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FE & HE Digest

Spring 2023

Latest news from the Further and
Higher education sectors

Now, for tomorrow





Welcome to the Spring term edition of FE/HE Digest



**On behalf of the MHA education team
may we wish you a Happy New Year.**

Following the Office for National Statistics (ONS) announcement that FE College's are being reclassified as public sector institutions, this edition of FE/HE digest has been dedicated to this single issue to provide practical help and guidance to our clients and contacts.

2023 is likely to be a significant year for the sector as we see industrial action throughout many UK public services alongside high levels of inflation and regulatory change. As for the latter, the reclassification will bring about wide ranging changes to how Colleges can operate, accordingly we have outlined some of the key considerations.

Best Wishes,
Further & Higher Education sector teams

In detail

Looking back at the decision itself, you may ask why did reclassification occur? It appears to have been two main factors at play.

Firstly, there is a new international guidance methodology that the ONS needed to follow, this gives a different interpretation to the level of control that the Secretary of State has in intervening with Colleges (this was a significant difference to when the sector was last reviewed in 2012). This has meant the ONS now takes into account more about what can theoretically happen versus what happens in practice.

The second factor was a by-product of the Skills and Post 16 Education Act which allowed for greater intervention from central government. These new powers meant that the ONS concluded that even greater levels of control can be applied by the state, making Colleges less independent. – these two issues combined have tipped the review's conclusions and results in reclassifying the sector into public ownership.

Key Considerations

The impact of the reclassification is wide ranging and some issues have already come to light over the last month or so. In this edition of FE/HE digest we will be focussing on the following:



Debt



Capital sales



VAT & Local
Government
Pension
Schemes



Accounting
year ends



Managing
public money



Debt

New borrowing rules came into effect on the 29 November 2022, from this date Colleges are not permitted (in practice) to make any new and/ or additional borrowing – **this includes:**

- Taking out new loans or overdrafts with external banks
- Renegotiating debt which results in amended terms and conditions that increase the cost of the loan or results in new borrowing
- Where balloon payments are due – Colleges are unlikely to be able to enter into new terms and conditions even if they replace the existing terms of the loan
- Increasing an existing overdraft by any amount

Some of these restrictions are likely to have been a major consideration as to whether the college could sign off the 2022 accounts.

Example:

College A has a 5 year loan of £3m which is due to expire on 31 March 2023 – the loan has repayment profile of 20 years – it would normally be the intention of the College simply to renew the facility on 31 March 2023. However, the College no longer has the ability to do this, instead the College can approach the ESFA to establish how the loan will be dealt with.

In making their assessment we understand that the ESFA will firstly ascertain if the College can afford to repay the loan itself, if so then the College may be instructed to repay the loan. If the College cannot afford to repay the loan, then the ESFA may take over the debt. This decision is under the control of the ESFA and will be assessed on a case-by-case basis. We understand that a queuing system is in place based upon the expiry date of the loan, this has proved problematic for some Colleges with loans expiring after 6 months who need to demonstrate the going concern assumption for their 2022 financial statements.

The ESFA have said they are willing to accept an extended filing deadline to 31 January 2023 if this is an issue (that can be resolved) or they expect an emphasis of matter in the 2022 auditor's report.



Capital sales

Another that came into force on 29 November 2022 with immediate effect was the ringfencing of proceeds from the sale of assets which can only be then reinvestment in capital assets. Concerns have been raised as to the definition of this requirement specifically what is deemed to be 'proceeds' and what indeed constitutes an 'asset'. We would suggest that the starting point would be the definitions already laid down by UK Generally Accepted Accounting Practices (UK GAAP) which would be FRS102 and the FE/HE SORP. There is likely to be guidance that will be issued on this matter in due course via the Financial Handbook but in any respect this provision will be reviewed in March 2025, so could be temporary.



VAT & Local Government Pension Schemes

Some Colleges were hopeful that the reclassification would afford Colleges some of the benefits that Academies already enjoy. This would include VAT126 claim status (which allows certain organisations to claim back input VAT on non-business activities) and government backing (via a guarantee) for each College's Local Government Pension Scheme. Either one of these benefits would have provided a significant financial boost for the sector, unfortunately no such announcement has been made but we know this will be an area the sector will lobby for.



Accounting year ends

The Treasury (hereafter referred to as HMT) has its own parliamentary expectations and key requirements being regularity, propriety, value for money and feasibility. In its accounting duties it is required to consolidate the financial activities of each department of government. It does this by setting standards in which annual reports and accounts must be published using the Financial Reporting Manual (FRM) and setting Accounts Directions. So now Colleges will form part of the Whole of Government accounts (WGA) and there will be significant pressure from HMT to ensure that the financial results of Colleges can easily be consolidated into the Department's accounts, which have a 31 March year end.

Obviously, this causes issues (as is currently the case for Academies) such that HMT's opening position is that Colleges will need to move their year end to 31 March unless there is a reason why this is not possible. The ESFA will be canvassing opinion on this matter in the coming months and the AoC is also likely to take opinion on the matter as well.

Another topic that is likely to be on the cards, but not in the short term, is the accounting framework used for Colleges. At present Colleges adopt the Statement of Recommended practice for Further and Higher Education. It might be debated as to whether the Colleges, like Academies adopt the Charities SORP in order to streamline the ESFA reporting requirements. As noted, there are no plans on the table at present to even consider this point – however we feel it will be a consideration for the future.



Managing public money

As public bodies Colleges now fall under the HMT rules for managing public money. This will set the new parameters by which regularity will be set and will form the basis for hard line 'do's and don'ts' that will decide whether or not a College can undertake certain transactions. These will range from special severance payments, compensation and ex-gratia payments to bad debt write offs. Whilst these rules will be set out in due course by the ESFA via the Colleges Financial Handbook, this is not due to be published until 2024. Therefore, we have provided some summary guidance to help Colleges get an overview of the scope and requirements of the document as well as some of the underlying principles.

These new rules contain what is about to become a well-known phrase which is 'Novel, Contentious and Repercussive transactions' (abbreviated to NCR's). These types of transactions are likely to require approval from the state before they are entered into. Further details are provided below.

- **Novel** payments or other transactions are those of which the College has no experience or are outside the range of normal business activity for the Corporation.
- **Contentious** transactions are those which might give rise to criticism of the trust by Parliament, and/or the public, and/or the media.
- **Repercussive** transactions are those which are likely to cause pressure on other corporations to take a similar approach and hence have wider financial implications.

Where appropriate in this section we have highlighted possible action points that Colleges may wish to take – these are denoted as **"ACTION"**.





Managing Public Money – in detail

One of the overarching considerations of being a public sector body is the requirement to abide by His Majesty's Treasury's (HMT) Managing Public Money guidance which sets out the main principles for dealing with resources in UK public sector organisations, it also provides some specifics on certain transactions or situations that must be followed.

The authority for these guidelines flows from the statutory duties of the accounting officer for the department/agency which is then delegated to the Accounting Officers of ALB's (Arms Length Bodies – i.e. Colleges). The key theme of the document is the fiduciary duties of those handling public resources to work to high standards of probity (honest and decency) and the need for the public sector to work in harmony with parliament.

The application of these principles came into force on the 29 November 2022 for Colleges. Whilst the majority of the requirements will already be embedding into the way in which most Colleges already operate it is important that all governors, accounting officers and finance teams are aware of the document and its contents, as noted above the Financial Handbook will provide more specific guidance in due course.

The HMT principles expected are: honesty, fairness, impartiality, integrity, openness, accountability, transparency, objectivity, accuracy and reliability.

These principles need to be carried out in the spirit of, as well as to the letter of, the law; in the public interest; to high ethical standards and by achieving value for money.

These principles align well to Colleges who adopt the Corporate Governance Code as well as those adopting the AoC's Code of Good Governance (which advocates the use of the Seven (Nolan) Principles; Selflessness, Integrity, Objectivity, Accountability, Openness, Honesty & Leadership and Four Values; Respectful, Professional, Prudent and Passionate).

Whilst not directly word for word aligned, the Nolan principle of Objectivity covers fairness and impartiality, nonetheless we may see the next iteration of the AoC Code more specifically aligning to the HMT principles. ACTION: Governance professionals may want to document their consideration of the HMT principles in line with the relevant code of governance that the college adopts.

As noted in point 4 above there is a term that will become increasing common to College's in the coming months; Novel, Contentious or Repercussive (NCR's). This flows directly from the HMT scheme of delegation whereby the Treasury cannot delegate responsibility for certain categories of expenditure. These are generally categorised as NCR's and as such the ESFA are required to obtain Treasury permission before proceeding with the transaction. **The specific examples give are:**

- extra statutory payments similar to but outside statutory schemes
- ephemeral ex gratia payment schemes, e.g. payments to compensate for official errors
- special severance payments, e.g. compromise agreements in excess of contractual commitments
- non-standard payments in kind
- unusual financial transactions, e.g. imposing lasting commitments or using tax avoidance
- unusual schemes or policies using novel techniques

Within the HMT guidance accounting officers of Colleges will be treated as Accounting Officers of Arm's length Bodies (ALB's), in the guidance it confirms that subsidiaries of Colleges are within the scope of 'managing public money' so all of the regularity and NCR's are applicable all entities within the College group.

The guidance also sets out some essentials that are expected of all ALB's for managing payments these are as follows:

- 1 Selection of projects after appraisal of the alternatives (see the Green Book), including the central clearance processes for larger commitments.
- 2 Open competition to select suppliers from a diverse range, preferably specifying outcomes rather than specific products, to achieve value for money.
- 3 Where feasible, procurement through multi-purchaser arrangements, shared services and/or standard contracts to drive down prices.
- 4 Effective internal controls to authorise acquisition of goods or services (including vetting new suppliers), within any legal constraints.
- 5 Separation of authorisation and payment, with appropriate controls, including validation and recording, at each step to provide a clear audit trail.
- 6 Checks that the goods or services acquired have been supplied in accordance with the relevant contract(s) or agreement(s) before paying for them.
- 7 Payment terms chosen or negotiated to provide good value.
- 8 Accurate payment of invoices: once and on time, avoiding lateness penalties.
- 9 A balance of preventive and detective controls to tackle and deter fraud, corruption and other malpractice.
- 10 Integrated systems to generate automatic audit trails which can be used to generate accounts and which both internal and external auditors can readily check.
- 11 Periodic reviews to benefit from experience, improve value for money or to implement developments in good practice.

Likewise, for income receipts the essential features are also detailed:

- 1 Adequate records to enable claims to be made and pursued in full.
- 2 Routines to prevent unauthorised deletions and amendments to claims.
- 3 Credit management systems to manage and pursue amounts outstanding.
- 4 Controls to prevent diversion of funds and other frauds.
- 5 Clear lines of responsibility for making decisions about pressing claims increasingly more firmly, and for deciding on any abatement or abandonment of claims which may be merited.
- 6 Arrangements for deciding upon and reporting any write-offs. Audit trails which can readily be checked and reported upon both internally and externally.

ACTION: All Colleges are likely to already have in place these systems – however it is advisable that procurement and sales teams assess each of these points for both payments and receipt systems, to ensure they are documented within financial regulations and/or procedures.

There are also additional responsibilities set out in relation to major/capital projects that need to be adhered to – these are cross referred to the 'Green Book' which is further HM Treasury guidance which covers the following:

- policy and programme development
- all proposals concerning public spending
- legislative or regulatory proposals
- sale or use of existing government assets – including financial assets
- appraisal of a portfolio of programmes and projects
- structural changes in government organisations
- taxation and benefit proposals
- significant public procurement proposals
- major projects
- changes to the use of existing public assets and resources

Some of these items will not be relevant to Colleges however there is pertinent guidance in relation to capital projects that will be applicable.

ACTION: Estate managers should ensure they are familiar with the Green Book requirements particularly in relation to capital projects, where appropriate they should document their adherence to these principals for all capital projects commencing in 2023 and beyond.

Delegated authority – the ESFA will be issuing as part of the Financial Handbook its scheme of delegated authority which will give greater details on the parameters of financial independence that Colleges can maintain. Whilst this is being prepared we have noted some of the likely parameters which are already set out in HMT’s guidance. Firstly, we have noted where the backstop of the ESFA’s limits will be – this is where they themselves will need to seek Treasury approval:

- public statements or other commitments to use of public resources beyond the agreed budget plans of the department
- guarantees, indemnities or letters of comfort creating contingent liabilities
- any proposals outside the department’s delegated limits
- all expenditure which is novel, contentious or repercussive, irrespective of size, even if it appears to offer value for money taken in isolation
- where legislation requires it
- fees and charges

The ESFA have clarified that indemnity clauses often are part of commercial contracts and do not require DfE approval however for those outside of the normal course of business, guarantees and letters of comfort in excess of:



of annual income or £45k (whichever is smaller); or



of annual income cumulatively (subject to a cumulative ceiling of £250k). Will require DfE approval.

Where Treasury approval has been overlooked, the case should immediately be brought to the Treasury’s attention.

All expenditure which falls outside a department’s delegated authority and has not been approved by the Treasury, is irregular, in certain circumstance the Treasury can give retrospective approval, if this is not given it is escalated to the National Audit Office. There are also certain specific transactions that are likely to be covered within the financial handbook they are:

1 Payments in advance or deferred

Payments in advance of need should be exceptional and should only be considered if a good value for money case for the Exchequer can be made. Exceptions to this rule are as follows:

- service and maintenance contracts which require payment when the contract commences, provided that the service is available and can be called on from the date of payment;
- grants to small voluntary or community bodies where the recipient needs working capital to carry out the commitment for which the grant is paid and private sector finance would reduce value for money;
- minor services such as training courses, conference bookings or magazine subscriptions, where local discretion is acceptable; and
- prepayments up to a modest limit agreed with the Treasury, where a value for money assessment demonstrates clear advantage in early payment.

Interim payments may have an element of prepayment and so public sector organisations should consider them carefully before agreeing to them. However, if they are genuinely linked to work completed or physical progress satisfactorily achieved, preferably as defined under a contract, they may represent acceptable value for public funds.

HMT consider that deferred payments are generally not good practice. They normally mean paying more to compensate the contractor for higher financing costs and are thus poor value for money. So any proposal for deliberate late payment is potentially novel and contentious.

2 Write offs

The ESFA will be required to report write-offs and losses to HMT, irrespective of the amount of money involved, if they:

- involve important questions of principle;
- raise doubts about the effectiveness of existing systems;
- contain lessons which might be of wider interest;
- are novel or contentious;
- might create a precedent for other departments in similar circumstances;
- arise because of obscure or ambiguous instructions issued centrally.

The ESFA have already provided more specific guidance on this matter and have confirmed that DfE consent will be required if the individual loss/write-off exceeds 1% of annual income or £45k individually (whichever is smaller), or 5% of annual income cumulatively (subject to a £250k cumulative ceiling). However, the above principles still need to be taken into account as there is no de-minis for these. Secondly, it is almost certain that all Colleges will need to report back to the ESFA on all write-offs made in the financial year and potentially on the nature of each transaction. ACTION: Ensure the College has adequate processes in place in order to document each write off and capture the justification for the transaction.

3 Special Payments

The following is a list of special payments which the Treasury may need to be consulted on:

- extra-contractual payments: payments which, though not legally due under contract, appear to place an obligation on a public sector organisation which the courts might uphold. Typically these arise from the organisation's action or inaction in relation to a contract. Payments may be extra-contractual even where there is some doubt about the organisation's liability to pay, e.g. where the contract provides for arbitration but a settlement is reached without it. (A payment made as a result of an arbitration award is contractual.)
- extra-statutory and extra-regulatory payments are within the broad intention of the statute or regulation, respectively, but go beyond a strict interpretation of its terms.
- compensation payments are made to provide redress for personal injuries, traffic accidents, damage to property etc, suffered by staff. They include other payments to those in the public service outside statutory schemes or outside contracts.
- special severance payments are paid to employees, contractors and others outside of normal statutory or contractual requirements when leaving employment in public service whether they resign, are dismissed or reach an agreed termination of contract.
 - ex gratia payments go beyond statutory cover, legal liability, or administrative rules, including:
 - payments made to meet hardship caused by official failure or delay
 - out of court settlements to avoid legal action on grounds of official inadequacy
 - payments to contractors outside a binding contract, e.g. on grounds of hardship.

Colleges will have delegated authority to make individual severance payments, provided any non-statutory/non-contractual element is under £50k or under 3 months' salary, whichever is the lower. Beyond this, DfE approval will be required. Furthermore, any proposed payments of whatever value that are linked to a non-disclosure agreement will also require DfE approval. However, noting that any such payment which is deemed to be NCR must be referred for DfE approval.

Note that in the specific case of 'Retention payments' which are designed to encourage staff to delay their departures or any form of Ex Gratia payments, are nearly always classified as novel and contentious so DfE approval is required.

Additionally colleges must obtain prior DfE approval before making a special staff severance payment where:

- an exit package which includes a special severance payment is at, or above, £100,000, and/or
- the employee earns over £150,000.

For compensation payments Colleges can approve payments where the non-statutory/non-contractual element does not exceed £50k.

ACTION: Ensure the College has adequate processes in place in order to document each special payment (including all termination payments for staff – contractual or not) and for all non-contractual/statutory payments capture the justification for the transaction and noting the Colleges conclusion as to whether ESFA approval was required or not.

4 Insurance

HMT state that managing risk through insurance in central government organisations is generally not good value for money. Therefore it is likely that Colleges will be restricted over the types of insurance it can obtain from third parties. The ESFA is currently exploring, with their Risk Protection Arrangement Scheme an alternative to commercial insurance. In the meantime Colleges are permitted to continue and renew their existing insurance arrangements.

5 Senior pay controls

HMT has issued process guidance, which over 23-pages, gives instructions that Colleges now need to adhere to. The guidance sets out the following principles that must be regarded when setting senior pay:

- Senior appointments should be remunerated at an appropriate level providing value for money,
- Senior appointments should be remunerated at an appropriate level to recruit, retain and motivate the best people,
- Senior remuneration should be set at an appropriate level that is consistent across grades to ensure fairness and consider the impact across the public sector,
- Recruitment should look beyond London to all corners of the UK to be more like the country we serve,
- Recruitment should attract a wide range of talent from more diverse backgrounds.

DfE approval will now be required for any remuneration provided when an appointment (new or existing) will attract:

- 1 total remuneration at or above the defined threshold of £150,000, or the pro-rata equivalent for part-time staff, or
- 2 performance related pay ('bonus') arrangements that exceed the threshold of £17,500; or
- 3 the appointment is for a position which attracts a total remuneration package greater than that of the CEO of the Corporation.

This includes where an individual exceeds the defined threshold following contractual adjustments or on moving to a new post, even if previously paid above the defined threshold. There are certain dispensations for temporary promotion appointments that are set out in the guidance. It is also important to note that pay includes all elements of base salary, fees, pension in excess of normal levels and allowances. Allowances constitute extra cash or non-cash benefits in kind aimed at supplementing an employee's or postholder's fee or total remuneration package.

The guidance also notes that private medical insurance and salary sacrifice arrangements, unless approved by HM Treasury, must not be provided. Round sum allowances, for example housing and travel allowances, count towards the pay threshold but should not normally be offered as part of the remuneration package unless there is a strong business reason to do so.

ACTION: College payroll teams should perform an assessment of all senior staff ahead of setting any pay awards to establish if DfE approval is required.



And Finally, in other new.... Association of Colleges Code of Governance

The AoC's Code of Governance was updated in September 2021, this became effective for 31 July 2023 year ends. As a reminder the key changes in the update were as follows:

- 1 Review of the wording of the provisions in each principle
- 2 Introduction of Environmental Sustainability principle
- 3 Update of EDI principle
- 4 Governance Review principle combined with Governance Structure principle
- 5 Full integration of the SPH Remuneration Code. Therefore, to be compliant with the Code, colleges must adopt or have due regard for the Remuneration Code. As with any other principle or expectation, this will be on a 'comply or explain' basis.



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If you would like any further details on any of the matters raised in the articles above please do get in contact with a member of the education team.



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