

May 2007/11

**Core funding/operations**

**Framework for  
accountability**

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This document explains how we will promote better regulation, and hold higher education institutions to account for the funds we distribute to them, through a new accountability process linked to our assessment of institutional risk. The new approach will come into effect from 1 August 2008.

This report is for information

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# Accountability for higher education institutions

**New arrangements from 2008**

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# Accountability for higher education institutions

## New arrangements from 2008

<b>To</b>	Heads of HEFCE-funded higher education institutions Heads of universities in Northern Ireland
<b>Of interest to those responsible for</b>	Audit, Finance, Management
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### Executive summary

#### Purpose

1. This document explains how we will promote better regulation, and hold higher education institutions (HEIs) to account for the funds we distribute to them, through a new accountability process linked to our assessment of institutional risk. The new approach will come into effect from 1 August 2008.

#### Key points

2. Our initial proposals for changes to the accountability framework were set out in a consultation document (HEFCE 2005/31). The accountability process under consideration became known as the 'single conversation'. There was strong support for the proposals (see HEFCE 2006/07) and in 2006 we piloted the proposed changes in 10 institutions in order to test the practical implications.

3. As a result of the lessons learned from the pilots, and from other feedback in the same period, we are now able to set out the format of the accountability framework between HEFCE and HEIs which will operate from 1 August 2008. The key features are as follows:

- a. HEFCE's institutional assurance and risk framework will be driven primarily by three elements:
  - the annual submission of accountability information from institutions in December of each year
  - the five yearly assurance review undertaken by HEFCE officers that will normally consist of a one-day visit to each HEI
  - a programme of data audit.

- b. These elements will inform HEFCE's assurance reporting to Parliament and the National Audit Office (NAO).
  - c. The information will also largely determine our risk assessments of each HEI. These risk assessments will be shared with other public funders to avoid duplication and to help minimise the accountability burden on institutions.
  - d. We will continue to work with other public funders toward having a common accountability framework for HEIs.
  - e. We will consult with the sector on a new Financial Memorandum and Accountability and Audit Code, to be adopted by 1 August 2008.
4. We consider that another step has been taken toward an optimal regulatory regime that balances public accountability against regulatory burden. We also hope that this is not the end of the road, and that as risk assessment techniques and institutional accountability improve, we can further streamline our approach and free up resources and energy for institutions to pursue their goals.

**Action required**

5. No action is required in response to this document.

## Introduction

6. HEFCE has been pursuing better regulation for a number of years. In 2000 we commissioned PA Consulting to assess the accountability burden on HEIs from all sources.<sup>1</sup> In 2004 they revisited the subject and found that in the intervening period accountability costs had fallen by some 25 per cent.<sup>2</sup> We had played a significant part in this by simplifying our processes for special funding initiatives and rationalising our audit work. Other improvements included the streamlining of quality assurance work undertaken by the Quality Assurance Agency for Higher Education (QAA). These developments had been encouraged by the Government's Better Regulation Task Force and by the Better Regulation Review Group and the Higher Education Regulatory Review Group (HERRG). The general direction of travel in higher education is undoubtedly toward better and more cost effective regulation.

7. In February 2006 we published the outcomes of our consultation on the accountability process (see HEFCE 2006/07 'Accountability for higher education institutions – responses to the consultation'). Our aim throughout this dialogue about accountability has been to reduce the burden of regulation on institutions by placing greater reliance on their own systems of management and governance. One key element of our proposals was the 'single conversation': concentrating the accountability process between HEFCE and HEIs as far as possible into an exchange of documents and dialogue during a specific period each year.

8. Following the publication of the outcomes, we took a number of steps to take forward the agreed programme, including:

- establishing a steering group of other public funders and stakeholders to co-ordinate our approaches to regulation
- piloting the single conversation with a group of 10 institutions

- continuing our consideration of the issues involved and listening to comments and criticisms from institutions.

9. The results of this work are now reflected in the accountability framework described in this document.

## The benefits of better regulation

10. Better regulation does not just mean lighter touch. As far as we are concerned, better regulation is desirable because it sharpens up the accountability provided by the end users of our funds – the institutions. This is why we consider better regulation and effective governance to be connected issues.

11. As far as institutions are concerned, better regulation provides the following potential benefits:

- a. Better accountability to HEFCE provides greater assurance to all investors and to the community that the institution serves. This improves the reputation of each HEI and of the sector as a whole. Financial institutions view the sector favourably in part because of the accountability framework, and this has a direct benefit in lower interest rates. It also increases investor confidence.
- b. Better regulation costs less inasmuch as there are fewer returns to be provided to HEFCE and other funders, and fewer (or shorter) audits and inspections to manage. This is at the heart of the reduction in accountability costs found by the two PA Consulting studies. This lower cost releases resources for HEIs to spend on core activities.
- c. The single conversation element of the accountability framework is more efficient, enabling institutions to provide the bulk of their accountability at one time, albeit that this will now be a one month 'window' rather than a single date. This element is made up of information and returns that any well run organisation needs for internal monitoring and public accountability these days.

<sup>1</sup> 'Better accountability for higher education', HEFCE 00/36, August 2000, on the web at [www.hefce.ac.uk](http://www.hefce.ac.uk) under Publications.

<sup>2</sup> 'Better accountability revisited: review of accountability costs 2004', PA Consulting, June 2004, available on the web at [www.hefce.ac.uk](http://www.hefce.ac.uk) under Publications/Research and evaluation.

- d. Our better regulation approach puts institutions in control of the risk assessments made about them by HEFCE as their major funder. Institutions can be confident that if they submit all the information and assurances expected of them, and that this information demonstrates a sustainable organisation, then the HEFCE risk assessment is going to be positive. Even where an HEI is facing difficulties, so long as the information shows that the institution is fully aware of and addressing those difficulties, from governing body level downward, the risk assessment will recognise as much.
- e. Our work with other public funders and with the NAO has created a climate where there is now broad acceptance of the logic to better regulation, which should produce more focused regulatory interventions in future. In our case, an early example of this is the new approach to capital funding announced in HEFCE Circular Letter 11/2007, in which we ask HEIs to demonstrate that they have a strategic and sustainable approach to infrastructure investment. In return we ask for minimal information and give greater flexibility in the use of capital funds.

## The single conversation

12. We worked with 10 pilot institutions to assess the implications of a single submission date (30 November 2006) for the following returns from HEIs:

- financial forecasts
- financial statements and management letter
- Code of Governance
- internal audit and audit committee annual reports
- designated officer's annual assurance
- the Higher Education Students Early Statistics (HESES) survey and the Research Activity Survey (RAS)
- Transparent Approach to Costing (TRAC) returns

- annual monitoring and corporate planning statements.

These are discussed further below, and in each case we explain the lessons learned.

13. Overall we have elected to specify a common submission period (the month of December) rather than a single date for all returns. We also accept that all documents can be submitted electronically and will make the necessary technical arrangements.

## Financial forecasts

14. Our original thinking had been that there were benefits for us in our risk assessment, and possibly also for some institutions' governing bodies, if past financial performance and future prospects were considered at the same time. We therefore asked that institutions' financial forecasts be submitted alongside their financial statements. This did prove awkward for some of our pilot group because it meant a further task of updating the forecasts at the same time as working on the annual accounts. Our requirements for financial forecast data are much reduced these days and we will be asking for financial forecasts to be submitted during December using our simplified template.

15. We will be happy to receive forecasts based on whatever information is the latest available for internal use at the time, that is, based on the most recent budgetary information submitted to the finance committee or equivalent. Our expectation is that most institutions will prepare a budget and forecasts before the beginning of the year, and that towards December the budget will be updated, in large part as full-time undergraduate recruitment becomes clear. We will assume, unless institutions tell us otherwise, that the December forecasts submitted to us have been prepared on this basis.

16. When we update the Accountability and Audit Code we will make a general request for each institution to tell us, at any time, about any material adverse developments that could affect the institution's sustainability. There will also be a specific request for an exception report by the end of October in each year if an institution's autumn recruitment figures fall significantly short of expectations.

17. We dropped our requirement for a mid-year finance return two years ago and do not intend to reintroduce it. However, where an institution's financial position could put HEFCE funds at risk we may request additional in-year financial updates.

### **Financial statements and management letter**

18. Following our original consultation, over 80 per cent of institutions said they could meet the earlier deadline of 30 November for producing audited accounts. The pilot group all met this deadline. We acknowledge that a faster accounts process in an HEI can be complicated because of committee timetables. However the evidence from the pilots, and from other HEIs who chose to submit early in 2006, is that institutions can meet the earlier deadline. This demonstrates efficiency on their part, enables us to undertake our risk assessments earlier and to provide faster assurances to our Audit Committee and the NAO, and reflects well on the sector at a time when faster reporting is being pursued in all sectors.

19. Accordingly, from 1 August 2008 the date for financial statements to be submitted to HEFCE will be 1 December each year. Thus the 2007-08 financial statements should be submitted by 1 December 2008, and we would welcome earlier submissions from those able to do so. Institutions may wish to anticipate this change and make 1 December their submission date in 2007. If, exceptionally, an institution feels that the December 2008 deadline is not achievable, we would consider a further transitional year.

### **Code of governance**

20. The financial statements include a statement on internal control and/or a corporate governance statement. We believe this should incorporate or clearly reflect the Code of Governance published by the Committee of University Chairmen (CUC), which all institutions say they have adopted. This provides external assurance that the effectiveness of corporate governance is subject to regular review, and thus adds confidence to the accountability returns generated by institutions.

### **Internal audit and audit committee annual reports**

21. These reports are crucial in the accountability framework in that they provide the fundamental assurances to confirm that internal control is effective, and value for money is being achieved. We will require these returns to be submitted during December, ideally at the same time as the financial statements. Again, if individual institutions wish to submit these returns earlier in 2007 this would be welcomed. These reports should also reflect the CUC Code of Governance.

### **Designated officer's annual assurance**

22. This assurance from the designated officer (normally the head of the HEI) complements the governance and audit assurances. In itself it is not an onerous requirement, although we expect the institution to have a sound assurance reporting framework to provide the designated officer with comfort before signing. This return, alongside the other information, provides overall assurance about the use of funds in the sector and about compliance, regularity, propriety and value for money. The designated officer's annual assurance will need to be submitted in December.

### **HESES and RAS data returns**

23. The original proposition was for a common submission date of 30 November, which would have meant earlier deadlines than at present for the HESES survey and the RAS. There were mixed feelings about the efficacy of this among the pilot group, and we do not now propose to change the deadlines given that we are opting for a submission month of December. Another reason for keeping the existing dates is that the data requirements associated with block grants will probably change as we revise the funding methods for research and teaching.

24. We do have concerns about institutional data returns, based upon our experience of finding significant errors in our validation and audit work. Therefore we would like institutional audit committees to consider whether quality control over their returns is adequate. This needs to happen as part of the audit committee's annual cycle and not

necessarily to fit with the submission timetable, but we will look to see that such work has been undertaken when we scrutinise audit committee annual reports.

### **TRAC returns**

25. Our experience with the pilot group showed that there are real difficulties in bringing forward the deadline for TRAC returns to the end of November. This is because there is a critical path for their preparation which begins with the final accounts. This is one of the main reasons why we have opted for a submission month rather than a specific date, and so the new deadline for TRAC returns will be the end of December. The 2006-07 return will be required by 31 January 2008, with the 2007-08 return due by 31 December 2008.

26. We have been concerned about the reliability of some of the TRAC returns and have pressed institutions to improve quality control. Again, we look to audit committees to assess the adequacy of those arrangements. We have elected not to add our own review requirement, however, on the grounds that the Research Councils are adopting just such a scheme of quality assurance for an interim period of two years, until they have confidence in the full economic costing rates being used in research grants. We have instead agreed that we will share our overall risk assessments with Research Councils UK, on an exception basis, and that they will alert us to any institutions where their quality assurance processes highlight significant problems with the TRAC data.

### **Annual monitoring and corporate planning statements**

27. Our consultation about the proposed change to the deadline for these statements did not seem controversial and posed no problems for the pilot group. Accordingly we will continue to ask for them at the same time as the financial forecasts, to be returned in the month of December. The pilot group stressed that, regardless of the timeframe, their contacts with HEFCE should clearly reflect our awareness of these statements. They expressed the view (which we accept) that what they write in these statements should be reflected, as appropriate, in our risk assessments, and in the dialogue with, and visits from, our regional and assurance teams.

28. The documents listed above constitute the formal annual accountability exchange between each institution and HEFCE. Where an institution is at higher risk, the contact will be more frequent as set out in our support strategy (see HEFCE 2005/31 Annex A). In due course we intend to streamline the exchange further for those institutions that are consistently effective in their accountability. For all institutions, there will also be dialogue with our regional consultants and regional teams as contact is maintained, relationships fostered, and initiatives and changes brought to fruition.

### **HEFCE's direct assurance work**

29. We have undertaken direct audit work in institutions: the current cycle of reviews of governance, audit, and strategic, financial and risk management was completed in March 2006. In our 2005 consultation we proposed a new type of audit process which is minimal (a one-day visit) and designed to provide additional assurance about the returns and assurances listed above. In December 2006 we confirmed to the sector that we would be introducing this new audit process from October 2007 (see HEFCE Circular Letter 25/2006).

30. The 'assurance review' will involve one of HEFCE's four assurance consultants meeting with the institution's designated officer and senior team, the auditors and the chairs of the governing body and audit committee, to receive explanations and scrutinise evidence that demonstrates the soundness of the institutional assurances. Each HEI can expect an assurance review once every five years. The reports from these reviews, once agreed and followed up, will be made available under our publication scheme in the spirit of freedom of information.

31. We also carry out data audit work. We have an ongoing programme of reviews of HESES and RAS returns, and have undertaken specific reviews, for example of TRAC data. As indicated above we do have concerns, based on evidence, about the reliability of data from across the sector. This is not acceptable since we fund on the basis of such data, as do other public funders who equally need confidence in the information being returned by institutions. Furthermore, proposed changes to our

funding methods – for example to use metrics in the Research Assessment Exercise and to recognise flexible study patterns in funding teaching – mean that data will continue to be critical.

32. We are embarking on a programme of work designed to enhance data systems and quality across the sector in conjunction with the Higher Education Statistics Agency and the Training and Development Agency for Schools (TDA). This is a medium-term strategy though, and for now we will continue to undertake data audits in institutions. At present we undertake data audits on a combined risk and cyclical basis in about 20 institutions each year. We will be producing a new data audit strategy during 2007 and will announce our intentions as soon as possible.

33. As with our general approach to accountability, the aim will be to rely on institutional assurance and to undertake our own limited work, on a risk basis, to complement institutional assurance or where that assurance is unreliable. In our 2005 consultation, the sector rejected the notion of their own internal or external auditors providing data assurance, but we may need to reconsider this idea as a means of providing confidence in future. We are aware that requiring institutions' own auditors to provide data assurance would have a cost implication.

## **Risk assessments of institutions**

### **Risk categories**

34. HEFCE is a public body accountable to Parliament, so clearly we have to assess the risks posed by the bodies that we fund. The Public Accounts Committee would be critical if, for example, we continued to fund a failing institution because we were unaware of its weaknesses, or we failed to respond to weaknesses that were identified. Our risk assessment is based to a large extent on the three pillars of accountability in this document:

- the accountability exchange which will take place in December of each year
- the assurance review undertaken by one of our assurance consultants
- our data audit work.

35. We categorise institutions as 'at higher risk' or 'not at higher risk'. Our risk assessments are based upon assessments of sustainability and accountability, in the light of each institution's position in the market and its strategy. At any one time there are very few HEIs in the higher risk category. Where an institution is deemed to be at higher risk it is generally because its combined financial and market positions require steps to be taken to ensure its long-term sustainability. It can also be because the rate, scale and cost of strategic change are stretching the resources and management capacity of the institution. Institutions face risk all the time: the existence of risk is itself not a worry, but it does become of concern in certain contexts and when governors and senior managers do not give confidence that they are managing the risks effectively.

### **Outcomes of assessments**

36. If institutions meet the December deadline for returns, we will aim to analyse and process all their accountability information, evaluate it against our audit and other information, and generate our risk assessment to each institution by the end of February. For most HEIs this will result in a letter expressing confidence in the assurances provided and reflecting a lower risk status. For a few in each year we will probably need to say that we consider them to be at higher risk, either overall or in some particular ways. In those cases we will aim to produce a risk assessment agreed with the institution by the end of March.

37. We feel that to conform to the spirit of freedom of information and enhance public accountability, these assessments should in principle be made available under our publication scheme, as is the practice with other public bodies. However, our view remains that to release those risk assessments when the institution is working to address the risks would further destabilise their position. Therefore we will not make our risk assessments available until three years have elapsed and then we will re-apply the public interest test under the Freedom of Information Act. This gives institutions a period equivalent to the duration of a full-time undergraduate course to rectify the problems.

## **Risk assessments and other funders**

38. We intend to share our risk assessments with other public funders of higher education. The Accountability and Audit Code of Practice already sets out that we can do so. Once again, if we knew that an HEI was at risk but did not share that knowledge with, say, the Learning and Skills Council (LSC) or the TDA, then we could be viewed by Parliament and the NAO as negligent if those bodies' funds were then in jeopardy. We hope and expect that other public funders will use our risk assessments to make their own regulatory requirements of HEIs as streamlined and risk based as possible. This is already our agreed position with the LSC and the TDA.

39. We have discussed with these other public funders whether we can join in a common accountability framework that uses an agreed joint risk assessment. We are unanimous that this is desirable but it cannot happen overnight. This is because all our partners have an accountability framework for their funds that is grounded in the conditions of grant for the funds, and in the separate conditions of grant that are imposed on these bodies by government. The common accountability idea is progressing in the following ways:

- the sharing of risk assessments discussed above
- our growing dependence on each others' regulatory work, for example we have determined that we will not undertake further quality assurance work on TRAC returns but will instead take assurance from the Research Councils' new programme of quality assurance
- we have entered into a memorandum of understanding with the TDA covering our regulatory work, and in effect have the same arrangement with the LSC. In due course we hope to have similar agreements with Research Councils UK, the Regional Development Agencies and the Department of Health.

40. There are interactions between this accountability framework and other HEFCE processes. As indicated above, data about estates and capital will be used explicitly in our new capital investment framework and, for those HEIs that can

deliver the information required, there will be less onerous reporting and monitoring processes. The outcomes of assessments within the capital investment framework will in turn inform our views about institutional risk.

## **Future progress**

41. We do not see these new accountability arrangements as the end of the process of improving our regulatory relationship with institutions, but rather as a stepping stone to further progress. We will continue working with the NAO because that body is also committed to streamlining accountability. We are open to new ideas on how to achieve our aim. One development we have encouraged is a project by three institutions – supported by our Leadership, Governance and Management Fund – to explore the potential benefits of more proactive and positive accountability by institutions.

42. For the accountability framework to be effective, all the elements in it must work well. We are pleased to be working with the Leadership Foundation for Higher Education, and with the backing of the CUC, on a development programme for audit committees in the sector. It is clear that if audit committees are doing their work well, and their assurances can be relied on, then there is scope for less external intervention and regulation. In the same spirit we feel that we and institutions need to ensure that internal auditors are operating effectively and are appropriately resourced. Their work helps demonstrate to the outside world that institutions can be relied upon. The HEFCE Audit Committee and the HERRG have asked that we undertake a programme to enhance and demonstrate the effectiveness of internal auditors across the sector. This programme is getting under way. We are also working closely with external auditors in the sector, through the Higher Education Audit Liaison Group, to maintain and enhance the effectiveness of external audit.

43. HEFCE's Financial Memorandum with institutions is due for review, and the Accountability and Audit Code of Practice soon will be. Therefore in autumn 2007 we will consult the sector on both these documents, with the aim of new versions

being in place for the formal adoption date for the accountability framework of 1 August 2008.

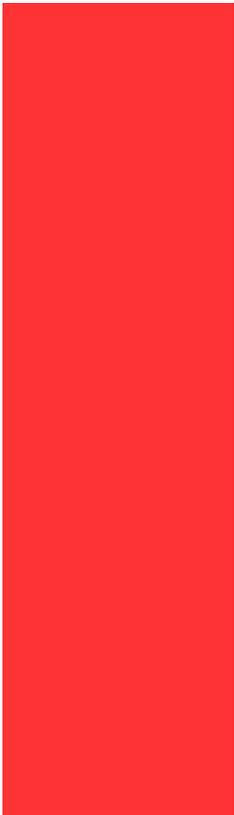
44. The Charities Act 2006 contains powers under which HEFCE will be designated as Principal Regulator of those HEIs that are exempt charities. HEIs will continue to enjoy charitable status and little change is likely to be required in the way they discharge their obligations. It is envisaged that the regulatory framework set out here and in the new Financial Memorandum and Accountability and Audit Code will meet the requirements on us as Principal Regulator, and we do not envisage this change adding materially to the accountability burden for the sector. The precise implications will become clear in coming months and will be reflected in regulations to be introduced by the Cabinet Office toward the end of 2007. There is more detail on the implications of the Charities Act in HEFCE Circular Letter 10/2007.

## **Conclusion**

45. This document summarises progress on HEFCE's accountability framework and sets out how the framework will operate from 1 August 2008. We are committed to making further progress in this area and we plan to commission a reassessment of the cost of the accountability burden in 2008-09, once these arrangements are in place. We would be happy to receive comments and observations about what is being said here, which should be addressed to our Head of Assurance, Paul Greaves, e-mail [p.greaves@hefce.ac.uk](mailto:p.greaves@hefce.ac.uk).

# List of abbreviations

<b>CUC</b>	Committee of University Chairmen
<b>HEFCE</b>	Higher Education Funding Council for England
<b>HEI</b>	Higher education institution
<b>HERRG</b>	Higher Education Regulatory Review Group
<b>HESES</b>	Higher Education Students Early Statistics survey
<b>LSC</b>	Learning and Skills Council
<b>NAO</b>	National Audit Office
<b>QAA</b>	Quality Assurance Agency for Higher Education
<b>RAS</b>	Research Activity Survey
<b>TDA</b>	Training and Development Agency for Schools



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