This paper was prepared for meetings of the Financial Sustainability Strategy Group (FSSG) and the TRAC Development Group (TDG) in June and July 2016. The FSSG and TDG agreed that this paper should be published

Annual TRAC 2014-15: UK sector analysis

FSSG 10/16
17 June 2016
TDG 10/16
5 July 2016

Issue

1. Summary and analysis of 2014-15 annual TRAC reporting by UK HEIs.

Recommendation

2. The Group is invited to discuss and note the analysis.

Timing for decisions

3. No decisions are required.

Further information

4. Further information is available from Heather Williams (0117 931 7113; h.williams@hefce.ac.uk).

Public presentation

5. This paper contains previously unpublished information. The 2014-15 sector analysis is based on submissions from 156 higher education institutions (HEIs).

6. HEFCE published sector aggregate TRAC data for 2014-15 on its website at the end of May 2016[1]. HEFCE has also produced UK-wide benchmarking data which is available to HEIs via the secure extranet facility.

[1] http://www.hefce.ac.uk/data/Year/2016/tracincome/Title,108872,en.html

Background

7. All UK HEIs are required to report Transparency Review data annually by 31 January each year. Data for 2014-15 is the sixteenth set of data reported by HEIs and is the eleventh that HEIs have been required to report income as well as costs for the TRAC activity categories.

8. HEIs' annual TRAC returns are required to be signed by the Head of Institution and the institution is required to provide details of the institutional board committee that was responsible for confirming compliance with the process standards, as set out by the Transparency Review requirements. HEIs are also required to confirm that tests for reasonableness had been carried out to give assurance that the data reported was fair and reasonable.

9. The annual TRAC reporting template includes validation checks to aid the robustness of reporting and enable HEIs to identify potential anomalies in their data, or data requiring explanation prior to submission of the data to the funding bodies.

10. As in previous years, the annual TRAC data collection exercise for 2014-15 also combined the collection of data on research project charge-out rates and research facilities rates on behalf of Research Councils UK (RCUK) as a single exercise. This data was required from all HEIs except those currently eligible for and claiming dispensation. The data is used by Research Councils for monitoring the rates charged on research projects, for the production of benchmark data for HEIs and for setting the dispensation default rates for use by those HEIs eligible for and claiming dispensation. This data has also been used to inform the implementation of, and monitor progress towards, the Research Councils' efficiency targets based on the proposals in the Wakeham report and required to meet the Research Councils' budget settlement.

11. The level at which institutions are eligible for dispensation from elements of the TRAC requirements[2] is £3,000,000 annual research income from public sources. There was a small increase in the number of institutions applying dispensation compared with 2013-14 reporting, with 43 institutions applying dispensation. There are a further 12 institutions that are eligible for dispensation but did not claim dispensation.

12. HEIs also submitted TRAC(T) data by 29 February 2016. This data is not discussed further in this paper.

[2] See Annex 1.2b of the TRAC guidance www.hefce.ac.uk/funding/finsustain/trac/

Discussion

Sector aggregate analysis – whole institution

13. Table 1 provides a summary of the TRAC data for the UK sector comparing 2013-14 and 2014-15. A number of HEIs recognised one-off Research and Development Expenditure Credits (RDEC)[3] in 2014-15 which increased their surpluses. As the RDEC income is a large one-off financial benefit to the sector we have shown a summary of the TRAC data excluding net RDEC income to assist year-on-year comparison.

Table 1: UK sector summary[4]

	2013-14		2014-15		2014-15 Excluding RDEC	
	Total (£M)	As % of total expenditure	Total (£M)	As % of total expenditure	Total (£M)	As % of total expenditure
Infrastructure adjustment	827	2.8	862	2.8	862	2.8
Return for financing and investment adjustment	1,479	5.0	1,598	5.1	1,598	5.1
Target sustainability surplus to cover long run costs (full economic costs)	2,306	7.9	2,460	7.9	2,460	7.9
Actual Surplus*	**1,234**	**4.2**	**1,775**	**5.7**	**1,369**	**4.4**
Target v actual surplus (Gap)	**1,072**	**3.7**	**684**	**2.2**	**1,091**	**3.5**

*This figure is different to the surplus reported in the annual financial statements due to adjustments in respect of joint ventures, minority interests and endowments in the TRAC returns.

14. For 2014-15 the sector reported a sustainability gap (difference between the value of the economic adjustments and the sector operating surplus) of £684M (2.2 per cent of expenditure). This was a reduction of £387M from the 2013-14 sustainability gap (£1,072M), however this improvement is attributable to RDEC. Excluding RDEC, in cash terms there was a small increase in the sustainability gap against the 2013-14 position to £1,091M (3.5 per cent of expenditure). This reflects an increase in the sector's surplus for the year

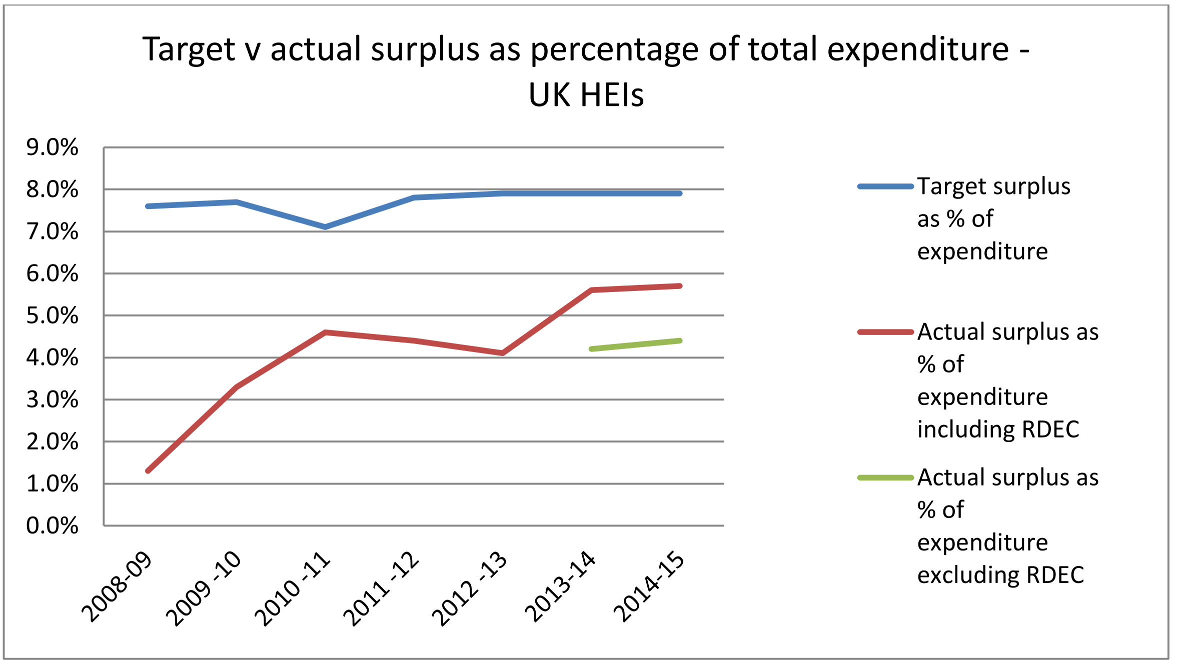
[3] The RDEC scheme was established by Government in 2013 to offer tax incentives to large companies to encourage greater investment in research and development. The scheme has now been amended so that universities and charities are unable to claim RDEC in respect of expenditure incurred on or after 1 August 2015, however a number of institutions have made claims to HM Revenue and Customs for eligible expenditure incurred in the period 2012-13 to 2014-15 and have therefore included RDEC in their financial accounts. We have carried out analysis of the latest financial accounts in order to estimate the net RDEC income included in the TRAC income figures in 2014-15.

[4] Figures in this table and subsequent tables may not sum due to rounding.

(excluding RDEC) of £135M, offset by corresponding increases in the economic adjustments in 2014-15: the return for financing and investment (RFI) by £119M (see paragraph 20); and the infrastructure adjustment by £35M. As a percentage of expenditure the combined economic adjustments remained the same at just under 8 per cent.

15. Based on analysis of HEFCE-funded HEIs[5], the sector's operating outturn was better than in 2013-14 with total income increasing by 8.2 per cent (6.5 per cent excluding RDEC) and total expenditure increasing by 6.0 per cent in cash terms. The sector's biggest expenditure continues to be staff costs, which totalled £14,159M in 2014-15, equivalent to 51.1 per cent of total income.

16. A timeline of the difference between the sector's headline surplus reported in institutions' accounts and the TRAC position is shown in the graph below. The apparent dip in the target surplus in 2010-11 is largely caused by the change in the basis of the RFI calculation.



17. The target surplus for sustainable operations is different from the headline surplus/deficit reported in the audited accounts because some institutions' accounting policies understate current asset values and thus could cause there to be inadequate investment in physical infrastructure. To allow for this an infrastructure adjustment[6] is added to costs.

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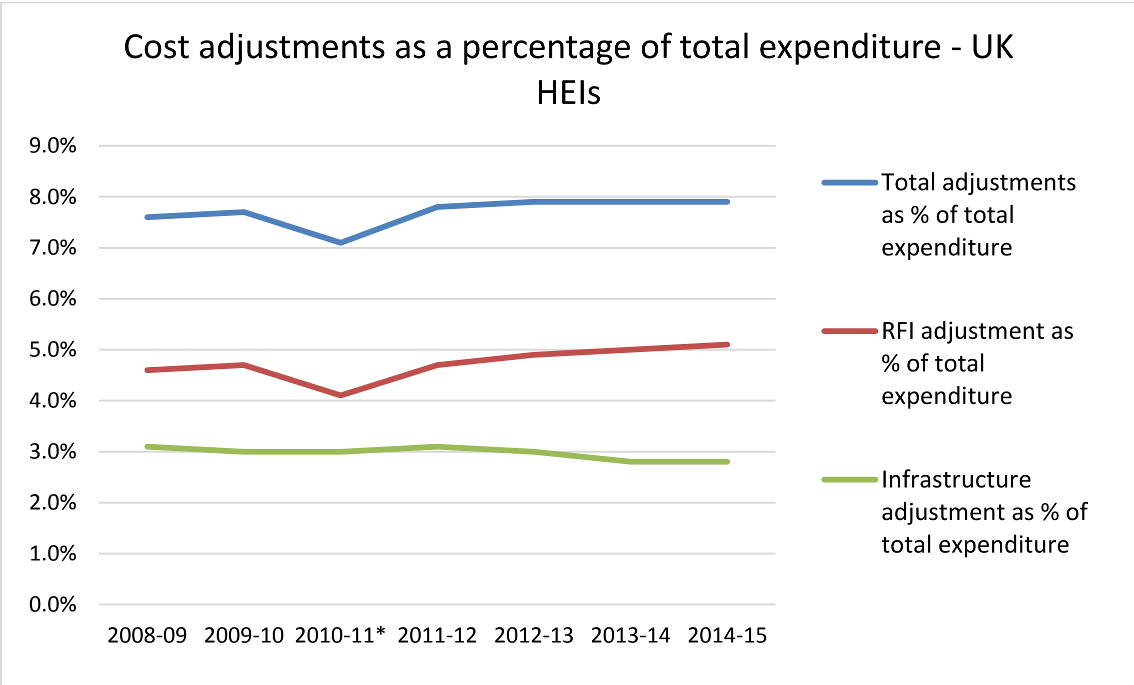
[5] HEFCE Publication 2016/04 Financial health of the higher education sector.

[6] The infrastructure adjustment adjusts the depreciation charge on buildings (based on either historic cost or valuation in the financial statements) to an insurance-based replacement value to better reflect the full cost of maintaining the current infrastructure. HEIs that revalue their buildings and maintain their estates in good order have a low infrastructure adjustment. HEIs that record their buildings at historical cost tend to have a higher infrastructure adjustment.

18. Institutions need to seek to generate additional cash to cover longer term capital investment needs and provide better facilities for students, to service borrowings, to fund restructuring of provision and build financial strength; these are the additional long run costs of operating a sustainable HEI and with diminishing capital grants institutions need to recover these costs. As HEIs are not operating in a marketplace where they can set prices across all their activities an adjustment to costs is needed to recognise these long run costs. This adjustment is the return for financing and investment (RFI) adjustment[7].

19. The graph below shows the infrastructure and RFI adjustment as a percentage of expenditure since 2008-09. The infrastructure adjustment has remained fairly stable whilst the RFI dipped in 2010-11 because of changes to the calculation. In 2014-15 the RFI added 5.1 per cent to institutions costs compared with 5.0 per cent in 2013-14. At the HEFCE sector level fixed assets increased by around £2.9bn and expenditure by £1.6bn when compared with 2013-14, and this accounted for most of the increase in the RFI given the formula to calculate the adjustment is based on the asset and cost base of institutions.



*The basis for the calculation of the RFI changed in 2010-11

[7] The return for financing and investment covers the surpluses required for rationalisation, updating and development of future productive capacity, including both physical and human infrastructure; and the costs of raising and servicing short-term borrowing. The RFI adjustment is calculated as a percentage of assets and a percentage of expenditure, net of actual financing costs.

20. Table 2 shows the total TRAC income and full economic costs by activity:

Table 2: TRAC income and full economic costs by activity 2014-15 for UK HEIs (Figures in £M)

	Teaching		Research	Research	Other	**Total**	**Total**
	Publicly funded	Non-publicly funded		Excluding RDEC			**Excluding RDEC**
Income	13,291	4,617	9,208	8,802	5,688	**32,804**	**32,398**
TRAC full economic costs	13,063	3,321	12,067	12,067	5,037	**33,488**	**33,488**
Surplus/(deficit)	227	1,296	(2,859)	(3,265)	651	**(684)**	**(1,091)**
Surplus/(deficit) as % of income	1.7%	28.1%	-31.0%	-37.1%	11.4%	**-2.1%**	**-3.4%**
Recovery of fEC %	101.7%	139.0%	76.3%	72.9%	112.9%	**98.0%**	**96.7%**
Recovery of fEC % (2013-14)	*101.6%*	*136.8%*		*74.8%*	*108.8%*		***96.6%***

Teaching activity

21. Overall publicly funded teaching activity showed a small surplus in 2014-15. The surplus on publicly funded teaching increased from £196M in 2013-14 to £227M in 2014-15.

22. The number of HEIs reporting surpluses on publicly-funded teaching has increased with 89 institutions reporting surpluses on PFT in 2014-15 compared with 86 in 2013-14. The number of HEIs reporting surpluses on PFT of greater than 5 per cent of income has decreased from 42 to 40. At the institution level, there is a wide variation of data ranging from deficits of 57 per cent to surpluses of up to 23 per cent[8]. Some degree of variation may be expected given the diversity of institutions in the sector, their mix of funding streams and different investment cycles.

23. Non-publicly funded teaching showed a surplus of £1,296M or 28.1 per cent of income for the UK sector which is an improvement compared with the previous year at 26.9 per cent reflecting a good level of performance after issues around student visas in prior years. This also demonstrates the extent of the contribution from this strand of activity in supporting the wider portfolio of HE activity.

[8] This range excludes one outlier.

Other activities

24. Other activities (including Residences and Catering, Consultancy and other services, Clinical services under knock-for-knock and research for non-EU governments or overseas sponsors) show an increased surplus of £651M (11.4 per cent of income) compared with £423M (8.1 per cent of income) in 2013-14.

Research activity

25. The overall deficit on research was £2,859M (31.0 per cent of income) with the recovery of full economic costs of 76.3 per cent, a slight increase on 2013-14 when 74.8 per cent of costs were recovered. However when RDEC income is excluded, the deficit on research activity increases to £3,265M (37.1 per cent of income) representing a decreased recovery of 72.9 per cent of the full economic costs.

26. Table 4 provides further analysis of research income and costs analysed by Research sponsor-type. Overall, when the one-off RDEC income is excluded, research continues to show a significant deficit across all sponsor categories. The recovery rate across sponsors at 72.9 per cent is consistent with a slow downward trend (2013-14: 74.8 per cent, 2012-13: 76.3 per cent), and is notably lower than in 2010-11 when the recovery rate on research peaked at 78.5 per cent.

27. Research Council projects have been funded based on 80 per cent of the full economic costs since 1 April 2006 and Research Councils estimated that by 2010-11 almost all its projects were funded on fEC basis (assuming most projects are three-year projects). Research Council activity accounts for the most costs of the external research sponsors, and recovery of those costs has fallen slightly to 71.8 per cent (2013-14: 73.6 per cent). This reflects the impact of the Research Councils' reduction in funding by the application of an efficiency adjustment on the research projects since April 2011.

28. The recovery of costs on "Industry funded research"[9] at 72.3 per cent has recovered to 2012-13 levels following a slight decrease in 2013-14 to 71.7 per cent.

29. The recovery of the costs on research sponsored by Other Government Departments (excluding RDEC income) has remained at 78.4 per cent of full economic costs, this is still notably below 100 per cent of full economic cost which is the principle for funding such activity under the dual support arrangements.

30. Recovery of costs on research commissioned by UK Charities fell from 62.8 per cent in 2013-14 to 59.7 per cent in 2014-15, while the recovery on EU-funded research also declined from 67.3 per cent to 65.3 per cent.

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[9] "Industry-funded research" includes all other organisations such as UK industry, commerce and public corporations, EU non-government organisations (that is, EU-based charities, EU industry and EU other), overseas (non-EU) charities, overseas (non-EU) industry and other sources.

31. Cost recovery on ‘Supervision and training of postgraduate researchers’ continues to show the lowest recovery across the externally sponsored research activity at 54.1 per cent, compared with 55.4 per cent in 2013-14. However, this category of activity is often more difficult for HEIs to capture robustly in their activity analysis as postgraduate research students usually work on externally sponsored research projects as part of their research training.

32. The TRAC guidance for 2014-15 introduced additional guidance (but not mandatory requirements) to encourage HEIs (particularly the more research intensive[10] HEIs) to analyse and improve understanding of the costs associated with training and supervision of PGR students. Within the TRAC return for 2014-15 HEIs reported for the first time on whether they reallocate income and costs relating to PGR activity away from the external sponsor type to the PGR category. This new question was introduced as it is possible that this could become mandatory in the future, at least for research intensive institutions. 41.4 per cent of HEIs responded that they do reallocate income and costs away from external sponsor types to the PGR category (research intensive HEIs: 58.9 per cent) while 47.1 per cent responded that they do not currently do this reallocation (research intensive HEIs: 41.1 per cent). All of the 11.5 per cent of responses indicating that this question was not applicable were from HEIs in TRAC peer groups E and F that are eligible for and apply dispensation.

[10] Research intensive HEIs have been defined as those HEIs in TRAC peer groups A and B.

Table 3: Research income and costs by sponsor type (UK HEIs) 2014-15 (Figures in £M)

	Recurrent research funding from the funding councils	Institution-own funded	Postgraduate research	Research Councils	Other govt departments	Other govt departments excluding RDEC	European Union*	UK Charities	Industry**	Total Research	Total Research excluding RDEC
Income	1,955	261	1,088	1,841	1,370	964	745	1,055	893	9,208	8,802
TRAC full economic costs		2,118	2,013	2,563	1,229	1,229	1,142	1,767	1,235	12,067	12,067
Surplus/(deficit)		**(1,856)**	**(925)**	**(722)**	**141**	**(265)**	**(396)**	**(712)**	**(343)**	**(2,859)**	**(3,265)**
Surplus/(deficit) as % costs		-87.7%	-45.9%	-28.2%	11.5%	-21.6%	-34.7%	-40.3%	-27.7%	-23.7%	-27.1%
2013-14		*-87.4%*	*-44.6%*	*-26.4%*		*-21.6%*	*-32.7%*	*-37.2%*	*-28.3%*		*-25.2%*
Surplus/(deficit) as % income		-710.4%	-85.0%	-39.2%	10.3%	-27.5%	-53.2%	-67.6%	-38.4%	-31.0%	-37.1%
FEC recovery (income as a % of costs)		**12.3%**	**54.1%**	**71.8%**	**111.5%**	**78.4%**	**65.3%**	**59.7%**	**72.3%**	**76.3%**	**72.9%**
2013-14		*12.6%*	*55.4%*	*73.6%*		*78.4%*	*67.3%*	*62.8%*	*71.7%*		*74.8%*

* European Union covers EU government bodies including the Commission.

** Industry includes all other organisations such as UK industry, commerce and public corporations, EU non-government organisations (i.e. EU-based charities, EU industry and EU other), Overseas charities, Overseas industry and Other sources.

Analysis of support costs

33. Table 4 below provides an analysis of total support costs and trends. This table is based on data from 113 institutions. Institutions that applied dispensation or that did not return any data in one (or more) of the years have been excluded from this analysis.

34. Total estates costs increased from £4,231M to £4,512M – an increase of 6.6 per cent between 2013-14 and 2014-15 and similar to the increase in the preceding period. High energy prices continue to impact on estates costs. The percentage of estates costs allocated to research remained broadly stable at 33.2 per cent when compared to the last three years data.

Table 4: Analysis of support costs, indirect costs and estates costs – UK HEIs
Source: Annual TRAC return Section F

	Value 2012-13 (£M)	Value 2013-14 (£M)	Value 2014-15 (£M)	Percentage difference between 2012-13 and 2013-14	Percentage difference between 2013-14 and 2014-15
Total estates costs	3,961	4,231	4,512	6.8%	6.6%
Estates costs allocated to research	1,305	1,400	1,496	7.3%	6.9%
% of estates costs allocated to research	33.0%	33.1%	33.2%		
Total estates costs excl RFI adjustment	3,462	3,639	3,837		
Estates costs excl RFI adjustment allocated to research	1,125	1,197	1,263		
% of Estates costs (excl RFI adjustment) allocated to research	32.5%	32.9%	32.9%		
Total indirect costs	11,896	12,449	13,088	4.6%	5.1%
Indirect costs allocated to research	2,893	3,098	3,296	7.1%	6.4%
% of indirect costs allocated to research	24.3%	24.9%	25.2%		
Total indirect costs excl RFI adjustment	11,244	11,788	12,401	4.8%	5.2%
Indirect costs excl RFI adjustment allocated to research	2,637	2,830	3,023	7.3%	6.8%
% of indirect costs (excl RFI adjustment) allocated to research	23.4%	24.0%	24.4%		

35. Total indirect costs increased to £13,088M with the staff-related element comprising approximately 53 per cent of these costs. Indirect costs increased by 5.1 per cent when compared with the previous year. Further analysis of the indirect costs shows that the most significant component of indirect costs is 'central services' at £7,208M representing 55 per cent of total indirect cost. Central service costs increased by 6.0 per cent in 2014-15 compared with a 4.4 per cent increase in the previous year.

36. Indirect costs allocated to research showed an increase of 6.4 per cent compared to the 7.1 per cent increase in 2013-14. This above inflation increase resulted from an increase in all categories of costs as per Table 5 below. However, the proportion of indirect costs allocated to research rose only marginally, 24.9 per cent in 2013-14 to 25.2 per cent in 2014-15.

Table 5: Analysis of indirect costs allocated to research	Percentage difference between 2013-14 and 2014-15
Support time of academic staff	7.4%
Central services	6.0%
Support staff in academic departments	-0.3%
Non-staff costs in academic departments	4.4%
Return for Financing and Investment	4.0%
Total indirect costs	5.1%

Communication and dissemination

37. HEFCE has published HEFCE-sector and UK-sector aggregate data on their website. UK-sector benchmarking data has also been made available to HEIs via the secure extranet facility. The TDG Management Information Project on benchmarking has suggested some improvements that can be made to the format and content of benchmarking data. Some of these improvements have been made to the benchmarking reports in 2014-15. Other improvements will be taken forward in the next few years.

Summary

38. The annual TRAC returns show that the sector had a full-cost deficit across all activities (excluding RDEC income) of £1,091 million (3.5 per cent of total expenditure). This is a deterioration on the previous year in monetary terms but is a slight improvement as a percentage of expenditure (3.7 per cent in 2013-14). As a percentage of expenditure the combined economic adjustments remained broadly the same at just under 8 per cent.

39. In line with previous years the sector still has a substantial level of activity that is not fully funded. A significant concern remains the volume of research activity in the sector and the extent to which such volumes are sustainable. In February 2016 RCUK confirmed that the efficiency factors continue to apply to grants awarded since June 2012 for the lifetime of the grants, and for any grants approved up to the end of March 2016.

RCUK also indicated that while plans for an efficiency programme for beyond April 2016 had not yet been agreed, they were not expected to continue to concentrate on applying efficiency factors to drive down indirect costs.

40. In this environment, it will be important for institutions to ensure they have a sound understanding of their costs to support their management decision-making processes.

Recommendation: The Group is invited to discuss and note the analysis.