Circular **02/12**

For Action: Responses requested by 30 September 2002

College Involvement in Companies

Consent to Participate in, Subscribe for or Otherwise Acquire Shares, or Securities of, Companies Providing Education Funded Wholly or Partly by the Council.

Summary

This Circular confirms that Further Education Corporations (Colleges) have a power to participate in, to subscribe for or otherwise acquire shares in, or securities of, companies. It sets out how the Council will deal with applications from colleges for consent required where these companies provide education that is, or will be wholly or partly funded by the Council.

It also provides guidance on the process and the criteria that the Council will use to consider consent and gives Colleges who already participate or have acquired shares and securities a temporary general consent.

The policies, principles and overall approach set out in the circular apply to college involvement in any company that provides education where this is funded wholly or partly by the Council. The Council has consulted with the Association of Colleges in the preparation of this circular.

July 2002

Learning+Skills Council

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Further information

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Responses

Responses requested by 30 September 2002

Executive Summary

Date: June 2002

Subject: Applications for consent for Further Education Corporations (colleges) to participate in, to subscribe for or otherwise acquire shares in, or securities of, companies providing education to be funded wholly or partly by the Learning and Skills Council (the Council).

Intended recipients: principals and chief executives of colleges

Status: For Information and Action

a. This Circular sets out how the Council will deal with applications for consent by colleges to participate in, to subscribe for or otherwise acquire shares in, or securities of, companies providing education that is, or will be, wholly or partly funded by the Council. It also deals with change of use of existing companies, that were not established to provide education, to now provide education. It gives guidance on the process and the criteria the Council will use when considering requests for consent.

b. The policies, principles and overall approach set out in the circular apply to college involvement in any company that provides education where this is funded wholly or partly by the Council.

c. This Circular provides a temporary consent up to 31 December 2002 for colleges that participate in, have acquired shares and/or securities in companies providing education wholly or partly funded by the Council prior to the date of this Circular.

d. This Circular should be read in conjunction with FEFC Circular 99/14: *College Companies, Joint Ventures and Overseas Operations* and the FEFC booklet published by HMSO: *College Companies and Joint Ventures, A Good Practice Guide.*

Consent to Participate in, Subscribe for or Otherwise Acquire Shares, or Securities of, Companies Providing Education Funded Wholly or Partly by the Council.

Introduction and Background

1 Further education colleges became independent corporations under the *Further and Higher Education Act 1992 (the F&HE Act)*. The specific powers of further education corporations are set out in Sections 18 (principal powers) and 19 (supplementary powers) of the *F&HE Act*.

2 The F&HE Act did not specifically provide for further education corporations (colleges) to participate in companies, although s19(1) provided that a college may do anything which appears to the corporation to be necessary or expedient for the purpose of, or in connection with, the exercise of any of their principal powers. The then Department for Education and Employment advised that colleges' supplementary powers were broad enough to enable them to create and participate in companies.

3 Paragraph 22 of Schedule 9 of the *Learning and Skills Act 2000 (the L&S Act)* amended s19 of the F&HE Act to provide specifically that colleges have a power to subscribe for or otherwise acquire shares in or securities of a company (s19(4)(bb)). The power given to colleges is restricted, however, as it cannot be exercised to:

i Conduct an educational institution (s19(4A) (running the college through a limited company)), or

ii Provision of education if the provision is secured (wholly or partly) by financial resources provided by the Learning and Skills Council (s19(4B)), without the consent of the Council (s19(4C)).

4 The Department for Education and Skills has confirmed that the requirement for consent in 3ii above, applies where the college participates in, acquired shares in or securities of a company:

i Prior to 1 April 2001;

ii Since the introduction of the L&S Act;

iii Which was established for a purpose other than the provision of education and where it is proposed to change the company's objectives and to use the company to provide education wholly or partly funded by the Council.

5 Where a college participates in a company providing education wholly or partly funded by the Council without Council consent, it is acting beyond its powers and its external auditors should qualify its financial accounts.

6 On 5 April 2001 the National Council decided to delegate the responsibility for giving consent for colleges to participate in companies providing education funded by the Learning and Skills Council to Local Councils. (Circular 01/03 *Corporate Governance, Annex A: Initial functions of Local Councils*)

College Participation in Companies

7 Previously, colleges created subsidiary companies for a number of reasons, for example:

- joint ventures with other partners;
- separation of charitable and commercial activities;
- joint procurement of services;
- the creation of a special purpose vehicle providing greater clarity and focus;
- marketing advantage;
- name protection;
- capital developments;
- VAT purposes.

8 A number of colleges used subsidiary companies as vehicles to deliver courses on behalf of the college as a franchise, or to provide work based learning. Since April 1 2001, this type of use requires the consent of the Council.

Impact of Legislation

9 The powers conferred on colleges by under s19(4) of the F&HE Act mean that colleges now have a specific power to participate in or create companies as long as the activities of that company are:

i Within the powers of a college as set out in sections 18 and 19 of the *F&HE Act* (as amended by schedule 9 of the *L&S Act*);

ii Not for conducting an education institution (i.e. running the college through a limited company);

iii Not for the provision of education that is wholly or partly funded by the Council unless the Council has given consent to the college to participate in or acquiring shares or securities in the company.

Grant of Temporary Consent

10 To deal with the situation where colleges already participate in or acquired shares and securities in companies providing education wholly or partly funded by the Council prior to the date of this Circular, the Council gives colleges a general temporary consent for their participation in companies, where it is required, up to 31 December 2002. Colleges must now seek a specific consent for their participation in companies providing education before the temporary consent ceases to ensure that they are acting within their powers.

11 Colleges participating in a company to which this general temporary consent applies should apply to their local Learning and Skills Council for a specific consent by 30 September 2002.

12 Colleges providing education through a company are required to cease such provision by 31 December 2002 where they have not applied for specific consent from their local Learning and Skills Council by 30 September 2002. Where a college has submitted an application before 30 September 2002 but has not been notified of the decision by 31 December 2002, the college needs to request an extension of the temporary consent from their local Learning and Skills Council.

Application for Consent

13 Any college requiring consent to use an existing company, or to participate in or create a company for educational provision wholly or partially funded by the Council should submit an application for consent to the Executive Director of its local Learning and Skills Council.

Information to be Provided by Colleges

14 An application for consent needs to include:

i Company name and number;

ii Shareholdings and details of other partners;

iii Names of Directors and the capacity in which they hold shares, if any;

iv Proposed main activity;

v The existing or proposed funding and financing structure to be put in place in the company, together with the sources of any funds;

vi How Council funding would reach the company, e.g. through contractual arrangements with the college for the provision of education, or directly;

vii Educational and business justification for the use of the company as a vehicle;

viii A copy of the corporation minute approving the college's participation in or the creation of the company;

ix A financial forecast and risk management plan for the acquisition (and the college if the cost of the acquisition or the transfer of funds is material);

x A generic contract where the college proposes to contract with the company for the provision of education.

Consent Criteria

15 Applications for consent will be considered against the following criteria:

i There is a genuine educational or business case for delivering the provision in this way rather than as direct provision;

ii The proposals are part of the college's strategic plans and financial forecasts;

iii The college obtains appropriate legal and financial advice;

iv The corporation has approved the proposal and the sums involved after informed consideration and is satisfied that participation in the company will assist in the delivery of the corporation's principal powers;

v Compliance with the requirements set out in FEFC Circular 99/14 *College Companies, Joint Ventures and Overseas Operations* and the FEFC booklet published by HMSO: *College Companies and Joint Ventures, A Good Practice Guide;*

vi If there is or will be a franchising agreement in place between the college and the company that it complies with FEFC Circular 99/37 *Franchising and Fees;*

vii The company or partnership arrangements are straightforward, transparent and available for scrutiny, with appropriate clear controls and accountability;

viii The college's internal audit plan includes scrutiny of the internal controls and systems supporting the company and the provision;

ix There are appropriate probity and quality monitoring procedures in place;

x The college, the Council and the National Audit Office (NAO) must have the right to examine the activities of the company.

16 Detailed guidance on the assessment of these criteria is set out in Annex A.

Accountability

17 The Council's *Audit Code of Practice* (currently the FEFC *Audit Code of Practice* - May 1998) set out in detail the accountability of colleges. The responsibilities set out in the financial memorandum, FEFC Circular 99/48, rest with the governing body and the principal. The corporation of each college must ensure that there is a sound system of internal control within the college and that there are high standards of conduct in the exercise of its functions. The existence of a rigorous framework of controls can assist governors to discharge this duty.

18 The college needs to demonstrate compliance with the all of the requirements set out in FEFC Circular 99/14: *College*

companies, Joint Ventures and Overseas Operations, and the FEFC booklet published by HMSO: *College Companies and Joint Ventures, A Good Practice Guide* and in particular:

i Arrangements exist to enable college governors to discharge their accountability and governance responsibilities in relation to the company;

ii Compliance with the requirements of the financial memorandum (FEFC Circular 99/48: *Financial Memorandum*);

iii Compliance with the college's instrument and articles of government. In particular the governors' responsibilities for the efficient and effective use of resources, the solvency of the corporation and the safeguarding of the corporation's assets;

iv Recommendations of the Committee for Public Accounts (PAC) and bodies such as the NAO as to what constitutes the good use of public funds;

v The college corporation approves both to the principle of using this company and to the sums involved;

vi The need for compliance with:

- the *Companies Acts*;
- the *Trustee Act 2000*;
- if subject to trust deeds, the investment powers set out therein;
- if a charity, the *Charities Acts*, and in particular, the trustees duty to safeguard and maximise the Charity's assets.

Refusal of Consent

19 The Council will not give consent for a college to use a company for the delivery of educational provision wholly or partly funded by the Council where there is clear evidence of non compliance with the criteria set out above. Where the local Learning and Skills Council is considering refusing consent, they will set out their reasons in writing and give the college the opportunity to make representations. After consideration representations from the college, the local Learning and Skills Council will notify the college in writing of its decision and the right to appeal.

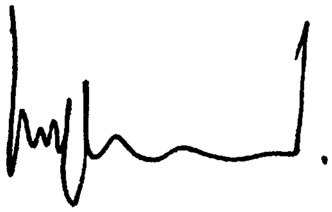
20 Where a local Learning and Skills Council refuses consent, the college may appeal against the decision in writing to the Director of Finance at the National Office. In considering such an appeal the national Director of Finance will consult with the Director of Operations at the National Office. A College has one month from the notification of the refusal to appeal. In these circumstances, the Council will consider giving a reasonable limited extension of the temporary consent to allow consideration of the appeal. If consent is declined the college will have until 31 July 2003 to cease the provision to enable an orderly withdrawal and to protect the interests of the students.

21 Where no decision on consent is communicated to the college by 31 December 2002, or within two calendar months of the date of application by the college, whichever is the later, the college should request a decision from the local Learning and Skills Council and send a copy of the request to the Director of Finance at the National Office.

Timetable for Processing Requests for Consent

22 Colleges should seek formal consent where necessary from their local Learning and Skills Council by 30 September 2002 in respect of any existing companies or any new arrangements already planned that uses Council funding. Subsequently, colleges must seek formal consent for participation in, the change of use of, or for the acquisition of shares in, or securities of, a company. Colleges are encouraged to consult their local Learning and Skills Council about any proposed future arrangements before making the formal application for consent.

23 Local Learning and Skills Councils should grant formal consent where considered appropriate, or give formal notification of refusal of consent by 31 December 2002, or within two calendar months of the date of application by the college, whichever is the later.



John Harwood, Chief Executive

Annex A : Detailed Criteria that a College Needs to Provide for Consent to Use a Company to Deliver Educational Provision

I There is a genuine educational or business case for delivering the provision in this way rather than as direct provision

- The participation or investment should clearly assist in the delivery of the college's principal powers as set out in sections 18 of the *Further and Higher Education Act 1992* and should not involve the college in an independent business venture of no benefit to the college;
- The college must identify the risks, advantages and disadvantages of the approach;
- The approach proposed must have demonstrable advantages over alternative arrangements;
- Where the proposal includes some form of joint venture, the college should have considered the benefits of going it alone and purchasing the specialist services as required;
- The advantages and disadvantages of a non company joint venture compared with the formation of a company should be demonstrated;
- The vehicle should not be designed merely to remove assets or liabilities from the college balance sheet;
- The transaction should not be intended to replace an existing franchise with a discounted funding rate with a non-discounted franchise with the same partner.

II The proposals are part of the college's strategic plans and financial forecasts

- The proposals are set out in the college's strategic plans;
- The proposals will contribute additional educational provision and are not simply a replacement for existing provision;
- A 3 year financial forecast indicates that the proposal makes a positive contribution to the college's financial health;
- The college has undertaken a suitable risk management assessment with appropriate sensitivity analysis and contingency planning. The college is bearing an acceptable level of risk.

III Take appropriate legal and financial advice

- The proposals are lawful and appropriate and fall within the powers of the college;
- The activities of the company are lawful;
- Any services provided by the company are ancillary to the company's main activities;

- Where the company is an overseas registered company or joint venture, the college should ensure that Learning and Skills Council Funding is not used for overseas activities;
- Obtain a rigorous and comprehensive due diligence study of the company. (This is not necessary for existing college companies.)

IV The corporation approves the proposal and the sums involved after informed consideration and is satisfied that the participation in the company will assist in the delivery of the corporation's principal powers

- There is a detailed minute of the corporation decision clearly evidencing the decision about the proposal, including the benefits and costs;
- The corporation has considered the potential maximum financial and non financial risks;
- There is a suitable risk management plan to deal with the risks identified.

V All of the requirements set out in FEFC Circular 99/14 *College Companies, Joint Ventures and Overseas Operations* and the FEFC booklet published by HMSO: *College Companies and Joint Ventures, A Good Practice Guide* are or will be complied with

- The college should be able to demonstrate how it will deal with these requirements, especially:

  i Restriction of company and joint venture activities;

  ii Organisation of companies and joint ventures;

  iii Use of college and public funds in relation to companies and joint ventures;

  iv Accountability and governance;

  v Financial control including financial procedures and regulations and financial performance.

VI Where appropriate, a franchising agreement in place between the college and the company will comply with FEFC Circular 99/37 *Franchising and Fees*

- There is an appropriate generic franchising agreement between the college and the company;
- There are appropriate probity and quality monitoring procedures in place;
- The college will demonstrate how it will comply with the requirements set out in Circular 99/37 *Franchising and Fees*.

VII The company or partnership arrangements are straightforward, clear and transparent and available for scrutiny, with appropriate transparent controls and accountability

- There are appropriate, transparent controls and accountability arrangements;
- The college must have representation from the college corporation on the board of any significant joint venture;
- The memorandum of agreement sets out the responsibilities of college governors and employees who are also directors;
- The college is aware of the ultimate ownership of the company and has identified if relevant, the ultimate holding company and its directors;
- The directors are not disbarred from directorships and are not and have not been bankrupt or insolvent, and do not have any judgments outstanding against them;
- All directors and staff in the company have complied with the requirements to disclose any conviction, caution

or binding over including 'spent convictions' under the *Rehabilitation of Offenders Act 1974 (Exemptions) Order 1975*, and a police check of previous criminal convictions has been carried out;

- There should be no conflicts of interest, for example: an interest in a major customer or supplier of the company or joint venture;
- No member of the college audit committee should also be a director of the company;
- There should be no remuneration of directors of college companies;
- There should be clear arrangements for day to day operational management of the company or joint venture and for the management of company or joint venture funds. These arrangements should be subject to regular audit inspection by the company or joint auditors;
- The company or joint venture should be subject to external audit and ISR audit even if the company or joint venture is not required to have auditors under small company legislation.

VIII The college's internal audit plan includes scrutiny of the internal controls and systems supporting the company and the provision

- The internal audit plan and risk assessment includes the company's procedures and control systems for review at an early date;
- If there is an existing report on the controls and procedures in place and operating, review the internal audit report to ensure that adequate controls are operating.

IX There are appropriate probity and quality monitoring procedures in place

- The college has appropriate controls and procedures to ensure that the educational provision made through the company will be at least as good as provided through the college;
- There will be a suitable overview of the college's operation to ensure compliance with the law, ensure that public funds are properly accounted for and spent in accordance with good practice and value for money.

X The college, the Council and the NAO must be able to examine the activities of the company

- There should be evidence of a memorandum of understanding providing access rights to both companies and joint ventures. This should include access to books and records, documents, company personnel and all company premises;
- The college's internal audit plan includes scrutiny of the internal controls and systems supporting the company and the provision;
- Wherever possible, the external auditors and ISR auditors of the college should be the external auditors and ISR auditors of the company.

Annex B: Further Reference

Learning and Skills Council Circulars

01/03 Corporate Governance

FEFC Circulars

99/48 Financial Memorandum

99/14 College Companies, Joint Ventures and Overseas Operations

99/37 Franchising and Fees

96/06 Franchising

FEFC publications

Audit Code of Practice

FEFC booklet published by HMSO:
College Companies and Joint Ventures, A Good Practice Guide

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Notes

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Publication enquiries: 0870 900 6800

Reference CIRC/0241/02