College Funding and Finance – May 2014

1. In 2014, colleges face serious funding and financial challenges which they are well placed to address but which will limit their ability to meet individual, employer and community need. This paper explains the key issues related to the funding of education and training for 16 to 18-year-olds, for adults and college finances. It makes a number of observations about where government action could help. The paper has also been written to help everyone working in colleges - governors, principals, managers and staff – to understand the environment so that they can make informed decisions.

Funding of education and training for 16 to 18-year-olds

Background

2. The Department for Education (DfE) provides funding to support 16 to 18-year-olds in education and training. The Education Funding Agency (EFA) manages the budget and gives allocations to colleges and schools via a national funding formula and rulebook.

3. Funding for education and training for 16 to 18-year-olds is worth around £13 million for the average further education (FE) college (47% of total income) and £7.6 million for the average sixth form college (91%). The money pays for more than 800,000 students aged between 16 and 18 as colleges provide the majority of places for the education of this age group.

Funding changes

4. The national budget for the education and training of 16 to 18-year-olds in 2014-15 is £7,180 million (£250 million less than in 2013-14). There have been some important changes to the funding system in recent years:

- After more than a decade of promises, DfE is moving towards a single funding formula with a single set of rates for school sixth forms and colleges.

- Since 2010, funding allocations for the education and training of 16 to 18-year-olds have been calculated on a lagged basis (i.e. Year 1 numbers determine Year 2 funding) rather than on a planned or negotiated basis.

- The funding formula was overhauled in 2013-14 as a result of the Wolf Review of Vocational Education1 and formed part of a plan to simplify the system. Funding is now paid at a fixed rate per full-time student with

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supplements for more expensive courses, for students who lack maths and English qualifications or live in disadvantaged areas. Funding is no longer linked to success in qualifications but there is an adjustment for students who drop out and account for the percentage of students who drop out of their study.

- A major change was made in 2014-15 to reduce spending. From 2014-15 a 17.5% lower full-time rate will be paid for 18 year-old students.

- Alongside the reform of the funding formula, EFA introduced new funding rules to encourage the teaching of study programmes, English and maths for those who did not achieve a grade A* to C at GCSE in these subjects and work experience.

- The funding of students with learning difficulties has also been changed in 2013-14. There is a single budget for those with higher needs commissioned by local authorities and funding for students with lesser needs has been merged into core funding.

Current situation

5. Since 2009 there has been a determined effort to reduce public spending and the budget deficit. These measures have hit spending on the education and training of 16 to 18-year-olds. The budget for the education of 5-16 year olds rose faster than inflation throughout up until 2010 and has been formally ring-fenced since then to protect funding per pupil and the pupil premium. This means that budget cuts agreed in successive spending reviews for DfE fall mainly on the funding of education for 16 to 18-year-olds and are hitting core college budgets.

6. In the 2010 spending review, DfE ministers agreed to reduce non-school budgets by 12% in real terms over the period to 2015. Further cuts to the DfE budget have been announced in the last 18 months but there are few details on where these will fall. Up to now, the practical impact of these budget cuts has been a long list of savings measures in 16-18 education:

- There has been no increase in funding for pay rises or inflation since 2010.

- Funding for full-time students has been cut by an average of 12% by the removal of an element in the formula that paid for tutorials and a rounded programme. This money has been withdrawn at a rate of 3% a year to help institutions manage budgets.

- Some of the additional funding paid to school sixth forms has been withdrawn although schools and academies continue have 100% of their
VAT reimbursed (worth about 4% of income for 16 to 18-year-olds) which colleges do not.

- Education Maintenance Allowances (EMA) were replaced by bursaries. This has reduced spending on support for 16 to 18-year-olds from low income families by around £300 million (60%).

- The decision to cut the full-time funding rate for 18-year-olds by 17.5% from £4,000 to £3,300 which saves £150 million while reducing EFA funding at FE colleges by 3%, at land-based colleges by 2.5% and at sixth form colleges by 1.2%. EFA will mitigate the reduction in 2014-15 by limiting losses to 2%.

7. The consequence of these cuts is that spending varies by the age of the young person much more than it used to. DfE has protected the schools budget up until the age of 16 while the Department for Business, Innovation and Skills has used tuition loans to maintain undergraduate funding from the age of 18 upwards. Chart One summarises these variations.

**CHART ONE: FUNDING FOR FULL-TIME STUDENTS BY AGE**

<table>
<thead>
<tr>
<th>Age</th>
<th>Funding Breakdown</th>
</tr>
</thead>
<tbody>
<tr>
<td>11-16</td>
<td>£5,620 School Grant Plus Pupil Premium</td>
</tr>
<tr>
<td>16-17</td>
<td>£4,645 National rate £4,000 Plus Weightings</td>
</tr>
<tr>
<td></td>
<td>17.3% Funding</td>
</tr>
<tr>
<td>18</td>
<td>£3,830 £3,300 rate plus weightings</td>
</tr>
<tr>
<td></td>
<td>17.5% Funding dip</td>
</tr>
<tr>
<td>19-21 in</td>
<td>£8,500 Average Full-time Covered By Fee loan</td>
</tr>
</tbody>
</table>

**Department for Education Budget**

8. DfE does not publish budget information apart from a few high level numbers so it is hard to work out what will happen next. A key factor in DfE’s budget is the existence of the school ringfence which protects around 80% of revenue expenditure. DfE’s revenue spending can be summarised as follows:
Ringfenced
£38.7 billion Dedicated Schools Grant (schools, high needs, early years)
£2.5 billion Pupil Premium

Not ringfenced
£7 billion spent on education and training of 16 to 18-year-olds
£1.5 billion on early intervention funding (paid via local government revenue grant)
c£2 billion on other schools items including £0.5 billion on teacher training and £0.7 billion on PFI revenue charges
£0.4 billion admin budget

9. In two successive autumn statements, HM Treasury announced cuts to DfE’s non-schools budget for 2014-15 (announced in December 2012) and 2015-16 (announced in December 2013). This suggests that the downward trend in spending on 16 to 18-year-olds will continue. DfE’s accounts report a substantial reduction in spending on this age group between 2009-10 and 2012-13 (see chart two). This reduction was exacerbated by a big shortfall in the number of apprentices aged between 16 and 18 in 2012-13. Total DfE spending on 16 to 18-year-olds fell from £7.7 billion in 2010-11 to £7.0 billion in 2012-13.

CHART TWO: DfE 16-18 EDUCATION AND TRAINING SPENDING
### Table one

<table>
<thead>
<tr>
<th></th>
<th>2009-10 £ mil</th>
<th>2010-11 £ mil</th>
<th>2011-12 £ mil</th>
<th>2012-3 £ mil</th>
</tr>
</thead>
<tbody>
<tr>
<td>College 16-18</td>
<td>3,793</td>
<td>3,977</td>
<td>4,070</td>
<td>3,782</td>
</tr>
<tr>
<td>Schools 16-18</td>
<td>2,334</td>
<td>2,409</td>
<td>2,414</td>
<td>2,350</td>
</tr>
<tr>
<td>Apprenticeships</td>
<td>688</td>
<td>745</td>
<td>764</td>
<td>679</td>
</tr>
<tr>
<td>Financial support</td>
<td>679</td>
<td>643</td>
<td>379</td>
<td>256</td>
</tr>
<tr>
<td>High needs (16-25)</td>
<td>234</td>
<td>261</td>
<td>274</td>
<td>287</td>
</tr>
<tr>
<td>DfE 16-18 total</td>
<td>7,494</td>
<td>7,774</td>
<td>7,627</td>
<td>7,067</td>
</tr>
</tbody>
</table>

*Source: Education Funding Agency and YPLA accounts.*

10. Although DfE and EFA do not publish budget information, successive letters from EFA's Director of 16-18 funding report total 16-18 participation expenditure by academic year. The plans for the 2012/13 academic year involved higher expenditure than in the 2011/12 academic year because 16-18 apprenticeships were expected to stay on trend but there is a substantial fall again in 2014-15:

### Table two

<table>
<thead>
<tr>
<th>Academic year planned</th>
<th>2012-13 £ million</th>
<th>2013-14 £ million</th>
<th>2014-15 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>16-18 participation</td>
<td>7,330</td>
<td>7,430</td>
<td>7,180</td>
</tr>
</tbody>
</table>

*Source: EFA letters to colleges and schools*

### Impact

11. The reduction in total spending on 16 to 18-year-olds, and the lower funding per student, are visible in the 2014-15 allocations issued by EFA in March 2014. Our funding survey carried out in April 2014 suggest the following trends:

- An average 0.8% cash cut in 2014-15 compared to 2013-14 despite an average 1.2% increase in numbers of students. This is an average cash funding per student reduction of 1.9%.

- Funding levels would be 0.8% lower were it not for the one-year mitigation funding for 18-year-olds and 2.1% lower were it not for Formula Protection Grant. Most colleges benefit from either form of funding protection but do not know what future plans imply.

- An emerging problem relating to the increase of full-time students in 2013-14 and the reduction in part-time numbers. Colleges have responded to DfE encouragement to introduce broad and balanced study programmes but have funded this change from their own resources in 2013-14 and 2014-15 in the expectation that the lagged funding system will pay their costs in 2015-16.
12. There are some ways in which colleges and schools can organise their education for 16 to 18-year-olds more efficiently but there is no magic bullet. Funding cuts have direct consequences for Government policy and for national aims in a number of areas:

- There will be an impact on the quality of the education offered to young people, including the choice of courses, the number of teaching hours and the ability of institutions to recruit new staff.
- It will be harder to make progress made in improving maths and English achievement.
- The wide gaps in the entry to selective universities between state and privately educated students will remain.
- Numbers of young people will drop out of education without finding work.

**Suggested action**

13. DfE can only manage with the funds it has at its disposal but should consider several actions:

- Publish a long term budget for each area of education (early years, primary schools, secondary schools and education for people aged between 16 and 18) including indicative spending figures alongside an estimate of the number of places needed in 2015, 2020 and 2025 (taking into account demography and participation), likely education levels (given school performance) and possible subject priorities. As in other parts of government, the purpose of this exercise would not be to plan from the centre but to open up available national data and intelligence to allow colleges, schools, local authorities and the DfE itself to make sensible judgements about how to distribute available resources.

- Use this budget planning exercise and the discussions about a national school funding formula to review the appropriate funding levels for each age group.

- Tackle anomalies in the way in which some institutions are funded for educating 16 to 18-year-olds. For example reimbursing insurance bills for academies or providing 100% capital grants to academies even when they have substantial reserves. DfE should also reconsider the policy of increasing the number of sixth forms at a time when the budget is falling.

- Carry out a review of VAT exemptions for some providers of education to 16 to 18-year-olds.
**Funding of education and training for those aged 19+**

**Background**

14. The Department for Business, Innovation and Skills (BIS) is responsible for funding further and higher education for people aged 19 or over. The Skills Funding Agency (SFA) manages the further education and skills budget and pays allocations to colleges and training providers for various programmes using a national funding formula and rulebook.

15. SFA funding for FE and skills is worth around £6 million for the average FE college (21% of total income) and £0.3 million for the average sixth form college (3%). The money pays for more than two million adult students including large numbers of apprentices, jobseekers and people looking to acquire basic skills.

**Funding changes**

16. The revenue budget for adult FE and Skills in 2014-15 is £3.3 billion. SFA also has a £0.4 billion budget for 24+ advanced learner loans and a £0.4 billion budget for capital. There have been some important changes in recent years:

17. Total Government spending on the education and training of adults (other than for apprenticeships) has fallen by 22% from 2009-10 to 2013-14, the point at which Government started to route some funding via income-contingent loans for students.

18. In 2010, the Coalition Government created an adult skills budget (ASB) to cover all adult learning, workplace learning and apprenticeships. The Government removed detailed qualification targets and delegated responsibility for responding to employers and communities to colleges. However revenue spending paid via the ASB will fall by 35% (equating to £1 billion) between 2009-10 and 2015-16.

19. Government spending on tertiary education was below OECD averages at the start of the decade (1.3% of GDP versus the 1.6% average) and will be far below by 2018.

20. The systems for funding adult FE and skills were overhauled in 2013-14 alongside the ground-breaking extension of the student loan scheme to Level 3 in further education but more reforms are in prospect:

- Various other initiatives have started including traineeships and employer ownership of skills pilots, but so far these have attracted relatively few students.
The Government plans to introduce a new funding system for apprenticeships by 2016 which will involve directing the existing budgets for 16 to 18-year-olds and adult apprenticeships via employers using a new formula and making payments for external training a pre-requisite for funding.

Local Enterprise Partnerships (LEPs) are taking over responsibility for the spending of the European Social Fund (ESF) budget (£170 million a year).

All publicly-funded qualifications for adults including apprenticeships, vocational qualifications and English for Speakers of Other Languages (ESOL) are being reformed. In addition higher apprenticeships have been introduced.

Current situation

21. The combination of reductions to the overall budget with changes to funding rules and a system in which money is withdrawn from colleges and training providers if they fail to meet targets has resulted in a complicated trajectory for adult FE and skills spending. There was a significant budget reduction made in 2009-10 followed by smaller reductions in the first two years of the Coalition and then larger reductions from 2013 onwards. The cuts in adult FE and skills funding are now fairly rapid.

22. For two successive years now, colleges have faced cuts averaging 15% to the money they have for adult skills other than apprenticeships. Funding for apprenticeships has been maintained in cash terms but revenue funding for all other skills provision has fallen sharply since 2013. AoC’s funding survey carried out in April 2014 revealed the following issues in the 2014-15 allocations:

- Colleges face an average reduction in their Adult Skills Budget of 17%. The policy to protect adult apprenticeship funding implies a cut of 23% in adult skills other than apprenticeships.

- Demand in colleges in 2013-14 has been sufficiently buoyant to mean that the average college expects to use all the adult skills funding available to it. Whereas SFA was able to make cuts in 2012 by withdrawing money from colleges who had missed targets, cuts in 2014 will happen by turning students away or closing courses.

- There is no chance to substitute fee income to replace lost SFA funding. Most of the students affected are either unemployed or covered by statutory entitlements, for example that apply to basic skills.

- The combined impact of EFA and SFA funding reductions is a 5% cash cut.
Colleges have had some success with the new 24+ advanced learner loan scheme but expect to use only about two-thirds of their 2013-14 facilities. SFA has offered colleges more money in 2014-15 but even if every college uses every pound offered to them, this would only improve the average cash cut to 4%.

**BIS budget**

**CHART THREE: BIS 19+ FURTHER EDUCATION AND SKILLS SPENDING**

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Adult Skills Budget</td>
<td>3,053</td>
<td>2,963</td>
<td>2,693</td>
<td>2,620</td>
<td>2,468</td>
<td>2,258</td>
<td>2,005</td>
</tr>
<tr>
<td>Other 19+ revenue</td>
<td>1,201</td>
<td>1,193</td>
<td>911</td>
<td>958</td>
<td>1,034</td>
<td>1,066</td>
<td>953</td>
</tr>
<tr>
<td>Capital</td>
<td>944</td>
<td>715</td>
<td>445</td>
<td>345</td>
<td>450</td>
<td>415</td>
<td>410</td>
</tr>
<tr>
<td>24+ Loans</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>129</td>
<td>398</td>
<td>498</td>
</tr>
<tr>
<td>Total BIS 19+ FE</td>
<td>5,198</td>
<td>4,871</td>
<td>4,049</td>
<td>3,923</td>
<td>4,081</td>
<td>4,138</td>
<td>3,866</td>
</tr>
</tbody>
</table>

*Source: Skills Funding Agency accounts (up to 2012-13) plus Skills Funding Statements*

23. BIS is a complicated Department with a wide set of responsibilities but the majority of its budget is spent in a few areas. In 2014-15, key budget lines include:
Revenue expenditure

£4.6 million for science and research (£1.6 million via HEFCE)
£1.9 billion for higher education (HE) teaching via HEFCE
£1.5 billion HE maintenance grants
£2.9 billion 19+ FE and skills
c£2.0 billion other BIS

Loans

£7.0 billion HE tuition fee loans
£3.4 billion HE maintenance loans
£0.4 billion 24+ advanced learner Level 3 and 4 fee loans
£0.9 billion Other BIS loans (government as shareholder)

Capital

£0.4 billion 19+ FE and skills capital
£0.4 billion HE teaching and research capital via HEFCE
£0.5 billion research council capital
£0.9 billion other BIS capital (mainly innovation, enterprise and business)

24. There is a big shift underway from HE teaching grants to HE tuition fee loans which made it possible for the Treasury to make a £3 billion reduction in BIS expenditure between 2010 and 2015. However, the cut in expenditure is partly offset by the impairment charge (estimated at 40%) on annual HE loan payments (now more than £10 billion a year). Furthermore, this shift cannot be done twice so the options for meeting likely post-2015 spending reductions either require a reform of HE finance or cash cuts to science funding or further cuts to the adult skills budget.

25. Although a continuing economic recovery will put more money into the pockets of employers and individuals, official forecasts suggest there will still be 1.8 million people who are unemployed in 2018 even if there are five years of growth. An increasing share of a diminishing skills budget is likely to be spent on those who are out of work which will leave little or no funding available to support companies and people in growth sectors or with retraining.

Suggested action

26. BIS needs to consider several actions:

- Publish a clear budget with indicative long-term figures for further and higher education for 2015, 2020 and 2025 to assist institutions and employers with long-term planning and also to clarify budget choices.
• Reform higher education funding and student support to make it more financially sustainable, less targeted on full-time residential study and focused more on part-time study, people from disadvantaged backgrounds and courses focused on work.

• Ensure that there continues to be capacity in colleges to meet demand from those who are unemployed and from employers whilst also ensuring that greater employer control of apprenticeships does not lead to a reduction in overall numbers.

• Make traineeships a permanent option for young adults aged under 25 by clarifying the benefit rules and allowing colleges with a good track record of providing training to employers, but with a grade 3 from Ofsted, to provide them.

College income generation

27. Colleges are adaptive, entrepreneurial and responsive organisations who use their assets and staff to meet needs as they arise. There are a variety of ways in which colleges generate income outside the DfE and core BIS budget including:

• Higher education (full-time and part-time).
• International student recruitment (here and overseas).
• Pre-16 education (14-16, school partnerships/sponsorships).
• High need pupils (though DfE's 16-25 is within the school ringfence).
• Back-to-work programmes (e.g. Work Programme).
• Major training contracts (e.g. defence, prisons or probation).
• Full-cost courses.
• Non-education revenue (e.g. farms, catering, accommodation).

28. Some colleges generate significant income from one or more of these sources, for example certain larger FE colleges or land-based colleges. However, every college in 2012-13 generated at least 50% of its income from EFA and SFA and the overall average was much higher, at 78%. This reflects the vital contribution that colleges make to the education and training of young people, adults with basic skills and adults who are unemployed.
Finance issues

29. Colleges have strong financial credentials which they have built up over 20 years since they secured self-governing status. The financial strengths of colleges are evident in:

- A strong and consistent record on financial reporting.
- The confidence with which some colleges have embarked on international partnerships, academy sponsorships and major training contracts.
- The willingness of major clearing banks to lend to the sector at relatively low margins over interbank rates. College borrowing means that the £400 million in SFA capital grants approved in 2013 will be supporting projects worth twice as much.

30. Although the sector as a whole displays good financial management, there are have been some examples of weak leadership or where colleges have got into financial difficulty. Over the last 20 years the various agencies that have regulated colleges have developed systems to monitor financial health and to intervene when there are problems. The process involves:

- Provision of financial information in a standardised form two times a year.
- A well-developed audit regime involving a good spread of firms.
- A published system for measuring financial health which grades operating surplus, solvency and gearing and which categorises college finances on a four point scale.
- Improvement notices issued to colleges with inadequate financial health or controls which are removed when clear recovery can be demonstrated.

31. A key financial trend for colleges this decade has been created by the annual reductions in public spending. FE colleges started the decade with 81% of their income coming from public sources. Sixth form colleges obtained 94% from public sources. Even with strenuous efforts to maintain or increase private funding, government grants will remain the majority source of income throughout the decade. It would take radical policy changes to see private income displace government funding.

32. Overall college income has fallen from £7.8 billion in 2009-10 to £7.6 billion in 2012-13. College budgets suggest total income will be £7.4 billion in 2013-14. We forecast a continuing, slightly accelerating, reduction over the next few years to £6.6 billion by 2016-17. At the same time, colleges spend an average of 63% of their income on their people and face cost increases which we explain later in this paper. The overall income position is shown in Chart Four.
Table 4

<table>
<thead>
<tr>
<th>Year</th>
<th>DfE</th>
<th>BIS Adult Skills</th>
<th>Other</th>
<th>Total income</th>
<th>Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-10</td>
<td>3,961</td>
<td>1,795</td>
<td>2,737</td>
<td>7,767</td>
<td>88</td>
</tr>
<tr>
<td>2010-11</td>
<td>4,047</td>
<td>1,658</td>
<td>2,228</td>
<td>7,733</td>
<td>96</td>
</tr>
<tr>
<td>2011-12</td>
<td>4,008</td>
<td>1,674</td>
<td>1,958</td>
<td>7,640</td>
<td>140</td>
</tr>
<tr>
<td>2012-13</td>
<td>3,934</td>
<td>1,693</td>
<td>1,934</td>
<td>7,570</td>
<td>58</td>
</tr>
<tr>
<td>2013-14</td>
<td>3,788</td>
<td>1,442</td>
<td>2,093</td>
<td>7,323</td>
<td>26</td>
</tr>
<tr>
<td>2014-15</td>
<td>3,667</td>
<td>1,227</td>
<td>2,275</td>
<td>7,168</td>
<td>25</td>
</tr>
<tr>
<td>2015-16</td>
<td>3,551</td>
<td>1,044</td>
<td>2,253</td>
<td>6,848</td>
<td>(151)</td>
</tr>
</tbody>
</table>

Source: Consolidated college accounts (up to 2012-13) plus AoC estimates
DfE figures includes 16-18 education, 16-18 apprenticeships and 16-25 high needs
BIS Adult skills excludes income from FE or HE Loans or HEFCE

Capital funding and projects

33. Colleges have made good use of the capital funding provided in recent years. Capital investment is well below the £1.5 billion peak reached in 2010 but £0.9 billion was spent in 2012-13. £70 million has been made available by DfE each year for sixth form colleges and approximately £300 million made available by BIS for FE colleges. College capital projects serve a number of purposes including ensuring existing buildings can continue to be used, rationalising space use and developing new facilities to meet new employment and curriculum needs. The annual funding round restricts colleges’ ability to plan effectively and therefore both DfE and BIS should develop a three or five year
capital fund (covering the period after 2015) which will provide better value for money.

**Staffing issues**

34. Colleges carry out their activity through the staff they employ and contract. The sector employs more than 100,000 teachers and around 60,000 support staff. Total pay costs of £4.1 billion in FE colleges and £0.6 billion in sixth form colleges will fall in the next few years as income falls which will mean job losses and continuing pay restraint. Colleges face rising employer contributions to pension schemes in April 2014 (for support staff) and in September 2015 (to the teacher's pension scheme -TPS). In 2016, their pay bill will rise by about 2% as a result of a tax rise following a change to national insurance rules. Pension and national insurance increases mean that the cost of employing a teacher rises by 5% in 2015-16. Colleges work hard to maximise productivity whilst also finding ways to ensure they offer attractive careers to staff, but one consequence of pay restraint at a time when the economy is recovering will be difficulties retaining and recruiting key staff, particularly in skills shortage areas like maths, IT and engineering.

**Colleges and universities**

35. The financial challenge for colleges is their dependence on government spending in areas where budgets are not protected and the difficulties associated with increasing fee income from employers or individuals. There is an interesting comparison with the university sector who, despite media coverage about financial problems, benefit from the science ring-fence, the increase in tuition fee loans, overseas and residence income. Chart 5 compares total university and college income taken from consolidated accounts and from the financial plans which each sector prepared in similar ways in July 2013. The figures are indexed to 100 in 2009-10.

**CHART FIVE: COLLEGE INCOME/UNIVERSITY INCOME**
**(Indexed to 2009-10)**
Regulation and control

36. At the start of 2014, it was evident that there are significant financial problems for a growing number of colleges. There are also gaps in the way in which government regulates the sector. The evidence of financial problems is as follows:

- The number of FE colleges reporting a deficit has risen from 70 in 2011-12 to 117 in 2012-13 (48% of the total). Collectively colleges reported a £58 million deficit which represents 0.8% of total income.

- A rising number of colleges have been provisionally assessed by SFA as having inadequate financial health (now 10% of colleges).

- Colleges normally report better financial results in the year-end return than they predicted in their July plans. This was not the case in 2013 because of clawback of SFA funds.

- Borrowing is rising because of the need to finance capital projects.

37. There are other colleges with healthy balance sheets and rising incomes but recent and future public spending cuts, funding changes, and the competition for students make the financial environment more challenging. There have always been problems in individual colleges but financial failure will become more common as challenging result of these changes. A downward spiral in one or two colleges resulting in a financial collapse would be very damaging to the whole sector but even the degree of ‘muddling through’ in the current arrangements may be inefficient.

Suggested action to address financial uncertainty in colleges

38. Oversight - SFA and EFA have worked together for several years to oversee the financial state of colleges. With the appointment of an FE Commissioner\(^2\), it would be helpful to show banks, partners and suppliers that colleges are effectively regulated.

39. Predictability- it helps that agencies are trying to simplify funding rules but greater predictability about policy and rules would be more beneficial. Short term initiatives and one year budgets induce responsiveness but don't support deeper rooted change.

40. Funding system changes – the current funding systems are designed to maximise outcomes but are complicated and include high penalties for one

year shortfalls. The funding agencies should review whether features like the use of logged data or end of year reconciliation are unnecessarily damaging.

41. **Rationalisation** - government and agency policies supported college mergers for about ten years but since 2008 they have generally been discouraged. Mergers bring costs as well as savings so are only worth doing when there is a clear justification, but at a time when colleges need to find new sources of income and to invest, it may be helpful to remove unnecessary obstacles to rationalisation.

42. **Pension debts** - colleges are required by employment law to offer Teacher Pension and Local Government Pension schemes to current staff. Even with the current reforms, the long-term sustainability of the arrangements are doubtful and leave colleges in a position where they pay higher employer contributions and carry inherited costs which their private sector competitors do not have.

43. **Access to finance** - there are currently two incumbent banks in the sector (Lloyds and Barclays) and two challengers (RBS and Santander). There is no particular problem in access to finance but it is possible that more could be done to help English colleges access support from European sources, Treasury funds (e.g. the infrastructure guarantee) or the Public Works Loan Board. There is no sign from central government of clear policy or process about post-2015 capital funding.

This paper has set the funding and financial scene for colleges in spring 2014. It makes a number of statements and judgements about which you may want further information or to question. Please contact Julian_Gravatt@aoc.co.uk if you have queries.

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