exceptional items	43	124	103	19	43	27	47
Historical cost surplus	310	448	282	119	172	374	525
Historical cost surplus as % of total income	2.4%	3.2%	1.9%	0.8%	1.0%	2.1%	2.8%

20. In the last two years financial forecasts the predicted levels of operating surpluses (before exceptional items) have been around 0.5 per cent of total income per annum. However, it should be noted that actual operating surpluses in 2002-03 and 2003-04 were each at least 1 per cent higher. For 2004-05 the operating surplus is forecast to be 0.5 per cent of total income before a deficit of 0.3 per cent of total income is seen in 2005-06. Future years show improving levels of surpluses, rising to 2.3 per cent of total income in 2008-09. The reasons for the deficit forecast in 2005-06 appear to be linked to high growth in staff costs and also partly due to a significant increase (over 10 per cent) in depreciation charges not covered by deferred grant income. These costs will continue in future years but the forecast income growth will reduce their pressure on the sector.

21. The deficit forecast in 2005-06 will be the first deficit since 2000-01, but in that year exceptional items more than covered the operating deficit. So, if there is still an operating deficit after exceptional items in 2005-06, then it would be the first one since Higher Education Statistics Agency (HESA) records began (1994-95). However, some institutions made pessimistic assumptions for the period before the introduction of variable fees, and it seems likely that actual sector performance in 2005-06 may be better than forecast.

22. The improvement in the sector's operating position towards the end of the period will be partly due to the variable fee effect but also due to increases in income from research grants and contracts. Expected slower growth in staff costs towards the end of the forecast period also

contributes to an improved operating position, after the costs of the new pay framework have been absorbed.

23. Our sector-wide analysis disguises the wide range of results and forecasts between institutions. The number of universities and colleges forecasting deficits each year is shown in Table 2.

**Table 2: Operating and historical cost deficits**

	<b>Number of HEIs with operating deficits (% of total HEIs)</b>	<b>Number of HEIs with historical cost deficits (% of total HEIs)</b>
2002-03 Actual	36 (27%)	22 (17%)
2003-04 Actual	27 (21%)	18 (14%)
2004-05 Forecast	36 (28%)	26 (20%)
2005-06 Forecast	43 (33%)	29 (22%)
2006-07 Forecast	35 (27%)	28 (22%)
2007-08 Forecast	18 (14%)	12 (9%)
2008-09 Forecast	10 (8%)	7 (5%)

24. The forecasts show that there has been a brief improvement in the number of institutions recording deficits, but from 2004-05 it will start to worsen again. Of those institutions forecasting deficits, most are small deficits (0 to -3 per cent of total income). Graphs at Annexes B and C show the trend in sector surplus and deficit levels and the frequency distribution of historical cost surpluses over the forecast period. Following the introduction of variable fees and other financial improvements the number of institutions forecasting historical cost deficits falls significantly to just seven by 2008-09.

25. Universities and colleges need to generate surpluses to provide the positive cash flow for reinvestment and to fund future developments, where these are not met from capital funding. The actual level of such surplus will vary, depending on the circumstances of individual universities and colleges.

## **Analysis of income trends**

26. Total income is forecast to increase by around 0.9 per cent per annum more than expenditure post 2006, although in 2004-05 and 2005-06 expenditure is set to increase at a faster rate. This is due to pay cost pressures and also the significant increases in depreciation charges. Over the five-year forecast period the level of income is estimated to increase 28.6 per cent and total expenditure to rise 26.2 per cent.

27. Grants from the funding bodies (HEFCE, the Training and Development Agency for Schools, TDA, and the Learning and Skills Council, LSC) are forecast to increase by 14.2 per cent over the period, with the main increases being in 2004-05 and 2005-06. The increases in these years are consistent with the levels of grants already announced, and the sector has taken a prudent view on increases in future years. The forecasts take account of potential inflation growth, and include additional funding for medical intakes, additional foundation degrees awarded and other HEFCE grants already announced.



28. The forecast increase in all higher education (HE) student numbers (full-time equivalents, FTEs) from 2004-05 to 2008-09 is 141,330 (10.5 per cent), of which home and EU undergraduates account for 80,948. Table 3 shows a breakdown of the forecast increases in student numbers.

**Table 3: Student number projections (FTEs)**

	<b>2004-05</b>	<b>2005-06</b>	<b>2006-07</b>	<b>2007-08</b>	<b>2008-09</b>	<b>% increase over period</b>
Home & EU full-time undergraduate	840,541	867,166	887,919	902,406	911,473	8.4%
Home & EU full-time postgraduate	103,402	110,195	113,115	116,442	118,758	14.9%
Home & EU part-time	251,818	254,797	259,487	264,692	268,751	6.7%
Overseas students	155,304	163,594	175,144	185,667	193,414	24.5%
<b>Total HE students</b>	<b>1,351,065</b>	<b>1,395,752</b>	<b>1,435,665</b>	<b>1,469,207</b>	<b>1,492,395</b>	<b>10.5%</b>

29. The projections of student numbers in Table 3 include student places already allocated for future years through the exercise to allocate additional student numbers, and aspirational additional student numbers. Overall, the growth forecast is more than predicted in the 2004 financial forecasts.

30. There are significant variations in the growth plans of institutions across the sector. Twenty-four institutions are forecasting growth of over 20 per cent in total student numbers from 2004-05 to 2008-09, contributing 34.7 per cent of the sector's forecast growth. Within this group much of the growth relates to existing developments, such as new medical school expansion, but a large amount is still aspirational. Over the forecast period nine institutions are expecting a reduction, albeit small, in student numbers. Almost all institutions identify under-recruitment or lack of demand for student places as a major risk. (Refer to paragraphs 54-58 for further information about risks.)

31. Total fee income is forecast to increase by £2,200 million (60.7 per cent) over the period 2004-05 to 2008-09 with over 70 per cent of the increase attributable to variable fee income.<sup>2</sup> As well as the impact of variable fees there are also likely to be increases in fee income arising from postgraduate, part-time and overseas students.

32. The number of overseas (non-EU) students is forecast to increase by 24.5 per cent over the five-year forecast period. This increase is slightly lower than previous years, and accounts for

<sup>2</sup> Information collected from HEIs' access agreements (Office for Fair Access, OFFA)

just over 38,000 FTE students. This follows significant increases already seen in the sector, with student numbers increasing by 66 per cent in the four years to 2003-04.

33. The sector is becoming increasingly reliant on income from overseas students. In 2003-04 fee income from non-EU students totalled over £1,000 million for the first time, which was equivalent to over 8 per cent of total income. From 1999-2000 to 2003-04 overseas fee income rose 76 per cent in real terms. Of this increase, 91 per cent can be attributed to the higher volume of students rather than price increases. Although the sector continues to recruit from a diverse set of countries, over 50 per cent of students come from just six countries. Overall the levels of growth forecast over the next four years seem very optimistic.

34. Income from research grants and contracts is forecast to increase by 31.2 per cent from 2004-05 onwards, averaging an increase of 7 per cent per annum. These annual increases are lower than those achieved over 1998-99 to 2002-03, which averaged 9 per cent per annum. Institutions have also included assumptions following the announcement of an extra £141 million linked to the introduction of full economic costing for Research Council grants from 2005-06. This funding accounts for 20 per cent of the increase in research income forecast over the period.

35. Other operating income, including income from residences, catering and other services, is forecast to increase by an average 3.8 per cent per annum. The forecast levels are lower than the actual increases achieved in 2002-03 and 2003-04 of more than 6 per cent each year. Due to the uncertainty of income from this area the sector appears to have taken a conservative view on future income growth, although a wide range of assumptions is being made across the sector. This is consistent with forecasts produced in previous years.

36. The sector's dependence on income from the funding bodies is forecast to reduce from 37.8 per cent of total income in 2003-04 to 34.0 per cent in 2008-09. The proportion of fee income should change the most. Over the period 2003-04 to 2008-09 fee income increases from 25.1 per cent of total income to 31.3 per cent. Other areas of income are expected to show relatively small changes.

## **Analysis of expenditure trends**

37. Staff costs are forecast to increase by 26.2 per cent from £8,485 million in 2004-05 to £10,709 million in 2008-09. In 2004-05 the sector is expecting staff costs to have increased by 6.3 per cent but in 2005-06 an increase of 7.8 per cent is forecast. The increases in future years should be smaller and diminish each year, with the increase in 2008-09 expected to be 4.9 per cent. These increases include pay awards, incremental drift, higher pension contributions and also changes in staff numbers. Most institutions have clearly included some provision for the effects of assimilation into the new national pay framework, but the effect of this is spread over 2003-06.

38. The Universities and Colleges Employers Association (UCEA) reached an agreement with seven campus unions for the movement to a single pay spine structure from August 2004, although some regions had discretion to delay the start date up to 2006. A UCEA survey of institutions <sup>3</sup> shows that 19 per cent of institutions have already implemented the pay spine, with

---

<sup>3</sup> UCEA Update 05/62 – Framework Implementation Progress – Survey Findings

a further 15 per cent due to implement it during 2005. The remainder plan to implement in August 2006. The overall cost to each institution of implementing the new agreement ranges from 1 per cent to 7 per cent of current staff costs with the average being 3.6 per cent. As shown in the forecasts in Annex A, this additional cost has put more pressure on the sector's operating performance, and for the first time an operating deficit is predicted in 2005-06.

39. Non-pay expenditure (other operating expenses) is forecast to increase by 25.4 per cent from 2004-05 to 2008-09, which averages an annual increase of 5.8 per cent. It is difficult to analyse the forecast data on non-pay expenditure in too much detail as this accounting line includes the additional expenditure relating to variable fees (such as bursaries). Over the period 23 HEIs are forecasting a real terms reduction in non-pay expenditure, with nine of these expecting an actual reduction (before inflation). Improving efficiency to this extent, given the increases in income forecast and the commitment to additional bursaries, may prove challenging.

40. Depreciation charges are expected to increase from £644 million in 2003-04 to £932 million in 2008-09. This large rise is linked to the increase in fixed assets owned by institutions and the extensive capital investment plans across the sector (see paragraph 50). The increased depreciation levels will put some additional pressure on the surplus positions across the sector, and are significantly greater than previous forecasts. However, the charges only reflect the additional investments being made by the sector to improve its infrastructure, and deferred capital grants will offset some of the additional depreciation charges.

41. Up to and including 2003-04 the sector was receiving more income from endowment and interest receivable than it was paying out in interest charges. However, from 2005-06 the sector is expecting to pay out more interest than it receives, due to the increases in borrowings (see paragraph 45) and the relatively low rates of return from investments.

## **Balance sheet**

42. The balance sheet for the sector as a whole is at Annex D. In aggregate, the sector is forecasting significant increases in the value of tangible fixed assets from £14,204 million (2003-04) to £19,468 million (2008-09). This 36.6 per cent increase is a larger growth than forecast in 2004 (28.9 per cent) or in 2003 (25.6 per cent). The forecast increase in fixed assets is to be financed by cash generated from operations, bigger capital grants and increases in borrowings. The availability of capital grants has increased the amount of capital expenditure being forecast by institutions, and in turn this should see the value of fixed assets held by HEIs rise significantly over the period.

43. Net liquidity<sup>4</sup> has increased annually since 2001-02, and at the end of the 2003-04 financial year totalled a healthy £2,319 million. The sector is now expecting a decrease in net liquidity annually to a low of £1,742 million in 2006-07, then small annual increases thereafter. This is due to the sector using cash reserves to finance capital expenditure plans. The number of days that liquidity covers expenditure is set to fall below 50 after 2004-05, which is the first time this will have happened since 2000-01. The trend in liquidity is also reflected in the net current asset position on the balance sheet.

---

<sup>4</sup> Current asset investments plus cash in hand/bank less bank overdrafts.

44. At the end of July 2004 the sector had external borrowing totalling £2,668 million, and this is forecast to increase significantly to £3,950 million by 31 July 2008. This represents a substantial investment for the sector, the majority of which appears to be supporting capital infrastructure investment. In comparison to previous forecasts the sector is now projecting higher borrowing, but given the current economic climate of low interest rates the increased borrowing is affordable. The rise in borrowing is also reflected in an increase in its proportion of total income from 19.2 per cent as at 31 July 2003 to a high of 22.6 per cent by the end of 2006-07. Annex E compares the level of borrowing and net liquidity to total income over the period.

45. Since 1998-99 external borrowing has been greater than net liquidity, however in 2005-06 the difference between the two will be over £1,000 million for the first time. Due to the large increase in borrowing and falling liquidity, by 2006-07 borrowing is expected to be £2,000 million more than net liquidity. Despite the widening gap between the two indicators, the most important element is that the levels of interest payable remain relatively low and affordable. This confirms the view that the sector is getting better at negotiating with financial institutions, and interest charges as a percentage of total borrowing are falling.

46. As reported in previous years, the aggregate sector financial position masks a significant spread of financial strength, with a concentration of financial strength in a small number of mainly old universities. Similarly, borrowing is concentrated in relatively few institutions (for example, at 31 July 2004, 51 per cent of the sector's borrowing was held by just 24 institutions). Thus, some institutions may be at or near the practicable limit of their borrowing capacity, whilst others could comfortably borrow more.

47. The full implementation of Financial Reporting Standard (FRS) 17 has been postponed, but interim reporting in notes to the financial statements has been required since 2002-03. The full implementation of FRS 17 will be required for all accounts produced in the sector from the 2005-06 financial year. FRS 17 is an accounting standard intended to ensure that all financial statements reflect the true cost and net assets or liabilities of pension schemes. These financial forecasts assume that FRS 17 is not implemented during the forecast period. However, as at 31 July 2004 the aggregate value of net pension scheme liabilities was £1,467 million. If these liabilities had been included on HEIs' balance sheets, as per FRS 17, 14 institutions would have seen discretionary reserves eliminated, and would have reported net accumulated deficits. In aggregate, the sector's discretionary reserves would have fallen from £5,375 million to £3,993 million. The forecasts show that discretionary reserves excluding FRS 17, are set to rise from £5,375 million (39.2 per cent of total income) in 2003-04 to £7,022 million (37.4 per cent of total income) in 2008-09.

## **Cash flow**

48. The cash flow forecasts for the sector are shown at Annex F.

49. Table 4 shows forecast capital expenditure and how this is expected to be financed.

50. Total capital expenditure for 2004-05 to 2008-09 is estimated to total £9,739 million across the whole sector. The capital expenditure forecast peaks during 2005-06 and then reduces significantly by 2008-09, reflecting the known availability of capital grants. This shows

that the availability of capital grants leads to an increase in capital expenditure rather than capital grants being used as a substitute for other sources of finance.

**Table 4: Capital expenditure and financing**

	Capital expenditure	Asset sales	Capital grants	New borrowings	Net capital to be financed	Available funds from operating cash flow
	£M	£M	£M	£M	£M	£M
2003-04 <sup>5</sup>	1,821	275	873	443	230	799
2004-05	2,030	255	997	490	290	364
2005-06	2,510	182	1,137	623	568	388
2006-07	2,184	107	956	497	624	600
2007-08	1,812	154	721	325	612	837
2008-09	1,203	100	562	107	434	996

51. The amount of capital expenditure forecast from 2003-04 to 2007-08 is £617 million more than forecast for the same period in the 2004 financial forecasts. That forecast was itself an increase on 2003, which implies that the sector is continuing to put more money into its infrastructure in order to remain viable in the long term. Some institutions are also planning investment prior to the introduction of variable fees, as they see enhanced facilities as being one area where they can achieve a competitive advantage.

52. As can be seen from Table 4, the sector is expecting the level of cash produced from operating activities to be lower in 2004-05 and 2005-06 compared to 2003-04. This is due to the additional cost pressures (see paragraph 37-41). Following the introduction of variable fees the cash position is set to improve annually. Across the sector 30 institutions are forecasting negative operating cash flow in 2005-06, but by 2008-09 this number reduces to just six.

## Statement of financial strategy

53. Institutions provided a statement (commentary) of financial strategy to accompany their forecasts, together with supporting notes. These included a statement of strategic context and the institution's financial strategy, as agreed by the governing body, that underpinned the corporate plan and focused on key high-level financial objectives. We have reviewed the corporate planning statements alongside the financial forecasts to ensure consistency between corporate objectives and HEIs' financial strategies.

## Key risks

54. Within the commentary provided by institutions is information on the key risks to financial health and sustainability over the forecast period. The HEFCE Assurance Service undertook an analysis of the information provided, both in terms of the nature and extent of risks across the sector and the quality of information provided on risk evaluation and management in the sector. An analysis of the key risks identified by institutions from the 2005 financial forecasts shows that

---

<sup>5</sup> Actual values for 2003-04

many of the risks and the typical actions to mitigate risks are the same as in the previous two years.

55. This analysis shows that student recruitment and retention are overwhelmingly the major risk for the sector. As income from overseas students increases each year, there will be added risks attached to this. Under-recruitment of overseas students is now being highlighted as one of the main risks facing institutions. Although recruitment of home students still remains a critical area for institutions, many are now highlighting changes in HEFCE funding methodology as a potential future risk.

56. With the introduction of variable fees now more firmly in institutions' plans, it is clear that although this will benefit the sector as a whole a number of institutions are highlighting the possible additional risks post 2006. A potential fall in recruitment in 2006-07 is not expected by the sector, although some institutions consider themselves more vulnerable than others.

57. The other major risks relate to the pressure to make pay awards above inflation, and failure to manage capital programmes. In the case of high salary increases, the onus is on institutions to manage this through their arrangements for recruiting and rewarding staff, and balancing this against the requirement for efficiencies, or increasing revenues through recovery of full costs. Nevertheless, there is inevitably some conflict between managing the risk of high salary increases and managing the risk of not being able to recruit and retain well-qualified staff. The additional costs of the new single pay spine will also add to the risks faced by the sector. The third major area of risk — management of capital programmes — reinforces the need for good management practice around capital investment and projects.

58. HEIs' commentaries on the actions they have put in place, or intend to put in place to ensure continued sustainability have been analysed to identify the main areas of action. The following is a list of the main actions commonly identified by institutions, and is in line with the actions highlighted by HEIs last year:

- control of staff costs
- control of non-pay costs
- growth in overseas student numbers
- growth in other operating income
- improved pricing and contributions to costs
- increasing student numbers
- estates developments and improved facilities
- implementation and consideration of collaborative opportunities.

# 2005 Annual monitoring statements

## Implementation of new AMS process

59. In HEFCE 2005/06, 'Financial forecasts, annual monitoring and corporate planning statements: Outcomes for 2004 and changes to annual monitoring statements in 2005', we set out our plans to revise the AMS process.

60. While much had been done to improve the process, we believed that there was room for further improvement, particularly in relation to reducing the regulatory burden. We also wanted to take advantage of the increased assurance that we receive for those HEIs that have adopted the CUC Governance Code of Practice.

61. Institutions were asked to tell us in the AMS whether or not they had adopted the CUC code, in full or in part. We said that we would seek further information from institutions that had not adopted the code (and were not planning to do so in the next 12 months) on a case-by-case basis. Almost all institutions reported that they had adopted (in full or in part) the CUC code.

62. Three principles underpinned the new approach:

- reporting by exception
- proportionality
- focus on outcomes and the impact of funding.

63. Institutions were asked to provide assurance that they have delivered the targets and objectives as originally outlined in their strategy or proposal documents. They were only required to provide more detail where there were problems with delivery or where there had been a significant underspend.

64. Institutions submitted a corporate planning statement (CPS) at the same time as the AMS and financial forecasts. Regional teams have carried out their analysis of the CPSs and will continue to use these in their discussions with institutions.

## AMS analysis

65. Table 5 shows the proportion of responses that reported slippage in delivery of targets and objectives for 2004-05 for each of the special funding initiatives monitored through the AMS (note that the Higher Education Active Community Fund, HEACF, is not included in this table - see paragraph 67 for further explanation).

66. Table 6 shows the proportion of responses that reported a significant underspend for 2004-05 for each of the special funding initiatives monitored through the AMS (please note Business Fellowships is not reported in this table as we did not ask the question on underspend in relation to this funding stream in the AMS).

67. In the case of HEACF, we sought assurance in relation to the number of volunteering opportunities, rather than the delivery of targets and objectives. Four per cent of the institutions that receive HEACF funding reported that they had not maintained and developed the quality and throughput of the appropriate number of existing HEACF round 1 volunteering opportunities. Three per cent reported that they had not created the appropriate number of new volunteering opportunities.

68. In addition to the special funding initiatives, we also collect monitoring information on race equality within the AMS as part of our obligations under the Race Relations Amendment Act (2000). Thirty-seven per cent of institutions reported slippage in their delivery of the targets and objectives set out in their race equality plans.

**Table 5: Proportion of responses reporting slippage in special funding initiatives\***

<b>Learning and teaching</b>	
TQEF	18%
SPS	47%
<b>Business and the community</b>	
Business Fellowships	9%
HEIF 2	35%
KTCF	26%
<b>Rewarding and Developing Staff</b>	
RDS	45%
<b>Research Capability Fund</b>	
UOA 10	10%
UOA 11	12%
UOA 41	13%
UOA 64	14%
UOA 65	20%
UOA 66	8%
UOA 69	8%

\* See List of abbreviations for definitions



**Table 6: Proportion of responses reporting significant underspends in special funding initiatives\***

<b>Learning and teaching</b>	
TQEF	24%
SPS	54%
<b>Business and the community</b>	
HEACF	11%
HEIF 2	46%
KTCF	26%
<b>Rewarding and Developing Staff</b>	
RDS	39%
<b>Research Capability Fund</b>	
UOA 10	5%
UOA 11	19%
UOA 41	7%
UOA 64	10%
UOA 65	20%
UOA 66	15%
UOA 69	8%

\* See List of abbreviations for definitions

## Follow-up work

69. We want HEIs to use funds to achieve improvements and additional activities, delivering outputs and outcomes as described in their plans to us. We also have a statutory responsibility to account for public funds. That is to confirm that they are used for the purposes for which they are given and that we are not paying in advance of need. Therefore we are concerned where we see activities not being delivered and sums being carried forward to future years.

70. Institutions were informed that we would potentially reprofile or suspend funding under the relevant funding programme in cases where a delay in delivery of targets and objectives and/or significant underspending has been reported to us. HEFCE regional teams took the lead in following up these cases, liaising with institutions and policy colleagues. Where necessary, agreement was secured either to reprofile or temporarily suspend funding to avoid funding in advance of need.

## List of abbreviations

<b>AMS</b>	Annual monitoring statement
<b>CPS</b>	Corporate planning statement
<b>CUC</b>	Committee of University Chairmen
<b>FTE</b>	Full-time equivalent
<b>FRS</b>	Financial Reporting Standard
<b>HE</b>	Higher education
<b>HEACF</b>	Higher Education Active Community Fund
<b>HEFCE</b>	Higher Education Funding Council for England
<b>HEI</b>	Higher education institution
<b>HEIF</b>	Higher Education Innovation Fund
<b>KTCF</b>	Knowledge Transfer Capability Fund
<b>RDS</b>	Rewarding and Developing Staff
<b>SPS</b>	Supporting Professional Standards
<b>TDA</b>	Training and Development Agency for Schools
<b>TQEF</b>	Teaching Quality Enhancement Fund
<b>UOA</b>	Unit of assessment

### Units of assessment supported by the Research Capability Fund

<b>UOA 10</b>	Nursing
<b>UOA 11</b>	Other Studies and Professions Allied to Medicine
<b>UOA 41</b>	Social Work
<b>UOA 64</b>	Art and Design
<b>UOA 65</b>	Communication, Cultural and Media Studies
<b>UOA 66</b>	Dance, Drama and Performing Arts
<b>UOA 69</b>	Sports-related Subjects