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Core funding/operations
Report

Effective 1 August 2006

The model financial memorandum, between HEFCE and the institutions we fund, sets out the terms and conditions for payment of HEFCE grants. The memorandum should be read in conjunction with Part 2, the schedule, which gives conditions specific to the institution, the funds available to the institution, and the educational provision the institution has agreed in return for those funds. This document replaces HEFCE 2003/54 issued in December 2003.

Model financial memorandum between HEFCE and institutions

HIGHER EDUCATION FUNDING COUNCIL FOR ENGLAND

Model financial memorandum between HEFCE and institutions

Introduction

General

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

Definitions

2. In this memorandum, 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

capital expenditure: expenditure used to create or purchase a new asset, replace an existing asset, or refurbish or remodel an existing asset

Chief Officer of the Council: the Chief Executive of HEFCE

connected institution: an institution receiving HEFCE grant funding from another HEI to whom it is accountable, rather than receiving funding directly from the Council

Council: the Higher Education Funding Council for England (HEFCE). See also ‘predecessor Councils’

CUC: Committee of University Chairmen

deficit: the historical costs deficit as given in the ‘Note of historical cost surpluses and deficits’ in the Statement of Recommended Practice (SORP): ‘Accounting in Higher Education Institutions’

Designated officer: head of an institution responsible and accountable to HEFCE (and ultimately to Parliament) for ensuring that the institution uses HEFCE 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

DfES: Department for Education and Skills

Exchequer funds: Government grant or grant-in-aid – including grants paid on the advice of the University Grants Committee, grants paid by HEFCE and its predecessor Councils, grants paid by the DfES to former voluntary and direct grant colleges, and grants from the Research Councils. It does not include funds provided by a local authority

Exchequer interest: the contingent interest in the institution held by HEFCE, arising in accordance with HEFCE 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.

FE college: a college in the further education sector

FRS: Financial Reporting Standard

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

HEFCE: Higher Education Funding Council for England

HEI: higher education institution

HESA: Higher Education Statistics Agency

the institution: (name of institution)

JANET: the Joint Academic Network, an electronic network supported by the seven higher and further education funding bodies which links universities and colleges in the UK. SuperJANET is the enhanced network

lead accountability: refers to lead accountability in all institutions designated by the DfES as higher education institutions, except where the DfES has assigned the lead accountability role to the TDA. These will normally be institutions which receive 55 per cent or more of their recurrent grant (that is, the combined recurrent grant from the TDA and the Council) from the TDA

legally distinct entity: an organisation receiving HEFCE grant funding from an HEI to whom it is accountable, but operating independently from that HEI

licence: any licence other than a licence of residential accommodation to a registered student

LSC: Learning and Skills Council

month: calendar month

NAO: National Audit Office

overseas activities: those activities taking place outside the United Kingdom of Great Britain and Northern Ireland

PFI: Private Finance Initiative

PPP: public-private partnership

predecessor Councils: the Polytechnics and Colleges Funding Council and 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 DfES

QAA: Quality Assurance Agency for Higher Education

Secretary of State: the Secretary of State for Education and Skills

SSAP: Statement of Standard Accounting Practice

SuperJANET: see JANET

TDA: Training and Development Agency for Schools (formerly the Teacher Training Agency)

1998 Act: the Teaching and Higher Education Act 1998

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. **Shall** and **must** denote mandatory requirements, and **should** denotes the Council's view of good practice.

Application

3. This memorandum is in two parts. Part 1 (this document) sets out the terms and conditions which apply in common to those institutions listed in paragraphs 5 to 7. Part 2, the schedule for each institution, 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. References to this memorandum embrace both Part 1 and Part 2.

4. 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.

Scope

5. The terms and conditions in this memorandum apply to all institutions for which the Council has lead accountability.

6. The following sections also apply to any institution for which the TDA has lead accountability and which receives funds from the Council:

- Introduction (paragraphs 1-4)
- Compliance with financial memorandum (paragraphs 8-9)
- Responsibilities of the Council (paragraphs 10-12 and 14-15)
- Stewardship (paragraphs 16-17)
- Provision of information (paragraphs 26-30)
- Connection to JANET or SuperJANET (paragraphs 33-34)
- Allocation and payment of funds (paragraphs 36-48)
- Estate management (paragraphs 49-52)
- Exchequer interest (paragraphs 53-67)
- Financial commitments (paragraphs 68-73)
- Monitoring (paragraph 74)
- Other matters (paragraphs 87-91).

7. The following sections also apply, via Part 2 of the financial memorandum, to any institution for which the LSC has lead accountability and which receives funds from the Council.

- Introduction (paragraphs 1-4)
- Compliance with financial memorandum (paragraphs 8-9)
- Responsibilities of the Council (paragraphs 10-12 and 14-15)

- Stewardship (paragraphs 16-17)
- Provision of information (paragraphs 26-30)
- Connection to JANET or SuperJANET (paragraphs 33-34)
- Allocation and payment of funds (paragraphs 36-39 and 45-48)
- Other matters (paragraphs 87-91).

<u>Compliance with financial memorandum</u>

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

9. In exercising its powers under this memorandum, the Council will act reasonably at all times.

Responsibilities of the Council

10. Payments to the institution by the Council are in support of activities specified in section 65(2) of the 1992 Act, namely:

for higher education institutions:

a. The provision of education and the undertaking of research.

b. The provision of any facilities, and the carrying on of any activities, which the governing body of the institution considers it necessary or desirable to provide or carry on for the purpose of, or in connection with, education or research.

for further education institutions:

c. The provision by such institutions as are within the further education sector of prescribed courses of higher education.

11. Payments will be subject to the provisions of the 1992 Act, the conditions set out in this memorandum, and such terms and conditions as the Council 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 the Council 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 the Council. In determining what funds to allocate to the institution, the Council does not wish to discourage the institution from maintaining and developing its funding from other sources, in accordance with section 66(2) of the 1992 Act.

12. The Chief Executive of the Council has been appointed as its Accounting Officer. As such he is responsible and accountable to Parliament for ensuring that the funds received from the Secretary of State 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.

13. As part of these responsibilities the Chief Executive must be satisfied that the governing body of the institution has appropriate arrangements for internal control (including financial management and accounting), and that the Council's funds are used for the purposes for which they were given.

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

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

Responsibilities of the institution

Stewardship

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

17. The governing body has a wide discretion over its use of public funds, and is ultimately responsible for the proper stewardship of those funds. Therefore it must ensure that it exercises its discretion reasonably, and takes into account any relevant guidance on accountability or propriety issued from time to time by the Council, the NAO or the Public Accounts Committee.

Designation of principal officer

18. The governing body shall designate a principal officer of the institution, who will normally be the head of the institution, and shall notify the Council whenever it designates such an officer. The designated officer will need to satisfy the governing body that the conditions in this memorandum are complied with, and may be required to appear before the Public Accounts Committee alongside the Chief Executive of the Council on matters relating to grants to the institution.

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

Financial management

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

21. The governing body of the institution shall plan and conduct its financial and academic affairs to ensure that it remains solvent and that, taking one accounting period with another, its total expenditure is not greater than its total income.

22. In meeting the requirement in paragraph 21:

a. The institution shall not have a historical cost deficit in two consecutive accounting periods unless there are sufficient discretionary reserves[1] to cover the deficit. A deficit of less than 0.5 per cent of total income as defined in the audited financial statements for the year in question, or £500,000, whichever is the lower, will not be taken into consideration for these purposes.

b. Negative discretionary reserves must be cleared by the end of the third accounting period after the year in which the deficit began to accumulate. (That is, negative discretionary reserves occurring by the end of year 1 must be cleared by the end of year 4.) An accumulated deficit will be regarded as cleared if it is less than 0.5 per cent of total income as recorded in the institution's financial statements for the latest accounting period, or £500,000, whichever is the lower.

For the purposes of paragraph 22 only, any pension scheme deficits included on an institution's balance sheet following the implementation of FRS 17 should be excluded. It is still expected that institutions will work towards improving any pension scheme deficits.

23. The Council may, at its discretion, waive these conditions and substitute others on written application from the institution.

24. The institution shall notify the Council of any event that has, or is likely to have, a material adverse impact on the financial position of the institution, as soon as this becomes apparent.

Value for money

25. The governing body is responsible for delivering value for money from public funds. It should 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 the Council, the NAO or the Public Accounts Committee.

Provision of information

[1] Discretionary reserves comprise general (rather than specific) endowments and income and expenditure account reserves as defined in the Statement of Recommended Practice: 'Further and Higher Education Institutions'.

26. The institution shall provide the Council, or agents acting on its behalf, with whatever information the Council 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 the Council or its agents.

27. The Council 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.

28. If the institution fails to return information required by the Council by the specified deadline, or that information is not of a satisfactory quality, the Council 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 recurrent grant.[2]

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

29. If the institution is overpaid grant as a result of the Council using estimated data, the Council reserves the right to recover any overpaid grant, plus interest, in accordance with paragraph 48 below.

30. Institutions will, from time to time, be asked to provide data that they have collected to HEFCE or to other bodies acting on the Council's behalf. At present, HESA acts as an agent both for the institution and for the Council, in collecting information required by the Council and passing that information to the Council and/or to the DfES on behalf of the Council. These data will often contain personal details for students and/or staff. To ensure that institutions and the Council can fulfil their duties under the Data Protection Act 1998 (including advising data subjects about what data will be processed and the purpose), institutions should 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 the Council as reasonably necessary to ensure that the Council and HESA, or any other agents of the Council, 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.

<u>Legislative requirements</u>

31. Institutions should have due regard for all legislative requirements placed upon them and their governing bodies to ensure fair and equal treatment of their staff and students. This includes, but is not restricted to, the Race Relations Amendment Act and the duty to promote race equality, the current legislation surrounding gender and disability, and EU regulations covering age, religion, sexual orientation and other equal opportunities issues. These

[2] This power relates to information required by the Council and returned to the Council or to its agents acting on its behalf.

requirements reflect the legislative obligations placed upon the Council itself, and will help inform the Council's risk assessment of institutions.

Subscription to HESA, QAA and the Higher Education Academy

32. The institution shall subscribe to the following bodies:

- HESA
- QAA
- the Higher Education Academy for the first three years of its operation from August 2004.

Connection to JANET or SuperJANET

33. The institution shall take appropriate measures, including signing its acceptance of the Acceptable Use Policy, to ensure that its use of JANET or SuperJANET, and networks connected to JANET or SuperJANET, conforms to acceptable practice and current legislation.

34. The Council reserves the right to withdraw the institution's connection to JANET or SuperJANET if it does not take the appropriate measures referred to in paragraph 33.

Risk management

35. The institution must ensure that it has an effective policy of risk management (incorporating appropriate insurance arrangements). Risk management arrangements should consider the key principles set out in the HEFCE's Accounts Direction to HEIs, which notes that effective risk management:

- covers all risks – governance, management, quality, reputational and financial. However it is focused on the most important key risks
- produces a balanced portfolio of risk exposure
- is based on a clearly articulated policy and approach
- requires regular monitoring and review, giving rise to action where appropriate
- needs to be managed by an identified individual and involve the demonstrable commitment of governors, academics and officers
- is integrated into normal business processes and aligned to the strategic objectives of the organisation.

Allocation and payment of funds

36. The Council will determine the amount of funds to be allocated to the institution in any year and may, in its allocations, distinguish between recurrent and capital funds. The Council may also, in its capital allocations, distinguish between formula capital funds and project capital funds.

37. The institution shall 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 HEI passes on a part of its HEFCE 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, and to colleges, schools or other education providers outside the higher and further education sectors.

a. The HEI must retain sufficient oversight that it may properly be considered to be 'providing' the education, 'undertaking' the research or 'providing' the related facilities or activities. This applies except in cases where:

i. the body to which the HEI passes funds is also an HEI in its own right, and

ii. the Council has given its consent to that arrangement.

b. This oversight should cover, among other areas, both financial accountability and quality assurance. A written statement of the arrangements should be agreed by both parties. This statement should ensure that the chain of accountability for the use of Council funds is not broken, and that the relevant parts of the financial memorandum apply to the eventual user of the funding.

c. If an HEI proposes to pass funds to a connected institution under Section 27 of the 1998 Act, the Council's consent must first be obtained.

d. In some cases an HEI (or an FE college) may be acting as the lead institution receiving HEFCE funding on behalf of a consortium of institutions providing higher education programmes. Where this is the case, the onward transmission of that funding from the HEI (or FE college) to the consortium members should be governed by a consortium agreement. That agreement should be prepared in accordance with the principles set out in HEFCE 00/54[3] or any subsequent code of practice for consortia.

38. The institution shall use any funds which the Council has earmarked or provided for specific recurrent or capital purposes, solely for those purposes.

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

40. The Council will normally pay formula funds to the institution in monthly instalments, in accordance with a funding profile for the academic year which takes account of expected need within the higher education sector as a whole, and receipts of tuition fees from students and the Student Loans Company.

[3] 'HE in FE colleges: Indirectly funded partnerships: codes of practice for franchise and consortia arrangements' (HEFCE 00/54, December 2000).

41. Formula funding for widening access and improving retention is conditional on submission by institutions of acceptable widening participation strategies and action plans.

42. The Council will also be prepared, on written application from the institution, to consider making exceptional or ad hoc payments from an institution's existing overall grant allocation. However such payments will not be made in advance of the institution's need to spend the money.

43. The Council may contribute to the costs of capital projects submitted at its request and which conform to criteria set by the Council.

44. The Council will pay its agreed contribution to the costs of capital projects in accordance with a payment profile agreed with the institution, as set out in the associated conditions of grant, and on submission of a final claim which has been accepted by the Council.

45. The Council will notify the institution, in writing, of the allocations of formula funds as soon as possible – normally by 31 March –in advance of the academic year to which they relate.

46. If the institution fails to comply with any conditions attached by the Council to the payment of funds, the Council reserves the right to require the institution to repay all or part of those funds.

47. The Council reserves the right to impose financial sanctions and/or withdraw funding from an institution if it fails an audit re-inspection by the QAA. This condition applies to HEIs and to FE colleges.

48. The Council 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 the Council under this or any other condition remains unpaid.

Estate management

49. The institution shall manage and develop its estate with regard to the guidance issued from time to time by the Council on estate procedures.

50. The institution shall keep its holdings of land and buildings under review, with the objective of rationalising and disposing of those which it considers, in light of its estate strategy, to be no longer needed.

51. Former voluntary colleges and other institutions holding land and buildings not covered by exempt charitable status shall also take into account the requirements of the Charity Commissioners.

52. The institution shall maintain its estate in accordance with a maintenance plan, covering its long-term and routine maintenance requirements.

Exchequer interests

53. The institution, having entered into an agreement with HEFCE effective on 1 August 2006 to enable the retrospective elements of a new system of accounting for exchequer interests to be enacted, shall follow the conditions set out below. Until this agreement is signed, the institution is bound by the pre-existing terms and conditions as set out in the pre-existing version of this model FM (HEFCE 2003/54).

54. The exchequer interest identified and agreed with HEFCE in this agreement will form the opening balance of a simple exchequer interest register maintained by HEFCE.
The register will be adjusted immediately for the addition of capital grants received in the year and annually for the following:

- indexation of the opening balance and all grants received in subsequent years; and
- writing down grants over the prescribed period.

55. The indexation rate used will be the GDP deflator published by the Treasury. This will take account of changes in value and ensure that the value of the exchequer interest is not eroded through inflation.

56. All capital grants made after 1 August 2006 that create an exchequer interest will be entered onto the register, regardless of how they are treated for accounting purposes.

57. The opening exchequer interest balance as at 1 August 2006 will be written down over a 10 year period on a straight line basis. All further grants will be written down annually over 15 years from the year of the grant in question on a straight line basis, to recognise their consumption through the provision of education over that period.

58. The closing balance of the register as at 31 July 2007 and annually thereafter will provide a single reportable sum for the exchequer interest, and will be confirmed annually with the institution by HEFCE.

59. As repayment of exchequer interest is a remote event contingent upon the occurrence of what are likely to be exceptional circumstances (see below) the advice received by HEFCE is that it does not need to be disclosed as a contingent liability in the institution's annual accounts.

<u>Circumstances in which the exchequer interest becomes repayable</u>

60. If either of the following remote events occur, then they will trigger immediate liability for the institution to repay HEFCE the full amount of the exchequer interest (as shown in the exchequer interest register at that date). The institution will recognise HEFCE as an unsecured creditor until such repayment is made. If a liability to make repayment arises,

HEFCE may agree to accept repayment of some other sum, or to delay repayment, at its absolute discretion, and such agreement may be on terms and conditions as HEFCE thinks fit.

61. The first trigger event will be if the institution becomes insolvent, including going into liquidation or administration, or if it dissolves or transfers its undertaking to some other body (for example, by the exercise of the Secretary of State's powers under the Education Reform Act 1988 or otherwise), or if it experiences any analogous event.

62. The second trigger event is if there is a significant reduction in the level of HEFCE-funded activity by the institution, using the following indicators:

- the absolute level of HEFCE income
- the absolute level of total income, and
- the percentage of total income represented by HEFCE income.

63. A base level for each of these indicators will be set as at 31 July 2006 by reference to the institution's 2005-06 financial statements. The trigger event will only occur if two or more of the three indicators reduce to at least 50 per cent from the base level.

64. This second trigger has been designed to ensure that HEIs are not discouraged from generating other sources of income, providing they continue to offer the same level of HEFCE-funded education. HEIs may activate the trigger if, for example, they cease to educate publicly funded students, significantly downsize or go into liquidation, but are unlikely to do so if activities continue as normal or they expand.

65. The agreed base level for each indicator will be reviewed every five years by HEFCE and may be reset if appropriate to reflect the changing nature of the provision of education and more general changes within public sector funding.

66. If two or more of the trigger indicators reduce to at least 30 per cent from the base level, this will lead to discussions between HEFCE and the institution about the impact of further downsizing, including consideration of whether to reset the base indicators.

67. If the triggers are activated, HEFCE has the right but not the obligation to request repayment. It has discretion to waive the requirement for repayment..

Financial commitments[4]

General

68. It is the Council's responsibility to protect the public investment in institutions. To help fulfil this responsibility, and in its role of monitoring the financial health of the sector, the Council will require the institution to satisfy certain conditions relating to long-term and short-term financial commitments. These conditions are set out below, with further details in Appendix 1 of this FM. These conditions are no more than the Council would expect the institution to be able to demonstrate in all cases, irrespective of whether Council consent is being sought. The Council would consider it good practice if, when undertaking new or revised financial commitments, the institution makes explicit the fact that it has acted in accordance with Council requirements. In particular, any new financial commitment should:

- be consistent with the institution's strategic plan and represent the best value option
- be consistent with the institution's financial strategy
- satisfy the Council that it is able to meet its financial commitments and to maintain financial and academic viability without recourse to additional grant
- satisfy the Council that the institution's governing body has taken an informed decision regarding the commitment.

Further details of these requirements are given in paragraphs 69 to 73 and in Appendix 2.

Long-term financial commitments[5]

69. The conditions that the Council requires to be satisfied when an institution undertakes any long-term financial commitment are:

a. Any new investment should be consistent with the institution's strategic plan and should represent the best value option.
b. Any new financial commitment, or refinancing arrangement, should be consistent with the institution's financial strategy and represent best value.
c. The institution must be able to meet its financial commitments, without recourse to additional grant from the Council, and its ability to maintain financial and academic viability must not be impaired as a result of its financial commitments.
d. The institution's governing body has taken an informed decision regarding any new investment and any new financial commitment or refinancing arrangement.

70. The institution shall obtain written Council consent before it undertakes such a level of financial commitment that the annualised servicing costs of all long-term financial commitments, including loans from the Council, exceed a threshold of 4 per cent of total

[4] Financial commitments include finance leases, as defined in SSAP 21 'Accounting for leases and hire purchase contracts' and other schemes where borrowing is the substance of the transaction, in line with FRS 5 'Reporting the substance of transactions'. This definition will be revised when the Accounting Standards Board issues its revised standard on accounting for leases.

[5] Long-term financial commitments mean amounts which are due for payment after more than 12 months, in accordance with GAAP.

income, as reported in the latest audited financial statements, or the estimated amount for the current year if that is lower. The annualised servicing costs of the financial commitments consist of the costs of capital repayments and total interest costs spread evenly over the period of the financial commitments. If there is an option (as opposed to a commitment) to extend any borrowing to a longer term, then the annualised servicing costs will still be measured on the original term.

71. In assessing total long-term financial commitments and total income, all inherited debt and lease payments which are fully reimbursed by the Council, and all such reimbursements, shall be ignored. The institution shall also ignore any individual lease provided that the combined annualised servicing costs of such leases do not exceed 0.5 per cent of total income.

Short-term financial commitments

72. The conditions that the Council requires to be satisfied when an institution undertakes any short-term financial commitment are:

a. That short-term financing is the most appropriate solution.

b. The proposed financing arrangement is consistent with the institution's financial strategy.

c. The institution's governing body has taken an informed decision regarding the short-term financing arrangements.

73. The institution shall obtain written Council consent before its negative net cash – as determined on a cash book basis and as defined in FRS 1 (revised 1996): 'Cash Flow Statements' – exceeds 5 per cent of total income, for more than 35 consecutive calendar days.

Monitoring of estate management and financial commitments

74. The Council will monitor compliance with the requirements in paragraphs 49 to 52 and paragraphs 68 to 73.

Costing and pricing of activities

75. Institutions should know and understand the full economic costs of the activities[6] that they undertake, and this information should be taken into account within their management decision-making processes.

76. Institutions should seek to recover the full economic costs of all their activities, whether pricing is determined by reference to those full economic costs or by reference to prevailing market conditions. While there may be cases for individual projects or activities to

[6] 'Activities' in this context refers to the five categories of activities as defined for reporting under the Transparency Review (publicly funded teaching, non-publicly funded teaching, publicly funded research, non-publicly funded research, and other).

be priced at below their full economic costs, this should be done as a conscious decision, within the context of strategic objectives. Institutions are expected, taking one year with another, to recover, **in aggregate**, the full economic costs of all their activities across the full range of their activities.

77. The Council does not expect HEFCE funds to be used to subsidise non-public activities.

Financial statements

78. The institution shall keep proper accounting records and shall prepare financial statements in respect of each accounting period. The institution shall provide the Council with three copies of its audited financial statements for the accounting period by 31 December following the end of the accounting period. At least one copy of the financial statements provided to the Council shall contain the signatures required under paragraph 80 of this memorandum, and shall be signed by the institution's external auditors. The institution shall make reasonable arrangements to make copies of the financial statements publicly available.

79. The institution shall ensure its financial statements comply with the Accounts Direction issued from time to time by the Council. The Accounts Direction will cover what information is to be in the financial statements, how they are to be presented, and the methods and principles for preparing them in accordance with GAAP.

80. The financial statements shall be signed by the designated officer and by the chairman or one other member of the governing body appointed by that 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.

Audit

81. The governing body of the institution shall appoint an audit committee, and arrange to provide for internal and external audit, in accordance with the Council's 'Accountability and Audit: HEFCE Code of Practice' (HEFCE 2004/27) and any other directions drawn up and published by the Council in consultation with institutions. Any requirements mandatory under the Audit Code of Practice shall be a condition of grant under this memorandum.

82. The Council's Audit Service will, from time to time, evaluate the institution's risk management, control and governance arrangements.

83. It may also carry out any additional 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 recurrent grant.

84. The institution shall provide the Council's Audit Service with access to all books, records, information and assets. The Audit Service 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 Comptroller and Auditor General.

85. The Council 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 Comptroller and Auditor General may also carry out value for money studies of the institution's use of resources.

86. DfES internal auditors and/or the NAO may accompany the Council's auditors on their visits to the institution. On such visits the DfES's and/or NAO's auditors will be concerned only with the way the Council's auditors are carrying out tasks, and will not themselves audit arrangements within the institution.

Other matters

Consultation with HEFCE on mergers

87. The Council has responsibilities in relation to the academic and financial viability of the institutions it funds, and to ensure that the interests of students are not being jeopardised. Even when no financial assistance is sought, the merger proposals are bound to have an impact on future funding requirements. Therefore institutions should actively involve HEFCE at the early stages of any proposed merger.

Revision

88. After consultation with the institution, and such bodies representing the institution as the Council considers appropriate, the Council 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 the Council for such changes. The Council will, from time to time, review the thresholds and monetary limits in paragraphs 22, 70, 71 and 73 of this memorandum to ensure they remain up to date. The Council will consult institutions if it intends to amend these limits.

Interpretation

89. The rights, powers and remedies reserved to the Council in this memorandum are in addition to any other rights, powers and remedies which it may hold now or at any time in the future. No failure to exercise or delay in exercising by the Council any of its rights, powers and remedies shall operate as a waiver of them. Nor shall any single or partial exercise of any such right, power or remedy preclude any further or other exercise of the same or any other right, power or remedy.

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

Effective date

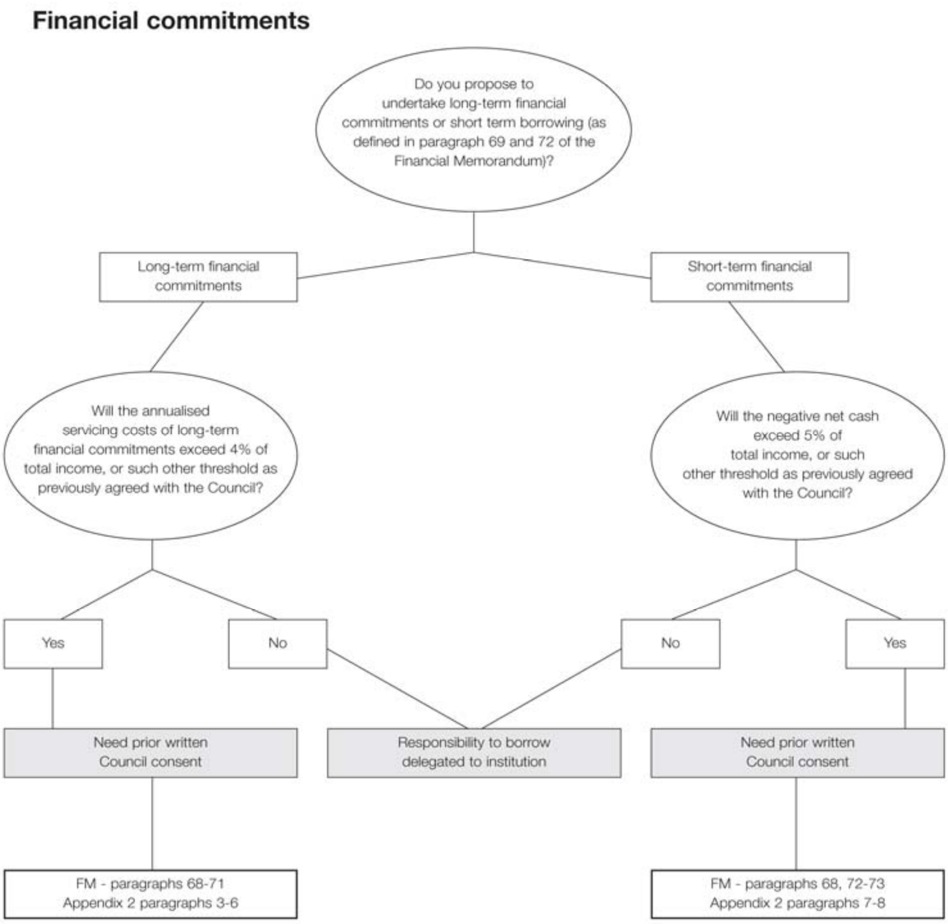
91. This memorandum shall take effect from 1 August 2006.

Signature of the designated officer

92. The designated officer of (**name of institution**) should signify below that they have received the financial memorandum, which sets out the terms and conditions for payment by the Higher Education Funding Council for England of funds to the governing body of (**name of institution**), out of funds made available by the Secretary of State for Education and Skills.

Appendix 1

Flow chart for prior Council consent



Appendix 2

Areas where prior Council consent is required

1. The Council's prior written consent is required if the institution wishes to:

   a. Undertake such a level of financial commitment that the annualised servicing costs of all long-term financial commitments exceed a threshold of 4 per cent of total income (paragraph 70).[7]

   b. Allow its negative net cash or cash equivalents to exceed a threshold of 5 per cent of total income for more than 35 consecutive days (paragraph 73).

2. The Council will endeavour to respond to a request for consent, which must be signed by the designated officer, within 15 working days of receiving all the relevant information as listed in this appendix. However, requests for consent which would take an institution's annualised servicing cost for long-term financial commitments above 7 per cent will require approval by the HEFCE Board.[8] Institutions should take account of this timescale in planning activities where Council consent is required. However the Council recognises that exceptional circumstances may arise which would require a faster response to paragraph 1b above.

Consent to exceed the threshold for long-term financial commitments

3. Paragraph 69 specifies the conditions which the Council requires the institution to satisfy when undertaking any long-term financial commitment.

4. Paragraph 70 states the circumstances in which written Council consent is required before the institution undertakes long-term financial commitments. The requirements of paragraph 70 will only operate when the institution intends to take out additional financial commitments, including loans from the Council, or to refinance existing financial commitments, such that the annualised servicing costs of total borrowings exceed the threshold of 4 per cent of total income. (This also applies to any threshold other than 4 per cent for which the institution has the Council's prior written consent.) Where the only cause of the institution exceeding the 4 per cent threshold is an increase in the interest rate(s) on variable rate borrowings, or a reduction in the institution's income, there is no need to seek Council consent. Appendix 4 provides guidance on how to calculate the annualised servicing cost.

5. Financial commitments include:

   - all borrowing, whether self-financing or not
   - finance leases, subject to the exclusion in paragraph 71

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[7] Unless otherwise indicated, all references are to paragraphs in the model financial memorandum.
[8] HEFCE Board meetings are normally held in January, February, April, June, September, November and December.

- all inherited debt and leases which are not fully reimbursed by the Council
- PFI arrangements which are accounted for as loans or finance leases in accordance with the requirements of SSAP 21 or FRS 5.

6. In considering requests for consent to exceed the threshold for long-term annualised servicing costs, the Council will require the institution to satisfy the conditions set out in paragraph 69, by submitting the information specified below. This information is similar to that which the Council would expect to have been provided to the institution's own decision-making body.

Condition 1	**Any new investment should be consistent with the institution's strategic plan and represent the best value option.**
<u>Information required:</u>	Council consent is not necessarily project specific (as many borrowing requirements are not directly related to individual projects). Its concern is with affordability and institutional risk. Therefore institutions should submit: a. A brief commentary addressing these issues. b. A description of activities requiring new investment. c. A demonstration of where such activities fit into the institution's strategic plan and supporting strategies. d. Confirmation that the Council's guidance on appraising investment decisions, including a full assessment of the key risks and uncertainties of the activity, has been followed. (A list of relevant HEFCE guidance is at the end of this section.)
Condition 2	**Any new financial commitment, or refinancing arrangement, should be consistent with the institution's financial strategy and represent the best value.**
<u>Information required:</u>	a. The reasons why additional long-term finance, or refinancing, is necessary and how this fits with the institution's financial strategy. b. The forms of finance or procurement which have been considered and the process and criteria for selecting the best value method. c. The net present value (NPV) for each of the financing options appraised and a brief commentary explaining why the preferred option was selected. d. Details of the preferred financing option, including the

	name of the lender, the principal sum to be borrowed, the period of the borrowing and the basis of repayment. e. The terms and conditions of the preferred financing option (a copy of the term sheet would satisfy this requirement), and an evaluation of the risks and uncertainties of this option.
Condition 3	**The institution must be able to meet its financial commitments, without recourse to additional grant from the Council, and its ability to maintain financial and academic viability must not be impaired as a result of its financial commitments.**
<u>Information required:</u>	a. The impact of any new activity and evidence to demonstrate that the proposed new financial commitment or refinancing arrangement is affordable. This should be presented in the context of the latest financial forecasts submitted to the Council, updated for any material changes. b. Details of any significant changes to the financial commitments or guarantees from those disclosed in the institution's most recent audited financial statements.[9] c. Guarantees made on behalf of entities that are not consolidated into the institution's financial statements.
Condition 4	**The institution's governing body has taken an informed decision regarding any new investment and any new financial commitment or refinancing arrangement.**
<u>Information required:</u>	a. The decision-making body involved and the date the decision was made. b. The basis on which it reached its decision.

[9] This will cover: finance and operating leases under SSAP 21 'Accounting for leases and hire purchase agreements'; PFI schemes where the substance of the transaction is not borrowing under FRS 5 'Reporting the substance of transactions'; or as required by the Council's Accounts Direction to higher education institutions.

Threshold	**Setting the new threshold for long-term financial commitments.**
Information required: (a template to record this information is available from the HEFCE Assurance Service)	a. A list of existing/continuing financial commitments (including the lender, term and annualised servicing costs), and details of the annualised servicing costs of the new financial commitment. b. Identification of the proportion of each commitment that relates to activities which should recover their full economic cost. c. Calculation of the threshold required based on total income as recorded in the latest audited financial statements.

HEFCE guidance documents

- Effective financial management in higher education (HEFCE 98/29)
- Estate strategies: guide to good practice (HEFCE 00/04)
- Financial strategy in higher education institutions (HEFCE 2002/34)
- Guide for members of governing bodies of universities and colleges in England, Wales and Northern Ireland (HEFCE 2004/40)
- Investment decision making: a guide to good practice (HEFCE 2003/17)
- Practical guide to PFI for higher education institutions (HEFCE 98/69)
- Strategic planning in higher education (HEFCE 00/24)

Consent to exceed the threshold for short-term financial commitments

7. Paragraph 72 specifies the conditions which the Council requires the institution to satisfy when undertaking any short-term financial commitment. Paragraph 73 states the circumstances in which prior written Council consent is required for short-term financial commitments.

8. In considering such requests, the Council will require the institution to satisfy the conditions set out in paragraph 72, by submitting the information specified below. This information is similar to that which the Council would expect to have been provided to the institution's own decision-making body.

Condition 1 Information required:	**That short-term financing is the most appropriate solution.** a. Details of the circumstances that have led to the need for increased short-term finance.
Condition 2 Information required:	**The proposed financing arrangement is consistent with the institution's financial strategy.** a. How the decision to take out increased short-term finance fits with the institution's financial strategy. b. The forms of finance considered and the factors that have been taken into account in selecting the preferred option. c. Details of the preferred financing arrangement, including the name of the lender, the principal sum to be borrowed, the period of loan and the basis of repayment. d. The terms and conditions of the financing arrangement (a copy of the term sheet would satisfy this requirement).
Condition 3 Information required:	**The institution's governing body has taken an informed decision regarding the short-term financing arrangements.** a. The decision-making body involved and the date the decision was made. b. The basis on which it reached its decision. c. Information submitted by the institution should be signed by the director of finance.
Threshold Information required:	**Setting the new threshold for short-term financial commitments.** a. The revised threshold required (in £s) and the period for which the increased threshold is required. b. Cashflow forecasts which demonstrate the need for the increased threshold.

Appendix 3

Decision-making delegated to the institution

1. In exercising a delegated responsibility, the institution must comply with this financial memorandum and have regard to any relevant Council guidance. Where required, the director of finance, or equivalent officer, of the institution must inform the Council, in writing, when such decisions have been taken.

2. The Council will assess how the institution has exercised its delegated decision-making powers, probably on a sample basis. Therefore the institution is expected to have sufficient information available to demonstrate that it has taken decisions in compliance with this financial memorandum.

3. The Council has delegated to the institution the ability to:

    a. Borrow or refinance existing long-term financial commitments where the annualised servicing costs are below the threshold (paragraph 70).

    b. Borrow on a short-term basis below short-term borrowing thresholds (paragraph 73).

New or revised financial commitments below the thresholds for long- or short-term financial commitments

4. Paragraphs 69 and 72 specify the conditions which the Council requires the institution to satisfy when undertaking long-term and short-term financial commitments respectively.

5. When it has undertaken new or revised long-term financial commitments, the institution must be able to satisfy the Council that it has acted in accordance with paragraph 69. One way of doing so is to have available all the information listed in paragraph 6 of Appendix 2. When it has undertaken short-term borrowing or refinancing, the institution must be able to satisfy the Council that it has acted in accordance with paragraph 72. One way of doing so is to have available all the information listed in paragraph 8 of Appendix 2.

Appendix 4
Clarification of annualised servicing cost (ASC) calculations

1. Paragraph 70 of the financial memorandum defines the ASC as follows:

> ‘The annualised servicing costs of the financial commitments consist of the costs of capital repayments and total interest costs spread evenly over the period of the financial commitments.’

For the purpose of calculation, this means the **total expected net cash payments** (capital and interest) over the period of the loan, divided by the period of the loan in years.

2. Where fixed interest rate arrangements are in place, these rates should be applied for the term of the commitment. In other circumstances, the rate currently payable should be applied.

3. Examples of the different types of financial instrument are outlined below.

4. In the case of deferred repayments or a repayment holiday, the period of the commitment is defined as starting at the point of the draw-down (or first point if in tranches) and ending when any liability concerning the commitment is fully extinguished.

5. Paragraph 71 of the financial memorandum states:

> ‘In assessing total long-term financial commitments and total income, all inherited debt and lease payments which are fully reimbursed by the Council, and all such reimbursements, shall be ignored.’

For the purpose of calculation, this means that any inherited debt reimbursements should be excluded from the long-term financial commitments, and the interest element should be excluded from total income. Similarly, lease payments and leases that have been converted into mortgages should be excluded from the calculations to the extent that they are reimbursed by the Council.

Inherited liabilities rolled into core funding

6. Where inherited liability reimbursements have been rolled into core funding these are no longer reimbursable by the Council. Therefore, local authority debts which are no longer reimbursed should be included as long-term financial commitments in calculating the institution’s ASC, and no adjustment should be made to total income.

Categories of institutional financial commitments

7. For the purposes of calculating the ASC of financial commitments, it is worthwhile categorising some of the different types of financial instrument currently in use, and outlining which figures should be used for calculation.

Category 1: Simple mortgages and loans

8. The principle here is that the institution borrows a capital sum and undertakes to repay the loan over a predetermined period. Repayments may be by equal instalments, annuity based or other varying instalments, or there may be a capital and/or interest ‘holiday’. Additionally, the interest rate may be fixed or variable or a combination of the two. In all cases, the ASC is the total cash payments, divided by the original period (in years) of the loan. Where the interest rate is known, or payments have already been made, these figures should be used. If the interest rate is variable, the rate (or rates where more than one rate applies) currently payable should be used for the balance of the loan period.

Category 2: Secured, cash-backed borrowing

9. Examples of this type of scheme are bonds, or debenture issues. In these cases, the repayment of the financing generally takes place through cash deposits into a designated account, which provides the majority (if not all) of the funds to repay the financing on the settlement date. Depending on the type of scheme, the settlement date may be predetermined, or there may be various dates on which an institution can exercise an option to settle. It is up to each institution to decide upon the most likely settlement date and calculate the ASC accordingly. In these instances, the ASC is the aggregate sum payable into the designated account (plus any other account required to top up the designated account), divided by the term of the financing, plus any interest or rent that may be payable each year. With these types of scheme, rates of interest/rent are often fixed in advance. If this is not the case, the rates currently payable or paid should be used in the same way as for category 1 loans.

10. In certain instances, part of the initial receipts from financing is used to create a sinking fund, designed to provide sufficient funds to repay the debt at a predetermined time. In these instances, the financing should be excluded from the ASC calculation, to the extent that it is fully covered by the sinking fund, provided that the sinking fund cannot be used for any purpose other than redeeming the financing.

Category 3: Finance leases

11. This financial memorandum specifically includes finance leases as defined in SSAP 21, ‘Accounting for Leases’. The first step is to establish what type of lease is under consideration:

a. A standard lease, where the asset was not previously owned by the institution.
b. Sale and leaseback of existing assets.
c. Lease and leaseback of existing assets.

12. For ASC purposes, the treatment of types a. and b. is identical. The ASC consists of the total of the cash amounts payable under the terms of the lease, divided by the original length of the lease (in years).

13. An added complication arises with type c. above, as the institution receives rental income that is inextricably linked to rental expenditure. In this instance, the ASC should be calculated on the net cash outflow.

Summary

14. In each of the above cases, the essential element in calculating the ASC is the inclusion of all cash payments that will be or have been made in servicing and redeeming the financing, even if a large lump sum is paid at the end of the term. Having established the total cash outflow, it should be divided by the original term of the loan, to arrive at the ASC. If interest rates are fixed, they should be used. In other circumstances, the rate (or rates if there is more than one) currently payable should be applied to future payments. In all cases, the calculation of the ASC should reflect economic substance, which may not mirror the legal form.

Changes to a scheme

15. If a financing scheme is to be shortened or extended, the ASC calculation needs to be reworked using the amended finance term and rates of interest. If the recalculation results in an ASC higher than the threshold currently permitted (or 4 per cent if no specific threshold exists), prior written consent for amendments to the scheme must be sought from the Council in accordance with Appendix 1.

Appendix 5

Scope of the financial memorandum

This appendix shows which paragraphs apply to institutions for whom the Council, the TDA and the LSC have lead accountability.

		Lead accountability		
Section	**Paragraph**	**HEFCE**	**TDA**	**LSC**
Introduction	1-4	*	*	*
	5-7	*		
	8-9	*	*	*
Responsibilities of the Council	10-12	*	*	*
	13	*		
	14-15	*	*	*
Responsibilities of the institution	16-17	*	*	*
	18-25	*		
	26-30	*	*	*
	31	*		
	32	*		
	33-34	*	*	*
	35	*		
Allocation and payment of funds	36-39	*	*	*
	40-42	*	*	
	43-48	*	*	*
Estate management	49-52	*	*	
Exchequer interests	53-67	*	*	
Financial commitments	68-73	*	*	
Monitoring	74	*	*	
Costing and pricing of activities	75-77	*		
Financial statements	78-80	*		
Audit	81-86	*		
Other matters	87-91	*	*	*
Signature of designated office holder	92	*		