

HEFCE 01/71

**December**  
Report

# Analysis of corporate plans, outcomes of 2001 financial forecasts and annual operating statements

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To Heads of HEFCE-funded higher education institutions  
Heads of universities in Northern Ireland

Of interest to those responsible for Finance, Planning, Management

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## Executive summary

### Purpose

1. This report sets out the key points from our analysis of the first cycle of institutions' corporate plans. Institutions were asked to submit corporate plans within a three-year cycle beginning in July 1999 (see HEFCE 01/23).
2. We are now requesting corporate plans for the second cycle of plans, beginning in July 2002. In doing so we invite institutions to take account of the key issues for development arising from the first cycle of plans, as set out in this report.
3. This document also provides a summary of financial projections for the higher education sector covering 2000-01 to 2004-05 and of the sector's annual operating statements for 2000-01. It is based on information provided by higher education institutions in July 2001.

## **Key points**

### Corporate plans

4. All HE institutions are asked to provide the Council with their corporate or strategic plan, which describes the institution's mission, sets out their overall strategy and long-term objectives, and explains how these are to be achieved.
5. Following consultation in 1998, we revised our approach to institutional corporate planning. To reduce the burden on institutions, we no longer asked for a full corporate plan to be provided every year, but asked for plans on a three-year cycle. The first cycle began in July 1999.
6. HEIs are required to provide summary annual operating statements and financial forecasts in July of each year. We also require specific strategies in return for HEFCE special funding for strategic areas (for example, widening access and participation, learning and teaching, and human resources).
7. We now invite institutions to submit plans for the second three-year cycle beginning in July 2002. To enable planning and reporting to be more effective in the future, we encourage a stronger focus in plans on the following:
  - a. Clearer identification of institutional missions and priorities.
  - b. More specific objectives and measurable targets.
  - c. Improved financial strategies to underpin plans, with associated risk assessment.
  - d. More effective integration of subsidiary strategies within the overall plan.

### Annual operating statements

8. This is the third year in which we have sought annual operating statements (AOSs). Our analysis of the 2000-01 AOSs has focused on the three key HEFCE strategic initiatives of widening participation, learning and teaching, and Higher Education Reach-out to Business and the Community, looking particularly at the second year of activity under these initiatives.
9. We will continue to evolve the framework, seeking to identify the minimum range of information that we need for monitoring purposes, and collecting as much as possible through AOSs. In April 2002 we will extend the AOS request to collect information on human resource strategies and the Higher Education Innovation Fund in addition to the three initiatives mentioned above.

### Widening participation

10. Over four-fifths of institutions reported that they are either fully or mostly achieving the activities and targets that they set for themselves in their initial statements. This was a slightly improved outcome compared to last year. Only a very small number of institutions reported a lack of progress against their widening participation plans.

11. In a small minority of cases the AOS gave insufficient information to enable us to make a judgement about progress in widening participation in 2000-01, but overall reporting on progress in widening participation has improved compared to last year.

#### Learning and teaching strategies

12. Almost all institutions were fully or mostly achieving the activities and targets they had set for themselves for 2000-01 (compared to around four-fifths last year). This is a very good result and shows that some institutions with earlier slippage in their plans were back on target. A very small number had fallen behind in their plans, and a few others had not provided enough information for us to form a view about progress.

#### Higher Education Reach-out to Business and the Community (HEROBC)

13. As last year, the great majority of institutions have fully or mostly achieved the activities and targets that they had set for themselves for 2000-01. Most institutions had provided sufficient information for us to form a view about their performance. A few institutions had fallen behind with their plans. A number of these had received funds only through the second round of HEROBC funding, and therefore 2000-01 was the first year they had received funding. Delay in making appointments was a significant factor for these institutions.

#### Follow-up work

14. We will follow up cases of insufficient information or apparently inadequate progress through our regular meetings between institutions and HEFCE Regional Consultants.

#### Financial forecasts

15. The sector forecasts have a history of reliability with actual results being close to forecast.

16. The operating position is forecast to be at break-even for 2000-01 and 2001-02, rising thereafter. The break-even forecast is substantially below the actual results for recent years, all of which exceeded £100 million a year.

17. Within the 2001 forecasts some assumptions (such as on funding council grants) are prudent, while others (such as on overseas fee income and rates of pay increases) will be more challenging to achieve. Overall the assumptions of increases in total income and expenditure are considered to be reasonable.

18. Universities and colleges are forecasting to keep income and expenditure in balance, but this is at a cost of, among other things, increasing student:staff ratios. Increases in income generation are forecast, but these carry risks and markets are becoming increasingly competitive.

19. There remain financial risks facing universities and colleges. These need to be managed, and include:
- a. The increasingly diverse range of income sources, both public and non-public, and the increasing competition in markets. (Although in some respects greater diversity is a means of reducing risk, the new income sources may be less stable and reliable than established sources such as HEFCE grants).
  - b. The reduction in financial flexibility in some institutions as liquidity reduces and fixed costs (such as from higher borrowing) increase.
  - c. The constraints on funds being generated, both to keep income and expenditure in balance and to reinvest in developing the physical and human capacity.
20. Actions which could address the projected financial situation include:
- a. Real increases in public funding to reverse past under-investment and the erosion of the unit of resource.
  - b. Continuing to diversify income sources.
  - c. Securing the right price across the range of activities and services provided by universities and colleges that reflect full costs and value to the customer.
  - d. Controlling recurring expenditure within affordable limits.
  - e. Removing duplications in expenditure through increased collaboration and improving asset utilisation.
21. The financial strength of the sector is satisfactory when viewed in aggregate, but a small number of HEIs are facing a tough operating situation with limited financial resources.
22. The level of capital expenditure is forecast to be considerably higher up to 2003-04 than in previous forecasts. This reflects increases in capital grant funding to supplement the limited funds being generated from operating activities.
23. The level of capital expenditure from 2004-05 will depend on the capital grants to be announced under the Government's 2002 spending review.

**Action required**

24. Institutions should review their corporate plan in the light of the feedback in this report. Regional Consultants will be writing to institutions to determine when in the second three-year cycle (beginning in July 2002) they wish to submit corporate plans.

## Corporate plans

### Introduction

25. After consultation in 1998, we revised our approach to institutional corporate planning. To reduce the burden on institutions, we no longer asked for a full corporate plan to be provided every year, but asked for plans on a three-year cycle. Higher education institutions (HEIs) are asked to provide summary annual operating statements and financial forecasts in July of each year in support of their corporate plans. We also ask for specific strategies in return for HEFCE special funding for strategic areas (for example, widening participation, learning and teaching, human resource strategies).

26. Our role is not to be prescriptive about institutional planning or approve institutions' plans. At sector level we collect planning information to inform our policies, and to advise the Secretary of State for Education and Skills on the needs and development of the sector. We also use the plans to advise institutions on what is known about good practice elsewhere in the sector.

27. It is for each institution to decide what should be in its corporate plan, and the process for preparing it. But we have a particular interest in those activities supported through HEFCE's special funding programmes and want to understand how the institution is approaching the priority areas we have identified. We also want to understand the relative ordering of the institution's priorities, and the links between them, so that we can reflect them in subsequent decisions about relevant grant allocations. Examples include:

- where proposals for additional student numbers, project capital funding, and widening access initiatives are all facets of a single strategic aim by the HEI
- where the HEI deliberately does not bid for one funding programme, because it has judged its key priority to lie within the scope of a different programme
- where there is an associated need for organisational change which might be supported through our restructuring and collaboration fund.

28. We also want to understand the linkages between institutions' corporate plans, AOSs and financial forecasts.

29. Consultation with institutions in 1998 showed that they were concerned that they received little feedback from us about their corporate plans. As part of our current approach, Regional Consultants consider each plan using a structured approach. They then meet with each institution to discuss its strategic direction, and its use of our strategic funding across a wide range of activity in support of its objectives.

30. Feedback from institutions indicated that they would welcome guidance on good practice in strategic planning. HEFCE 00/24, 'Strategic planning in higher education: A guide for heads of institutions, senior managers and members of governing bodies' was produced in collaboration with the sector. It was based on an analysis of plans previously submitted to the Council and a number of case study institutional visits. The guidance highlighted good practice in a range of institutions. In 2001 we also published a good practice guide on risk

management (HEFCE 01/28, 'Risk management: A guide to good practice for higher education institutions').

### **Common issues arising from the first cycle of corporate plans**

31. We believe that this approach to institutional corporate plans – using them as a basis for discussions between institutions and HEFCE – is a marked improvement on previous practice. However, these discussions also highlighted a number of common issues, outlined below.

32. We received:

- 20 per cent of HEI corporate plans in July 1999
- 30 per cent in July 2000
- 38 per cent in July 2001.

33. The figures sum to 88 per cent, not 100 per cent, because there was some slippage in the second half of the cycle, and 12 per cent of plans will not be submitted until 2002. The delay in submission of corporate plans is often because institutions are in transition, undertaking major structural change (including mergers), or reviews linked to a change in the head of the institution. We expect postponements to be discussed with us in advance.

34. The format of institutions' corporate plans varies greatly, reflecting differences in their intended audiences (internal and external stakeholders), how widely they are intended to be disseminated within the institution, and the extent to which autonomy is devolved within the institution.

### **HEFCE's priorities**

35. When we announced our new approach to institution's corporate plans (HEFCE circular letter 3/99) we identified priority areas where additional funding was being made available to support development, which we expected to be relevant to all institutions. These were:

- recognising and encouraging excellence in learning and teaching
- widening student access and participation
- working with business and the wider community
- supporting growth and restructuring in student numbers and subject provision through additional student numbers
- effective estate management and improving the capital infrastructure
- developing information strategies
- recognising and encouraging good management of HEIs.

36. A majority of corporate plans included some comment on these themes, although they varied greatly in the depth of discussion. Where we requested specific institutional strategies linked to special funding we received much more detailed commentary.

## Missions

37. The first cycle of corporate plans showed far more similarity than differentiation in mission statements. Given the current debate about the need to promote greater diversity and mission differentiation between HEIs, we would encourage HEIs to review their mission statements, with a view to articulating more specifically what makes the institution distinctive. That should provide a firmer basis for setting objectives and priorities.

## Targets

38. In general terms, where the corporate plan was aimed at a wide audience including external stakeholders, it was less likely to include SMART (specific, measurable, achievable, realistic and time-bound) objectives and targets. Only a minority of plans included specific and measurable objectives, and actions flowing from these. In some cases institutions supplied separate operating plans, which detailed actions flowing from their corporate plan. However, in many instances our discussion with institutions was principally around a high-level statement of institutional priorities and objectives. Disappointingly, few institutions presented the details of the costs which underpin their objectives and actions in their corporate plan, or cross-referred their plan to a financial strategy.

## Link between corporate plan and AOS

39. When we re-introduced the AOS arrangements, we felt that most HEIs would already be producing an AOS for their own internal management purposes. However, we are increasingly using the AOS as our main means of monitoring relevant special funding programmes to reduce the accountability burden on institutions. We recognise that this raises issues for the way in which an institution's AOS is able to 'cascade' down from the institution's corporate plan. We try to understand the links between the full corporate plan and AOS by seeking information on generic areas of activity in addition to activities supported by our strategic funding.

## Financial strategy

40. We understand that institutions may have reservations about the degree of operational and financial detail they publish in their plans. However we want to be sure that institutions have assessed the underpinning resource implications. Many institutions have managed in the past without a systematic and integrated approach to financial strategy, but we are now encouraging institutions to take a more strategic approach to managing their financial future. We hope to publish guidance on developing financial strategies in early 2002.

## Competitive pressures and confidentiality of plans

41. Some institutions chose to submit annual plans to HEFCE that addressed corporate strategy in the short to medium term. These plans generally looked forward three or four years and tended not to be very expansive about the institution's long-term vision.

42. In discussions with Regional Consultants some institutions stressed the very competitive market in which they operate, and saw disadvantages in disseminating their

strategies widely. Despite our emphasis on reducing institutional burden and requesting planning information which institutions prepare for their own purposes, a small number of institutions continue to submit a edited version of their 'real' plan. This not only reflects external competitive confidentiality issues but also internal institutional sensitivities. We will, of course, fully respect the confidentiality of any information which institutions consider sensitive. But we can only engage in a meaningful discussion if the institution is prepared to share its real intentions.

#### Planning process

43. Relatively few plans outlined how the plan itself had been prepared. In meetings with institutions, Regional Consultants sought to understand the extent to which there had been consultation and an element of 'bottom-up' planning, and to get an overview of the institution's planning processes.

#### Risk assessment

44. Most institutions identified their priorities, but environmental analysis tended to be an implicit rather than an explicit discussion. Small and specialist institutions were more likely to include a detailed discussion of their environment. There was limited evidence of systematic analysis of risks, and benchmarking or use of performance indicators was not widespread.

#### Integration of strategies

45. A number of institutions did not integrate their subsidiary strategies within the overarching structure of the institution's plan, and many plans appear as a series of subsidiary strategies. We hope to encourage institutions in the next cycle of plans to make more effective links between their subsidiary strategies (including those linked to HEFCE special funding) within their corporate plan.

#### **The future – areas to focus on**

46. While institutional planning has improved significantly, there are still several areas which could be enhanced. We recognise that if we become too prescriptive about the structure and themes of plans, this may be counter-productive. We want institutions to continue to enhance their planning processes in a way which is right for their own context – and in doing this to reflect on where and how HEFCE's particular areas of interest fit into their own priorities.

47. In our request for future plans, we again wish institutions to address the indicative themes of particular interest to us (listed in paragraph 35 above). We also hope that plans will be strengthened in the following areas:

- clearer identification of institutional missions and priorities
- more specific objectives and measurable targets
- improved financial strategies to underpin plans, with associated risk assessment
- more effective integration of subsidiary strategies within the overall plan.

48. We believe that it is most useful for us to discuss with institutions their medium- to long-term planning framework. We understand the sensitivities that surround this. We hope that, as work on financial strategies develops, we can have more useful discussions with institutions about their strategic position, and, where appropriate, support change through our restructuring and collaboration fund.

## **Annual operating statements**

### **Overview**

49. In April 2001 we asked institutions to provide their AOS and financial forecast by the end of July 2001 (HEFCE 01/23). This is the third year in which we have sought AOSs. Our request asked HEIs to provide summary statements indicating their strategic direction and priorities for action in the academic year 2001-02, and their assessment of their progress against strategic initiatives.

50. We expect institutions to produce annual operating statements for their own purposes. AOSs have also become the main way in which we monitor the outcomes of our major strategic funding programmes. Our request for the AOS allowed institutions to report through their own operating statements or to complete a standard template. The majority of institutions filled out the template directly, while most of the remainder have cross-referred to an AOS prepared for the institution's own purposes.

51. This approach facilitated a reasonably structured approach to the analysis of AOSs. We compared institutions' descriptions of the set of activities for 2000-01 that they said they would undertake with their allocations from relevant strategic funding programmes, against their evidence in the AOS. Our analysis of this year's AOS focused on the three key strategic initiatives of widening participation, learning and teaching and Higher Education Reach-out to Business and the Community, looking particularly at the second year of activity under these initiatives. For the purpose of this analysis we classified institutional responses under the three strategic initiatives as satisfactory or unsatisfactory.

52. The proportions given in this analysis necessarily reflect an element of judgement, because of the variation in institutions' reporting practices and the amount of evidence provided. To get as much consistency as possible, Regional Consultants held moderation meetings within their teams, and the AOS project team had a cross-regional benchmarking role.

53. In a small minority of cases institutions did not provide any evidence – or only provided scanty information – about their progress in 2000-01, which may not actually reflect their performance. We are contacting these institutions to clarify the position.

54. Where the AOS shows that for a second year an institution has not undertaken its intended activities we warned that we may re-profile funds or provide no further funding under the relevant funding programme, or in extreme cases take back funding. In those very few cases where we have identified problems in two consecutive years, regional teams will explore the position further with institutions to determine what action is appropriate.

## **Targets**

55. Targets within this year's AOS have been largely concerned with the undertaking of specified activities supported by the funds allocated, rather than about ultimate outcomes to widen participation, improve teaching and learning, and so on. Our presumption is that it will continue to be for each HEI to determine its own targets within the context of information we disseminate about good practice. But increasingly we need institutions to produce more specific and measurable targets, and to provide the evidence of the ultimate outcomes rather than the achievement of activities and processes.

56. We use our analysis of the AOS to inform discussion with institutions and to promote the setting of more specific targets in future years. This is particularly true as we introduce new initiatives (for example, human resource strategies) or move to the second cycle of funding for new widening participation strategies. In each case we have the expectation that clear and measurable targets must be set, and that they should include outcomes as well as processes.

## **Widening participation**

57. The purpose of student-related additional funding for widening participation was to support the additional costs of provision for the students concerned, to support success in widening participation, and to provide an incentive for institutions to develop widening participation activity.

58. In October 1999 institutions provided initial statements on their strategies including plans for spending the additional formula funding allocated for widening participation, recruitment targets for under-represented groups, and targets for improvements in their retention. The format of the initial statements was not tightly prescribed.

59. For 2000-01 we provided £25 million to institutions in proportion to their success in recruiting students from neighbourhoods where the rate of participation in higher education is low. This funding (the postcode premium) has sometimes been used to embed activities or consolidate posts which were previously supported through short-term funding rather than being used for completely new projects or activities. Where funding was used to support these 'mainstreamed' activities, it has sometimes been difficult for institutions to demonstrate the outcomes in the AOS.

60. We have requested a second generation of institutions' widening participation strategies to cover the period 2001-02 to 2003-04, and used our assessment of institutional progress reported in the 2000 and 2001 AOSs to inform the analysis of second generation strategies. We also have drawn on our experience of the difficulties of reporting mainstream widening participation activity to encourage the setting of clear organisational and numerical targets in new widening participation strategies as a basis for tracking progress in the future.

61. Our analysis of progress in the widening participation area as reported in the AOS suggests:

- a. Over four-fifths of institutions (84 per cent) are either fully or mostly achieving the activities and targets that they set for themselves in their initial statements which dealt with use of the 'postcode premium'. This outcome is a slight improvement on the position last year (81 per cent).
- b. In a small minority of cases (14 per cent), the AOS gave insufficient information to enable us to make a judgement about progress in widening participation during the 2000-01 academic year. However, reporting on progress in widening participation has improved compared to last year, when reporting was felt to be problematic in about a fifth of cases. Regional teams are pursuing all cases where further information is required, and particularly the six institutions providing insufficient information on widening participation in two consecutive years.
- c. The reports from 3 per cent of institutions suggested a lack of progress against their widening participation plans. This compared to 2 per cent of institutions last year. Regional teams will investigate the position further and determine what action is appropriate.
- d. As part of the report on widening participation we asked institutions to explain how they had used mainstream funding for disability and additional funding for administration of various funds for student support. Only just over half of institutions provided this information in their AOS, although those receiving the more significant sums were much more likely to provide information. We had not previously asked institutions for their plans for use of such funds.
- e. We are concerned that many institutions did not provide information on the use of the mainstream disability premium, particularly given the developments in disability legislation, and have written to the institutions concerned.

### **Learning and teaching – institutional funding**

62. The purpose of our special funding in this area is to promote the development and implementation of institutional learning and teaching strategies. Funds are to support extending existing activities or generating new activities, and to encourage other institutional resources to be directed at delivering learning and teaching strategies. We also encourage institutions to address a number of national priorities, such as employability and staff development (see HEFCE 99/48).

63. Strategies and details of activities covered the three-year period 1999-2000 to 2001-02. The total allocation for the three-year period of this special fund is £48 million.

64. In their learning and teaching strategies and action plans, institutions were encouraged to be specific about proposed activities, and to include both intermediate and final targets whose achievement could be objectively demonstrated. When reviewing AOSs, therefore, we had specific information against which to monitor institutional progress.

65. Our analysis of progress on learning and teaching strategies suggests:
- a. Almost all institutions (97 per cent) were fully or mostly achieving the activities and targets they had set for themselves for 2000-01 (compared to 82 per cent last year). This was a very positive outcome, and showed that some institutions with earlier slippage in their plans were back on target. Only a small number provided insufficient information to enable us to form a view on progress.
  - b. A few institutions (3 per cent) had fallen behind in their plans, and we will discuss appropriate action with them.
  - c. As institutions' learning and teaching strategies covered a three-year period, we already held details of proposed activities for the final year of funding (2001-02). Most institutions took the opportunity to refine these slightly in the light of experience, with 10 per cent of institutions introducing additional activities in the final year.

### **Higher Education Reach-Out to Business and the Community**

66. Institutions were asked to draw up a strategy for improving their interaction with business, reflecting their mission, track record, and regional and national needs of business. They were asked to identify measurable outcomes flowing from the activities supported through additional funding.

67. Our approach to HEROBC had a stronger competitive element than for the other two initiatives. Institutions supported in the first round of HEROBC funding are receiving funds from January 2000 to July 2003, and those funded in the second round are being supported from August 2000 to July 2004. Eighty-three<sup>1</sup> institutions funded for 2000-01 were supported through the first round, and will receive a share of £60 million over the four-year period. Thirty-two<sup>2</sup> institutions, funded for the first time in 2000-01, will receive a share of the further £22 million available for the second round.

68. Our analysis suggests:
- a. The great majority of institutions (89 per cent) have fully or mostly achieved the activities and targets they had set for themselves for 2000-01. This was the same percentage as last year.
  - b. Most institutions had provided sufficient information for us to form a view about their performance (93 per cent). This was a similar percentage to last year, but, as the number of institutions receiving these funds has increased, we need to follow up a greater number of cases where we have insufficient information.
  - c. A small minority of institutions (7 per cent) had fallen behind in their plans. However, half of these institutions had received funds through the second round of HEROBC funding, and therefore 2000-01 was the first year they had received funding. Delays in making appointments were a significant factor for these institutions.

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<sup>1</sup> This figure includes bids from institutions in Northern Ireland. It excludes collaborative bids because we would not be comparing 'like with like' in the analysis.

<sup>2</sup> This figure excludes collaborative bids.

d. Regional teams will follow up cases where there is insufficient information, and will have detailed discussions with all institutions who have fallen behind in their plans to determine what action is appropriate.

e. As institutions' plans span four years, we already held details of proposed activities for 2001-02. Most institutions were following the plan for which they bid, with minor refinements. In 5 per cent of cases, the activities and targets described for 2001-02 differed significantly from the bid, and regional teams will explore these cases to determine the reasons for the proposed changes.

69. As the Higher Education Innovation Fund (HEIF) programme begins, we are confident that we have a firm basis against which to monitor progress, because the bidding criteria required institutions to identify the performance indicators they would use and to make explicit their baseline figures. In bidding for funding, institutions also had to demonstrate their progress under the HEROBC programme.

### **Other areas of activity**

70. We are also interested in key targets which HEIs set themselves in other areas. From our analysis of previous AOSs we identified areas generic to most statements, in addition to our strategic funding initiatives. In their AOSs the vast majority of institutions commented on their progress so far and targets for next year, under the broad headings listed in Table 1.

Table 1 **Main themes included in annual operating statements**

<b>Theme</b>	<b>% of HEIs with targets for each theme</b>
Governance and management	87
New academic developments	88
Research	88
Finance	89
Human resources	95
Estate	92
ICT and information strategies	95
Regional activities	84
International activities	85

## Financial forecasts

### Income and expenditure

71. These forecasts, as in previous years, were prepared on assumptions reflecting the current funding announcements and the prevailing general economic climate. The 2001 forecasts take account of the outcome of the year 2000 spending review, the detail of which was announced after last year's forecasts were submitted.

72. The actual results each year have tended to confirm the reliability of the sector's short- to medium-term forecasting, with the variances being less than 1 per cent of total income. Longer-term forecasting is subject to greater uncertainty and tends to be more prudent. A time series from 1994-95 of forecasts and actual results is at Annex A: it shows a marginal deterioration in the forecast operating results for 2000-01 to 2002-03 compared with the forecast provided in July 2000. This reflects the continuing financial pressure expected in these years.

73. The forecast income and expenditure position for the sector as a whole is at Annex B, and is summarised in Table 2.

Table 2 **Actual and forecast income and expenditure position**

	<b>Actual 1998-99 £M</b>	<b>Actual 1999-00 £M</b>	<b>Forecast 2000-01 £M</b>	<b>Forecast 2001-02 £M</b>	<b>Forecast 2002-03 £M</b>	<b>Forecast 2003-04 £M</b>	<b>Forecast 2004-05 £M</b>
Total income	9,915	10,465	10,848	11,476	11,956	12,491	12,890
Total expenditure	9,741	10,370	10,860	11,485	11,912	12,404	12,813
Surplus/deficit after depreciation of assets at valuation and tax	173	125	-1	-7	62	140	84
Surplus/deficit as % of total income	1.74%	1.19%	-0.01%	-0.06%	0.52%	1.12%	0.65%

74. These projected levels of operating surplus are materially affected by exceptional items, mainly gains or losses on property transactions (as shown in Table 3). These show that the underlying operating position is forecast to continue to be weak, with the sector as a whole operating around break-even.

**Table 3 Actual and forecast operating surpluses and exceptional items**

	<b>Actual 1999-00</b>	<b>Forecast 2000-01</b>	<b>Forecast 2001-02</b>	<b>Forecast 2002-03</b>	<b>Forecast 2003-04</b>	<b>Forecast 2004-05</b>
	<b>£M</b>	<b>£M</b>	<b>£M</b>	<b>£M</b>	<b>£M</b>	<b>£M</b>
Surplus/deficit after depreciation of assets at valuation and tax (including exceptional items)	125	-1	-7	62	140	84
Exceptional items	31	11	3	20	54	9
Surplus/deficit after depreciation of assets at valuation and tax (excluding exceptional items)	94	-12	-10	42	86	75
Surplus/deficit (excluding exceptional items) as % of total income	0.90%	-0.11%	-0.09%	0.35%	0.69%	0.58%

75. Forecast increases in total income and total expenditure are kept broadly in line over the forecast period, at an average of just above 4 per cent a year.

76. Forecast increases in annual UK funding councils' grants average 2.5 per cent a year from 2001-02. These take account of uplifts for inflation growth. These look conservative, given that student numbers are forecast by institutions to increase by 12 per cent from 2000-01 to 2004-05, within the context of the Government's target of 50 per cent participation by 2010 by those between 18 and 30.

77. In contrast, there are forecast average annual increases from 2000-01 in fee income of over 6 per cent, and in research grants and contracts of 6.5 per cent. This would include fee income from additional home and EU students and additional income being generated from non-public sources for third stream activity. Overseas student fee income is forecast to increase by 38 per cent (from £634 million to £874 million) over the forecast period. Some of these increases may be difficult to secure in light of the current economic climate and as many HEIs will be competing with each other and with overseas competitors in certain markets. However, changes in pricing policies by HEIs, to more closely reflect full costs and the value to the customer, are expected to contribute to higher net income from these activities.

78. Pay rates across the sector are forecast to increase by an average of over 3 per cent a year. Coupled with incremental drift of 1 per cent a year this represents an increase in pay expenditure of over 4 per cent a year. Pay as a percentage of total expenditure is forecast to increase marginally from 58.2 per cent in 2000-01 to 59 per cent by 2004-05. These increases, however, may be low given the pressures on recruiting and retaining staff. Staff numbers are forecast to increase only marginally, from 221,000 in 2000-01 to 224,000 by 2004-05. With forecast increases in student numbers this represents further increases in the student:staff ratio.

79. Non-pay inflation is forecast to increase in line with increases in the GDP deflator of 2.5 per cent a year, representing no real increase in the level of expenditure despite the increase in the level of activity. Universities and colleges are therefore expecting to have to continue to deliver efficiencies.

80. Income from non-public sources is forecast to increase by 20 per cent between 2000-01 and 2004-05. This forecast rate of increase is almost exactly the same for publicly funded activity. Consequently, the dependence of universities and colleges on public funding is forecast to remain at around 62 per cent over the forecast period for the sector as a whole. A time series from 1994-95 to 2004-05 is at Annex C.

81. We ask HEIs to provide supporting commentaries to their forecasts. These set out how the forecasts reflect HEIs' overall aims and objectives, and articulate key elements of their financial strategies. Key messages and actions include:

- a. A number of HEIs have set specific operating surplus targets.
- b. Actions to increase income include:
  - investing in new and emerging areas
  - investment to improve student retention
  - increasing enterprise activity
  - increasing exploitation of intellectual property rights
  - increasing overseas and postgraduate students
  - improving cost information and addressing under-pricing
  - increasing use of campus throughout the year.
- c. Actions to control costs include:
  - reviewing the academic portfolio and closing non-viable areas
  - academic reorganisation
  - estate rationalisation
  - elimination of loss making activities
  - reductions in staff numbers and increases in student:staff ratios
  - capital expenditure only where external funding available
  - improvements in procurement
  - value for money review of support services
  - improved appraisal of capital projects.
- d. Themes that run through many of these actions include:
  - an increasing awareness that HEIs need better market information if they are to meet what their stakeholders (including students and funders) expect
  - the need for improved management information (financial and non-financial) to aid decision-making
  - increased exploitation of the outcomes of the knowledge generated by universities and colleges
  - elimination of loss making activities.

82. Universities and colleges need to generate annual operating surpluses to provide the positive cash flow for reinvestment and to fund future developments, to the extent that these are not met from capital funding. The actual level of such an annual operating surplus will

vary, depending on the circumstances of individual universities or colleges. Across the sector we have previously assessed this as being in the region of 3 per cent to 4 per cent of total income. It should now be possible to operate on tighter margins, given the continued availability of separately allocated capital funding.

83. Data emerging from the Transparency Review<sup>3</sup> for 1999-2000 indicates that HEIs should collectively be spending around an additional £270 million a year if they are to meet the full costs of keeping their present estates capacity in good order. This figure excludes any similar adjustment for equipment. The figure would be reduced to the extent that this requirement is met from additional capital funding (which had not flowed through to HEIs in 1999-2000). In 2001-02 capital funding being distributed by us for such areas is £210 million. This rises to £315 million by 2003-04 – but these funds are also addressing past under-investment as well as maintaining present capacity.

84. As stated in previous years, there is no single or simple solution to securing appropriate levels of surplus and investment, but it will need to be tackled through actions at sector and at local levels, including:

- a. Continuing to press for real increases in public funding to address the past under-investment.
- b. Continuing to increase the level and range of non-public income sources.
- c. Securing the right price across the range of activities and services provided by universities and colleges.
- d. Controlling recurring expenditure within affordable limits.
- e. Removing duplications in expenditure through increased collaboration and improving asset utilisation.

85. Some of these actions are for universities and colleges to take themselves; the details in paragraph 81 indicate that some of these are already in hand. Other actions will require co-ordination across the sector, some of which will require additional up-front funding to enable the cost benefits to be secured. The extent to which we can assist will depend on the funding we have available.

86. The sector-wide analysis covers a wide range of operating results and forecasts between institutions. The number of universities and colleges forecasting operating deficits is shown in Table 4.

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<sup>3</sup> Data from all HEIs based on 1999-2000 costs.

Table 4 HEIs forecasting operating deficits

Academic year	Number of HEIs forecasting operating deficits	Percentage of total number of HEIs
1999-00 <sup>4</sup>	54	42%
2000-01	57	44%
2001-02	50	38%
2002-03	42	32%
2003-04	33	25%
2004-05	36	28%

87. There is a marked increase in the number of HEIs forecasting deficits in 2000-01 to 2002-03, compared with last year's forecasts. The numbers are forecast to reduce from 2001-02, with these improvements reflecting the outcomes of the actions described in paragraph 81.

88. The number of universities and colleges that are forecasting operating surpluses in excess of 3 per cent to 4 per cent varies between 10 and 20 across the forecast period (between 8 per cent and 15 per cent of the sector). This is a significant reduction across all years compared with last year's forecast as the financial pressures on universities and colleges continue.

89. The relatively low levels of operating margins increase the impact of changes in the key assumptions that underpin the forecasts. As in previous years, even 1 per cent adverse changes in pay increases, non-pay inflation, or funding levels from those assumed in the forecasts could have significant financial consequences for some universities and colleges. This impact would be reduced to the extent that compensatory action was both possible and was taken.

### Financial strength

90. The balance sheet for the sector as a whole is at Annex D. In aggregate the sector shows forecast increases in the value of fixed assets, financed by cash generated from operations, increased capital grants and increased borrowing. Net current assets, cash and liquid resources decline over the forecast period.

91. The cash and liquid reserves held by the sector are modest. Net cash balances<sup>5</sup> expressed in the number of days of expenditure are low. For the sector as a whole these are only 13 days at 31 July 2001 and are forecast to reduce further to 9 days at 31 July 2005. The broader measure of liquidity<sup>6</sup> is forecast to reduce from 49 days at 31 July 2001 to 39 days at 31 July 2005. These reductions will limit the financial flexibility available to some universities and colleges to manage unforeseen events.

<sup>4</sup> Actual for 1999-2000.

<sup>5</sup> Bank and cash balances less overdrafts.

<sup>6</sup> Bank and cash balances plus current asset investments less overdrafts.

92. Aggregate external borrowing is forecast to increase by a third over the forecast period from £1,950 million outstanding at 31 July 2000 to £2,574 million by 31 July 2005. This will add to the pressures on operating cash flows over the forecast period, as shown by the forecast increase in interest costs.

93. At the same time, as private income represents nearly 40 per cent of total income, universities and colleges continue to need cash reserves to manage the risks associated with these potentially more volatile cash flows.

94. As reported in previous years, these aggregate sector financial positions mask the wide disparity between institutions, with much of the financial strength of the sector continuing to be concentrated in a small number of mainly old universities.

### Cash flow

95. The cash flow forecasts for the sector as a whole are at Annex E.

96. The level of cash generated from operations continues to act as a constraint on the sector's capacity to reinvest and provide for new developments, despite the substantial increases in capital grants. Table 5 shows the forecast levels of capital expenditure and how these are forecast to be financed.

**Table 5 Actual and forecast capital expenditure and financing**

<b>Academic year</b>	<b>Capital expenditure</b>	<b>Asset sales</b>	<b>Capital grants</b>	<b>New borrowing</b>	<b>Net expenditure to be internally financed</b>	<b>Available funds from operating cash flow</b>
	<b>£M</b>	<b>£M</b>	<b>£M</b>	<b>£M</b>	<b>£M</b>	<b>£M</b>
1999-00 <sup>7</sup>	994	202	290	292	210	218
2000-01	1,125	125	449	265	286	225
2001-02	1,629	96	800	360	373	320
2002-03	1,550	116	812	251	371	385
2003-04	979	161	404	171	243	415
2004-05	500	23	129	76	272	419

97. The table shows that the availability of capital grants (such as through the Joint Infrastructure Fund, the Science Research Investment Fund and the HEFCE's project capital funding) increases the level of capital expenditure rather than substituting for other sources of finance. This effect is clearly forecast for 2001-02 and 2002-03. In the following years, as the forecast levels of capital grants decrease, there is a marked reduction in capital expenditure, reflecting uncertainty over continued capital grants and the financial constraints within which universities and colleges are operating.

<sup>7</sup> Actual values for 1999-00.

98. Increasing levels of capital expenditure, above forecast levels, can be achieved through one of the following:

- a. Continued provision of capital grants (the level of capital expenditure in 2003-04 and 2004-05 is expected to increase to the extent that the outcome of the Government's 2002 spending review continues to provide capital grants).
- b. Increased operating cash flows from higher operating surpluses generated through the actions set out in paragraph 81. This would allow either increased direct expenditure or higher levels of borrowing to be serviced.
- c. Further increases in borrowing.