National Audit Office

Regulating the financial sustainability of higher education providers in England

Department for Education and Office for Students

REPORT

by the Comptroller and Auditor General

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Key facts

2.3m

students attending higher education providers in England, excluding those in further education and sixth-form colleges

32%

of providers with an in-year deficit, excluding accounting adjustments for pension revaluations and provisions, in 2019/20

10

providers subject to enhanced monitoring by the Office for Students (the OfS), as at December 2021, because of heightened risk to their financial sustainability

254	higher education providers in England, excluding further education and sixth-form colleges, registered with the OfS in July 2021
£36.1 billion	total income of higher education providers in 2019/20, of which 36% came from public sources
64	providers out of 247 (26%) forecast at the end of 2020/21 that their cash balance would fall below 30 days' net liquidity at some point in the next two years
33%	students viewing their course as providing good value for money in 2021, with 54% saying it was not good value for money
£27.7 million	running costs of the OfS in 2020-21, mainly funded by registration fees paid by providers
£2.8 billion	aggregate net in-year deficit for higher education providers in 2019/20 on a full economic cost basis, taking into account all the direct and indirect costs of sustaining their activities

Throughout this report, government financial years are written as, for example, '2020-21' and run from 1 April to 31 March; higher education sector academic and financial years are written as '2020/21' and run from 1 August to 31 July.

Summary

Introduction

1 Universities, and other higher education providers, are autonomous institutions with a high degree of financial as well as academic independence. They are free to conduct commercial activities in addition to teaching and research. For a provider to access government funding for research or teaching, however, or for its students to receive government tuition fee and maintenance loans, it must be registered by the Office for Students (the OfS), the sector regulator. The OfS is sponsored by the Department for Education (the Department).

2 In July 2021, there were 254 higher education providers in England registered with the OfS, excluding further education and sixth-form colleges, educating an estimated 2.3 million students. Of these, 1.8 million were from the UK, and 1.6 million were undergraduates. Some providers are also 'anchor institutions' with a significant influence within their local economies and communities. The total income of higher education providers in 2019/20 was £36.1 billion, 36% of which came from public sources.

3 The OfS has very broad objectives: to help students access higher education; ensure they have a high-quality experience of higher education; protect their interests while they study; make sure they can progress to employment or further study; and ensure they receive value for money. Should higher education providers become financially unsustainable or unviable, students would be adversely affected in all these areas. Financial pressure could increase the risk of providers failing, closing campuses or courses, reducing the quality of teaching, or limiting access.

4 This is our first report on the OfS, which began operating in 2018. Having spent its first year registering providers, it became fully operational as a regulator in August 2019. It was therefore still a relatively new body when the COVID-19 pandemic began in early 2020. Risks to the financial sustainability of higher education providers were already increasing, and the pandemic added major disruption and new risks to the sector – and consequent additional challenges to the OfS.

5 Our report focuses on the OfS's responsibilities to protect students' interests from the consequences of financial risk in higher education providers. We have not looked at the OfS's other responsibilities for matters such as teaching quality. As the OfS is a young organisation we reviewed its performance with a view to identifying areas where it should focus as it continues to mature.

Key findings

Financial risk in the higher education sector

6 **The proportion of providers with an in-year deficit, even after adjusting for the impact of pension deficits, increased from 5% in 2015/16 to 32% in 2019/20.** Reported results for some providers over recent years have appeared volatile because they include large one-off accounting adjustments caused by revaluations in pension scheme liabilities – especially in respect of the Universities Superannuation Scheme, which has a large deficit. Excluding these adjustments to show a more consistent view of underlying trends, the proportion of providers with an in-year deficit has increased year on year. The number with an in-year deficit of 5% or more of income has also grown each year, from one out of 133 (1%) in 2015/16 to 37 out of 244 (15%) in 2019/20. Reporting a deficit in any one year is not necessarily evidence of underlying financial problems in an individual provider. However, of the 80 providers with an in-year deficit in 2019/20, 20 had been in deficit for at least three years. Although the population of providers has changed over time, in particular with the registration of many smaller providers, the recent trend of rising in-year deficits also applies to providers for which there are continuous data over the whole period from 2015/16. The OfS reported in July 2021 that 133 higher education providers in England, together with two in Northern Ireland, had an aggregate in-year deficit of £2.8 billion for 2019/20 on a full economic cost basis, taking into account all the indirect as well as direct costs of sustaining their activity – double the deficit of £1.4 billion reported in 2018/19 (paragraphs 1.12, 2.2, 2.4 and 2.8, and Figure 4).

7 **Financial stress is not confined to one part of the sector.** Higher education providers are a very diverse group, with different business models and financial performance reflecting wide variations in their numbers and type of students, size and sources of income and extent of research activity. The size of a provider, its entry requirements or whether it is a specialist institution, for example, are not predictors of financial strength. The 20 providers that have had an in-year deficit for at least three years range in size from 200 students to more than 30,000 (paragraphs 2.3 and 2.4).

8 **The number of providers of all types that appear to be facing short-term risks to their financial sustainability and viability is small but not insignificant.** The OfS uses liquidity (a measure of a provider's ability to continue to pay its bills) as an indicator of the risk of a provider failing. The OfS does not apply rigid targets, but it normally engages with providers if their liquidity falls below 30 days' expenditure. There is more variation within groups of otherwise similar providers than between these groups. During 2020/21, 33 out of 247 providers (13%) had forecast liquidity below 30 days – including at least one from each group (paragraph 2.4 and Figure 6).

9 **Short-term financial risks are dominated by COVID-19, but medium- and long-term risks are systemic.** The COVID-19 pandemic created immediate risks that providers would lose income from a potential fall in international student fees, and also from conferences, accommodation and research. At the same time, they had to invest in new ways of teaching. Providers still also face the systemic risks that existed before COVID-19. Valuations of pension schemes (particularly the Universities Superannuation Scheme) indicate that higher employer contributions will be needed. Publicly funded teaching and research make a loss across the sector once the full economic costs of those activities are taken into account. This makes the financial viability of some providers highly dependent on cross-subsidy, primarily from fees paid by international students. For most providers, the cost of research activity also exceeds the value of research grants. The OfS's own assessments have highlighted that many providers' medium- and long-term financial forecasts depend on assumed continued growth in overseas as well as domestic student numbers. The OfS has questioned whether it is realistic for all providers to be making similar assumptions in a competitive market (paragraphs 1.12, 2.6 to 2.11, 4.13 and 4.18, and Figure 8).

Effective regulation of financial sustainability

10 **The OfS has adopted a deliberately data-led approach to regulation.** The OfS collects the same base set of detailed annual financial and performance data from all regulated providers. It also places a responsibility on providers to report events such as breach of conditions associated with loans or credit facilities (banking covenants), changes to teaching provision, or other events that might increase financial risk. The OfS relies on these data to identify providers for further scrutiny (paragraphs 3.8 to 3.10).

11 **The OfS makes good use of the financial data it collects, analysing it in a systematic and structured way to identify providers for closer scrutiny.** In this way, during 2021 it identified some 98 out of 245 providers (40%) for detailed review of their financial viability and sustainability. As part of its risk-based approach to regulation, the OfS applies a degree of judgement in setting the level of risk it is prepared to tolerate, reflecting its estimate that it does not have the resources to examine all providers in detail. The level of financial risk in providers the OfS accepts is, therefore, influenced by resource constraints as well as its perception of the potential impact on students. The OfS links the outcome of its financial analysis with other information it holds on providers. It seeks further information from providers where it has identified concerns about their financial sustainability. The OfS could usefully explore how it can use insights from its increased engagement with providers during the COVID-19 pandemic to supplement its existing knowledge of their business models. The OfS has undertaken some financial analysis and scenario modelling of key risks but does not yet have an integrated model to bring together and assess the impacts of ongoing, multiple and systemic risks to financial sustainability, carry out sensitivity analysis or test scenarios. It told us that it is planning to develop such a model – and that this work will in future help inform its assessment of risk in individual providers (paragraphs 3.6, 3.10 and 3.13 to 3.18).

12 **As at December 2021, the OfS had made 10 providers subject to enhanced monitoring because of concerns about increased risk to their financial viability.** It was also engaging with a further 13 providers to understand their level of risk. The OfS's interventions for financial viability and sustainability are based on its assessment of risk in individual providers. It has a range of regulatory responses available, including enhanced monitoring (that could include, for example, requiring additional information from the provider), imposing specific conditions, monetary penalties, and suspending or removing a provider's registration altogether (paragraphs 3.9, 3.14, 3.17 and 3.19).

13 **The Department and the OfS have not yet been successful in achieving a good understanding among providers of why the OfS collects all the data it does, and how it uses it.** The OfS collects the same data from all regulated bodies on the grounds that doing so allows it to apply consistent principles to identify risk, and therefore target interventions only where needed. It uses this information in support of its statutory functions to monitor and report on the financial sustainability of the sector as a whole, and to monitor (and, if necessary, intervene) in relation to financial viability and sustainability risks in individual providers. Some of the stakeholders and providers we spoke to, on the other hand, were critical of what they perceived as a 'one-size-fits-all' approach to data collection – and the corresponding regulatory burden – rather than a more tailored approach (paragraphs 3.9, and 3.11 to 3.13).

14 **There is more the OfS could do to help the sector and other stakeholders understand its regulatory approach.** Giving stakeholders clarity over the fundamental aim and means of regulation helps ensure a shared understanding of its purpose and intended outcomes. The OfS aims to be a principles-based regulator, which means it focuses on the outcomes it wants providers to achieve without prescribing how they should do so. The OfS relies heavily, although not exclusively, on financial metrics to identify risks to providers' financial sustainability and has designed a regulatory approach that does not involve routine discussion with individual providers. The sector bodies and providers that we spoke to told us that the OfS did not routinely speak with most providers, leading them to doubt whether the OfS had all the information needed to put financial data into context. The OfS told us it considered it had engaged with providers sufficiently to understand risks to their financial sustainability. Early in the COVID-19 pandemic, the OfS spoke to most providers to understand how they were responding to new pandemic-related risks. This engagement was well received in the sector and was an effective way to quickly understand emerging financial risks (paragraphs 3.4 to 3.6).

15 **The Department responded to new financial challenges for providers during the COVID-19 pandemic by enhancing the role of the cross-government higher education financial sustainability oversight group.** The Department has a coordinating role as the chair of the higher education financial sustainability oversight group – a cross-government group of officials from the Department, the Department for Business, Energy & Industrial Strategy (BEIS), UK Research and Innovation, and the OfS. During the pandemic, the group was strengthened by bringing in a representative from HM Treasury, given its interest in financial support measures that were being considered. The group does not have access to all the commercially sensitive provider-level data available to the OfS, and it provided a practical way to coordinate government intervention to support the sector during the pandemic (paragraph 3.24).

16 **The OfS does not yet have a complete and transparent set of performance measures to demonstrate its own performance as a regulator.** The OfS sets out on its website the measures against which it intends to assess how well it is performing its regulatory functions and whether it is delivering value for money. Out of 26 indicators, eight are still in development or have incomplete performance information, and a further 11 indicators do not yet have associated targets (paragraphs 1.10 and 3.25).

17 **The OfS does not routinely ask providers and sector stakeholders for feedback on its own performance as a regulator.** The Department, as primary sponsor of the OfS, holds quarterly performance reviews with the OfS's leaders. The Department maintains, and discusses with the OfS, a risk assessment of potential threats to the OfS's effective performance of its functions. Although the OfS consults widely on changes to the regulatory framework, it has no routine mechanism (for example, through a survey) to gain structured feedback from providers on its own performance (paragraphs 3.5 and 3.6).

Consequences for students and providers

18 **The OfS lacks a strong measure with which to judge the value for money students get from their courses.** The OfS routinely collects students' views on, for example, the quality of teaching and learning they are experiencing, and their perception of the value for money of their degree. It carries out an annual National Student Survey but, because it is open to final-year students only, it will not have captured the views of all students, particularly first-year undergraduates who are most likely to have been affected by the closure of university accommodation during the COVID-19 pandemic. In a separate survey in February/March 2021, 33% of undergraduates said they thought university offered good value for money and 54% thought it did not. The OfS does not attempt to define value for money, on the grounds that it may mean different things to different people or may change over time. The OfS argues that it seeks to track perceptions over time but, without a consistent definition, it lacks a strong measure with which to judge value for money (paragraphs 4.6 to 4.8).

19 **The OfS found during the COVID-19 pandemic that it needed stronger powers of intervention to protect students' education when a provider is at material risk of market exit.** The OfS requires all higher education providers to have in place a student protection plan that the OfS has approved as appropriate for the level of risk presented by the provider and for the risk to continuity of study for all its students. No student protection plan has ever had to be implemented at short notice. During the COVID-19 pandemic, however, the OfS identified that there were common weaknesses in student protection plans – including providers being over-optimistic about the risks they faced, lack of detail about what specific actions providers would take, and weak refund and compensation policies. The OfS implemented a new condition of registration, effective from 1 April 2021, giving it additional powers to direct providers it considers at material risk of market exit to implement specific measures to protect students (paragraphs 4.2 to 4.5).

20 **Some providers would likely have faced financial difficulty had they been required to refund tuition fees.** Student satisfaction fell sharply between 2020 and 2021, when pandemic lockdown measures were in place. The proportion of students viewing their course as good value for money also fell, from 38% in 2020 to 33% in 2021. The government's position was not to support tuition fee refunds. One of the smaller providers we spoke to told us that, had government applied more pressure to offer significant fee refunds, this would have caused it, and likely some similar providers, to fail (paragraphs 4.7, 4.8 and 4.20).

21 **Higher education providers proved more resilient during the COVID-19 pandemic than government had feared.** The Department's early modelling in May 2020 estimated that the adverse impact of COVID-19 on the sector could range between £3.9 billion and £22.3 billion, with a central estimate of a £13.9 billion loss in 2020/21. Providers were able, for example, to draw on their reserves or use commercial credit facilities to maintain cashflow, and some deferred capital spending plans. Importantly, income from overseas students' fees was maintained – there were 17% more non-EU students in 2020/21 than in 2019/20. Because of genuine concern at the beginning of the pandemic, however, that falling income could make providers unviable, the Department and BEIS both put in place measures to provide emergency support:

- **The Department accelerated payment of student fees to providers.** Providers were able to access £2.6 billion in the first term of the 2020/21 academic year that would normally have been paid later in the year.

- **The Department announced in July 2020 a restructuring regime to prevent chaotic market exit.** The scheme provided time-limited access to support and emergency funding and was intended as an intervention to be used in the last resort. The Department told us that it received 18 enquiries from providers, of which three had applied to the regime.

- **BEIS announced a 'research stabilisation package' intended to maintain UK research capacity.** Early modelling by BEIS, in May 2020, estimated that the extent of reliance on cross-subsidy for research income was £4.3 billion in 2018-19, and that some £3.0 billion could be at risk. The stabilisation package included £200 million in new government investment, and redistribution of £80 million of existing funding. BEIS also made available a package of loans and grants designed to make up for losses in international student numbers. Demand for that additional support was lower than forecast – BEIS provided funding to five applicants, totalling £21.4 million in loans and £298,000 grant funding (paragraphs 4.10 to 4.14 and 4.17).

22 **A-level grade inflation distorted the higher education market and increased financial risk for some providers.** The adoption of centre-assessed grades in place of examinations in summer 2020 caused significant grade inflation, making more students eligible for places at their first-choice provider and on high-tariff courses. As a result, some high-tariff universities were oversubscribed, and lower-tariff universities undersubscribed. Further grade inflation in summer 2021 compounded the situation. This has caused challenges for both oversubscribed and undersubscribed universities and increased financial risk for some providers in the medium as well as the short term. The Department anticipated that some high-cost courses would become oversubscribed and provided additional revenue and capital funding to support providers to increase capacity. The Department did not model or draw insights from the OfS to understand in advance the potential financial consequences on undersubscribed providers, despite the potential impacts being foreseeable (paragraphs 4.21 to 4.28).

Conclusion on value for money

23 The financial sustainability of higher education providers can have a profound impact on the quality and value for money of education for two million students every year. The current regulatory system, with the OfS at its heart, was established to protect the interests of students. So far, the OfS's regulatory approach has not witnessed any provider failures, but rising numbers of providers in deficit indicate increased financial pressure in the sector. At this early stage in its development as a regulator the OfS has had to adapt to the challenges of the COVID-19 pandemic, during which students' satisfaction with the value for money of their university education fell sharply. Its heavily data-driven approach to assessing financial risk does not yet have the full confidence of all providers.

24 To protect students' and taxpayers' interests adequately, the Department and the OfS should now reflect on the lessons that can be learned from good-practice principles of effective regulation. Implementing these will strengthen the OfS's understanding of the risks that pressures on the financial sustainability of providers pose for students. It will also build higher education providers' confidence in the OfS as a regulator, and better equip it to deal with sustained and increasing risks to providers' financial sustainability.

Recommendations

25 The Department should:

a **review, improve and agree with the OfS the key performance measures and other indicators it uses to hold the OfS to account,** to include measures of the impact of the regulatory regime, rather than measures outside the OfS's control;

b **make clear what tolerance the government has for provider failure, and the circumstances under which it would or would not intervene;** and

c together with the OfS, **assess how redistribution of student numbers between providers, as a result of higher A-level grades awarded in 2020 and 2021, has affected students' experiences and providers' finances,** and draw on this to understand the likely consequences following release of A-level grades awarded in 2022.

26 The OfS should:

d **communicate more effectively with the sector to build trust in its approach as a regulator;** improve providers' understanding of its attitude to risk and how it defines risk-based, proportionate, regulation; and be more ready to share sector insights to improve efficiency and competitiveness in the sector;

e **set out how it will secure provider and stakeholder views of its work;**

f **review, improve where necessary and then reauthorise student protection plans for all providers** to ensure they remain adequate and can respond to new risks; and

g **prioritise finalising its key performance indicator on how it assesses the value for money students see in their education and set out how its work will reverse students' declining satisfaction rates.**