

# **Financial Memorandum Part 1**

## **December 2006**

**This document sets out the financial relationship between the Learning and Skills Council (LSC) and colleges.**

**This document is of interest to FE college principals, chairs of governors, chairs of college finance committees, chairs of audit committees, directors of finance and clerks of governing bodies and in addition regional finance and resources directors at regional LSCs.**

**This document is effective from the 1<sup>st</sup> August 2006 until further notice and supersedes the Further Education Funding Council's Circular 99/48**

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# Financial Memorandum

## Part 1

### Preamble

1 This financial memorandum sets out the financial relationship between the Learning and Skills Council (LSC) and colleges. While it necessarily concentrates on financial matters, the LSC's relationship with colleges goes well beyond this to a whole set of mutual obligations encompassing the wider communities and interests that both the LSC and colleges serve. For the financial arrangements set out in this financial memorandum to be effective, the LSC and colleges need to work in partnership and have a relationship based on trust.

2 This document should be read in conjunction with the LSC's Audit Code of Practice, and the Instrument and Articles of Government.

3 The financial memorandum describes a grant-in-aid funding relationship between the LSC and colleges. This is a form of government funding peculiar to bodies in which there is a high degree of public interest, such as colleges. Grant-in-aid funding is assumed to be continuous, requiring deliberate action to end it. Although grant-in-aid funding gives the LSC a high degree of interest in all aspects of colleges' operations, it is also a relationship well suited to trust and to colleges' autonomy. It also offers the LSC the flexibility to fund colleges in a way that recognises their position in the wider community.

4 The form of a financial memorandum for grant-in-aid is largely dictated by HM Treasury requirements for non-departmental public bodies and also the LSC's financial memorandum with the DfES. One of the DfES' financial memorandum requirements of the LSC is that the LSC should have a financial memorandum as a grant agreement in place with colleges for the purposes of regulating the relationship on financial and other matters. The LSC has interpreted the requirements from HM Treasury and the DfES in a way that maximises the ability of college governing bodies and principals to manage their own affairs while ensuring that there is a strong framework to account for public funds.

5 The key areas of the memorandum therefore reflect the LSC's own responsibilities for public accountability over the funds it provides to colleges. Some parts of the financial memorandum focus on areas of particular interest, for example the considerable public investment in colleges' capital programmes, and the extent of colleges' liabilities that might accrue ultimately to the public purse.

However, the LSC's expectation is that, as independent corporate bodies, colleges will take full control of their own financial affairs. The LSC does not consider that the financial memorandum includes any requirement which colleges should not expect of themselves or find unduly onerous.

### **The college's expectations of the LSC**

6 This financial memorandum necessarily concentrates on the LSC's requirements and expectations of colleges and the memorandum does not try to capture all of the LSC's obligations to colleges. Colleges are entitled to expect that the LSC will conduct its business with them at all times to the highest standards required of public bodies. The LSC will act reasonably on the basis of the evidence available and on the LSC's objective analysis of this evidence. The LSC will be open and transparent with colleges and other stakeholders and will give reasons for all its decisions.

### **Legislation**

7 The Learning and Skills Act 2000 gives the LSC the power to impose conditions in respect of its funding of providers of post-16 education and training. In this financial memorandum, the LSC sets out the terms and conditions on which it pays funds to the College. Nothing in this memorandum shall require the College to act in a manner which would cause it to lose its charitable status, or which would be inconsistent with its instrument and articles of government.

### **Definitions**

8 For the purpose of this financial memorandum, the definitions in Table 1 apply.

**Table 1: Definitions of terminology used in the financial memorandum**

Act	means the Further and Higher Education Act 1992, as amended by the Learning and Skills Act 2000
DfES	means the Department for Education and Skills
College	means the educational institution conducted by the Further Education Corporation and named in part 2 of this memorandum
College funds	For the purposes of propriety, means all of a College's income and receipts derived from whatever source
ESF	means the European Social Fund
Governing body	means the body established under or designated under the Act to conduct the College
Financial year	means the College's financial year 1 August to 31 July
LSC funds	means the funding paid to the College by the LSC
Principal	means the Chief Executive Officer or Principal appointed by the governing body
Public funds	for the purposes of regularity, means all of a College's income and receipts from the LSC and from the Higher Education Funding Council for England (HEFCE)
Secretary of State	means the Secretary of State for Education and Skills
Senior postholder	means the Principal and holders of the other posts designated as senior posts by the governing body
Provider	means a provider of education and training funded by the LSC pursuant to its powers under the Act

### **Responsibilities of the LSC**

9 The LSC's Chief Executive has been designated its accounting officer under the LSC's financial memorandum with the DfES. The LSC's accounting officer is responsible and accountable to Parliament for ensuring that the uses to which the LSC puts its funds are consistent with the purposes for which the LSC was given the funds and that the uses comply with the conditions attached to them. The LSC's accounting officer is also responsible for the regularity and propriety of expenditure for those uses and for securing the best possible value for money from them.

10 The DfES requires the LSC's accounting officer to monitor the College's compliance with the terms and conditions attached to the LSC's funds. The LSC's accounting officer must be satisfied that the College has appropriate arrangements for sound governance, financial management, securing value for money and accounting, and that the College's use of public funds is consistent with the purposes for which the funds have been given.

### **Responsibilities of the College**

11 The governing body of the College has wide responsibilities under statute which are not repeated here. Specifically, it is responsible for ensuring that the College's funds are used only in accordance with the governing body's powers under the Act, this financial memorandum and any other conditions that the LSC may from time to time impose.

12 The governing body has wide discretion over its use of the College's funds and it is ultimately responsible for the proper stewardship of those funds. The governing body must ensure that it uses its discretion reasonably, and takes into account any relevant guidance on accountability or propriety issued from time to time by the LSC, the National Audit Office or Parliament.

13 The respective responsibilities of the governing body and the principal are set out in the College's articles of government. Within this framework, the governing body shall require the principal to take personal responsibility, which shall not be delegated, to assure them that there is compliance with the financial memorandum and all terms and conditions referred to above.

14 As accounting officer, the principal may be required to appear before the Parliamentary Committee of Public Accounts, alongside the accounting officers of the LSC and the DfES, on matters relating to the College's use of public funds and College funds.

15 The principal shall be responsible for advising the governing body in writing if, at any time, in his or her opinion, any action or policy under consideration by the governing body is incompatible with the terms of the financial memorandum. The principal shall be similarly responsible for advising the governing body in writing if the governing body appears to be failing to act where required to do so by the terms and conditions of the financial memorandum. Where the governing body determines to proceed despite the advice of the principal, the principal should consider the reasons the governing body gives for its decision. If, after considering the reasons given by the governing body, the principal still considers that the action proposed by the governing body is in breach of the financial memorandum, the principal shall advise in writing the LSC's accounting officer of the position.

16 The clerk is responsible for the administrative support for the governing body's work, for advising on proper procedure, and for intervening when the clerk considers that the governing body is acting inappropriately or beyond its powers, in which case the clerk may need to seek external advice. College governing bodies are advised to agree procedures they would expect the clerk and the governing body to follow if there were difficulties in this area. The LSC would not consider that action within such procedures should provide grounds for disciplinary action or the suspension of the clerk.

### **Allocation of funds**

17 The LSC will decide the amount of funds it will pay to the College in any year after the LSC has considered the activities to which the funds will be applied, and taking account of other competing demands on the resources granted to the LSC.

18 The LSC may distinguish between recurrent funds and capital funds. Recurrent funds are intended to meet the ongoing operating costs of the College. Capital funds are intended to meet expenditure on land and buildings, new construction and extension of and alteration to buildings and the purchase of any other fixed assets having an expected life of more than one year. Capital expenditure excludes the routine maintenance of buildings and other assets. The LSC will notify the College, in writing, of the allocation of relevant recurrent funds as soon as possible in advance of the academic year to which they relate. Ideally this will be at least four months in advance of the academic year.

19 The LSC will seek to not substitute its judgements for those that are properly at the discretion of the College. In particular the LSC will seek to maximise the College's discretion to use the LSC's funds in achieving the LSC's objectives for granting those funds as agreed with the College. On occasion, the LSC may allocate funds to the College for a specific purpose. Depending on the terms and conditions of the LSC's allocation, the College shall apply or spend, or both, any the funds only for that purpose.

20 The College or its sub-contractors shall not apply public funds to learning provision for which the College has already received other funding, public or otherwise, unless the LSC so specifies. Where the LSC identifies that the College has applied public funds in a way not specified by the LSC, the LSC may deduct the value of such funding from LSC funds payable to the College.

21 The College must not use the funding from this schedule to make bids or claims from any European source of funding on its own behalf or on behalf of the LSC without obtaining the LSC's written consent. The LSC will give reasonable consent. The LSC reserves the right to use LSC funds as match-funding for ESF co-financing projects. The College shall, if requested to do so by the LSC, inform learners or others that learning provision has been financed by the ESF.

## **Payment of funds**

22 The LSC will make payments to the College in monthly instalments in accordance with a funding profile for the whole funding year. The LSC may be prepared on written application from the College to make exceptional ad-hoc payments to the College. Such payments will not be made in advance of the College's need to spend the money.

## **Capital transactions**

23 The College should manage and develop its property with regard to the guidance issued from time to time by the LSC on property procedures, including strategic property management, option and investment appraisal, the affordability of the project and private finance. The LSC requires the College to normally apply the proceeds of asset sales to investment in land and buildings fixed assets. The College must seek independent professional advice when disposing of land and buildings.

24 The LSC requires the College to obtain its consent for capital transactions where the total cost or proceeds exceed £1.5 million or 5 per cent of the College's annual revenue<sup>1</sup>, whichever is the lesser. Where the transaction is a disposal or the renting or leasing of property to a third party, the College must seek to secure the best obtainable value for money. The total cost of a property transaction includes all costs whether these are to be met by the College or a third party.

25 Where the College proposes to dispose of or lease or rent<sup>2</sup> land and buildings which may have been acquired by public funds, the LSC may require the College to surrender some or all of the proceeds.

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<sup>1</sup> The annual revenue of a College shall be taken to be the turnover declared in its most recent audited financial statements less any release of capital grant included in turnover.

<sup>2</sup> Where property transactions involve rental rather than purchase, the LSC will establish a rate at which rent payments or receipts are converted to a capital sum. For the purpose of paragraph 25, a rent is deemed to be a sum 10 times the amount of the annual rent, save where the property is subject to a lease for a fixed term of which fewer than 10 years remain, in which case, in order to calculate the deemed capital sum, the annual rent is to be multiplied by a factor equal to the number of years of the term remaining.

## **Borrowing**

26 The College must seek the LSC's prior written consent for any secured or unsecured borrowing by itself or its subsidiaries, unless it falls within the following statements or any special conditions the LSC may include in the schedules to the financial memorandum:

- The LSC gives consent for unsecured borrowing by the College of up to 5 per cent of the College's total annual income
- The LSC gives consent for secured borrowing by the College up to a cumulative maximum of 5 per cent of the College's total annual income in order to finance the construction, refurbishment or purchase of land and buildings provided that only the land and buildings so purchased or constructed are offered as security.

27 The LSC reserves the right to withdraw the College's consent to borrow where the LSC has assessed that there are financial or other major causes for concern in line with guidance which shall be issued after consultation.

## **Contingent liabilities**

28 The College shall not give any guarantees or indemnities other than in the normal course of business.

## **College companies**

29 The Act requires the College to seek consent to participate in companies providing education funded wholly or partly by the LSC. This applies where the College participates in, acquires shares in or securities of a company which was established for a purpose other than the provision of education and where it is proposed to change the company's objectives and to use the company to provide education wholly or partly funded by the LSC.

## **Financial reporting**

30 The LSC shall specify its requirements as to the information to be contained in the College's financial statements, the manner in which they are to be presented and the methods and principles according to which they are to be prepared.

31 The College shall keep proper accounting records and shall prepare financial statements in respect of each accounting period. The College shall provide the LSC with copies of its audited financial statements as specified by the LSC. As charities, colleges are expected to make their financial statements available to members of the public on request.

32 The College must ensure that it has an effective policy of risk management (including appropriate insurance arrangements). The College's risk management arrangements should consider the key principles given in LSC guidance.

33 The College must notify the LSC in writing if at any time there is a significant deterioration in its financial position. Where the LSC has concluded that there is a significant risk to the College's financial position, the LSC may require the College to put in place a plan that will secure a recovery to a satisfactory financial position.

## **Audit**

34 The governing body shall appoint an audit committee and arrange to provide for internal and financial statements audit, including regularity audit, in accordance with the LSC's *Audit Code of Practice* and any other directions drawn up and published by the LSC in consultation with colleges. Any mandatory requirements under the LSC *Audit Code of Practice* shall be a condition of funding under this financial memorandum.

35 The LSC may from time to time carry out audits at the College and its sub-contractors. The National Audit Office (NAO) may carry out value-for-money studies at the College. The College shall provide the LSC and the NAO with access to all books, records, information, explanations, assets and premises and the LSC may take copies of any relevant documents. The LSC may conduct interviews, including interviews with learners, during its audits at any reasonable time. The LSC will give the College reasonable advance notice in writing of its proposed audits.

36 The College shall retain all records necessary to verify the provision delivered by it or its sub-contractors in relation to this financial memorandum for six years after the end of the period to which funding for the provision relates. Where any of the provision is funded by the LSC using the ESF and the LSC uses any funding as match-funding for an ESF co-financing project, the College must retain all required records until 31 December 2014. Representatives of the European Commission and the European Court of Auditors shall have the right to visit the College and its subcontractors.

37 By exception, the DfES' internal auditors and the NAO may accompany the LSC on audits. The DfES and the NAO will normally be concerned with how the LSC carries out its audits and will not normally themselves audit the College.

38 The College shall investigate and report to the LSC all significant cases of internal and external fraud or suspected fraud or irregularity (as defined in the LSC *Audit Code of Practice*). The LSC reserves the right to review the College's fraud investigation files.

## **Procurement and contracting**

39 As an organisation considered to be carrying out significant public business, the College shall comply with all relevant UK and European regulations and requirements for acquisition of all goods and services and works.

## **Payments to employees on termination of employment**

40 Payments made to employees on the termination of their employment should normally only be for the purposes of meeting contractual obligations and items such as pension enhancements within the limits set out in the relevant pension scheme rules. Exceptions should be justified by explicit and quantified reference to value for money.

41 The College must be able to demonstrate that payments in respect of termination are regular, secure value for money and are affordable and avoid spending public funds on settlements where disciplinary action would have been more appropriate.

42 In determining individual settlements to senior postholders, or where settlements might be considered novel or contentious, the College must take appropriate professional advice and the terms of any final agreement should be agreed by the governing body. Appropriate records of each stage of negotiations shall be retained and the cost of all settlements must be declared in the College's financial statements. All settlements must be brought to the attention of the College's financial statements auditors.

## **Provision of information**

43 The College shall provide the LSC, or agents acting on the LSC's behalf, with the information the LSC requires in exercising its responsibilities and to meet European funding requirements. This information shall be of sufficient quality to meet the purposes for which it has been requested. The College will provide the information at the times and in the formats specified by the LSC and its agents. The LSC will consider the impact on College business of the deadlines it specifies for the provision of information. On occasion the LSC will require urgent information from the College, usually as a result of requests to the LSC to fulfil its duties to provide information to the Secretary of State and account to Parliament.

44 The LSC will act reasonably in its requests for information and will have regard to the costs and timescales of providing the information, and where appropriate to its confidentiality. In requesting information, the LSC will also consider information previously supplied by the College to the LSC or other stakeholders with whom the LSC is realistically able to share information. The LSC will also seek to request information that the College gathers to meet its own needs.

45 In the event that the College does not return the information the LSC requires by the specified deadline or that the information is not of an acceptable quality, exceptionally the LSC reserves the right to either to:

- carry out whatever investigations it deems necessary to collect the information, where appropriate in consultation with the college. The LSC may, as appropriate, deduct all or part of the cost of the investigations from the LSC's recurrent funding of the College
- use reasonable estimates to exercise the LSC's functions under the Act.

46 If the LSC overpays the College as a result of the LSC's use of estimates, the LSC reserves the right to recover any overpaid funding.

47 The LSC may be required to provide information in relation to the College and this financial memorandum if requested under the Freedom of Information Act 2000. We have 20 working days to gather, consider disclosure of the information and respond. Although there is no legal obligation to do so the LSC will usually consult with third parties including Colleges where the information requested was provided by them.

48 The College must notify the LSC's Chief Executive in writing of the vacating or filling of the positions of chair of the governing body, principal and clerk, and, when the principal is absent from the college for an extended period, the name of the person who will discharge the principal's responsibilities during his or her absence.

### **Interpretation**

49 The rights, powers and remedies reserved to the LSC in this memorandum are in addition to any other rights, powers and remedies that it may hold now or at any time in the future. No failure to exercise or delay in exercising by the LSC any of its rights, powers and remedies shall operate as a waiver of them. Nor shall any single or partial exercise of any such right, power or remedy preclude any further or other exercise of the same or any other right, power or remedy.

51 While the LSC reserves the right to resolve any questions arising on the interpretation of any provision of this memorandum, it shall only do so after consulting the College and taking into account any representations made by the College or any other bodies representing the College as the LSC considers appropriate.

## **Repayment**

52 In the event that the College does not comply with any conditions attached by the LSC to the payment of funds, the LSC reserves the ultimate right to require the College to repay all or part of those funds.

The LSC shall only make use of this power by exception.

## **Revision**

53 After consultation with the College, and such bodies representing the College that the LSC considers appropriate, the LSC may from time to time revise, revoke or add to any of the conditions in Part 1 of this financial memorandum. The College may itself make proposals to the LSC for such changes. The LSC will from time to time review the thresholds and monetary limits in this memorandum to ensure they remain up to date. The LSC will consult the College if it intends to amend these limits.

## **Effective date**

54 These arrangements shall take effect from 1 August 2006.

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