Managing cash flow at South Bank University

Deborah Findlay of South Bank University dissects the problems inherent in keeping a large UK university solvent.

Universities receive funds for their teaching activities from three main sources: a funding council grant from HEFCE, Local Education Authorities (LEAs) which pay for full-time undergraduate and a few postgraduate students (who are means tested for LEA funding) and from students themselves (both UK and overseas). Only about 40% of SBU students are eligible for LEA funding of their tuition fees – a relatively low percentage for a university. This means that self-funding students represent a very significant source of income for SBU, a factor that leads to major credit control issues each year.

Soon after becoming director of finance at SBU I had a meeting with the university's bank. The university's overdraft facility had become due for renewal. I discovered that the facility was costing the same amount of money as it would to employ an extra member of staff so I did not want to renew it if it was not strictly necessary.

To come to a decision I had to understand the nature of SBU's income and expenditure and gain some understanding of the cash inflow and outflow.

Income

Funding council grant – This is dependent on the number of students enrolled at the university. If targets are met, the cash is guaranteed and timing of receipts is provided by the HEFCE before the start of the financial year. This is almost a certainty, although we never know if we have recruited to target until the beginning of December (month 5). However, if the university were to over-recruit no further money would be made available. Although the grant is the university's largest single source of cash, it does come with conditions. It must used to provide teaching services for students and to cover all necessary infrastructure costs that result, for instance the library.

Academic fees and support grants – There are three distinct payers in this group: regional health authorities (RHAs) for nurse education, LEAs for non-nurse education and self-funded students. SBU has a small number of students whose fees are paid by their employers but the overall amount is negligible. RHAs pay on receipt of invoice every month. LEAs pay a lump sum in February on confirmation of student attendance. Student debtors are very difficult to predict.

Research grants and contracts – This represents income from SBU's research projects. There are about 500 live projects and it is quite difficult to work out when the income comes in.

Other operating income – This is mainly income from halls of residence and catering operations and some consultancy income. The exact figure is difficult to predict month by month, but the main components are unlikely to cause a shortfall of cash: one pays as one goes for catering, and hall fees are generally paid in advance by term. Consultancy income, like that from research projects, is difficult to predict.

Interest receivable and endowment income – This is the only income that is made available for the day to day management of SBU which appears to

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Fact file

South Bank University (SBU) has some 19,000 students, of which about 80% undertake undergraduate, 15% postgraduate and 5% diploma and pre-degree programmes. About 40% of students study part-time or in the evening and 50% are women. More than 56% are mature students (25 and over). Over 40% are from ethnic minorities.

The background

The university has two main London campuses: Elephant & Castle (Southwark) where the majority of the university facilities are based, and Wandsworth Road, about three miles from the Southwark campus, where the Faculty of the Built Environment is housed in purpose-built accommodation. From September 1995 Redwood College of Health Studies, based in Harold Wood, Essex was incorporated within the Faculty of Health. The university is also one of the largest higher education providers of engineering courses.

The university can trace its origins all the way back to the Borough Polytechnic Institute that was founded in 1892. The institute amalgamated with four other colleges in 1970 to form the Polytechnic of the South Bank. Then in 1989 the polytechnic became independent of the Inner London Education Authority (ILEA), and the Polytechnic and Colleges Funding Council became its main funding body. Finally, in 1992 the polytechnic was awarded university status and the main funding body became the Higher Education Funding Council for England (HEFCE).

be balanced through each year.

Expenditure

Staff costs – This is the largest item of expenditure. Although there are peaks and troughs due to term time-only staff, the outgoing is broadly constant at about £4m per month, paid on day 22.

Depreciation – About £5m.

Operating expenses – This includes all other items of expenditure. As there are so many types it is not easy to assess cash flow timing.

Interest payable – For all loans that were taken out to build or purchase the halls of residence. Funding council rules require that halls of residence are completely self-funded and so hall fees must cover these interest payments. The interest is paid quarterly or semi-annually.

Financial planning

In the year in question there was no planned capital expenditure. However, to ensure resources are available to meet liabilities, a budget is drawn up each year, prepared on the basis that expenditure cannot exceed income. The budget must include depreciation, so SBU's cash reserves increase by an amount equal to depreciation each year if no fixed assets are purchased.

Unlike most other businesses, SBU's original fixed assets were given to it when the polytechnic first became incorporated. This means that no cash was paid for the assets. That factor allowed SBU to continue its business without having to incur significant liabilities in its early years.

Cash flow

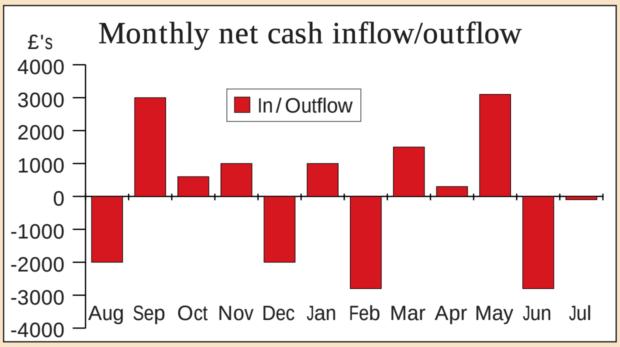
A review of SBU's income clearly demonstrates that it does not have complete discretion over how it spends its money. Often it is provided for specific purposes. Many universities approach this by assuming that their main business is HEFCE activities and that all other activities should be treated as 'marginal'. Broadly speaking the sources of cash can be divided into two distinct categories: HEFCE-funded activities, including funding of the infrastructure required to run university courses; and funds earmarked for specific activities which generally must be accounted for separately. A breakdown of these activities is shown in *Table 1*.

Given this divide in the business, I decided it was easier to build up a picture of the broad cash flow by looking at each part individually.

On the HEFCE side, it seemed that the critical area of timing was in the receipt of grants and payment of salaries. If the profile over the year was such that income was received earlier than salaries were paid, the rest would probably fall into place. In any case, we had started the year with cash in the bank so we had a cushion. In 1996 the amount was about £8m.

With non-HEFCE activities it was more complicated. Further investigation showed that academic staff are not generally permitted to spend against a project until funds are in. For commercial sponsors invoices are usually raised at regular intervals throughout the project, and some are invoiced in arrears. However this represents a small proportion so would probably be immaterial to the cash flow.

FIGURE 1



Sufficient cash

Figure 1 shows a similarity in troughs which confirmed my view that the critical months were December, February and June. Investigation of interest payable which could involve large sums of money in a month and capital payments showed that there were no payments planned for those critical months.

Overall I was satisfied that having begun the year with £8m, I would end it with a balance close to £13m. I also ascertained that month by month there would always be sufficient cash.

However...

Inherent in my assumptions was that SBU would receive cash from students on time. But this never happens. I needed to build in a buffer for payment of debts by students. The best evidence I had was the previous year's payment histories. Of the £9m invoiced to students, up to £1.2m may be outstanding by year-end. Given the buffer of £8m from the opening cash balance and the fact that the net cash outflow was no greater than £3m, I concluded that SBU did not need an overdraft facility.

Investment of surplus funds

Finally, any surplus funds, as a matter of course, are placed on overnight deposit with the main clearing banks on periods of between overnight and six months. ■

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TABLE 1

HEFCE activities

- 48% of all cash received in a year comes from the funding council. SBU receives details of grant payment dates the April before the financial year.
- 10% is received from LEAs in February.
- 12% is paid directly by self-funding students (50% in October and 50% at the end of January). This source of cash is usually received late each year due to debt collection problems.
- The major cash outflow is payment of staff salaries (45% of all cash received). Non-staff costs account for 21% of cash received. This includes the costs to support health service contracts.

Non-HEFCE activities

- Each source of funds is accounted for individually. Specific budgets are set up for research contracts, courses, consultancies and health contracts to ensure that the expenditure (which is generally on staff) does not exceed income received. A similar approach is applied to residence and catering activities. However cross-subsidies are permitted so long as, as a whole, the activities break even.
- The activities provide 30% of total cash received. The staff costs account for 15% of the cash outgoings and the non-staff costs 11%.