Independent review of college financial oversight

Dame Mary Ney DBE

October 2019

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Foreword

Colleges have a vital role to play in providing high quality education and training opportunities for those over 16 years. They serve some of the most vulnerable groups in society including those with special educational needs and those who have previously struggled in the school system, as well as ensuring the workforce has the skills needed for the local economy to prosper. There has been concern at the degree of financial instability within the sector. This review makes a number of recommendations with a view to improving the support individual colleges and the sector receive, and enhancing oversight and intervention arrangements. The Education and Skills Funding Agency (ESFA) and the Department for Education (DfE) have developed a range of tools for dealing with financial failure. However, this review finds that these are unlikely to achieve a step-change in the number of colleges with serious financial issues without a more proactive and preventative approach. This requires the sector to be valued and individual institutions to be nurtured. There should be a new relationship with individual colleges which this review proposes.

In undertaking this review I am grateful for the assistance and co-operation of staff in DfE, ESFA and the Further Education Commissioner’s office. I am especially grateful to all those from the college sector and wider who gave their time willingly to contribute their expertise and perspective on the issues.

Finally, I received excellent support from Catherine Hayes from the Higher and Further Education Directorate, DfE who acted as secretary to the review and so willingly shared her knowledge and expertise with me, assisted in examining the information collected and provided a sounding board in developing recommendations.

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1. Scope of the review

1.1 The terms of reference for the review are:
'In light of the financial difficulties at Hadlow and West Kent & Ashford Colleges, to review the way Government monitored and exercised its oversight of those colleges' finances and financial management, and their effectiveness in practice, including the work of the Education and Skills Funding Agency (ESFA) and the Further Education (FE) Commissioner's team; and to recommend changes that would reduce the risk of such problems recurring, taking account of colleges' independence and the need to minimise regulatory burden.'

1.2 It should be noted that this is a review and not an investigation of what occurred at Hadlow and West Kent & Ashford Colleges which is the subject of a separate investigation being undertaken by the ESFA. This review seeks to discuss and make recommendations for improvements to the current oversight arrangements. These recommendations are made on the basis of deliverability within the bounds of the current legal framework but do include potential use of existing powers more fully. However, Chapter 12 refers to wider possibilities should there be an appetite for more long term radical change in this regard.

1.3 Since the commencement of this review proposals have been announced by the DfE to look at the potential role of Ofsted in oversight of the financial standing of colleges, and the National Audit Office has announced its intent to undertake a review for publication in 2020 as a follow up to its 2015 report 'Overseeing financial sustainability in the further education sector'. In addition, the review has learned that DfE and ESFA are reviewing policy and guidance on leadership and governance for colleges, and the wider policy framework for the sector.

2. Approach to the review

2.1 The review commenced on 30 August 2019 and was required to be completed by 31 October 2019. The approach has been to review key documents and websites; and to engage with a variety of stakeholders from the college sector, the department and its agencies in order to obtain an overview of both issues and practice. Whilst the focus has been on financial oversight, wider strategic issues of governance and assurance have needed to be explored. It is considered that sufficient information and views have been gathered to enable recommendations to be made to improve oversight.

2.2 Attached at Appendix A is the list of documents reviewed. In addition to a meeting with the Minister, Lord Agnew, a number of discussions have been held:

- Meeting with a group of college chairs;
- Meeting with a group of college governance professionals;
- Telephone conversations with 2 external auditors;
- Meetings or telephone conversations with 15 college leaders (including current and former Principals/CEs, Directors of Finance, governors and governance professionals)
- A site visit to a college;
- Meetings or telephone conversations with 16 officials and office holders working for:
    - ESFA
    - DfE
    - The FE Commissioner
    - The Office for Students
    - Ofsted
    - HMT
- Meetings or telephone conversations were also held with:
    - Association of Colleges
    - Sixth Form College Association
    - National Audit Office
    - Education and Training Foundation

A number of written submissions were also received and reviewed.

3. The legal status of colleges

3.1 Colleges are independent bodies and are not subject to statutory regulation (although they are subject to a wide variety of sources of regulation, only a small proportion derives directly from statute). Sixth-form college and further education corporations (established under the Further and Higher Education Act 1992) are entities that operate one or more colleges. They have the legal status of statutory corporations and exempt charities. A college is a charitable activity undertaken by its corporation; it does not have a separate legal entity distinct from that of its corporation. Members of the corporation form the governing body.

3.2 The main responsibilities of the corporation are set out within their Articles of Government (which must meet the requirements of Schedule 4 of the Further and Higher Education Act (FHEA) 1992). The Articles must include the effective and efficient use of resources, the solvency of the institution and the corporation, and the safeguarding of their assets. The Articles must prohibit the corporation from making changes to the Articles that would result in the body ceasing to be a charity. Further responsibilities are set out within:

- other legislation, including the Apprenticeships, Skills, Children and Learning Act 2009
- charity law (as applicable to exempt charities)
- college accounts direction
- specific terms and conditions from other sources of funding.

These complement the general duties of governors as charity trustees. Under sections 22 and 33L of the 1992 of the FHEA 1992 corporations may change their Articles, although any change is subject to the limitations set out in the Act and charity law.

3.3 Under the charity legal framework, the Secretary of State for Education is the principal regulator of FE corporations and sixth-form college corporations having a statutory duty to promote compliance with charity law.

4. The Current Framework

4.1 Despite their independence and the lack of statutory regulation, colleges receive a large amount of public money through grant funding agreements and contracts with the ESFA. These funding agreements set out in detail the requirements placed on, and responsibilities of corporations and are the key mechanism for providing assurance on the good stewardship and use of public resources. The agreements also provide a mechanism through which the ESFA can exercise the Secretary of State's role as principal regulator of FE and Sixth Form college corporations.

4.2 To help colleges operate effectively DfE provides information for college leaders. This includes:

- a governance guide;[1]
- a handbook on financial planning;[2]
- guidance on preparing their annual report and financial statements 'accounts';3
- an audit code of practice;[4] and
- guidance on insolvency.[5]

The Department also provides some support for the development of college leaders via the Education and Training Foundation, as well as via the National Leaders of Governance and the National Leaders of Further Education schemes run by the FE Commissioner.

4.3 In April 2019, the government published 'College Oversight: Support and Intervention'[6], which outlines the 4 categories of support and intervention:

- prevention,
- early intervention,
- formal intervention, and
- restructure or exit

Currently the financial oversight of colleges is managed by the ESFA's FE Territorial Teams. The Provider Market Oversight team within the ESFA

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[1] https://www.gov.uk/guidance/fe-governance
[2] https://www.gov.uk/government/publications/financial-planning-handbook
[3] https.://www.gov.uk/government/publications/college-accounts-direction
[4] https://www.gov.uk/government/publications/post-16-audit-code-of-practice
[5] https://www.gov.uk/government/publications/further-education-bodies-insolvency-guidance
[6] https://www.gov.uk/government/publications/college-oversight-support-and-intervention

provides expert financial analysis and assurance oversight, investigations and support, including in cases of college restructuring.

4.4 The work of the ESFA is complemented by that of the FE Commissioner and his team, who are appointed by the Secretary of State to make recommendations to colleges in intervention on actions to improve. The ‘College Oversight, Support and Intervention’ document sets out the approach that the FE Commissioner may take.

4.5 Ofsted inspects and reports on the leadership and management; the quality of education; personal development; and behaviour and attitudes. Ofsted have no current specific role in financial oversight.

4.6 The National Audit Office has no direct role in the oversight of the financial performance of colleges.

5. Current Financial Health of the FE college sector

5.1 As at May 2019, there were 247 FE colleges and Sixth Form Colleges. In April 2019 123 colleges (45%) were in financial intervention categories, with 32 in formal intervention. Of this group 21 have been in intervention for more than 20 months including 4 in intervention for more than 5 years. As at April 2019, the FE Commissioner Team held 50 live cases. In summer 2019, the first 2 colleges were put into administration under the new college insolvency regime. Whilst there has been a downward trend in the total number of colleges in intervention in recent years, the overall profile of fragility of financial standing of colleges remains alarming. The tendency for financial instability is far less prevalent in Sixth Form Colleges and this is invariably attributed to the greater clarity of their mission and role, certainty of learner numbers and less complex funding streams.

5.2 In contrast to the performance on financial standing, Ofsted inspects around 50 colleges each year and outcomes indicate that around 80% of colleges achieve outstanding or good ratings.[7]

5.3 Whilst in any sector there will from time to time be incidents of irregularity and fraud, in the main the ESFA's own analysis of the circumstances around failures in financial health point to the following financial factors:

- Complexity in estimating learner numbers in a competitive market and tendency for over optimism of forecasts
    - which leads to cash flow difficulties
    - which in turn leads to the need for bank loans.
- Complexity of funding streams
- Financial restraint over the past decade
- Cost of estates and lack of access to capital funds
- Potential insufficiency of skilled leadership at executive and board level to meet the challenge

The review found widespread agreement that these are the key causes of instability.

[7] Figure 5, https://www.gov.uk/government/publications/further-education-and-skills-inspections-and-outcomes-as-at-28-february-2019/further-education-and-skills-inspections-and-outcomes-as-at-28-february-2019-main-findings

6. Achieving quality outcomes, good financial management and sustainability

6.1 Colleges have a critical role in delivering high quality education and training for those aged 16+. They should be inspirational places to learn, preparing students with valuable skills for the workplace. Importantly colleges can provide an essential pathway to skills for young people who have struggled and been failed by other parts of the education system, those with special educational needs and those returning to education and reskilling. Colleges are independent statutory bodies, but most of their income comes from the government via the ESFA (and increasingly Mayoral Combined Authorities and the Greater London Authority).

6.2 Skills provision has been a priority for successive governments. Over the last 10 years, governments have reformed both academic and technical education for students who are 16+. A level reform, apprenticeship reforms and the introduction of T levels have all focussed on increasing the rigour, quality and relevance of the curriculum. These reforms have broadly been “provider blind” meaning that government has not differentiated between colleges, schools, higher education institutions and independent training providers in its reform programmes. More recently government has announced increases in funding of £300m for 2020/21 and has emphasised the important role that FE Colleges must play in providing the key infrastructure for delivering the skills the workforce needs.

6.3 To support delivery of programmes by colleges the government has pursued a number of initiatives to drive quality and financial resilience in the college sector including:

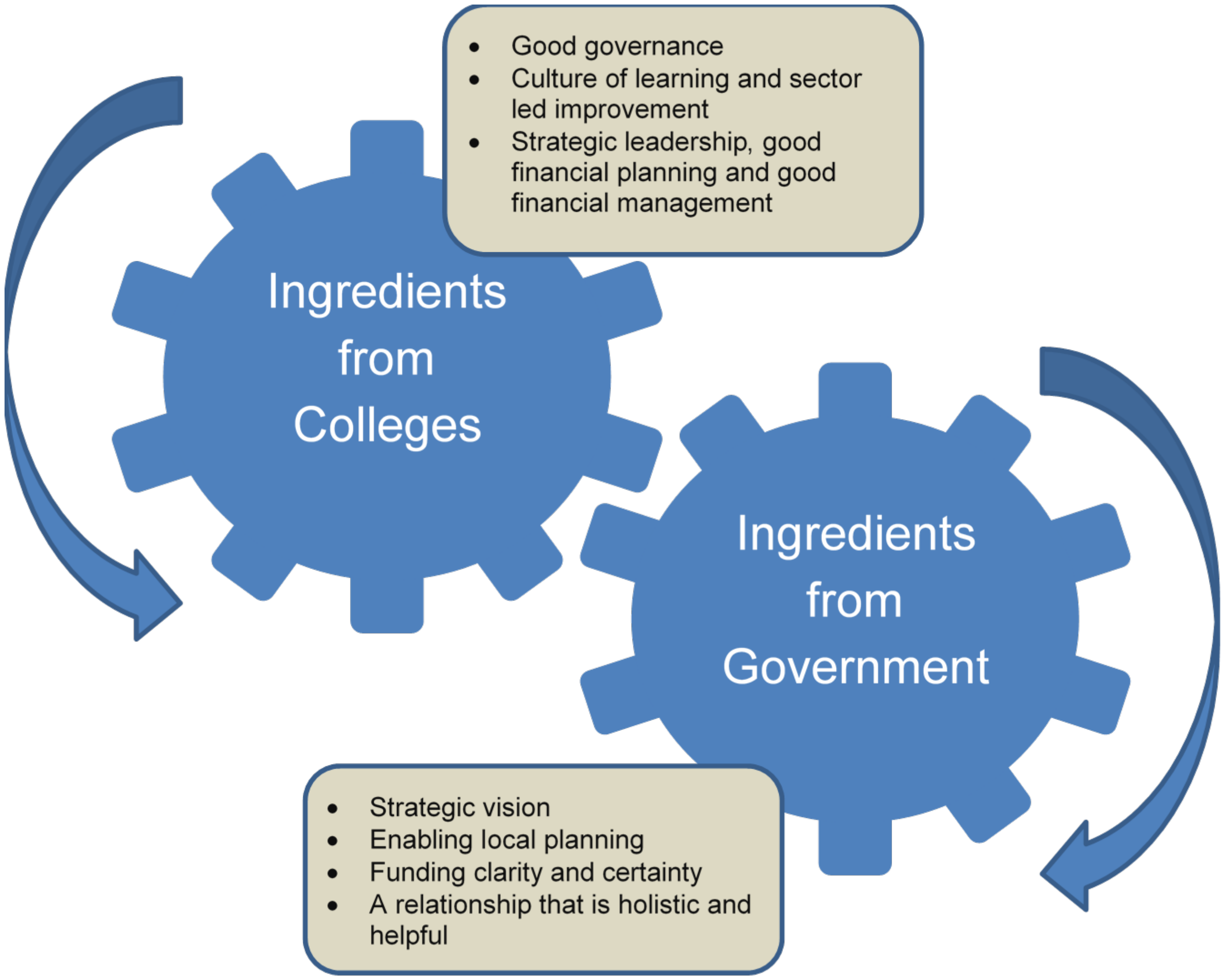
- The FE Commissioner role was created in 2013 to provide independent advice to Ministers on the capacity of leadership and governance in colleges that have, or are at risk of, serious weakness in terms of quality or financial health.
- The area review programme from 2015 to 2019 was delivered to provide an opportunity for institutions and localities to restructure their provision to drive efficiency and meet local need. Not all providers of post-16 education were obliged to participate. This programme resulted in over 57 mergers, of which 46 received financial support through the government’s Restructuring Facility.
- The Strategic College Improvement Fund, launched in 2017 helped improve the quality of provision in 80 colleges

- The FE Commissioner's National Leaders of Further Education and National Leaders of Governance have been appointed to provide mentoring and peer support to colleges in the sector.
- Funding has been provided to the Education and Training Foundation to provide learning and development programmes for the sector at board and senior executive level.
- The government has issued and refreshed guidance (see 4.2 above)
- The ESFA has strengthened its capacity for financial analysis and assurance and to predict colleges which may face difficulty and is currently reviewing the financial information it monitors to place greater focus on cash flow and forward financial planning.
- In April 2019, the government published 'College Oversight: Support and Intervention' which sets out the government's approach to financial oversight including the role of the ESFA and the FE Commissioner and the support available for colleges in the various stages of intervention.

6.4 However, the financial resilience of colleges, remains a continuing cause for significant concern. Colleges have a crucial role to play in ensuring that the workforce, particularly young people, have the skills they need to achieve their potential and to deliver economic growth in line with Local Industrial Strategies. Colleges must deliver high quality outcomes for learners and a context of such widespread financial instability will inevitably distract from that task. Whilst the tools in the current oversight regime have a vital role to play for those experiencing serious financial problems, it seems unlikely that the current measures alone can achieve a speedy step change in financial resilience which is so problematic in the sector. A more radical approach is required which this report puts forward.

There needs to be a shift in emphasis to promoting the strategic role of the sector and, crucially, to nurturing all institutions on an individual basis. There should be a shift away from a focus solely on silo programmes and towards a wider concept of support for institutions thus preventing problems arising.

6.5 The starting point to achieving this shift is the identification of the ingredients for a successful skills sector and for thriving institutions from the perspective of both government and the colleges.



6.6 The **ingredients which government need to provide** are:

- **Strategic Vision**

Government needs to set a more explicit strategic vision for colleges. It should outline priorities for their role and the expectation of their contribution to the skills base in their localities aligned to the skills employers need, their local economy, and Local Industrial Strategy. It should also ensure it includes the role of the sector in delivering for people with special educational needs, and providing for those who have struggled to achieve in the school system. The vision needs to celebrate the proactive contribution that colleges can bring to their localities and fit coherently with the concept of national specialist colleges. It should be forward looking and enable colleges to develop their own college forward plan for at least a three year period.

- **Enabling Locality Planning**

To enable colleges to improve their own curriculum and financial planning, there needs to be robust “capacity and curriculum planning” at a local geographical level in the context of the national strategy that has been set by government. Whilst the area review programme attempted to address some of these issues, it was a one-off piece of work and was focused mostly on colleges. Similarly the FE Commissioner Local Provision reviews are one off exercises mainly focussed on those in formal intervention. Effective “capacity and curriculum” planning needs to be an ongoing collaborative activity which is annually refreshed and collectively owned at local level by all the key players including Local Enterprise Partnerships (LEPs), Mayoral Combined Authorities who are accountable for developing and driving the Local Industrial Strategy, colleges, schools, regional schools commissioners, higher education providers, local authorities and local businesses. This is a more challenging task in places with a wide variety of types of institution providing a 16 to 19 curriculum but in such places it is essential to achieving stability, improvement in financial planning and value for money. The review heard of various examples of local collaboration which demonstrate the potential benefits of local planning and engagement. In addition colleges and schools already have a duty to co-operate with the local authority to develop and review the local offer as part of the Government’s SEND code of practice.[8] Establishing commitment to this wider range of “capacity and curriculum” planning at a local geographical level will need the Government to prescribe the expectations on how this should be delivered, to incentivise compliance and if necessary prescribe a duty to collaborate and implement. It may be that this could be lead and delivered via local authorities in their “place shaping/ leadership of place” role, or via the newly set up LEP Skills Advisory Panels building on their existing role. Further comment is made on this at chapter 7.

- **Funding clarity and certainty**

There is widespread acknowledgement that the system of funding for colleges is complex with a variety of funding streams and conditions. The review found that there are currently 10 different categories of funding which may have up to 10 different subsidiary categories with varying payment arrangements. This complexity is a function of the layering of many policy initiatives over the years which have served to drive complexity into the system. This leads to planning uncertainties, burdensome data management and turbulence in cash flow. The ability for colleges to improve their financial

[8] Section 4.14 – 4.17 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/398815/SEND_Code_of_Practice_January_2015.pdf

planning would be enhanced by government moving to a three year funding settlement (as is experienced in other sectors) and reviewing the current programme approach to funding to achieve a more integrated and streamlined offer. Whilst there may be some element of variation each year and between programmes, such a move would assist colleges and the sector in ”capacity and curriculum” planning at a local geographical level, in developing a three year financial strategy, improving their income forecasts and would help address some of the issues of cash flow.

- **A Relationship that is holistic and helpful**

The nature of the current regime, the lack of a sector-wide strategy and the capacity and resources of the ESFA have resulted in a relationship between government and the sector which is largely focused on financial failure and which inhibits colleges being transparent with government. The relationship between government and colleges is largely contractual, focused on the funding agreements and therefore government does not have sufficient line of sight on the wider issues colleges face and early warning signs of difficulty. As a consequence, the sector lacks confidence in seeking support and advice at an early stage. In particular, the relationship does not have at its heart:

- the scope for sufficient ownership of the development of the sector and the promotion of excellence as a whole;
- the quality of learner outcomes, partnership with employers and the contribution to local economic growth;
- promoting the need for colleges to deliver high quality provision for students with special education needs and for those who have previously struggled to reach their potential;
- nor does it have the capacity to nurture improvement and the prevention of failure in individual colleges.

It is a regime which does not position itself as nurturing individual organisations and therefore has little to offer in terms of prevention and support. It therefore inhibits colleges in seeking help at an early enough stage.

On an individual basis, the review found that many colleges in intervention expressed a positive view of the relationship and support they received from the ESFA teams, whilst others expressed some frustration at the inflexibility of the regime and the perceived passive approach of some officials.

Whilst a shift in the role of government may have resource implications in terms of capacity and the skills set that it needs to deploy initially, in the longer term a more proactive and supportive relationship should lead to fewer cases of intervention and lower costs of emergency support, when combined with other measures recommended in this review.

Government needs to identify how it can more wholeheartedly and proactively support improvement at sector and individual college level. The government's Strategic College Improvement Fund was well received and valued and consideration needs to be given to how this might be built upon as part of a new relationship.

6.7 The **ingredients which colleges need to contribute** to achieving a successful sector and thriving institutions are:

- **Good governance**

Colleges must demonstrate a stronger commitment to good governance and the stewardship of public funds. Although they are independent bodies they need to embrace the principles of governance, stewardship and transparency which should be prevalent in organisations which are responsible for public funds. Whilst many do strive to meet high standards there is some scope for improvement to move the whole sector forward in this regard in particular in ensuring transparency and in supporting governors (boards and audit committees) to challenge and scrutinise the executive. Good governance needs to be valued by college leaders and appropriate resources provided to ensure the quality of governance practice in the organisation is robust.

- **Culture of learning and sector led improvement**

The concept of a sector which takes ownership for promoting a learning culture and supporting self-improvement could be more developed. Whilst the context of competition is sometimes cited as a bar to collaboration, if the sector wishes to enjoy the confidence of all stakeholders it needs to improve its focus on achieving excellence and learning the lessons from past failures which requires a degree of frankness. There is scope for this, and this review has seen a strong appetite to develop more tools and improve existing networks to support improvement e.g. peer review, describing 'good', sharing good practice, improvement partner models etc.

- **Strategic leadership and good financial planning and management**

The quality of college leadership and financial planning is essential to confidence in quality outcomes for learners, good governance and robust stewardship of public funds. If government is to shift the nature of its relationship with the sector, college leaders need to respond with a commitment to developing robust local plans and to collaboration with other providers. This needs to contribute to stronger three year forward financial planning and monitoring of financial performance at executive and board level. Colleges need to ensure robust estate management strategies and a commitment to ongoing efficiency programmes, including to deliver value for money in procurement and to sharing learning in this regard.

6.8 The ESFA and the FE Commissioner have a wide range of tools for oversight and intervention in the financial position of colleges and have shown a commitment to reviewing and updating these. However, tackling the high and persistent levels of financial instability is unlikely to be achieved through current measures alone which are essentially responsive to failure.

Recommendation 1

For the sector to succeed, institutions to thrive, and learners to achieve excellent outcomes it is recommended that attention needs to shift to the ingredients outlined above.

The recommendations which follow below emanate from this premise.

7. National Strategic Vision and Locality Planning

7.1 In line with the comments in chapter 6 there is a need to clarify the strategic role and priorities which government wishes colleges to address. The current approach provides a disparate range of policies, statements of priority and funding streams, but no overarching strategy for the sector. It will be important for this to include the vital role of colleges in providing for those who have previously struggled to achieve as well as those with special educational needs in line with the governments aspirations for SEND provision, as well as working with local employers to deliver the skills they need for the local economy to thrive.

7.2 Government should set the expectation for “capacity and curriculum planning” at a local geographical level to be undertaken in conjunction with local stakeholders in the context of the national strategy that has been set by government. It will be important for colleges to engage a wide range of local stakeholders in this task and government has a key role in ensuring collaboration from other education and training institutions, regional schools commissioners, local authorities, Mayoral combined authorities/ the GLA, LEPs and local businesses. Developing this approach can draw on examples of good practice which some areas are already pursuing, as well as building on the experience and role of the new Skills Advisory Panels of LEPs or using the place shaping leadership role of local government or mayoral combined authorities to enable this. It is suggested that various approaches might be piloted in the first instance. In the longer term government may need to consider whether a duty to collaborate in locality place planning and delivery is warranted. Where locality capacity planning leads to the need for reconfiguration of the provider landscape, assistance should be available on a similar basis to that provided in circumstances of intervention.

7.3 For this strategy to succeed the government must build a new relationship with the sector. This relationship should support the delivery of government priorities, and nurture individual institutions enabling them to deliver excellent outcomes for students across the whole college sector (outlined further at chapter 11).

Recommendation 2

It is recommended that government sets out a strategic vision for the further education college sector and creates effective mechanisms, and potentially a duty, for “capacity and curriculum” planning at a local geographical level and delivery that includes all post 16 provision.

8. Governance

8.1 Thriving institutions which deliver quality outcomes for their learners and their place, and which are financially sustainable require strong and skilled leadership at both board and executive level as well as robust governance arrangements. Any organisation, regardless of its legal status, which is responsible for the stewardship of large amounts of public funds has a particular responsibility to provide high standards of transparency in its governance arrangements.

8.2 DfE have produced a governance guide[9] (updated February 2019) which sets out the legal and regulatory requirements that apply to FE and Sixth Form Colleges. This is a comprehensive document that provides clarity on the wide range of arrangements that colleges must and should have in place including:

- the duty of boards and board members, board composition and recruitment;
- the conduct of governors, conflict of interests;
- the role of the clerk and governance professionals;
- stewardship of resources, financial, risk and estate management; and
- Safeguarding and Prevent duties.

8.3 Aspects of the guidance are mandatory such as the duty of boards, the requirement for an audit committee and the safeguarding of assets. These reflect legislative provisions. However the guidance is permissive about the way in which colleges implement many aspects of governance including some measures which lie at the heart of good stewardship and transparency of public funds for example, adoption of the Nolan Principles, codes of conduct, managing conflicts of interest, declarations of gifts and hospitality, whistleblowing, publishing information and the role of governance professionals.

8.4 Whilst some colleges will be robust in setting high standards, it is difficult to assess adherence to the guidance overall as there is no general oversight of whether and how colleges implement these permissive arrangements. A review of a random selection of 20 college websites showed that a majority of those surveyed had adopted the Nolan Principles. However, it highlighted a lack of transparency with:

[9] https://www.gov.uk/guidance/fe-governance

- only 2 websites providing declarations of interest for governors or senior leaders;
- less than half providing information on whistleblowing;
- 3 with no conflicts of interest policies; and
- a quarter showing no board minutes at all for the year 2019.

The low visibility on websites of whistleblowing arrangements is of particular concern in the context of ensuring probity. In addition, the opportunity to whistleblow outside of the organisation would provide further reassurance and should be prominent.

8.5 The review identified that practice is variable in the status and role played by clerks/ governance professionals. This ranges from those who are engaged on a ‘day rate‘ mainly to take minutes, to examples of Directors of Governance who have credibility within the organisation, are part of the executive team, are able to assist the board and the audit committee to develop their role and provide effective challenge. Respected governance professionals should have the status to provide independent challenge in meeting high standards of governance and conduct.

8.6 With some exceptions, the sector is confident that it can and does attract good quality governors with a range of skills and experience including accountancy and financial management. DfE provides some funding to support training and development of governors to the Education and Training Foundation (ETF) which provides a varied programme for chairs and board members both face to face and online, which are valued by those participating.

8.7 Failures of financial stewardship have at their core weaknesses in leadership and poor adherence to effective governance arrangements. The review has identified that there is scope for raising expectations and improving standards. If the government shifts its relationship with colleges (as discussed and recommended at 6.4 and at 11 below) it will have greater line of sight on the strength and weaknesses of governance arrangements in individual organisations. Government would then be able to support early corrective action including to strengthen capacity of boards and audit committees and the effectiveness of challenge.

8.8 In addition, it is suggested that the existing governance guide is reviewed. It should provide more prescription of those matters which should be addressed in the interests of transparency and good stewardship of public resources in line with expectations on other bodies responsible for public resources (including those identified at 8.3 and 8.4). It is recognised that the degree of prescription will need to take account of the government's desire to maintain the private sector classification of colleges.

Recommendation 3

It is recommended that there is greater clarity and higher expectations of good governance practice for those responsible for the stewardship of public funds and that government achieves this through a combination of:

- **Improving the line of sight via a new relationship with colleges which would enable monitoring of governance arrangements**
- **Reviewing the governance guide and raising the expectations of standards of governance required particularly in relation to transparency and whistleblowing**
- **Ensuring all college websites provide information on whistleblowing outside of the organisation to the ESFA.**
- **Setting requirements for the governance professional to have sufficient status and credibility to provide independent challenge of standards of governance and conduct.**
- **Committing to supporting training and development opportunities and learning networks for chairs, board members, audit committee members, senior leaders and governance professionals.**

9. Financial stewardship and financial planning including audit issues

9.1 The government has provided colleges with comprehensive guidance on financial stewardship including the college financial planning handbook 2019[10] and an audit code of practice[11]. The governance guide also sets out expectations on the accountability of Boards for oversight and challenge of financial performance. In addition, the individual funding agreements set out requirements in relation to specific programmes which include compliance with the financial planning handbook. Taken together they provide clarity and a comprehensive framework within which colleges must operate.

9.2 Given the role of the ESFA in providing assurance, there is a focus within these guides on the information which all colleges must submit rather than how colleges might operate. Currently every year at the end of July colleges provide:

- three year financial plans for previous, current and following year;
- 24 month cash flow forecast; and
- a commentary on the assumption in the plans.

In December each year colleges submit their audited Annual Report and Financial Statements (for the previous year ending 31 July) to the ESFA. These are used to provide the ESFA with assurance, to monitor the financial health of colleges and to produce a points score which is provided to colleges together with a Finance Dashboard each March. The dashboard is primarily aimed at Board level to assist discussion and includes college and comparative sector data on the cash position, planning and projections, funding streams and the three ratios the ESFA uses to assess financial health. The dashboard prompts the board to ask questions of the data but this is a general set of questions, neutrally posed, and not tailored to the circumstances of the particular position of the college. The dashboard would have greater relevance to boards if it was published more promptly. The ESFA also commissions a sample of funding assurance visits each year.

9.3 The review found that there were varying views across the sector on the appropriateness of these financial health measures but a consensus that there was a need for data collection which takes a forward view rather than the current historic approach. There was also consensus that tracking monthly cash flow on a more regular basis was important, including the suggestion that statements of management accounts provided to college

[10] https://www.gov.uk/government/publications/financial-planning-handbook
[11] https://www.gov.uk/government/publications/post-16-audit-code-of-practice

boards monthly could also be provided routinely to the ESFA. The ESFA has already responded to the need to improve the range of data collected and has been consulting with sector representatives to institute a new financial template with a monthly cash flow forecast to be submitted in January each year from 2020. Several in the sector observed that updated cash flow returns should also be provided in July to enable a better assessment. The ESFA has not yet finalised what feedback it will provide to colleges from this new data flow and how the dashboard and financial health score will be adjusted to incorporate this new data.

9.4 Taking account of existing capacity, the ESFA analysis of financial data is largely a desktop processing of historic data undertaken by accountants within the Provider Market Oversight Teams leading to a financial health score. For those colleges who are not indicating a cause for concern there would not normally be any follow up. For those colleges triggering the stages of concern, further scrutiny is pursued in line with the 'College Oversight and Support Framework' and more forensic financial analysis is available from Provider Market Oversight Teams. As a consequence colleges may be identified to be placed in intervention categories largely on the basis of remote data analysis and without the benefit of more granular understanding of the circumstances of the college. The lack of capacity for a preventative approach combined with a prescriptive tick-box approach to categorisation with little scope for flexibility may be pushing some colleges into early intervention unnecessarily and delaying timely exit. For instance, the review heard of examples where greater flexibility and a proactive approach might have provided an earlier and more granular understanding of college circumstances and prompted action to mitigate difficulties. Whilst there is merit and clarity for colleges in the current approach of setting out triggers for intervention and exit, this needs to be balanced with scope for applying judgement to individual circumstances.

9.5 A frequently cited concern in the forward financial planning capability of colleges is over optimism in terms of learner numbers and cash flow. The review has identified some of the issues which lead to this over optimism on the part of colleges which a change in approach from government could impact :

- Uncertainty on learner numbers arising from the range of local providers. This review has made recommendations at chapter 7 in relation to "capacity and curriculum" planning at a local geographical level which will assist with this.
- Complexity of funding streams leading to diversity of data requirements to capture and reconcile learner numbers as well as variable

arrangements for payment of income. (An example given where funding was received later than anticipated by a college was an increased lead time for apprenticeship funding which had added to cash flow problems). There is scope to review the current approach to funding regimes with a view to streamlining and stripping out complexity. When introducing new funding arrangements it would be beneficial for implementation arrangements to be scrutinised from the college perspective to ensure alignment with their financial planning and management of cash flow and to avoid perverse impacts.

9.6 In developing a strategic framework for colleges government should consider how its funding mechanisms incentivise “capacity and curriculum” planning at a local level.

9.7 Good estate management and effective use of capital investment are important components of financial planning. Whilst the review heard few issues about this, government should provide clarity about the availability of and access to capital resources over a three year time frame to assist the decision making of colleges.

9.8 The governance guide requires the establishment of an Audit Committee and provides a very brief outline of the role of the committee. Audit Committees have a key role in providing assurance on the adequacy of governance, risk management and control processes and the quality of financial management and discipline within the organisation. The Committee has a responsibility to oversee the adequacy of key policies concerned with stewardship and probity and for implementing recommendations of external auditors. It would be helpful if the existing guidance on the role of Audit was expanded to provide stronger direction on the areas of potential concern which Audit Committees should give particular focus e.g. risk management arrangements, and the Committee assisting the board to articulate its risk appetite. The latter is particularly important for those colleges considering pursuing commercial activity.

9.9 External auditors also have a key role to play in assurance and accountability requirements and the review heard of a number of auditors who have teams with specific expertise in colleges. DfE provides an Audit Code of practice which sets out a common standard for the provision of assurance in relation to funding of post-16 providers which is regularly updated. The Reporting Accountant is also required to give a regularity opinion based on a limited assurance engagement. The ESFA has developed a regularity self-assessment questionnaire to assist colleges in drafting their statement of regularity, propriety and compliance. The completed questionnaire is signed off by the College Accounting Officer and the Chair of Governors and provided to the independent Reporting Accountant. The approach to providing a regularity opinion is not the same as either the academies sector, or the higher education sector and there is scope at the next review to consider whether it would be overall beneficial to add further requirements to the current framework. This should address criticism that the current limited assurance approach to external audit does not provide sufficient assurance and is unable to identify weaknesses.

The review heard of examples of good practice including:

- external auditors attending all Audit Committee meetings during the year to ensure a deeper understanding of risks
- external auditors holding specific sessions with the Audit Committee without the executive present to allow them to discuss their findings.

However, it appears not to be common practice for External Auditors to present their findings to the Chair or Board of Governors which would enhance the understanding and accountability of the Board.

Recommendation 4

The review endorses the ESFA proposals to shift to use of forward financial planning and cash flow data and away from historic analysis. There should be further consideration and consultation with colleges on ways to make this more effective including:

- **whether data that is produced routinely should be submitted to the ESFA more frequently;**
- **whether monthly management accounts should be shared with the ESFA; and**
- **how the new analysis can be incorporated into the financial dashboard and health score.**

It is recommended that the feedback dashboard to colleges on the ESFA analysis is more timely and provides a more tailored narrative for each college individually to assist governing bodies in focusing on areas of concern and in providing challenge.

As part of developing a preventative approach (see chapter 11), it is recommended that the ESFA and FEC should adopt a more flexible approach to moving colleges to an intervention categorisation and to the exit criteria. This should take account of local context and levels of confidence in plans and mitigating actions colleges already have in place.

The review recommends that the potential for 3 year funding settlements are explored and the approach to funding is simplified and streamlined. This should include incentivising "capacity and curriculum planning" at a local geographical level. As the government develops new and existing programmes, more scrutiny should be provided on how and when colleges are paid so that funding rules can be simplified and aligned which will then support better financial stability and cash flow forecasting.

It is recommended that the guidance on the role of audit committees is strengthened to ensure they play a robust role in good stewardship and risk management and articulating risk appetite.

At the next review of the post-16 audit code of practice it is recommended that consideration be given to the effectiveness of the framework for the regulatory opinion. It is recommended there is a requirement for the External Auditor to present their findings to the Chair and Board members either at a Board meeting or by invitation to join the Audit Committee meeting receiving the Auditor's report.

10. Oversight and Intervention

10.1 The government published 'College Oversight: Support and Intervention.' in April 2019 which sets out 4 categories of oversight:

- prevention,
- early intervention,
- formal intervention, and
- restructure or exit

The ESFA Territorial Teams undertake analysis of college data to assess financial health and identify risks. This may trigger further conversations with colleges and the provision and analysis of additional data. Whilst some colleges reported receiving helpful advice and practical support to put in place mitigating action plans, the general perception was that support available is limited without triggering the 'Early Intervention' stage. The need for a more proactive and preventative capability within the ESFA is discussed at chapter 11.

10.2 Once a college is in Early Intervention or Formal Intervention the ESFA Territorial Teams provide a case manager role and there are a range of tools set out in the guidance which may be deployed by the FE Commissioner and/or the ESFA Provider Market Oversight Teams including:

- FE Commissioner Diagnostic assessments
- National Leaders of Governance
- National Leaders of Further Education
- FE Commissioner Intervention Assessments
- Independent Business Reviews
- FE Commissioner led Structure and Prospects Appraisal
- FE Commissioner local provision reviews
- Emergency funding
- Funding to support long term change
- Secretary of State powers
- Insolvency regime

The Oversight Guidance together with the Insolvency Guide provides clarity for colleges on what they can expect and what will trigger further escalation. The FE Commissioner and the ESFA Directors meet regularly to review actions in relation to individual colleges and to ensure good coordination between them and effective case management. Some of these arrangements are new and inevitably not all colleges have clarity on the roles of the different players. Whilst there are a mix of tools available to provide both practical help and analysis of issues, the weight is towards a range of assessments and investigations of the problem. There seems to be few examples of the placement of practical expert help at an early stage to work alongside boards and executive teams, to develop and oversee an improvement plan or to identify and promote good practice. Such support might usefully be in the form of an experienced former executive, a good practice partner college, or an experienced governor appointed to the board to fill a skills gap, model challenge or oversee an improvement/recovery plan.

10.3 Whilst the Secretary of State has powers to appoint a member to the Board (under Sections 56A and 56E of the FHEA 1992) there is a reluctance to use this because of the desire to maintain the private sector classification of colleges. Strong governors have been put in place by mutual agreement in some cases of colleges already in intervention. However, it may be that in some circumstances providing additional expert capacity at board level at an early stage may provide the practical assistance to accelerate recovery and should be explored without impacting the private sector classification of the college or the rest of the sector.

10.4 Inevitably, the review heard different perceptions from colleges of the experience of being in intervention. They expressed positive views for on the ground intervention methods which provided practical analysis and advice on what works from experienced practitioners including the National Leaders initiatives. There is an expressed lack of confidence and trust resulting from the perceived inflexibility and tick-box approach of the intervention regime which was referred to at 9.5 above. Whilst there are reports of a positive and helpful relationship from some who have experienced intervention, others commented on a lack of experience and skills to proactively contribute and a tendency for the department to act as observers and critics rather than participants in recovery.

10.5 As at April 2019, 21 colleges had been in intervention for over 20 months. One college has been in intervention for over 6 years. Such excessive periods of intervention create great uncertainty and have a significant impact on colleges with the potential to divert board and management capacity, destabilise recruitment and retention of quality staff, demoralise the workforce, impede recruitment of learners, and undermine value for money procurement. This appears to be caused at times by difficulties in securing merger solutions and a somewhat linear approach progressing through an array of diagnostics, investigations, assessments and reviews. There needs to be flexibility to provide an ongoing special funding solution in very exceptional circumstances, where no structural solution can be found but where there is a specific local need that cannot be otherwise met. Such provision should be committed to on a basis which would allow the college to be released from intervention.

10.6 The review noted that it is currently possible to receive a good judgement from Ofsted whilst being in intervention for financial weaknesses. It is suggested that to avoid this unhelpful disconnect the department considers whether judgements about the financial health, governance and leadership from those involved in financial oversight can be formally considered in the Ofsted inspection and be reflected in the overall Ofsted judgement and specifically the judgement on leadership. The ESFA may decide to undertake some field work alongside Ofsted in some circumstances. Such an approach would be cost effective and provide a holistic view drawing on the existing knowledge and expertise held by the ESFA without the need for Ofsted to form a separate judgement on financial health which could be dysfunctional. Consideration of this approach has already commenced.

Recommendation 5

It is recommended that DfE, the FE Commissioner and the ESFA review the Oversight Guidance to allow greater flexibility to match actions to individual circumstances, to avoid linear progression through the various types of investigations and reviews and to shorten time periods in intervention.

The ESFA should develop the case manager role for colleges in intervention to provide more proactive support and practical advice to college leaders in formulation and delivery of recovery plans, signposting good practice, facilitating coaching and mentoring. This will require a review of the skills and experience needed by staff in this case management team to ensure it has the capacity and credibility to fulfil this role, and to interact effectively at board and senior executive level.

The review recommends that those involved in financial oversight contribute to the Ofsted judgement on leadership to provide an holistic view and avoid disconnect between the judgements of the two bodies.

Without a change in the law, the use of the Secretary of State's powers to appoint to a college board should be proactively considered at an early stage to support the delivery of an improvement programme.

11. A New Relationship – Support and Prevention

11.1 The overarching recommendation from this review is that there needs to be a new relationship with the sector. Government should be more proactive and supportive which in turn will allow early line of sight on potential weaknesses and the opportunity to prevent the slide into financial failure. Currently the government supports learning and improvement generally, through funding to the ETF which is well regarded (for instance the review found that the new Chairs Leadership Programme was praised by participants). However it does not provide the government with knowledge of and leverage on the needs of individual colleges for support and advice.

11.2 Whilst each college currently has a named liaison worker from the ESFA Territorial Teams, in practice capacity only allows this to be a desk-based oversight of college data which in the main relates to financial returns. This only becomes a more active role for colleges which are on the intervention pathway. This means that in the main the ESFA Territorial Teams do not have a relationship with colleges which gives them any regular granularity of understanding of such matters as vision and ambition, leadership strengths and weaknesses, resource planning, governance compliance etc. Importantly it does not give them a line of sight to early signs of potential weaknesses nor allow the government to hold colleges to account for compliance with its guidance and expectations. For instance for colleges not in intervention, the extent of compliance with the governance and financial planning guides is largely unknown. Generally, there is no line of sight of the functioning of boards and audit committees; there is not an in depth assessment of the quality of management accounts and financial planning; there is no scrutiny of governance or counter fraud policies; and there is no discussion around curriculum planning, trading/commercial activity, estate management, risk management, partnership working and whether the college is supporting the needs of local employers or the economy. Colleges are required to complete an annual regularity self-assessment as part of their annual audit which covers some of these issues but these are not routinely provided to or analysed by the ESFA. It is acknowledged that there has been a 60% reduction in ESFA capacity for this work which has led to prioritisation of resources to focus on the most problematic cases.

- The development of a more proactive relationship with all colleges individually would give oversight of all of these issues and allow a stronger culture of prevention to be developed. It would give colleges the confidence to seek timely advice and help, leading to fewer colleges in intervention and fewer demands for financial support. It would benefit from clearer structural delineation between those teams providing support (e.g. the Territorial

Teams and the National Leaders of Further Education and National Leaders of Governance), and those with a role in intervention (e.g. the FE Commissioner and the Provider Market Oversight teams). Specifically, a shift to a more proactive relationship should enable both the avoidance of financial failure, assurance on the alignment of colleges' curriculum planning with local and national objectives, and find speedier resolutions if formal intervention is required. In giving effect to this structural alignment consideration would be needed to how to fulfil the case management role during intervention and specifically whether to maintain the supportive case manager role separately from the case management of intervention.

Recommendation 6

It is recommended that the ESFA and FE Commissioner develop a new relationship with colleges. This new relationship would provide a structural realignment between those fulfilling the liaison arrangements, prevention and support, and those providing intervention so that colleges have confidence to come forward for help at an early stage.

- **This would enable a stronger relationship and line of sight with all colleges. This could incorporate annual conversations, looking holistically at the college as a critical friend but also allowing the college to showcase their achievements and raise their concerns**
- **This would give the ESFA the ability to deploy a range of advice, practical support and preventative measures and to promote good practice. The National Leaders of Further Education and Governance should be made more widely available to colleges not in intervention and colleges should feel able to approach them without fear of opening the door to an intervention regime**
- **This would require ESFA staff to become active participants in nurturing college development. Teams would need appropriate skills and experience to provide support tailored to the circumstances of each college.**

To support the new relationship, the Department should continue to invest in providing training, development and networking opportunities to promote good practice in the sector.

The Department should consider a further round of the Strategic College Improvement Fund.

12. Regulatory Issues

12.1 Colleges are independent bodies and are not subject to a single, statutory regulatory regime. This review has aimed to make recommendations which are consistent with operating within that legal framework but which may see the government using powers already in legislation more readily. Whilst a more traditional regulatory regime might allow some aspects of failure to be more speedily addressed, this would not obviate the need to build a new relationship with the sector and individual colleges as referred to in the review's recommendations. However, it would strengthen the ability to mandate standards of governance and financial stewardship, to ensure compliance and in cases where intervention is required to enforce changes of leadership and structure. It could provide a means to enforce the outcomes of the proposed locality capacity and curriculum planning proposals where these are stalling. Overall the power to be more decisive could lead to shorter periods in intervention for colleges in difficulty who need a structural solution. A new regulatory regime would require an appetite for radical legislative change and therefore is a matter for more long term consideration. Alternatively, without regulatory reform, government could drive change in the sector by ensuring that a National Strategy and funding mechanisms incentivise college compliance.

12.2 However, the review identified that there may be scope to be more proactive in the use of the Secretary of State's powers to make governor placements on a board to secure the delivery of an improvement plan and that this would not automatically impact on the private sector classification of the college nor the sector.

Summary of recommendations

Recommendation 1

For the sector to succeed, institutions to thrive, and learners to achieve excellent outcomes it is recommended that attention needs to shift to the ingredients outlined above.

The recommendations which follow below emanate from this premise.

Recommendation 2

It is recommended that government sets out a strategic vision for the further education college sector and creates effective mechanisms, and potentially a duty, for "capacity and curriculum" planning at a local geographical level and delivery that includes all post 16 provision.

Recommendation 3

It is recommended that there is greater clarity and higher expectations of good governance practice for those responsible for the stewardship of public funds and that government achieves this through a combination of:

- **Improving the line of sight via a new relationship with colleges which would enable monitoring of governance arrangements**
- **Reviewing the governance guide and raising the expectations of standards of governance required particularly in relation to transparency and whistleblowing**
- **Ensuring all college websites provide information on whistleblowing outside of the organisation to the ESFA.**
- **Setting requirements for the governance professional to have sufficient status and credibility to provide independent challenge of standards of governance and conduct.**
- **Committing to supporting training and development opportunities and learning networks for chairs, board members, audit committee members, senior leaders and governance professionals.**

Recommendation 4

The review endorses the ESFA proposals to shift to use of forward financial planning and cash flow data and away from historic analysis. There should be further consideration and consultation with colleges on ways to make this more effective including:

- **whether data that is produced routinely should be submitted to the ESFA more frequently;**
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It is recommended that the guidance on the role of audit committees is strengthened to ensure they play a robust role in good stewardship and risk management and articulating risk appetite.

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or by invitation to join the Audit Committee meeting receiving the Auditor's report.

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Recommendation 6

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good practice. The National Leaders of Further Education and Governance should be made more widely available to colleges not in intervention and colleges should feel able to approach them without fear of opening the door to an intervention regime

- **This would require ESFA staff to become active participants in nurturing college development. Teams would need appropriate skills and experience to provide support tailored to the circumstances of each college.**

To support the new relationship, the Department should continue to invest in providing training, development and networking opportunities to promote good practice in the sector.

The Department should consider a further round of the Strategic College Improvement Fund.

Annex A: List of documents reviewed

Association of Colleges: The Composition of English Further Education College Boards and College Governance Frameworks 2015	https://www.aoc.co.uk/sites/default/files/Board%20Composition%20Survey%202015.pdf
College accounts direction 2018-19	https://www.gov.uk/government/publications/college-accounts-direction
ESFA: college financial planning handbook and financial plan	https://www.gov.uk/government/publications/financial-planning-handbook
FE Area Review reports (2 samples reviewed)	
FE Commissioner Diagnostic assessments (sample reviewed)	
FE Commissioner Intervention Assessment (sample reviewed)	
FE Commissioner Stocktake assessment (sample reviewed)	
FE Commissioner Structure and Prospects Appraisal (sample reviewed)	
FE Insolvency Guidance	https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/774096/FE_Insolvency_Governor_Guidance.pdf
Further education corporations and sixth-form college corporations: governance guide	https://www.gov.uk/guidance/fe-governance>
Independent Business Review (sample reviewed)	
NAO Report: Overseeing financial sustainability in the further education sector	https://www.nao.org.uk/report/oversight-of-financial-sustainability-in-the-further-education-sector/
Ofsted: Further education and skills inspection handbook	https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/782172/Further_education_and_skills_inspection_handbook_181218_updated_for_1_March_2019_final.pdf
Post-16 audit code of practice	https://www.gov.uk/government/publications/post-16-audit-code-of-practice

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