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Cylchlythyr | Circular

Consultation on revisions to the Financial Memorandum

Date:	17 July 2015
Reference:	W15/16HE
To:	Heads of higher education institutions in Wales Principals of directly-funded further education colleges in Wales
Response by:	7 September 2015
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This consultation circular seeks views on proposed changes to the Financial Memorandum between HEFCW and institutions, which is proposed to take effect from 1 November 2015.

If you require this document in an alternative accessible format, please telephone us on (029) 2068 2225 or email info@hefcw.ac.uk.

Purpose of this consultation

1. This consultation document sets out proposed revisions to the Financial Memorandum between HEFCW and institutions and seeks views on those proposed changes.

2. The financial memorandum under consultation is attached as Annex B. This document constitutes Part 1 of the financial memorandum. We will be consulting separately on proposed changes to Part 2, the annual schedule of funds and conditions relating to each institution.

Background

The need for a Financial Memorandum and Audit Code of Practice

3. The Financial Memorandum sets out the terms and conditions for the payment by the Higher Education Funding Council for Wales (HEFCW) of funds to the governing body of an institution, out of funds made available by the Minister for Education and Skills. The Financial Memorandum is the formal mechanism by which HEFCW oversees the stewardship of funds distributed to institutions in support of activities specified in section 65(2) of the 1992 Further and Higher Education Act and the way in which accountability for use of those funds is laid down.

4. The Audit Code of Practice sets out HEFCW's audit and accountability requirements. Requirements which are specified as mandatory are conditions of funding under the Financial Memorandum.

5. HEFCW reviews the Financial Memorandum and Audit Code of Practice (hereon referred to as the 'FM') from time to time to ensure that it continues to remain fit for purpose and reflects the environment in which it is designed to operate. The last such review was conducted in 2008.

Why we are proposing updates

6. HEFCW's current FM was published in November 2008 and was designed for the prevailing funding environment at the time. Since that publication, the funding environment has changed, as has the way we engage with institutions.

7. Changes are needed to keep memorandum up to date with changes in the funding environment. The major changes include the changes to the receipt of teaching funding from HEFCW recurrent grant to student fees, the changes in borrowing options available and the potential greater use of revolving credit facilities and changes in the way that HEFCW engages on issues of risk.

8. Our current FM sets a borrowing consent threshold based on the annualised servicing costs (ASCs) of the debt – that is, an institution requires consent if the ASC of borrowing exceeds 4% of total income. The current borrowing

consent approach based upon the ASC is no longer suitable because banks are now generally lending on shorter timescales, albeit the expectation is that such lending will be renewed. In addition there is greater use of revolving credit facilities, so the distinction between short-term and long-term borrowing is increasingly blurred.

9. The majority of teaching funding now derives from students in the form of tuition fees paid by the Student Loan Company rather than from HEFCW grants.

10. We have outlined more detailed rationale for each change under the ‘rationale’ section of each proposed update.

Relationship of this FM to the Financial Management Code requirements of the HE (Wales) Act 2015

11. In March 2015, the Higher Education (Wales) Bill received Royal Assent. The Act provides a legal basis for a revised framework to regulate higher education in Wales.

12. The Act has, accordingly, brought in a new regulatory system addressing three main aspects of higher education provision, one of which is a mechanism for regulating the financial affairs of regulated institutions via a Financial Management Code (FMC), binding on regulated institutions, to be published by HEFCW.

13. Since the FMC is designed to make provision over the financial affairs of institutions, the requirements of the FMC are therefore likely to be very similar to the requirements of the FM. We have taken a view of the potential requirements of the FMC in preparation of this revised financial memorandum and audit code of practice. However, preparation and consultation on the FMC will be conducted separately to this consultation.

How we’ve approach the proposed revision

14. We have been mindful of a number of guiding principles in the preparation of the FM. Primarily, these are:

    a. Protecting the exchequer interest and accountability for exchequer funds;
    b. The need to maintain stakeholder confidence in the Higher Education sector;
    c. The protection of the student interest;
    d. Minimising regulatory burden and removing duplication;
    e. Recognising institutional autonomy;
    f. Reasonable and proportionate accountability; and
    g. Adopting a consistency of approach with other UK funding councils where possible, in order that the regulatory environment supports the ability of Welsh institutions to operate competitively.

15. We've taken the opportunity to reduce the length of the FM with this revision and have also taken the opportunity to integrate our risk approach so that the document is more comprehensive and coherent.

Proposed effective date 1 November 2015

16. We are proposing to introduce this memorandum with an effective date from 1 November 2015 or as soon as possible after that.

Responding to the consultation

Respond via email

17. Responses should be emailed to assurance@hefcw.ac.uk. The consultation closes on **7 September 2015 at 17:00**.

Our duties under the Freedom of Information Act 2000

18. All responses may be disclosed on request, under the terms of the Freedom of Information Act 2000. The Act gives a public right of access to any information held by a public authority, in this case HEFCW. This includes information provided in response to a consultation. We have a responsibility to decide whether any responses, including information about your identity, should be made public or treated as confidential. We can refuse to disclose information only in exceptional circumstances. This means that responses to this consultation are unlikely to be treated as confidential except in very particular circumstances. Further information about the Act is available at www.ico.org.uk

19. However, if you would like us to treat your personal details as confidential for those areas in which we have discretion (such as reporting) please indicate this within your response.

Our approach to analysing responses

20. We will commit to read, record, and analyse the views of every response to this consultation in a consistent manner. For reasons of practicality, usually a fair and balanced summary of responses rather than the individual responses themselves will inform any decision made. In most cases the merit of the arguments made is likely to be given more weight than the number of times the same point is made. Responses from organisations or representative bodies which have high relevance or interest in the area under consultation, or are likely to be impacted upon most by the proposals, are likely to carry more weight than those with little or none.

We will publish a summary of consultation responses

21. We will publish an analysis of the consultation responses and an explanation of how the responses were considered in our subsequent decision. Where we have not been able to respond to a significant and material issue raised, we will usually explain the reasons for this.

Finalising the new Financial Memorandum

Consideration of responses and ratification by HEFCW's Council

22. The HEFCW Council will consider a summary of the responses to this consultation, and, subject to any changes they believe to be necessary following consultation, it is intended that they will approve the new version in late September 2015.

Further information

23. For further information, contact Matt Lody (tel 029 2068 2306; email matt.lody@hefcw.ac.uk).

Overview of proposed changes

24. The principal proposed changes to the financial memorandum and audit code of practice are as follows:

    a. *Financial Commitments*

    Short summary of proposed change: We're proposing changing the conditions where institutions must apply to HEFCW for consent to borrow. Our current FM sets a borrowing threshold based on annualised servicing costs (ASCs) of the debt – that is, an institution requires consent where the ASC of borrowing exceeds 4% of total income.

    We're proposing replacing this with a threshold-based mechanism, which is instead based on total income. This will initially be set at five times (5x) EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation). This change will mirror the change made in the Higher Education Funding Council for England's (HEFCE) Memorandum of Assurance and Accountability, which was consulted on with the English HE sector and HE sector bodies including BUFDG and the CUC.

    Note:
    The current definition of EBITDA will need revision in order to account for changes introduced to the reporting of the primary statements by the new Further and Higher Education Statement of Recommended Practice, based upon FRS 102. Principally, the new SORP will result in adjustments to the EBITDA calculation, as well as making it contingent upon accounting policy choices resulting in varying bases for threshold calculations between institutions. We will aim to consult on, and issue an update to the Financial Memorandum once this issue is resolved. The UK Funding Councils, with input from BUFDG, are currently developing potential approaches. Once an approach is determined we intend to consult again with the sector and introduce the change subject to the outcome of the consultation.

    Rationale for change: This change is intended to reflect the changes that have occurred in the way that HEIs have raised finance over recent years. HE institution's borrowing has evolved in recent years, from a long-term basis (25 to 30 years) to a shorter term basis, typically 5 years. The addition of short-term revolving credit facilities which are not tied to specific deadlines has also become more typical. Lenders typically amortise loans over 25 years but the underlying borrowing comprising that loan is made over shorter periods in the market. This results in the ASC approach giving an artificially high value, since it distributes the cost of borrowing to the HEI over the term of the loan.

In addition, the ASC-based thresholds apply only to borrowing that is on an HEI's balance sheet, so therefore excludes financial commitments that are accounted for as operating leases or other forms of off-balance sheet finance. This limits the effectiveness of the threshold approach in addressing risks.

Our general principle is that UK funding councils should, where possible, aim to standardise such requirements in order to provide parity of access to funding from lenders. The approach we have adopted therefore largely mirrors HEFCE's approach.

The principal risks that we are seeking to address are:

- that HEIs take on financial commitments that are unaffordable;
- that HEIs accept covenants that cannot be met, that then trigger repayments that cannot be met or which threaten the student experience;
- that HEIs accept financial commitments on terms that are not value for money; and
- that HEIs have a financial strategy that does not address the risk where asset or investment lives and financial commitment terms are not aligned.

If these risks are not properly managed by institutions there is a risk that HEFCW may be required to intervene, that there may be a call on public funding to support an institution, or that the student experience is threatened. It is therefore in stakeholders' interests to ensure that there is an appropriate mechanism in place to oversee borrowing levels of publically-funded institutions. The operation of the current ASC thresholds for approval by HEFCW has not necessarily led to requests to increase borrowing being rejected, but a number of proposals (and their associated risk profiles) have been shaped by the requirement to obtain such consent.

Detail of proposed change: We have outlined the methodology for calculating EBITDA at Annex C to the FM.

Question 1: **Do you agree that HEFCW should, if possible, maintain parity with HEFCE in setting thresholds for borrowing consent?**

Question 2: **Do you agree that the current distinction between short-term and long-term borrowing is no longer appropriate, and should discontinue within future arrangements? Do you have any other comments?**

b. *Increased focus on the student interest*

Short summary of proposed change: We have included a greater focus on the need to protect the student interest.

Rationale for change: The existing FM and its previous versions have focused on the public interest, given the level of grant funding that HEFCW has distributed. The shift from grant to tuition fees has now placed additional emphasis on the collective student interest at the heart of everything HEFCW does.

In many cases the collective student interest and the public interest coincide, such as in ensuring good quality provision and in the sustainability of institutions, and in ensuring prospective and current students have access to good quality information and a clear means for any complaint to be addressed.

Detail of proposed change: We have included particular further focus on the student interest in the following areas:

- Reframing the institution's responsibilities in terms of responsibilities to us and to students;
- Formally including the grounds of 'student interest' in the reasons for exceptionally disclosing an institution's risk assessment (para 19);
- Noting that the governing body has a duty to protect the student interest (para 26);
- Inclusion of HEFCW's monitoring of equality and diversity across the student body (para 69);
- The requirement for institutions to have in place a robust system for handling student complaints (para 74);
- Reframing the risk of financial commitments in terms of the potential risk to the collective student interest (para 102);
- Noting that we have a responsibility on behalf of students to respond appropriately in cases where an institution is designated 'high risk' (para 135 and throughout Annex B).

Question 3: Does the draft revised financial memorandum adequately place the collective student interest alongside the public interest? Do you have any comments?

c. Audit Code of Practice

Short summary of proposed change: Our proposed revision reduces the length of the Audit Code of Practice quite significantly. The Audit Code of Practice will continue to set out the requirement for HEIs to have audit committees and to have both internal and external audit, as we believe both are essential to achieve the necessary levels of assurance on the management of risk, internal control and governance, as well as on value for money.

Rationale for change: There is now guidance from a number of sources on good practice, including the CUC Audit Committee Handbook, and we would expect such guidance to be followed by HEIs in how they meet the requirements in the Code.

Detail of proposed change: The current Audit Code of Practice (ACOP) runs to 30 pages. We've reviewed the entire code to identify opportunities for making it more concise. We have also sought, where possible, to reduce the number of direct requirements made within the Code and have instead referenced external sources of good practice against which we expect an institution to measure itself.

The proposed Audit Code of Practice has reduced the length to eight pages. It specifies the requirements for universities to have appropriately composed audit committees as well as both internal and external audit, as we believe that all are necessary to achieve the necessary level of credibility in risk management, internal control, governance and value for money. There are now many sources of good practice (such as the Audit Committee Handbook issued by the Committee of University Chairs) that we would expect to be followed.

Question 4: **Do you agree that the revised Audit Code of Practice at Annex A to the draft financial memorandum is sufficient to set out HEFCW's requirements? If not, what changes would you suggest? Do you have any other comments?**

d. Institutional engagement and support strategy

Short summary of proposed change: We will integrate the engagement and support strategy (including risk assessment processes) into the Financial Memorandum and Code. We will set out more explicitly what actions we might take if circumstances warrant this.

Rationale for change: This is required given the need for complementarity between these processes.

Question 5: Do you agree that the institutional engagement and support strategy strikes an appropriate balance between institutional autonomy and the protection of public funds, the student collective interest and the sector's financial reputation?

e. *Reporting on the value of exchequer interests*

Overview of proposed change: We ask that an annual return is made to us (HEFCW will supply the template) to confirm the value of exchequer interests.

Rationale for change: In part, this change is aimed at simplifying the current Financial Memorandum's requirements in this area, and being more explicit about how exchequer interests are handled. In general, we aim to remove the regulatory burden from institutions where possible, and we recognise that this does facilitate an extra annual report (albeit it might be integrated to an existing process). However, the aggregate figure for the value of exchequer interests is already reported by most HEIs in their annual accounts so it is expected that it will be straightforward to confirm this figure within the reporting to us.

Question 6: Do you agree that the requirement to report the exchequer interest is necessary for helping to ensure the appropriate use of exchequer assets?

f. *Other changes*

i. *Material adverse events*

Paragraph 26 of the current Audit Code of Practice contains a requirement for the governing body of an HEI to inform us of adverse material events or important developments.

We have not changed the substance of this requirement, but have updated the text.

ii. *Equality and diversity*

The Equality Act 2010 introduced nine protected characteristics on the grounds of which (in most cases) it is illegal to discriminate. We have updated the Financial Memorandum to account for this.

iii. *Other items*

There are a number of other, smaller changes. We have included, amongst other changes, extra provisions in respect of:

1. aiming to improve the equality and diversity of governing bodies;
2. the requirement to notify us of changes to senior staff members, governance arrangements and strategy;
3. explicit linkages to the unsatisfactory quality policy; a clarification of the handling of exchequer interests (including the requirement to annually report the value of exchequer interest held by the institution);
4. the requirement to comply with state aid laws;
5. an explicit link to the research integrity concordat;
6. recommending (but not mandating) the preparation and appropriate review of an ASSUR statement.

We have also amended the order of some sections of the document and brought together some areas in order to enhance readability.

We set out in the preceding paragraphs all relevant changes we propose to make to the Financial Memorandum. We have also made a number of minor editorial revisions or clarifications and whilst we have not specifically highlighted these in this consultation, would invite you to comment on any other issues that you feel we have not addressed or properly addressed.

Question 7: Do you have any other comments on the proposed revised financial memorandum that have not been covered in the preceding questions?

25. The draft financial memorandum is attached to this consultation at Annex B.

Annex A: Summary of consultation questions

Question 1: Do you agree that HEFCW should, if possible, maintain parity with HEFCE in setting thresholds for borrowing consent?

Question 2: Do you agree that the current distinction between short-term and long-term borrowing is no longer appropriate, and should discontinue within future arrangements? Do you have any other comments?

Question 3: Does the draft revised financial memorandum adequately place the collective student interest alongside the public interest? Do you have any comments?

Question 4: Do you agree that the revised Audit Code of Practice at Annex A to the draft financial memorandum is sufficient to set out HEFCW's requirements? If not, what changes would you suggest? Do you have any other comments?

Question 5: Do you agree that the institutional engagement and support strategy strikes an appropriate balance between institutional autonomy and the protection of public funds, the student collective interest and the sector's financial reputation?

Question 6: Do you agree that the requirement to report the exchequer interest is necessary for helping to ensure the appropriate use of exchequer assets?

Question 7: Do you have any other comments on the proposed revised financial memorandum that have not been covered in the preceding questions?

Cyngor Cyllido Addysg
Uwch Cymru
Higher Education Funding
Council for Wales

hefcw

Circular W15/16HE: Annex B

Financial Memorandum 2015

Draft version for consultation

Noddir gan
Lywodraeth Cymru
Sponsored by
Welsh Government

Contents

Introduction

1. This memorandum sets out the terms and conditions for the payment by the Higher Education Funding Council for Wales (HEFCW) of funds to the governing body of (**name of institution**), out of funds made available by the Minister for Education and Skills.

2. This memorandum supersedes the Revised Financial Memorandum and Audit Code of Practice 2008 (W08/36HE).

3. The definitions of terms used within this document are set out within '**Annex D: Glossary**'.

Application of this document

4. This memorandum is in two parts:

Part 1 (this document)	Part 1 sets out the terms and conditions which apply in common to all institutions.
Part 2	Part 2 is the schedule for each institution issued each year, which gives conditions specific to that institution, a schedule of funds available in the academic year and the educational provision the institution has agreed to make in return for those funds.

5. References to this memorandum encompass both Part 1 and Part 2.

   This document does not supersede the requirements of the institution's charter, statutes (or equivalent) and the law relating to the institution's charitable status but is intended to complement and reinforce them. Nothing in this memorandum shall require the institution to act in a manner which would cause it to lose its charitable status, or which would be inconsistent with its charter and statutes.

6. Where an institution receives funds from both HEFCW and the Welsh Assembly Government (for the provision of further education in accordance with the Learning and Skills Act 2000) the Memorandum which will apply will be that derived from the body providing the greater proportion of funds to the institution. In this Memorandum, references to funds received from HEFCW should also be taken to include any funds received from the Welsh Assembly Government for the provision of further education.

7. Where we use the term ‘must’, we mean it is a specific legal or regulatory requirement. Institutions must comply with these requirements. We use ‘should’ for items we regard as minimum good practice, but for which there is no specific legislation or regulatory requirement. We will, however, consider the extent to which an institution has adopted the ‘should’ provisions (or alternative, equally robust arrangements) in our annual assessment of risk.

8. Any requirements mandatory under **Annex A: Audit Code of Practice** shall be a condition of grant under this memorandum.

9. From time to time, we may, within subsequent guidance, attach extra mandatory requirements to the conditions of funding, following appropriate consultation with the sector.

10. This document, including **Annex A: Audit Code of Practice** takes effect from 1 November 2015.

Responsibilities of HEFCW

Payment of funds in accordance with legislation

11. Payments to the institution by HEFCW are made in support of activities specified in section 65(2) of the 1992 Act.

12. Payments will be subject to the provisions of the 1992 Act, the conditions set out in this memorandum, and such terms and conditions as HEFCW may from time to time prescribe in accordance with the 1992 Act, and after the consultation required under section 66(1) of the Act. In accordance with section 65(3) of the 1992 Act, the payment of funds will be subject to such terms and conditions as HEFCW may impose, including those set out in this memorandum. However, in accordance with section 65(4) of the 1992 Act, these terms and conditions will not relate to the application by the institution of any funds not derived from HEFCW. In accordance with section 66(2) of the 1992 Act, HEFCW does not wish to discourage the institution from maintaining or developing its funding from sources other than HEFCW.

Protection of public funds

13. The Chief Executive of HEFCW has been appointed as its Accounting Officer. As such s(he) is responsible and accountable to Welsh Government for ensuring that the funds received from the Minister for Education and Skills or successor are used for the purposes for which they were given and in ways that comply with the conditions attached to them. The Chief Executive is also responsible for promoting good value for money through grants paid to institutions and associated guidance.

14. The Chief Executive must satisfy himself or herself that the governing body of the institution has appropriate arrangements for internal control (including financial management and accounting), and that HEFCW's funds are used for the purposes for which they were given.

Right to suspend payment of funds

15. In their role as Accounting Officer, the Chief Executive of HEFCW may suspend the payment of grant, either in whole or in part and either permanently or temporarily, if in his or her opinion it is appropriate and reasonable to do so in order to safeguard public funds.

16. In their role as Accounting Officer, the Chief Executive of HEFCW shall inform the institution's governing body and/or its audit committee if (s)he has serious concerns about the institution's financial affairs or system of internal controls.

Risk assessment of funded institutions

17. HEFCW will provide a confidential risk assessment to the institution's accountable officer and governing body. We will not normally make our risk assessments public until at least three years have elapsed. This period, based on advice from the Information Commissioner, gives an institution that is designated 'high risk' time to ameliorate its risk rating.

18. We will make our risk assessments available within this three-year period, on an exceptional and confidential basis, to:

- other public funders and other regulators to enable those bodies to make their own assessments of risk; and
- the Wales Audit Office who may exceptionally need to discuss those assessments at the Public Accounts Committee or disclose them in a published report.

We must do this to minimise the risk to public funds distributed by those bodies or other regulatory remits they hold.

19. We will exceptionally make public a risk assessment at any stage if we have strong grounds for believing that it is in the collective student or the public interest to do so. We will only share or publish our risk assessments after having notified the accountable officer and governing body of the institution concerned. When we assess an institution to be at 'high risk', we will engage with it in line with our institutional engagement and support strategy (cf '**Institutional engagement, support and safeguarding actions**').

20. We define an institution as 'high risk' when in our judgement, on the basis of all available evidence, it:

- faces threats to the sustainability of its operations, either now or in the medium term;
- has serious problems relating to value for money, propriety or the use of funds for the purpose intended; or
- has materially ineffective risk management, control or corporate governance.

Responsibility to act reasonably

21. In exercising its powers under this memorandum, HEFCW will act reasonably at all times.

22. We will respect commercial confidentiality within the constraints of the Freedom of Information Act 2000 and our own obligations to Welsh Government under the framework document with our sponsor body.

Responsibilities of the institution to us and to students

Governing Body responsibility for compliance with this document

23. The responsibility for ensuring that the institution complies with this memorandum and related guidance rests with the governing body of the institution.

Proper stewardship of public funds

24. The governing body of the institution is responsible for ensuring that funds from HEFCW are used only in accordance with the 1992 Act, this memorandum and any other conditions that HEFCW may from time to time prescribe.

25. The governing body must exercise its discretion reasonably in the use of public funds and take into account any relevant guidance on accountability or propriety issued from time to time by HEFCW, the WAO or the Audit Committee of the National Assembly for Wales.

26. The governing body of the institution has a responsibility to protect the collective student interest and the public interest and must ensure that consideration of these elements takes place within its key decision making processes.

Robust, accountable and transparent governance structures

27. The governing body of an institution is collectively responsible and has ultimate responsibility that cannot be delegated for overseeing the institution's activities, for determining its future direction, and fostering an environment in which the institution's mission is achieved.

28. Institutions should adhere to recognised standards of good governance. We expect that institutions will adhere to the Higher Education Code of Governance issued by the Committee of University Chairs[1] but where they have not done so an explanation should be given within the institution's annual report. This explanation should describe the alternative governance procedures adopted in lieu of those suggested by the Code of Governance.

29. Compliance with the Higher Education Code of Governance is not a specific condition of grant. We recognise that the code is voluntary and institutions may be able to apply alternative governance practices to achieve similar outcomes. However, we consider that the principles and intended outcomes (referred to as 'the Elements') of the Code are sound. Consequently, we will not regard non-compliance with the Code negatively, provided that the

[1] Accessible at www.universitychairs.ac.uk/publications/

explanation within the annual report describes equally robust alternative arrangements that are in place or indicates that there are appropriate and reasonable grounds for non-adherence.

30. We will assess the institution's compliance with good governance practices as part of our risk process. Inadequate and/or ineffective corporate governance arrangements may lead to us assessing an institution as 'high risk', at which point our support strategy will be implemented.

31. Members of governing bodies and accountable officers must comply with the seven principles set out by the Committee on Standards in Public Life. The governing body must inform HEFCW's Chief Executive immediately should it become aware that a member or accountable officer has violated one or more of these principles.

32. Governing bodies and accountable officers are accountable for their decisions and actions, and must submit themselves to whatever scrutiny is appropriate to their office. They must also be as open as possible about all the decisions and actions that they take that may affect funding provided by HEFCW.

33. HEFCW will write to the new chair of each governing body of an institution, on appointment, drawing attention to their own and their governing bodies' responsibilities under this memorandum and related guidance.

Composition of the governing body

34. The composition of the governing body is first and foremost the responsibility of the governing body itself, acting within the bounds of its statutes and ordinances.

35. However, the governing body should consider the diversity of its composition, particularly in terms of protected characteristics. At each step of the recruitment exercise for new members, care should be taken that an applicant's ability is not conflated with their experience. Recruitment efforts for governing body memberships should be proactive and target under-represented groups. We do not consider it sufficient to openly advertise a vacancy without taking proactive measures to bring the advert to the attention of under-represented groups.

36. The accountable officer must inform HEFCW's Chief Executive if neither an external search consultancy nor open advertising has been used in the appointment of a governing body member.

37. External members of the governing body should not normally serve for more than two terms of four years, or three terms of three years, except where subsequently undertaking the role of Chair. We expect institutions to notify us where it is decided to exercise an exception to this good practice.

38. HEFCW will consider the composition of the governing body and the institutions' report on its equality and diversity policies within its Institutional Risk Review process.

Accountable officer's role and responsibilities

39. The head of an institution is first and foremost responsible for leadership of the academic affairs and executive management of the institution.

40. The governing body shall appoint a senior officer (normally the head of the institution) as the 'accountable officer' to be accountable for reporting to HEFCW on behalf of the institution. The institution shall notify HEFCW whenever it designates such an officer.

41. The accountable officer is personally responsible to the governing body for ensuring that the conditions in this memorandum are complied with and for providing HEFCW with clear assurances to this effect.

42. It is a condition of grant that HEFCW be able to meet the accountable officer within a reasonable timeframe following their appointment.

43. The accountable officer may be required to appear before the Public Accounts Committee of the National Assembly for Wales alongside the Chief Executive of HEFCW on matters relating to grants to the institution.

44. The accountable officer shall advise the governing body immediately if, at any time, any action or policy under consideration by the governing body appears to the accountable officer to be incompatible with the terms of this memorandum. If the governing body decides nevertheless to proceed, the accountable officer must immediately inform the Chief Executive of HEFCW in writing.

Absence of, or removal of accountable officer

45. If, in the judgement of the HEFCW Chief Executive, there is evidence of serious failure in relation to the oversight and management of public funds, (s)he will raise this as appropriate with the accountable officer concerned, the chair of the governing body or both; provide the relevant evidence; and seek and consider a response.

46. In extremis, and after all due process has been exhausted, the HEFCW Chief Executive may conclude that the accountable officer is unable or unwilling to meet his or her responsibilities under this Financial Memorandum. HEFCW may then ask the governing body to appoint someone else to report to HEFCW on behalf of the institution. In taking this action HEFCW will not seek to influence the employment relationship between the governing body and the

head of the institution. The governing body is clearly entitled to maintain the head of the institution in post. However, the governing body would then have to appoint another senior officer as the accountable officer, and adjust the roles and responsibilities of the head of the institution accordingly.

47. In the event of a prolonged absence from work (or absence that is reasonably expected to be prolonged) or a sudden departure by the accountable officer, the clerk to the institution's governing body must ensure that HEFCW is made aware immediately of the identity of the interim accountable officer.

Responsibility for reporting significant events

48. The institution's accountable officer must report any event (whether already arisen or forecast) that has, or is likely to have, a material adverse impact on the financial position of the institution, as soon as this becomes apparent, to:

    a. The chair of the institution's audit committee;
    b. The chair of the institution's governing body;
    c. The institution's head of internal audit;
    d. The external auditor; and
    e. The HEFCW Chief Executive.

49. The institution's accountable officer must notify HEFCW of any serious weakness, such as a significant and immediate threat to the institution's financial position, significant fraud or major accounting breakdown. Should the accountable officer be implicated in wrongdoing, the responsibility for reporting this information lies with the governing body.

50. 'Serious weakness' is more fully defined within paragraph A51 and A52 of '**Annex A: Audit Code of Practice**'.

51. The institution's accountable officer must inform HEFCW, without delay, about major changes in strategy, risk profile, plans for major restructuring or merger with another institution or organisation.

52. The governing body must inform HEFCW without delay of the removal or resignation of the external or internal auditors before the end of the term of their appointment.

Governing Body's responsibility to deliver value for money

53. The governing body is responsible for delivering value for money from public funds. It must keep under review its arrangements for managing all the resources under its control, taking into account guidance on good practice issued from time to time by HEFCW, the Auditor General for Wales or the Public Accounts Committee of the National Assembly for Wales.

Responsibility to provide HEFCW with accurate and timely information

54. The institution must provide HEFCW, or agents acting on its behalf, with whatever information HEFCW requires to exercise its functions under the 1992 Act. This information shall be of a satisfactory quality and shall be provided at the times and in the formats specified by HEFCW or its agents.

55. HEFCW will act reasonably in its requests for information and will have regard to the costs of providing this information, and, where appropriate, to its confidentiality.

56. If the institution fails to return information required by HEFCW by the specified deadline, or that information is not of a satisfactory quality, HEFCW reserves the right to do either or both of the following:

    a. To carry out whatever investigations it deems necessary to collect the data. All or part of the cost of such investigations may, where circumstances warrant it, be deducted from the institution's revenue grant;

    b. To use its own reasonable estimates of data which it requires to exercise its functions under the Act.

57. The institution must provide HEFCW with access to all books, records, information and assets. HEFCW can require any officer to give any explanation which it considers necessary to fulfil its responsibilities. The books and records of the institution shall also be open to inspection by the Auditor General for Wales.

58. If the institution is overpaid grant as a result of HEFCW using estimated data, HEFCW reserves the right to recover any overpaid grant, plus interest, in accordance with paragraphs 82 and 83 below.

59. Institutions will, from time to time, be asked to provide data that they have collected to HEFCW or to other bodies acting on HEFCW's behalf. At present, HESA acts as an agent both for the institution and for HEFCW in collecting information required by HEFCW and passing that information to HEFCW and/or to Welsh Government on behalf of HEFCW. These data will often contain personal details for students and/or staff. To ensure that institutions and HEFCW can fulfil their duties under the Data Protection Act 1998, institutions must satisfy themselves when collecting data that students and/or staff are aware of these possible requirements and have given their consent. The institution will co-operate with HEFCW as reasonably necessary to ensure that HEFCW and HESA, or any other agents of HEFCW, are able to comply with the Data Protection Act 1998 in processing information supplied by the institution. It is for each institution to decide what they tell students

and/or staff based on good practice and guidance, such as HESA model collection notices.

Notification of changes to senior roles

60. The institution must notify us on the formal appointment of a new chair of the governing body, a new clerk to the governing body and the appointment of members of the senior executive team.

61. Where a member of the governing body, audit committee, finance committee, human resources committee or a clerk to one those bodies resigns from their post due to disagreement, the accountable officer must notify us immediately of the reasons for the resignation.

62. The accountable officer must also notify us immediately of the resignation or removal due to disagreement of a member of the senior executive team.

Securing quality provision of education

63. HEFCW has a statutory responsibility to secure that assessment is made of the quality of provision it funds. We currently exercise this duty partly through contracting the Quality Assurance Agency (QAA) to review the quality of provision in institutions.

64. References to ‘the quality inspectorate’ mean the QAA or any successor body. Similarly, references to stated judgement levels are made with reference to QAA standards or the equivalent standards of any successor bodies.

65. If an institution receives a published judgement of ‘does not meet UK standards or expectations’ (or equivalent) in one or more area(s) of judgement by the quality inspectorate then HEFCW’s policy for addressing unsatisfactory quality will apply (see HEFCW W12/16HE). This includes assessing the risk status of the institution; we may then implement our strategy for supporting institutions at ‘high risk’ (cf ‘**Institutional engagement, support and safeguarding actions**’).

66. If an institution with a ‘does not meet’ or ‘requires improvement to meet UK standards or expectations’ judgment fails to make the necessary improvements through the quality inspectorate’s follow-up process, then HEFCW will take the lead, arranging regular meetings with the institution. HEFCW steps in at this point because it has a clear regulatory interest to ensure that Institutions in receipt of public funds provide value for money and are responsible in their use of these funds, as described in this Financial Memorandum. Improvements will be expected and, in exceptional circumstances, sanctions may be applied. Our ultimate sanction is the withdrawal of some or all HEFCW funding.

Compliance with the Research Integrity Concordat

67. HEFCW is one of the signatories to the Concordat to Support Research Integrity[2], together with Universities UK, the other three UK higher education funding bodies, Research Councils UK, the Wellcome Trust and other Government departments. It is our firm expectation that all universities in Wales should comply with the terms of the Concordat. All institutions are asked to provide confirmation annually that they are compliant with the Concordat.

Legislative requirements

68. Institutions must have due regard for all legislative requirements placed upon them and their governing bodies.

69. HEFCW will monitor institution's progress with regard to equality and diversity across the student body, executive and governance structures within the Institutional Risk Review process (cf. Table 2: HEFCW institutional risk system within Annex B).

Effective risk management processes

70. The institution must ensure that it has an effective policy of risk management.

Sound financial management

71. The governing body of the institution must ensure that it has a sound system of internal management and control.

72. The governing body of the institution must plan and conduct its financial and academic affairs to ensure that it remains solvent.

73. In accordance with FSSG[3]'s recommended good practice, institutions should prepare an ASSUR statement on an annual basis. This statement should be reviewed by the Governing Body.

Monitoring of complaints

74. Institutions must have a robust process in place for the handling of complaints made by students, staff and third parties. Governing bodies must be provided with a complaints report at least annually, which provides the Governing Body with assurance that complaints are being handled appropriately.

2 www.universitiesuk.ac.uk/highereducation/Documents/2012/TheConcordatToSupportResearchIntegrity.pdf
3 Financial Sustainability Strategy Group (www.hefce.ac.uk/whatwedo/lgm/finsustain/fssg/)

Appropriate use of public funds

75. HEFCW funds must not be used to subsidise non-public activities.

76. The institution must only use Council funds for the activities eligible for funding as specified in sub-sections 65(2)(a), (b) and (c) of the 1992 Act. This condition also applies where the institution passes on a part of its HEFCW grant to another legally distinct entity for provision of an activity which is eligible for funding. That includes passing on grant to colleges in the further education sector.

77. If passing on HEFCW-provided funds to another legally distinct entity:

    a. The institution remains accountable for the funds and must retain sufficient oversight such that it can ensure that the funds are used for qualifying purposes under the Act. This oversight must cover, among other areas, both financial accountability and quality assurance. A written statement of the arrangements must be agreed by both parties. This statement must ensure that the chain of accountability for the use of HEFCW funds is not broken, and that the relevant parts of the financial memorandum apply to the eventual user of the funding.

    b. This applies except in cases where the body to which the institution passes funds is also an institution funded in Wales. In such cases, as set down in Section 65(3A) of the Further and Higher Education Act 1992, the institution must obtain our consent before passing HEFCW funds to the connected institution. If HEFCW consents to the passing of funds, HEFCW will give notice to all parties stating which party will be held accountable for the funds.

78. The institution must use any funds which HEFCW has earmarked or provided for specific revenue or capital purposes, solely for those purposes.

79. If any Council funds which were earmarked or provided for specific purposes are used for other purposes, the institution must report such use to HEFCW as soon as it becomes aware of it.

Circumstances in which public funds become repayable

80. Under section 65(4) of the 1992 Act HEFCW may require repayment by the institution, in whole or in part, of funds received from HEFCW if the institution fails to comply with any terms and conditions attached by HEFCW to the payment of funds

81. As outlined in paragraph 58, we may require an institution to repay funds if it has been incorrectly over-funded.

82. As described in paragraph 63, HEFCW has a statutory responsibility to secure that assessment is made of the quality of provision it funds and reserves the right to impose financial sanctions and/or withdraw funding from an institution where HEFCW considers the quality of provision to be unsatisfactory.

83. HEFCW also reserves the right to require the institution to pay interest at 2 per cent over the Bank of England base rate, in respect of any period during which a sum due to HEFCW under this or any other condition remains unpaid.

84. The value of the Exchequer interest in the institution (cf paragraph 91 to 99) becomes immediately repayable if the institution becomes insolvent, including going into liquidation or administration, or if it dissolves or transfers its undertaking to some other body, or if it experiences any analogous event.

Requirement to subscribe to other bodies

85. Under the Higher Education Act 2004 institutions are required to subscribe to the Office of the Independent Adjudicator.

Prudent management of the estate

86. The institution should give due regard to the guidance issued from time to time by HEFCW on estate procedures.

87. Institutions must manage their estate in a sustainable way, in line with an estates strategy and a maintenance plan, covering its long-term and routine maintenance requirements.

88. Institutions must put in place and regularly review a carbon management plan.

89. S(6), Annex 4 of the WGSB Framework Document: Higher Education Funding Council for Wales) obliges HEFCW to require institutions to keep their holdings of land and buildings under review, with the objective of rationalising and disposing of those which institutions consider to be no longer needed.

90. Consequently, we recommend that institutions should prepare and regularly review space plans. The metrics for measuring the success of such plans should be pre-agreed by the Governing Body.

Monitoring of the exchequer value held within the institution's assets

91. Institutions must make an annual return to HEFCW detailing the gross and depreciated value of exchequer interest in the assets of the institution. The institution must also detail the depreciation charge to the assets made within the year as well as the value and nature of any additions or impairments. HEFCW will issue a schedule to the institution to be returned annually in order that these elements can be identified.

92. Institutions must abide by the Charity Commission's requirements over the disposal of charity land and buildings, which include requirements over the disposal price in relation to the market value of the asset.

93. Since repayment of the Exchequer interest only occurs at the discretion of HEFCW on the disposal of an asset (which would be considered atypical) or in the exceptional circumstances of insolvency, it does not need to be disclosed as a contingent liability in the institution's accounts.

Disposal of assets in which there is an exchequer interest

94. HEFCW is required (cf S(6), Annex 4 of WGSB Framework Document: Higher Education Funding Council for Wales) to safeguard the exchequer interest in institutions.

95. Institutions must request consent in advance from HEFCW before disposing (in full, or in part) of assets in which there is an exchequer interest and whose valuation exceeds a market value of £25,000.

96. Institutions must also apply for consent from HEFCW where they intend to cease using an asset containing an exchequer interest for its intended purpose.

97. In providing consent, HEFCW will determine the extent to which the public investment is repayable.

98. If a property comprising an exchequer interest is leased for use for activities other than vacation lettings or those eligible for funding by HEFCW under section 65(2) of the 1992 Act, then rent or an appropriate proportion thereof (after deduction of any ground rent or other charges, administration costs and any expenditure necessary to keep the property in a state to command that rent) must be paid to HEFCW.

99. Proceeds from the sale of Exchequer assets remain the property of the Exchequer and therefore remain subject to the provisions of this memorandum.

Negative cash forecasts

100. The institution should prepare cashflow forecasts on a regular basis.

101. The institution must inform HEFCW immediately if, at any point in the following 12 months, negative net cash (as defined within FRS 102 S(7), to include cash and cash equivalents) is forecast for more than 30 consecutive days.

Financial commitments

102. The primary responsibility for assessing the affordability of, and risks around, financial commitments rests with Institutions' governing bodies. HEFCW's role is to assess whether any financial commitments entered into by an institution present challenges to the institution's sustainability that could impact adversely on the past and continuing public investment in an institution, become a call on public funds, or adversely affect the collective student interest.

103. Institutions must apply the following principles prior to entering into any financial commitments:

   a. The risks and affordability of any new on- and off-balance sheet financial commitments must be properly considered, including through the use of prudent, sensitised downside forecasts;
   b. Financial commitments must be consistent with the institution's strategic plan, financial strategy and treasury management policy;
   c. The source of any repayment of a financial commitment must be clearly identified and agreed by the governing body at the point of entering that commitment;
   d. Planned financial commitments must represent value for money;
   e. The risk of triggering immediate default through failure to meet a condition of a financial commitment must be monitored and actively managed;
   f. The institution must ensure that it retains sufficient liquid cash or equivalents to service working capital requirements as well as a prudent level of reserve to be called upon in the case of extraordinary events; and
   g. The institution must be able to meet its financial commitments without recourse to additional grant from HEFCW and its ability to maintain financial and academic viability must not be impaired as a result of its financial commitments.

104. Institutions are able to make financial commitments up to a predefined threshold. This threshold is calculated based on earnings before interest tax depreciation and amortisation (EBITDA) and initially is set at five times the institution's average EBITDA-based surplus (cf '**Annex C: Approval of increases in a financial commitment threshold**').

105. An institution must obtain written permission from us to increase its EBITDA-based threshold, before it agrees to any new financial commitments where its total financial commitments would breach this level.

106. Annex C sets out how the EBITDA-based financial commitments threshold is calculated, as well as the information we need to assess requests to increase the threshold. When we designate an institution as 'high risk' any increase in its financial commitments or any increase in the securities placed over

exchequer interests (regardless of the threshold) will require written permission in advance. In such cases, the institution must seek written permission in advance.

107. The threshold is not a limit, and should not deter an institution from increasing its financial commitments where appropriate. An institution must determine the level of its financial commitments that are both affordable and consistent with its financial strategy.

108. In any case presented to us we ask the institution to demonstrate that the proposal represents good value, and to confirm that:

a. No key information or opinions relating to the proposed commitment or financial circumstances have been withheld from the governing body and the governing body has been supplied with all necessary information required to allow reasonable individuals to come to a reasonable, balanced conclusion;
b. The governing body confirms that paragraph 103 above has been complied with;
c. That, following receipt of this information, the governing body has approved the borrowing as presented to us.

109. In responding to requests for consent we aim to be helpful and pragmatic, taking into account the circumstances of each proposal.

110. Under Section 69(4) of the 1992 Act, HEFCW has a duty to protect the exchequer interest in the development of any land, building or other asset which was:

a. acquired by the institution using public funds; with
b. the public funds having a condition attached requiring the institution to obtain the Minister's consent before raising capital finance on the security of those assets.

111. This duty requires that the institution must obtain prior written consent from HEFCW where the institution wishes to grant security over such an asset. In seeking such approval from HEFCW the institution must demonstrate in writing its compliance with the conditions set out in paragraph 108.

Activity costs should form part of decision making

112. An institution should know the full cost of its activities and use this information in making decisions. If it does not seek to recover the full cost, this should be the result of a clear policy set by the governing body and included in the financial strategy, and must not risk putting the institution in financial difficulty.

Compliance with EU state aid law

113. Institutions must ensure compliance with European Union state aid law in their own uses of HEFCW funding. In the case of any breach of state aid law we may be required to recover all or some funding, together with interest. HEFCW may also be required to withhold funding or aspects of funding to any institution which is subject to a state aid enquiry or which has an outstanding recovery notice against it.

Financial statement preparation

114. The institution must keep proper accounting records and must prepare financial statements in respect of each accounting period.

115. Financial statements for the institution (or consolidated group accounts where the institution is a parent entity) must be prepared in accordance with the SORP ('Statement of recommended practice: accounting for further and higher education 2015'[4]) or its successor document.

116. The institution must provide HEFCW with a copy of its audited consolidated financial statements for the accounting period by 31 December following the end of the accounting period.

117. The institution must also send the audited accounts of its subsidiaries to HEFCW annually, no later than 31 January following the end of the accounting period.

118. The institution must make copies of the consolidated financial statements publicly available in a timely manner.

119. Institutions and their external auditors must comply with the prevailing Accounts Direction issued by HEFCW.

120. The financial statements must be signed by the accountable officer and by the chair or one other member of the governing body as appointed by the governing body. If the institution is a company, the requirements of the Companies Act 1985 (as revised by the Companies Act 1989) for signatories to the financial statements shall apply.

121. The following information must be included in the institution's audited financial statements and related reports:

    a. The members must confirm in the annual report that they have carried out a robust assessment of the principal risks and material uncertainties facing the institution, including those that would threaten its business

[4] www.fehesorp.ac.uk/sorp2015/

model, future performance, solvency or liquidity. The report must describe those risks and explain how they are being managed or mitigated;

b. A statement from the members as to whether they consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements, having considered the principal risks and material uncertainties existing over a period of at least twelve months from the date of approval of the financial statements; and

c. A description of the governing body's policy on diversity and membership, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.

122. We may provide more detail about some of the above in the HEFCW accounts direction to institutions, which is published in an annual circular letter.

Oversight of audit

123. The governing body of the institution must appoint an audit committee and arrange to provide for internal and external audit, in accordance with the Audit Code of Practice (cf **Annex A: Audit Code of Practice**)and any other directions drawn up and published by HEFCW in consultation with institutions.

HEFCW's right of access for investigations

124. HEFCW may carry out any investigations that it considers necessary. All or part of the cost of such additional investigations may, where circumstances warrant it, be deducted from the institution's revenue grant.

125. HEFCW may carry out reviews designed to improve economy, efficiency and effectiveness in the management or operation of the institution, including value for money studies. The Auditor General for Wales may also carry out value for money studies of the institution's use of resources.

126. Welsh Government's internal auditors and/or the WAO may accompany HEFCW on institutional visits to the institution. On such visits Welsh Government's and/or WAO's auditors will be concerned only with the way HEFCW is carrying out tasks, and will not themselves audit arrangements within the institution.

Institutional engagement, support and safeguarding actions

127. As a public sector funding body HEFCW must be confident that the bodies it funds have adequate and effective risk management, control and governance arrangements to protect the investment of public funding; and arrangements for delivering value for money (VFM) from public funds.

128. HEFCW operates a number of processes designed to provide HEFCW with the necessary assurance while minimising burden on the sector. The strands are:

a. annual assurance returns;
b. HEFCW Assurance Reviews;
c. Institutional Risk Reviews;
d. Strategic Planning and Engagement documents; and
e. data audits and assurance.

129. As far as possible the assurance process between HEFCW and institutions is concentrated into an exchange of documents and dialogue during a specific period following the end of the financial year. Our aim is to minimise our demands on Institutions, and as far as possible to rely on data and information that they have produced to meet their own needs.

Annual assurance returns

130. HEFCW takes assurance from a suite of assurance returns, including audited financial statements, financial forecasts and independent audit reports, which must be submitted to HEFCW by a specified date or dates. They provide HEFCW with a view of each institution's risk management, control and governance, financial sustainability, arrangements for promoting VFM and managing and quality assuring data. By using information and assurances, much of which is needed for internal management and assurance purposes by the institution, HEFCW is able to minimise its audit requirements and reduce burden. See paragraphs 135 and 136 below on institutional engagement and support.

131. The annual assurance returns are analysed by HEFCW as part of the annual Institutional Risk Review process, which results in a risk assessment of each institution. The risk assessment is reported to the governing body and accountable officer. Sometimes we will ask for more information to clarify uncertainties.

HEFCW Assurance Review

132. The HEFCW Assurance Review is a short site visit to Institutions to ensure that there are suitable accountability processes within each institution to

assure the validity of its annual assurance returns. This helps us to validate the systems of self-regulation on which we rely.

Data assurance

133. Institutions must supply HEFCW with data to inform allocations of funding and for other purposes. The responsibility for the quality and accuracy of that data rests with the institution. HEFCW relies on the institution's own data assurance processes where possible.

134. HEFCW monitors the reasonableness of data and undertakes verification, validation and reconciliation work between HESA data and other datasets. HEFCW undertakes audits at institutions on a five-year cyclical basis. Data audits assess the strength of institutional systems and controls as well as assessing the accuracy of the data submissions.

Institutional engagement and support

135. When we assess an institution as being 'high risk' we must respond appropriately to protect the public and the collective student interest. Our institutional engagement and support strategy (see Annex B) describes the range of ways in which we might respond to help Institutions resolve difficulties and manage risks. We will always discuss our concerns with the institution's accountable officer, and take his or her views and actions into account, before we formally make an at 'high risk' designation. We will also try to reach agreement on what needs to be done. When we consider the institution to be no longer at high risk, we will write to its accountable officer and its governing body to confirm this.

136. Beyond the exchange of assurance information each year, we welcome the opportunity for regular and informal discussions with Institutions about their plans and developments. We believe this will help us to work together and reduce the risk of misunderstanding.

Safeguarding actions

137. Our institutional engagement and support strategy, and risk assessment process, has been described in paragraphs 127 to 136 above and is set out in detail at Annex B.

138. If an institution fails to take any agreed action HEFCW will seek explanations and, if appropriate and justified, issue warnings to improve.

139. If the institution still fails to address the risks and issues then the institution will be informed that one or more of the safeguarding actions will be applied. This is very much a last resort and an action that we would not expect to take often.

140. The two safeguarding actions at HEFCW's disposal, which could be deployed if other routes to secure compliance are not successful, are:

a. **Financial** – through the recovery of grant funding or the denial of access to future grant funding, including access to specific grants or to discretionary funding. Ultimately HEFCW can withdraw funding entirely, should circumstances warrant such action.
b. **Information** – through making public our concerns about an institution where there are strong grounds to do so and where this is in the public or collective student interest (both current and prospective students, and past students where relevant).

141. In addition HEFCW may:

a. provide advice to the Charity Commission where an institution may have breached its charitable obligations; and/or
b. provide advice to the Equality and Human Rights Commission where discrimination may have occurred.

Other matters

Revisions to this document

142. After consultation with the institution and such bodies representing the institution as HEFCW considers appropriate, HEFCW may from time to time revise, revoke or add to any of the conditions in Part 1 of this memorandum. The institution may itself make proposals to HEFCW for such changes.

Interpretation of statements within this document

143. Questions on the interpretation of any statement in this memorandum shall be resolved by HEFCW after consultation with the institution and such bodies representing the institution as HEFCW considers appropriate.

Signature of the accountable officer

144. The accountable officer of (**name of institution**) must signify below that they have received the Financial Memorandum and Audit Code of Practice, which sets out the terms and conditions for payment by the Higher Education Funding Council for Wales of funds to the governing body of **(name of institution**) out of funds made available by the Minster for Education and Skills.

Signed…………………………………………………................................

Dated ……………………………………

Annex A: Audit Code of Practice

Overview

A1. In this Audit Code of Practice (the Code) the word 'must' denotes a mandatory requirement, whereas 'should' denotes our view of good practice.

A2. The Code sets out what we require institutions to have in place to provide themselves and us with adequate assurance on good governance, internal controls, the management of risk and achieving value for money (VFM).

Governing bodies of Institutions

A3. The responsibilities of governing bodies are set out within the financial memorandum.

A4. Governing bodies are responsible for the appointment and removal of external and internal auditors. Governing bodies are also responsible for appointing outsourced internal audit providers (on the advice of the Audit Committee) and for choosing to move between outsourced and insourced internal audit provision, also after taking advice from the Audit Committee. Staff appointments and terminations for insourced internal audit staff are a matter for management, with the Audit Committee advising on the appointment and termination of the Head of Internal Audit.

A5. The governing body must satisfy itself that where the institution has departed from the provisions in this document that are denoted with 'should' (i.e. our view of good practice) there are reasonable grounds for doing so and these reasons are not detrimental to the control environment within the institution. HEFCW may, from time to time, request the governing body to supply such confirmation.

A6. Where the clerk to the governing body has significant responsibilities at senior management level within the institution, the governing body must consider whether the independence of the clerk's position is at risk of being compromised; whether the role should be transferred to someone else or whether sufficient safeguards can be built into existing arrangements. This should be reviewed by the whole governing body on an annual basis in open discussion.

Audit committees in institutions

A7. Each institution must have an audit committee which follows good practice in Higher Education corporate governance. The audit committee is responsible for assuring the governing body about the adequacy and effectiveness of:

a. risk management, internal controls and governance effectiveness;
b. VFM; and

c. the management and quality assurance of data.

A8. The Committee of University Chairs has published detailed guidance about audit committees[5]. This reflects good governance practice, and HEFCW expects Institutions to take account of such guidance in meeting the required standards or explain why the guidance is not being applied and good practice is not being followed.

A9. An audit committee can undertake whatever work it considers necessary to fulfil its role. This should include assuring itself about the effectiveness of the internal audit function and the external auditors. Audit committees will only be able to provide the necessary assurances if they are supported by suitably resourced internal audit and external audit functions, operating to recognised professional standards. They should also consider evidence-based assurances from management.

A10. Members of the audit committee must not have executive authority. Audit committees must include a minimum of three lay members of the governing body. The chair of the governing body should not be a member of the audit committee.

A11. Audit committee members should not be members of an institution’s finance committee or its equivalent. This is because it would create a potential conflict of interest when the audit committee is considering issues involving the finance committee. If an institution’s governing body determines that cross-representation involving one member is essential, this should be the subject of an explicit, recorded resolution, which sets out the rationale for such a decision – but it should not be an option for the chair of either committee or the chair of the governing body.

A12. Where internal audit undertake advisory work, the audit committee should satisfy itself that the objectivity of future audit work over the same areas is not compromised.

A13. The committee must produce an annual report for the governing body and the accountable officer. The report must cover the financial year and include any significant issues up to the date of signing the report and its consideration of the financial statements for the year. The report must be presented to and reviewed by the governing body before the audited financial statements are signed.

A14. The report should record the work of the committee and consider the following:

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[5] www.universitychairs.ac.uk/wp-content/uploads/2014/09/Handbook-for-members-of-Audit-Committees.pdf

a. The external auditors' communication with those charged with governance and the management letter;
b. The internal auditor's annual report;
c. Audit reports and assurances received during the year in respect of the controls in place to manage the quality of data returns made by the institution for funding purposes;
d. Value for money work;
e. Any relevant HEFCW correspondence, such as the Institutional Risk Review letter.

A15. The report must formally record the committee's opinion on the adequacy and effectiveness of the institution's arrangements for:

a. risk management, control and governance
b. economy, efficiency and effectiveness (VFM)
c. management and quality assurance of data submitted to the Higher Education Statistics Agency, the Student Loans Company, HEFCW and other bodies.

A16. The final annual report to the governing body and the accountable officer must be shared with HEFCW each year.

Internal audit arrangements in Institutions

A17. Internal audit is a vital element in good corporate governance since it provides governing bodies, audit committees and accountable officers with independent assurance about the adequacy and effectiveness of risk management, control and governance, and VFM.

A18. Consequently each institution must have a suitably resourced internal audit function which must comply with the Public Sector Internal Audit standards. Internal audit terms of reference must make clear that its scope encompasses all the institution's activities (including those not funded by HEFCW), the whole of its risk management, control and governance, and any aspect of VFM delivery.

A19. The internal audit service must produce an annual report which must relate to the financial year and include any significant issues, up to the date of preparing the report, which affect the opinions. It must be addressed to the governing body and the accountable officer and must be considered by the audit committee.

A20. The report must include the internal auditor's opinions on the adequacy and effectiveness of the institution's arrangements for:

a. risk management, control and governance; and
b. economy, efficiency and effectiveness (VFM).

A21. The final annual report to the governing body must be shared with HEFCW each year.

A22. The head of internal audit must have direct access to the institution's accountable officer, the chair of the audit committee and, if necessary, the chair of the governing body.

A23. Whether provided internally or externally, day to day line management and overall reporting arrangements for the internal audit service must be such as to preserve its objectivity by avoiding concentration of responsibility and reporting with any one senior person within the institution. Particular attention must be paid to a reporting line where the head of internal audit reports to those charged with principal responsibility for risk management, financial management or governance processes. In such cases, the institution must design appropriate safeguards to protect the independence and objectivity of the head of internal audit. The institution must formally document that the head of internal audit is free to act in an independent manner and must not be fettered in their scope or reporting.

A24. Where internal audit is provided as an in-house service, there should be periodic consideration of whether this continues to be the appropriate type of provision for the institution.

A25. Where internal audit is provided from an outside source, market testing should be undertaken at least every five years.

A26. Where an institution is assessed by HEFCW as 'high risk', the management action plan for recommendations arising from those internal audits covering core financial work, governance and risk management must be shared with HEFCW as soon as they are agreed, or an explanation forwarded in the event of delay in agreeing the recommendations. The responsibility for sharing this information rests with the institution and not the internal auditor; however, internal auditors should remind the institution of their responsibilities should they become aware that information is not being shared. Under the terms of this memorandum, institutions must not penalise auditors who notify HEFCW of their suspicion of a deliberate delay in the reporting of this information to us, whether or not it be proven to be true.

A27. The governing body must inform HEFCW without delay of the removal or resignation of the internal auditors and of the reasons.

External audit arrangements in Institutions

A28. External audit must provide an opinion to the governing body on whether funds (including public funds) have been applied for the intended purposes and on whether the financial statements provide a true and fair view of the financial results for the year. External audit must also form a view about whether an institution is a going concern. External auditors of Institutions do not have a duty of care to HEFCW.

A29. Institutions may ask external auditors to provide additional services. The audit committee must agree all significant matters with a bearing on the auditor's objectivity and independence. Additional work must not impair the independence of the external audit opinion.

A30. Institutions must disclose separately, by way of a note to the financial statements, the fees paid to their external auditors for other services.

A31. Market testing should be undertaken at least every seven years. One named individual partner in the firm is normally responsible for the institution's audit; (s)he should not hold this position for more than ten consecutive years.

External auditor selection procedures

A32. The criteria required for eligibility as external auditors of higher education institutions are set out in Schedule 8 of the Further and Higher Education Act 1992. Institutions must ensure that their auditors are eligible for appointment as external auditors under the provisions of the Companies Act 1985. Auditors must be registered with one of the appropriate professional bodies.

A33. Selection criteria and procedures for the appointment of external auditors should be determined by the institution in advance of receiving proposals and should be endorsed by the audit committee.

External auditor's report

A34. External auditors must issue a report (or reports, if more than one, covering different stages of the annual audit) to those charged with governance which records accounting issues and control deficiencies arising from the audit. HEFCW would expect any issues around the use of charitable assets for non-charitable purposes to be highlighted in such reports. The institution's management must provide written responses to any recommendations made or issues raised. The report(s), including management response, is one of the annual assurance returns which must be submitted to HEFCW.

A35. The report(s), with management responses, must be made available to the institution's audit committee in time to inform the committee's annual report.

A36. The external auditors must report whether in all material respects:

A37. The financial statements give a true and fair view of the state of the institution's affairs, and of its income and expenditure, recognised gains and losses, and statement of cash flow for the year. They should take into account relevant statutory and other mandatory disclosure and accounting requirements, and HEFCW requirements.

A38. The financial statements have been properly prepared in accordance with UK general accepted accounting principles and the ‘Statement of recommended practice: Accounting for further and higher education’, and relevant legislation.

A39. Funds from whatever source administered by the institution for specific purposes have been properly applied to those purposes and managed in accordance with relevant legislation.

A40. Funds provided by HEFCW have been applied in accordance with the Financial Memorandum and any other terms and conditions attached to them.

A41. The requirements of HEFCW’s accounts direction have been met.

A42. Auditors should have regard to the specific requirements of the financial memorandum such as compliance with those provisions relating to increases in financial commitments thresholds, or other issues of non-compliance, in their management letters or reports, as set out in paragraph A34 above.

A43. External audit should indicate within the management letter whether, or to what extent, it is content to rely on the work of the internal auditors in support of external audit work.

HEFCW access to auditors

A44. HEFCW may wish to communicate with an institution’s external or internal auditors, particularly in connection with a HEFCW Assurance Review and should have unrestricted access to do so. This will normally be arranged through the institution’s accountable officer or representative. HEFCW will exchange letters where necessary with both parties to deal with confidentiality and the terms under which access is given.

Provision of audit services

A45. Internal and external audit services must not be provided by the same firm or provider.

Auditors’ access to information

A46. Internal and external auditors must have unrestricted access to information – including all records, assets, personnel and premises – and be authorised to obtain whatever information and explanations the head of internal audit service or the external auditor considers necessary.

A47. The Auditor General for Wales, head of the Wales Audit Office (WAO), is the external auditor of both the Welsh Assembly Government and HEFCW. S/he has the right to inspect the accounts of any institution that receives HEFCW grant or Welsh Government funding and to carry out value for money investigations.

Restriction on auditors' liability

A48. Where the internal audit service is provided through a contractual arrangement with an external provider, the provider may ask the institution to agree to a restriction in the internal auditors' liability arising from any default by the auditors. Normally such liability should be without limit. However, Institutions may negotiate a restriction in liability so long as the decision is made on an informed basis and the liability remains at such a level as to provide reasonable recourse for the institution. The governing body, through the audit committee, must be specifically notified of any request for a liability restriction.

A49. Institutions must not agree to any restriction in external auditors' liability in respect of the external audit of their annual financial statements.

A50. For other types of work performed by the external auditors, the provider may ask the institution to agree to a restriction in the auditors' liability arising from any default by the auditors. However, as with internal audit services, Institutions may negotiate a restriction in liability if the decision is made on an informed basis and the liability remains at such a level as to provide reasonable recourse to the institution. The governing body, through the audit committee, should be notified of any liability restriction agreed.

Reporting serious weaknesses

A51. A serious weakness is one which has resulted in, or could result in, a significant loss of funds or a significant risk to an institution's property, work, beneficiaries or reputation.

A52. Significant fraud and financial irregularities encompassed by this definition includes those where one or more of the following apply:

a. The sums of money are, or potentially are, in excess of £25,000;
b. The particulars of the fraud or irregularity are novel, unusual or complex; or
c. There is likely to be public interest because of the nature of the fraud or irregularity, or the people involved.

There may be cases of serious weakness that fall outside this definition. In these cases, Institutions can seek advice or clarification from HEFCW. In view of the public interest, Institutions should normally notify the police of suspected or actual fraud. Where the police are not notified, management should advise the institution's audit committee of the reason for not doing so.

A53. Institutions must report serious weaknesses to HEFCW at the time when they are identified. We have also included in HEFCW's annual assurance return a specific declaration that serious weaknesses have been reported appropriately to us.

A54. Serious weaknesses, including those that are suspected but not confirmed, must be reported to the institutions' internal auditors immediately, in order that they can assess the adequacy of the relevant controls and any impact on their opinion of risk management, control and governance processes.

A55. We would welcome a provisional report if it is likely that internal investigations may be time-consuming.

A56. A report of a serious weakness should be sent to the HEFCW chief executive. Institutions should provide as much information as possible to help us to understand the appropriateness of the response and what, if any, further action is planned. In particular we would expect the report to indicate:

a. whether the incident has happened or is suspected;
b. when it occurred and who was involved;
c. the impact of the incident on the institution and any stakeholders;
d. what inquiries have been made and actions taken, including any reports to other regulators or the police ;
e. what controls were in place that apply to the incident, whether they were followed and, if not, why; and
f. whether the members have determined that controls need to be introduced or revised – and if so, how and by when.

A57. In extreme cases, a serious incident report may lead us to invite the Charity Commission to consider opening a formal Inquiry under s46 of the Charities Act 2011.

A58. We appreciate that information provided under the terms of paragraphs A51 to A56 may be of a sensitive nature, and we undertake to treat it with care. As a public authority, HEFCW is subject to the Freedom of Information Act. We will only disclose information to someone outside HEFCW in circumstances where we are legally obliged to do so.

Professional standards

A59. Internal auditors must adhere at all times to the Public Sector Internal Audit standards, or any successor standard. External auditors must adhere at all times to the professional standards of a recognised accrediting accounting body.

A60. Internal and external auditors must not take on any executive management responsibilities, or hold any interest, financial or non-financial, direct or indirect, in the institution (other than the normal employee or contractor relationship, or the funding of any prize, scholarship or academic appointment).

A61. It is generally not acceptable for a firm to provide an opinion as external auditor about the same firm's work as internal auditor, unless the audit partner has changed and the institution has requested and obtained sufficient assurances over the objectivity and independence of the external audit team.

Appointment, removal or resignation of internal and external auditors

A62. Governing bodies are responsible for the appointment and removal of external and internal auditors. Where auditors cease to hold office for any reason, they should provide the governing body with either a statement of any circumstances connected with their removal which they consider should be brought to the governing body's attention, or a statement that there are no such circumstances.

A63. Any such statements as outlined in paragraph A62 must also be sent to HEFCW by the accountable officer.

Annex B: Institutional engagement, support and safeguarding actions

Introduction

B1. This annex sets out how we will engage with and support institutions on matters relating to assurance and risk assessment. It also describes what will happen when, as a result of our assessment, we find there to be significant risks either to the organisation itself or to the collective student or public interest that HEFCW is charged to protect. Our risk assessment methodology is summarised in Table 2.

B2. The principles underlying our institutional engagement and support strategy are that we will:

a. respect the independence of institutions;
b. protect the collective interests of students, the public and the taxpayer;
c. maintain an open dialogue on matters of mutual interest;
d. seek to intervene only when necessary but we will do so vigorously, using the full extent of our powers, when we judge that an institution's management and governors are not effectively addressing risks to public funds and the collective interests of students;
e. be open with the institution in our risk assessment and requirements and, if warranted, on student or public interest grounds, disclose our risk assessments publicly;
f. ensure our involvement is proportionate to the risks;
g. end our enhanced involvement as soon as possible.

B3. In broad terms there are three levels at which HEFCW may engage with institutions:

a. normal contact;
b. focused dialogue (in cases where we are supporting an institution's change or development or where we perceive there to be medium-term risks which, if not addressed, will put the institution at high risk); and/or
c. support strategy (for institutions at high risk or institutions which in HEFCW's view will be at high risk if decisive action is not taken).

Each of these is dealt with in detail below.

Normal contact

B4. As part of our routine engagement with institutions we will want to understand their mission, strategy and operational plans. This will help us to make appropriate responses to the needs of the institution and the higher education sector, and to gain assurance about matters that affect the delivery of our own objectives. There will often be a formal visit by a representative of HEFCW to the institution in each year, sometimes in addition to more frequent and less formal exchange of information and views. It is also part of our normal contact to discuss an institution's assurance returns and give feedback, as part of the annual assurance returns exercise.

Focused dialogue

B5. There are occasions when it is to the advantage of both HEFCW and institutions to explore issues in more detail. For example, an institution may wish to secure our support for particular plans, and we will want to understand how best to provide help to meet its development needs and fit with our wider objectives for the sector. Likewise, we may wish to discuss with an institution whether there are opportunities to improve its performance or work collaboratively with others. There will also be cases where an institution's risks are increasing because of strategic reasons, for instance, changes in student demand or increased competition, its performance or its internal control arrangements. At such times HEFCW will seek to engage to try and ensure that the risks are appropriately addressed.

Support strategy

B6. We have a risk assessment system covering all institutions. This draws on the information we routinely collect through the annual assurance returns exercise and on other information such as research and teaching quality assessments. Sometimes we will ask for more information to clarify our understanding. We classify according to three risk categories:

Low risk	We have no major concerns.
Moderate risk	Some risk and/or accountability issues identified which may raise concerns about long-term sustainability and which HEFCW needs to understand better through further engagement with the institution.
High risk	We have concerns that the institution: • faces threats to the sustainability of its operations, either now or in the medium term; or • has serious problems relating to value for money, propriety or the use of funds for the purpose intended; or • has materially ineffective risk management, control or corporate governance.

B7. Through these annual returns or other contacts with an institution there may be issues that require further discussion. All institutions face business and operating risks. The issue is therefore about managing risk, putting in place systems to identify, mitigate and report on risk. In many cases, as a result of further discussions, we will conclude quickly that there is no need for any further action.

B8. When we have major concerns we need to intervene to protect the collective student interest and the wider public interest. We will firstly discuss these issues with senior management, specifically the accountable officer of an institution. We will seek a common understanding of the issues, clarify what actions have already been taken or are planned, and if necessary then agree an appropriate support strategy. Table 1 sets out the range of possible actions, though sometimes we will agree a different approach with an institution.

B9. A HEFCW director will lead our support activity, but a relevant senior manager will manage the day-to-day engagement. In exceptional cases, our Chief Executive will become involved. The process will be overseen by our Audit and Risk Assurance Committee and individual cases reported to the HEFCW Council. The role of the HEFCW Audit and Risk Assurance Committee is to advise on process, whereas the role of the HEFCW Council is to form a judgement.

B10. When an institution receives an opinion of ‘does not meet UK expectations’ or ‘requires improvement to meet UK expectations’ (or equivalent) in one or more areas within the quality inspectorate’s review, the first stage in addressing the identified issues is led by the quality inspectorate.

B11. When the issues remain unresolved HEFCW will take the lead in a second stage: improvements will be expected and, in exceptional circumstances, sanctions applied.

B12. If an institution does not address its problems to our satisfaction, it might be in the interest of current and prospective students and the public for us to disclose our risk assessment (see paragraph 19 of the main text). In the case of unsatisfactory quality the quality inspectorate may make its concerns public. We expect this to be a rare occurrence, because in our experience institutions generally do take appropriate action.

Table 1: HEFCW support strategy for institutions at 'high risk'

Overall
We may require institutions to make changes as conditions of grant if we feel that risks to our funding and the interests of students and the public are not being addressed. We will only do so after due consideration and consultation, and only on the basis of appropriate advice. Thus it will always be our intention to make only reasonable demands of institutions. The actions that we might take are escalatory, and we will not escalate our actions until we have exhausted prior stages in the engagement and support strategy. However, there may be circumstances where it is necessary to take action more urgently. If institutions do not comply with conditions of grant, then after we have exhausted the elements of the support arrangements, we will consider withdrawing grant in part or in full and making public our risk assessment. We see this as a last resort. In addition to the actions below we will consider any other action that we believe is necessary to support institutions at risk and protect the interests of the public, the taxpayer and the collective interest of students.
At governor and senior manager level we:
a. Will engage with senior management, including the accountable officer. b. Will assess the institution's compliance with the Financial Memorandum and Audit Code of Practice, including the requirement to have effective management and quality assurance arrangements over data supplied to the Higher Education Statistics Agency, the Student Loans Company, HEFCW and other funding bodies. c. Will inform the governing body of any change in risk assessment and seek commitments to improvement. We will notify other public funders, as appropriate, of any at 'high risk' assessment, and exceptionally we will make such an assessment public at any time where we consider it to be in the collective interest of students or the public to do so. d. Will engage directly with the chair of the governing body, the chair of the audit committee or both. e. Will engage with the whole governing body and, if necessary, take steps to ensure improvements are made to governance arrangements. f. May require observer status at governing body or audit committee meetings to enable us to assess whether our specific concerns are properly understood and are being addressed. This could be for individual meetings or over a period of time. Our observer will always be a senior HEFCW officer.

g. May request the appointment of interim managers, where we consider the institution has insufficient capacity to address its risks properly.

Regarding information and audit we may:

a. Require or commission additional information, reports and data relating to the risks.

b. Require that information and reports be audited.

c. Request changes to internal or external audit arrangements.

d. Undertake or commission audit investigations.

Regarding planning and strategy we may:

a. Require or commission a recovery or action plan.

b. Discuss possible changes to strategic plans and market positioning.

c. Explore collaborative opportunities with other institutions.

Regarding funding we may:

a. Re-profile grant to assist an institution that has a cash flow difficulty.

b. Consider the use or withdrawal of special funding.

c. Attach special conditions to grant.

d. Reduce or withdraw funding.

e. Use our own estimates of data where we are not satisfied that information from the institution can be relied on.

As the risk significance decreases we will:

a. Inform the institution (and others who may have been notified of our risk assessment) about changes in our risk assessment.

b. Remove special conditions of grant and other requirements.

Table 2: HEFCW institutional risk system

Introduction

HEFCW's management of risk obliges it to assess the risk to the collective interests of students and to public funds or the activities provided from those funds posed by institutions. We maintain an assessment of each institution, which focuses on the broad range of operations undertaken by an institution, including financial sustainability, governance, internal control, risk management, management of the student interest, strategic planning, research undertakings and estates procedures.

Sources of information

We have a number of mechanisms and sources for enabling us to assess risk, including:

a. **The annual assurance returns process** in which institutions submit a range of information and returns relating to financial performance and forecasts, student numbers, the use of funds and risk management, control and governance and sustainability assessments.

b. **Our own institutional audit processes**, including data audits and cyclical assurance visits.

c. **The continuing dialogue that we have with each institution** about their changing priorities and strategies, and their reporting of material events.

d. **Information from other sources** including public bodies that might potentially impact on our concerns with sustainability or the delivery of provision, among other issues. For example, quality assurance judgements, any implications under our policy for addressing unsatisfactory quality (HEFCW Circular W12/16HE) or National Student Survey outcomes.

e. **Information given to us through public interest disclosures** but only when substantiated in dialogue between us and the institutions concerned.

f. **Other sources** of publicly available data.

Our risk assessment

Financial sustainability

Our assessment of the risk to **financial sustainability** is based on historical (two years) and forecast (four years) financial information supported by a narrative commentary. We perform assessments throughout the year on an ongoing basis and as necessary. We try to look beyond the snapshot position which the indicators represent to an institution's trends and how its performance compares with the sector and its peers. We feedback key parts of our financial assessment to each institution in our annual risk letter.

Risk management, control and governance

Our assessment of institutional **risk management, control and governance** is concerned with ensuring that public funds are being administered by well-run institutions and that the collective interests of students are not at risk. In addition to information on finances and the use of funds, our own data and assurance reviews enable us to corroborate institutional assurances. Overall, the regular sources of information for this risk assessment include:

a. the annual assurance returns and the annual report of the institutions' Audit Committee;

b. the outputs of the institution's internal and external auditors;

c. information from other public bodies;

d. Meetings with key staff members;

e. HEFCW's own audit and assurance work.

Protection of the exchequer interest

Our assessment of risk relating to the **exchequer interest** is concerned with all exchequer funds being used for the purposes intended by Welsh Government, fraud and impropriety being prevented or dealt with effectively, and value for money (economy, efficiency and effectiveness) being pursued in the application of those funds. We do not normally audit these matters directly ourselves but derive information for our risk assessment from these sources:

a. The annual submission by institutions of the reports of the governing body, audit committee, accountable officer and internal and external auditor.

b. Information and evidence from institutions themselves and other organisations and sources that indicate any material misuse of funds. From time to time we may receive information through these routes relating to any aspects of an institution's operations or provision that could cause us to reconsider our risk assessment. We would make such a judgement on a case-by-case basis having consulted with the institution concerned.

c. The analysis of financial sustainability outlined above.

d. The annual return from each institution outlining the exchequer interest held in the institution's assets.

Risk notification

The work undertaken by HEFCW, augmented by information from other sources, enables us to make an annual risk assessment within our **Institutional Risk Review** process. For the majority of institutions this results in a letter from the HEFCW Chief Executive to the accountable officer, normally by the end of July advising of HEFCW's Council's judgement of risk. We ask that all our risk letters be communicated to the governing body. For some institutions a second risk letter may be issued in the autumn following assessment of their financial forecast submissions.

The HEFCW assessment letter will be qualified by comments alerting the institution to concerns we have that need to be addressed and which, in some cases, if not addressed, may lead to a worsening of the institution's risk status. The comments can include a range of issues, including financial performance, future sustainability, strategic challenges and issues of non-compliance with assurance requirements. Some of these matters are more serious than others. We will endeavour in such cases to explain the issues fully, and we expect that our concerns will be considered and dealt with by the institution.

In exceptional cases, HEFCW's Council's judgment will be that an institution is at 'high risk'. This assessment is most likely to be made for financial reasons. Whatever the reason for the judgment, the process of making and communicating the judgment is very thorough and will be communicated to the institution concerned and the support strategy, as outlined at paragraphs B6 to B12 and Table 1: HEFCW support strategy for institutions at 'high risk' will come into play.

Annex C: Approval of increases in a financial commitment threshold

Introduction

C1. An institution must get prior written approval from us to increase its financial commitments threshold, before it agrees to any new financial commitment meeting either of the following criteria:

a. Where total financial commitments (long-term and short-term) exceed five times its average earnings before interest tax depreciation and amortisation (EBITDA); or

b. Where it is assessed by us as being at high risk.

Definitions

Average EBITDA	The average is based on six years' EBITDA (as defined by the British Universities Finance Directors Group – see Earnings Before Interest, Taxation, Depreciation and Amortisation (EBITDA): Clarifying the definition for the HE sector), as provided in the July financial forecasts. Note that this method of calculation may be subject to review given the introduction of the new SORP.
Financial commitment	Financial commitments should be defined as those that are on balance sheet, in accordance with FRS 102. Financial commitments include: a. all financial commitments, whether self-financing or not, drawn or undrawn b. finance leases c. Private Finance Initiative arrangements which are accounted for as loans or finance leases in accordance with the requirements of Statement of Standard Accounting Practice 21 or Financial Reporting Standard 5 d. repayable grants. In calculating the threshold financial commitments pension fund liabilities and all provisions should be excluded. Where existing financial commitments exceed institutions' EBITDA-based threshold at 31 July 2014, HEFCW will automatically provide approval for the higher financial commitment threshold, though any changes to financial commitments after this date will require approval. As part of this transition, we may need to engage with some institutions about their ability to service their financial commitments. Where a university or college exceeds its financial commitments threshold in the future because of a decline in its EBITDA, it need not apply for a higher threshold, but the institution must inform us of this fact. Whilst an application for a higher threshold will not be required, the decline in EBITDA it is likely to lead to engagement with that institution about its ability to service its financial commitments.

Our response

C2. We take a risk-based approach to each institution's application for a higher financial commitments threshold. This approach will determine whether the application is considered by the HEFCW Chief Executive or by the HEFCW Council. We therefore expect institutions to include their financial commitments plans as far as possible in their annual financial forecasts submissions, to enable HEFCW to review them at an early stage. Institutions are also advised to discuss their plans informally with HEFCW at an early stage. Where HEFCW approves the application for a higher financial commitments threshold, we will write to the institution setting out the revised threshold. As part of this approval we may set out additional conditions which will need to be adhered to.

Information required

C3. All applications for a higher financial commitments threshold must be signed by the accountable officer. In signing the application, the accountable officer is confirming that the institution's governing body has reviewed the terms and conditions of the financial commitment providing assurance over value for money, and has reviewed affordability and compliance with banking covenants under different scenarios (meaning that the proposed financial commitments have been stress tested). In addition we ask for confirmation that the student interest has been considered in any application.

C4. We set out in 'Table 3: Information required by HEFCW to consider a request to increase a financial commitments threshold' the information we require to consider a request for an increase in the financial commitments threshold. This addresses the issues on which we would expect the institution's own governing body to seek assurance before approving additional financial commitments. The main focus is on affordability and risk, not necessarily on the individual project.

Table 3: Information required by HEFCW to consider a request to increase a financial commitments threshold

Financial commitments

1. There should be a reasonable case for the new investment.

Information required:

a. A brief description of the new investment.

b. An explanation of how it broadly fits with the institution's mission and strategic priorities.

c. Confirmation that the institution has considered appropriate guidance on appraising investment decisions.

d. A description of how the student interest will be taken into account.

2. The new financial commitments or refinancing arrangement (where these will result in an increase to financial commitments threshold) should be consistent with the institution's financial strategy and represent good value for money.

Information required:

a. An explanation of why additional finance or refinancing is necessary and how this fits with the financial strategy.

b. The forms of finance considered and the selection process and criteria.

c. The net present value for each financing option, and a brief explanation of why the chosen method was selected.

3. Details of the new financial commitments.

Information required:

a. Details of the chosen option, including name of lender, value of new financial commitment, repayment period, basis of repayment and financial covenants.

b. Terms and conditions of the financing (such as a copy of the offer letter) and an evaluation of the risks and uncertainties.

4. The new investment and financial commitments must be affordable.

Information required:

An update of the latest financial forecasts, to include the impact of the new investment and financial commitments, and demonstration that they are affordable. This update must include any other material changes in the institution's financial prospects, including guarantees to third parties.

5. The institution's governing body must have made an informed decision about the new investment and financial commitments.

Information required:

a. Details of when the governing body approved the new investment and financial commitments, and a minute of the decision reached.

b. A summary of the information the governing body received in reaching its decision.

c. Confirmation that:

    i. No key information or opinions relating to the proposed commitment or financial circumstances have been withheld from the governing body and the governing body has been supplied with all necessary information required to allow reasonable individuals to come to a reasonable, balanced conclusion;
    ii. The governing body confirms that paragraph 103 of the financial memorandum has been complied with;
    iii. That, following receipt of this information, the governing body has approved the borrowing as presented to us.

6. Details of the new threshold.

Information required:

a. Details of existing financial commitments (including the lender, terms, interest rate and financial covenants) and of the new financial commitments.

b. A calculation of the new threshold required.

Annex D: Glossary

In this financial memorandum and code of practice, the following definitions apply:

Academic year	The 12 months from 1 August to 31 July.
Accounting period	The period covered by the institution's audited financial statements, usually the 12 months from 1 August to 31 July.
ASSUR	Annual Sustainability Assurance Report, developed by the FSSG.
the Code	HEFCW's Audit Code of Practice.
Council	The Higher Education Funding Council for Wales (HEFCW). See also 'predecessor Council'.
CUC	Committee of University Chairs.
Accountable officer	Head of an institution responsible and accountable to HEFCW (and ultimately to the National Assembly for Wales) for ensuring that the institution uses HEFCW funds in ways that are consistent with the purposes for which those funds were given, and complies with the conditions attached to them. These include the conditions set out in the Further and Higher Education Act 1992 and in this financial memorandum.
EBITDA	Earnings before interest, tax depreciation and amortisation.
Exchequer funds	Government grant or grant-in-aid. In the context of this Memorandum, the definition of such funds encompasses grant or grant-in-aid paid by HEFCW and its predecessor funding bodies, Welsh Government, Local Authorities, the Research Councils, and the Welsh Office to former voluntary and direct grant colleges.
Exchequer interest	The contingent interest in the institution held by HEFCW, arising in accordance with HEFCW guidance from the use of exchequer funds in the form of specific capital funds. Such interest may create an obligation upon the institution to repay grant, or recognise a liability, on the occurrence of certain exceptional circumstances.
FEI	Further education institution.
FRS	Financial Reporting Standard.
FSSG	Financial Sustainability Strategy Group

	(http://www.hefce.ac.uk/whatwedo/lgm/finsustain/fssg/).
GAAP	Generally accepted accounting principles.
Governing body	The university council, board of governors or other body ultimately responsible for the management and administration of the institution's revenue and property, and the conduct of its affairs.
Group	As defined under s. 1159(1) of the Companies Act 2006. It is therefore not a reference to a public benefit entity group.
HEFCW	Higher Education Funding Council for Wales.
HEI	Higher education institution.
HESA	Higher Education Statistics Agency.
Higher Education Code of Governance	The Code of Governance published by the Committee of University Chairs (www.universitychairs.ac.uk)
institution	An HEI or FEI
the institution	(name of institution).
JANET	High-speed computer network supported by all the four higher and further education funding bodies, which links universities and colleges in the UK. SuperJANET is the enhanced network.
Minister	The Minister for Education and Skills.
Month	Calendar month.
SORP	Statement of Recommended Practice: Accounting for Further and Higher Education (www.fehesorp.ac.uk)
WAO	Wales Audit Office.
Predecessor Council	the Universities Funding Council, including responsibilities inherited from the University Grants Committee under the Education Reform Act 1988;
providing body	the providing body of a former voluntary college directly funded by the Welsh Office;
QAA	Quality Assurance Agency for Higher Education.

VFM	Value for money.
1992 Act	The Further and Higher Education Act 1992.

References to the **financial position, financial statements, financial commitments** or **borrowing of the institution** mean the consolidated financial position, financial statements, financial commitments or borrowing of the institution and its subsidiary undertakings, as defined in the Companies Act 1985 and revised by the Companies Act 1989, and in accordance with generally accepted accounting principles.