Written evidence submitted by the Association of Colleges

1. The National Audit Office report on the financial sustainabily of colleges in England[1] reaches a number of related conclusions:

- **College finances**: Many colleges are financially weak. There was some financial improvement between 2015 and 2019[2] but this has stalled in 2020 because of the pandemic.

- **Narrow focus on financial health and teaching quality**: This improvement in college financial health did not compromise performance in Ofsted ratings[3] but NAO comment that these improvements have come at a cost of colleges reducing course breadth, holding down staff pay and reducing building maintenance.

- **Government funding cuts and reforms:** There have been cuts in funding levels since 2014-5 (including a real-terms 9% cut in 16-18 funding over 5 years) and reforms to apprenticeships whose impact on colleges was not properly assessed in advance.

- **Over complicated oversight:** The oversight arrangements leave colleges in intervention for several years[4]. The government introduced a college insolvency regime in 2019 to provide a last resort but this has proved an expensive solution in the two cases where it is being used.

- **Area review programme**: The government's Area review programme encouraged mergers and provided funding to support some of them. DfE provided £431 million in restructuring funding and wrote off £253 million in exceptional financial support. Much of this money was used to support the costs of more than 50 mergers and to repay debt that colleges had had to take out to match fund capital projects. It is still too early to assess the lasting impact of the government's Area Review programme. Some funding decisions undermined the government's objectives to stabilise the sector.

2. NAO staff started their work at the end of 2019 and visited several colleges before March but a lot has happened since the 2018-9 financial year which is the year on which they report:

- **The first lockdown**: Colleges shut down most of their buildings in March 2020 and shifted to remote learning for most of their students Ofsted recently reported that colleges managed this switch at speed with much success but that learners missed out, particularly on practical courses[5].

- **Falling income:** Income from private sources dried up in the summer including fees from adult learners, international students, companies, from students for on-site catering and from apprenticeships where numbers of starts have fallen dramatically.

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[1] https://www.nao.org.uk/report/financial-sustainability-of-colleges-in-england/
[2] Based on their 2018-9 accounts, 65% of colleges had good or outstanding financial health which was an improvement from 61% in 2013-4 but this meant 85 (35%) had inadequate or requires improvement financial health
[3] By the end of 2019, Ofsted judged 82% of colleges as being good or outstanding compared to 74% two years earlier in 2017
[4] 13 colleges have been in full intervention and 10 in early intervention for a full 3 years
[5] Ofsted briefing on further education and skills, October 2020 https://www.gov.uk/government/publications/covid-19-series-briefing-on-further-education-and-skills-october-2020

- **Stabilisation measures:** DfE ministers made quick and helpful decisions to support the sector, including continuing to pay grants to support remote education of 16-to-18 -year-olds and adults with rule changes to remove clawback in most cases if targets were not achieved. Rules were adjusted to help more apprentices continue their programme online, even if they were furloughed[6].

- **New programmes:** The Chancellor of the Exchequer's summer economic update included several education and employment programmes but the extra funds require new college spending.

- **Higher costs in autumn 2020:** Colleges restarted in-person teaching in September 2020 though in difficult circumstances. Social distancing makes education less efficient because it requires more space, smaller class sizes and fewer people on transport to college. Colleges are providing more IT, PPE, staff for security and stewardingand cleaning. The extra funding allocated by the government for 16-18 education has been absorbed in costs arising from Covid, pensions and extra students.

3. NAO reported an improving financial position for the sector in 2018-9 but also that the sector collectively made a deficit (on an adjusted operating basis) of £80 million. Colleges will not finalise their 2019-20 accounts until January 2021 but we expect the lost summer income to result in a deterioration. The full-year impact of the loss in income, increased costs and the loss of new apprentices are likely to largely wipe out the extra 16-18 income in 2020-1 and leave many colleges financially weaker by summer 2021[7]. What happens after that depends, in part, on the 2020 spending review decisions.

4. Colleges earn on average 65%[8] of their income from government grants because the majority of their students are under 19 or are low income adults taking courses at Level 3 skills level or below. Another 15% of the sector's income is routed via government agencies in the form of apprenticeship training payments or student loans. Treasury and DfE decisions on public spending matter very much to the ability of colleges to support national objectives, the recovery, the development of skills and the improvement of less successful towns and regions. However, there are some other issues which deserve attention:

    - **Oversight arrangements:** DfE assigns a lot of people and spends a lot of money on intervention with half of colleges in early or formal intervention. There is no clear view from DfE about how colleges can improve their finances because funding rates are simply inadequate to generate improved margins. Outsiders making brief visits to colleges often have good ideas and practice to share but most college leaders and governing bodies do a good job with insufficient funds. A small number of colleges have not done such a good job, but they are outliers. Generalisations from the poorly-led and managed should not be made about the majority. Recent events have had a severe impact on commercially focused colleges with larger non-public income. Around 40 colleges have asked for support from DfE and these numbers will rise but, as yet, there has been no change to the very negative intervention regime[9].

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[6] DFE made a number of changes to funding rules in April 2020 and following months which are reported in the FE operational guidance

[7] A longer note explaining this is on the AoC website here https://www.aoc.co.uk/news/where-did-the-%C2%A3400-million-16-19-year-olds-go-2-november-2020

[8] Figures in this paragraph from an analysis of college 2018-9 accounts

[9] DfE's College Oversight and Intervention regime published in February 2019

- **Funding colleges on a transactional basis**: Colleges are also subject to an apprenticeship funding regime designed essentially for for-profit providers. This means that colleges which generally provide high-cost, high quality apprenticeships to small companies and to younger apprentices struggle to maintain provision because the risks are high and there is little stability in the funding.

- **Cashflow:** DfE underpays colleges each year in March by 6% on grant income[10]. The bureaucracy associated with apprenticeships means that payment from government often comes three months after activity. In a recent AoC survey of college July financial returns, a quarter of colleges predicted that they will have fewer than 10 cash days in March 2021. There have been cases where ESFA staff have suggested colleges should adopt creditor payment policies to ease their cashflow. In the private sector a creditor payment policy typically involves giving priority to some suppliers but taking longer to pay others but this is counter to a wider government push to encourage prompt payment throughout supply chains[11].

- **Loss of education and training capacity:** College governing bodies are required to keep costs within income. An AoC survey in October 2020[12] forecast a 50% reduction in new apprenticeship starts, including in areas with long-term growth potential like construction and engineering. There is a clear danger that the fall in the number of new apprentices will force colleges to cut staff and capacity in sectors which will be a high priority in the recovery.

- **Parallel arrangements:** DfE runs two parallel intervention arrangements for schools and colleges which has resulted in unhelpful obstacles, for example related party transaction rules which make partnerships harder or decision-making processes which make it harder for colleges to take on University technical college assets when the latter institutions have closed.

- **Regulating higher technical education appropriately**: OfS regulates and funds 168 colleges on its register but along with its designated bodies (QAA, HESA), overlapping the work of FE funding agencies and regulators (ESFA, Ofsted, IFATE). This results in confusion, duplication and excessive costs. Mayoral Combined Authorities also overlap with this regime. Those taking higher technical courses in colleges generally pay lower fees but a larger amount per student is being spent on administration and compliance.

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[10] By the 31st March (66% through the academic year), DfE has paid 60% of grant to colleges. DfE pays grant to colleges on the 18th of the month while making an even 1/12th payment on the 1st of the month to academies

[11] https://www.gov.uk/government/news/tough-new-rules-on-prompt-payment-come-into-force

[12] AoC Report of the High Volume Apprenticeships Advisory Group