

Review of Financial Data Returns

Office for Students
Final Report
December 2023



Contents

Disclaimers and limitations	1
Executive summary	2
1. What are the risks to HE provider finances that the OfS needs to be aware of?	4
2. What information is required to assess the highlighted risks?	7
3. What information is being collected by the OfS and are there any gaps?	10
4. What does good practice look like relative to other regulators that collate financial information from the providers they oversee?	15

Distribution list

Nolan Smith - Director of Resources and Finance
Jamie Black – Head of HE Market
Will Dent – Head of Financial Analysis
Sam Muzzlewhite – Head of Financial Assessment



Disclaimers and limitations

To ensure that the recipient (“you”) has a clear understanding of the terms under which this Report is being provided please read the following terms.

We confirm that we give our consent to you accessing the Report on the clear understanding that the Report was addressed to Office for Students (“OFS”) and was prepared on their instructions as set out in our agreement dated 21 June 2023 and therefore the Report will not address or reflect the interests or circumstances of the recipient or any other third party. Furthermore, we accept no duty or responsibility and deny any liability to the recipient or to any other third party in relation to the subject matter in this report or otherwise, whether or not the Report influences the decision or action of the recipient or any other party.

Receipt of the Report should not be a substitute for enquiries the recipient should undertake for its own purposes and any independent advice it should obtain. You will be bound by a duty of confidentiality to PricewaterhouseCoopers LLP, as well as to OFS, and that in respect of any Personal Data in the Report, you are required to comply with the Data Protection Act 1998. Consequently, the Report, and information obtained from it, must not be made available or copied, in whole or in part to any other person without our prior written permission which we may, at our discretion, grant, withhold or grant subject to conditions (including conditions as to legal responsibility or absence thereof).

Where disclosure of the Report or information contained in the Report is required by law or regulation, the recipient should i) ensure that a copy of these terms is disclosed with such information so that the other party receiving the information is on written notice of the terms on which the recipient itself had access to it; and ii) where legally permissible inform us promptly of the specific requirement to disclose and before making any disclosure.

This letter shall be governed and construed in accordance with the laws of England. The Courts of England and Wales will have exclusive jurisdiction to settle any claim, dispute or difference which may arise out of or in connection with this letter.

Executive summary

Background, scope and approach

Background to the review and review scope

The Office for Students (OfS) has a statutory duty to monitor and report on the financial sustainability of providers. The Annual Financial Return (AFR) process is designed to gather data and intelligence to identify risk across the sector and for different types of provider. Part of the AFR data is taken from audited financial statements and is collected from over 270 registered higher education (HE) providers through an Excel template and accompanying Word document where commentary is provided. The OfS uses the collected data to a) assess the financial viability and sustainability of the registered providers and b) perform financial analysis at a sector level and scenario modelling across providers to inform its financial sustainability annual publication. Providers identified as greater risk through a triaging process are then subject to further review and potentially a requirement to submit additional information to aid the completion of a detailed assessment. This can then lead to more direct action and enhanced monitoring of the provider's financial sustainability.

We held an initial kick off meeting on 7 July 2023 to confirm the scope of the review. It was agreed that the review would focus on the following key questions:

- What are the risks to HE provider finances that the OfS needs to be aware of?
- What information is required to assess those risks?
- What information is being collected by the OfS and are there any gaps?
- What does good practice look like relative to others regulators that collate financial information from the providers they oversee?

The OfS has an on-going Data Transformation Programme which is assessing how data is collected, stored and processed, including for the AFR. Our review has not therefore considered the mechanics of how the data is submitted by providers to the OfS. Our review has also not included a detailed review of the risk-based triage process/methodology that is used to support the risk based interventions.

Limitations of Scope

When reading this report, the following limitations of scope should be taken into consideration:

- The fieldwork for this review was undertaken during July to September 2023, the findings set out in this report have not been updated to take into account any changes since then.
- This review focused solely on the data collected by the OfS through the AFR, we have not considered the OfS' processes and controls in relation to assessing / using the information provided through the AFR.
- The majority of our fieldwork was completed through engagement with the OfS and did not include engagement with any individual HE providers. As noted below, our fieldwork did include some, limited engagement with sector representative bodies.

Approach to the delivery of the review

Our review was completed through a series of interviews with key internal stakeholders involved in the initial collection, processing and analysis of the AFR information. We also met with representative bodies within higher education including UK Research and Innovation (UKRI), the British Universities Finance Directors Group (BUFDG) and Independent Higher Education.

Our interviews were supplemented by a review of key documents including: the Annual Financial Return; Regulatory advice 14; Guidance for providers for the Annual Financial Return; and the Financial Sustainability Project Risk Register. We also undertook a comparative exercise to review the financial information that is collected across other regulatory bodies.

Executive summary

Overall conclusions

The AFR provides a useful base data set upon which the OfS can perform a financial sustainability analysis of individual providers and the overall HE sector. Compared to some other regulators, the OfS obtains more detailed financial information, particularly in relation to future years' financial forecasts, but this information is currently only collected annually. In other sectors, regulators focus on collecting more targeted financial information, on a more frequent basis (e.g. quarterly / monthly) to supplement an initial / annual data submission.

There is an opportunity for the OfS to collect less detail in relation to providers' longer term financial forecasts (e.g. years 4, 5, 6 and 7). This longer-term data is hard to predict accurately and generally represents an optimistic view of the future financial position of providers. It may be more effective for the OfS to challenge that optimism bias by collecting financial information more frequently to take account of the increasing volatility of financial risks facing the sector (for example recent inflationary pressures and changes in visa policy impacting international student recruitment). This is important, as the single biggest risk to a provider failure would be running out of cash and therefore more timely information would support the OfS in assessing the short term cashflow needs of individual providers. We do acknowledge that following triage and analysis of the AFR, the OfS collects additional data for some providers (including scenario analyses for best and worst cases), and that providers are required to submit a reportable event if they forecast having less than 30 days liquidity at any point in the future.

To gain the assurance required over the financial stability of providers and the sector, the OfS may need to move towards collecting more targeted, risk based financial information (with a focus on cash), on a more frequent basis and place greater focus on understanding how providers have developed their financial forecasts.

Summary of key findings

The key findings and recommendations from our review are summarised below. Further detail on each of these is provided across the report, which has been structured in alignment with the questions set out in the scope section above.

- **Risks to provider finances** - We found that the OfS had a good awareness of the most critical financial risks faced by the higher education sector, including risks associated with providers' income streams (e.g. international students and partnerships) and increased expenditure pressures through: economic challenges (e.g. inflation, increases in borrowing costs etc); and operational expenditure such as capital maintenance backlogs. Given the dynamic nature of these financial risks, and the fact that many of them are connected, it will be important for the OfS to ensure the AFR process collects relevant and timely information in future years.
- **Information required to assess financial risks** - In order to fully assess the financial stability challenges faced by providers (and the sector as a whole) there is some additional information that may need to be collected. Examples we noted include: forecast student domicile information by country (which would enable the OfS to analyse the reliance on international students from a single country); the size of repairs and maintenance backlogs at providers; information on the income that is being generated from partnership arrangements; and expenditure analysis including the size of any cost reduction / efficiency programmes. It will be important that the cashflow impact of these areas is considered for individual providers.
- **The information collected by the AFR** - The AFR collects a significant volume of financial information, but to gain coverage of all the key financial risks facing the sector, the OfS will need to collect more detail, particularly on the areas noted above. In addition, the supplementary commentary template needs to be refined, taking into account a) the ease at which information can be compared, particularly key assumptions against modelled scenarios, b) ensuring there is a clear basis on which to include the narrative questions, such as aligning to the Financial Sustainability Risk Register, and c) the introduction of broader questions that enable the OfS to gauge the strength of the broader processes and controls in place at individual providers regarding the production of the financial forecasting information.
- **Good practice compared to other regulators** - The volume of information collected by the OfS for the following financial year is similar to that collected by other regulators, however the OfS collects significantly more detail for future years. The frequency with which the OfS requests data from providers is also similar to other regulators, but it should be noted that some regulators use additional in-year information requests to support their annual analysis. The OfS has an opportunity to ask for more targeted / risk based information, rather than requesting a similar level of detail for multiple forecast years. Some of this information could be provided in the commentary template which supports the AFR, but the OfS could also consider collecting more detail on the governance / oversight processes on how providers themselves assure their financial sustainability. This could then be backed up with a sample of visits to providers each year.

1. What are the risks to HE provider finances that the OfS needs to be aware of?

This section of the report focuses on addressing the first of the four key questions our review focused on, namely ‘What are the risks to HE provider finances – is the OfS aware of these?’ We have focused our review on the most critical risks facing provider finances at the time of our work (August / September 2023). One of the most significant drivers of the financial challenges facing the sector is the freezing of UK undergraduate tuition fees (at £9,250). As this risk is well known, we have not specifically focused on it in the section below.

Risk to provider finances - international students

For all UK HE providers, student tuition fees are critical to their financial stability. It is well known that UK undergraduate tuition fees were set at a maximum of £9,000 per annum in 2012/13 and have only risen once since then to £9,250 per annum in 2017 (and will remain so until at least 2024/25). Universities are considering how to grow income streams, with the most common approach being placing a greater focus on increasing international student recruitment. This creates a number of potential risks for the HE sector including:

- a) An overreliance on a single country, such as China / India / Nigeria, where there could be regulatory changes / sanctions or economic issues that remove accessibility to the market.
- b) Increasing competition from other international markets, for example China now has nine universities in the top 100 of the Times World Universities 2023.
- c) Demand for international students outstripping the supply, as many institutions seek to recruit from similar geographical areas. This may also create a greater gap between larger more established international student recruiters and universities who need to grow quickly in this area.
- d) Visa / Home Office regulation and guidance around international students may change, which could limit international student visas and / or the attractiveness of the UK as a place to study. At present, the UK Visas and Immigration Service (UKVI) is also delivering an inspection programme with the aim of visiting all providers over the next two years. The implications of losing a sponsor license in the current environment would be catastrophic for most providers.
- e) Forecasting international student enrolments through a recruitment cycle is challenging as the behaviour of international students is difficult to predict and without a central admissions service overseeing the process, there is less visibility and / or control on where international students are receiving and accepting offers from.
- f) The recovery of fees from international students is also a risk the sector is facing, as many institutions have allowed international students to receive education without paying tuition fees up front.
- g) Predicting continuation statistics for international students is also becoming more challenging and where continuation is poor, this will have both a financial impact (if fees haven't been paid) and a visa compliance impact.
- h) There is also a risk of getting the balance of international and home students right, as focusing too much on one or the other can have impacts in terms of under-recruitment, impairment of the student experience and a lack of clarity on direction.

Risk to provider finances - backlog of capital maintenance

The Covid-19 pandemic resulted in institutions seeking to consolidate their financial performance. This often manifested itself by deferring investments into buildings and facilities.

The pandemic also had the effect of impacting how individuals now work on a weekly basis, with increasing amounts of time spent working from remote spaces rather than being physically present at work every day of the week, requiring changes to the spaces available to work within.

Changes to working patterns and academic teaching models have also resulted in institutions looking towards rebalancing their physical and digital infrastructure investments.

The increasing emphasis placed on net zero targets also means that institutions are having to invest in their existing facilities to reduce their impact on the environment and make them more sustainable.

This creates a number of potential risks for the HE sector including:

- a) A significant backlog of capital maintenance / investment may have built up that providers have to manage to ensure that service delivery is not affected. Insufficient surpluses and residual cash may be available to meet this backlog resulting in higher maintenance costs.
- b) Significant increases in recent borrowing costs mean that debt is more expensive and potentially less accessible for providers.
- c) High rates of inflation are continuing to push up costs of construction making reductions in backlog maintenance more challenging.
- d) Space across institutions may not be being utilised effectively and may require investment to ensure it remains fit for purpose.
- e) The increase in borrowing costs has also made some capital programme structures / arrangements where a private provider is involved (e.g. to build and maintain student accommodation) less attractive / less financially sustainable.
- f) Digital investment costs may not always be considered as part of a broader capital programme, meaning the costs may not be controlled / monitored in the same way at institutions.

1. What are the risks to HE provider finances that the OfS needs to be aware of?

Risk to provider finances - partnership income

Providers are increasingly exploring opportunities to expand their revenue streams through partnering arrangements, both within the UK and more broadly across the world. One common example of a partnership would be Transnational Education, but increasingly providers are looking to strengthen partnerships across their education, research and enterprise activities.

This creates a number of potential risks for the HE sector including:

- a) There is increasing noise in the sector regarding the assurance over the quality of the provision within education partnerships. Providers with a high reliance on a small number of partners could be potentially exposed if quality assurance concerns are identified.
- b) Providers that are seeking to mitigate the inflationary pressures may be willing to take additional risk with a partnership venture that could expose the sustainability of the provider if not carefully managed.
- c) Significant fraud risks, including where the partner may not provide accurate / complete information to the provider and / or through collusion with staff employed by the provider.
- d) International partnership arrangements expose providers to similar risks to over reliance on international students / research projects from a single country, such as sanctions, export controls, the National Security and Investment act etc.

Risk to provider finances - inflationary pressures

The UK has been experiencing its highest rates of inflation in over a decade, with the Consumer Price Index peaking at 11.1% in October 2022. Inflation has been driven from a number of factors including the Covid-19 pandemic, the conflict between Ukraine and Russia and Brexit. One area of expenditure that has seen a significant increase during this period has been the cost of energy which in turn has driven up costs more broadly.

This particularly creates a risk for those providers with larger, aged estates, potentially those that are more research intensive, who will see considerable increases in their expenditure. The full impact of this may yet to have materialised due to hedging arrangements that may be in place.

Higher inflation also creates a cost of living challenge for both students and staff. Employees seek higher rates of pay to offset the inflation pressure and students may look to study closer to home or remotely to mitigate costs. Both of these can impact on the ability of a provider to recruit staff and students. The increased cost of living may also impact on student choices, meaning fewer students may choose to study for 'traditional' undergraduate degree courses.

Risk to provider finances - interest rates / cost of borrowing

The high rates of inflation (as referenced above) have resulted in interest rates rising to their highest level in over a decade. The cost of debt is therefore rising considerably. This creates a number of potential risks for the HE sector including:

- a) Providers may be unable to access debt facilities to support investments in facilities due to the cost of borrowing.
- b) Providers may see considerable spikes in existing borrowing arrangements / refinanced arrangements that may increase the risk of default.

The strength of a provider's balance sheet (or lack thereof) is also important, for example; understanding whether providers' are fully geared and / or have the required quality of assets, will impact on whether the provider has the ability to obtain a cash boost via new lending.

1. What are the risks to HE provider finances that the OfS needs to be aware of?

Risk to provider finances - government and OfS policies	Risk to provider finances - pension schemes
<p>Government policy can have varying impacts on providers depending on the changes being introduced. Examples of recent announcements include:</p> <ul style="list-style-type: none">• Potential student recruitment limits on 'poor' outcome courses.• Reduction in the course fees for foundation degrees.• Visa rule changes for family members.• Introducing the NHS surcharges for international students. <p>All of the above could expose providers that have a particular dependency on a) a small number of subject areas, b) foundation degree income, c) reliance on international students for countries impacted by the Visa change.</p> <p>Less certain changes to government policies that could affect the financial stability of providers include:</p> <ul style="list-style-type: none">• Changing of the home undergraduate tuition fee regime (currently set at a maximum of £9,250 per annum).• Future changes to research policies / funding arrangements (e.g. participation in the Horizon programme).	<p>Valuations of pension schemes over the last decade have resulted in higher contributions being required from institutions to ensure that the investment fund is sufficient to cover the previous and current workforce requirements. The increase in contributions to the Local Government Pension Schemes and Teachers' Pension scheme is likely to continue in the short term, which many providers will be affected by.</p> <p>The significance of this risk in the shorter term may decrease due to the high rates of interest rates, and thus returns, that are being achieved on invested funds which in turn reduces the dependency on contributions from members. For example, the Universities Superannuation Scheme (USS) has benefitted from higher interest rates, which has meant that proposed increases in contributions have been scaled back. It is important to note here though, that the USS is joint and several, so its sustainability is critical for the financial sustainability of a number of providers.</p>
Other risks	Risk to provider finances - ESFA funding clawback
<p>Other risks which may have a significant impact on providers' financial stability, but which are much less certain than other risks included above include:</p> <ul style="list-style-type: none">• The impact of global events (e.g. pandemic, conflict, geopolitical deterioration).• Industrial disputes / action.• A failure of management and/or governance. <p>Given the unpredictability of these risks, it is unlikely that the AFR would be designed to collect financial information on their impact. Instead, as the OfS did during the COVID19 pandemic, such events may require detailed financial information to be collected to identify any providers whose financial stability would be at risk if they occurred.</p>	<p>With over 90 higher education providers offering higher and degree apprenticeships and over 70,000 learners signed up, funding provided from the Education Funding and Skills Agency (ESFA) is under greater scrutiny than ever before with a very specific set of funding rules applied to such funding. As a result, for the last three years, the ESFA has included universities within its annual funding assurance review spotlight.</p> <p>The audits can result in significant penalties / clawback of funding where non-compliance is identified, which could impact on the sustainability of providers with a particular dependency on this income stream.</p>

Conclusion

Our interviews with OfS employees highlighted that there was a good awareness of the majority of the risks set out above (slides 3 to 5). This is also supported by the OfS's report 'Financial sustainability of higher education providers in England' (dated 16 May 2023) which itself highlights key provider risks including the impact of inflation, cost of living, sustainability of pension schemes, investment in facilities and the environment, and reliance on international student recruitment. It is likely that the above risks will affect providers, for some time, but in different ways and they will continue to evolve. It is therefore critical that the AFR process remains under review to ensure that it collects relevant and timely financial information from providers.

2. What information is required to assess the highlighted risks?

This section of the report focuses on addressing the second key question of our scope, namely 'What information is required to assess the highlighted risks above?'. It should be noted that some of the information set out below is already collected by the OfS. The gaps in information collected through the AFR process are set out in the following section.

Risk	Information required to assess the highlighted risk
Risk to provider finances - international students	<p>To assess the risks around international student recruitment, the OfS will need to ensure it collects:</p> <ul style="list-style-type: none"> • Information on the domicile of students enrolled at each provider, enabling an analysis of the dependency on international students and an assessment of the reliance on a particular country. • Information on any potential regulatory issues in relation to UKVI sponsor licences. • Details of international student debt and whether there are any potential recoverability issues. • Details on any plans for growth and what happens if these plans are not achieved.
Risk to provider finances - backlog of capital maintenance	<p>To fully assess the financial impact of this risk, the OfS will need to collect / utilise:</p> <ul style="list-style-type: none"> • Information on the size of the capital backlog that an institution has, combined with the level of investment that the institution (across repairs and new buildings) is forecast to undertake. • Details of any major capital projects / investment schemes which are no longer financially sustainable. • Details on digital investment programmes, which have the potential to escalate in cost.
Risk to provider finances - partnership income	<p>Partnership arrangements will vary between providers, but the OfS will need to ensure it has sufficient information such as:</p> <ul style="list-style-type: none"> • Information on the revenue that has been received from key partnership arrangements, potentially broken down into the type of partnership to allow for an assessment of the providers' reliance on this income. <p>The OfS could also look to triangulate information from reportable events and Higher Education Statistics Agency (HESA) data to assess whether there are any specific partnerships which providers have a high reliance on, or any issues in relation to partnerships which would have a significant impact on the providers' financial position.</p>

2. What information is required to assess the highlighted risks?

Risk	Information required to assess the highlighted risk
Risk to provider finances - inflationary pressures	<p>Inflationary pressures are well known across the sector and the OfS will need to collect:</p> <ul style="list-style-type: none"> • Expenditure information broken down into subjective areas to show how much is being committed on items like utilities that would enable sensitivity analysis to be performed to assess the relative vulnerability of providers. • Information on the cost reduction initiatives (or revenue generation ideas) that the provider intends to pursue to help offset the impact of inflation. • Information on staff numbers and expected salary cost increases compared to forecast inflation.
Risk to provider finances - interest rates / cost of borrowing	<p>The OfS will need to collect:</p> <ul style="list-style-type: none"> • Information on provider borrowing arrangements in place, including value, interest rate and maturity. • Details on future forecast borrowing. • Details of any major bullet repayments on capital market debt which are due in future years and how the provider is assured of its ability to meet them. • Details of any major financial restructuring projects needed in the next five year period and if the impact of those has been remodelled. • Details on the credit ratings of the providers to assess their ability to access borrowing. • Information on any potential covenant breaches across the forecast financial period. <p>In addition, the OfS should continue to maintain its relationships with key lenders to the sector, so that overall trends in borrowing / lending can continue to be obtained.</p>
Risk to provider finances - government policies	<p>As government policy is likely to shift and change, the OfS will need to consider what information it needs to collect on a regular basis. At present the following areas should be considered:</p> <ul style="list-style-type: none"> • Information on the subject areas being delivered by a provider. • Details on the number of foundation degrees (and associated income) being delivered by a provider. • Details on the domicile of the students in attendance at the provider.

2. What information is required to assess the highlighted risks?

Risk	Information required to assess the highlighted risk
Risk to provider finances - pension schemes	<p>Pension scheme contributions continue to change and therefore the OfS should ensure it collects information on the pension schemes that providers are part of and details on the size of contributions that are being made to each scheme.</p> <p>Pension contributions are also likely to change in the next few years, so the OfS should also collect details of assumptions that providers have applied in their future pension contributions.</p>
Risk to provider finances - ESFA funding clawback	<p>The OfS should consider collecting information on the income received from the ESFA by providers and details of any potential clawbacks from audits undertaken. It will also be important to consider future forecasts for growth in apprenticeship income and the assumptions which underpin any growth.</p>

Conclusion

Whilst the OfS is aware of the risks to provider finances, there is some additional information (set out above), which the OfS will need to consider collecting to ensure that it can obtain a full picture of the financial challenges facing individual providers and the sector as a whole. One of the key challenges the OfS will face is that the pace of change in financial risks facing the sector is likely to continue to increase. As providers start to look at alternative / new solutions to meet their financial sustainability challenges, it is likely that the AFR will need to be regularly updated to ensure the OfS collects sufficient and relevant information to assess the financial stability of providers and the sector as a whole.

3. What information is being collected by the OfS and are there any gaps?

This section of the report focuses on addressing the third question our review focused on, namely 'What information is actually being collected by the OfS on the risks and are there any gaps?' The AFR collects data in an Excel worksheet and narrative information in a Word document. We have separated out the gaps noted in each of these areas below.

Data collected in the AFR - the data collected in the AFR is through an Excel worksheet and potential gaps in this part of the AFR are summarised below.

Risk	OfS information gathered and potential gaps	Recommendation
Risk to provider finances - international students	<p>The AFR captures details on student income that is broken down into UK-domiciled, EU-domiciled and Non-EU domiciled over the next five years. A similar breakdown is also obtained for Full Time Equivalent numbers (FTE). No information is captured at a more granular (individual country) level. Whilst this may be challenging to predict over a longer term period, most institutions should be able to provide details in the medium term of where they expect international students to come from.</p> <p>The 'Financial sustainability of higher education providers in England - 2023 update - Office for Students' overarching financial assessment published by the OfS contains historical data from 2021/22 and 2020/21 of student domicile to individual country based on information obtained from HESA but no forecast information is included.</p>	<p>The OfS should consider:</p> <ul style="list-style-type: none"> Utilising the supporting commentary, or a supplemental collection of data, to provide additional insight on international (diversification) strategies. Requesting in the AFR details of any potential regulatory issues in relation to sponsor licenses (as noted in Regulatory Advice 16 and paragraph 494 of the Regulatory Framework). This information could also be triangulated with any reportable events disclosed by the providers. The impact that the HESA Data Futures programme will have on the OfS's ability to assess where international students are domiciled for each provider. Once in year collections start from 2025 onwards, the OfS should have more up to date information on student domiciles.
Risk to provider finances - backlog of capital maintenance	<p>The AFR captures details on the sources of funding for the latest year of audited capital expenditure. The cash flow forecast also captures a high level overview of anticipated payments to be made for capital. There is no detail required on:</p> <ul style="list-style-type: none"> The capital backlog of an institute. Any major capital projects / investment schemes which are no longer financially sustainable. Any significant digital infrastructure programmes which are running behind / over budget. 	<p>The OfS should consider the merits of collecting more detailed information on: capital backlogs, major capital projects and significant digital infrastructure projects which providers see as a significant risk to their finances.</p> <p>The information collected should focus on future cashflows, to ensure the provider has the cash required to meet the needs of the capital programme.</p>
Risk to provider finances - partnership income	<p>There is no specific section to capture income generated from major partnership arrangements. The 'Income' tab within the AFR has a line for 'Subcontracted in course fees' line.</p>	<p>The OfS should also continue to utilise other information it collects (e.g. from reportable events) in relation to partnerships, which could include a material fraud and / or the entry / exit of working with a large partner.</p>

3. What information is being collected by the OfS and are there any gaps?

Risk	OfS information gathered and potential gaps	Recommendation
<p>Risk to provider finances - inflationary pressures</p>	<p>The AFR captures information on the face of the Income and Expenditure statement which breaks down expenditure into staff costs, restructuring costs, other operating expenses, depreciation and amortisation and interest and other finance costs. Staff costs are broken down into more detail, including average FTE. No further breakdown of non-staff expenditure (apart from between academic, professional services etc.) is obtained.</p> <p>The AFR does not capture detail on the size of any cost savings / efficiency schemes that are required for the delivery of the forecast figures by providers.</p>	<p>The OfS should consider gathering more information on significant cost reduction programmes where they are required to maintain a providers' financial stability.</p> <p>In doing so, the OfS should ensure this enables an assessment of cash savings and whether they are sufficient to support the future cash needs of providers.</p>
<p>Risk to provider finances - interest rates / cost of borrowing</p>	<p>The 'commitments' tab of the AFR captures details on the existing arrangements in place and a combination of the cash flow forecasts. The supporting Word commentary requires details of plans for short term future debt arrangements. However, there is no specific question or detail collected on whether the provider has any major financial restructuring projects needed in the next five year period and if the impact of those has been modelled / considered. There is also no specific information on credit scores / ratings collected.</p>	<p>The OfS should consider collecting sufficient information on risks relating to provider borrowing arrangements.</p>
<p>Risk to provider finances - government or OfS policies</p>	<p>Academic quality is subject to separate regulations and reviews by teams outside of the AFR process. This information isn't therefore included in the AFR, but the OfS could triangulate the information it collects in this area (e.g. the recent assessment reports into business courses).</p> <p>Information on full time and part time students at undergraduate and postgraduate levels is included but details of students on foundation courses is not separately captured. Other data sets captured historical information on this.</p>	<p>As referenced in slide 3, the forecasts for individual country for students is not captured and the OfS should consider capturing this information, given its criticality on many providers' financial stability.</p>
<p>Risk to provider finances - pension schemes</p>	<p>No specific gaps identified, though the OfS will need to ensure it continues to assess assumptions made by providers on the costs of future pension contributions in its longer term forecasts.</p>	<p>No specific recommendations made.</p>
<p>Risk to provider finances - ESFA funding clawback</p>	<p>ESFA income is requested within the AFR which would enable an assessment of the dependency of the provider to that income sourced to be assessed. Details on potential anticipated clawbacks is not requested and may be an area that can be requested from ESFA.</p>	<p>The OfS should consider how it can gather information on potential ESFA clawbacks (e.g. from the ESFA or providers themselves).</p>

3. What information is being collected by the OfS and are there any gaps?

Commentary to support the OfS Annual Financial Return 2023 workbook – the Excel AFR is supplemented by a Word document that enables providers to expand on the information that has been submitted. The document captures key information on forecast assumptions that have been included within the submitted figures as well as requesting explanations for movements of +/- 10% across the student and financial forecasts between years. Our review of the Word document identified the potential gaps in the detail captured and areas for improvement below:

Area	OfS information gathered and potential gaps	Recommendation
<p>Format of the assumption table</p>	<p>The assumption table included in Word format inhibits the comparability of the information gathered. The table was previously included in the excel AFR but was removed due to limits on the characters that could be added within cells and providers submitting pictures / extracts from reports.</p>	<p>Moving forward, the OfS will be running upfront risk based scenarios to support the triaging process and these will require easier access to the assumptions to be able to identify the relative vulnerabilities of providers to the scenarios. The OfS should ensure it makes best use of this additional layer of data analysis and also explains to providers how this data analysis will support the assessment of the information in the AFR.</p>
<p>Basis driving the narrative questions included</p>	<p>The questions contained in the supporting Word document do not reconcile to a methodology or a risk assessment.</p> <p>Our review challenged the basis on which each question was included in the Word document and a frequent response was that it was included because of a legacy concern raised previously, such as details on the intangible assets that providers currently own or plan to in the future.</p> <p>A Financial Sustainability Project Risk Register has been developed by the provider assessor team to help inform risks that should be modelled.</p>	<p>This risk register, or a similar approach, should be adopted to provide a clear basis on which risks are being included in the Word document for providers to respond to. This exercise would also provide an opportunity to reflect on a) whether the volume of questions included is appropriate or can be reduced and b) whether questions can be targeted at the most significant provider risks / key information that is needed to quickly assess financial sustainability of providers, i.e. minimum cash days, working capital issues, debt issues.</p>
<p>Knowledge of provider risks</p>	<p>The Word document includes the following questions: ‘How is your provider ensuring its financial viability and sustainability, including the identification and management of material risks to viability and sustainability?’ and ‘What scenario planning, sensitivity analysis or stress testing has been undertaken to understand and mitigate the risks to financial viability and sustainability that arise from uncertainty in your financial and student number forecasts?’ There is no table included to capture the top 5-10 risks that a provider believes may impact on the delivery of their financial forecasts. Other sectors request potential risks but also what the monetary value of those risks may be and the actions that are being taken to mitigate those risks.</p>	<p>The OfS should consider capturing details of, say, the top 5 risks to provider finances. This should help in the OfS achieving its objectives around the financial sustainability of the sector.</p>

3. What information is being collected by the OfS and are there any gaps?

Commentary to support the OfS Annual Financial Return 2023 workbook continued

Area	OfS information gathered and potential gaps	Recommendation
<p>Covenant breaches that have occurred</p>	<p>We note that the OfS in Regulatory Advice 16 does include the following statement, which would require providers to declare a reportable event:</p> <p>‘A likely breach of any financial covenant attached to a loan, where that breach has not been waived by the lender’.</p> <p>The Word document attached to the AFR requests that ‘If relevant, what are your debt covenants and how do you manage your compliance with them? Do your forecasts show that you will continue to meet these covenants for the full forecast period?’</p>	<p>This question could be amended to ensure that any covenant breaches over the past 12 months are reported. It should request details of any independent reviews of covenant compliance that have taken place and the results of those reviews. It is noted that providers should report this to the OfS under Regulatory Advice 16.</p>
<p>Cash balances</p>	<p>We note that the OfS in Regulatory Advice 16 does include the following statement, which would require providers to declare a reportable event:</p> <p>‘A likely drop in the provider’s liquidity to below 30 days’ average expenditure unless this is the provider’s normal cash management policy or is mitigated through an agreed revolving credit facility, overdraft or other financing’.</p> <p>Whilst it is helpful that the OfS has this as a mechanism to detect providers which may be in financial distress, it may be too late to take action at the point a provider reports that its liquidity days are falling below 30 days if it does not communicate this when originally forecast but rather when it actually occurs.</p> <p>Other regulators that analyse financial information are more proactive in asking their regulated bodies more specific questions around cash / liquidity, for example: If liquidity days fall below XXX, what actions could you take to ensure they are brought back up?</p>	<p>The OfS should consider integrating more robust questions around providers’ liquidity days and proposed mitigating actions should this arise in its commentary to support the AFR. This may support the OfS in determining if there are specific pinch points in future years across the sector, which may be indicative of a risk to the sector’s financial stability as a whole.</p> <p>This section could also be supplemented with questions around the providers’ processes for managing cash, for example, obtaining details on:</p> <ul style="list-style-type: none"> • Providers’ processes for producing and monitoring 13 week rolling cashflow forecasts. • Providers’ analysis of monthly forecast cash against their banking facilities. • Forecast covenant performance / potential breaches in covenants.

3. What information is being collected by the OfS and are there any gaps?

Commentary to support the OfS Annual Financial Return 2023 workbook continued

Area	OfS information gathered and potential gaps	Recommendation
Actual performance to budget	The AFR questions do not require a provider to explain its actual performance in the audited year relative to the forecast position included in the prior return. Given the timing of the AFR, most providers will have details of student enrolments for the academic year and should therefore be able to provide some level of assurance on their financial stability in the medium term.	The OfS should consider requesting details on the movement between the actual performance and the prior forecast performance to support its assessment of the financial management of providers.
Governance over financial returns	The AFR provides the OfS with an opportunity to gauge the strength of the broader processes and controls in place at individual providers regarding the production of the financial forecasting information. Providers are required to confirm that the form has been accurately completed and has been signed off by a senior executive and questions are contained in the Word document around what scenario planning, sensitivity analysis or stress testing has been performed. However, other regulators include broader questions that can help to push providers to assess the strength of their own controls.	The OfS may consider including 1 or 2 questions on a rotational basis that help to build up a picture of the control environment in place at each of the providers. These questions could be themed around the following headings: <ul style="list-style-type: none"> • Plan production and processes / controls in place for in year monitoring. • Budget approval and sign off across all provider levels. • Budget monitoring and reporting. • Forecasting. • Efficiency savings. • Board reporting. • Financial governance. • Culture, training and development.

Conclusion

Our review of the AFR relative to the information required to assess the key risks (see Question 2 on prior slides) has shown that there is information being collected to varying degrees on all the key risks identified. There are opportunities for the OfS to collect more focused / risk based information in certain areas, to enable a more comprehensive assessment of key financial risks to be undertaken.

If additional information such as that suggested above is requested, the OfS will need to consider whether it is required from all providers. The financial resilience of providers varies significantly and the extent to which some can withstand sizable financial shocks will depend on a number of factors. Taking a more risk-based approach may support the OfS to more quickly identify providers who have significant financial challenges, but it may also result in the OfS not identifying providers with a medium-term financial challenge. Not collecting the same data for all providers may also make the OfS's role in regulating to overall financial stability of the sector more challenging to undertake.

4. What does good practice look like relative to other regulators that collate financial information from the providers they oversee?

This section of the report focuses on addressing the fourth key question our review focused on, namely 'What does good practice look like relative to others regulators that collate financial information from the providers they oversee?'. The tables below capture a) outputs from our comparative work between the AFR and examples used by other regulators that collate financial information to monitor the financial sustainability of their regulated bodies and b) themes from our external interviews. We have summarised below under a series of themes our findings and recommendations for the OfS to consider.

Volume of information requested in the AFR

Area	Finding	Recommendation
Forecast Income	<p>The AFR is set up to include the two previous year's audited financial years information (year 1 is pre-filled by the OfS), the current year audited forecast financial information and five subsequent years of forecast information.</p> <p>This level of detail is requested at both the overarching financial statement level (closely following the model financial statements developed by BUFDG), but also in more granular detail such as the tabs for detailed income breakdown, fee breakdown and FTE numbers.</p> <p>The reliability of the forecast information diminishes significantly as the years progress. Regulatory advice 3: Registration of English higher education providers with the OfS only requires financial forecast information for the full five years to be provided for the key financial statements. This is also consistent with the forecast information requested by other regulators who require organisations to provide forecast financial information for a number of years.</p>	<p>The OfS has an opportunity to reduce the volume of forecast information being requested, particularly in the more detailed tabs for future years. In doing so, the OfS should consider the comments made above in relation to the current risks to provider finances. This may mean that the OfS could introduce a more focused set of requests for providers to disclose detail of their financial resilience around specific risks, rather than capturing the current level of detail.</p>
Information Gathered on Behalf of Third Parties	<p>A number of the tabs in the AFR contain information for third parties such as UKRI. It was not clear from our discussions with either the OfS or UKRI that all the detailed information being collated, such as the cost centre breakdown, is actually being utilised in practice. The OfS needs to validate that the information being requested in the AFR is being utilised.</p> <p>Our external interviews also noted that providers are not always aware of why the current level of detail is collected in the AFR and who the information is collected for.</p>	<p>The OfS should ensure that providers are aware of the third parties that depend on the information that is gathered in the AFR to help support the basis of the information being collected.</p>

4. What does good practice look like relative to other regulators that collate financial information from the providers they oversee?

Frequency of Provider Interactions

Area	Finding	Recommendation
Frequency of Provider Interactions	<p>The AFR is required to be submitted on an annual basis. The draft submission occurs roughly four months after the provider year end with the final submission occurring a month later after the completion of the external audit and OfS validations on the workbook. This information will then be used both for the individual provider assessment process and for the overarching financial sustainability modelling and reporting. These exercises are therefore being undertaken on information that is a number of months out of date.</p> <p>Other sectors request more frequent submissions of information from organisations, such as the NHS which requires quarterly (England) and monthly (Wales) financial submissions. Other sectors, such as private social housing, are required to submit a survey on a quarterly basis to update on key information alongside the annual returns. It is recognised that the OfS did request further information from providers during the Covid-19 pandemic to support their financial resilience assessments in relation to a specific set of risks / circumstances.</p>	<p>There is further scope for updates to key information or emerging risks to be collated during the year rather than waiting for the annual submissions. Refining down the volume of initial information requested (as referenced above) may also then help to facilitate a more frequent gathering of targeted information.</p>
Provider Engagement	<p>The AFR process does not require direct engagement with all providers. Engagement may occur after the triaging assessment where further information is sought to explain individual providers' financial performance, but this often translates to requests for further information rather than formal meetings with senior management.</p> <p>Our external interviews noted that often providers see the questions that the OfS poses as being about the format of data collected, rather than the underlying risks / issues around financial sustainability.</p>	<p>It may help engagement and understanding of providers if a small sample were to be visited each year to formally discuss the information that they were submitting. This gives providers the opportunity to explain and demonstrate their knowledge and understanding of their financial performance whilst also providing the OfS with opportunities to broaden its knowledge and understanding of the operational make up of providers and challenges that they face. Other regulators, such as within the NHS, require providers to attend meetings to explain their in-year performance, particularly where significantly adrift from their budget.</p> <p>It would also provide the OfS an opportunity to further educate providers on the drivers of the information being collected within the AFR, such as the third party information requests (as referenced above). Provider visits are commonly used across other sectors by regulators to supplement financial data returns.</p>

4. What does good practice look like relative to other regulators that collate financial information from the providers they oversee?

Conclusion

The information requested via the AFR for the following financial year is comparable to the volume of information that other regulators require (i.e. some regulators collect less information, but some collect more). The OfS does request more information on financial performance for future years than we typically see at other regulators. This means that the OfS has an opportunity to reduce the volume of financial data collected in the AFR for forecast years 4, 5, 6 and 7 in particular, but in doing so might need to collect more targeted, risk based information for forecast years 1, 2 and 3 particularly in relation to some of the gaps noted above.

The OfS could also learn from the approach of other regulators, such as consideration of undertaking more provider visits and broadening the questions included in the AFR to cover the governance / oversight processes in place over the production financial returns by providers.

pwc.co.uk

In the event that, pursuant to a request which the Office for Students has received under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made thereunder (collectively, the 'Legislation'), the Office for Students is required to disclose any information contained in this document, it will notify PwC promptly and will consult with PwC prior to disclosing such document. The Office for Students agrees to pay due regard to any representations which PwC may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation to such [report]. If, following consultation with PwC, Office for Students discloses this document or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

This document has been prepared only for the Office for Students and solely for the purpose and on the terms agreed with Office for Students in our agreement dated 21 June 2023. We accept no liability (including for negligence) to anyone else in connection with this document, and it may not be provided to anyone else.

© 2024 PricewaterhouseCoopers LLP. All rights reserved. In this document, 'PwC' refers to the UK member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details

190219-133533-JS-OS