September 2013/21

Regulation and accountability

Consultation

This consultation seeks views on proposed revisions to the financial memorandum between HEFCE and institutions.

Responses should be made online by 1700 on Friday 6 December 2013

Financial memorandum: conditions of grant payments to institutions

Consultation on arrangements for 2014-15 onwards

HIGHER EDUCATION FUNDING COUNCIL FOR ENGLAND

Contents

Financial memorandum: conditions of grant payments to institutions

Consultation on arrangements for 2014-15 onwards

To	Heads of HEFCE-funded higher education institutions Heads of HEFCE-funded further education colleges Key stakeholders with an interest or involvement in the regulation of higher education
Of interest to those responsible for	Vice-chancellors and principals, Governing bodies, Senior management, Finance, Audit, Providers of capital, Student representatives, Other beneficiaries of regulatory assurance
Reference	2013/**21**
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Executive summary

Purpose

1. This consultation seeks views on proposed revisions to the financial memorandum between HEFCE and institutions.

Key points

2. The financial memorandum between HEFCE and the institutions it funds is the formal accountability mechanism for the grant funding that HEFCE distributes. It derives from the Further and Higher Education Act 1992. HEFCE has reviewed the financial memorandum periodically to ensure it remains fit for purpose. The last revision was in 2010.

3. This latest review is part of that continuing process, but also takes account of the Government's reforms to the funding of higher education (HE) and how those are being introduced.

4. The proposed changes to the financial memorandum are limited as HEFCE is operating within the existing legislative framework. We have taken the opportunity to reduce the overall length of the document and include only what we consider necessary.

5. The review of and proposed revisions to the financial memorandum have been based on a number of principles. These are:

- institutional autonomy
- the collective student interest
- the public interest and accountability for public funds

- proportionate accountability
- maintaining stakeholder confidence
- minimising burden and removing duplication
- transparency and openness.

6. There is a history of self-regulation across the sector, and where we have confidence in the institution's processes we will rely on the assurances that HEIs provide for themselves. From time to time we will validate these assurances. This respects autonomy and limits the cost of regulation.

7. The most significant issue for consultation is what requirements are necessary to manage the risks around financial commitments taken on by HEIs. The current borrowing consent approach, based upon annualised servicing costs, is no longer suitable because banks are now generally lending on shorter timescales, albeit the expectation is that such lending will be renewed. In addition there is greater use of revolving credit facilities, so the distinction between short-term and long-term borrowing is increasingly blurred. There are different views as to what new arrangements we should put in place. We are not indicating any preference but are proposing alternatives (see paragraphs 31 to 60 below). We have not, therefore, included revised text on financial commitments in the draft financial memorandum because we wish to seek views from the sector and, importantly, from banks.

8. Other proposed changes are:

- **Research integrity** – in line with the outcome of our consultation on the concordat on research integrity, we are reflecting the HE sector's agreement that this is a condition of research grant funding.
- **Material adverse events** – the current financial memorandum refers to governing bodies being required to inform us about material adverse events. We are not proposing to revise the substance of this, but depending on the views on financial commitments, this could explicitly refer to significant increases in financial commitments.
- **Register of HE providers** – The database will provide information for prospective and current students about providers of higher education, including their corporate form and arrangements for quality assurance and student complaints. Where there are concerns that we believe should be brought to the attention of prospective or current students, we intend to flag these in the register. We will work with sector bodies to set out the criteria for assessing when such concerns would lead to a flag in the register.
- **Subscriptions to Jisc** – Jisc is now a separate legal entity and is in transition whereby its funding is moving from less grant funding to more subscription income. We are proposing to support this transition by requiring HEIs to subscribe to Jisc for the three years from August 2014 to July 2017.
- **Sustainability assessments** – The Financial Sustainability Strategy Group is overseeing the development of sustainability assessments. A pilot scheme has been operating and HEIs are providing these data voluntarily by

December 2013. We welcome the Committee of University Chairs' (CUC's) willingness to consider including these sustainability assessments in its revised Governance Code of Practice and General Principles. The assessments will be of benefit to HEIs' governing bodies, and will be valuable assurance to HEFCE and the Research Councils. Adoption within the revised CUC Governance Code of Practice and General Principles would respect the principle of self-regulation and enable the assessments to serve multiple purposes, thus reducing cost.

- **Audit Code of Practice and annexes to the financial memorandum** – we are proposing to reduce significantly the Audit Code of Practice (Annex A to the draft financial memorandum) and are also proposing to reduce the total number of annexes because some of these are no longer necessary or can be covered through other routes.
- **Exchequer interest**[1] – this is created through the provision of capital grants to HEIs. The current financial memorandum sets out the circumstances that could lead to some or all of this being repaid. One of the triggers that would lead to such repayment is reduction to HEFCE income. With the shift from grant to tuition fees, repayment would be triggered (because of the reduction in HEFCE income) in circumstances not envisaged when the system was created. To prevent this we are proposing to revise the trigger to HEFCE and Student Loans Company income combined.
- We have made some minor revisions to the **institutional engagement and support strategy** in light of how this has worked over recent years, and set out more explicitly what actions we might take if circumstances warrant this.
- We have updated the text and annex to more fully reflect HEFCE's role as **principal regulator** for those HEIs that are exempt charities. We have also updated the section on equality and diversity to take account of the requirements of the Equality Act 2010.
- There are a number of other minor textual changes or updates. We have also re-ordered some sections and brought these together to aid the reader and avoid duplication.

9. The draft financial memorandum forms Annex B to this consultation.

Responding to this consultation

10. The closing date for responses is **1700 on Friday 6 December 2013.** Responses should be made using the online form that accompanies this consultation on the HEFCE

[1] When public capital grants are provided to HEIs there is an expectation that the assets created (either partly or fully) with those capital grants remain in use for the provision of higher education. Such assets have lives of many years and should be applied for their intended purpose for the duration of those lives. Should an HEI dispose of an asset created partly of fully with such a capital grant – and the proceeds are not reinvested into another higher education asset – this could lead to that HEI being required to repay some or a proportion of the original capital grant. This is because the purpose for which the capital grant was awarded originally is no longer being met.

web-site. The consultation questions are throughout the document but are listed at Annex A.

11. We will be holding two consultation events, on 1 November 2013 in Manchester and on 18 November 2013 in London. We are inviting stakeholders to these events. If you have not received an invitation and would like to request a place, e-mail i.lewis@hefce.ac.uk. Please note we may need to limit places. Details about the venues and programmes for the two events can be found at www.hefce.ac.uk/news/events/

Freedom of Information Act 2000

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

Analysis of responses

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

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

Next steps

15. The HEFCE Board will consider a summary of the responses to this consultation, and approve the new version, in March 2014.

16. The new financial memorandum will be effective from 1 August 2014.

Introduction

17. In 2011 the Government published its higher education White Paper 'Students at the Heart of the System' and consulted on possible changes to HEFCE's role. The Government has subsequently decided not to introduce new primary legislation but has looked to deliver its higher education (HE) reforms through administrative means within the existing legislative framework. It wished to see the impact of these reforms before considering primary legislation.

18. The regulatory environment though has changed since 2011, with the shift in funding from grant to tuition fees and the increased recognition and regulation of alternative providers.

19. The Regulatory Partnership Group has worked with its key partner bodies and the Department for Business, Innovation and Skills (BIS) to develop an Operating Framework[2] which describes the current regulatory landscape. The statement to Parliament by the Minister for Universities and Science on 11 July 2013 set out reforms to how higher education is regulated. There are therefore a number of regulatory components that need to be viewed as contributing to the overall regulatory system, including:

- HEFCE financial memorandum with higher education institutions (HEIs); and HEFCE funding agreements with HEIs and further education colleges (FECs)
- HEFCE's institutional designation of HEIs for student support funding (see paragraph 21)
- the Skills Funding Agency's (SFA's) financial memorandum with FECs
- BIS' course designation for alternative providers for student support funding.

20. The 2011 White Paper envisaged a single regulatory system, but this can only be achieved if new primary legislation is introduced. The published Operating Framework therefore set out what is possible in the absence of new primary legislation.

21. This means the revised financial memorandum will apply to HEIs. It does not apply to alternative providers of HE, who will be subject to the terms and conditions of course designation determined by BIS. As announced in the ministerial statement on 11 July, BIS intends to set out separate arrangements in respect of conditions relating to automatic designation or student support funding. These arrangements will apply to all publicly funded HEIs.

22. It also means that the scope for HEFCE's current revision of the financial memorandum is limited to take account of change, including:

- how HEIs take on financial commitments
- where there are new requirements, such as those already agreed on research integrity

[2] www.hefce.ac.uk/about/intro/wip/rpg/of/

- an update to more fully reflect HEFCE's role as principal regulator of those HEIs that are exempt charities.

23. At the same time we have removed unnecessary detail, particularly in the Audit Code of Practice. We are also proposing to remove annexes, as some of these are no longer necessary or are documents that are best maintained separately on HEFCE's web-site, as good practice.

24. The existing financial memorandum and its previous versions have focused on the public interest, given the level of grant funding that HEFCE has distributed. The shift from grant to tuition fees has now placed additional emphasis on the collective student interest at the heart of everything HEFCE does.

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

26. HEFCE has had a financial memorandum with the HEIs it funds since 1993 and has periodically reviewed and revised this to ensure it remains fit for purpose.

27. The financial memorandum continues to be in two parts.

- Part 1 is a standard set of institutional terms and conditions that apply to all HEIs in receipt of HEFCE grant funding.
- Part 2 is an individualised funding agreement that sets out the specific conditions relating to grants provided to each HEI and further education college in receipt of HEFCE grant funding.

28. This is a consultation on Part 1 only. This was last revised in 2010 (www.hefce.ac.uk/pubs/year/2010/201019/). This sets out the terms and conditions that HEIs are required to meet in exchange for the funding provided.

29. In developing the draft financial memorandum we have held discussions with a number of key stakeholders and sector bodies. We are very grateful for their willingness to contribute to our thinking. Their input has led to a better draft document on which we are now consulting.

Question 1: Do you agree that the draft revised financial memorandum fully takes account of the regulatory landscape that currently exists with no new primary legislation?

Do you have any comments?

Question 2: Does the draft revised financial memorandum adequately place the collective student interest alongside the public interest?

Do you have any comments?

Proposed changes to the financial memorandum

30. The proposed text of the revised financial memorandum is included at Annex B. The changes and the reasons for proposing these changes are set out below under the following headings:

- Financial commitments
- Research integrity
- Material adverse events
- Register of HE providers
- Subscription to Jisc
- Inclusion of institutional sustainability assessment
- Changes to the Audit Code of Practice
- Changes to Exchequer interest repayment triggers
- Updating on institutional engagement and support and on safeguarding actions
- Updating on HEFCE charities role
- Updating on equality and diversity
- Annexes to current financial memorandum
- Other issues.

Financial commitments

31. Annex B does not include a change on financial commitments as we wish to seek views on the best way forward. Our discussions with a number of sector bodies and other stakeholders, including lenders, have confirmed our own view that the present requirements for HEIs to seek approval ahead of entering into increased levels of short-term or long-term borrowing (paragraphs 31 to 32 and Annex F of the current financial memorandum) need to change.

32. This is because the way that HEIs raise finance has changed over recent years. Lending by banks is now typically over shorter timescales – often five years, when previously it was 25 to 30 years – and increased use of revolving credit facilities which are not linked to specific timescales. While banks amortise their loans to HEIs over 25 years, they cannot borrow in the market for those lengths of time so lend for shorter periods of time. This also allows them the opportunity to review interest rates and other terms.

33. This means the annualised service cost (ASC) approach that spreads the costs of borrowing over the repayment period of the borrowing creates an artificially high value.

34. A second issue is that the current ASC thresholds apply only to borrowing that is on an HEI's balance sheet. This excludes financial commitments that are accounted for as operating leases or other forms of off-balance sheet finance. This limits the effectiveness of the threshold approach in addressing risks.

35. The risks that we are seeking to address are:

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

36. If these risks are not properly addressed they may lead to intervention by HEFCE at its discretion that could become a call on public funds, or they may threaten the student experience or undermine the quality of research.

37. The assessment and management of these risks rests primarily with the governing bodies of the HEIs. That said, there needs to be both respect for institutional autonomy and protection of the public investment and the collective interest of students. There also needs to be confidence in HEFCE's monitoring arrangements. A strength of the current system is that it identifies future or potential issues, so we can work constructively with HEIs to reach solutions.

38. The operation of the current ASC thresholds for approval by HEFCE has not led to requests to increase borrowing being rejected, but a number of proposals have been withdrawn, modified or had conditions attached that have reduced the risks. The number of such requests has increased, not necessarily through increased borrowing but, for example, because shorter-period loans create higher annual repayments under the ASC approach. There is also less distinction between short-term and long-term term financial facilities than when the previous thresholds were devised.

39. Although risks need to be managed and controlled, thresholds would need to be sufficiently high to recognise that financial judgement and responsibility rests with HEIs' governing bodies.

40. The institutional risk assessment processes operated by HEFCE draw on a range of information including financial forecasts and supporting financial commentaries, and an indication of future financial commitments, but only as far as they are included. A question is then whether these existing processes are sufficient to manage the risks set out at paragraph 35 above without the borrowing consents that exist at present – or whether some form of approval needs to be retained.

41. HEIs will continue to receive substantial amounts of public funding – either directly through grants from HEFCE and other public funders, or indirectly through publicly funded student loans. The Research Councils and the Skills Funding Agency rely on HEFCE's financial health monitoring role to be assured about the sustainability of HEIs. Also BIS, which is accountable to Parliament for these public funds, formally asks HEFCE to have and operate adequate assurance arrangements over the financial sustainability of HEIs and their use of public funds.

42. In addition, banks and other financial institutions may be aware of the wider accountability framework, including the financial health monitoring role carried out by

HEFCE. While this framework is not designed for, addressed to or for the benefit of lenders, it may influence their assessment of risk and, therefore, the availability, cost[3] and terms of borrowing by HEIs. This may be a benefit to HEIs. The views of these lenders will be important in deciding what arrangements we include in the revised financial memorandum.

43. The key issue is how HEFCE can best receive advance information that would identify the potential risk of an HEI taking on financial commitments that were unaffordable, were poor value for money, or on onerous terms. In most cases the current requirements provide this early notification, but are there alternative and better ways for HEFCE to operate?

44. We have considered a range of options as to how we might evolve the current financial memorandum requirements so these remain fit for purpose in a changed financing environment. We have discussed these with sector bodies and with lenders, and there are two broad approaches on which we would welcome views. We would, however, welcome alternative approaches that address the risks set out at paragraph 35 above.

45. The text of the draft financial memorandum (paragraph 50 and Annex C of the draft financial memorandum) has been left incomplete pending the outcome of this consultation.

46. The two broad approaches are:

- an alternative threshold
- enhancing the information on financial commitments to be included within the accountability information provided to HEFCE.

We recognise that these two approaches are not mutually exclusive and that new arrangements could include elements of both.

Alternative threshold

47. HEIs' financial statements are prepared in accordance with the Statement of Recommended Practice that applies to FECs and HEIs (SORP). The SORP is in the process of revision. In addition Financial Reporting Standard 102 (FRS 102) will introduce international reporting standards into UK financial reporting from 2015-16, although comparative financial information for 2014-15 will need to be produced. FRS 102 will also bring changes to what is recognised as income and to what is included as liabilities on balance sheets, as well as changes to financial indicators used for assessing performance and comparisons.

48. The British Universities Finance Directors Group has worked with the Financial Sustainability Strategy Group to develop a measure of surplus as part of the sustainability assessment metrics. This measure is referred to as EBITDA – earnings before interest, taxes, depreciation and amortisation.

[3] We estimate that bank lending rates would rise by between 1 per cent and 2 per cent, with increases in interest costs of between £50 million and £100 million a year.

49. A multiple could be applied to EBITDA linked, say, to the timescale over which banks are lending to HEIs. However, there is no uniform lending period, so the multiple would need to be based on an agreed average lending term.

50. One option, therefore, is that a threshold could be set that would require an HEI to seek approval where its financial commitments exceed a multiple of its reported EBITDA surplus. There may be volatility in reported surpluses from one year to another. This could be addressed through taking an average, say over the last three reported annual surpluses.

51. There are of course other potential alternative thresholds that have been suggested to us. These include gearing ratios, or a ratio of net debt to income. We have modelled some of the alternative thresholds:

- borrowing as a percentage of income
- net debt as a percentage of income
- EBITDA (cash flow from operations used as proxy).

52. Illustrative examples have been shared with the British Universities Finance Directors Group, and other key stakeholders, as part of the consultation, and are available on our web-site at
www.hefce.ac.uk/whatwedo/reg/instfinance/financialmemorandum/

53. The advantage of a threshold approach is that it continues to provide advance notice of an HEI's intentions to increase its financial commitments. However, there may be volatility between years. While FRS 102 will bring more financial commitments onto an HEI's balance sheet, there may still be other financial commitments that are not included.

Enhanced accountability information to HEFCE

54. The present requirement for an HEI to seek prior approval when it intends to increase its borrowings above a threshold is not part of the annual accountability return and financial health monitoring processes. An alternative approach to having such a threshold would be to include additional information in the annual accountability return on an HEI's plans to increase its financial commitments.

55. The levels of financial commitment would therefore inform the risk assessments of HEIs. This in turn would impact on whether an HEI was considered to be 'at higher risk' or 'not at higher risk'. We would require all those HEIs considered to be 'at higher risk' to seek approval to increase their financial commitments; and we would reserve the right to require other HEIs 'not at higher risk' to seek such approval where we considered their levels of financial commitment to be significantly above sector norms, or where large transactions are involved.

56. This could be supplemented by an increased focus on comparisons of actual financial performance, including on levels of financial commitments and capital investment, against forecast. In addition, the requirement on accountable officers to report on material adverse events (paragraphs 54 and 55 of the draft financial memorandum) could include a requirement to notify HEFCE's chief executive of the intention to significantly increase the level of financial commitments.

57. Such an approach would reduce the burden on HEIs and reinforce that the primary responsibility to manage risks around financial commitments rests with governing bodies. It would also integrate these risks within HEFCE's overall financial health processes. Increases in financial commitment are one risk, but it is the totality of HEFCE financial health monitoring and assurance arrangements that provide assurance for students, the public and other stakeholders. This may, however, appear weaker than the current requirements to the capital markets and might increase borrowing costs.

58. A variant of enhancing the accountability information could be to set a threshold value of financial commitments for each HEI based on the financial forecast and other accountability information provided each year. This again would reduce the burden on HEIs because would be integrated with the overall financial health processes while possibly providing added assurance to lenders.

Considering the options

59. The question though is which approach, or combination of approaches, would best ensure sufficiently early notice of an HEI's intention for HEFCE to act should the need arise.

60. Once it is clear what requirements will be included in the revised financial memorandum, we will work with the British Universities Finance Directors Group to agree definitions and to set out clearly how processes would work. This will include setting out a level of materiality so that only material financial commitments are included.

Question 3: Do you agree that the current distinction between short-term and long-term borrowing is no longer appropriate, and should discontinue within future arrangements?

Do you have any other comments?

Question 4: We have set out alternative approaches to how the risks to the public and the collective student interest around financial commitments are addressed by HEFCE. We would welcome comments on and preference for each of these.

Question 5: Do you agree that future requirements should be based on total financial commitments? If so, how are these best defined? If not, what should they be based on, and why?

Do you have any other comments?

Question 6: Are there other alternatives we have not considered? If so please describe these and how they would manage the risks set out at paragraph 35 of this document.

Research integrity

61. Universities UK developed the concordat about standards and integrity in UK research with the HE funding bodies and Research Councils, the Wellcome Trust and a number of government departments. It was launched on 11 July 2012. It sets out five commitments that assure Government, the wider public and the international community that the highest standards of rigour and integrity will continue to underpin research in the UK.

62. We consulted earlier this year on implementing the concordat[4]. The consultation invited comments on whether compliance should become a mandatory requirement for institutions, and how this might best be monitored. The outcome of the consultation was to support the mandatory requirement proposal. This is now included in HEIs' individual grant letters and in standard terms and condition of research funding. We have reflected this in the draft financial memorandum.

Material adverse events

63. Paragraph 18 of the current financial memorandum includes a requirement for the governing body of an HEI to inform us of material adverse changes or significant developments that could impact on the mutual interests of the HEI and HEFCE.

64. We have not changed the substance of this but have updated the text. Depending on the consultation outcome on financial commitments (see paragraphs 31 to 60 above), material events could also include significant increases in financial commitments.

Register of HE providers

65. As described in the Operating Framework we are developing a register of HE providers. The register will include HEFCE-funded providers and providers not in receipt of HEFCE funding but which have courses designated for student support. The register will provide information for prospective and current students about providers of higher education, including their corporate form and arrangements for quality assurance and student complaints. Where there are issues that we believe should be brought to the attention of prospective or current students, we intend to flag these in the register. We will work with sector bodies to set out the criteria for assessing when such concerns would lead to a flag in the register.

Question 7: Do you agree with the proposal to identify issues for prospective and current students in the register of HE providers (paragraphs 20 and 81 of the draft financial memorandum)?

Do you have any other comments?

Subscription to Jisc

66. Jisc is a major UK asset and has been for many years. Jisc works in partnership with HEIs and FECs, creating agile digital services to strengthen their global market

[4] HEFCE Circular letter 21/2013.

position while keeping costs under control. In direct cost savings and cost avoidance alone, Jisc saves the education sectors £259 million (www.jisc.ac.uk/about/facts-and-figures), in addition to the further value arising from productivity, efficiency and added value benefits. This means that Jisc saves the education sectors more than two and a half times the investment needed to operate the organisation.

67. Jisc became a separate legal entity in December 2012. The shift in funding of higher education in some jurisdictions in the UK from grants to increased tuition fees means that the way Jisc is funded will be changing, with a shift in the proportion of its funding to be met directly from users. A Jisc membership model will be introduced from August 2014, creating a closer relationship between Jisc and those it directly serves. Taking into account the efficiencies that Jisc has already made and expects to continue to make, Jisc will absorb the majority of grant funding reductions. Jisc will be establishing a VAT cost-sharing group prior to August 2014 so there will be no VAT to pay on membership subscriptions.

68. The Jisc chair, Sir Tim O'Shea, has recently written to institutions to outline the implications of the change in funding. A comprehensive list of Jisc's services and resources can be found on a dedicated page on Jisc's web-site (www.jisc.ac.uk/network/).

69. We have therefore included in the draft financial memorandum (paragraphs 62 and 63 of the draft financial memorandum) a requirement that HEIs subscribe to Jisc from August 2014 to July 2017, at which point we will consider the situation again. Jisc subscription will include the existing subscription to JANET, which HEIs have paid for some time.

70. This kind of requirement is not new. A similar requirement was included in a previous financial memorandum to support the Higher Education Academy in its initial three years.

Question 8: Do you agree with the intention to require HEIs to subscribe to Jisc?

Do you have any comments?

Inclusion of institutional sustainability assessment

71. The Financial Sustainability Strategy Group is overseeing the development of an institutional sustainability assessment and report (ASSUR), for adoption by HEI governing bodies. A pilot scheme has been operating and HEIs are to provide these voluntarily by December 2013.

72. We welcome the Committee of University Chairs' (CUC's) willingness to consider including these sustainability assessments in its revised Governance Code of Practice and General Principles. The assessments will be of benefit to HEIs' governing bodies, and will be valuable assurance to HEFCE and the Research Councils. Adoption within the revised CUC Governance Code of Practice and General Principles would respect the principle of self-regulation and enable the assessments to serve multiple purposes (including institutions' own going-concern assessments), thus reducing cost.

Changes to the Audit Code of Practice

73. The current Audit Code of Practice (ACOP) runs to 12 pages. We have reviewed this to see where this could be reduced so that it sets out what we require and does not go into detail about how those requirements might be achieved.

74. The revised version at Annex A to the draft financial memorandum seeks to do this. It sets out the requirement for HEIs to have audit committees and to have both internal and external audit, as we believe both are essential to achieve the necessary levels of assurance on the management of risk, internal control and governance, as well as on value for money. There is now guidance from a number of sources on good practice, including the CUC Audit Committee Handbook, and we would expect such guidance to be followed by HEIs in how they meet the requirements in Annex A to the draft financial memorandum.

Question 9: Do you agree that the revised Audit Code of Practice at Annex A to the draft financial memorandum is sufficient to set out HEFCE's requirements? If not, what changes would you suggest?

Do you have any other comments?

Changes to Exchequer interest repayment triggers

75. The Government expects assets created fully or partially by HEFCE capital grants, or certain other capital funding, to continue to be used for higher education purposes. This is the Exchequer interest.

76. The Exchequer interest system was reformed in 2006 to streamline reporting requirements; write down the Exchequer interest over the expected life of the investment; and provide a mechanism for repayment in certain circumstances.

77. Paragraphs 9 to 13 of Annex G to the current financial memorandum set out the circumstances in which the Exchequer interest becomes repayable. There are currently two trigger events that would lead to an HEI being required to repay the outstanding Exchequer interest. The first of these relates to insolvency, so remains valid and it is not proposed to change this.

78. The second trigger event is if there is a significant reduction in the level of HEFCE-funded activity at an institution. This has been measured in relation to:

a. The absolute level of HEFCE income.

b. The absolute level of total income.

c. The percentage of total income represented by HEFCE income.

79. The trigger event will currently occur if two or more of the three indicators reduce to at least 50 per cent from the base level determined at August 2006.

80. Clearly a and c (in paragraph 78 above) no longer work with the reduction in HEFCE grant funding. We are proposing (see paragraph 64 and Annex D of the draft financial memorandum) that 'HEFCE income' should be changed to 'HEFCE and income from the Student Loans Company combined'. We see this as a practical solution that

would in effect put the HEI back into the same position as before the shift from grant to fees.

Question 10: Do you agree with the proposed changed to the second trigger for the repayment of Exchequer interest from HEFCE income to the total of HEFCE and SLC income?

Do you have any comments?

Updating on institutional engagement and support; and on safeguarding actions

81. Annex D to the current financial memorandum sets out our institutional engagement and support strategy. We have reviewed this in light of how it has worked over recent years. This has not led to any major changes but we have sought to make it clear that this addresses the collective student interest as well as the public interest. We also wish to be more explicit around what action we might take to safeguard those interests should circumstances warrant it. We have therefore included a specific section on institutional engagement, support and safeguarding actions in the main text (paragraphs 67 to 82 of the draft financial memorandum) with more detail at Annex B of the draft financial memorandum.

Updating of HEFCE charities role

82. HEFCE has a statutory role to act as principal regulator for those HEIs that are exempt charities. We have updated Annex H and the text in the current financial memorandum, which sets out the information requirements for HEIs that are exempt charities, to take account of recent charities legislation.

83. There are a number of references to HEIs as charities and that members of governing bodies of these HEIs are also trustees and subject to the requirements of charity law. As such they have an obligation to ensure charitable objectives are followed and charitable assets not put at risk. The updated information requirements for HEIs that are exempt charities are at Annex E of the draft financial memorandum.

Updating on equality and diversity

84. Since the current financial memorandum was introduced the Equality Act 2010 has come into force. This Act introduced nine protected characteristics in respect of which discrimination is unlawful in most situations. The protected characteristics under the Act are:

- age
- disability
- gender reassignment
- marriage and civil partnership
- pregnancy and maternity
- race

- religion or belief (including lack of belief)
- sex
- sexual orientation.

85. We have therefore updated the text on equality and diversity, set out at paragraphs 57 to 59 of the draft financial memorandum.

Annexes to current financial memorandum

86. The current financial memorandum includes 11 annexes. We have reviewed each of these to see if they are still required; and if they are, whether they need updating or revising. The result is that we are proposing to reduce these to five. The position in respect of each annex is set out below.

Annex in existing financial memorandum	**Proposed annex in revised financial memorandum**
Annex A: Mandatory requirements of the financial memorandum and Audit Code of Practice	We think this is no longer needed as the main text is clear and only includes the actual requirements. We can though include this if there is sufficient demand in responses to the consultation
Annex B: Audit Code of Practice	Annex A: Audit Code of Practice, but reduced in detail
Annex C: Allocating and paying funds	We think this is no longer needed because this can be addressed through information on HEFCE’s web-site
Annex D: Institutional engagement and support strategy	Annex B: Institutional engagement, support and safeguarding actions
Annex E: Model assurance return from institutions	We think this is no longer needed because this can be addressed through information on HEFCE’s web-site
Annex F: Consent for financial commitments	Annex C: Financial commitments. The content of this annex depends on the outcome of the consultation
Annex G: Exchequer interest	Annex D: Exchequer interest
Annex H: Information requirements for HEIs that are exempt charities	Annex E: Exempt charities
Annex I: Summary of responsibilities of members of governing bodies	We think this is no longer needed because we expect this to be adequately covered by the next CUC *Guide for Members of Higher Education Governing Bodies in the UK: Governance Code of Practice and General Principles,* which is being revised

Annex J: Model letters of appointment for new heads of institution and the accountable officer	We think this is no longer needed because this can be addressed through information on HEFCE’s web-site
Annex K: Model letter of appointment for new chair of a governing body	We think this is no longer needed because this can be addressed through information on HEFCE’s web-site

Question 11: Do you agree with the proposed changes to the annexes to the financial memorandum? If not, please set out what you would wish to see instead and why.

Other issues

87. We have set out in the preceding paragraphs all the material changes to the financial memorandum. There are further minor textual changes or added clarifications. We have not highlighted these but would welcome comments on any issues which you believe we have not addressed or addressed adequately.

Question 12: Do you have any other comments on the proposed revised financial memorandum that have not been covered in the preceding questions?

Annex A: List of consultation questions

Question 1: Do you agree that the draft revised financial memorandum fully takes account of the regulatory landscape that currently exists with no new primary legislation?

Do you have any comments?

Question 2: Does the draft revised financial memorandum adequately place the collective student interest alongside the public interest?

Do you have any other comments?

Question 3: Do you agree that the current distinction between short-term and long-term borrowing is no longer appropriate, and should discontinue within future arrangements?

Do you have any other comments?

Question 4: We have set out alternative approaches to how the risks to the public and the collective student interest around financial commitments are addressed by HEFCE. We would welcome comments on and preference for each of these.

Question 5: Do you agree that future requirements should be based on total financial commitments? If so, how are these best defined? If not, what should they be based on, and why?

Do you have any other comments?

Question 6: Are there other alternatives we have not considered? If so please describe these and how they would manage the risk set out at paragraph 35 of this document.

Question 7: Do you agree with the proposal to identify issues for prospective and current students in the register of HE providers (paragraph 20 and 81 of the draft financial memorandum)?

Do you have any other comments?

Question 8: Do you agree with the intention to require HEIs to subscribe to Jisc?

Do you have any comments?

Question 9: Do you agree that the revised Audit Code of Practice at Annex A to the draft financial memorandum is sufficient to set out HEFCE's requirements? If not, what changes would you suggest?

Do you have any other comments?

Question 10: Do you agree with the proposed changed to the second trigger for the repayment of Exchequer interest from HEFCE income to the total of HEFCE and SLC income?

Do you have any comments?

Question 11: Do you agree with the proposed changes to the annexes to the financial memorandum? If not, please set out what you would wish to see instead and why.

Question 12: Do you have any other comments on the proposed revised financial memorandum that have not been covered in the preceding questions?

Annex B Draft financial memorandum

July 2014/XX

Core operations

Report

Effective 1 August 2014

The 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 'grant letter' , 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 supersedes HEFCE 2010/19 issued in July 2010.

[Draft] financial memorandum between HEFCE and institutions

Terms and conditions for payment of HEFCE grants to higher education institutions

HIGHER EDUCATION FUNDING COUNCIL FOR ENGLAND

Contents

Foreword

HEFCE is a non-departmental public body. This means that while our remit is set by the Secretary of State for Business, Innovation and Skills, we are not part of any government department. This enables us to act as a broker between universities, colleges and the Government ensuring the appropriate institutional freedom for teaching and research.

The Government decides on the total public funding for higher education, and we distribute this funding fairly and transparently, according to agreed criteria.

Under the Further and Higher Education Act 1992, which established HEFCE, the Secretary of State is not entitled to frame his conditions of grant to us by reference to specific institutions, or to particular courses of study or programmes of research, or to the criteria for the selection and appointment of academic staff or for the admission of students. This is designed to safeguard both institutional and academic autonomy, which are widely regarded as key factors in the success of English higher education. We strongly endorse these principles which are unaffected by the Government's recent reforms of the higher education system.

Higher education in England is made up of a diverse range of institutions of varying size and complexity. To give expression to the principle of autonomy, every institution is headed by a governing body which is unambiguously and collectively responsible for overseeing the institution's activities, determining its future direction, and fostering an environment in which the institutional mission is achieved and the potential of all students is realised. The governing body ensures compliance with the statutes, ordinances and provisions regulating the institution and its framework of governance. HEFCE funding is provided explicitly to the governing body as the institution's ultimate authority.

In addition to their responsibilities for good governance and financial stewardship, the leadership of institutions works closely with students. Higher education is a partnership between students and the university or college that is delivering their courses or programmes of study. Universities and colleges have responsibilities with regard to their students, and take pride in the high quality of education they provide and the wider experience enjoyed by their students. They are committed to the continuous improvement of learning and teaching and the co-curricular experience they provide, and the vast majority of students have a good relationship with the institution where they study.

As accounting officer, the chief executive of HEFCE has a personal responsibility to safeguard public funds and achieve value for money as set out in HM Treasury guidance, 'Managing Public Money'. This includes responsibility for the public funds allocated by HEFCE to higher and further education institutions and other bodies for education, research and associated purposes.

This approach draws on the expertise and diligence of governors, the effective academic management of institutions and an established relationship of trust between HEFCE and universities and colleges in England which serves higher education extremely well.

HEFCE, in turn, has responsibilities to protect the collective student interest – a role given more prominence in the recent government reforms – and to secure the wider public interest, particularly in relation to the funding of higher education.

In relation to the collective student interest, HEFCE remains legally responsible for making sure that the quality of learning and teaching is assessed in each university and college across England which it funds. We also assess the quality of research, enabling us to fund research selectively by supporting excellence wherever it is found, and promoting vibrant PhD and post-doctoral communities. HEFCE also has a role in respect of students by providing assurance about the financial sustainability of the universities and colleges where they are studying and the operation of policies that promote student opportunity and success. But a student’s primary relationship remains with their institution.

In relation to the wider public interest, HEFCE has a clear regulatory duty to ensure that universities and colleges in receipt of public funds provide value for money and are responsible in their use of these funds. We also ensure that the funding we distribute accurately reflects what is delivered. In addition, we act as the principal regulator for those universities and colleges that are exempt charities, advising the Charity Commission where appropriate. We aim to reduce the accountability burden on institutions by enabling other public bodies, wherever possible, to rely on our systems of oversight and assurance. We in turn seek to take assurance from institutions’ own systems of self-regulation and control.

The principle of institutional autonomy and the system of regulation on which it depends therefore relies on clear lines of accountability for the proper stewardship of public funds and on being able to demonstrate to Parliament and the public that, in the exceptional circumstance when something goes wrong, there is a clear mechanism to put it right. The purpose of the financial memorandum is to provide this clarity and assurance by defining the formal relationship between HEFCE, governing bodies and heads of institutions.

Alan Langlands
Chief Executive
Higher Education Funding Council for England
September 2013

Financial memorandum between HEFCE and institutions

Purpose of this document

1. The financial memorandum sets out the formal relationship between HEFCE and the governing bodies and accountable officers of the higher education institutions (HEIs) it funds. It reflects HEFCE's responsibility to provide annual assurances to Parliament that:

- funds provided to us are being used for the purposes for which they were given
- risk management, control and governance in the higher education (HE) sector are effective
- value for money is being achieved.

2. In addition HEFCE has to take account of the collective interest of students in how it operates. This 2014 financial memorandum has, therefore, been designed to address both the collective student and the public interest.

3. This financial memorandum is in two parts:

- Part 1 sets institutional conditions of grant that apply to HEIs, but with specific conditions that also apply to further education colleges (FECs). Where requirements apply to both HEIs and FECs this is stated as 'HEIs and FECs'. Where the requirements only apply to HEIs, then it is stated as 'HEIs'.
- Part 2 sets conditions to specific grants that are paid to HEIs and FECs. This is known as the funding agreement. It is issued each year as the 'grant letter'.

References to the financial memorandum or the memorandum embrace both part 1 and part 2.

4. For those HEIs that are exempt charities the financial memorandum sets out the requirements for information to enable us to carry out our responsibilities as principal regulator under the terms of the Charities Act 2011. These responsibilities apply to all the funds and assets of HEIs that are exempt charities.

5. The financial memorandum sets out the mandatory requirements placed on HEIs and FECs as conditions of grant.

6. HEIs are bound by the requirements of their charter and statutes (or equivalent) and by the law relating to their charitable status. This document does not supersede those requirements but is intended to complement and reinforce them.

7. This document, including the Audit Code of Practice (Annex A), takes effect from 1 August 2014.

Linkage to Operating Framework and the register of HE providers

8. The financial memorandum applies to HEIs and FECs in receipt of grant funding from HEFCE. This forms part of a suite of accountability arrangements, covering both access to and continued operation in the HE sector, that provide coverage across all higher education providers which have one or more of the following features:

- its courses are validated by a listed body
- it has degree-awarding powers
- it has university or university college title
- its courses have been designated as eligible for access to student finances
- it has been designated as an HEI eligible to receive HEFCE grant funding.

9. These, and details of the register of HE providers, are set out in full in the Operating Framework[5]. This financial memorandum does not apply to alternative providers[6].

Requirements of other bodies

10. It is a condition of HEFCE grant that HEIs and FECs in receipt of HEFCE grant funding subscribe to the Quality Assurance Agency for Higher Education (QAA). It is also a condition of HEFCE grant that HEIs subscribe to and provide data or other information requested by the Higher Education Statistics Agency (HESA).

11. Under the Higher Education Act 2004 HEIs are required to subscribe to the Office of the Independent Adjudicator.

12. Non-compliance with regulatory requirements or requirements of other bodies, such as QAA or HESA, may lead to a flag in the register of HE providers to alert current and prospective students and others to the non-compliance. Whether the non-compliance leads to a flag will depend on the circumstances and the impact of the non-compliance. Any such areas of non-compliance may also be taken into account by HEFCE in our assessment of risk, and there may be actions that flow from that assessment, as set out in our support strategy.

Our responsibilities

13. HEFCE provides grant funding for the provision of education and the undertaking of research by those universities, institutions conducted by higher education corporations, and institutions of higher education designated as eligible to receive HEFCE grant funding (collectively referred to as 'higher education institutions' or 'HEIs'). and FECs. HEFCE has lead responsibility for public accountability for HEIs.

14. As such we will endeavour to work with HEIs and others in the higher education sector to the highest standards of openness, integrity and consistency expected of public

[5] This can be found at www.hefce.ac.uk/about/intro/wip/rpg/of/

[6] Alternative providers are subject to separate conditions attached to designated courses (www.hefce.ac.uk/whatwedo/reg/desig/).

sector bodies. We recognise that universities, other HE providers and FECs are autonomous bodies and acknowledge that HEIs and FECs accept that they are accountable for the funding they receive. We will not ask for information that we already have, and as far as possible we will rely on data and information that HEIs and FECs have produced to meet their own needs. We will make regulation efficient and effective and seek to ensure that its benefits outweigh the costs to HEIs and FECs, ourselves and other parties.

15. We will respect commercial confidentiality within the constraints of the Freedom of Information Act 2000 and our own obligations to Parliament and under the framework document with our sponsor department.

16. Our grants to HEIs are to fund activities defined by the Further and Higher Education Act 1992 ('the 1992 Act'). For HEIs these are:

- providing education and undertaking research
- providing facilities and undertaking activities that the HEI's governing body thinks are necessary or desirable for providing education or undertaking research.

17. We will review an HEI's annual accountability returns to us, and give to the accountable officer and governing body a confidential risk assessment. We will not normally make our risk assessments public until three years have elapsed. This period, based on advice from the Information Commissioner, gives an HEI that is designated 'at higher risk'[7] time to reduce its risk classification.

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

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

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

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

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[7] The classification of HEIs as 'at higher risk' or 'not at higher risk' is planned to be reviewed and will be the subject of a separate consultation. Consequently this wording differs from the terminology used in the 2013 Operating Framework, which is more aspirational in how this might develop.

21. We define an HEI as ‘at higher risk’ when in our judgement, on the basis of all available evidence, it:

- faces threats to the sustainability of its operations, either now or in the medium term
- has serious problems relating to value for money, propriety or regularity (that is, whether funds are used for the purpose intended), or
- has materially ineffective risk management, control or corporate governance.

22. More detail on how HEFCE assesses institutional risk is given at Annex B, Table 2.

Responsibilities of universities and colleges to us and to students

23. HEIs are required to supply HEFCE with certain information about their viability and the way they operate, because we have:

- an oversight role for regulation of higher education
- responsibility and lead public accountability for HEIs designated to receive HEFCE grant funding
- responsibility to protect the collective student interest and the public interest
- responsibility as principal regulator of those HEIs that are exempt charities
- or any combination of the above.

Regularity and propriety

24. A condition of grant is that HEIs and FECs must use HEFCE funds only for activities that are eligible for funding under the Further and Higher Education Act 1992, as this is the intended purpose for which the funds have been provided by Parliament. When using these grants HEIs and FECs should ensure they apply proper processes that ensure effective accountability.

25. This condition also applies where the HEI passes on part of its HEFCE grant to another legally distinct entity for the provision of facilities or learning and teaching, or for research to be undertaken. In such cases, as set down in Section 65(3A) of the Further and Higher Education Act 1992, the HEI must obtain our consent before passing HEFCE funds to the connected institution. In these circumstances the HEI awarded the funding by HEFCE will be held accountable for those funds; and the HEI should therefore ensure adequate accountability arrangements are in place when it passes on such funding to another entity.

26. Members of HEI governing bodies and accountable officers should comply with the seven principles set out by the Committee on Standards in Public Life.

27. Governing bodies and accountable officers are accountable for their decisions and actions, and must submit themselves to whatever scrutiny is appropriate to their office. They should also be as open as possible about all the decisions and actions that they take that may affect funding provided by HEFCE. HEFCE will write to the new chair of

each governing body of an HEI, on appointment, drawing attention to their own and their governing bodies' responsibilities under the financial memorandum.

Governing bodies

28. Members of governing bodies of HEIs have a set of legal responsibilities and other duties. Taken together, the responsibilities of members of a governing body and of the governing body as a whole are considerable, and must be met. The governing body of an HEI is collectively responsible and has ultimate responsibility that cannot be delegated for overseeing the HEI's activities, to determine its future direction, and to foster an environment in which the HEI's mission is achieved. In accordance with the HEI's own statutes and constitution, there should be effective arrangements for providing assurance to the governing body that the HEI:

- has a robust and comprehensive system of risk management, control and corporate governance
- has regular, reliable, timely and adequate information to monitor performance and track the use of public funds
- plans and manages its activities to remain sustainable and financially viable
- informs us of any change in its circumstances which – in the judgement of the accountable officer and in agreement with the governing body – is a material change, including any significant developments that could impact on the mutual interests of the HEI and HEFCE
- uses public funds for proper purposes and seeks to achieve value for money from public funds
- complies with the mandatory requirements relating to audit and financial reporting, set out in our Audit Code of Practice and in our annual accounts direction
- sends us:
  - the annual accountability returns
  - other information we may reasonably request to understand the HEI's risk status
  - any data requested on our behalf by HESA
  - information needed to enable us to act as principal charity regulator (exempt charities only)
- has effective arrangements for the management and quality assurance of data submitted to HESA, the Student Loans Company (SLC), HEFCE and other funding or regulatory bodies (HEFCE reserves the right to use its own estimates of data where we have reason to believe HEI or FEC data are not fit for purpose). Responsibility for the quality of data used for internal decision-making and external reporting, which must be fit for purpose, rests with the HEI or FEC itself. Data submitted for funding and student number control purposes must comply

with directions published by HEFCE; if in doubt an HEI or FEC should ask its HEFCE regional consultant to provide an authoritative, written ruling

- has an effective framework – overseen by its senate, academic board or equivalent – to manage the quality of learning and teaching and to maintain academic standards
- considers our assessment of its risk status, engages with us during the risk assessment process, and takes action to manage or mitigate the risks we agree upon.

Governing body members are also trustees

29. Where HEIs are charities, whether registered or exempt, members of their governing bodies are also trustees and have the responsibilities and potential liabilities that go with trustee status. They must apply the HEI's charitable assets for the charitable purposes of the HEI and not put them at undue risk. Members who act prudently, lawfully and in accordance with the governing instrument will not find themselves liable for their actions. However, in exceptional cases HEFCE will use its role as principal regulator to refer an issue to the Charity Commission, which may then investigate and take action against trustees who have not fulfilled their roles. Trustees need to be particularly careful to ensure that the charity has the means to meet its obligations when the HEI is entering into substantial contracts or financial commitments.

Accountable officer

30. The head of an HEI is first and foremost responsible for leadership of the academic affairs and executive management of the HEI. The appointment (or dismissal) of the head of an HEI is governed by employment law, and this is clearly the responsibility of the governing body. HEFCE has no role, rights or responsibilities in relation to the appointment (or dismissal) of the head of an HEI, and has no wish to change this position. We presume that in a case where a head of an HEI does not discharge his/her duties or acts improperly the governing body will take appropriate action.

31. Under this financial memorandum, the governing body is responsible for the use of public funds. To assist and enable it to discharge this responsibility and to provide clear accountability, the governing body will designate a senior officer, normally the head of the HEI, as the 'accountable officer': that is, the officer who reports to HEFCE on behalf of the HEI. On being notified by, or on behalf of, the governing body of a new accountable officer, HEFCE will write to that individual explaining what the responsibilities of an accountable officer involve.

32. The accountable officer is personally responsible to the governing body for ensuring compliance with the terms of this financial memorandum and for providing HEFCE with clear assurances to this effect.

33. The head of an HEI as the accountable officer is also required to report to HEFCE on behalf of the HEI in relation to the requirements set out in paragraph 28. In exceptional circumstances HEFCE may take the view that the accountable officer is failing to meet these responsibilities. Faced with this position HEFCE would be obliged to respond in a fair, reasonable and proportionate way.

34. If, in the judgement of the HEFCE chief executive, there is evidence of serious failure in relation to the oversight and management of public funds, (s)he will raise this as appropriate with the accountable officer concerned and/or the chair of the governing body; provide the relevant evidence; and seek and consider a response. Experience suggests that most difficulties can be resolved through this process.

35. *In extremis*, and after all due process has been exhausted, the HEFCE chief executive may conclude that the accountable officer is unable or unwilling to meet his/her responsibilities under this financial memorandum. HEFCE may then ask the governing body to appoint someone else to report to HEFCE on behalf of the HEI. In taking this action HEFCE will not seek to influence the employment relationship between the governing body and the head of the HEI. The governing body is clearly entitled to maintain the head of the HEI in post. However, the governing body would then have to designate another senior officer as the accountable officer, and adjust the roles and responsibilities of the head of the HEI accordingly.

36. The HEI's accountable officer and/or chair of the governing body may be required to appear before the Public Accounts Committee alongside the chief executive of HEFCE in his/her role as accounting officer, on matters relating to grants to the HEI.

37. In the event of a prolonged absence from work or a sudden departure by the accountable officer, the clerk to the HEI's governing body must ensure that HEFCE is made aware immediately of the identity of the interim accountable officer.

Provision of information to HEFCE

38. Our information requirements are set out in this financial memorandum and in guidance on accountability and other returns. It is a condition of grant that HEIs provide the requested accountability or other information. We keep these information requirements under review to ensure we only ask for the information we need.

39. HEIs also have an obligation to supply information to enable us to fulfil our role as principal regulator of HEIs as exempt charities under the Charities Act 2011. The information required for this is summarised at Annex E, and largely draws on existing returns that HEIs make to HEFCE.

40. HEFCE publishes an annual accounts direction, and HEIs and their external auditors must comply with it. The accounts direction states HEFCE's financial reporting requirements.

Provision of information for students

41. To inform student choice the Key information Set (KIS) has been introduced to make course comparison easier. It is a condition of funding that key data are displayed on institutions' web pages for specific courses via a 'widget', which links through to courses nationwide. As with rest of the KIS data, the widget data will be updated annually by institutions and they will be expected to have the widget on their relevant course pages each year. The widget should be displayed prominently on each main course page (for those courses where a KIS is required). Guidance on how to embed the widget into course pages is provided on the HESA web-site (www.hesa.ac.uk/content/view/2297/233/).

Quality of provision

42. HEFCE has a statutory duty to 'secure that provision is made for assessing the quality of education provided in HEIs and FECs for whose activities they provide, or are considering providing, financial support'[8]. In exercising this duty and in considering quality in the exercise of our other functions, we aim to ensure that students receive higher education provision of sufficient quality and that England's reputation for high-quality higher education is maintained. We exercise this duty partly through contracting the QAA to review quality of provision in HEIs and FECs.

43. If an HEI or FEC receives a published judgement of 'does not meet UK standards or expectations' in one or more area(s) of judgement in a QAA Higher Education Review (HER) then HEFCE's policy for addressing unsatisfactory quality will apply (a revision to the policy is due to be published in October 2013). This includes assessing the risk status of the HEI; we may then implement our strategy for supporting HEIs 'at higher risk'.

44. If an HEI or FEC with a 'does not meet' or 'requires improvement to meet UK standards or expectations' judgment fails to make the necessary improvements through the QAA follow-up process, then HEFCE will take the lead, arranging regular meetings with the HEI or FEC. HEFCE steps in at this point because it has a clear regulatory interest to ensure that HEIs and FECs in receipt of public funds provide value for money and are responsible in their use of these funds, as described in this financial memorandum. Improvements will be expected and, in exceptional circumstances, sanctions may be applied. Our ultimate sanction is the withdrawal of some or all HEFCE funding.

Research integrity

45. Compliance with the concordat to support research integrity[9] is a condition of HEFCE grant for all HEIs eligible to receive our research funding. Each HEI is required to confirm in its annual assurance return that it complies with the concordat, particularly in relation to its recommendations for internal processes and guidance, and for staff training.

Sustainability of universities and colleges

46. HEIs should have a financial strategy that reflects their overall strategic plan, sets appropriate benchmarks and performance indicators, shows how resources are to be used, and how activities and infrastructure will be financed. This should include how the HEI assesses and reviews its own sustainability, including the use of sustainability assessments.

47. To remain sustainable and financially viable HEIs should also assess, take and manage risks in a balanced way that does not overly constrain freedom of action in the future.

[8] Further and Higher Education Act 1992, part II, section 70 www.legislation.gov.uk/ukpga/1992/13/section/70#commentary-c1106607

[9] www.hefce.ac.uk/whatwedo/rsrch/rinfrastruct/concordat/

48. We normally expect that an HEI will make a surplus in line with its financial strategy for sustainability, and thus that its discretionary reserves will grow over time, all other things being equal. A series of deficits, even if covered by discretionary reserves, might cause us concern, as could low levels of liquidity or increased financial commitments. In such cases we would expect to discuss financial performance and strategy with the HEI, to understand how sustainability is assessed and to be maintained and then, if appropriate, agree an action plan. We would expect financial strategies to include how the HEI intends to address pension scheme deficits.

49. HEIs must apply the following principles when entering into any financial commitments:

a. The risks and affordability of any new on- and off-balance sheet financial commitments must be properly considered.

b. Financial commitments must be consistent with the HEI's strategic plan, financial strategy and treasury management policy.

c. The source of any repayment of a financial commitment must be identified and agreed at the point of entering that commitment.

d. Planned financial commitments must represent value for money.

e. The risk of triggering immediate default through failure to meet a condition of a financial commitment should be monitored and actively managed.

50. HEFCE is concerned to ensure that any financial commitments entered into by an HEI are affordable and do not leave challenges to its sustainability that will have to be faced in the long term. [Note: The requirements around financial commitments will be included here once the outcome of the consultation is clear.]

51. As part of ensuring its long-term viability, an HEI should know the full cost of its activities and use this information in making decisions. If it does not seek to recover the full cost, this should be the result of a clear policy set by the governing body and included in the financial strategy, and should not put the HEI in financial difficulty. We do not expect public funds to subsidise non-public activities.

52. The Financial Sustainability Strategy Group is overseeing the development of sustainability assessments. A pilot scheme has been operating and HEIs are providing these assessments voluntarily by December 2013. We welcome the Committee of University Chairs' (CUC's) willingness to consider including these sustainability assessments in its revised Governance Code of Practice and General Principles. The assessments will be of benefit to HEIs' governing bodies, and will be valuable assurance to HEFCE and the Research Councils. Adoption within the revised CUC code of practice would respect the principle of self-regulation and enable the assessments to serve multiple purposes (including institutions' own going-concern assessments), thus reducing cost.

53. HEIs should manage their estate in a sustainable way, in line with an estates strategy and the requirements of HEFCE's Capital Investment Framework. HEI are required to have carbon management plans in accordance with guidance in HEFCE

2010/02[10], and performance against these plans is a factor in determining future capital allocations.

Material adverse events

54. The HEI's accountable officer must report any material adverse change without delay – such as a significant and immediate threat to the HEI's financial position, significant fraud[11] or major accounting breakdown – to all of the following:

- the chair of the HEI's audit committee
- the chair of the HEI's governing body
- the HEI's head of internal audit
- the external auditor
- the HEFCE chief executive.

55. The HEI's accountable officer must also inform HEFCE about major changes in strategy, plans for major restructuring or merger with another institution or organisation.

56. The governing body must inform HEFCE's assurance service without delay of the removal or resignation of the external or internal auditors before the end of their appointment.

Equality and diversity

57. The Equality Act 2010 makes unlawful discrimination on the grounds of age, disability, gender reassignment, marriage or civil partnership, pregnancy or maternity, race, religion or belief, sex or sexual orientation. It introduced a public sector equality duty requiring HEIs and HEFCE to show due regard to the need to eliminate discrimination, advance equality of opportunity and foster good relations between protected groups.

58. This law applies to employment; education; the provision of goods, facilities and services; the management of premises; and the exercise of public functions. For the HE sector, the legislation applies to both staff and students, before, and during the relationship with the HEI, and for any dealings arising out of a past relationship.

59. HEFCE's Equality and Diversity Scheme (www.hefce.ac.uk/pubs/year/2012/201203/) sets out the actions taken to meet the equality duty both as a provider of public funds and as an employer. Every HEI should, as a minimum, comply with the Equality Act's requirements, and HEFCE will monitor HEIs' progress with regard to equality and diversity.

Contributing to meeting policy objectives

60. We expect HEIs to consider how their actions affect our policy objectives for the higher education sector, as set out in our strategy statement[12].

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[10] www.hefce.ac.uk/pubs/year/2010/201002/

[11] Defined as fraud of £25,000 or higher.

[12] See www.hefce.ac.uk/about/howweoperate/strategystatement/

61. HEIs and FECs are required to submit an integrated strategic widening participation document to both HEFCE and the Office for Fair Access (OFFA) which will contain the information needs of both organisations. [Note: Guidance for these integrated documents will be issued in January 2014 for a submission date in April 2014.]

Other requirements

62. HEIs are required to subscribe to Jisc from August 2014 to July 2017. This will enable Jisc to have financial stability in the short-term during the transition towards lower grant funding and increased reliance on subscriptions.

63. HEIs and FECs must ensure that their use of JANET and SuperJANET networks conform to acceptable practice and current legislation.

64. There is an Exchequer interest that has built up over time in HEIs in receipt of HEFCE capital funding. These HEIs entered into an agreement with HEFCE effective from 1 August 2006; and are required to follow the conditions set at Annex D.

Payment of grant

65. Each year we determine how much money to allocate to each HEI or FEC. HEIs and FECs should use this money only for the purposes we are empowered to fund, as defined in the Further and Higher Education Act 1992 or other relevant legislation.

66. We may withhold or require an HEI or FEC to repay part or all of a grant if it does not comply with the conditions we attach to the grant or if it has been incorrectly over-funded. In cases where we require repayment we may charge interest, at 2 per cent above the Bank of England base rate, for the period before the HEI or FEC repays the funding to us.

Institutional engagement, support and safeguarding actions

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

68. HEFCE’s accountability framework has three main strands designed to give HEFCE the necessary confidence while minimising burden on the sector. The strands are:

- annual accountability returns
- HEFCE Assurance Reviews
- data assurance.

69. As far as possible the accountability process between HEFCE and HEIs is concentrated into an exchange of documents and dialogue during a specific period following the end of the financial year. We will confirm the specific content of this exchange each year and consult the sector on any major changes to the process. Our aim is to minimise our demands on HEIs, and as far as possible to rely on data and information that they have produced to meet their own needs.

Annual accountability returns

70. HEFCE takes assurance from a suite of accountability returns, including audited financial statements, financial forecasts and independent audit reports, which must be submitted to HEFCE by a specified date or dates. They provide HEFCE with a view of each HEI's risk management, control and governance, financial sustainability, arrangements for promoting VFM and managing and quality assuring data. By using information and assurances, much of which is needed for internal management and assurance purposes by the HEI, HEFCE is able to minimise its audit requirements and reduce burden. See paragraphs 75 to 77 below on institutional engagement and support.

71. The annual accountability returns are analysed by HEFCE, which then carries out a risk assessment of each HEI. The risk assessment is reported to the governing body and accountable officer – see Table 2 of Annex B. For those we consider to be 'not at higher risk' (our experience to date suggests that this is the vast majority) there will be no need for further information or discussion of accountability until the following year's return, except in the case of an unanticipated change in circumstances. Sometimes we ask for more information to clarify uncertainties.

HEFCE Assurance Review

72. The HEFCE Assurance Review (HAR) (see HEFCE Circular letter 25/2006) is a short site visit to HEIs to ensure that there are suitable accountability processes within each HEI to assure the validity of its annual accountability returns. This helps us validate the systems of self-regulation on which we rely.

Data assurance

73. HEIs and FECs are required to supply HEFCE with data to inform allocations of funding and for other purposes. The responsibility for the quality and accuracy of that data rests with the HEI or FEC. HEFCE relies on the institution's own data assurance processes where possible.

74. HEFCE monitors the reasonableness of data and undertakes verification, validation and reconciliation work between HESA data and other datasets. HEFCE may undertake audits at an HEI or FEC if it deems this necessary. Data audits will assess the strength of institutional systems and controls as well as assessing the accuracy of the data submissions.

Institutional engagement and support

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

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

77. In response to requests from HEIs our annual risk letters also provide high level feedback to governing bodies on a number of quantitative measures and highlight any issues that we wish to bring the HEI's attention but do not regard as sufficiently serious to warrant 'at higher risk' status.

Safeguarding actions

78. Our institutional engagement and support strategy, and risk assessment process, has been described in paragraphs 67 to 77 above and is set out in detail at Annex B.

79. If an HEI fails to take any agreed action HEFCE will seek explanations and, if appropriate and justified, issue warnings to improve.

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

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

a. Financial – through the recovery of grant funding or the denial of access to future grant funding, including access to specific grants or to discretionary funding, such as the Catalyst Fund. Ultimately HEFCE can withdraw funding entirely, should circumstances warrant such action.

b. Information – through making public our concerns about an HEI where there are strong grounds to do so and where this is in the public and/or collective student interest (both current and prospective students). This would include an entry in the HEFCE register of HE providers.

82. In addition HEFCE may:

- provide advice to OFFA where there are issues around access
- provide advice to the Charity Commission where an HEI may have breached its charitable obligations
- provide advice to the Equality and Human Rights Commission where discrimination may have occurred.

83. The Government has signalled its intention to delegate to HEFCE the power to attach conditions to the automatic designation of HE courses for student support purposes. Failure to comply with these conditions could ultimately result in de-designation. HEFCE will in due course consult on the conditions and the process of de-designation.

Revision to financial memorandum

84. We will make material revisions to this document only after consulting the higher education sector or its representative bodies, as appropriate.

Annex A: Audit Code of Practice

Overview

1. In this Audit Code of Practice (the Code) the word 'must' denotes a mandatory requirement under the financial memorandum.

2. The Code sets out what we require HEIs to have in place to provide themselves and us with adequate assurance on good governance, internal controls, the management of risk and achieving value for money (VFM). How these requirements are met is for HEIs to decide themselves.

Governing bodies of HEIs

3. The responsibilities of governing bodies include ensuring that the HEI:

- remains sustainable, academically and financially
- has a robust and comprehensive system of risk management, control and corporate governance. This should include the identification of fraud and bribery
- uses public funds for proper purposes
- seeks to achieve VFM from public funds
- has effective arrangements for the management and quality assurance of data submitted to HESA, SLC, HEFCE and other bodies
- delivers its charitable purposes for the public benefit.

4. Governing bodies are also responsible for the appointment and removal of external and internal auditors.

Audit committees in HEIs

5. Each HEI must have an audit committee which follows best practice in HE corporate governance. The audit committee is responsible for:

   a. Assuring the governing body about the adequacy and effectiveness of risk management, control and governance.

   b. VFM.

   c. The management and quality assurance of data.

6. The Committee of University Chairs has published detailed guidance about audit committees (HEFCE 2008/06). This reflects best governance practice, and HEFCE expects HEIs to take account of such guidance in meeting the required standard or explain why the guidance is not being applied.

7. An audit committee can undertake whatever work[13] it considers necessary to fulfil its role. Audit committees will only be able to provide the necessary assurances if they

[13] As described in HEFCE 2008/06.

are supported by suitably resourced internal audit and external audit functions, operating to recognised professional standards. They should also consider evidence based assurances from management.

8. Members of the audit committee must not have executive authority. Audit committees should include a minimum of three lay members of the governing body. Audit committee members should not be members of an HEI's finance committee or its equivalent. This is because it would create a potential conflict of interest when the audit committee is considering issues involving the finance committee. If an HEI's governing body determines that cross-representation involving one member is essential, this should be the subject of an explicit, recorded resolution, which sets out the rationale for such a decision – but it should not be an option for the chair of either committee.

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

10. The report must include the committee's opinion on the adequacy and effectiveness of the HEI's arrangements for:

- risk management, control and governance
- economy, efficiency and effectiveness (VFM)
- management and quality assurance of data submitted to HESA, SLC, HEFCE and other bodies.

11. The final annual report for governing body must be shared with HEFCE each year.

Internal audit arrangements in HEIs

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

13. Consequently each HEI must have a suitably resourced internal audit function which must comply with the professional standards of the Chartered Institute of Internal Auditors (IIA). Internal audit terms of reference must make clear that its scope encompasses the whole of the HEI's risk management, control and governance, and any aspect of VFM delivery.

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

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

- risk management, control and governance

- economy, efficiency and effectiveness (VFM).

16. The final annual report for the governing body must be shared with HEFCE each year.

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

External audit arrangements in HEIs

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

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

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

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

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

Audit report

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

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

b. The financial statements have been properly prepared in accordance with UK general accepted accounting principles (UK GAAP) and the FE and HE statement of recommended practice (SORP) (or its successor), and relevant legislation.

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

d. Funds provided by HEFCE have been applied in accordance with the financial memorandum and any other terms and conditions attached to them.

e. The requirements of HEFCE's accounts direction have been met.

24. Auditors should have regard to the specific requirements of the financial memorandum such as compliance with the short-term and long-term borrowing conditions [Note: This wording will be updated in light of responses to this consultation], or other issues of non-compliance, in their management letters.

25. Market testing should be undertaken at least every seven years. One named individual partner in the firm is normally responsible for the HEI's audit; he or she should not hold this position for more than seven consecutive years.

HEFCE access to auditors

26. HEFCE may wish to communicate with an HEI's external or internal auditors, particularly in connection with a HAR. This will normally be arranged through the HEI's accountable officer or representative. HEFCE will exchange letters where necessary with both parties to deal with confidentiality and the terms under which access is given.

Provision of audit services

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

Auditors' access to information

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

Restriction on auditors' liability

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

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

31. For other types of work performed by the external auditors, the provider may ask the HEI to agree to a restriction in the auditors' liability arising from any default by the auditors. Normally, such liability should be without limit. However, as with internal audit services, HEIs may negotiate a restriction in liability if the decision is made on an informed basis and the liability remains at such a level as to provide reasonable recourse to the HEI. The governing body, through the audit committee, should be notified of any liability restriction agreed.

Appointment, removal or resignation of internal and external auditors

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

Annex B: Institutional engagement, support and safeguarding actions

Introduction

1. This annex sets out how we will engage with and support higher education institutions (HEIs) and our related bodies[14] on matters relating to accountability and risk assessment. It also describes what will happen when, as a result of our assessment, we find there to be significant risks either to the organisation itself or to the collective student or public interest that HEFCE is charged to protect. Our risk assessment methodology is summarised in Table 2. The strategy applies to our work both as funder of HE and as principal regulator on behalf of the Charity Commission.

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

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

3. In broad terms there are three levels at which HEFCE may engage with institutions:

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

Each of these is dealt with in detail below.

[14] Related bodies are organisations, not HEIs or FECs, that help and support HEFCE in delivering its objectives. These include Jisc, QAA and HESA.

Normal contact

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

Focused dialogue

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

Support strategy

6. We have a risk assessment system covering all institutions and related bodies. This draws on the information we routinely collect through the annual accountability returns exercise and on other information such as research and teaching quality assessments. Sometimes we will ask for more information to clarify our understanding. There are currently two risk categories: ‘not at higher risk’ (the vast majority of HEIs at any time) and ‘at higher risk’ (for a small number of institutions).

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

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

9. The HEFCE associate director responsible for dealings with the HEI or related body will lead our support activity, but a relevant senior manager – the HEFCE regional

consultant, or relationship manager in the case of a related body, or assurance consultant – will manage the day-to-day engagement. In exceptional cases, our chief executive will become involved. The process will be overseen by our audit committee and individual cases reported to the HEFCE Board. The role of the HEFCE audit committee is to advise on process, whereas the role of the HEFCE Board is, where required, to form a judgement.

10. If an institution or related body does not address its problems to our satisfaction, it might be in the interest of current and prospective students and the public for us to disclose our risk assessment (see paragraph 81 of the main text). We expect this to be a rare occurrence, because in our experience institutions generally do take appropriate action.

Table 1 HEFCE support strategy for HEIs and related bodies 'at higher risk'

Possible HEFCE actions

Overall
We may require institutions to make changes as conditions of grant if we feel that risks to our funding and the interests of students and the public are not being addressed. We will only do so after due consideration and consultation, and only on the basis of appropriate advice. Thus it will always be our intention to make only reasonable demands of institutions. If institutions do not comply with conditions of grant, and after we have exhausted the elements of the support arrangements, we will consider withdrawing grant in part or in full and making public our risk assessment. We see this as a last resort. In addition to the actions below we will consider any other action that we believe is necessary to support institutions at risk and protect the interests of the public, the taxpayer and the collective interest of students.
At governor and senior manager level we:
• Will engage with senior management, including the accountable officer or chief executive. • Will assess the institution's compliance with the financial memorandum, including the requirement to have effective management and quality assurance arrangements over data supplied to HESA, SLC, HEFCE and other funding bodies. • Will inform the governing body of any change in risk assessment and seek commitments to improvement. We will notify other public funders, as appropriate, of any 'at higher risk' assessment, and exceptionally we will make such an assessment public at any time where we consider it to be the collective interest of students or the public to do so. • Will engage directly with the chair of the governing body and/or chair of the audit committee.

- Will engage with the whole governing body and, if necessary, take steps to ensure improvements are made to governance arrangements**.**
- May require observer status at governing body or audit committee meetings to enable us to assess whether our specific concerns are properly understood and are being addressed. This could be for individual meetings or over a period of time. Our observer will always be a senior HEFCE officer.
- May request the appointment of interim managers, where we consider the institution has insufficient capacity to address its risks properly.

Regarding information and audit we may:

- Require or commission additional information, reports and data relating to the risks.
- Require that information and reports be audited.
- Request changes to internal or external audit arrangements.
- Undertake or commission audit investigations.

Regarding planning and strategy we may:

- Require or commission a recovery or action plan.
- Discuss possible changes to strategic plans and market positioning.
- Explore collaborative opportunities with other institutions.

Regarding funding we may:

- Re-profile grant to assist an institution that has a cash flow difficulty.
- Consider the use or withdrawal of special funding.
- Attach special conditions to grant.
- Reduce or withdraw funding.
- Use our own estimates of data where we are not satisfied that information from the institution can be relied on.

As risks decline we will:

- Inform the institution (and others who may have been notified of our risk assessment) about changes in our risk assessment.
- Remove special conditions of grant and other requirements.

Table 2 HEFCE institutional risk system

Introduction

HEFCE's management of risk obliges it to assess the risk to the collective interests of students and to public funds or the activities provided from those funds posed by institutions. We maintain an assessment of each HEI, which focuses on the three areas of risk identified in paragraph 21 of the financial memorandum:

- institutional sustainability
- value for money, propriety or regularity
- risk management, control or governance.

Sources of information

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

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

b. **Our own institutional audit processes**, including data audits and cyclical assurance visits, which are designed to provide assurance on institutions' accountability returns.

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

d. **Information from other sources** including public bodies that might potentially impact on our concerns with sustainability, among other issues. For example, we have memoranda of understanding with other funders of HEIs that commit us, on a confidential basis, to share information which could have a bearing on each other's assessments of the risk to funds. This furthers part of our commitment to minimise the accountability burden on institutions.

e. **Indicators** that we do not monitor systematically for the purpose of institutional risk but which, at times and in specific institutional cases, could have a bearing on our risk assessments. For example, quality assurance judgements, any implications under our policy for addressing unsatisfactory quality (a revision to the policy is due to be published in October 2013) or National Student Survey outcomes.

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

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

Our risk assessment

Our assessment of the risk to **financial sustainability** is based on historical (two years) and forecast (four years) financial information supported by a narrative commentary. A number of indicators are employed as set out below. We perform assessments throughout the year on an ongoing basis and as necessary. We have internal benchmarks for each of these indicators which help us to flag concern. We also try to look beyond the snapshot position which the indicators represent to an institution's trends and how its performance compares with the sector and its peers. We feed back key parts of our financial assessment to each institution in our annual risk letter. The current indicators are:

- historical cost surplus as percentage of total income
- cash flow from operations as a percentage of total income
- liquidity expressed in days
- affordability of borrowing (as indicated by the level of annual servicing costs of borrowings, in line with our consent procedure for financial commitments) [Note: This wording will be updated in light of responses to this consultation]
- discretionary reserves as percentage of total income
- staff costs as percentage of total income.

We develop and supplement these indicators over time and in response to individual cases.

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

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

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

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

- the annual accountability returns, including the governance and accountable officers' assurances
- the outputs of the institution's internal and external auditors
- information from other public bodies

- HEFCE’s own audit and assurance work.

Risk notification

The work undertaken by HEFCE, augmented by information from other sources, enables us to make an annual risk assessment. For the majority of institutions this results in a letter from the HEFCE chief executive to the accountable officer, normally by the end of April advising that in HEFCE’s judgement the institution is not at higher risk. We ask that all our risk letters be communicated to the governing body. For some institutions a second risk letter may be issued in the autumn following assessment of their financial forecast submissions.

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

In a small number of cases, HEFCE’s judgment will be that an institution is ‘at higher risk’. This assessment is most likely to be made for financial reasons. Whatever the reason for the judgment, the process of making and communicating the judgment is very thorough and will be communicated to the institution concerned and the support strategy, as outlined at paragraph 6 to 10 and Table 1 of this annex, will come into play.

Annex C: Financial commitments

To be completed in light of responses to this consultation.

Annex D: Exchequer interest

Introduction

1. This annex reflects the agreed system for Exchequer interests, which provides accountability for public funding without imposing an undue administrative burden on institutions and enabling them to manage their estates flexibly (see HEFCE Circular letter 12/2006).

Requirements

2. Each HEI, 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, must follow the conditions set out below.

3. The Exchequer interest identified and agreed with HEFCE in that agreement formed the opening balance of a simple Exchequer interest register maintained by HEFCE. The register is adjusted immediately for the addition of capital grants received in the year, and annually for both of the following:

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

4. The indexation rate used will be the GDP deflator published annually 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.

5. All capital grants made by HEFCE after 1 August 2006 that create an Exchequer interest are entered onto the register, regardless of how they are treated for accounting purposes.

6. The opening Exchequer interest balance as at 1 August 2006 is written down over a 10-year period on a straight-line basis. All subsequent capital grants are 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.

7. The closing balance of the register as at 31 July 2007 and annually thereafter provides a single reportable sum for the Exchequer interest, and is confirmed annually with the institution by HEFCE.

8. As repayment of Exchequer interest only occurs in exceptional circumstances (see below), it does not need to be disclosed as a contingent liability in the institution's annual accounts.

Circumstances in which the Exchequer interest becomes repayable

9. If either of the following remote events occurs, they will trigger immediate liability for the institution to repay to 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.

10. 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 if it experiences any analogous event.

11. The second trigger event is if there is a significant reduction in the level of total of HEFCE-funded activity and tuition fee income paid by the Student Loans Company to the institution, using the following indicators:

- the absolute level of HEFCE grant funding and SLC tuition fee income
- the absolute level of total income
- the percentage of total income represented by HEFCE and SLC income.

12. A base level for each of these indicators was set as at 31 July 2006 by reference to the institution's 2005-06 financial statements. This value is indexed each year, as are previous years' capital grant additions, before being written down, as set out at paragraphs 3 and 4 above.

13. 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.

14. 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 or SLC-funded education. HEIs may activate the trigger if, for example, they cease to educate publicly supported students, significantly downsize or go into liquidation, but are unlikely to do so if activities continue as normal or they expand. We will not use our Exchequer interest rules to penalise institutions that are successful in diversifying their income.

15. The agreed base level for each indicator will be uprated annually for inflation by HEFCE (as described in paragraphs 3 and 4 above), and may be reset if appropriate to reflect the changing nature of the provision of education and more general changes within public sector funding.

16. 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.

17. 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.

Annex E: Exempt charities

1. HEFCE is the principal regulator of those HEIs that are exempt charities. The benefit of HEFCE having this role is that we can utilise existing assurance processes, so minimising the burden on institutions as well as enhancing confidence.

2. This annex sets out our main requirements relating to annual and longer-term cyclical monitoring of HEIs that are exempt charities. They arise from our role as principal regulator of HEIs as charities (see www.hefce.ac.uk/whatwedo/reg/charityreg/ for more information).

3. In addition to the requirements set out here, from time to time we may need to ask for other information to enable us to deal with particular issues about HEIs as exempt charities. Our power to do so is set out in Section 79A of the Further and Higher Education Act 1992. In particular, our principal regulator role applies to entities that are exempt charity 'connected institutions' by virtue of Paragraph 28, Schedule 3, Charities Act 2011 (paragraph 28 connected institutions). Although we do not directly monitor those entities, we have the power to request information about them.

4. The information requirements of HEIs as exempt charities (see paragraphs 5 to 9 below) are similar to those of the Charity Commission for registered charities. However the collection and publication arrangements have been tailored to the sector, and reflect our responsibilities as the lead regulator of HEIs in respect of their accountability for public funds, and are largely embedded in our normal monitoring processes. For example, the Charity Commission publishes some of the information it collects on its own web-site; instead we require each HEI to publish information on its own site.

Information to be made readily available on HEIs' web-sites

5. HEIs that are exempt charities must maintain a page on their web-site to provide a gateway to the following information:

   a. The legal name and correspondence address of the HEI. The preferred name(s) used by the HEI should also be shown.

   b. The main constitutional document of the HEI (such as its Royal Charter, Memorandum and Articles, or Trust deed). This should be the latest version, but HEIs should provide earlier versions back to at least the one that was in force in 2009-10.

   c. The names of the trustees on 31 January each year, together with a list of **all** other charities (if any) of which each trustee is then also a trustee.

   d. The full audited consolidated financial statements for at least five years.

6. The 'gateway' web page should be easy to locate on the HEI's web-site and must be updated with the previous year's information no later than six months after the end of the previous academic year. HEIs must provide HEFCE with the up-to-date web address (URL) of the gateway page so that third parties can access it via our own web-site.

Information to be included in audited financial statements

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

a. The charitable status of the HEI.

b. The trustees who served at any time during the financial year and until the date the financial statements were formally approved.

c. A statement that the charity has had regard to the Charity Commission's guidance on public benefit.

d. A report on how the HEI has delivered its charitable purposes for the public benefit. For detailed guidance, see www.hefce.ac.uk/whatwedo/reg/charityreg/goodpracticeguidanceforinstitutionsascharities/reportingonthedeliveryofpublicbenefit/

e. Information about payments to or on behalf of trustees, including expenses; payments to trustees for serving as trustees (and waivers of such payments); and related party transactions involving trustees. For detailed guidance and materiality levels, see www.hefce.ac.uk/whatwedo/reg/charityreg/goodpracticeguidanceforinstitutionsascharities/transactionswithtrustees/#section3

f. Information about 'paragraph 28' connected institutions of the HEI.

8. We do not specify where in the financial statements this information should be presented, but it is likely that:

- a and b above will form part of the corporate governance statement
- c and d above will either form part of the operating and financial review or be presented as a separate section
- e and f above will be included in appropriate notes to the financial statements.

9. We may provide more detail about some of the above in the HEFCE accounts direction to HEIs, which is updated by an annual circular letter.

Reporting serious incidents

10. A serious incident is one which has resulted in, or could result in, a significant loss of funds or a significant risk to a charity's property, work, beneficiaries or reputation. For more guidance see: www.hefce.ac.uk/whatwedo/reg/charityreg/goodpracticeguidanceforinstitutionsascharities/seriousincidentreporting/

11. HEIs must report serious incidents to HEFCE at the time when they are identified. We have also included in HEFCE's annual assurance return a specific declaration that serious incidents have been appropriately reported to us. This declaration will be made on behalf of all trustees. It would be appropriate therefore for the trustees to be informed about incidents reported to HEFCE; however, we do not stipulate how this should be done.

12. Where HEIs report the loss of an HEI’s assets through fraud, theft or other cause, we will consider an incident reported both as funder and as principal regulator.

13. In addition, and as principal regulator in the first instance, we expect HEIs to report the following serious incidents:

- donations of more than £25,000 from unknown donors or where the source cannot be verified
- abuse or mistreatment of a charitable beneficiary involved in activities of the HEI
- disqualification of a trustee
- known or alleged links (other than for bona fide academic reason) with proscribed organisations or terrorism; this applies to trustees, staff, students or anyone else associated with the HEI.

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

14. A report of a serious incident should be sent to the HEFCE chief executive. Our primary concern is to satisfy ourselves that the HEI has responded to the incident in an appropriate way, designed to protect the HEI as a charity. In order for us to do this, HEIs should provide as much information as possible to help us to decide if their response has been appropriate and what, if any, further action is planned. In particular we would expect the report to indicate:

- whether the incident has happened or is suspected
- when it occurred and who was involved
- the impact of the incident on the HEI, any beneficiary involved, or both
- what inquiries have been made and/or actions taken, including any reports to other regulators or the police
- what policies and procedures were in place that apply to the incident, whether they were followed and, if not, why
- whether the trustees have determined that policies and procedures need to be introduced or revised – and if so, how and by when.

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

16. We appreciate that information provided under the terms of paragraphs 10 and 11 may be of a sensitive nature, and we undertake to treat it with care. We ask for the information to fulfil our statutory obligations as principal regulator, and such obligations may require us to consult the Charity Commission to ensure that we deal with an issue in a manner consistent with the regulation of charities generally. As public authorities, both HEFCE and the Charity Commission are subject to the Freedom of Information Act. We will only disclose information to someone outside HEFCE or the Charity Commission in circumstances where we are legally obliged to do so. Further guidance about the way HEFCE applies the Freedom of Information Act and the Data Protection Act 1998 is available on our web-site.

Definitions and abbreviations

1992 Act	Further and Higher Education Act 1992
Accountable 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
Accounting officer (of HEFCE)	As accounting officer, the chief executive of HEFCE has a personal responsibility to safeguard public funds and achieve value for money as set out in HM Treasury guidance, 'Managing Public Money' and any subsequent guidance. This includes responsibility for the public funds allocated by HEFCE to higher and further education institutions and other bodies for education, research and associated purposes
Annual accountability returns exercise	A streamlined accountability process between HEFCE and institutions, linked to an assessment of institutional risk, which comprises an exchange of documents and dialogue during a specific period each year
Annual accounts direction	HEFCE publishes an annual accounts direction, which states HEFCE's financial reporting requirements. HEIs and their external auditors must comply with it. The most recent accounts direction was published as HEFCE Circular letter 25/2013
CUC	Committee of University Chairs
EBITDA	Earnings before interest, taxes, depreciation and amortisation
FEC	Further education college
Governance Code of Practice	'Guide for Members of Higher Education Governing Bodies in the UK: Governance Code of Practice and General Principles' (HEFCE 2009/02)
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
HAR	HEFCE Assurance Review
HE	Higher education
HEFCE	Higher Education Funding Council for England

HEI	Higher education institution
HESA	Higher Education Statistics Agency
IIA	Institute of Internal Auditors
JANET	High-speed computer network supported by all the four higher and further education funding bodies, which links universities and colleges in the UK. SuperJANET is the enhanced network
Key information Set (KIS)	Key Information Sets or KIS are comparable sets of information about full- or part-time undergraduate courses, published on course web pages. All of the KIS are published on the Unistats web-site
Operating Framework	The Operating Framework explains how higher education providers in England are held to account and regulated
QAA	Quality Assurance Agency for Higher Education
Register of HE providers	Being developed in 2013-14
Related body	A non-HEI/FEC body through which significant levels of HEFCE funding are distributed or activities promoted
Regularity	Regularity is a public finance requirement for funds to be applied only to the extent and for the purposes authorised by Parliament
Secretary of State	Secretary of State for Business, Innovation and Skills
SLC	Student Loans Company Limited
the Code	HEFCE's Audit Code of Practice
VFM	Value for money

References to the **financial position, financial statements, financial commitments or borrowings** 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 2006, and in accordance with generally accepted accounting principles.
Shall and **must** denote mandatory requirements, and **should** denotes our view of good practice.