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Policy paper

Further education reclassification: government response

Published 29 November 2022

Applies to England

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Introduction

Following a review into the classification of the statutory further education (FE) sector (FE colleges, sixth form colleges and designated institutions) and their subsidiaries in England, the Office for National Statistics (ONS) has reclassified colleges and their subsidiaries into the central government sector.

The ONS is an agency independent of ministers, and periodically reviews the classification of all sectors of the economy for the purposes of national accounts. You can find more information about the classification and how they reached this decision on the [ONS website](#).

At the outset of the review, we wanted to ensure that if colleges were reclassified, it happened in as seamless a way as possible, maintaining continuity and stability for the sector. We've taken the time to get these changes right to:

- give colleges the support that they need as the transition takes place
- explore the ways that colleges, learners, employers, and communities might all make the most of this change

We've set out how the government is responding to make sure that colleges can continue to fulfil their role at the heart of their communities, working in partnership with employers, local government, and other providers to meet the needs of learners and the labour market. We've balanced this against the importance that the Accounting Officer for DfE can adequately demonstrate we're managing public money well.

To support and protect colleges, we'll be:

- investing £300 million of payments before the end of the current financial year to:
 - eliminate the current deficit in funding
 - move to a profile of funding which better matches need, recognising the challenging environment the sector faces
- providing an additional £150 million of capital grant funding in 2023 to 2024 to support and protect colleges planning to invest in their infrastructure and estate where previously they would have borrowed

from commercial lenders

- allowing colleges to retain flexibility on using surpluses and sale of assets ensuring that colleges can continue to invest in their estates, while complying with the managing public money framework
- committing to work in partnership with the sector to develop the future approach to financial reporting, and a new college handbook

The ONS decision to reclassify the FE sector will not alter the strategic aims of colleges. Colleges will continue to play a leadership role in England's skills system. We'll continue to work to make sure that colleges provide the world-leading skills infrastructure that our country needs.

Managing public money

Following the reclassification, colleges and their subsidiaries are now part of central government. This means they are subject to the framework for financial management set out in [managing public money](#), guidance on senior pay and other central government guidance.

It is our intention that reclassification allows colleges to continue to operate efficiently and in the best interests of students and taxpayers, while complying with [managing public money](#) and other central government guidance.

Colleges will retain many of the flexibilities they currently have, for example the ability to keep and spend any surpluses. The day-to-day operations will continue with minimal changes, so colleges can maintain a smooth delivery.

[Managing public money](#) explains the main principles and requirements for dealing with resources in UK public sector organisations. It changes how colleges report to and interact with government and requires colleges to ensure their systems of financial control support public sector standards of accountability.

This government response sets out the position in relation to some of the key areas where managing public money applies. A letter to accounting officers provides more detail on other areas where managing public money

applies, such as:

- severance
- write offs
- indemnities

Many of the requirements of [managing public money](#) are just good common sense, and exemplify sound financial management. It also includes some specific rules and conventions.

Next steps

We'll begin work to write a new college financial handbook.

We'll engage with representatives from the sector, with a view to sharing a draft with colleges and sector bodies in autumn 2023 for consultation. This will make it clear what is expected of them and build their understanding and support.

We'll also set up the necessary processes and data collection systems to operationalise the new requirements.

The handbook will be finalised for publication in March 2024, ahead of an effective date of August 2024. This will explain the actions colleges must take to comply with managing public money and other public sector guidance.

We'll write to college principals and accounting officers to explain how managing public money and other guidance applies. We'll let colleges know how we'll support them to work as quickly as possible towards complying with the new rules.

Existing debt

Colleges' existing debt commitments do not need to change.

We expect that colleges will repay their existing loans to maturity. However, some loans have lump sums to pay at the end of their fixed term. Some colleges may have been expecting to refinance the debt commercially.

Refinancing commercially is unlikely to be possible under the managing public money framework, and certain colleges will not be able to pay off the lump sum themselves. In these cases, we'll provide funding to enable the college to repay the debt. We'll then recover the funds from the college over an agreed timeline by withholding an agreed amount of planned future funding. We'll provide colleges with more details about how this will work in the accounting officer letter.

Further use of existing overdraft and revolving credit facilities will be subject to a DfE consent process set out in the accounting officer letter. We expect colleges to phase out existing overdrafts and revolving credit facilities by no later than August 2024.

New private sector borrowing

Managing public money is clear that from 29 November 2022 colleges as public sector organisations may borrow from private sector sources only if the transaction delivers value for money for the Exchequer. Because non-government lenders face higher financing costs, in practice it is very unlikely that colleges will be able to satisfy this condition for future private sector borrowing.

Any proposals for new private sector borrowing will need DfE consent. We'll update college learner grant agreements to include this as a condition of funding.

Our new initiatives relating to capital investment and payment profiles are designed to replace funding previously sourced from the private sector.

Colleges will be able to continue with any existing finance leases until they come to the end of their term and will also be able to enter into new finance leases.

Capital investment

Through research conducted with the sector, we recognise that some colleges may have planned to borrow commercially and pay commercial interest rates to fund estate condition improvement projects.

To take into consideration the new limitations on commercial borrowing, we propose to build on the existing FE capital transformation programme, adding £150 million of capital funding to FE colleges and sixth form colleges. This funding will be allocated to FE colleges and sixth form colleges in spring 2023.

Payment profiles

To help colleges manage their cashflow, we'll address the historical issue of uneven monthly payments from central government, which leave colleges out of pocket by March. We'll invest £300 million before the end of the current financial year in bringing forward payments. This will enable us to smooth out the funding, so we have a new even profile for colleges from 2023 to 2024 for both the 16 to 19 and adult education budgets.

To make a transfer between financial years in government spending, we plan to make an:

- additional funding payment to each college by March 2023
- equivalent reduction in funding for each college between April and July 2023, which is then available to each college between January and March the following year

We'll then be able to set a new profile for academic year 2023 to 2024.

Retention of surpluses

Currently, colleges have the flexibility to carry over surpluses, in full, from one year to the next. This includes any unspent grants. This flexibility will remain in place after reclassification.

Colleges could experience good years and bad years financially and the retention of surpluses helps smooth this out. Not having a limit on retention allows colleges to engage in long term financial planning.

Colleges will continue to be able to save for cyclical costs such as capital asset replacement.

Asset disposals

Currently, colleges can:

- dispose of fixed assets without approval
- keep the proceeds from disposals without approval

This remains in place after reclassification and will be kept under review. Proceeds must be ringfenced for capital expenditure.

The retention of both surpluses and asset disposal proceeds will help colleges meet their future commitments.

Novel, contentious, or repercussive transactions

Transactions by colleges or their subsidiaries that may be considered novel, contentious, or repercussive must always be referred to DfE for prior approval.

Novel transactions are those of which a college has no experience or which are outside its range of normal business. Contentious transactions are those that might cause controversy or criticism of the corporation by Parliament, the public or the media. Repercussive transactions are those that set a precedent or are likely to cause pressure on other colleges to take

a similar approach, and hence have wider financial implications.

Subsidiaries and commercial operations

Colleges will retain the ability to operate their trading subsidiaries.

Many colleges have subsidiaries, some of which are profit making entities with commercial operations. Subsidiaries play an important role in the college system, both in delivering provision and generating commercial income.

ONS has reclassified colleges' trading subsidiaries, with the colleges themselves, into the central government sector.

Senior pay controls

Colleges remain responsible for setting the pay, and terms and conditions for their workforce. However, reclassification means that colleges will fall within the scope of [senior pay controls](#), as set out by HM Treasury (HMT). Colleges should familiarise themselves with this guidance.

We'll update our existing guidance on executive pay to reflect the principles set out in HMT's guidance.

We'll work with the sector to make sure that colleges are able to get approval from us for any new or amended reward packages that fall within the scope of the controls. This includes all new appointments that are due to be advertised from May 2023.

Financial reporting

Colleges will continue to produce their own annual report and accounts as normal for the year ended 31 July 2023. Working with the sector, we'll

review the options for future years. There is no requirement to produce additional information in relation to the financial accounts for year ended 31 July 2023.

From 2024, the department must consolidate the accounts for all colleges into one. This means we'll need additional information from colleges. We'll be working with the sector to ensure that the impact of this request is manageable.

Budgetary reporting

We'll be asking for information from colleges regarding their budgetary spend on a fiscal year basis to 31 March. We'll be working with the sector to ensure that the request is manageable and determine whether the current budgetary information is an acceptable proxy.

VAT

The ability of colleges to recover VAT is not related to their ONS classification. Many public bodies cannot recover the VAT they incur. We keep all taxes under review, and any proposals to change the tax system would need to be considered in the context of the broader public finances.

Banking

Colleges can continue to use commercial bank account facilities. They are also able to bank with the [Government Banking Service](#) from day one. We'll encourage colleges to switch to the Government Banking Service over time.

International students

There is no change to the recruitment of international students after reclassification.

Pensions

The reclassification of the FE sector does not require any action for colleges with regards to the local government pension scheme.

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