



RiR 2017:28

Why are higher education institutions building up capital?

– An audit of agency capital at Swedish public universities and university colleges

Summary and recommendations

The Swedish NAO has audited agency capital at public HEIs. The audit covers the period 2007–2016, and the auditees are the 31 public universities and university colleges and the Government.

Agency capital at HEIs consists of accumulated resources in the form of unused government allocations for research and education, and surpluses from activities funded by external grants or fees.¹

At the turn of the year 2016/17 public universities and university colleges had total agency capital of SEK 12.3 billion. This is an increase of almost SEK 7 billion (in 2016 prices) since 2007, corresponding to 126 per cent.

According to the higher education institutions, the existence of agency capital provides better conditions for planning and economic stability and is an important resource for future strategic investments. In the opinion of the Swedish NAO, the fact that there is some shifting of resources over time is reasonable considering the complex operations

¹ Agency capital should not be confused with unused grants, which are a separate item in the HEIs' balance sheets and thus are not included in agency capital.

and activities of the HEIs. However, the increasing extent to which allocated funds are accumulated without any specific plans of being used in the coming years, which has been the case for many HEIs, may indicate that some of the planned activities have been delayed or not implemented. Large accumulations of agency capital may also indicate mismanagement of state funds, which in turn may reduce confidence in the higher education sector as a whole.

All in all, this means that the Swedish NAO decided to audit agency capital at public universities and university colleges.

Audit questions

The purpose of the audit is to investigate whether HEIs use their resources, in the form of funds allocated, appropriately and effectively.

The audit is based on the following audit questions:

- Is the build-up and management of agency capital by the HEIs consistent with economic, efficient and effective use of resources and good management of state funds?
- Has the Government's management of the HEIs' agency capital been compatible with good management of state funds?

Audit findings

Since the Swedish NAO has not audited the development and management of agency capital at each individual HEI the audit findings and conclusions apply to the aggregated level.

How and where has agency capital been built up?

The possibility of public universities and university colleges to build up agency capital by retaining unused appropriations is due to the HEIs' resource allocation system and the exemption from cost-based accounting for appropriations applicable to the HEIs. The exemption means in practice that the HEIs may retain the entire appropriation, regardless of how low or high their costs were during the year. For other central government agencies that do not consume the year's allocated appropriations, a review is carried out of the appropriation saving, and regardless of whether the agency is allowed to keep the unused appropriation or not, it does not become agency capital. The HEIs' agency capital is therefore to some extent a consequence of the Government's financial governance of public universities and university colleges.

The increase has slowed down but agency capital continues to be substantial at many HEIs

The increase in agency capital in the period audited applies by and large to all universities and university colleges. Even if the increase overall has diminished in recent years, and agency capital at some HEIs has started to decrease, the agency capital still remains at historically high levels at most HEIs.

Agency capital has been built up in both education and research

The major part of agency capital, and the increase, consists of unused appropriations. This means that the appropriations allocated by the Riksdag and distributed by the Government have not been fully used. This development applies to both fields of operation at the HEIs: First and second cycle education as well as research and education at third cycle level. The build-up of agency capital in education is more difficult to justify than in research. In the opinion of the Swedish NAO, the fact that some HEIs have more students than they have been allocated resources for at the same time as available resources in education are not used may create credibility problems, not only in relation to central government but also in relation to teachers and students.

Why are not all the funds used?

In 2007–2016 the total revenues of HEIs increased by almost SEK 20 billion (in current prices), while agency capital increased by SEK 7.6 billion (in current prices). The Swedish NAO can note that almost 40 per cent of the revenue increase was not used in activities but is retained by the HEIs as saved resources. The audit has shown that it is not the increased funds as such that are behind the increase but that there are various factors, both internal and external, that have affected the use of the increased funds. According to the Swedish NAO's observations, the factors below have contributed to the development of agency capital (both build-up and spending) at the HEIs:

- Difficulties in adjusting the level of activities above all in terms of staff, to increased appropriations
- Difficulties in complying with the principle of full cost coverage in the fee-financed operations
- A conscious build-up of agency capital to create a buffer for unforeseen events and strategic investments
- Insufficient knowledge of the components of the agency capital in the form of reserved and unreserved funds
- Budgeting challenges; for example, the HEIs have a tendency to overbudget staff costs

How have the HEIs managed the build-up of agency capital?

The HEIs have taken some measures in the form of increased follow-up and strategic initiatives

The audit shows that many HEIs have taken measures to prevent the build-up of agency capital. Most HEIs have set up their own targets for agency capital and many have developed procedures for internal follow-up of the capital. Some HEIs have implemented cutbacks or relocations within the institution, and about half have used the capital built up to carry out strategic initiatives.

In the opinion of the Swedish NAO these measures may have contributed to the general slowing of the increase in recent years. At the same time, the Swedish NAO considers that at many HEIs there is capacity for more internal control and follow-up of both the agency capital and strategic initiatives financed with this capital.

How has the Government managed the build-up of HEIs' agency capital?

As described before, the regulations allow the HEIs to build up agency capital. However, according to the HEIs, there is some lack of clarity, for example as to what constitutes a reasonable size for agency capital. About half of the HEIs consider that the Government's governance of agency capital is unclear, and some others consider that there is no governance at all.

The Government has not taken any direct measures

According to the Swedish NAO's observations, the Government's follow-up of the HEIs' agency capital has been at far too general a level, and the Swedish NAO considers that on the basis of the reference material requested by the Government from the HEIs it is probably difficult for the Government to form an adequate picture of HEIs' agency capital.

The Swedish NAO is aware that the question of HEIs' agency capital will probably come to the fore in the ongoing inquiry, which is tasked with an overall review of the governance of universities and other higher education institutions, but does not consider that in other respects the Government has taken any direct measures to prevent the build-up of HEIs' agency capital.

The Riksdag has not been informed

The Swedish NAO can also note that the Riksdag has not been informed of the unused appropriations and the development of agency capital. Considering the size of the capital, and that it is mostly a matter of unused central government appropriations, the Swedish NAO considers that this is significant information that should be communicated to the Riksdag.

Overall conclusions

From the perspective of public finances, the build-up of HEIs' agency capital is not consistent with efficient and effective use of public resources.

The Swedish NAO notes that the agency capital has been built up within the framework of the system determined by the Riksdag and the Government. Moreover, the Swedish NAO considers that unused appropriations, and thus positive agency capital at an individual higher education institution does not in itself imply inefficient and ineffective use of resources. A higher education institution can conduct cost-effective operations of high quality while running a surplus, or consciously save resources with a view to being able to fund future investments or other strategic initiatives.

At the same time the HEIs, in total, have not used the economic scope decided by the Riksdag and Government. According to the Swedish NAO, this indicates that the operations have not been conducted at the rate and extent the Riksdag and Government have provided resources for. An important explanation is the central government allocation of resources. A rapid inflow of large resources, or for example the expansion of educational programmes that have difficulty in recruiting students, may mean that the HEIs find it difficult to use the resources for operations.

One consequence of the above is that extensive central government resources, where it is unclear how great a share is made up of a conscious buffer or of funds earmarked for future commitments, are lying unused at universities and other higher education institutions, when they could be used in other priority areas of the central government budget. The Swedish NAO's overall conclusion is thus that the build-up of agency capital that has taken place in the past ten-year period at total level is not consistent with economic, efficient and effective use of resources from the perspective of public finances.

Some buffer is reasonable, but it should be transparent

Furthermore, the Swedish NAO considers that some capital to meet future commitments in the form of co-funding, for example, and to have an economic buffer for sustainability of operations is justified, considering the risks and particular nature of the operations at HEIs. However, in the opinion of the Swedish NAO, this buffer should be linked to clearly presented reference material and calculations at the respective higher education institution, which is seldom the case today.

Many HEIs have taken measures to manage the build-up. At the same time, the Swedish NAO can note that documentation and follow-up of HEIs' agency capital can be developed at many higher education institutions to ensure good management of state funds.

Unclear governance on the part of the Government

The Swedish NAO shares the opinion of the HEIs concerning the lack of clarity in the Government's governance of agency capital, which the Swedish NAO considers has contributed to the unjustifiably large differences between HEIs in levels of agency capital.

The Swedish NAO's recommendations

Based on the results and conclusions of the audit, the Swedish NAO makes the following recommendations to the Government and higher education institutions.

Recommendations to the Government

- The Government should ensure clear, strategic and transparent governance and follow-up of agency capital at universities and university colleges by considering the following:
 - develop criteria for assessing the size of agency capital linked to the needs and circumstances of individual HEIs (HEI-specific targets), for example based on their risk analyses, investment plans and operational focus, as well as the HEIs' own targets
 - introduce a reporting requirement for the HEI-specific targets
 - introduce a quantitative reporting requirement for accounting for agency capital broken down into reserved and unreserved capital
 - introduce a quantitative reporting requirement for the rate of consumption of agency capital in coming years for the HEIs whose capital is ten percentage points higher than the HEI-specific target under point 1.

- The Government should consider giving the ongoing Governance and Resource Inquiry supplementary terms of reference to take into particular account the consequences of the proposed governance and resource allocation system for the HEIs' agency capital.
- The Government should regularly inform the Riksdag on the continued development of the agency capital.

Recommendations to public higher education institutions

To increase spending of agency capital and provide better information to the Government the Swedish NAO recommends that the HEIs should

- ensure that there is documentation on the contents of the agency capital in the form of reserved and unreserved funds.
- develop their internal procedures for planning and following up spending of agency capital.