Skills Funding Agency

Consent for Further Education Colleges to Invest in Companies

June 2011

Of interest to college principals and finance directors as well as staff within the Skills Funding Agency.

Summary: This guidance document is aimed at college principals and finance directors as well as staff within the Skills Funding Agency. It lays out the requirements for Further Education (FE) colleges to seek Skills Funding Agency (the Agency) consent to invest in companies or charitable incorporated organisations established to conduct an educational institution or providing education that is wholly or partly funded by the Agency. It provides guidance to colleges on the main issues to be considered when investing and the process and criteria to be followed when seeking consent from the Agency.

Although this guidance refers to the action and responsibilities of the Skills Funding Agency, it should be noted that the legal entity in whom the statutory functions are vested in is the Chief Executive of Skills Funding. The Skills Funding Agency is the term used to describe the Chief Executive of Skills Funding and his staff to whom he can delegate his functions.

Contents

BACKGROUND

1 This document sets out the implications in respect of involvement by colleges in companies or charitable incorporated organisations and the responsibilities of the Skills Funding Agency (the Agency) for approving college involvement in such companies and organisations.

2 This document replaces LSC Circular 02/12: *College involvement in* Companies and FEFC Circular 99/14: *College Companies, Joint Ventures and Overseas Operations*.

Legislation

3 Further education colleges became independent corporations under the Further and Higher Education Act 1992 (the 1992 Act). The specific powers of further education corporations are set out in Sections 18 (principal powers) and 19 (supplementary powers) of the 1992 Act as amended by the Learning and Skill Act 2000 ,the Further Education and Training Act 2007 and the Apprenticeships, Skills, Children and Learning Act 2009.

4 The relevant provisions in the 1992 Act as amended are s19(4) and (8) which provides as follows in relation to the powers of a further education corporation to participate or invest in a company or charitable incorporated organisation:

19(4) A further education corporation may—

[(*bb*) form, participate in forming or invest in a company,

(*bc*) form, participate in forming or otherwise become a member of a charitable incorporated organisation (within the meaning of section 69A of the Charities Act 1993),]

[(4A) The power conferred by subsection (4)(*bb*) above may not be exercised for the purpose of—

(*a*) conducting an educational institution, or

(*b*) investing in a company conducting an educational institution.

(4AA) The power conferred by subsection (4)(*bc*) above may not be exercised for the purpose of—

(*a*) conducting an educational institution, or

(*b*) becoming a member of a charitable incorporated organisation conducting an educational institution.

(4AB) But a restriction on the exercise of a power imposed by subsection (4A) or (4AA) above shall not apply to the extent that the appropriate authority consents to the exercise of the power in a way which does not comply with the restriction.

(4AC) In subsection (4AB) above 'the appropriate authority' means—

- (*a*) in relation to a further education corporation in England, the [Skills Funding Agency];

- (*b*) in relation to a further education corporation in Wales, the Welsh Ministers.]

[(4B) [Neither the power conferred by subsection (4)(*bb*) above nor the power conferred by subsection (4)(*bc*) above may be exercised] for the purpose of the provision of education if the provision is secured (wholly or partly) by financial resources provided by [the Skills Funding Agency] or the [National Assembly for Wales in the discharge of its functions under Part 2 of the Learning and Skills Act 2000].

(4C) But subsection (4B) above shall not apply to the extent that [the [Skills Funding Agency]] [or the National Assembly for Wales (as the case may be)] consents to the exercise of the power conferred by subsection (4)(*bb*) above [or the power conferred by subsection (4)(*bc*) above] in a way which does not comply with the restriction in subsection (4B).]

19 (8) A reference in this section to investing in a company includes a reference to becoming a member of the company and to investing in it by the acquisition of any assets, securities or rights or otherwise.]

* Note: A charitable incorporated organisation is a new corporate structure designed for charities. Further details about charitable incorporated organisations can be found on the Charity Commission website

5 The former Department for Education and Skills confirmed that the requirement for consent applied where the college acquired shares in or securities of a company:

a. prior to 1 April 2001
b. since the introduction of the Learning and Skills Act
c. which was established for a purpose other than the provision of education and where it is proposed to change the company's objectives and to use the company for the provision of education wholly or partly funded by the Agency.

6 References in the document to companies includes charitable incorporated organisations.

Types of Company

7 A variety of models for college companies exist and there are some important variations in the nature of these companies:

a	*nature of limited liability* – college companies may be limited by share or guarantee
b	*extent of ownership* – the extent of college ownership of a company may vary from a 100% shareholding to a minority shareholding
c	*extent of control* – colleges may or may not exert control over the companies in which they have ownership
d	*place of registration* – college companies are normally registered in England and Wales or, exceptionally, in some other country

8 There are a number of reasons which colleges give for the creation and use of companies. A college may have seen benefit in delivering an educational programme by establishing a company with other partners in order to deliver the programme. In other cases a company may have been created to enable the college to distinguish, in particular to the HMRC, between charitable educational activities and those on offer for commercial purposes. Other reasons which colleges have presented for establishing companies include:

a	*purchasing power* – some colleges have set up a company as a vehicle for jointly procuring certain services
b	*improved clarity* – it is believed, by colleges, that the creation of a special purpose vehicle such as a company gives greater clarity and focus to the activity and provides for improved accountability
c	*marketing advantage* – although many colleges undertake commercial activities directly, some colleges perceive that the marketing effectiveness of the activity may be enhanced if the same activity is undertaken through a college company;
d	*Name protection* – to prevent another organisation from registering a company with the name in question
e	*Joint venture – a college may establish a company to carry out a joint venture with other bodies*

Why Colleges Need Consent from the Skills Funding Agency

9 Where a college participates in a company providing education, wholly or partly funded by the Agency without its consent, it is acting beyond its powers and its external auditors should qualify its financial accounts. In addition, the education provided by the subsidiary company will be ineligible for funding by the Agency.

KEY ISSUES FOR COLLEGES

10 The following key issues should be considered by colleges which have created or are considering the creation of companies.

Rationale for Company Formation

11. It is essential that colleges consider the educational, commercial, financial and legal reasons for forming a company and the advantages, disadvantages and risks the company would give over some alternative arrangement. Colleges should take **appropriate financial and legal advice** before any firm decision is made. As part of this process, colleges should take advice as to how they can minimise any potential liabilities they may face as a consequence of the activities of their companies.

12 Taking activities through a college company may provide the college with a measure of protection against claims such as breach of contract claims if the company is the contracting party. However, a college company will not always provide protection against claims on the college, or those of its staff or governors who serve as directors and who may be personally liable, and where a college intervenes in its subsidiary's affairs to an the extent that it becomes a shadow director it could expose itself to liability.

13 Further education corporations should be satisfied that the formation of a company will assist in the delivery of the corporation's principal powers. This will have implications for the memorandum and articles of the company which clearly must have as its main object the helping of its parent further education corporation in the delivery of its principal powers rather than some independent business venture that is of no benefit to the corporation. Although this is a wide-ranging power, it has its limits and the following points should be noted:

<table>
<tr><td>a</td><td>the Agency and NAO should be able to examine the activities of subsidiary companies. Colleges should ensure that access rights to subsidiary companies are secured through the memorandum of understanding</td></tr>
<tr><td>b</td><td>college companies must ensure that they do not exceed their powers as set out in the memorandum and articles of association of the company</td></tr>
<tr><td>c</td><td>college companies are subject to, and therefore must legally comply with, all of the provisions of the Companies Act 1985,1989, 2004 and 2006 (the Companies Act). Colleges are referred in particular to the following requirement of the Companies Acts, in particular:
• duties to keep accounting records and prepare annual accounts
• distribution of profits, for example, the covenanting of profits back to the corporation
• distribution of assets and liabilities, for example, the approach to be</td></tr>
</table>

	applied on dissolution of the company • directors' duties and enforcement of fair dealings by directors and persons connected with them. For example, the Companies Act provide that any director (or persons connected with them) of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company must declare any interest in such a contract. In addition, companies are prohibited from entering into certain substantial property transactions involving directors or persons connected with them unless the arrangement is first approved by a resolution of the company in a general meeting • company administration. The Companies Act contain extensive provisions on the running of companies which include the following requirements: - to maintain various statutory registers (for example, members, directors, mortgages and charges) - to deliver annual returns to Companies House and various other returns (such as allotments of shares, changes of directors, increase of share capital) - to hold annual general meetings and the procedures for giving notice for and conducting meetings generally, passing resolutions and maintaining records of proceedings
d	colleges should be aware of the fiduciary duty, to act in the best interests of the company, which directors of college companies owe to those companies in law. Care must be taken to ensure that a conflict does not arise in the case of individuals who have a dual role within the college and as a director of the company
e	college companies must comply with the provisions of the *Insolvency Act 1986*. The attention of directors of college companies should be drawn in particular to sections 213 and 214 of the *Insolvency Act 1986*, relating to the penalties for wrongful and fraudulent trading of companies, which provides that, in certain circumstances, the court may declare that any persons who are knowingly parties to the carrying on of wrongful or fraudulent trading are to be liable to make such contributions to the company's assets as the court thinks proper;
f	colleges may not trade and any services they or their company provide must be ancillary to their main activities

14 Particular issues arise if a college considers exceptionally an overseas registered company or overseas joint venture (see paragraphs 32 and 33). Agency funding should not be used to support activities of colleges or their companies overseas as the funding of overseas activities is not an appropriate use of public funds meant for educational purposes in England. Commercial, social and legal practices in other countries vary enormously, are often considerably different from those in the United Kingdom, and colleges are likely to have limited knowledge about these practices. Before entering into such a venture, colleges should take **appropriate and country-specific advice** about the nature of the proposals being considered.

15 The same considerations apply to the acquisition of companies. Where colleges acquire, in part or in full, the ownership of an existing company, they must additionally undertake a rigorous and comprehensive due diligence study of the company in question.

16 All formations and acquisitions should be approved by the college's board of governors.

Organisation of companies

17 The Agency would expect colleges to pay particular attention to the following organisational aspects of their companies

<table>
<tr><td>a</td><td>structure – arrangements should be straightforward, clear and transparent. Colleges should guard against the creation of complex structures and give careful consideration to the appropriateness of arrangements between a college company and the college</td></tr>
<tr><td>b</td><td>Board arrangements – a company must, in law, have a board of directors.</td></tr>
<tr><td>c</td><td>directors – for the purposes of accountability, the board of directors of a college company must have representation from the college's board of governors. The precise degree of representation on the company will depend on the level of ownership and involvement by the college in that company. In particular, the memorandum of understanding between the college and the company should set out the responsibilities of college employees and governors who are also directors of college companies to: protect the individuals and emphasis their legal responsibilities to the company as set out in the Companies Acts; and to clarify what the college can and cannot ask them to do in such situations. In particular, five factors must be taken into account:

with larger and more active companies it is appropriate to have a non-executive governor of the college on the company
companies should arrange their affairs so that their boards have no conflicts of interest. Board members should make a declaration of interest and should not be appointed in situations which are likely to give rise to frequent conflicts of interest through, for example, an interest in a major customer or supplier of the company
to maintain a degree of independence in audit matters, members of the college audit committee should not sit on the company board
remuneration of directors – a director of a college company should not be remunerated for fulfilling the role without express permission from the secretary of state for education and employment
management arrangements – clear arrangements must be established for the day-to-day operational management of the company and for the management of company funds. These arrangements should be subject to regular audit inspection by the company auditors
</td></tr>
</table>

Use of college funds in relation to companies

18 Before any college funds are made available to a company, the college should ensure that it will receive a satisfactory return and that the college bears an acceptable level of risk. Colleges are expected to take a prudent view of any risks to which they are exposed. For each proposed business venture governors will wish to undertake a thorough review of its business plan and proposed control arrangements. In particular, colleges will wish to ensure:

a	compliance with the financial memorandum of the college
b	compliance with the college’s instrument and articles of government. In particular, governors’ responsibilities for the efficient and effective use of resources, the solvency of the corporation and the safeguarding of the corporation’s assets
c	that recommendations of the PAC and bodies such as the NAO as to what constitutes the good use of public funds are properly regarded
d	approval has been given by the college’s board of governors both to the principle and the sum involved

Use of public funds in relation to companies

19 In addition, the following legal considerations must be taken into account:

a	that when colleges exercise their powers to invest they are subject to the *Trustee Act 2000*
b	if colleges are subject to a trust deed, they must comply with the investment powers set out in that trust deed
c	colleges which are charities should note that if they ‘invest’ in a college company, for example, by making employees available to it free of charge or allowing it to use charity premises for less than the market rent, this could amount to a breach by the trustees of their duty to safeguard and maximise the charity’s assets. Such wider ‘investment’ may also be in breach of other express duties, for example, to ensure the efficient and effective application of resources in the charity’s operations
d	investments in companies other than those which have been incorporated for the purpose of carrying out college functions must, in any case, be an efficient, economic and effective use of resources and must realise a commercial rate of return.

20 Funds provided by the Agency may be used to purchase goods and services from a company, subject to the usual requirements with regard to value for money. However, the Agency’s funds should not be used to fund or subsidise private trading ventures by colleges, either through direct transfers of cash or indirect funding or subsidy arrangements such as granting subsidiaries more favourable terms of trade than other customers and providing staff free of charge or at a rate which does not cover the full costs involved. Equally, college companies should not charge those under 19 for the costs of full-time education. Where college costing and other accounting systems do not distinguish public funds from other funds, governors should regard all the funds at their disposal as if they were public funds.

Accountability and governance

21 Colleges should ensure that arrangements are in place to enable college governors to discharge their accountability and governance responsibilities in relation to companies. The Agency would expect to see:

a	appropriate representation by governors on the board of a college company
b	a nominated person representing the college as a shareholder attending the annual general meeting of each company in which the college has an interest
c	clear arrangements for regular reporting, to governors, on the past performance and future plans of the company. This would involve company performance and plans being monitored on a quarterly or termly basis as a standing item on the agenda of the committee responsible for financial matters in the college. Incorporated into this would be a minimum framework of controls for each of the companies involved
d	a formal memorandum of understanding between the college and the company setting out the relationship between the company and the parent college
e	where a college is a wholly owned or majority shareholder in a company, it is desirable for the external auditors of the college to be also the external auditors of the company. This will provide for commonality of standards and fuller awareness of the relationship between the two organisations

22 In many situations it is inevitable that the activities of a college company will be intricately involved with the operational activities of the college itself. For example, the following situations may arise:

- the company using the services of college staff;
- the company using the services of college buildings and equipment;
- college managers having responsibilities in relation to the management of the company;
- activities of the company utilising the quality assurance processes of the college.

23 The relationship between the company and the parent college must be clearly defined and transparent in nature. A formal memorandum of understanding between the college and the company should be established.

24 Furthermore, where situations arise that the company makes material use of the assets and resources of the college (or vice versa), it is essential that these arrangements are properly reflected in the accounts of both the company and the college. To do this, appropriate systems must be in place to record and reflect the full cost of the transactions involved and to ensure that the college's usual credit control policies apply.

Business planning and risk management

25 Good business planning contributes to the effectiveness of the company's operations and minimises the risks of failure. Active college companies which involve the conduct of trading activities must have a business plan prepared for those activities.

26 Although it is for each college to decide the precise format of the business plans for its companies, such business plans must, at least, contain the following items:

a	the principal objectives of the company and how these link to the overall mission and objectives of the college
b	a set of financial projections, including cashflow projections covering, at least, a three-year period
c	an assessment of the risks facing the company in conducting its operations
d	a description of the way in which it is intended that these risks be managed
e	a description of the management arrangements of the company

Financial Arrangements

27 In forming college companies, colleges need to give consideration to issues concerning both direct and indirect taxes. With all types of college company effective tax planning and tax arrangements will be needed. Colleges should seek specialist advice in these areas as appropriate.

28 The Agency sees it as paramount that colleges ensure that its companies operate within a robust framework of financial control. Colleges should ensure that adequate systems are in place to enable the financial performance of companies to be monitored frequently. The existence of such systems is essential to enable the college and its governors to discharge their duties of accountability for company performance.

29 A college company should have its own set of financial procedures and regulations and these could be the same procedures and regulations as the college itself or a different set of procedures and regulations, which are more suited to company activities. Reference must be made to the college's financial memorandum with the Agency which covers subsidiary companies and significant decisions cannot be delegated by colleges to companies. As a minimum, the financial procedures and regulations should cover the following:

a	the regulation of company or expenditure authorisation, income collection and control of assets
b	the establishment of appropriate levels of authorisation that should be given by the college governors in relation to the college company
c	specific procedures involving the authorisation of expenditure on overseas activities

30 Colleges should ensure that the systems and procedures of companies are subject to adequate internal audit review and reporting. The internal auditors of the college have a duty to form a view on the quality of controls in the company joint venture. In most cases the internal auditors of the college should be appointed to provide an internal audit service to the company.

Overseas operations

31 The extent of overseas operations by colleges is limited. However, where a college exceptionally enters into overseas operations, it is essential that there are robust arrangements in place to plan, manage and control them.

32 If, exceptionally, a college wishes to undertake overseas activities it should:

a	develop a strategy for overseas activities that is within its powers. The strategy will, among other things, demonstrate how the number and range of overseas ventures fit with the college's legal powers and educational aims. The strategy should be approved specifically by the college governing body and informed by an analysis of the financial implications of such activity
b	undertake thorough business planning for all new overseas operations before deciding whether to proceed. In particular, the college should undertake market research to forecast accurately the likely demand for the particular activity being considered. All costs should be included in the cost benefit and/or investment appraisal analysis, and should be subjected to sensitivity analysis for changes in key variables
c	be able to demonstrate that it has not used public funds intended for the support of teaching activity within England to finance the development of overseas activities, or to offset any losses which may arise as a result of such overseas activities. In particular, the structure of the college's management accounts should enable it to demonstrate the cost recovery and net operating surplus or deficit of overseas operations. It follows that such accounts should include an appropriate allocation of overheads to overseas activities
d	ensure that it has adequate systems for controlling its assets, including those used on overseas activities
e	ensure that its financial regulations are adequate in relation to the handling of cash payments and overseas travel arrangements, and that staff are aware of the regulations
f	apply quality assurance arrangements to any overseas activities which are of the same standard as those that exist for other elements of its activity. This will ensure that the college applies the same high standards of management and control to overseas activities as it does to its other activities

APPLICATION FOR CONSENT

33 Any college requiring consent to use a company for educational provision wholly or partially funded by the Skills Funding Agency should submit an application for consent to the Agency. Annex A provides a proforma of the information that should be submitted with the application for consent.

Criteria to be met for Consent

34 An assessment of the proposal will be made of whether the proposal meets the Agency's criteria when deciding whether to give consent. Guidance on the criteria that will be considered is set out in Annex A.

35 The decision on whether to grant consent will be made by the Agency's Chief Executive following consultation with appropriate Agency staff.

Refusal of Consent

36 Consent for a college to use a company for the delivery of educational provision wholly or partly funded by the Skills Funding Agency should only be declined where there is clear evidence that the criteria have not been met, or if the accountability arrangements have not been complied with.

37 Where the Skills Funding Agency decides not to give consent, the reasons for that decision should be clearly notified to the college, which is then given the opportunity to make representations before the formal refusal is given. The college may then, if it so wishes, appeal the decision within one month of receiving notification of the decision.

Annex A

College Request Proforma for consent to Use a Company to conduct an educational institution or deliver education provision funded by the Skills Funding Agency

The proforma below is designed to assist colleges in their application to receive the Skills Funding Agency's consent to invest in a company(s) conducting an education institution or providing education that is wholly or partly funded by the Agency. Colleges are not required to submit their application in the format suggested below but they are advised to provide the supporting evidence requested as this will help the decision making process.

The first section below provides some basic information about the formation of the company and its details. The second section provides a checklist to aid colleges in providing the appropriate documentary evidence to support their application. Colleges are advised to reflect on the key issues for Colleges Section of the guidance when providing supporting evidence and are invited to provide any additional comments to provide context to the supporting evidence provided.

Where a college is unclear or has any doubts about what would constitute appropriate evidence it should consult with its Provider Services Account Manager.

Section 1 – Company Details

(a) Name of College	
(b) Company name and number (charity number of Charitable incorporated organisation)	
(c) College Shareholding and details of other partners	
(d) Names of Directors and the capacity in which they hold shares, if any	
(e) The existing or proposed funding and financing structure to be put in place in the company, together with the sources of any funds	
(f) Is it envisaged that the Agency would fund the company directly for any education provision delivered by it or would funding be provided to the college?	

Section 2 – Key Criteria

Criteria	Evidenced Yes/No	Comments from College
(a) There is a genuine educational or business case for delivering provision in this way rather than as direct provision. ▪ The college should provide evidence that this approach has demonstrable advantages over alternative arrangements. The proposals should be part of the college's strategic plans and financial forecasts. The college should demonstrate that the proposal will contribute additional educational provision (not replace existing provision) and make a positive contribution towards to the college's financial health • The college should also provide evidence that it has taken appropriate financial and legal advice and that the proposals are appropriate and fall within the powers of the college		
(b) The company arrangements are straightforward, clear and transparent and available for scrutiny, with appropriate transparent controls and accountability. The college should provide evidence detailing the structure of the company and verifying that it has representation from the college corporation on the board of any significant joint venture and a memorandum of agreement should set out the responsibilities of college governors and employees who are directors of the company		

(c) The Use of College funds will provide a satisfactory return and any risk will be at an acceptable level. • The college should provide evidence (including appropriate minutes) that the corporation has fully considered the costs and benefits of the proposal and taken account of the potential maximum financial and non-financial risk		
(d) The Use of Public funds will provide value for money and will not be used to fund or subsidise private training ventures by colleges. • The college should provide evidence that they have taken account of legal considerations e.g. the Trustee Investment Act when choosing to invest in a company. The college should also demonstrate that the investment is an efficient, economic and effective use of resources and will demonstrate a commercial rate of return.		
(e) The college must have a business plan prepared for company activities. • The college should provide evidence that it has an effective business plan for the company which minimises the risks of failure.		

(f) The college's internal audit plan includes scrutiny of the internal controls and systems supporting the company and the provision. • The college should provide evidence that the internal audit plan and risk assessment includes the company's procedures and control systems for review at an early date.		
(g) There are appropriate probity and quality monitoring procedures in place. • The college should provide evidence that appropriate controls and procedures are in place to ensure that educational provision made through the company will be at least as good as provided through the college • The college will have a suitable overview of the company operation to ensure compliance with the law, ensure that public funds are properly accounted for and spent in accordance with good practice and value for money.		
(h) The college, the Skills Funding Agency and the NAO must be able to examine the activities of the company. • The college should provide evidence that the above parties will have access rights to company books and records, documents, company personnel and all company premises. •		

(i) Where a college enters into an overseas operation it is essential that it has robust arrangements in place to plan, manage and control them. The college should provide evidence that it has taken advice to ensure that the activities of the operation will be within the powers of the college and that adequate arrangements are in place to provide value for money and minimise any risks.		

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