National Audit Office

Department for Business, Innovation and Skills
Higher Education Funding Council for England

# Regulating financial sustainability in higher education

## Detailed methodology

MARCH 2011

# Detailed methodology

**1** This document provides a detailed description of the methodology we used for our report, *Regulating financial sustainability in higher education* (HC 816, Session 2010-11). A summarised version is available in Appendix One of the main report. The six main elements of our methodology were:

- analysis of financial data from higher education institutions;
- semi-structured interviews;
- census of institutions;
- visits to institutions;
- observations of Higher Education Funding Council for England visits; and
- analysis of value for money savings reports.

## Analysis of financial data from higher education institutions

**2** We obtained three principal sources of financial data from the Higher Education Funding Council for England (the Funding Council):

- The Higher Education Statistics Agency Finance Statistics Returns (the Finance Statistics Return) for academic years 2005/06 to 2008/09 which provide detailed analysis of institutional income, expenditure and balances.
- Institutions' Financial Forecast Returns (the Financial Forecast Return) made to the Funding Council for 2002 to 2010 which provide summary analysis of institutional income, expenditure and balances for both historic and future years.
- An extract of the Higher Education Statistics Agency data (provided by the Funding Council) contained in the Staff Person and Staff Contract tables for 2005/06 to 2008/09 that provide detailed, anonymised information on higher education staff including role, length of service and salary.

**3** Financial analysis uses the Finance Statistics Return except in 2009/10 and 2010/11 where no Finance Statistics Record is yet available. For these years, we have used the Financial Forecast Return for 2010. We have also used data on borrowing from the Financial Forecast Returns. In presenting data, our rounding convention is to ensure that data adds as presented in tables.

**4** The Funding Council funds 130 higher education institutions, including University Campus Suffolk, a joint venture between the University of Essex and the University of East Anglia. The University Campus Suffolk does not provide separate financial data and the data are included within the returns for the Universities of Essex and East Anglia.

**5** Time series data, such as that in Figure 5, generally use the data as published soon after the year end. We do not generally adjust for institutional mergers that happen in a subsequent year. We also do not generally adjust for changes in accounting policy.

**6** The partial exception to this is Figures 7 and 8. In these figures, we are doing comparisons of institutional data against Funding Council internal benchmarks over short time series. Each year, institutions provide financial data for the academic year just ended and a restatement of the previous academic year on the same basis. In our analysis we have used the restated financial data where indicators are reviewed over multiple years. For two indicators in Figures 7 and 8, namely historical cost surplus or deficit and net cash flow from operating activities, the benchmark looks at time series over three years. We have not adjusted the earliest of these years for accounting policy changes in the last year, as data is not available. Where possible we have adjusted for institutional changes. In some cases, though, this is not possible. For example, on the 1 August 2007 the University of Cumbria was formed from the merger of the Cumbria Institute of Arts, St Martin's College and the Cumbria Campus of the University of Central Lancashire. Data for the new University of Cumbria is available for 2006/07, as a restated comparator in 2007/08. However, for 2005/06 neither data for the combined University of Cumbria nor separate data on the Cumbria Campus at the University of Central Lancashire is available. As a result, we cannot assess the position of the University of Cumbria against the historical cost surplus or deficit indicator or the net cash flow indicator in 2007/08. In these circumstances, we assume that an institution is operating above the benchmark.

**7** Throughout the report, we have defined total income using the Funding Council's approach of including income from subsidiaries and joint ventures gross of the share due to other shareholders.

**8** Institutions report Funding Council grant against four headings in the Financial Forecast Returns. These are teaching grant (65 per cent of all Funding Council grant); research grant (23 per cent of all Funding Council grant); release of deferred capital grants (5 per cent); and other (7 per cent). In Figure 1, we have allocated Funding Council deferred capital grants and other grants across teaching and research using the ratio, at institutional level, of teaching to research grant.

**9** In some figures, we have adjusted historic data for inflation using a GDP deflator series provided to us by the Funding Council. This series adjusts the September 2010 HM Treasury series such that it is on an academic year basis.

**10** The six financial indicators are defined as follows:

| Description used in main report | Definition |
| --- | --- |
| Historical cost surplus or deficit | Historical cost surplus or deficit for the year after tax as a percentage of total income.<br><br>This indicator is not adjusted for differences arising from whether defined benefit pension schemes are accounted for on or off balance sheet. |
| Net cash flow from operating activities | Net cash inflow/outflow from operating activities as a percentage of total income. |
| Net liquidity | The balance of cash at bank and in hand less any short term overdraft plus any current asset investments all divided by total expenditure less depreciation and then multiplied by 365. |
| Discretionary reserves | The accumulated balance on the income and expenditure account, before pension liability, plus any expendable endowments as a percentage of total income.<br><br>For consistency with the Funding Council, this indicator is adjusted for differences arising from whether defined benefit pension schemes are accounted for on or off the balance sheet. The accounting treatment of endowments changed in 2007-08 and prior to that year the concept of general endowments is used.<br><br>Some institutional returns for accumulated income and expenditure are also adjusted where later Funding Council analysis identified that institutions had incorrectly split out the pension liability. |
| Staff costs | Total pre-exceptional staff costs as a percentage of total income. |
| Affordability of borrowing | The annualised service cost, which is the average annual net cash payment (capital and interest) over the period of any loans outstanding, as a percentage of total income. |

**11** Some data for three institutions on affordability of borrowing is not available, as they did not make the appropriate return to the Funding Council. These institutions are:

- London Metropolitan University and Leeds College of Music for 2006/07 and 2007/08.
- University of Cumbria for 2008/09.

**12** Figure 9 compares forecasts of historical cost surplus or deficit made eight to twelve months in advance of the end of the financial year with the actual historical cost surplus or deficit recorded. Institutions make forecasts for all indicators and do so for several years in the future. We have carried out additional analyses to ensure that the graph in Figure 9 is representative of the wider pattern of institutional forecast accuracy.

**13** Staff analysis presented in paragraph 1.8 is based on an analysis of the Staff Person and Staff Contract tables that we obtained from the Funding Council. The numbers presented exclude atypical contracts and adjust the full-time equivalents recorded in the Staff Contract table such that no member of staff is counted as more than one full-time equivalent.

## Semi-structured interviews

**14** We conducted a number of semi-structured interviews with a range of staff within the Funding Council. The purpose of these meetings was to gain information about specific areas of the Funding Council's work (such as its approach to institutions rated At Higher Risk), to improve our understanding of wider issues relating to the sector, and to clarify certain technical issues of relevance to our work (such as information about the data we would obtain from the Funding Council). We have drawn on these interviews throughout our report.

**15** We also conducted a smaller number of interviews with officials within the Department. These interviews centred on the Department's sponsorship of the Funding Council, and its policies on funding. We have drawn on the understanding gained from these meetings throughout our report.

**16** We also conducted a number of interviews with representatives from a range of third parties:

- Association of Heads of University Administration;
- British Universities Finance Directors Group;
- Committee of University Chairs;
- Edinburgh Napier University;
- GuildHE;
- Leadership Foundation for Higher Education;
- Lloyds Banking Group;
- Million+;
- Monitor;
- National Union of Students;
- Oakleigh Consulting Ltd;
- Russell Group;
- Scottish Funding Council;
- SUMS Consulting and Southern Universities Purchasing Consortium;
- University Alliance;
- Universities and Colleges Employers Association;
- University and College Union;
- Universities UK; and
- 1994 Group.

**17** The purpose of these meetings was to gain insights about the Funding Council's assurance role, the financial health of the sector, and the challenges facing the sector. We used these insights in designing our census, and have drawn on them throughout our report.

## Census of higher education institutions

**18** We sent an online questionnaire to all 129 higher education institutions in England that receive funding from the Funding Council. The questionnaire was sent to heads of institutions in the first instance. We issued the questionnaire in the week commencing 18 October 2010, and continued to receive responses until the week commencing 22 November 2010. We received responses from 109 institutions, a response rate of 84 per cent.

**19** The purpose of this census was to gain both quantitative and qualitative evidence on a range of issues, including the Funding Council's assurance work, the sector's relationship with the Funding Council and the financial challenges facing the sector. We have drawn on the results throughout our report. A detailed summary of the results of the census is available separately on the National Audit Office website, www.nao.org.uk/HE-Finance-2011.

## Visits to higher education institutions

**20** We carried out site visits to six institutions, selected to provide us with a variety of size, type, and location of institution. Each visit comprised several meetings held over a period of between one and five days:

- Bishop Grosseteste University College (September 2010);
- Leeds Metropolitan University (September – October 2010);
- London Metropolitan University (June – July 2010);
- University of Birmingham (July 2010);
- University of Durham (July 2010); and
- University of Hertfordshire (May – June 2010).

**21** In these visits we conducted semi-structured interviews with a range of key individuals, including the Vice-Chancellor/Principal, Finance Director, Secretary/Registrar, Chair of Governors or Chair of Finance/Treasury/Audit Committee, Head of Estates, and representatives from the student body, academics, non-academic staff, and unions. Before the visits we reviewed key documents relating to the institutions' financial strategy and performance, executive and governing committee minutes, and internal audit reports. Visits were also preceded by a review of Funding Council documents relating to the institution's financial health, as well as discussions with relevant Funding Council staff responsible for monitoring and liaising with the institution.

**22** The purpose of these visits was to gain insights into the strength of the Funding Council's monitoring of the financial health of institutions. We also used the visits to gain information about issues relating to financial health and the relationship between the institution and the Funding Council. This helped us design the census.

**23** To provide background information relating to higher education finance and regulation which would help us to scope our study, at an early stage we visited two other institutions:

- University of Brighton; and
- University of Huddersfield.

**24** We also conducted telephone interviews with the Principal or Finance Director from a number of smaller institutions in June 2010:

- The Arts University College at Bournemouth;
- Harper Adams College;
- University College Falmouth;
- University of Worcester; and
- York St. John University.

**25** The purpose of these interviews was to gain insights into the financial challenges and opportunities relating specifically to smaller institutions. We drew on these interviews in designing our census and in shaping our understanding of the challenges affecting both the sector and the Funding Council.

## Observations of Funding Council assurance review and data audit visits to institutions

**26** We accompanied Funding Council staff in their visits to three institutions:

- Kingston University (Funding Council assurance review);
- University of Birmingham (Funding Council data audit); and
- Imperial College (Funding Council assurance review).

**27** Our purpose was to observe the Funding Council's processes in key elements of its assurance and audit work. We used our visits to help us understand and evaluate the effectiveness of the Funding Council's regulatory function, to design questions for our census, and to improve our understanding of institutions' financial management, governance, and relationship with the Funding Council.

## Analysis of the Funding Council's annual value for money report

**28** Following the 2007 Comprehensive Spending Review (CSR07), the Department gave the Funding Council responsibility for overseeing annual value for money savings targets for the higher education sector. In its annual report on value for money savings in the 2009-10 financial year, the Funding Council reported delivering savings totalling £273.7 million against its target of £241.8 million for that year.

**29** We reviewed this 2009-10 value for money savings report. In doing so, we used the criteria for assessing these savings as set out by HM Treasury, and modelled our analysis on the practices used by the National Audit Office in reports devoted to other departments' CSR07 savings.[1] We focused on the three most significant areas of saving by size of reported savings. We drew on this analysis both in framing questions for our census, and in considering the ability of the Funding Council to effect efficiency savings within, and verify those reported by, institutions.

1 For example, Comptroller & Auditor General, *Department for Education: independent review of reported Comprehensive Spending Review 2007 Value for Money savings*, Session 2010-11, HC 294, National Audit Office, July 2010.

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