

3 December 1999

CIRCULAR

FUNDING COUNCIL

Financial Memorandum

Cheylesmore House
Quinton Road
Coventry CV1 2WT

To

Chairs of governing boards
Principals of colleges
Clerks to governing boards

Circular type

Information

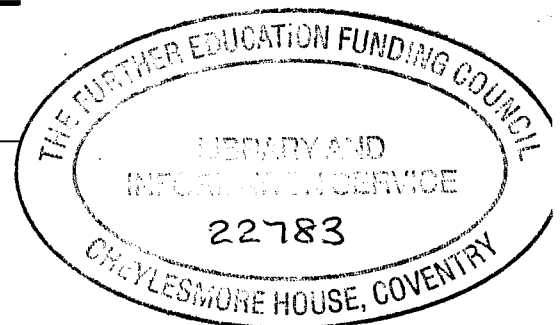
Supersedes

Circular 98/30

Summary

The revised financial memorandum between the Council and colleges. The revised memorandum is deemed to come into effect on 1 August 1999.

Reference number: 99/48



**FOR
REFERENCE ONLY**

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**NOT TO BE
TAKEN AWAY**

99/48

Financial Memorandum

The present requirement for college boards to establish a remuneration committee and a committee or committees to advise on financial matters and employment policy be withdrawn

Introduction

1 This circular contains, at annex B, the revised version of the Council's financial memorandum with colleges. It was approved at the Council's meeting held on 3 November 1999 in the light of responses to consultation on the proposed changes to the memorandum circulated to colleges with the Council chief executive's letter dated 19 August 1999.

Background

2 The Council's own financial memorandum with the Department for Education and Employment (DfEE) requires it to 'make a financial memorandum with each institution they fund for the purposes of regulating their relationship on financial and related matters, setting out the terms and conditions on which payments of grant will be made by the Council to the institution'.

Responses to Consultation

3 Two hundred and fifty-nine responses were received to the consultation, although not all respondents commented on each of the proposals. The analysis of the responses is provided at annex A. The main issues raised are set out in the following paragraphs.

Colleges will be expected to have separate providers of internal and external audit services no later than the year commencing 1 August 2000

4 Those colleges which did not support the proposal felt that they would be likely to incur significant additional audit fees which would, in the context of the risks involved, be a waste of resources, and divert much-needed funds from their core purpose of providing education and training to students. A number of rural colleges felt that it would be difficult for them to identify two separate firms of auditors to undertake the work.

5 Those colleges which did not support the proposal felt that it would be a retrograde step, which would remove a very important safeguard in the effective discharge of governors' responsibilities.



Responses to Consultation

	<i>Agree</i>	<i>Disagree</i>	<i>No comment</i>
1 Colleges will be expected to have separate providers of internal and external audit services no later than the year commencing 1 August 2000	194	64	1
2 The DfEE's internal auditors should be allowed to make unaccompanied visits to colleges in relation to the assessment of the adequacy and effectiveness of controls within the further education sector	191	62	6
3 The present requirement for college boards to establish a remuneration committee and a committee or committees to advise on financial matters and employment policy be withdrawn	158	95	6
4 The audit committee must include at least one person, whether a governor or not, with relevant financial/audit experience	247	10	2
5 College governing bodies must receive at least termly a report that reviews the college's financial position	252	5	2

Financial Memorandum

Introduction

1 This memorandum sets out the terms and conditions of the agreement under which the Council provides funds to Colleges. It provides information on the framework of relationships between Colleges and the Council.

Definitions

2 For the purpose of this memorandum:

- 'Act' means the *Further and Higher Education Act 1992*
- 'Board' means the further education corporation or, in the case of an unincorporated institution, the person or persons conducting the College and in receipt of funds from the Council
- 'Principal' means the chief executive or principal appointed by the board of a further education corporation or the equivalent individual in the case of a designated institution
- 'Clerk' means the person appointed by the Board to the position of clerk to the board or in the case of a designated institution the person appointed by the governing body to fulfil a similar duty
- 'College' means the educational institution conducted by the Board and named in part 2 of this memorandum
- 'Council' means the Further Education Funding Council for England
- 'Financial year' means the College financial year 1 August to 31 July
- 'DfEE' means the Department for Education and Employment
- 'Exchequer funds' means government grant or grant-in-aid, including grant paid by the Council and grant paid by the former Department of Education. 'Exchequer funds' does not include funds provided by a local authority
- 'Secretary of State' means the secretary of state for education and employment
- 'Senior Postholders' means the chief executive and holders of the other senior

posts whom the board have selected for the purposes of the articles of government of the College relating to the appointment and promotion of staff.

3 The financial memorandum is in two parts. Part 1 sets out the general terms and conditions under which the Council funds boards. Part 2 is specific to each College and will include:

- the annual notification of the main allocation payable to the Board
- the educational provision which the College has undertaken to deliver
- individual limits on borrowing and property transactions where these are lower than those provided for in paragraphs 24, 28 and 29
- any specific conditions which relate to the financial year
- any specific conditions which relate to the particular College.

This document is part 1 of the financial memorandum. Each College will receive individual annual notification of part 2 of the financial memorandum.

General

4 The financial memorandum does not over-ride the duties and powers given to the Council and to Boards by the Act.

Responsibilities

Council

5 The Council intends that in all its dealings with Colleges it should operate fairly and as openly as possible.

Council's accounting officer

6 As accounting officer the chief officer of the Council is responsible and accountable to Parliament for ensuring that the uses to which the Council puts its funds are consistent with the purposes for which the funds were given and comply with the conditions attached to them. The chief officer of the Council is responsible for the regularity and propriety of expenditure from those funds and for securing the best possible value for money from them.

7 Funds paid to Boards are subject to the terms and conditions determined by the Council. These terms and conditions include those in this financial memorandum. The chief officer of the Council is required to monitor the College's compliance with any terms and conditions attached to its funding. She or he must be satisfied that each Board has appropriate arrangements for sound financial management, achieving value for money and accounting and that the uses to which the Council's payments are put are consistent with the purposes for which they have been given.

College

8 The respective responsibilities of the Board, the Principal, and the Clerk are set out in the College's instrument and articles of government. The role of the Board is to set objectives for the College, to determine the limits on the Principal's discretion to act, to monitor the performance of the College, the Principal and themselves and to be accountable to the College's stakeholders. The role of the Principal is to manage the College towards the objectives set by the governors and within the limits they have prescribed. As accounting officer the Principal is responsible for the College's application of public funds. The Clerk is responsible for administrative support for the Board's work, for advising on proper procedure and for intervening when the Clerk considers that the Board is acting inappropriately or beyond its powers. Further guidance is given in the Council's publications: *Guide for College Governors*; *College Governance: A guide for clerks* and the *Notes for Governing Bodies* series.

The Board

9 The Board can only use funds from the Council in accordance with the Act. The Board must use funds from the Council only in accordance with this memorandum and any other conditions which the Council may from time to time prescribe.

¹ In the case of some designated colleges this responsibility rests with a trust. It is not intended that the financial memorandum will affect the legal position. Guidance on how these responsibilities should be discharged in the case of terminating contracts of employment by agreement is given in the explanatory notes to the financial memorandum.

- 10 The responsibilities of the Board include:
- determining the educational character and mission¹ of the College and for oversight of its activities
 - ensuring the solvency of the College and the safeguarding of the College's assets. In particular, College governing bodies must receive at least termly a report that reviews the College's financial position
 - appointing, grading, suspending, dismissing and determining the pay and conditions of service of the Principal and other Senior Postholders
 - setting a framework for pay and conditions of service of all other staff
 - ensuring that the financial, planning and other management controls, including controls against fraud and theft, applied by the College are appropriate and sufficient to safeguard public funds
 - approving the appointment of external auditors and an internal audit service
 - securing the efficient, economical and effective management of all the College's resources and expenditure, capital assets and equipment, and staff, so that the investment of public funds in the College is not put at risk
 - ensuring that appropriate financial considerations are taken into account at all stages in reaching decisions and in their execution
 - planning and conducting its financial and academic affairs so that its total income is not less than sufficient, taking one year with another, to meet its total expenditure
 - making appropriate arrangements to appoint a Clerk with the necessary expertise to fulfil the duties of the post
 - approving an annual budget before the start of each financial year
 - determining tuition fees
 - approving rules and procedures relating to staff grievances, conduct, suspension, dismissal and appeals
 - approving the students' union constitution and rules relating to the conduct of students
 - in the case of further education

corporations, acting only within the powers given in sections 18 and 19 of the Act.

11 The Board shall establish:²

- an audit committee.

The Board shall establish an audit committee. The audit committee must include at least one person, whether a governor or not, with relevant financial/audit expertise. Boards may also establish other committees. The Board shall periodically review the membership and terms of reference of its committees. In determining the terms of reference of these committees the Board shall not delegate responsibility for determining the educational character and mission of the College, approving the budget, ensuring the solvency of the College, safeguarding the College's assets or the appointment or dismissal of the Principal and other Senior Postholders. In particular, College governing bodies must receive at least termly a report that reviews the College's financial position.

Principal

12 Within this framework the Council and the Board will require the Principal to take personal responsibility, which may not be delegated, for ensuring the proper and effective operation of the financial, planning and management controls referred to in paragraph 10 above, and for giving effect to the Board's policies for securing the efficient, economical and effective management of all the College's income, assets and expenditure.

13 The responsibilities of the Principal include:

- making proposals to the Board about the educational character and mission of the College and for implementing the decisions of the Board
- the organisation, direction and management of the College and the leadership of its staff
- preparing a budget for consideration and approval by the Board and for managing the College within the budget approved by the Board
- the maintenance of student discipline.

14 The Principal shall be responsible for ensuring that funds from the Council are used only for the purpose for which they are given and in accordance with any terms and conditions attached to them. These terms and conditions include those set out in the financial memorandum. As accounting officer, the Principal may be required to appear before the Committee of Public Accounts, alongside the chief officer of the Council, on matters relating to the funds paid by the Council to the College and the use made by the College of such funds. The Principal has a duty to report to the Council should the Board adopt a policy or commission an action which is incompatible with the terms of this memorandum or which would infringe the requirements of propriety or regularity.

15 The Principal is responsible for advising the Board in writing if any action or policy under consideration by them is incompatible with the terms of this memorandum or would infringe the requirements of propriety or regularity. The Principal is also responsible for advising the Board in writing if the Board appears to be failing to act where required to do so by this memorandum or where required to meet the requirements of propriety or regularity. The report should include a reference to the Principal's duty to report to the Council should the board seek to over-rule his or her advice. Where the Board determines to proceed despite the advice of the Principal, the Principal should consider the reasons the Board have given for their decision. If after considering the reasons given by the Board the Principal still considers that they could not defend such a policy or action then they should advise the chief officer of the Council in writing of the situation at their College. The Council would not consider the provision of such a written report to the Board or the notification of the Council as grounds to take disciplinary action or suspend a Principal.

Clerk

16 The Clerk is responsible for administrative support for the Board's work, for advising on proper procedure and for intervening when the Clerk considers that the Board is acting inappropriately or beyond its powers. Guidance on these matters is given in *College Governance: A guide for clerks*. Each Board should specify the procedures they would expect the Clerk and the Board to follow if

² This reference is not intended to imply that the Board may not establish other committees.

there were difficulties in this area. The Council would not consider that action within the specified procedures should provide grounds for disciplinary action or the suspension of the Clerk.

Allocation of funds

17 The amount of funds to be paid to the Board in any year will be decided by the Council after considering the activities to which they will be applied, and taking account of other competing demands on resources. The payment of funds will be subject to such terms and conditions as the Council may impose, including those set out in this memorandum.

Virement

18 The board shall use any funds earmarked by the Council solely for the purposes for which they have been earmarked. The Board may apply its main allocation to capital purposes.

Payment of funds

19 The Council will explain to the College the basis on which any funds are to be allocated. It will send to the College as soon as possible in advance of the financial year a statement of the college's funding allocation awarded for the year. This notification will normally be issued by the end of May prior to the start of each financial year.

20 The Council will make payments to the Board in monthly instalments in accordance with a funding profile for the whole financial year. The profile will be constructed to take account of expected need within the further education sector as a whole. Instalments will normally be paid through the Banks Automated Clearing System Ltd. The Council intends to provide Colleges with a notification of their monthly payment at the beginning of each month.

21 The Council may also make exceptional *ad hoc* payments to the Board between monthly instalments. Such payments will only be made on written application from the College, will not be made in advance of the College's need to make disbursements and will not be additional to the sums allocated to the Board.

22 In addition to the main allocation the Council may also make allocations for specific purposes, for example access funds.

Land and buildings transactions

23 The Board should manage and develop its estate with regard to the guidance issued from time to time by the Council on estate procedures, including strategic estate and equipment management, option and investment appraisal, the affordability of the project and private finance. The Board should also:

- 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
- maintain its estate in accordance with its accommodation strategy.

24 The Council requires the Board to obtain its consent for land and buildings transactions where the total cost exceeds £1,000,000 or 5% of the College's annual revenue whichever is the lower. Where the transaction is a disposal or the renting or leasing of property to a third party the College should seek to secure the best obtainable value for money. The Council intends to respond promptly to requests for consent under this paragraph.

25 Where the College is proposing to dispose of or lease or rent, land and buildings which have been acquired by Exchequer funds the Council may require the College to surrender some or all of the proceeds.

26 The Council would normally expect Colleges to apply the proceeds of asset sales to investment in fixed assets. Colleges should seek independent professional advice when disposing of land and buildings.

Borrowing and leasing

27 Save as provided for in paragraphs 28 and 29 and any special conditions the Council may include in the second part of the financial memorandum, the Board must seek the prior written consent of the Council for any secured or unsecured borrowing by itself or its subsidiaries.

28 The Council gives consent for the Board to borrow up to 5% of its annual revenue on an unsecured basis.

29 The Council gives consent for the Board to borrow up to a cumulative maximum of £1,000,000 or 5% of its annual revenue, whichever is the lesser, on a secured basis in order to finance the

construction or purchase of buildings provided that only the buildings so purchased or constructed are offered as security.

30 Leasing of freehold and leasehold land and buildings from a third party is subject to the procedures set out in paragraph 24 above.

Accounts and financial management

31 The College shall keep proper accounts and accounting records and shall prepare in respect of each financial year a statement of accounts. The College shall provide the Council with audited accounts for the financial year no later than five months after the year-end. The accounts shall be signed by the Principal and by the chairman or one other member of the Board as appointed for this purpose. The College shall make arrangements to make copies of the accounts publicly available.

32 The Council shall, after consulting Colleges, specify its requirements as to the information to be contained in the accounts, the manner in which they are to be presented and the methods and principles according to which they are to be prepared.

33 The College should notify the Council in writing if at any time there is a significant deterioration in its financial position.

34 Where the Council has concluded³ that there is a risk to the College's liquidity, service delivery or asset base it may require the College to put in place a recovery plan or a risk reduction plan.

External institutions

35 The College is required to seek from the external auditors of those institutions to which the College has given financial support under section 6(5) of the Act, an audit certificate stating whether in the opinion of the external auditors the funds have been applied for the purposes intended. This certificate shall be forwarded to the Council in accordance with the guidance which it publishes for each year.

³ *In arriving at these conclusions the Council intends to follow the procedures set out in Circular 98/12 'The Council's Approach to Identifying Colleges Requiring Additional Support'. The Council will normally consult the college regarding the requirement to put in place a plan.*

Audit

36 The College shall arrange external and internal audit in accordance with the requirements and guidance published by the Council in its *Audit Code of Practice* and in succeeding publications and supplementary guidance. In particular, it will not be permissible for colleges to appoint the same firm to undertake both internal and external audit services for audits commencing with the audit in respect of the College financial year starting 1 August 2000.

37 The Council may undertake examination of the College's internal financial and management controls and may recommend improvements. These examinations will normally take place as part of the cycle of College inspections. DfEE auditors may accompany the Council's staff during these examinations. The Council may also carry out reviews designed to improve economy, efficiency and effectiveness in the management or operation of the College.

38 The books and records of the College will be open to inspection by the Council and by the Comptroller and Auditor-General. The Comptroller and Auditor-General may also carry out value-for-money studies of the College's use of resources. To help in providing an assurance on the adequacy and effectiveness of controls within the further education sector, the DfEE's internal auditors may make unaccompanied visits to colleges and undertake such enquiries and review such books and records as they may reasonably require to undertake their work.

Contingent liabilities

39 The College shall not give any guarantees, letters of comfort, or indemnities incurring contingent liabilities other than in the normal course of commercial business dealings.

Information

40 The College shall provide to the Council information concerning its finances, staffing, students and programmes. This will normally include:

- the College's annual financial statements, finance record, external auditor's management letter and internal audit annual report
- the College's strategic plan and strategic plan updates, together with the financial forecast which supports the plan

- where appropriate a mid-year financial forecast update
- individualised student record data, in-year funding returns, final funding unit claim, external auditor's report and management letter
- staff individualised record data.

Colleges will also be required to provide periodic information on their accommodation strategies. Additional information, including a self-assessment, will be required before a College inspection and a requirement to provide additional information is likely to be part of the terms and conditions of earmarked grants. Colleges will normally have discretion whether or not to apply for earmarked grants. Where additional information is sought in data collections it is intended that this will normally be announced before the start of the relevant financial year. Where the Council intends to request special additional information from specific Colleges it will normally consider whether it should make a payment to the College to reduce the financial burden of providing the additional information.

41 Colleges shall report all significant (as defined in the *Audit Code of Practice*) cases of fraud or irregularity to the Council.

Requirement to inform the Council

42 The College shall notify the chief officer of the Council in writing of any of the following changes:

- the intention to carry forward a major change in the nature or location of the College
- the vacating and the filling of the following positions:
 - chairman of the Board
 - Principal
 - Clerk
- when the Principal will be absent from the College for an extended period the name of the person who will be discharging the Principal's responsibilities during their absence.

Penalties

43 Where a Board fails to comply with any of these conditions of funding the Council may take further action including withdrawing funds from the College.

Interpretation

44 Questions arising on the interpretation of any statement in this memorandum shall be resolved by the Council after consultation with the College.

Effective Date

45 The arrangements shall take effect from 1 August 1999.

Explanatory Notes

Terminating Contracts of Employment by Agreement

Principles

1 The principles set out in the financial memorandum apply when terminating contracts of employment by agreement including premature retirement. Colleges should be able to demonstrate that payments in respect of termination are regular, secure value for money and are affordable.

2 Colleges should avoid spending public funds on settlements where disciplinary action would have been more appropriate.

3 Normally public funds should only be used to meet contractual obligations and items such as pension enhancements within the limits set out in the relevant pension scheme rules. Exceptions should be justified by explicit and quantified reference to value for money.

4 Confidentiality clauses are generally contrary to the public interest.

Practice

5 Colleges should establish a framework and a procedure for determining settlements. In determining individual settlements Colleges should take appropriate professional advice.

6 Appropriate records of each stage of negotiations should be retained. The cost of settlements must be declared in the College's financial statements.

7 In the case of Senior Postholders, Boards should consider establishing a special committee to oversee negotiations. The outcome of negotiations should be reported to the Board and all settlements should be brought to the attention of the College's external auditors. Once it has established a framework for determining a settlement with a Senior Postholder, the Board may delegate to the special committee the power to reach a settlement.

Secured Borrowing

For estates

8 In considering applications for secured borrowing consent the Council will have regard to:

- the Board's approval of the project
- planning and other relevant permission
- the economics of the project. Projects would normally be expected to generate at least a 6% real rate of return
- whether the College has considered a wide enough range of options
- the financial viability of the College. Colleges would normally be expected to demonstrate that when the project is operational the College can run at a surplus and make sufficient cash from operations to meet its debt charges
- the terms on which it is proposed to borrow
- whether appropriate private-public partnerships have been considered.

9 The Council would normally expect to respond to an application for secured borrowing consent within 30 working days of being provided with copies of the minute of the Board's approval of the borrowing, evidence of any necessary approvals, investment and option appraisals carried out according to the standards set by Her Majesty's Treasury, a financial forecast which shows the impact of the project, details of the procurement process and a copy of the offer letter from the proposed lender.

For solvency

10 The Council would expect to take into account the likelihood that the College would be able to repay the borrowing, the financial controls in place at the College, the capacity of the Board and management team, the steps the College was making to improve its financial position and the development of the College's recovery plan. The Council may require an independent audit report.

For equipment

11 Equipment should only be acquired by lease or by hire purchase if, in the view of the College, that method of finance represents the best value for money. Equipment acquired with funds secured

against the equipment does not require the specific consent of the Council. In determining its response to requests for borrowing consent the Council may take into account a College's commitments to make lease or hire purchase payments.

Converting Rents and Leases into Committed Sums

12 For the purpose of paragraph 24 a rent is deemed to be a sum of 10 times the amount of the annual rent, save where the property is subject to a lease for a fixed term of which less than 10 years remains, in which case, in order to calculate the deemed capital sum, the annual rent is to be multiplied by a factor equal to the number of years of the term remaining.

Significant Land and/or Buildings Transactions

13 For the purpose of paragraph 24 the total cost of a land and/or buildings transaction includes all costs whether these are to be met by the College or a third party.

Other Matters

Public access to college accounts

14 Under the terms of the *Charities Act 1993* the Board is required to supply any person with a copy of the College's most recent accounts within two months of a request. The Board may require a reasonable fee. It is expected that Colleges will go beyond this minimum requirement: for example by providing copies of their accounts to local libraries and allowing members of the public to inspect their statement of accounts during normal working hours.

Boards and colleges

15 The DfEE advises that further education corporations and the Boards which run them are for legal purposes one and the same thing. The Act permits the Council to fund Boards. Boards then run educational institutions; that is to say 'Colleges'. Thus in the financial memorandum the term 'Board' is used for legal purposes on a number of occasions where it might be more natural to refer to 'Colleges'. For example, the memorandum refers to payments being made to Boards.

Annual revenue

16 The annual revenue of a College shall be taken to be the turnover declared in its most recent audited financial statements less any payments made to the College under section 6(5) of the Act and less any release of capital grant included in turnover.

Significant deterioration in financial position

17 This should include all adverse changes which are likely to cause a College to fall into financial health categories B and C, or which will cause the College to borrow to maintain its solvency. For Colleges which are already in category C any adverse change which is likely to affect its surplus for the year, its general reserve, its cash holding or its net current assets (or liabilities) position by more than 10% should normally be regarded as a significant deterioration in its financial position.

Complaints, appeals and the ombudsman

18 Circular 96/25 *Complaints about the Council's Administration* provides information on the complaints procedure put in place by the Council. In the event that the internal stages of the complaints procedure do not lead to a satisfactory outcome the issue may be referred to the Council's ombudsman.

