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FE & HE Digest

Summer 2023

Latest news from the Further and Higher education sectors

Now, for tomorrow

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Welcome to this latest edition of FE/HE Digest.

2022/2023 has already been quite an eventful year for the Further Education sector, not just as a result of the Office for Students reclassification in November; we are also starting to see macro-economic issues adversely affecting a number of providers, with some struggling to recruit and retain apprenticeships whilst others are trying to boost the numbers of students going through the T Level provision.

If these matters were not enough, a number of providers are about to or already have come to the end of utility contracts, meaning the full effect of cost increases are starting to hit the bottom line. Staff recruitment and retention also remains a challenge, with pay settlements being a top priority for unions.

In this environment we are seeing more and more colleges starting to look at their financial position and consider setting formal reserves policies to help governors ensure the finances of the institution can support its strategic direction, as well as allowing governors greater oversight.

In this edition of FE/HE Digest we provide an overview of what we believe makes for a good reserves policy. We also report on the recently published College Accounts Direction and Post 16 Audit Code of Practice.

Best Wishes,
Further & Higher Education sector teams

Reserves policy

The topic of reserves has been discussed within the sector for many years. A number of colleges and universities have set formal or informal reserves policies over the years, but few have chosen to publicise them within their Annual Reports; indeed the wording in the majority of college accounts states that the college does not have a formal reserves policy. However, we are starting to see more and more colleges want to implement a formal reserves policy and accordingly we have assisted a number of our clients achieve this aim. This article sets out some key practicalities.

There are a number of considerations to make when looking to create a formal reserves policy. Firstly, the need for such a policy. Whilst many colleges have taken comfort from the strength of cash reserves, substantial asset bases or the lagged funding model, many institutions are now seeing finances stretched more than ever. Secondly, the reclassification of the sector has now removed the ability for colleges to take on additional debt in order to manage cashflow. The removal of this safety net has been mitigated in part by a potential change to the insolvency regime that public ownership brings, however there are no changes to the fiduciary duties of Governors in this regard, so insolvent trading is not to be taken lightly.

The hallmarks of a good reserves policy are:

1. The policy fully justifies and clearly explains the need for keeping reserves.
2. The policy identifies and plans for the continuance of essential education services for beneficiaries.
3. The policy reflects the risks of unplanned closure associated with the college's business model, spending commitments, potential liabilities and financial forecasts.
4. The policy helps to address the risks of unplanned closure on their beneficiaries (in particular, vulnerable beneficiaries), staff and volunteers.

In order to demonstrate that the Governors have discharged these duties it is recommended that a formal reserves policy is drafted and approved by the Corporation.

We are strong advocates of using the college's existing risk management framework in making an assessment for the amount of reserves the college requires. This process involves the monetisation of the college's risk register such that an underlying calculation is performed for each risk in order to assess the financial consequence of that risk crystalising. For example, if a college's risk register contains the risk of a significant drop in commercial income then the financial consequence would be the need to hold working capital in order to weather the dip in income or to wind down that particular activity.

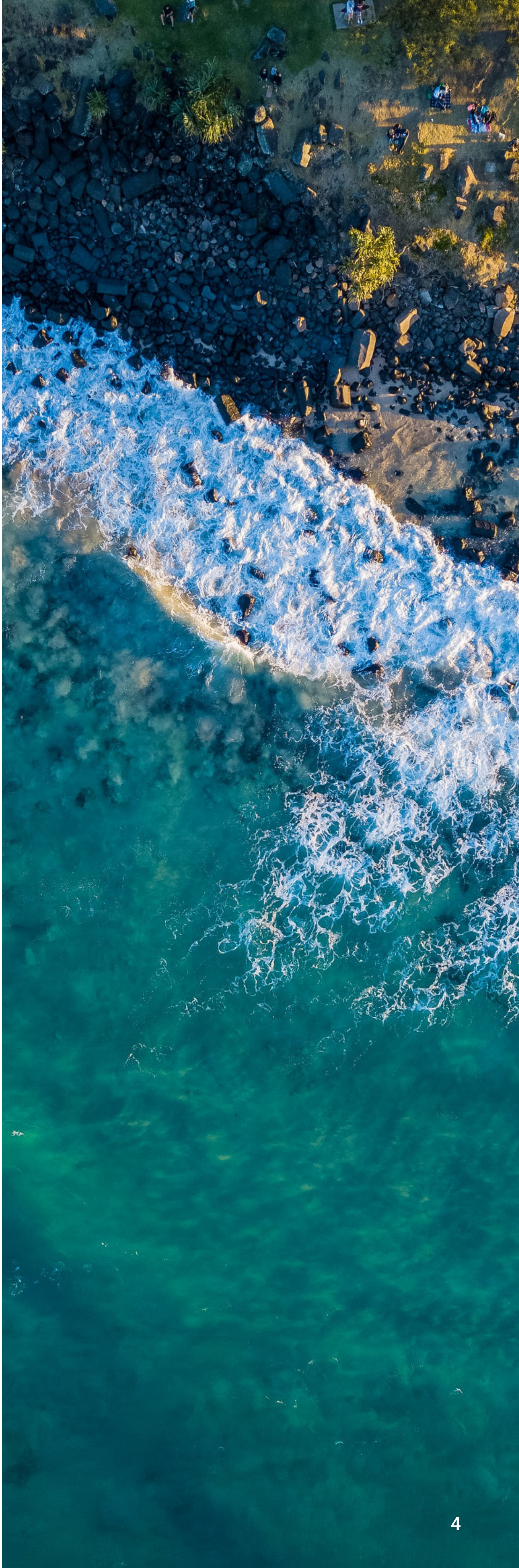
Once monetised, the risk register should then be used to calculate a reserves requirement, which should then be assessed against the likelihood and impact of the risks crystalising. This process can be performed in order to achieve a reserves range based on a low or high likelihood/impact. This calculation should then sit alongside the formal reserves policy.

The policy should be reviewed regularly in order to monitor its effectiveness in light of the changing funding and financial climate and other risks. The monthly management accounts should then report back on the level of reserves currently held by the college and how these are held (e.g. as readily available cash or in less liquid funds)

In summary the reserves policy should set out:

1. How much your college needs to hold in reserve and why
2. How and when your college's reserves can be spent
3. How often the reserves policy will be reviewed

We have developed a pro-forma reserves policy based upon Charity Commission guidance. Our team would be happy to assist any institution in developing and implementing such a policy.



College accounts direction

Published in April, the 2023 College Accounts Direction includes all the new disclosure requirements for a college's Financial Statements for the Year Ending 31 July 2023. The main changes for this year's Direction have arisen from the reclassification of the College sector.

These requirements mean that colleges and their subsidiary companies must now meet the overall requirements in HM Treasury's Managing Public Money (MPM) document, and other related obligations. In our Spring Issue of FE/HE Digest we provided a summary of the key considerations of MPM and have been strongly encouraging our clients to ensure they update their Financial Policies and Procedures to ensure they capture all the new reporting and regulatory requirements.

Turning back to the 2023 Direction, the additional reporting requirements are as follows:

1. **'Statement of Corporate Governance and Internal Control'**

The Statement of Corporate Governance and Internal Control must now specifically address whether policies, procedures and approval processes were updated to ensure compliance with the new MPM requirements following reclassification. In particular, the Statement must disclose whether the college has established systems and processes to identify and handle any transactions for which DfE approval is now required. Therefore, an updated Financial Policy document is a **MUST** – this will likely adversely affect the regularity opinion if not actioned.

2 'Statement of Responsibilities of the Members of the Corporation'

The Statement of Responsibilities of the Members of the Corporation must now include the following words "...that any transactions entered into by the corporation are within the delegated authorities set out in the "Dear accounting officer" letter of 29 November 2022 and ESFA's bite size guides."

This disclosure is also mirrored in the Statement of Regularity, Propriety and Compliance, which requires the signature of both the Accounting Officer and Chair of the Corporation (noting that a separate signature and statement is required for each individual as effected by the 2022 Accounts Direction). Accordingly it follows that all Governors should be aware of and **MUST** have read the Accounting Officer letter and listened to the bite size guides.

3 'Payments for loss of office'

Colleges must disclose the individual value of all special staff severance payments (which are amounts paid to employees outside of statutory and contractual requirements) made during the period of the financial statements. This is regardless of value, however the names of the recipients do not need to be disclosed. Helpfully, a note is not required if no transactions arose.

Furthermore, colleges are now required to disclose the number of severance payments they made by band during the period of the financial statements, as well as the individual value of any special severance payments. This disclosure is in addition to existing staff pay disclosures requirements.

4 'Write-offs and losses'

Colleges **MUST** disclose the total value of any debts written off or other losses incurred. There must also be individual disclosure of any such transactions where the value was £5,000 or more and the rationale provided. For the avoidance of doubt, all such transactions must be disclosed not just those where consent was obtained from DfE.

5 'Guarantees, Letters of Comfort, and Indemnities'

Colleges must disclose the total value of any guarantees, letters of comfort, and indemnities not entered into in the normal course of business, and which it has provided during the year (including any issued to a wholly owned subsidiary). There must also be individual disclosure of any instances above £5,000 and the rationale provided. For the avoidance of doubt, all such transactions must be disclosed, not just those where consent was obtained from DfE.

6 'Compensation Payments and ex-gratia payments'

Colleges **MUST** disclose the total value of all compensation payments during the period. There must also be individual disclosure of items over £5,000 and the rationale provided. Again, all such transactions must be disclosed not just those where consent was obtained from DfE. No disclosure is required if no transactions took place. In the case of ex-gratia payments, all payments must be disclosed, regardless of value, including an explanation of the nature of the payment and the legal authority, although payments may be aggregated where they are of a similar nature and where this does not impact on the understanding of the arrangement.

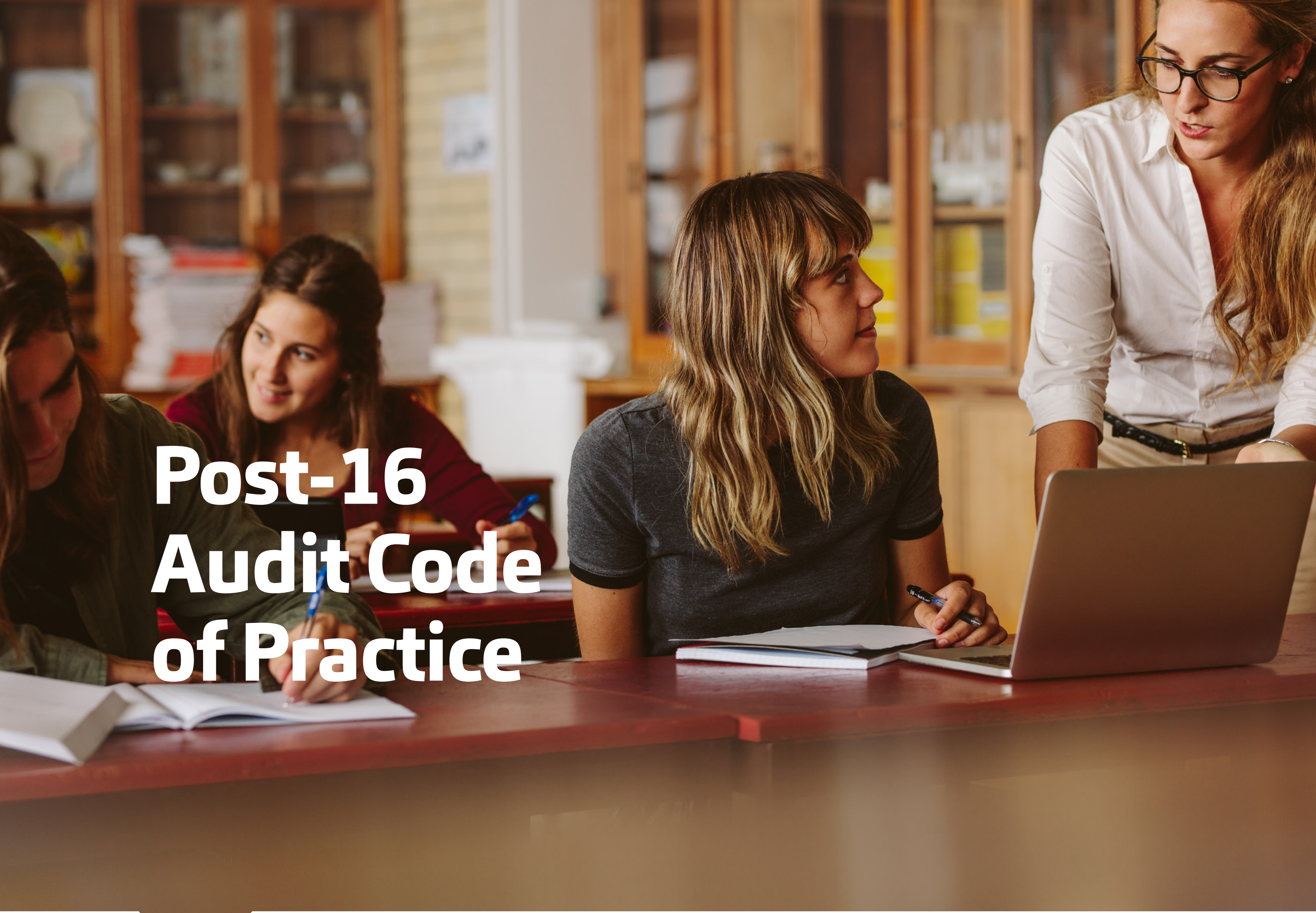
7 'Coverage'

The board should ensure there is adequate coverage in the event of the departure or absence of key signatories, including the Accounting Officer. The board should decide what interim arrangements are required. However, at all times the Corporation is required to have an Accounting Officer.

8 'Key Management Personnel'

Key management personnel disclosures have been simplified with the following requirements having been removed:

- The number of key management personnel whose emoluments received in the year (gross of any salary sacrifice arrangements and excluding any employer pension costs) that fall within each band of £5,000 from a starting point of £nil
- Aggregate emoluments due to key management personnel but waived



Post-16 Audit Code of Practice

Like the Accounts Direction, the changes to the 2023 Post-16 Audit Code of Practice have been limited to the effects of the reclassification. The major changes are set out below:

- It is expected that the auditor will review and take into consideration the additional College MPM Return to the 31 March 2023 that was submitted by the college earlier in the year.
- MPM and other obligations arising from reclassification have been added to the list of sources from which the general responsibilities of the corporation's flow. This is further to the additional disclosures which must be made in the Statement of Responsibilities of the Members of the Corporation and the Statement of Regularity, Propriety and Compliance, as detailed above.
- The Regularity Self-Assessment Questionnaire has been updated to reflect the new requirements arising from reclassification. There are new questions this year that specifically relate to policies and procedures that should have been updated for the MPM guidance. Your auditor will need to see evidence of this as part of the audit.
- 'Retaining evidence' has been expanded to include enquiries relating to consent for transactions and DfE approval for certain transactions. Where relevant, this should include evidence in relation to any instances where:
  1. Enquiries were made by ESFA or others as to whether consent was required before entering into a transaction, and the outcome;
  2. It would have been necessary to obtain approval for any transactions beyond the delegated financial authorities set out in the "Dear Accounting Officer" letter of 29 November 2022 and ESFA's bite size guides.
- The 'Regularity and Propriety testing' section has been enhanced to capture the "Dear Accounting Officer" letter of 29 November 2022 and ESFA's bite-size guides which list the requirements arising from reclassification that colleges/ college groups must follow. When concluding over regularity, the college's auditor will need to take these into consideration. This includes the Managing Public Money requirements and failure to respond to the changes arising from reclassification by the college, in terms of updating the college's systems and procedures may result in a modification to the regularity report.

Holiday Entitlement and Holiday Pay – update

Back in 20 July 2022, the long awaited Supreme Court judgment in Harpur Trust v Brazel clarified the law in relation to holiday entitlement for Part-Year workers.

The case concerned a Part-Year worker who had a continuing contract but did not work every week of the year. The decision affected employers of Part-Year workers, Zero-Hour workers, Seasonal workers, but not those of part-time workers who are contracted to work every week.

Prior to this case being brought, it had been the accepted wisdom that such employees could be paid a pro rata amount for holiday entitlement, calculated at the 12.07% rate (being 5.6 weeks divided by (52-5.6) expressed as a percentage).

The Supreme Court found, however, that anyone on a Part Year continuing contract was entitled to 5.6 weeks' holiday, not a pro-rated entitlement, despite not working every week in a year. It also found that holiday pay needed to be calculated based on the preceding 52 weeks in which work was performed (i.e., excluding weeks in which it was not performed). This obviously had huge implications for the education sector where Term-Time-Only and other Part-Year working is commonplace.

How did this happen?

Most employers who had Part-Year workers were operating on the "but surely…" principle i.e. anyone working less than full time, whether it be hours per week, days per week or weeks per year must surely be entitled to a pro rata holiday entitlement of their full time counterparts. That, however, is not what the law says!

The Working Time Directive (the original EU legislation) contained the 'conformity principle' meaning that anyone working less than full time, be that hours per week or weeks per year, would have a pro-rated entitlement. When the Directive was enacted in the UK as the Working Time Regulations in 1998, this was not included. Therefore, the Regulations state that all workers are entitled to 5.6 weeks' leave per year. The Working Time Directive does not prevent a more generous provision being made by domestic law.

Thus, the judgment in Harpur Trust v Brazel was a victory for Mrs Brazel who correctly identified this sloppy drafting of the UK legislation.

What happens now?

The current situation is that employees on these types of contract are now entitled to 5.6 weeks' holiday per year, and there could also be an appetite for backdated claims. Employers have generally chosen either to settle potential claims or put money aside for such claims should they be made. It should be noted that there is a two-year limit on claims for backdated holiday pay (unlike the six-year limit on other deductions from wages claims); however, a "chain" of deductions will be broken if there is three months or more between them.

The Supreme Court is now considering the Chief Constable of the Northern Irish Police v Agnew in respect of whether that gap of three months or more between underpayments does in fact end a claim. If the Supreme Court judgment is in favour of the claimant, this will substantially increase the value of claims for backpay in respect of underpaid holiday pay.

At the same time, however, Mrs Brazel's claim has resulted in the Government finally opening consultation regarding proposed new legislation whereby part-year workers' holiday entitlement is pro-rated according to their actual weeks of work. It has only taken them 25 years!

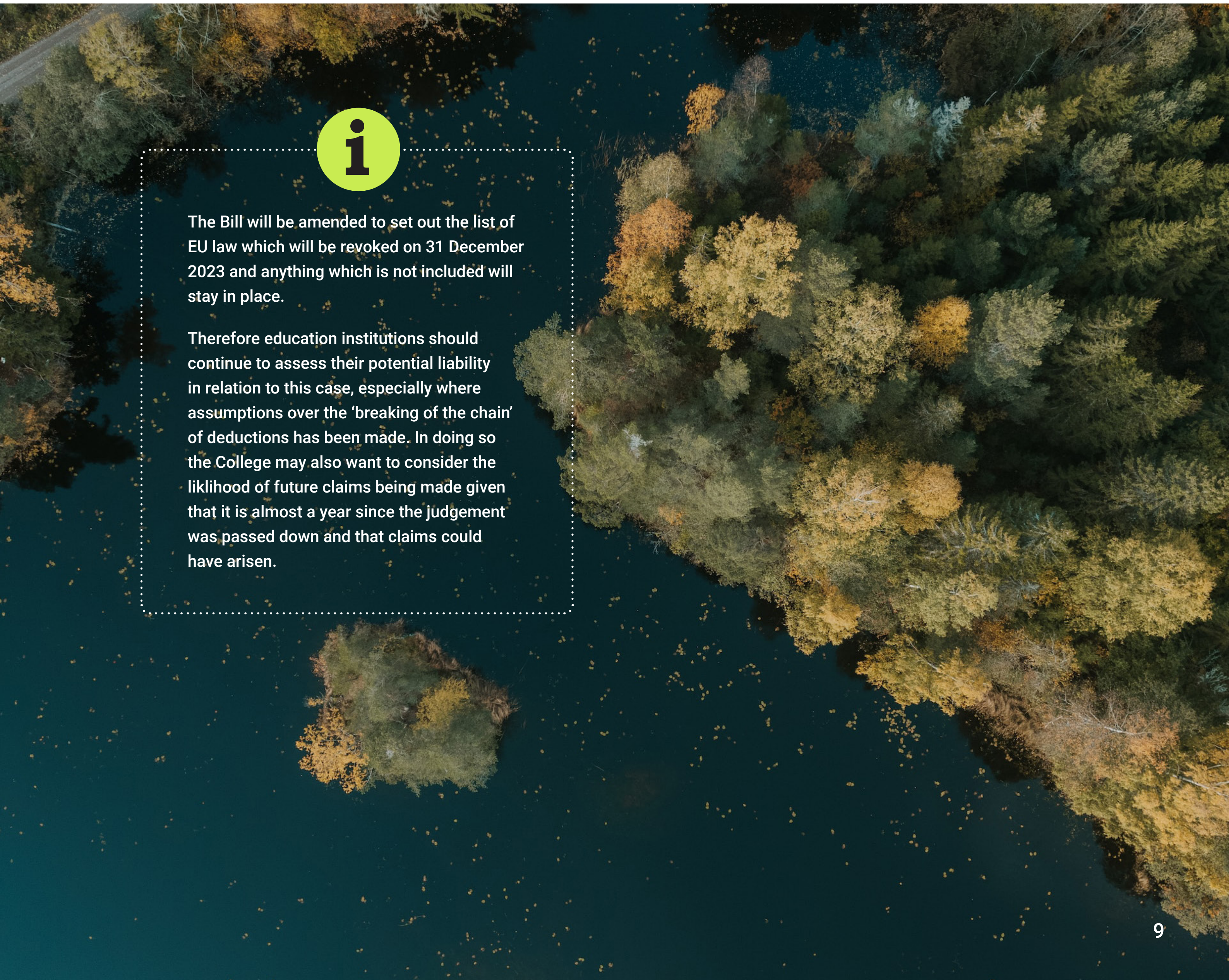
The proposals include calculating a part-year worker's holiday entitlement at the beginning of the leave year by reference to what was worked in the previous leave year.

Consultation closed on 9 March 2023 and the Government is now considering the feedback. As we know, it can take some considerable time for proposed legislation to come into effect.

In the meantime, of course, the Retained EU Law (Revocation and Reform) Bill has been making its way through parliament with the aim of reviewing all EU-derived laws and deciding whether to repeal or retain them by 31 December 2023.

The Working Time Regulations are obviously one such piece of legislation, so we were waiting to see if changes might be implemented via this route instead!

Then, on 10 May 2023, the Government announced that it was abandoning the "sunset clause" in the Bill whereby almost all EU-derived law would be automatically revoked at the end of 2023, unless it was specifically retained. This means instead that EU law will in fact remain in place unless it is expressly revoked.



The Bill will be amended to set out the list of EU law which will be revoked on 31 December 2023 and anything which is not included will stay in place.

Therefore education institutions should continue to assess their potential liability in relation to this case, especially where assumptions over the 'breaking of the chain' of deductions has been made. In doing so the College may also want to consider the liklihood of future claims being made given that it is almost a year since the judgement was passed down and that claims could have arisen.

Meet our Further & Higher Education sector experts

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