Further Education College Clerk
Development and Training Programme Resource Pack

Module 10
Finance

For suggestions on how to get the most out of these self-study materials, see the booklet on 'Using the Materials'.

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Introduction

Welcome to Module 10, which explores the financial aspects of the college's business. Since 2010 there has been a declining state budget and Government has focused on implementing a set of austerity measures. These include a reduction of the unit of resource and stopping funding of certain courses and substituting with a loan system. There have also been changes to the funding methodology and a greater emphasis placed on apprenticeships, English and maths and programmes of study for 16-19 year-olds. These changes all impact on colleges' financial planning and the sustainability of certain departments within a college.

This module concentrates on income coming from the two main funding agencies: the Skills Funding Agency (SFA) and the Education Funding Agency (EFA); however some colleges are becoming increasingly dependent on higher education (HE) funding and on students in receipt of 24+ Advanced Learning Loans.

The governing body has a key role in the financial management of the college. There are a number of statutory requirements for the governing body which necessitate a reasonable level of understanding in order adequately to discharge them, specifically to ensure the efficient and effective use of resources and the solvency of the college and to safeguard the college's assets. As clerk, you must work with the finance director to ensure governing body meeting agendas include enough time for this area, and that governors are competent in their understanding.

Aims

By the end of this module you should be able to:

- outline the governing body's main legal responsibilities towards ensuring the college's solvency and the safeguarding of its assets;
- understand financial terminology, key performance indicators and funding body requirements;
- adequately scrutinise and challenge the financial information presented; and
- understand the key risks facing the college and the potential impacts on its financial health, as well as the role of auditors.

Contents

Mark the sections you want to study and tick them off as you complete them.

To do	Done		
		Section 1	Roles and responsibilities
		Section 2	Financial key performance indicators (KPIs)
		Section 3	Financial planning
		Section 4	Financial health grading
		Section 5	Setting and monitoring financial targets
		Section 6	Audit and financial assurance
		Section 7	Risk management
		Section 8	Funding methodology

Working on the self-study activities

These materials have been designed to be used flexibly (e.g. dip in and out for reference; complete in one sitting; work through alone or with others).

Where you need to make notes in response to activity questions, we suggest you do this in a notebook or on separate sheets of loose-leaf paper, and store the information you compile along with the module for future reference. References listed in the further reading section may also be helpful.

Section 1. Roles and responsibilities

Role of the governing body

The responsibilities of the governing body are set out in the Instrument and Articles of Government, as defined by the Education Act 2011, Schedule 12, Section 4: *"the responsibilities of the governing body must include in any case the effective and efficient use of resources, the solvency of the institution and the body and the safeguarding of their assets"*. Further responsibilities are included in the Joint Audit Code of Practice (JACOP), including the requirement that an audit committee be established. This means that governors are required to:

- have responsibility for the effective and efficient use of resources, the solvency of the institution and the body, and the safeguarding of their assets;
- establish an audit committee to advise on matters relating to the college's audit arrangements and systems of internal control. This committee has to operate in accordance with the requirements specified by the funding bodies;
- co-operate with any person who has been authorised by the funding bodies to audit any returns of numbers of students or claims for financial assistance, and give any such person access to any documents or records held by the corporation, including computer records;
- examine and evaluate, at such times as it considers appropriate, its systems of internal financial and other control to ensure that they contribute to the proper, economic, efficient and effective use of the corporation's resources;
- keep proper accounting records and prepare a statement of accounts for each financial year, which gives a true and fair account of the state of the corporation's affairs at the end of the financial year and of its income and expenditure over the financial year, and complies with any directions given by the funding bodies as to the information to be contained in it; and
- appoint external auditors to audit the accounts in respect of each financial year. The auditors must conduct their audit work in accordance with the requirements of the funding bodies.

Under the Education Act 2011, individual colleges may make changes to their Instrument and Articles, though any such changes are subject to the limitations set out in the Education Act 2011 and provisions elsewhere within the JACOP.

The full JACOP can be accessed through the Skills Funding Agency (SFA) website

Role of the principal

The principal, as chief executive of the college, is the chief accounting officer of the college; therefore the governing body should require that s/he takes personal responsibility for complying with the college's Instrument and Articles and financial memorandum with the relevant funding agency, either the Skills Funding Agency (SFA) or the Education Funding Agency (EFA). While a finance professional may be appointed to take charge of the day-to-day running of the college finances, e.g. a finance director, ultimate responsibility remains with the principal and these responsibilities cannot be delegated. The responsibilities of the principal include:

- preparing annual estimates of income and expenditure for consideration and approval by the governing body;
- the management of budget and resources within the estimates approved by the governing body;
- ensuring funds are used only for the purpose for which they are given and in line with any terms and conditions attached to them;
- appearance before the Parliamentary Committee of Public Accounts on matters relating to the college's use of public and college funds, where required; and

- advising the governing body of any action or policy under consideration that is incompatible with the financial memorandum.

The line between governance and management

It is important to understand the two distinct and different roles of the governing body and the principal as outlined above and to respect the principal's right to organise, direct and manage the college and lead the college. As such, s/he will be responsible for applying the policies and procedures that form the framework agreed by the governing body. As clerk, you will need to facilitate this relationship.

Financial memorandum

In addition to the responsibilities above, the funding body also refers to financial responsibilities in the financial memorandum, which is divided into two parts. Part one is a static agreement setting out the general terms and conditions of the financial relationship between the college and the funding body. This can be accessed here.

The funding bodies contract with the college on an academic year basis, which forms the second part of the financial memorandum. This sets out the additional specific terms and conditions and contains the cash values and student volumes. This second part of the financial memorandum is to be signed by the principal and returned to the funding body to confirm acceptance by the college to the terms, conditions and contract values contained therein.

Financial reporting

The financial memorandum identifies the key pieces of financial information that a college is required to produce, and deadlines for their submission.

Financial plan – the funding body provides a spreadsheet template for colleges to deliver a three-year financial plan covering the forecasted outturn for the current year, the budget for the coming year and a forecast for the following two years. This is to be submitted to the funding body by 31 July.

Financial statements – the funding body provides a template for preparing the annual financial statements, which sets out the presentation and the methods and principles according to which they are to be prepared. This is to be submitted to the funding body by 31 December.

Finance record – the funding body also provides a template spreadsheet for the college to input extracts from the financial statements and other pertinent data, which then provides data that enable, amongst other things, further education (FE) sector benchmarking. This is also to be submitted to the funding body by 31 December.

In addition to the above financial reporting, the college is also required to:

- keep proper accounting records;
- ensure that it has an effective risk management policy including appropriate insurance arrangements;
- notify the funding body in writing of any significant deterioration in financial health;
- obtain funding body consent for significant capital transactions; and
- comply with all relevant UK and European regulations and requirements for the acquisition of all goods, services and works.

The funding body publishes a sector benchmarking tool each year. The most recent one can be found via here.

With regard to 16-19 provision, additional funding guidance may be found here.

Activity

- Using the funding body's published benchmarking tool, check how your college compares with others of a similar size and type.
- If there are significant differences, establish why this might be the case. This could be an area that the college may consider as requiring review, or it could be a specific area of investment that is backed up by a clear rationale in the strategic plan or annual business plan.
- Establish the size of the pay budget. What is the pay budget expressed as a percentage of total income? How does the pay budget expressed as a percentage of income compare to others in the selected benchmarking group? Is your pay budget higher or lower by comparison? Are you satisfied that the college management has provided adequate explanation as to the cause?

Viewpoint

Benchmarking is an essential tool for governors, as it enables the college to be compared like for like with similar colleges. Where there are significant differences in financial performance (e.g. finance ratios) then these should be thoroughly examined and reported on by the principal or finance director. Governors may wish to set targets for improvement in the light of such examination.

Pay costs are the largest item of expenditure on the current account and must be kept under close control. Differences identified through benchmarking should also be thoroughly examined and reported on. Governors may again see it as necessary to set challenging targets in order to reduce pay costs. This could be done by increasing class sizes, employing part-time staff - possibly on zero hours contracts - by holding down annual pay increases, or through rationalisation and redundancies.

It is important for the financial well-being of the college that governors are well-informed and regularly updated. As clerk, you must consider how best this might be achieved. Some colleges have developed online financial tools for supporting the governor's scrutiny role; others are establishing dashboards to cover the college's whole activity and are not just relying on SFA returns.

Section 2. Financial key performance indicators (KPIs)

In order to adequately monitor the college's finances, it is important to agree a number of financial measures against which the college is to be assessed. The funding body has defined three key areas to assess a college's financial health: solvency, performance and gearing. The college KPIs are then scored according to these measures, resulting in an overall financial health score and grade. The grades follow the Ofsted grading categories: outstanding, good, requires improvement, inadequate. More detail on this is contained in Section 3. The sector average for each measure is included, based upon the college finance records submitted to the funding bodies for the most recent academic year. These are useful guides, however it should be noted that there is a wide variety of colleges included within this sample of differing size, type and financial health. For benchmarking purposes, you may decide to narrow down this sample to include, for example, only similarly sized colleges to your own or to only include colleges with either your current or aspiring financial health.

Solvency

This is a measure of a college's ability to meet its financial liabilities in the short term. It therefore relates to current assets, such as cash; other assets that can be relatively quickly turned into cash, such as stocks; and debtors and creditors due for payment within one year, which include overdrafts, trade creditors (goods or services provided on short credit terms, e.g. 28 days' or 30 days' credit) and taxes owing to HMRC.

The funding bodies use one KPI for measuring a college's solvency:

Adjusted Current Ratio

This is the ratio between current assets and creditors falling due within one year. The adjusted current ratio used by the funding body excludes restricted cash from disposal of fixed assets held for future reinvestment, and assets held for resale. The sector average for 2012/13 was 1.44:1.

$$\frac{\text{Cash + Debtors + Stocks}}{\text{Creditors falling due within one year}} : 1$$

Adjusted Cash Days in Hand

This is another useful measure of solvency and provides an indication of how long current cash reserves would last if all sources of income ceased immediately and typical levels of expenditure continued to be incurred. The sector average for 2012/13 was 75 days.

$$\frac{\text{Cash}}{\text{Adjusted Income}} \times 365 \text{ days}$$

Performance

This is a measure of a college's ability to generate a surplus of income over expenditure.

Operating surplus as a percentage of income

The operating position is a measure of a college's profitability and is measured through assessing the operating surplus (or deficit) as a percentage of income. This ratio excludes surpluses or deficits relating to asset disposals, taxation and reserve movements. The sector average for 2012/13 was -0.09%. The 'Operating %' is calculated:

$$\frac{\text{Income} - \text{Expenditure}}{\text{Income}} \times 100$$

Performance Ratio

The funding body has introduced a new measure of profitability, referred to as the 'Performance Ratio'. The income figure used above is adjusted to exclude any 'non-cash' items, such as capital grant releases and pension finance income as well as excluding any one-off exceptional support income. Similarly, the expenditure figure used above is adjusted to exclude depreciation, taxation and other pension-related adjustments. These adjustments aim to provide a better measure of the underlying operating position and a more useful measure for comparison purposes, and this is the KPI now used by the funding body to assess a college's financial health. The sector average for 2012/13 was 0.42%.

$$\frac{\text{Adjusted Operating Surplus/(Deficit)}}{\text{Adjusted Income}} \times 100$$

Gearing

This is a measure of a college's level of debt.

Borrowing as a % of income

This is a measure of the level of borrowings expressed as a percentage of income and is a good measure of how high the level of borrowing is relative to the 'size' of the college. The sector average for 2012/13 was 22.77%.

$$\frac{\text{Loans + Overdrafts + Finance Leases}}{\text{Adjusted Income}} \times 100$$

Gearing Ratio

This ratio shows the level of borrowings as a % of the accumulated reserves (excluding pension reserves), referred to as 'net assets'. Net assets are a reflection of a college's financial stability over a long period of time and the funding body uses this measure to calculate a college's level of gearing for financial health calculation purposes. The sector average for 2012/13 was 43.02%.

$$\frac{\text{Loans + Overdrafts + Finance Leases}}{\text{Net Assets}} \times 100$$

Other useful KPIs

There are many other KPIs that you may find useful to accurately assess the financial health of the college. Below are some suggestions, but this is by no means intended to be an exhaustive list.

Pay costs as a % of income

This ratio is a measure of how much of the college's income is spent on staffing. This is therefore useful in ascertaining whether or not the college is obtaining value for money from its 'human resource'. The sector average for 2012/13 was 62.56%.

$$\frac{\text{Pay costs incl. contract tuition services}}{\text{Adjusted Income}} \times 100$$

Dependency on funding body income

Calculating the funding body (EFA and SFA) income as a % of total income gives an indication of the college's relative reliance on these income sources. These are the key funding bodies for the FE sector, so you would expect this percentage to be high. However, it may be considered prudent to try to minimise the reliance on any one source of income in order to minimise the financial risks facing the college of any one funding stream ending or materially reducing. The sector average for 2012/13 was 78.9%.

EFA Income + SFA Income x 100
Adjusted Income

Cash Generation
This is a ratio that measures the amount of cash generated by the normal operations of a college. It therefore shows how much of a college's income is left over after normal operating expenditure, e.g. staffing, premises running costs, etc. It does not include interest payments, capital expenditure, receipts from the sale of fixed assets or loan and finance lease repayments. Whereas the operating position of the college may contain some large non-cash items, such as depreciation and capital grant releases, this is a measure based solely on the cash transactions of the college. The sector average for 2012/13 was 5%.

Net cash flow from operating activities x 100
Adjusted Income

Administration costs
This gives an indication of the proportion of the college's annual expenditure that is incurred by administration staff and non-staff costs and can therefore be used to give an indication of the level of efficiency in an college's 'back office' functions. The sector average for 2012/13 was 16.99%.

Administration Costs x 100
Total Expenditure

Activity

Using financial KPIs and ratios to oversee the college's financial health

- Obtain the college's most recent set of audited financial statements.
- Calculate as many of the above ratios as you are able.
- Obtain a copy of the finance record that corresponds with the financial statements obtained.
- Check your calculations against the ratios automatically calculated by the finance record.

Viewpoint

- KPIs are a useful measure of financial performance and allow comparison with other colleges.
- The funding body has reduced the number that it uses to calculate a college's financial health, so it is essential that a college has targets for at least these three KPIs.
- Additional KPIs will also aid governors in deciding if the college is providing good value for money, and the use of sector benchmarks will aid this process.
- Colleges will struggle to balance their budget if they are unable to contain their pay costs and obtain value for money from their staff, therefore also include some sort of measure of the level of pay expenditure and staff utilisation, some of which are mentioned above.

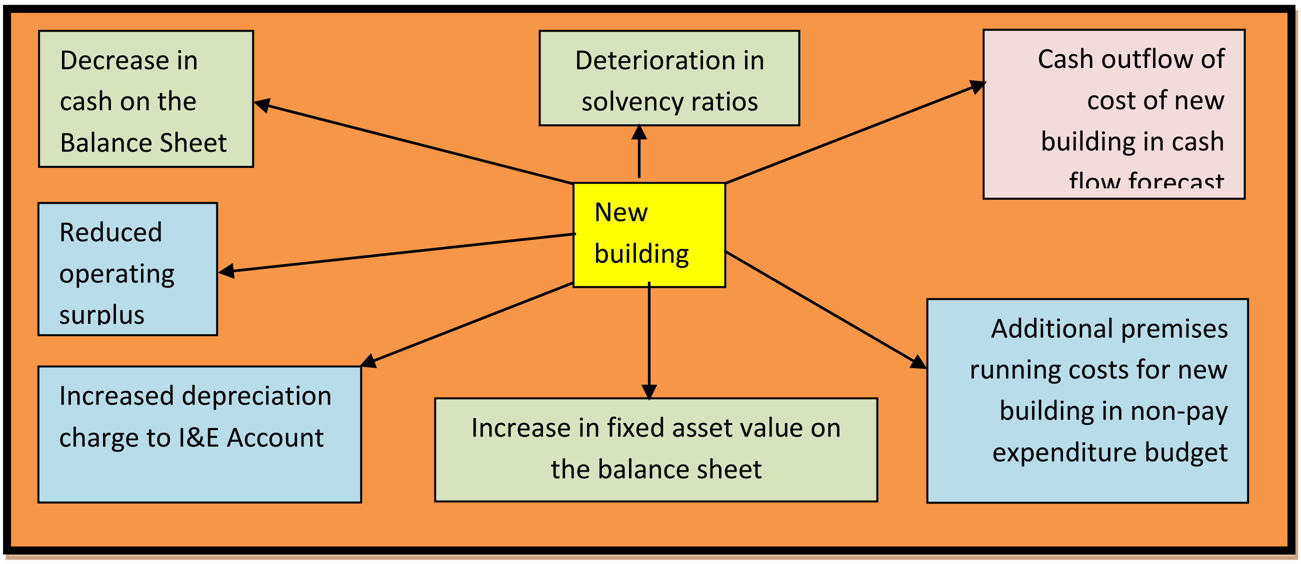
Section 3. Financial planning

A key element in the financial planning cycle is approving the annual budget. This budget should agree with the corresponding year in the three-year financial plan and both need to be delivered to the funding body by 31 July. While the finance committee may review the budget and make recommendations for its approval, it is the responsibility of every governor to satisfy themselves that the budget can be approved in order to adequately discharge their statutory responsibility for ensuring the solvency of the college. This can only be done at a full governing body meeting.

Approving the budget

It is imperative that governors obtain sufficient evidence and assurances to be able to reasonably ensure that the budget is based upon sound assumptions prior to giving approval. It also needs to be consistent with any other strategic plans as there will inevitably be a cost attached to many of the college's plans.

The diagram below shows an example of some of the financial impacts of a strategy to construct a new building from cash reserves, which should be considered for budgeting purposes:



In order to approve the budget, governors should obtain certain assurances and/or a written report setting out the key assumptions contained therein. As demonstrated above, it is also important to ensure that it is consistent with other aspects of the college's strategic and operational plans. Some suggestions for useful consistency checks could include:

- key further education grant income budgets are based upon the relevant funding body contracts;
- student recruitment targets are supported by detailed curriculum plans to ensure that they are deliverable and that the assumed level of student demand exists;
- sufficient teaching resource is contained within the budget to deliver the curriculum plan and the teaching hours allocated to each course correspond with the funded level of guided learning hours (GLH). 'Over-teaching' a course is effectively delivering teaching hours 'free of charge' while still incurring a cost to the college;
- pay budgets are consistent with the college's human resource strategy, new legislation and planned workforce levels;
- adequate levels of inflation (especially fuel costs, which have seen exceptionally high levels of inflation in recent years), cost of living and incremental pay awards, changes to employers' national insurance rates and employer's pension contributions have been factored into the budget;
- the cost impacts of new strategic plans have been separately identified and included in the budget.

In addition to applying logical consistency checks, the governors should also consider the credibility of the information being presented. The accuracy of previous budgeting would be a good guide to how reliable the information being presented may be and this can be checked through comparing previous years' accounts against the original budgets.

The typical format for budget information should include the following:

- income and expenditure account;
- balance sheet;
- cash flow forecast;
- capital expenditure plans; and
- key assumptions.

The governors may also require certain additional evidence relating to some of the consistency checks suggested above.

Approving the financial plan

The financial plan should be produced to show the current year's forecast, the following year's budget and for a minimum of a further two years, but can be up to ten years in total. The financial plan is intended to help the governing body and the appropriate funding body to assess the financial effect of a college's strategic plans. The format for the financial plan is provided as a spreadsheet template by the funding body, which can be expanded up to 10 years hence.

Many of the methodologies for arriving at the budget will also apply to the production of the financial plan, and governors need to follow similar principles when satisfying themselves that the financial plan is equally realistic and credible. The college will not have any definitive contract information for future years upon which to base the income forecasts, but the funding bodies may publish guidance to give the college recommended assumptions to use.

Activity

Understanding the importance of financial planning and sound budgeting principles

Obtain a copy of the college's most recent set of audited financial statements.

Obtain a copy of the original budget for that year.

- How accurate was the original budget compared to the final out-turn?
- Did you receive adequate explanation for any differences during the year?

Obtain a copy of the most recent financial plan.

- Is there sufficient explanation of what the key assumptions are and how they have been arrived at?
- Do you agree that the assumptions are both prudent and realistic?
- Is there sufficient analysis to provide assurances that these assumptions have been sufficiently thought through?
- Does college management have a proven track record of accurate financial forecasting and budgeting?

Viewpoint

The FE sector has seen significant changes in recent years, many of which have had a material impact on a college's finances, often with insufficient prior notice. There may, therefore, be good reason why budgets have differed from actual financial results. However, the credibility of the financial information being presented should be a factor for governors to consider when approving the budget.

- With income streams largely seeing no inflation or even deflation, and inflationary and other cost pressures ever-present, the college will have to seek continuing efficiency gains or growth in order to just maintain the operating surplus at its current level, let alone improve on it.
- Be wary of income forecasts showing short-term significant growth, especially in areas that have been traditionally difficult markets, such as full-cost recovery and international markets, or where funding bodies have expressly forewarned of future funding reductions.
- Management will be facing some very difficult decisions in this regard, and governors need to be aware of the risk of over-estimating income-generating possibilities and suppressing expenditure inflation and other cost pressures in order to balance the budget.

Section 4. Financial Health Grading

As discussed in Section 2, the funding bodies measure a college's financial health through a combination of three KPIs. These are derived from the college's financial plan as discussed in Section 3 above. This is required to be approved by governors and submitted to the relevant funding body by 31 July each year. The grade definitions under the methodology are summarised below:

Grade	Definition	Indicators
1 Outstanding	A provider that has very robust finances to fulfil its contractual obligations and to respond successfully to opportunities or adverse circumstances.	Normally, a provider with excellent/good indicators for solvency (current ratio), performance (cash-based operating surplus/(deficit) to income ratio), and gearing (borrowing to net assets ratio).
2 Good	A provider that has sufficiently robust finances to fulfil its contractual obligations, and to respond successfully to most opportunities or adverse circumstances.	Normally, a provider with at least two good indicators for solvency, performance and gearing.
3 Requires Improvement	A provider that appears to have sufficient resources to fulfil its contractual obligations, but also appears likely to have limited capacity to respond successfully to opportunities or adverse circumstances.	Normally, a provider with at least two satisfactory indicators for solvency, performance and gearing.
4 Inadequate	A provider that is in financial difficulty and very likely to be dependent on the goodwill of others. There is a significant risk of providers in this group not being able to fulfil contractual obligations because of weak financial health.	Normally, a provider with at least two inadequate indicators for solvency, performance and gearing.

The scoring for each of the three relevant KPIs is as follows:

Score	Adjusted Current Ratio	Performance Ratio	Gearing Ratio
0	< 0.5	< 0%	>= 90% or negative
10	>= 0.5	>= 0%	< 90%
20	>= 0.6	>= 1%	< 80%
30	>= 0.7	>= 2%	< 70%
40	>= 0.8	>= 3%	< 60%
50	>= 1.0	>= 4%	< 50%
60	>= 1.2	>= 5%	< 40%
70	>= 1.4	>= 6%	< 30%
80	>= 1.6	>= 7%	< 20%
90	>= 1.8	>= 8%	< 10%
100	>= 2.0	>= 9%	0%

The three scores above are totalled, leading to the overall financial health grade as follows:

Score	Grade
240 - 300	Outstanding
180 - 230	Good
120 – 170	Requires improvement
<= 110	Inadequate

The college has the ability to 'moderate' this financial health grade in relation to certain circumstances, such as the college is undertaking a significant capital project, or has incurred significant one-off staff restructuring costs or professional fees.

This financial health grade should then be 'self-assessed' by the college, and the governors should confirm this self-assessment, although it is not expected to differ from the auto-score grading, except in very exceptional circumstances.

Where a college's financial health is graded as 'inadequate' for the first year (either per the forecast or actual out-turn from the financial statements) or the second budgeted year, the college will receive a Financial Notice to Improve from the funding body.

Additionally, where a college's financial health is identified as declining year-on-year, this will normally form the basis for the relevant funding body requiring a financial improvement plan or equivalent, except where a college is implementing a major capital project.

Activity

Understanding the principles and practice of financial health grading

Obtain a copy of the college's current financial plan.

- Identify your current financial health group and the financial health group for the final year of the financial plan.
- Do these differ and, if so, what has caused the change?
- Is it a realistic forecast in the current economic climate and factoring in your own local issues?

Viewpoint

The sector is faced with the challenge of managing continuing inflationary cost pressures during a period of reducing national funding rates, programme weightings and contract sizes for certain age groups and types of provision.

- It may be increasingly difficult for colleges to meet the criteria for the higher bandings of financial health given these factors.
- Governors should be aware of this 'more for less' culture and be mindful of seeking an appropriate balance of financial stability whilst still maintaining suitable levels of pay and other investments in the college infrastructure.

Section 5. Setting and monitoring financial targets

The use of KPIs, as discussed in Section 2, is an important element of the financial management of the college but the KPIs are relatively uninformative without some form of comparator. Using a combination of funding body financial health measures, FE sector benchmarks and the college's own historical performance, it should be possible to set challenging but achievable strategic financial targets. Financial targets can be set over a variety of periods, e.g. monthly or annual, or can be indefinite.

Example

A college wishes to invest in a new building with an estimated cost of £1.5 million. In order to achieve this, the college needs to raise its cash balances by £500,000 per annum over the next three years to be able to afford this investment without further borrowings. The college needs to target a calculated level of cash generation in the budget, set at 7% and, during this period, the college also has a floor target for the current ratio of 1.5:1 and a minimum of 30 cash days in hand to ensure the college has an acceptable level of solvency at all times. This is an example of long-term, medium-term and short-term target-setting all working towards one clear financial strategy.

Setting financial targets

Taking the college's financial position forward by one year based on the budgeted income, expenditure and other cash movements, such as loan repayments and capital expenditure budgets, will enable the college to forecast its KPIs for the year-end. Having gone through a rigorous budget approval process, it would be inconsistent to impose financial targets that differ from the ones resulting from meeting the budgeted outcomes.

Alongside these budgeted targets, the governing body should also consider suitable on-going targets to ensure that they are discharging their responsibility of safeguarding the college's solvency. For example, the governing body could set a target that there should always be a minimum number of cash days in hand, current ratio or actual bank balance.

As with all targets, financial targets need to be specific, measurable, achievable, relevant and time-bound (SMART). An example of this is set out below:

Specific	**Measurable**	**Achievable**	**Relevant**	**Time-bound**
Operating surplus is a clearly defined term that is a widely-used financial measure	The operating surplus is a standard KPI that can be calculated	The targeted operating surplus is comparable to the previous year's	The operating surplus is a key measure of the college's cost effectiveness	The college has a clearly-defined deadline by which the target must be achieved

Target: The College will achieve an operating surplus of 0.5% in the 2014/15 academic year.

The KPI targets should be clearly defined with no ambiguity. Some KPIs can be open to a certain amount of interpretation and therefore calculated in different ways, with options to include and exclude certain items in the calculation. It should be clearly defined how these ratios are to be calculated and they should be consistent with whatever comparator is being used. For example, a KPI being compared against a previous year, where a one-off item was included in the calculation, would not give a true and fair measure.

Monitoring financial targets

Once the budget and the KPIs have been agreed by governors, a timetable for monitoring the college's performance against those KPIs along with the format of the reporting should also be agreed. As clerk it is your role to ensure this timetable is adhered to.

Some of the KPIs can be fairly easily calculated and compared, e.g. the current ratio can be measured and forecasted monthly once all the proper month-end accounting has taken place.

Other targets are more difficult to monitor and will depend greatly on the college's ability to keep on top of certain internal processes. For example, the monitoring of the funding body income will depend greatly on the ability of the Management Information System's (MIS) function to provide timely and accurate management information. The inputting and recording of student information is a complicated process and is critical to the provision of a college's management information. Errors therein could result in inaccurate management information being provided leading to ill-informed decision-making at senior leadership level.

Example

The 16 to 18 recruitment target for a college is 2,000 full-time students, and by the end of October the MIS function reports that there are only 1,500. The college will not be able to meet its target as there is very little that the college can do to make up a significant shortfall in 16 to 18 full-time recruitment after the September in-take. The MIS function then reports that 200 student records were incorrectly entered, resulting in invalid data and, therefore hadn't been counted along with a further 300 student records that hadn't been input when the report was produced. Therefore, the college has, in fact, met its 2,000 full-time student target. This demonstrates how critical accurate and timely data-input and validation can be.

Monthly reporting

Good practice for the provision of financial reporting would include the production of monthly management accounts, which could easily be expanded to include data on other areas of a college's business that impact on its finances, such as the student recruitment targets mentioned above.

As a minimum, governors should expect to be presented with the following information, ideally on a monthly basis, within 2-3 weeks of the end of the reporting month. These deadlines should be set and agreed at the beginning of the academic year.

Financial commentary

An important element of management accounting is a written report explaining any variances between budget and actual results, how they affect the forecasted position and details of any intended remedial actions, if any are possible. This report should cover the key funding body contract positions for the college, identifying where there has been or is forecasted to be any over- or under-recruitment of students and its associated financial impact. Failure to meet student recruitment targets may not have an immediate financial impact, as some contracts do not contain provision for the claw-back of funding in-year associated with under-performance. However, this will have an impact on future contract levels, so will have a financial impact in the future and is, therefore, no less important for the long-term stability of the college's finances.

Income and expenditure account (I&E)

The typical layout for an income and expenditure account contained with the monthly management accounts might be as follows:

	Current Month			Cumulative (year-to-date)			Full Year		
	Actual	Budget	Variance	Actual	Budget	Variance	Forecast	Budget	Variance
Income	A	B	A-B	C	D	C-D	E	F	E-F
Expenditure	A	B	B-A	C	D	D-C	E	F	F-E
Surplus / Deficit	A	B	A-B	C	D	C-D	E	F	E-F

Current convention would be for negative variances to be shown in brackets as per the above formulae:

- income higher than budget is 'good news';
- income lower than budget is 'bad news';
- expenditure lower than budget is 'good news';
- expenditure higher than budget is 'bad news';
- the 'bad news' is shown in (brackets).

Other conventions could include the use of a traffic light colour-coding system to highlight favourable and adverse variances, or text could be used next to the variance to indicate whether it is favourable of adverse.

Balance sheet

The layout for the balance sheet could be similar to the above suggested format for the I&E account, with the exception that a balance sheet is always a 'snapshot' at a fixed point in time, usually a month-end or a year-end. The current month and cumulative figures shown in the I&E account example above will be the same, so only one set of figures will be required.

Cash flow forecast

The statutory accounts include a cash flow statement, which is a backward-looking review of the cash movements over the year. However, for management accounting purposes, a more useful report would give you a forward-looking view, often referred to as a cash flow forecast. The cash projection effectively gives an early-warning system for any forecasted cash flow problems. It will advise governors of when the college is going to run low on its cash reserves and potentially have difficulty in paying its creditors or staff.

Capital expenditure

Capital expenditure differs from revenue expenditure in that it is expenditure on items that are expected to have a 'useful economic life' of more than 12 months, whereas revenue expenditure is more 'consumable' in nature. The governors should have already approved the capital expenditure plans of the college at the same time as signing off the revenue budget. It is therefore important that governors receive a report on capital expenditure and how this compares with the capital budget that was approved. Again, a critical piece of information here is an accurate forecast of expenditure for the year.

Debtors report

A simple report setting out the higher-value debtors owing money to the college, how long the money has been owing and how likely it is to be recovered is useful information for governors. Artificially inflating debtors improves the appearance of the short-term solvency of the college and, as such, the current ratio. It is therefore important that only genuinely recoverable debts are included.

Creditors report

As with the debtors report above, it is useful for governors to be aware of how effectively the college is able to meet its payments to creditors. Any poor payment performance can result in reputational damage to the college, delays in goods and services being received and potential difficulties in obtaining credit with suppliers.

Additional information on the repayment of any material borrowings could also be useful.

KPIs

Any KPIs that have been agreed need to be reported against and can be presented in a simple, easy-to-understand format, an example of which is below:

Current Ratio

Targeted Year-End	1.5 : 1	
Current Month-End	1.4 : 1	Below Target
Forecasted Year-End	1.5 : 1	On Target

Contribution Analysis

A key measure of the cost-effectiveness of the income-generating areas of the college, such as the curriculum departments, is the use of contribution analysis. This is a method of producing income budgets at curriculum department level, based on their student recruitment targets. The curriculum departments will have drawn up plans to deliver the student targets and can therefore be costed to produce the staffing budget and non-pay expenditure budgets. The surplus of income over expenditure here is known as the 'contribution' to overheads.

This analysis needs to include all sources of income, including course fees. Some departments may have a unique mix of income, such as SLDD (students with learning difficulties and/or disabilities) provision generating additional learning support funding to subsidise the small groups and additional teaching support required for these students.

The simplest way to arrive at a contribution is to just calculate the staffing cost of each curriculum department as a proportion of its income. As a guide, the sector average for 2012/13 was for teaching pay costs to constitute 35% of college income, leaving a contribution to overheads of **65**%.

A more detailed contribution analysis would also include other teaching costs, such as teaching materials. As a guide, the sector average for 2012/13 was for 40% of the college's income to be spent on all direct teaching costs, therefore a **60**% contribution.

It is important that a standard is set as to which costs are to be included in the contribution calculations and which are not in order to give a fair result across all curriculum departments. This measure of efficiency can be used alongside other human resource measures such as each individual member of teaching staff's timetabled teaching hours as a proportion of their contracted hours.

Managing budget pressures

Where the management accounting process has identified adverse pressures on the budget, it is important that governors request the production of robust and achievable action plans to retrieve the situation, wherever possible, from management. Once these action plans have been minuted, they can be followed up in the next meeting to ensure sufficient progress is being made and tangible improvements in the forecasted position are being achieved.

Activity

Understanding the importance of accurate financial reporting

An example of how the quality of the financial reporting you have been receiving can be assessed is to compare the changes to the forecast throughout the year, including the final set of management accounts, to the final year-end result.

- How closely does the year-end result match the original budget?
- How closely does the year-end result match the forecast from the July management accounts?
- Are you satisfied with the explanations you have received for the differences, and that they were both unavoidable and unforeseeable?

Viewpoint

Whilst this section has put forward some suggested formats for useful in-year financial reporting, there are no prescribed templates to follow in the way that the annual financial statements are pre-determined by the funding body. Governors need to ensure that the reports that are received are fit for purpose, timely and understandable.

- In-year financial reporting is not exclusively based upon the reporting of pure fact. In reality, some of the most critical elements, such as budgeting and forecasting, require a far higher level of skill and experience than simply interpreting and following a set of accounting rules to arrive at a set of financial statements in a prescribed template.
- It is therefore an important element of financial governance to ensure that the financial reports presented to the governing body are sufficiently challenged to ensure that the assumptions and logic applied are consistent and credible.

Section 6. Audit and financial assurance

It could be argued that there is a potential conflict of interests between college management's responsibility for the college's ultimate success or failure and those same individuals often being the governors' single source of information. The use of auditors is therefore an essential method of obtaining professional and independent assurances.

The audit committee

Notwithstanding colleges' ability to modify their Instrument and Articles of Government, it is a condition of funding, through the Financial Memorandum, for governors to establish a committee, to be known as the audit committee, to:

- advise on matters relating to the college's audit arrangements; and
- ensure there are systems of internal control.

Further details on the audit committee are contained within module 12.

Internal auditors

Internal auditors are used to provide assurances to the governors that the:

- internal controls are adequate;
- governance processes are effective and efficient; and
- strategic objectives are being met.

The internal auditors are expected to provide recommendations for improvement in those areas where opportunities or deficiencies are identified.

While management is responsible for internal controls, the internal audit activities should provide assurance to management and the audit committee that internal controls are adequate.

The Education Act 2011 removed the requirement for colleges to appoint internal auditors. Since 1 August 2013 it has not been mandatory under the JACOP for any college corporation to have to appoint an internal audit service. It is for each college corporation, on the advice of its audit committee, to determine for itself how best to fulfil its obligations to secure the proper, economic, efficient and effective use of resources and to safeguard the college's assets. It remains to be seen what systems other than a formal internal audit colleges devise to meet their statutory obligations.

External auditors

The external auditor, sometimes referred to as the 'financial statements auditor', has a statutory duty to make a report to governors on the truth and fairness of the college's annual financial report. This report must state the auditor's opinion on whether the statements have been prepared in accordance with the relevant guidelines and legislation and whether they give a true and fair view, and to report any reservations.

Funding body financial assurance arrangements

The funding bodies have additional responsibilities towards the college and have published an audit code of practice. The purpose of the code is primarily to ensure that:

- public money is expended in accordance with the requirements of regularity and propriety; and

- public money is used for the purposes that it was intended.

The funding body's responsibilities fall into four main categories:

- **Internal control**: that the systems of internal control, risk management and governance are adequate and effective for the purpose of securing the college's objectives and adhering to statutory, funding body and other requirements. Assurance over the college's system of internal control is usually obtained from the internal audit annual report where required, or financial management and control evaluation returns or both.
- **Regularity and propriety**: that expenditure has been incurred in a regular and proper manner. Assurance over a college's regularity and propriety is obtained from the regularity audit opinions.
- **Accounting requirements**: that the college's annual financial reports are produced in accordance with accounting requirements established by the funding bodies and accounting profession. Assurance over a college's accounting requirements is obtained from the financial statements and financial statement management letters.
- **Use of funds**: that the college has earned the funding paid to it in accordance with its funding agreements. Assurance in this area is sometimes derived from the work of the college's financial statement auditors, but can also be derived from direct funding assurance work carried out on the college's funding claims.

Activity

Understanding the role and differences between external and internal audit

- Do you know who your college's auditors are?
- How long have they been the college's auditors?
- Are you aware of the internal auditor's planned programme of audit work?
- Were you involved in determining what should be included into the planned programme of audit work?
- Do you feel that it covers the key risks that governors should be receiving assurances for?

Viewpoint

- The use of auditors can often be governors' only truly independent view of the college's activities, but is a finite resource. As already noted, it is no longer a requirement for the governing body to appoint internal auditors under the new JACOP. However, if the governing body continues to discharge its duties through the assurances gained from auditors, it is essential that, in the case where no internal auditors have been appointed, some form of internal audit provides assurances to the governing body on the areas of highest risk to the college's finances. This is covered in the next section.
- External auditors should be providing assurances on the financial statements, which include a thorough investigation of the appropriateness of the college's expenditure and the accuracy of the college's income.

Section 7. Risk management

The financial plan should be based upon suitably robust plans and levels of activity. However, given the level of uncertainty in the current economic climate and other challenges facing the college, it is prudent to have in place robust risk assessment processes and contingency planning.

Sensitivity analysis

Schedule 5 of the financial planning template provided by the funding body contains a section that requires the college to consider what it would do in the event of certain key financial assumptions proving adversely inaccurate, including such key financial areas as funding body income and staff costs.

The financial plan should be based upon the most likely outcomes. The sensitivity analysis should therefore be used to re-forecast given the worst-case scenario that the college believes it could face, by modelling the effect of an adverse percentage change against the prescribed key areas of the financial plan.

There are narrative boxes to accompany each sensitivity to be used to record an explanation of why the selected percentage changes have been chosen and what the college would do to minimise the impact on its finances.

The model identifies the change to the operating position from each sensitivity and then re-states the three main KPIs for solvency, performance and gearing. The financial plan template then re-states the combined impact from all the sensitivities on the college's financial health, giving the revised financial health score. This will give governors an indication of the potential impact on the financial health of the college.

If there are significant changes possible, leading to critical impacts on the college's financial health, it is considered essential by the funding body that a second financial plan be produced in full to reflect this alternative scenario.

Risk management plan

The funding bodies have previously requested that a risk management plan be submitted to accompany the financial plan, but this is no longer a requirement. Colleges are still expected to keep this document updated on an on-going basis and there is published guidance which sets out the requirements for risk management planning to allow colleges to comply with the Turnbull Report on the Combined Code of Corporate Governance. It should be noted that both the SFA and EFA provide detailed guidance on financial planning and risk management. The UK Corporate Governance Code may be found here.

It is useful to assess both the likelihood and the probable impact of each risk in turn to establish its overall level of importance to the college, and it aids accountability if the responsibility for each risk is assigned to an individual (or their post) within the college.

Risks are sometimes measured using a scoring system. For example, a score out of ten could be assigned to the level of impact for each risk and a score out of ten could be used to measure the likelihood of the risk occurring. These could then be multiplied together to arrive at a risk percentage. The higher the result, the more robust the contingency planning needs to be.

Example 1 Risk of severe earthquake destroying the college

Likelihood	1
Impact	10
Risk Score	10%

Example 2: Risk of under-recruitment of 16 to 18 students

Likelihood	8
Impact	8
Risk Score	64%

This methodology is useful to simplify the risk assessment process and make it easier to understand, but standardisation is essential if this is to be used across the college by different individuals.

It is suggested that college's plans should cover the following types of risks:

- strategic
- compliance
- operational
- financial
- reputational

In practice, these risk 'types' will overlap and it is probable that even non-financial risks will result in a financial impact on the college. Some examples of risks typically arising in college risk management plans might include:

- poor student recruitment, retention and achievement;
- inability to adequately recruit and retain key staff;
- weak financial solvency and financial health;
- unsatisfactory buildings/learning environment;
- ineffective MIS function;
- poor Ofsted inspection/audit result;
- negative publicity.

Disaster recovery plan

Colleges are expected to have in place contingency plans that would be required in the event of a major disaster affecting day-to-day operations. In addition to the usual risks of fire, flood or other 'Acts of God', colleges should consider the effects of events such as failure of information technology services, corruption or loss of essential data, sudden loss of key staff or default of major suppliers.

Colleges are recommended to establish a formal process to define and allocate responsibilities for action to be taken in the event of any major disaster occurrence. As a minimum, this process should identify a key manager who will take on the role of business continuity management. This position would take control of the implementation plan and identify such support as necessary. The main initial aspects of this role would be to:

- implement immediate emergency reaction;
- notify and mobilise support services;
- control central co-ordination;
- assess actual and potential damage;
- communicate clear instructions and guidance; and
- restore essential functions.

Colleges should be clear in establishing contingency plans and of the need for regular review and assessment of the plans' functionality. Regular testing, monitoring and feedback should ensure that the need for updating is considered.

Good practice self-assessment checklist

The funding body has published a self-assessment checklist as part of the financial planning handbook to assist colleges in reviewing their risk and disaster management plans. It is not considered that all elements of the checklist would apply to all colleges but it is a useful prompt to select those items considered to be important to your college and agree an appropriate review process with management.

The key headings are:

- senior management supports and promotes risk management;
- the college's culture supports well thought-through risk-taking and innovation;
- risk management policies and the benefits of effective risk management are clearly communicated to all staff;
- risk management is embedded in management processes;
- management of risks is closely linked to the achievement of objectives; and
- risks associated with other colleges are assessed and managed.

Activity

Understanding the importance of risk management planning and its impact on the college

Obtain a copy of your college's risk management plan.

- How recently was it updated?
- Does it identify all the key risks you would expect?
- Have the likelihood and impact of each risk been estimated and scored?
- Is the contingency planning sufficiently thorough and does it cover all the significant risks?

Viewpoint

- The funding body assesses a college's financial health based upon its financial plan and financial statements and will issue a Financial Notice to Improve if the financial health is inadequate. There is therefore a risk that forecasts and budgets contained within the financial plan are either overly optimistic to avoid giving the funding body this picture of the college's finances, or give an overly optimistic view of the speed and extent of a financial recovery from a currently inadequate financial health assessment.
- Governors need to be aware of all the key risks facing the college and their potential impact on financial health to ensure that they have been adequately considered in the preparation of the financial plan. Appropriate and challenging scrutiny in this area will ensure that the financial plan is based upon the most likely outcomes and that governors can avoid, as far as is possible, the risk of 'nasty surprises'.
- Risks have been identified in each section throughout this module; therefore it is clear that robust risk assessment is an essential skill for effective financial governance. This includes being able to assess the credibility of the financial data being presented and the people presenting it.

Section 8. Funding methodology

The methodology behind FE funding is extremely complicated and there are too many intricacies to go into in sufficient detail in this section. However, given the usually substantial proportion of a college's income that comes from the funding bodies, it is useful to at least have a basic understanding of some of the key elements that affect a college's funding body income and some of the terminology that you may encounter. It should be noted that from the 2013/14 academic year, a new funding methodology came into effect. As a consequence of this implementation, funding rules governing pre- and post-19 learners have diverged. Additionally, learners over the age of 19, or in the case of those with special learning needs 25, have ceased to be grant-funded for some levels of study and will be required to pay for their learning in full, either entirely self-financed or with the support of a student loan.

Funding for learners aged 16 to 18 comes from the Education Funding Agency (EFA) and funding for learners aged 19 or over and apprentices of all ages post-16 comes from the Skills Funding Agency (SFA). The qualifying date for determining which funding body a student falls into is 31 August. Any student aged 19 or over on this date will be classified as an 'adult' for funding purposes and fall under the SFA's remit. Conversely, any student aged 18 or under as of this date will be funded by the EFA.

EFA funding formula

The elements that make up the current funding formula are as follows:

- student numbers
- basic funding rate per student, per academic year
- retention factor
- programme cost weighting
- disadvantage funding
- area cost allowance

Funding = ((Student Numbers x Basic Funding Rate x Retention Factor x Programme Cost Weighting) + Disadvantage Funding) x Area Cost Allowance

For further information, see the EFA document; Overview of the 16 to 19 Funding Formula

Student number

The student number is calculated based upon the number of students participating in the previous year. This is known as the 'lagged learner number system'. Colleges experiencing a period of significant growth will be disadvantaged by this system, whereas colleges seeing falling student recruitment will benefit.

Basic funding rates

The basic funding rate for each student is the same for all students at all colleges and is reviewed annually by the funding body, currently £4,000 per FTE.

Retention factor

The new arrangements from 2013/14 will provide funding on a per student basis, and study programmes will often include non-qualification bearing and work experience elements. Applying success rates at student and at programme level is considered by the EFA to be overly complex and burdensome to institutions. The achievement element has therefore been removed, and the retention element maintained, which is applied at student level and not at qualification level and is calculated against a core aim.

In some cases, the previous use of qualification success rates as an integral part of the funding formula acted as a perverse incentive. It sometimes encouraged colleges to place young people on programmes that were too easy, in order to protect institution success rates, and thereby avoid a reduction in funding in a subsequent year. This new system aims to remove that incentive.

Programme cost weightings

The number of programme cost weightings has now reduced to four:

Weight Category	Weightings
Base	1.0
Medium	1.2
High	1.3
Specialist	1.6

Programme cost weightings increase the amount of funding received for a programme of study in relation to the relative cost of delivery.

The programme cost weightings are averaged up to college level to determine the overall college-level programme cost weighting applied in the contract.

Disadvantage funding

Disadvantage funding is broken down into two 'blocks'.

1. Block One – Economic Deprivation Funding (EDF)
This is similar to the previous disadvantage uplift and provides additional funds to recognise the additional costs associated with engaging, recruiting and retaining young people from disadvantaged backgrounds. This is paid on a sliding scale ranging between 8.4% and 33.6% depending on the degree of deprivation, which will be based on the student's home postcode as it is now.

2. Block Two – Support needs to progression
This funding recognises the inverse correlation between attainment in maths and English at 16 and the support needed to achieve and progress post-16. This block is therefore allocated for prior attainment in GCSE English and maths at a flat rate of £480 for a qualifying full-time study programme student

Area cost allowance

As before, there is an additional uplift to institutions in those areas in London and the South East and parts of the East where it is proven that the costs of delivery are higher than other areas.

When does a student count as a 'start'?

A threshold applies to all learning based on the planned number of days between the actual start date and the planned end date. In order for a student to be funded they have to remain 'in learning' up to and including the 'threshold day' as per the table below.

Planned Duration	Qualifying
Programmes greater than 24 weeks	6 weeks
Programmes less than 24 weeks	2 weeks
Programmes less than 2 weeks	Not funded

Only when a student reaches this threshold will the college generate any funding for them and this is also the point at which they count for success rate purposes. Therefore, the benefits of keeping a learner for one day after the threshold would result in the full amount of funding being drawn down, but they would also count as a non-retained student and, therefore reduce the college's success rates.

SFA Funding Formula

The elements that make up the current funding formula are as follows:

Funding = (Rate x Disadvantage Uplift x Area Cost Uplift) – Non-Government Contribution

Rate

The rate is a cash value allocated to each fundable learning aim.

Disadvantage uplift

The disadvantage uplift, works in a similar way to the EFA disadvantage funding Block One, in that it provides extra funding to support the most disadvantaged learners, recognising that they can be more costly to recruit and retain, using the Index of Multiple Deprivation (IMD) 2010. This results in an uplift for learners living in the 27% most deprived areas of the country (known as lower-layer super output areas). It is based upon the learner's home post code and provides an uplift of between 8% and 32%.

Area Cost Uplift

As with EFA-funded provision, an area cost uplift is applied to reflect the same higher cost areas of England.

Non-Government Contribution

This applies where the learner (or the employer) makes a cash contribution to the cost of funding the provision. E.g. learners who are not 'fully-funded' according to the funding rules are expected to contribute 50% of the un-weighted base rate of the learning aim.

Contract Management

The action taken for under- or over-performance against contract will vary between each funding body and has often varied year-on-year, so it is important to keep up-to-date with the current funding body policies.

The EFA will generally not adjust a college's funding in-year but may review future funding allocations for colleges that consistently under-deliver against their contract.

2013/14 will be the fourth year that the SFA will operate its simplified performance management and payment arrangements. Most colleges will not usually be subject to in-year contract adjustments and this will only take place at the final funding claim stage. There will be no automatic payments for over-delivery, although the SFA have done so recently in over-delivery against apprenticeships. Other providers that are paid on actual delivery will be subject to different in-year reconciliation rules where the SFA may adjust contract levels on a quarterly-review basis.

However, the SFA will take account of any forecasted under-delivery when agreeing allocations for the following academic year, including looking at the accuracy of previous years' mid-year forecasts. There will be no automatic payments for over-delivery but the SFA may wish to discuss increases to a college's maximum contract value if there are funds released to the sector during the year due to forecasted under-performance from other colleges.

Module review

After working through this module you should now understand and feel comfortable with:

- outlining the governing body's main legal responsibilities towards the college's finances and the responsibilities it delegates to the principal;
- the governing body's responsibilities towards the college's solvency, safeguarding of its assets and approving the annual budget;
- the use of financial information and implementing action plans where indicators are adverse; and
- the use of risk management to identify key risks and the preparation of contingency plans.

Summary of key learning points

Governors have the ultimate responsibility for ensuring that the public resources made available to them are used both effectively and efficiently and for ensuring the solvency of the institution.

In order to discharge this responsibility, governors must establish an audit committee to advise them on matters relating to the institution's arrangements for external audit and systems of internal control. The appointment of independent external auditors is a legal requirement. Whilst there is no legal requirement for internal auditors to be appointed, governors must be able to give assurance regarding their systems for internal control of finances.

The principal has specific responsibilities as the accounting officer which include the preparation of annual estimates of income and expenditure for approval by the governing body and for the management of the budget and resources within the estimates approved by the governing body. He/she must also ensure that funds are only used for the purpose for which they have been given. The rules by which the principal and the governing body exercise their powers to spend are laid down in a financial memorandum agreed with the relevant funding agency.

In order to adequately monitor the institution's finances, it is important for a number of key performance indicators (KPIs) to be used which in turn enable the funding agency to assess the financial health of the institution.

Finances are allocated as part of a three year planning cycle whereby the relevant funding agency approves expenditure. It is the governors' responsibility to approve the annual estimate of income and expenditure and the 3-year financial forecast and therefore imperative that they obtain sufficient evidence and assurances to be able to reasonably ensure that the budget is based upon sound assumptions accompanied by appropriate consideration of potential variances.

The relevant funding agency will use the estimates and actual expenditure returns to grade the financial health of the institution as one of four grades: 'outstanding', 'good', 'satisfactory' or 'inadequate'. Where an institution's finances are graded as inadequate or declining from year to year, a Financial Notice to Improve may be issued requiring a financial recovery plan.

As with all targets, financial targets must be specific, measurable, achievable, relevant and time-bound (SMART). Once these have been agreed appropriate and regular monitoring arrangements must be put in place, including the issuing of monthly management accounts with a financial commentary that ex plains any significant variances.

It is important for members of the audit committee to be knowledgeable and independent regarding financial matters and to ensure that the arrangements for appointing auditors and responding to their recommendations are robust.

The financial plan should be based upon suitably robust plans and levels of activity. There should also be a comprehensive risk management plan in place which is regularly reviewed. The funding bodies have published a financial self-assessment checklist to assist in the process of reviewing risk and disaster management plans.

The funding methodologies used to allocate funding are complex and subject to regular change but it is important for governors to have a basic understanding of the elements that make up the funding formula. These include student numbers, the basic funding rate per student per academic year, a retention factor, programme area cost weighting, disadvantage funding and area cost allowance.

Where next?

You have now completed work on Module 10: Finance. If there are areas in which you need more guidance or information, they may be covered in other modules. Turn to ‘Check your current knowledge and skills’ in ‘Using the Materials’. This self-assessment questionnaire will help you to decide which modules or sections of modules may help to fill these gaps. Tick the useful sections for further study.

If you cannot find the information you need within these materials, turn to the ‘Action Planner’ in ‘Using the Materials’. Note down what further information, support or guidance you would like. The ‘Action Planner’ gives advice on who may be able to help. Follow up the web links in the modules to support your general knowledge of relevant FE issues.

Putting it into action

We hope that working through this module has raised useful questions, increased your knowledge and awareness of issues and given you ideas for practical action that you would like to follow up. The ‘Action Planner’ contains a section where you can note down any questions or action points that you want to follow up within your own college.

Further reading

Horner, D (2013) *Accounting for Non–Accountants*. Kogan Page. 9th edition.

SFA Regularity Audit Framework

16 to 19 Education Financial Management and Assurance

SFA Funding Rules 2014 to 2015

16 to 19 Education: Funding Guidance

Acknowledgements

The first edition of these training materials was published in 2000. They have been periodically updated and this fourth edition of the training materials has been published by the Association of Colleges (AoC) as part of its Governance Library, commissioned and funded by the Education and Training Foundation and is updated to September 2014.

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