

## 2. WHERE TO START - THE BIG PICTURE

- 2.1 Chapter 1 identified some of the challenges governing bodies face in governing the complex finances of an HEI. This chapter expands on those issues, and suggests ways in which governors can build up their knowledge about the finances of their institution and how it works.
- 2.2 In practice, many key financial issues facing governors emerge from an analysis of four basic questions, and each is considered in turn:
- What are the institution's current vision and priorities?
  - How are they reflected in financial strategies and policies?
  - How are they reflected in budgets and capital plans?
  - Is the institution sustainable?

### What are the institution's current vision and priorities?

- 2.3 There are over 160 HEIs in the UK. They are not identical and will probably be more different in the future. The ways in which they develop will be substantially influenced by government policy, student and employer demand, resource constraints and a host of other factors. All HEIs need to be responsive to such changes, but this will not be sufficient to create the successful institution that you and your fellow governors seek. More likely the board would prefer a clear vision with associated priorities as the basis for financial decisions and knowing where to invest or divest. Where can you find such information? The obvious place to look is the strategic plan.
- 2.4 Every HEI has a strategic plan, partly because the funding council insists. But you will need to 'drill down' from an overall strategy to ascertain the real institutional priorities, and its commitments to them when resources are scarce and awkward choices are necessary. It's not difficult to write platitudes about what an HEI would like to see happen and which will satisfy all constituents because it doesn't threaten or offend any. Strategic plans need to be aspirational, but not unrealistically so. The better plans set out steps which will be taken to realise the vision and priorities, the milestones to measure realisation, responsibility for delivery, and the resources needed.
- 2.5 All governors should have been given a copy of their institution's strategic plan when they were appointed; if not, your clerk or secretary should provide one. As a development exercise, you might like to compare it with a few others which can be obtained on the websites of many HEIs.
- 2.6 More formally, the CUC Guide<sup>8</sup> notes that "the governing body plays a key role in the strategic development of the institution. It should be involved in the development and approval of the institution's strategic plan, which influences and guides all decisions coming before the governing body. It should also approve an annual operating plan that identifies those aspects of the strategic plan being implemented in the year in question." It also notes that "strategic plans play an important role in

*"From a private sector perspective my HEI's strategic plan is weak. It lacks detail and KPIs, and I get the feeling that the executive wants it that way as it makes it harder for us to hold them to account"*

LAY GOVERNOR

<sup>8</sup> CUC, Guide for Members of Higher Education Governing Bodies in the UK, revised version 2009. Available from [www.shef.ac.uk/cuc](http://www.shef.ac.uk/cuc)

informing the relationship between institutions and the funding councils". When properly written, such plans give governors opportunities to understand and approve where an HEI wants to go, and gives a framework for the next task of aligning resources with plans. They set priorities - that's why they're useful.

### **How is the strategic plan reflected in financial strategies and policies?**

- 2.7 A good strategic plan will be accompanied by a number of subsidiary ones, setting out an HEI's more detailed ideas in key areas, eg teaching and learning, research, enterprise, finance, estates, human resources, etc. However, finding and reading all these at once is not recommended!
- 2.8 There are, perhaps, two critical questions here: first, are all these strategies and plans consistent? This should not be assumed; remember that the strategies will probably have been produced by different people, and may have been approved in different committees, so consistency cannot be guaranteed. The board have a real role here: to probe, test, constructively challenge, and ensure consistency. Failure to do so may result in scepticism from the academic community about the value of the strategies, as governors can be sure that staff will spot the inconsistencies quickly.
- 2.9 The second key question is: quite simply, do an HEI's strategic aspirations match its resources? The only way of checking is a robust and convincing financial plan, which takes account of all those associated strategies, targets and milestones. As a governor it's not your job to do this, but it is your job to check that it's been done. It is not helpful for an HEI to publish a strategic plan before checking whether the figures add up!
- 2.10 One very important associated strategy that governing bodies should look out for is a realistic estates strategy. It's entirely right in an academic institution to put academic needs near the top of the priorities list, but not to the exclusion of everything else. If money is tight (you will be told), why not cut back on maintenance or equipment replacement? The way to tackle this issue is to look for the condition survey which should be the foundation of the estates strategy - and it should be carried out independently, as the equivalent of an audit. Indeed, there's a good argument for asking the surveyors to meet the audit committee, since so many major decisions may rest on their work. The results of that survey will have major implications for budgeting, and should be strategy led. There is much more on this topic in the separate materials in this series on estates.

### **How are strategies reflected in budgets and capital plans?**

- 2.11 Each spring, HEIs enter their annual budgeting process, which should lead up to a presentation to the governing body in early summer. Whilst the principal objective is to set a series of subsidiary budgets, income targets and expenditure limits for operational use and subsequent monitoring, the process should be accompanied by a longer term view. Though there will be uncertainties in the budget for the following year (student recruitment being the most obvious) it is important to have a robust budgeting process in place. It is the foundation of financial control.

#### **SUGGESTED TASK**

Watch out for important documents like strategies as they arrive in governing body papers, extract them and build up a working file. They can be hard to find subsequently.

*"We have a real problem in that the Finance Director always tries to present us with a 'fait accompli', and if we try and change something he says it's too late"*

LAY GOVERNOR

- 2.12 There is a difficult balancing act here. The board needs enough data to know that the budget is deliverable, but not so much that it cannot see the overall picture. You need to question how the budget process has been influenced by the strategic plan. Is there evidence of appropriate prioritisation in resource allocation - indeed, is there any prioritisation at all? What strategic priorities will be affected?
- 2.13 There is a good case for governors (or a subgroup, perhaps) having a preliminary or strategic discussion about budget priorities, well before numbers are considered. At this stage, it will be much more practical to consider what elements of the strategic plan might be prioritised in the year ahead, what key assumptions should be made (and thus better understood by governors) and what areas should come under special scrutiny as the detailed debates about budgets go on in management meetings.
- 2.14 Whilst the main purpose of the discussion in the governing body will be to approve the budget (or not - it should never be a foregone conclusion), there should be an opportunity to discuss the annual financial forecasts which funding councils require. These are a very important opportunity to check whether the institution's plans are consistent, and at least one institutional failure of governance would have been avoided if some robust questions of this nature had been asked at the right time.
- 2.15 Obviously, budgets and forecasts contain estimates, and associated risks should be spelt out for the governing body. The degree of tolerance in any estimate is critical and not easily discovered without considerable experience. It may be worth asking for a 'worst case scenario'. The whole issue of risks in relation to financial issues is discussed in separate material in this series.

### Is the institution sustainable?

- 2.16 This question leads naturally from the last paragraph. In the end, it is the key question. It arises at two levels - immediate and long term. The immediate is the state of next year's budget. If the executive has a track record of both delivering results close to budget and also producing a budget for next year which predicts a surplus in line with the financial strategy, there will usually be no need for close questioning of what is presented to the board. But if the record is not good, or a deficit is forecast, the lack of a serious debate about the budget by the governors (and perhaps the finance committee before that) could have serious consequences.
- 2.17 Budget deficits can arouse strong feelings. Successive chairmen of the board of the author's own HEI refused to tolerate them, despite arguments from others that failure to spend now would have serious consequences for future success. Some HEIs have been prepared to tolerate a deficit in suitable circumstances - a major build up in a new venture, perhaps, or the costs of winding down an existing activity. If such a budget is to be accepted, clear arguments will be an essential part of the short term strategy and they should include robust recovery processes.

- 2.18 Budgets are not the only aspects of institutional finances which may show signs of distress. The outcomes of the 'credit crunch' show that 'cash is king' when avoiding cash flow problems. If an HEI cannot pay its bills, it will be under a legal duty to seek the appointment of a receiver to manage its affairs - a disastrous turn of events which would in all probability be terminal. In practice, modern financial and risk monitoring processes should have led to funding council intervention effectively overriding governors. Liquidity (the availability of cash and other readily realisable assets with which to pay the bills) is a key test of sustainability, and is considered later.
- 2.19 Longer term sustainability has more to do with the overall state of the educational 'business' than its finances. Clearly a financially over stretched HEI has long term problems as well as short term ones. But the state of recruitment to its courses, its research performance, the enthusiasm and skills of its staff and the state of its property and equipment, and the quality of its leadership, will have more impact on its future. As such, long term sustainability requires sufficient investment in people, property and systems to maintain operating efficiency and productive capacity. Sacrificing tomorrow for today is unwise. The link to a robust and consistent strategy may be evident, but may not be easy to achieve.

### Self-challenge questions

- Is your institutional financial strategy still current? If not why not?
- Are your HEI's main financial priorities clearly identified for the next few years, and do all governors have a similar understanding of them?
- Are the links to all other strategies (eg learning and teaching, research, estates, etc) consistent? If not why not?
- Is your institution financially sustainable, and has sustainability been properly considered by your governing body?
- Has your governing body been told of the worst case financial scenario?

The Hefce publication 'Effective Financial Management in Higher Education'<sup>9</sup> contains additional questions, along with examples of possible answers.

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<sup>9</sup> Available at [www.hefce.ac.uk/pubs/hefce/1998/98\\_29.htm](http://www.hefce.ac.uk/pubs/hefce/1998/98_29.htm)

## A GOVERNOR'S DILEMMA 1:

The outcome of a strategic review of your HEI (initiated by your governing body) is that it has an uncertain future and may not be sustainable, and a merger has been suggested. Your HEI's finances are stable, but not strong. It has recorded small deficits in each of the past three years (1-2% pa). Its liquidity is 13 days, discretionary reserves amount to 30 days, cash generated last year was negative and long-term borrowing is 7%.

It is heavily focused on art and design, with some teacher training. It has recruited undergraduate students well in recent years, but has struggled with postgraduate courses. The outcome of its last RAE submission was disappointing. Some key staff saw this as a signal to leave for HEIs with a stronger research base. The head of institution has decided to retire.

The choice of merger partner lies between two other HEIs, both located in your city. One is a Russell Group<sup>10</sup> member of 20 research-intensive HEIs, and the other is in the Million+ Group<sup>11</sup> and achieved university status in 1992. The former generally recruits well qualified students easily, has an extensive range of postgraduate activity and substantial research income. It has a large estate in a good state of repair and a major overseas campus. Its finances are unusual; it has made a very small surplus in each of the last three years (and this after property disposals have boosted income), liquidity of 15 days, discretionary reserves of 76 days, negative cash generation in each of the last three years and long term borrowing of 32% of income. This institution has no existing art and design activity, but does have some secondary teacher training in other areas.

The second HEI also recruits well in general, but struggles with some of the more traditional academic subjects. It also has a strong postgraduate portfolio, especially in business and law and has strong research ambitions. Being in the city centre, it has major opportunities to rationalise its over generous property portfolio in partnership with commercial developers and is in the process of doing so. It has a strong relationship with the city council. Its finances are more conventional. It has made a surplus of over 4% in each of the last three years, has liquidity of 55 days, discretionary reserves of 46 days, strong cash generation in each of the last three years and long-term borrowing of 12% of income. This HEI has substantial existing art and design activity and a lot of secondary teacher training.

As a governor, what are the key factors that would influence your decision and why?

<sup>10</sup> [www.russellgroup.ac.uk](http://www.russellgroup.ac.uk)

<sup>11</sup> [www.millionplus.ac.uk](http://www.millionplus.ac.uk)