Module 5 Financial management

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

Introduction

This module explains governors' key role and responsibilities for the financial management of a college. It is aimed at all governors and assumes that the reader does not have specialist financial knowledge, or detailed knowledge of post-16 education and training and its accounting policies.

There are three main parts to the module. Sections 1 to 6 deal with governors' responsibilities, Sections 7 to 10 cover strategic financial management and Section 11 reviews the main source of funding for the sector. The module has been divided into 11 short sections to help the reader tackle the subject. It should take two to three hours to complete if you choose to work through all the sections.

Summary of changes to the 2002 edition

With effect from 1 April 2001, the Learning and Skills Council (LSC) has taken over responsibility for the planning, monitoring and funding of post-16 education and training from the Further Education Funding Council (FEFC). At present, the LSC is adopting the basic funding methodology of the FEFC, with minor changes, but this looks set to change in 2002/03 when a common funding framework will be introduced to accommodate the wider range of providers funded by the LSC.

All colleges are required to share their strategic plans with the local LSC at set intervals. The three-year financial forecast is an integral part of the strategic plan. The local LSC uses the three-year financial forecast together with other evidence to produce a financial health grading (A, B or C) for the college which is compared with the college's self-assessment of financial health. Detailed new LSC definitions of the financial health grades are presented in this module.

The LSC now requires colleges to submit a risk management plan which includes a sensitivity analysis (assessment of the impact of identified risks on the college's financial health) and a contingency plan to cope with major disasters. A new LSC circular suggests a range of questions to be asked and points to be considered during the risk assessment process, and these are reproduced here.

The order of material within this module has been changed to make it read more logically. Increased emphasis has been placed on the college financial regulations and common areas of weakness in financial management. There is also greater emphasis on the important task of approving the annual budget, with expanded information on what governors should expect to find in the monthly financial reports. The importance of clear presentation in financial reports for the attention of the governing body is highlighted.

Be aware that FEFC circulars adopted by the LSC when it came into existence are likely to be re-issued or periodically updated, and that it is important to use the latest

version of any circular. The LSC website (lsc.gov.uk) has the latest edition of circulars and draft circulars.

Key terms

Cash days in hand – How long a college could last with its current cash balance and its normal expenditure patterns without receiving further income. This is calculated by taking total cash (including any short-term investments), dividing by total income and multiplying by 365.

Current ratio – A measure of short-term solvency, used to calculate whether a college can cover its short-term liabilities (less than one year) with its current cash and bank balances, plus other assets that can be converted to cash (e.g. stock and debtors). The calculation is current assets divided by creditors less than one year.

General reserve – This is the ongoing balance built up or reduced from either the surplus or deficit made each year by the college.

Operating surplus – This is college income less the expenditure from the operations of the college before any movements on reserves. If expenditure were more than income this would be a deficit.

Positive cash flow from operations – Based on all the cash movements in a college, this is the net position of all money actually received against money paid out during the year. It is not the same as income and expenditure because of timing differences (e.g. the time taken to collect debts or to pay suppliers).

Capital expenditure – This is expenditure on land and buildings and equipment which is over a certain financial limit set by the college. This expenditure will not be included in the income and expenditure account, but instead will be included as part of the fixed assets in the college balance sheet. An annual charge (known as depreciation) is made against the cost of these assets, based on its estimated useful life to the college. It is this annual depreciation charge that is included in the college income and expenditure account.

Aims

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

- explain the role of the governing body in monitoring the financial position of the college and its audit process
- identify the range and purpose of financial documents that will be presented to you as a governor
- explain the broad indicators used by the LSC to evaluate a college's financial health
- describe common areas of weakness in financial target setting, financial monitoring and financial management within post-16 education and training
- explain the use of risk management plans in a college financial forecast
- identify good practice in financial management
- explain LSC funding methodology.

Contents

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

To do *Done*

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☐ ☐ Section 8 Indicators of a college's financial health
☐ ☐ Section 9 Financial target setting
☐ ☐ Section 10 Risk management plan
☐ ☐ Section 11 The LSC funding methodology

Working on the self-study activities

These materials have been designed for flexible use. You can work through them with other governors in training and development sessions. You can also work through sections and activities in your own time and at your own pace if you find it difficult to attend organised training sessions. Governors who have used these materials point out how valuable it is to work on at least some of the suggested activities together with another governor or group of governors, as there is such potential to learn from each other's experience. For suggestions on how to organise this kind of support for yourself, see the booklet on *Using the materials*.

What you will need

To complete activities in this module you will need to get hold of the following information or documents from the clerk:

- a copy of the college's financial memorandum with the LSC (the document which sets out the conditions under which the LSC funds colleges) – FEFC Circular 99/48 *Financial memorandum*
- the agendas for last year's meetings of the governing body
- the college's most recent set of audited financial accounts
- the college's most recent three-year financial forecast
- the most recent set of management accounts provided to governors
- the college's financial regulations.

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.

Section 1 Governors' responsibilities – an overview

The governing body of a college has a number of significant responsibilities for financial matters. A summary of the responsibilities of the governing body is set out in paragraph 8 of FEFC Circular 99/48 *Financial memorandum*. This states that 'the role of the board is to set objectives for the college, to determine the limits on the principal's discretion to act, to monitor the performance of the college, the principal and themselves and to be accountable to the college's stakeholders'.

The Department for Education and Skills (DfES) requires governors to have a role in ensuring 'the efficient and effective use of resources, the solvency of the institution and the governing body and for safeguarding their assets and for approving annual estimates of income and expenditure'.

Financial monitoring: notes for governing bodies

These provide a summary of specific responsibilities governors have in relation to financial matters, i.e. for:

- the solvency of the college, that is to say, that the college has sufficient cash to pay its staff and suppliers
- approving the college's annual budget
- securing value for money
- ensuring financial matters are always taken into account when making decisions
- safeguarding the college's assets
- operating an audit committee
- giving an annual account of their stewardship of the college's funds
- ensuring that there are adequate management controls in place to enable them to discharge their other responsibilities.

The most important of these responsibilities is ensuring the solvency of the college. Governors should be aware of two very useful ratios that will help them assess the solvency at any given time. These key ratios are **cash days in hand** and **current ratio**. The methods for calculating these ratios are explained in the 'Key terms' section on page 2. The use of these measures is considered further in Section 8.

The FEFC had a procedure of establishing a financial memorandum with each college, and for the time being the LSC is following the same procedure. The financial

memorandum has two parts. The first part states the general terms and conditions of the agreement under which the LSC provides funds to colleges. The second part of the financial memorandum sets out for each year the additional terms and conditions in the LSC funding agreement with that college. This second part has to be signed by the principal and returned to the local LSC each year to confirm acceptance on behalf of the college of the terms and conditions, including the college's individual annual funding target.

In addition to the requirements set down by the LSC, the college may well have responsibilities for reporting returns to other stakeholders such as the European Commission and other grant awarding bodies. The governing body must also be aware of its responsibilities in these areas.

Activity Review your college's recent financial statements

Obtain a copy of your college's most recent audited financial statements. What were the values of the following items? (See 'Key terms' at the front of the module for an explanation of these items.)

Item	*Value*
capital expenditure	
operating surplus	
cash days in hand	
current ratio	
cash flow from operations	
general reserve	

Have you carefully considered the different reports containing financial information that you have received during governing body and committee meetings over the last twelve months, or have you merely glanced at them and filed them away to be read at some future date?

Are you aware of the operational cycle and time scales within which each report was created and required? For example, can you recall when the governing body approved the college's current annual budget?

Viewpoint

If you found this activity difficult, arrange with the clerk for the college's director of finance or an experienced governor to explain these concepts to you.

If you feel that your answers indicate areas where information produced by the college is unclear or inadequate, discuss this with the clerk to the governing body. You could suggest specific ways in which you would like to see the information improved, or suggest that governors' views be sought on what information they want and how it should be supplied. As a governor, you have a responsibility to ensure the financial solvency of the college. It is therefore crucial that you read and understand all the

relevant documents. To make this possible, information needs to be presented in a way that you can understand.

Look at the calendar of key financial and funding returns to the LSC in Appendix A, to remind yourself of the timing of key events in the financial calendar. This will determine when you receive financial reports.

Section 2 Monitoring the financial position of the college

In this section we look at the important role of governors in monitoring the financial position of their college. We shall look first at the key documents and processes that you need to be aware of; secondly, at particular college activities which need special attention; and, thirdly, at common areas of weakness in financial management.

Key documents and processes

The **financial memorandum** identifies the key documents and processes for maintaining your college's financial viability. You need to be familiar with its provisions to ensure that you are aware of your college's financial status and to ensure that its provisions are met. The other key document dealt with in this section is the college's **financial regulations**.

The financial memorandum

This makes 'further requirements' of colleges' accounting and financial management. It requires that:

- the college keeps proper accounts and accounting records and prepares a statement of accounts in respect of each financial year
- the college provides the LSC with audited accounts for the financial year no later than five months after the year-end
- the accounts are signed by the principal and by the chair or one other member of the governing body appointed for this purpose
- the college arranges for its accounts to be made publicly available
- the college notifies the LSC in writing if at any time there is a significant deterioration in its financial position
- college governors receive at least termly a report that reviews the college's financial position.

The LSC, after consulting colleges, specifies the information required in the accounts, the manner in which the accounts are to be presented, and the methods and principles according to which they are to be prepared.

The financial memorandum further requires colleges to provide the local LSC with information on its finances, staffing, students and programmes. This normally includes:

- the college's annual financial statements, finance record, external auditor's management letter and internal audit annual report
- the college's strategic plan and strategic-plan updates, together with a commentary, the financial forecast supporting the plan, and a risk management plan
- where appropriate, a mid-year financial forecast update
- individualised student record data (ISR), in-year funding returns, the final funding unit claim, the external auditor's report and management letter
- staff individualised record data
- periodic information on the accommodation strategy.

Where a college fails to comply with any of these conditions of funding, the LSC may take further action, including withdrawal of funds from the college.

A calendar of key financial and funding returns is attached at Appendix A.

LSC approval

The financial memorandum specifies transactions for which colleges are required to obtain the local LSC's consent. These are:

- significant land and/or buildings transactions
- unsecured or secured borrowing arrangements.

The general consents are set out in part 1 of the financial memorandum. These may not apply to your college for particular transactions if your college has been granted a withdrawal of a general consent for these transactions. The financial limits generally applicable to consents are 5% of total college income, or £1 million (whichever is the lower). Borrowing limits are calculated on a cumulative basis, so any existing borrowings must be taken into account. If there is a withdrawal of a general consent for your college it will be set out in part 2 of the financial memorandum, or in correspondence from the FEFC/LSC.

Financial regulations

The college's financial regulations document is a vital one in safeguarding its assets. The financial regulations should be approved by the governing body and reviewed annually (and, if appropriate, amended). It should include the procedures and limits of authority for:

- ☐ committing the college to expenditure
- ☐ generating and receiving income
- ☐ handling cash
- ☐ dealing with college assets
- ☐ carrying out budget preparation, financial management and monitoring
- ☐ reporting of fraud and irregularities
- ☐ controlling capital expenditure.

Activity Check your financial regulations

Obtain a copy of your college's financial regulations. Check to see that the points in the list on page 7 are covered. How does your governing body ensure that the financial regulations are being observed in practice? Are your college's financial regulations clear?

For example:

1 Do your financial regulations clearly show how much expenditure may be incurred without reference to governors?

2 Are the procedures for approving the principal's and governors' expenses clear?

3 Do the regulations spell out at what stage governors should become involved if fraud or irregularity is suspected?

Viewpoint

Where you find the financial regulations unclear, or if you have answered 'no' to any of the questions above, raise the issue with the clerk and consider bringing the issue to a governors' meeting.

Activities which need special attention

Companies and joint ventures

Governors need to ensure that all college companies, joint ventures (both formal and informal) and overseas operations are conducted in accordance with the guidelines issued in FEFC Circular 99/14 *College companies and joint ventures.*

Key responsibilities for governors

The governing body should:

- seek appropriate legal and financial advice to ensure that any proposed activities are lawful and any potential risks or liabilities are minimised
- gain governing body approval for all formations and acquisitions
- ensure that the organisation of companies and joint ventures are appropriate (including avoidance of any potential for conflicts of interest)
- thoroughly review the business plan and proposed control arrangements
- ensure that suitable arrangements are in place to enable the governing body to discharge its responsibilities. This includes governor representation on the company/joint venture board, attendance at the AGM, regular reporting on performance and future plans, appropriate audit arrangements, and a formal memorandum of understanding between the college and the company or joint venture.

Franchising

Governors need to be aware of any franchising arrangements made by the college. This can be a high risk area, so governors need to ensure that franchising arrangements are conducted in accordance with FEFC Circular 99/37 *Franchising*. In particular, governors need to ensure that the college is fully in control of provision. The control criteria required are set out in various other circulars referred to in Circular 99/37.

Franchising controls

The governing body should:

- approve franchising proposals as part of the strategic plan approval
- ensure the college is using the model contract for the provision (as set out in the supplement to Circular 99/37)
- ensure that a review of franchised provision is in the internal audit plan
- receive and consider regular reports on franchised activity. (Governors should be aware that some franchising activities are discounted by one-third and will not therefore generate the full value of funding units that the same provision would if it were delivered directly by the college).

College fees

The governing body has a responsibility for setting the policy by which tuition fees and other fees payable to the college are determined. It is for the management of the college to set the actual fees payable within the policy framework approved by the governors.

Register of interests

The governing body needs to maintain a register of interests to ensure probity. The register of interests should cover more than financial interests and must also include the relevant interests of senior postholders and governors' families. For more information see *Module 1 Introduction,* Section 5 'Integrity in working practices'.

Common areas of weakness in financial management

It is very important that governors identify any potential weaknesses in financial management and ensure appropriate action is taken at the earliest opportunity to improve the situation. The most common areas of weakness are:

- reports that are not user-friendly
- information received too late or on an *ad hoc* basis
- reports that are either too brief or far too detailed
- inaccurate or unreliable financial data
- weak financial controls, or controls not being adhered to
- failure to consider the financial implications in full when making decisions

- weak senior management
- lack of planning.

All of these areas are discussed further in other sections of this module.

Activity Reviewing key information for financial monitoring

1. Look back at the types of transaction for which the college needs specific LSC approval. Is your college considering any of these transactions in the short- to medium-term? Are you satisfied that the transactions are being dealt with appropriately?
2. Look at the list of common areas of weakness in financial management. Do you consider that any of these might apply to your college?
3. Are you confident that the governing body's approach to the following areas is in line with the guidance and best practice outlined in this section?
   - ☐ Companies and joint ventures
   - ☐ Franchising
   - ☐ College fees policy
   - ☐ Register of interests

Viewpoint

This activity might raise one or two questions in your mind about aspects of the governing body's responsibility for financial monitoring. If there are questions you would like to ask or documents you think it would be useful to read, note these down in the 'Action planner' in *Using the materials* and decide with whom and when it would be appropriate to raise the issues that concern you.

Section 3 Range and purpose of financial documents

Governors need to receive and approve a range of documents to discharge their financial duties properly. These include, but are not limited to, the checklist opposite.

Activity Review the financial documents received by your governing body

Look over the list of documents opposite. Which of these can you recall seeing in the past year? Tick off those you have seen and put a question mark beside those you have not.

Viewpoint

If this activity has made you aware of gaps in the financial documents that your governing body receives, and you think these might be important omissions, discuss this with the clerk.

Section 4 The audit process – governors' responsibilities

The audit process provides an important independent check on the assets of the college. It enables the governors, and others, to check whether the actual financial situation of the college reflects the budgeted or planned financial situation of the college. It also provides an opportunity for identifying any financial irregularities. The current FEFC audit requirements could well be updated by the LSC in the future. Governors should keep this possibility in mind and be ready to adopt the new requirements if and when they are published.

The role of the audit committee and governors

The full governing body is required to approve the audited financial statements; these are then signed by the chair on behalf of the governing body and the principal. It is normal for the finance committee to review the accounts and recommend them for approval to the full governing body. The audit committee should restrict themselves to a review of audit issues relating to the annual financial statements.

The governing body has a mandatory requirement to establish an audit committee to advise on matters relating to the governing body's audit arrangements and systems of internal control. The audit committee should:

- take a 'step back', and be largely independent of the other committees or the college senior management team
- establish a system of financial checks and balances on behalf of the governing body
- scrutinise the financial information received by governors and the systems that generate it.

The audit committee membership should not include the principal, the chair of governors or members of the college finance committee. It should not be clerked by the clerk to the governing body if he or she has significant financial responsibilities at senior management level within the college.

An FEFC amendment to the financial memorandum requires at least one member of the audit committee to have relevant financial experience. This individual does not have to be an accountant but somebody with experience of organisational financial matters, and they need not necessarily be a governor.

The governing body must determine terms of reference for the audit committee. The governing body should be careful to avoid adding terms of reference that compromise the requirement for independence and objectivity. The model terms of reference established by the FEFC are contained in Circular 98/15 *Audit code of practice* and are summarised in *Module 8 The audit committee,* Section 2 'What does an audit committee do?'.

The audit process and the function of internal and external auditors

The governors' role in the audit process and the functions of the internal and external audit are covered in *Module 8 The audit committee*. It is the responsibility of the governors to ensure that colleges have an appropriate system of internal control in order to provide assurance that public funds are safeguarded and used for appropriate purposes.

In addition, it is a requirement under the financial memorandum that a governing body must appoint separate providers for the internal and external audit service to the college.

Protecting the college's assets

The audit committee has responsibility for advising the governing body on the college's systems of internal control. These systems are critical for assuring governors that they can fulfil their duty to safeguard college assets.

Activity Check what you know about your audit committee

Are you confident that you know enough basic information about your own audit committee? Read through the following statements, and tick the appropriate box.

	Yes	*No*	*Not sure*
I know who the members of the audit committee are and I am confident that at least one member has relevant financial experience.	☐	☐	☐
I am confident that the audit committee is independent of senior management and is objective.	☐	☐	☐
I know that the audit committee has ensured an appropriate system of internal control in the college.	☐	☐	☐
The audit committee has appointed separate external auditors and I know them to be independent.	☐	☐	☐

Viewpoint

If you ticked 'not sure' or 'no' for any of the above statements, find out the answers from the audit committee chair or clerk. The governing body as a whole is responsible for ensuring that the audit committee is working in line with guidance and is effective.

Section 5 **Approving the annual budget**

Governors have specific responsibilities for their college's budget and corporate financial statements. They also need to satisfy themselves that their college has an effective financial control system in place. This section looks at these responsibilities after considering the separate and distinct responsibilities of the college principal for financial matters.

The role of the principal as the accounting officer

The financial memorandum states that the principal is the accounting officer of the organisation. In practice, it is the director of finance who will take day-to-day responsibility for financial matters at the college. The role and responsibilities of the principal as accounting officer are set out in the financial memorandum. These include:

- preparing a budget for consideration and approval by the governing body
- managing the college within the budget approved by the governing body
- ensuring that funds from the LSC are used only for the purpose for which they are given and in line with any terms and conditions attached to them
- appearing, if required, before the committee of public accounts on matters relating to LSC income and its use
- a duty to report to the LSC any policy or proposed action of the governing body which is incompatible with the financial memorandum.

Budget approval and monitoring of performance

The governors have to approve the annual budget before the start of the new financial year, which is in August. This is a task that cannot be delegated to the finance committee or equivalent. In practice the finance committee would initially review the budget plan and recommend it to the full governing body for approval. As all governors have a statutory responsibility for ensuring the solvency of the college, it is logical that all governors should have the opportunity to challenge any assumptions and information in the budget before approving it.

The budget should be the same as that in the first year of the college's three-year financial forecast. The budget therefore needs to be an integral part of the college's operating plan and strategic planning process. It should, in effect, provide a financial translation of the college's specific objectives and targets for the coming year at a 'whole college' level. This translation of the operating plan into a consistent, viable and agreed financial plan provides the framework for protecting the solvency of the college. Governors should therefore be aware that any items in the annual operating plan that have resource implications must also be fully reflected in the budget plan.

A clear timetable for the budget preparation should be set out by college management and agreed by governors. All colleges have a financial year-end of 31 July. It would be normal for the majority of the budget preparation work to take place

in May and June of each year. The approved college budget should on all occasions agree with the financial forecasts submitted to the local LSC.

In most colleges, the budget would be considered by the finance committee before being approved by the full governing body. It is therefore likely that there would be a finance committee meeting in June/July each year, followed by a full governing body meeting shortly afterwards. The governing body will also have to approve the three-year financial forecast at the same meeting, as this too must normally be returned to the local LSC by 31 July.

In order to approve the budget, governors need to be aware of:

- key assumptions made in the budget preparation
- key areas of risk and how these will be addressed should they materialise (this is covered in more detail in Section 10)
- the process by which the budget has been built up.

As a minimum the governors should expect to see:

- an income and expenditure account
- a balance sheet
- a twelve-month cash flow forecast
- a capital expenditure plan
- a supporting commentary for all of the above, which clearly states the key assumptions made in preparing the budget.

Activity Is the budget consistent with the college operating plan?

Have a look at the targets set in the college operating plan and compare these with the annual budget.

Are there targets in the operating plan that have resource implications for the college? These might include increased staffing, capital investment in equipment or buildings, or one-off development costs. Check to see that these are included in the college budget plan. Has a realistic approach been taken to both the financial demands associated with these targets and the timescale?

Viewpoint

It is essential that the budget fully reflects anything included in the operating plan. The budget should cost out these targets and demonstrate whether the operating plan can be afforded.

Section 6 Monthly financial reports

Monthly reports

Colleges should produce monthly management accounts. It is good practice to send these accounts to each member of the finance committee every month. Members of the full governing body should, at a minimum, receive copies of these monthly accounts at their termly meeting. In some colleges the monthly management accounts are routinely sent out to all governors. The DfES and the financial memorandum make it clear that the full governing body should receive a report dealing with the college performance against budget at least once a term.

Good practice

There is no prescribed format or process that colleges have to follow when monitoring their financial performance. However, there are basic principles of good practice that should be in place if governors are to meet their responsibility for solvency.

As a minimum, governors should receive the financial information listed below each month.

- An income and expenditure account comparing budgeted income and expenditure with actual results to date, and a forecast of the expected position at the end of the financial year. The level of detail for the income and expenditure heads should relate clearly to the main headings in the published accounts.
- A balance sheet showing the financial position at the end of the previous month, again comparing the budgeted position against actual results.
- A rolling 12-month cash flow projection.
- An accompanying commentary, which explains the main variances between actual results and budget, and any action that needs to be taken.
- Information on student numbers and/or LSC units of funding.

It is important that accounts are received by all governing body members and are timely, certainly no later than 15 working days after the previous month end. Deadlines for distribution of the monthly reporting pack should be set and agreed at the start of the financial year. Failure of the accounts to arrive on time could act as an early warning system of potential problems. If adverse variances do require action, the governing body should be informed as early as possible so that it can make effective plans to deal with the situation.

Actions agreed at committee meetings where management accounts are discussed, must be minuted and followed up at the next appropriate meeting.

These are minimum requirements. Many colleges have now become far more sophisticated with their monthly financial management reporting. Some examples of useful financial information provided by colleges are given opposite.

Examples of useful financial information

- An executive summary (of about one side A4 in total) of the headline results with variances against projections. This provides a quick overview.
- A mix of tabular and graphical presentation of the finances to assist clarity. Graphical presentation is useful in identifying trends over time.
- A cash flow statement that compares the budgeted cash estimates against the actual cash balances achieved, together with a rolling 12-month projection. This is an extremely important area where governors need to be confident that the information received is accurate and reliable. Obviously, no college can afford to run out of cash. By providing the historical trends, the governors can see at a glance how accurate the officers have been in predicting cash balances. They can thereby gain confidence in assessing the accuracy of the information being presented to them.
- An enhanced income and expenditure statement with the following additional columns:
  1. Budget for the full year
  2. Forecast out-turn for the full year
  3. Budget for the most recent month
  4. Actual outcome for the most recent month
  5. Variance expressed as a % and/or amount, with variances outside a pre-determined level of tolerance highlighted in bold
  6. 'Adverse' or 'favourable' simply annotated by A or F (another common version is B – better or W – worse).
  7. All of the above columns repeated for the year-to-date position.
- Age analysis of debtors showing large debtors and total value by length of delay.
- Analysis of creditors showing large creditors and total value by age.
- A capital expenditure summary showing budgeted, actual, and committed expenditure. A separate statement is required for any major capital project.
- A summary analysis of financial performance by cost centre/department, so that governors are aware of the contribution made by each area or subsidy.
- Analysis of LSC funding units by curriculum area, showing actual against target and trends from previous years.
- Analysis of retention and achievement rates.
- At appropriate times of the year, an analysis of applications and enrolments.
- An analysis of franchising activity.
- A statement showing performance of any subsidiary companies or joint ventures.
- A separate analysis of the college enterprise and overseas activities, showing margins generated, so that these can be monitored to ensure that they represent added value.

- A staff analysis showing establishment against actual staff. For the academic staff, this could be extended to information about the use of contracted hours.
- A statement showing current performance against each of the key financial objectives agreed by governors at the start of the year.

It is likely that governors would not wish to receive all of the above information as they would be overloaded – finance is only one aspect of college's activities. Each college needs to determine an appropriate monthly financial reporting pack for governors, senior managers and budget managers. Each audience will have different needs, so the director of finance or equivalent should agree in advance with each group what information they need.

Presentation and use of financial reports

The presentation of the report needs almost as much attention as the actual content. Information presented in a confusing way will generally not be used by recipients. Presenters need to remember that the majority of the audience are likely to have non-financial backgrounds. The presentation of the reports should be agreed in advance with the users and, where appropriate, training provided to aid comprehension. Reports should then follow the agreed format.

Budget managers are more likely to use reports if there is a regular reporting routine, so it is important that reports are sent out in a routine and timely manner. This could mean budget managers receiving cost centre reports on a set day each month, and being required to respond with explanations and proposed corrective action if budget variances are outside set limits. Equally, the senior management team should have a review of monthly management accounts as a standing monthly agenda item. Normally, this review should take place before the reports to the governing body are written, so that a meaningful commentary on the current financial situation and the underpinning rationale can be included. Such routines provide a useful discipline which help the director of finance to produce financial information on time.

Activity What financial information do you receive and when?

Think for a moment about the financial information that your governing body receives and answer the following questions on a separate piece of paper.

1. What type of financial information do you receive as governors to help monitor the financial position in your college?
2. How often is information presented to governors?
3. If your college is in financial difficulty or has recently been in this situation, has the frequency of financial reports increased (for example on a monthly basis rather than once a term)?
4. How clear is the financial commentary that accompanies the data in your financial reports?
5. Do you think all governors at your college are aware of the college's overall financial position in the short- and long-term?

6 Are any performance indicators used to demonstrate succinctly the college's financial position?

Viewpoint

The governing body should expect financial information to be presented in a way that can be clearly understood by all governors. For example, not everyone can understand balance sheets and income and expenditure accounts on their own. If this activity has highlighted weaknesses in the way that information is presented to your governing body, note down how you might follow this up.

Section 7 Strategic financial management – an overview

All colleges are required to share their strategic plans with the local LSC at set intervals. An integral part of the strategic plan is the three-year financial forecast. This forecast should cost the strategic plan and include all of the resource implications of its targets. The process of integrating the financial forecast is essential to ensure that the plan is both affordable and realistic.

The process of producing strategic plans and financial forecasts is normally iterative. In other words, when the effects of the first draft of the strategic plan are costed, it may be found that the plan cannot be afforded or would miss a key financial target. This is then followed by a revised strategic plan and financial forecast which provides a better fit between targets and resources available.

The role of the governors is to set the general strategic framework within which the college management and staff operate. Governors should therefore be actively involved in:

- the formation and adoption of the strategic plan, the annual operating statement and the associated financial forecast
- recording the governing body approval of the plan before dissemination throughout the college and to external stakeholders
- referring to the plan frequently in governing body considerations
- monitoring progress towards its objectives and targets on a regular basis
- reviewing the whole plan annually to assess progress
- updating it by producing a new operating statement and financial forecast for the coming year.

The three-year financial forecast is the long-term financial plan for the college and as such is probably the most important financial document that a governor is responsible for reviewing. It is essential that governors understand the key assumptions underlying the forecast and rigorously challenge any part of the plan they feel doubtful about. The forecast should be supported by a commentary that clearly states the underlying assumptions, plus any other information requested by the LSC. Colleges normally have to submit their three-year financial forecast to the local LSC by 31 July. This

forecast is reviewed by the local LSC along with information known about the college, including its strategic plan, accommodation strategy and other returns. Using this information, the local LSC finance team will make a judgement about the financial health of the college and grade it as category A, B or C. The college is asked as part of its submission to self-assess its own financial health, and the local LSC will then confirm whether they concur with the college's self-assessment. The financial health grades A, B and C are defined in the next section.

It is important for colleges to present a realistic position because the national LSC aggregates all the financial forecasts submitted in order to assess the overall financial health of post-16 education and training. This assessment contributes to advice given to the Secretary of State for Education and Skills in preparation for the annual spending review.

Activity How robust are the key assumptions made in the financial forecast?

Get hold of your college's three-year financial forecast and commentary and ask yourself the following questions:

1. Are all the key assumptions underlying the financial plan clearly explained in the commentary? Do you think there are any assumptions made in the figures that have not been explained?
2. Do you think the assumptions made are realistic, or do they appear hopeful and not based on the underlying information?
3. Is there likely to be a significant financial implication if an assumption is wrong? If so, has this been covered in a sensitivity analysis?

Viewpoint

This activity should have helped you to decide whether you are comfortable with the key assumptions that underpin the financial strategy of your college. If you are not entirely comfortable with one or more of them, ask questions in the governing body meeting. Remember, you and your fellow governors have a statutory responsibility for the financial solvency of the college, so you need to feel satisfied that the strategic financial plan is realistic and meets that objective.

Section 8 Indicators of a college's financial health

A college's financial health depends on the overall strength of the college's key financial indicators for the forecast period, and on their sensitivity to areas of risk. The LSC has adopted the FEFC's system for grading financial health to reflect this. There are three groups – A, B and C. The definitions of these groups are published in Supplement A to LSC Circular 01/01 *Planning*. These definitions should be regarded as guidelines rather than absolute criteria. The final grading decision is made on the basis of all known information about the college. The group definitions are explained opposite.

Group A

'Providers which appear to have sufficiently robust finances to implement their strategic plan and to deal with the circumstances which are most likely to occur during the planning period. These providers will normally have:

- a positive cash flow from operations each year
- more than 25 days cash in hand
- a current ratio above 1.5:1
- a positive balance on their general reserve (I & E account)
- an operating surplus year on year
- total borrowing less than 50% of their general reserve.

These providers will also have carried out a rigorous sensitivity analysis and modelled the issues which are most critical to their success. They will also have identified contingency plans to deal with the most adverse variances.'

Group B

'Providers that show signs of financial weakness which might limit their ability to implement their strategic plan if they encounter adverse circumstances during the planning period. Providers in this group are likely to have weaker solvency than those in group A but still should have:

- more than 15 days cash in hand
- a positive cash flow from operations each year
- a positive balance on their general reserve (I & E account)
- a current ratio between 1.0:1 and 1.5:1
- operating position at break even
- total borrowing no greater than their general reserve.

In addition, this group also covers those providers which may appear to have features similar to those for group A but whose assumptions appear either over-ambitious or optimistic. For example, some providers in group B are planning significant efficiency savings without having robust plans to achieve those savings. These providers may also have included income generation without a supporting business plan. Conversely, this group also covers those providers which are improving from a group C position.'

Group C

'Providers that are financially weak and which are or may become dependent on the goodwill of others. This might involve, for example, a loan from their bank for solvency purposes. Providers in this position are likely to have:

- an accumulated deficit on their general reserve account
- net current liabilities (current ratio of less than 1:1 in one or more years)
- a cash outflow from operations in one or more years

- less than 15 days cash in hand
- an operating deficit
- total borrowing in excess of their general reserve.'

The software provided by the LSC will calculate a computed financial health score based on the following ratios:

- operating surplus/deficit
- cash generation
- general reserve
- cash days in hand
- current ratio
- total borrowing.

The financial forecast covers a period of four years, which includes a plan for the next three financial years and an estimate of the projected position for the year about to finish. When evaluating the financial health of the college, all four years are taken into account. However, in assessing the true position, a greater weighting is given to the first two years' performance (as this should be based on more realistic information). Assuming that appropriate financial reporting systems exist, the college should be able to predict the likely outcome for the existing year with a fair degree of accuracy when the forecast is prepared. In addition, the first year of the three-year forecast should reflect the budget already approved by the governing body.

Similarly, a greater weighting is also given to the solvency indicators over the other financial indicators. A college's financial objectives should concentrate on levels of solvency rather than profitability. Governors should take all of these factors into account when making their own judgements about the financial health of the college. They do not necessarily have to agree with the computed health score, as there may be one-off circumstances which affect some key ratios and therefore distort the true financial position of the college. Some examples of such circumstances are listed below:

- Sale of land or buildings which will increase the cash balances until the proceeds have been spent on allowable items.
- Drawing down a bank loan prior to the end of the financial year but not using the cash for the purpose of the loan until a new financial year. This will have the impact of increasing cash balances and improving the current ratio.
- Significant capital expenditure prior to the end of a financial year, with a loan to be drawn down in the new financial year or strong cash inflow planned in the new budget which will replenish cash levels.

Activity In which group is your college?

Which financial health group does your college fall into and why?

Viewpoint

If your college is group C it should be clear how this position was reached and what plans are in place to improve matters. If your college is group B, has a conscious decision been made by governors to adopt this level of risk in order to meet certain obligations? If this is not a deliberate policy, it may be an issue that needs to be addressed.

Section 9 Financial target setting

The financial forecast is an integral part of the college strategic plan. Clear linkage should exist between the objectives set in the strategic plan and the financial targets set in the financial forecast. The financial targets should support the objectives set in the strategic plan and assist the college in achieving those objectives.

Measurable targets

Targets should be set which are measurable, achievable and sufficiently challenging. They need to include periodic checks so that governors can measure whether the objectives are being achieved. Targets should have a measurable, clear performance indicator, which can be benchmarked against past performance and performance in post-16 education and training more generally. The target should include an identified timetable for staged implementation against which progress can be reviewed.

One of the key responsibilities of governors is to ensure the solvency of the institution. Governors should therefore make sure that there are financial targets that address solvency – such as requiring a minimum number of cash days in hand and a minimum current ratio. Similarly, financial targets should be set to support the governors in discharging their responsibilities for financial management and monitoring, for ensuring effective management controls and reporting systems, and for safeguarding college assets.

Once targets have been set there should be regular reviews against progress towards those targets. The targets can be updated if necessary to reflect the changing priorities within the strategic plan. If targets are not on track then an action plan should be agreed with governors to bring them back in line.

It is essential that governors receive regular reports to help them monitor the financial situation. The reports should be clear, accurate and timely. Governors should question and challenge any aspects of the report that do not meet these criteria. Probably the most important financial report for governors is the monthly management account. Good practice for the monthly reporting pack is covered in detail in Section 6.

Common areas of weakness in financial target setting and financial monitoring

The most common areas of weakness are:

- **lack of clarity when setting financial targets** – often targets are too general or vague. For example *'We will improve our cash days in hand'* is an inadequate target, whereas *'We will have a minimum of 25 cash days in hand by 31 July 20XX'* provides governors with a measurable target and a deadline.
- **targets do not link to the strategic plan** – the financial forecast should fully reflect the financial implications of the objectives set in the strategic plan. For example, if the college has an objective to improve the accommodation through a major refurbishment of an existing building, then this should be reflected in the financial forecast. There should also be a financial target that includes the level of capital investment required, and the date by which the project should be completed.
- **targets that are not met in the financial forecast –** once financial objectives have been agreed a realistic financial forecast should be produced which meets the objectives.
- **accurate monitoring of funding unit targets –** a common failure in monitoring financial performance is in accurately monitoring student numbers. For example, overestimating student units by 10,000 could result in a £172,200 loss of income (based on an Average Level of Funding (ALF) of £17.22). Accurate recording of student data is of critical importance. Governors need to be both aware of and satisfied with the accuracy of the college's system for collecting student numbers and calculating the units generated.
- **poor quality financial information produced for governors** – poor quality financial information still exists in colleges. Good practice in financial reporting is covered in more detail in Section 6.
- **monthly financial reports that are produced far too late** – financial information is of little use if it is produced infrequently or very late. If there are financial issues to be tackled, governors need to be aware of them as soon as practically possible so that corrective action can be agreed before it is too late. It is good practice for colleges to publish in advance the dates by which reports should be produced – usually at the beginning of each financial year.
- **governors not challenging potential issues arising out of information received** – having received information from the college management, it is important that governors challenge any aspects that are not clear to them or give them concern. This should not be seen as distrust of the college management, rather as part of a normal healthy working relationship between governors and management.

Activity What are your college's financial objectives?

What are the current financial objectives within your college's strategic plan and financial forecast? How is progress against them monitored and measured?

Viewpoint

Governors should set clear financial objectives for the college to achieve, and receive regular (at least once a term) monitoring information on performance against them. Typically this information should be a core component of the ongoing financial monitoring reports.

Section 10 Risk management plan

In recent years the FEFC required colleges to prepare a sensitivity analysis and contingency plan as part of their commentary to the three-year financial forecast. The LSC now requires colleges to submit a separate risk management plan that includes a sensitivity analysis and contingency plan.

Risk management plans based on sensitivity analyses are important tools for minimising risk – something which every college should seek to do. However, there are still some colleges that do not give adequate attention to risk management.

The LSC now requires the principal to certify on the financial forecast that the risk management plan has been approved by the governors.

A risk management plan should contain the following:

- a brief description of each area of risk together with an assessment of the likelihood of occurrence
- a quantification of the potential financial impact
- the name of the individual within the college management who has responsibility for monitoring that particular area of risk
- contingency plans in the event of an adverse variance – these must be realistic
- a description of the monitoring process.

The risk management plan should also include the college's disaster planning arrangements.

The LSC has identified a number of business risks in its Circular 01/01 *Planning* which includes some very useful questions which governors should ask, and points to consider when they are assessing risk. These are listed opposite. The activity on page 27 asks you to consider which questions are most useful for your own college.

Checklist: Risk management questions to be asked and points to be considered

LSC funded provision

- ☐ How is growth in funding units to be achieved?
- ☐ Is the growth forecast outside the parameters set out in the forecasting assumptions?
- ☐ Is the college monitoring learner numbers as well as funding units?
- ☐ How likely is it that learner number targets will be achieved?
- ☐ What percentage of units is franchised to other colleges?
- ☐ What percentage of franchised activity is subject to the discount factor?
- ☐ What contribution to overheads is generated from this activity?
- ☐ Are over 10% of learners recruited from outside the college's wider recruitment area? (10% is a threshold determined by the LSC as a higher risk)
- ☐ What percentage of provision is undertaken via open and distance learning?
- ☐ What level of provision may be at risk should the LSC choose not to contract for franchise provision?
- ☐ What percentage of enrolments on qualifications is delivered via load-banded qualifications?
- ☐ What percentage of provision, as measured in guided learning hours, is delivered as NVQs?
- ☐ What is the total number of learners with non-English postcodes?
- ☐ Where there is a student with a non-English postcode can it be demonstrated that there is no comparable provision in the home country?

European structural funds

- ☐ What proportion of income is received from European structural funds?
- ☐ What contribution to overheads is generated from European funded activity?
- ☐ Where is the college's matched funding coming from?
- ☐ What is the impact on the college's cash flow forecast?

Links with other bodies

- ☐ How many partnerships, joint ventures or joint arrangements is the college a member of, and what is the level of any potential liability?
- ☐ How many subsidiary companies does the college have, and what are their activities?
- ☐ Has the college reviewed FEFC Circular 99/14 *College companies and joint ventures* and satisfied itself that it has appropriate control over the activities of the subsidiary companies and that those activities are not *ultra vires*?
- ☐ What investment has been made in these ventures, and does this comply with regulations regarding the use of public funds?

Key points to consider

- ☐ The implications of sharing information with other providers.
- ☐ The impact of the activities of other post-16 providers.
- ☐ Any proposals for new sixth forms or LEA sixth-form centres.
- ☐ Planned mergers of FE colleges or of other local providers.
- ☐ Whether the financial health of the college brings it within group C and/or is declining.
- ☐ Whether the college has an ongoing major capital project.
- ☐ Any qualified audit opinions from internal or external auditors.
- ☐ The opinion of the FEFC audit service or the LSC provider assurance service on financial management.
- ☐ Whether the college is forecasting a shortfall against its unit allocation and has made appropriate provision for recovery of funds.
- ☐ Whether governors are receiving regular and prompt management information.
- ☐ The procedures for monitoring expenditure commitments.
- ☐ Benchmarking of the college's activities with that of others.
- ☐ Whether the college has assessed the contribution to be made from any new venture as well as the income.
- ☐ Any grade 4s or 5s received in a college inspection.
- ☐ Retention, achievement or attendance rates below the median or any other issues identified in a college inspection.
- ☐ The impact of any changes in senior management or college systems and whether any such changes require notification to the LSC in accordance with the financial memorandum.
- ☐ A history of late data returns.
- ☐ The alliances with higher education (HE) institutions and how consortia arrangements might respond to the different needs of their learners.
- ☐ The proportion of income received from HE.
- ☐ The implications of QAA (Quality Assurance Authority) audit.
- ☐ The potential impact of Foundation degrees.

Activity What are the key aspects of risk management for your college?

Work through the checklist above and decide which questions and points for consideration are the most important priorities for your college. Mark each item in the checklist as follows:

✓ = very useful/relevant to my college

? = not sure if relevant/need to find out more

✗ = not a priority for my college.

Viewpoint

The checklist provides a useful overall starting point for developing the governing body's awareness of business risks, and the kinds of question to ask to ensure that risk management is adequately considered by the financial management team. All the questions and points to consider are useful but you may find it helpful to focus on those which seem most relevant to the present financial circumstances and future plans of your own college.

Disaster planning

The LSC requires colleges to have in place contingency plans to cope with major disasters that could affect the day-to-day operation of the college. The process to be followed in the event of such a disaster should be formally documented. This document should identify the individual responsible for the implementation of the plan. The aim of the plan should be to minimise potential damage and restore business continuity as quickly as possible. The plan should be reviewed on a regular basis and should be tested as far as practically possible.

Sensitivity analysis

Sensitivity analysis involves assessing the impact that risks could have upon the financial health of an institution if they were to happen. It is the first stage in the formulation of a risk management plan.

No matter how good a college is at forecasting and how robust the college finances are, things can still go wrong. It is therefore vital that colleges carry out suitable sensitivity analysis on the main areas of risk within the forecast and prepare adequate contingency plans.

When preparing financial forecasts, colleges make a number of assumptions. Some of these assumptions will derive from the college's strategic plan. They often relate to uncertainties in the external environment or to the more challenging aspects of the strategic plan. Typical examples are:

- college predicts a high level of growth in non-LSC income – is this realistically achievable in the timescale, and what margins have been assumed?
- college has high levels of franchising – will the providers decide to contract directly with the LSC ?
- college plans large-scale growth – can the additional students be recruited and, if so, will they be funded?
- college faces intense competition – can current student levels be maintained?
- college plans large-scale building works – can the costs of the building project be contained?

It is important that each of the assumptions is clearly stated, so that the risks associated with each assumption can be properly assessed. For each area of risk, consideration should be given to:

- the likelihood of the risk occurring, i.e. high, medium or low
- an estimate of the potential financial impact.

Where there is a combination of high likelihood of a risk materialising and a significant potential financial impact, there are serious implications for the achievement of the financial forecast. Clearly, the governors should ensure that these areas are closely monitored by management, with regular reports provided to governors.

As well as considering individual risks, governors need to be aware of the possibility of more than one area of risk materialising. The combination of two or more risks occurring may have serious consequences. Governors may well want management to consider a 'worst case scenario'.

Activity Developing your awareness of financial risks

1 Has your college completed a risk management plan? If so, what was the outcome in terms of significant impacts upon the college's viability?

2 Does the sensitivity analysis quantify the potential financial implications of all the key risks identified in the risk management plan?

3 Has the college prepared a contingency plan containing realistic action it could take to cover potential areas of risk identified?

Viewpoint

Governors have a responsibility to consider the assumptions underlying financial plans and to anticipate what might go wrong with the finances of the college. Get in the habit of asking yourself 'What are the financial assumptions behind this document and are they realistic?'. This will help you to become alert to potential areas of risk in the financial information you receive.

Section 11 The LSC funding methodology

Colleges generally receive their biggest proportion of income from the LSC. In the past this has typically been about 75% of total college income, but now, with the new arrangements for funding work-based learning introduced in April 2001, it is often higher. The LSC have announced that they intend to introduce their own funding methodology for 2002/03. This will accommodate the wider range of providers that they fund into one common funding framework. In the meantime, the LSC have largely adopted the FEFC funding methodology with a few minor changes.

The FEFC funding methodology is broadly based upon:

- number of students enrolled on a course
- length of study programme
- whether or not the student completes the course
- the subject area studied
- achievement of the qualification aim.

Additional funding can be claimed through the funding methodology where:

- the student is under 19 years of age on a full-time programme
- the student is in receipt of a means-tested benefit
- a student lives in a certain postcode area
- a student receives additional support from the college where an assessment has identified that a student has certain needs.

The funding methodology is highly sophisticated but is based on the principle of funding each individual student's learning programme. Because of the numbers of students involved, the management of the data associated with student tracking is a significant task. It is also a significant risk because of the direct impact that errors have on funding.

It is important that governors have a basic understanding of the funding methodology because of its complexity and financial significance. Each year, usually in December, the FEFC published an update of any changes to the funding methodology for the following year. It is likely that the LSC will continue this process. The update takes the form of a circular and includes the funding tariff table for each of the areas listed above. The tariff consists of units, each college being paid a certain amount of money for each unit earned. (The new methodology will no longer be unit based but will be cash based.)

The units earned for each student are made up of three separate core elements:

- entry units
- on-programme units
- achievement units.

The entry units are dependent on the value of the basic on-programme units and are paid to reflect the advice and guidance that students are given when enrolling on a course. This will either be two, four or eight units. It is likely that the new funding methodology will not have entry units.

Census dates

The main element of the funding is received through the on-programme element. A one-year course is generally based on 84 basic on-programme units. These are earned by a student still attending a course on a census date during each term. For the college to receive all 84 units, the student has to be attending the course until all

three census dates have been passed, i.e. until after 15 May each year. The census dates each year are:

- 1 November (the LSC has announced that, under the new funding methodology, this will be earlier in the year, 1 October)
- 1 February
- 15 May.

Provided the student is still attending on the census date, the college claims one-third of the basic on-programme units (assuming a one-year course) i.e. 28 units. The basic on-programme units are then enhanced by a cost weighting factor depending on the course subject area. This takes account of some subject areas being more expensive to organise and deliver than others. Part-time courses have lower unit values.

The third element is achievement units, earned if the student completes the qualification aim, recorded in the learning agreement for their study programme.

Unit value

The amount paid per unit currently varies, although there is a convergence process operating to bring all colleges to a standard funding level of £17.22 per unit by 2001/2002.

The standard level is known as the Average Level of Funding (ALF) and is simply calculated as the total funds divided by the total target number of units for the college.

Retention is critical for sound finances

Large sums of monies can be involved. For instance a student on a one-year construction course which currently has a cost weighting factor of 2.0 could be worth the following units:

Entry		8
On-programme	(84x2.0)	168
Achievement		10
Total units		**186**

If a college were being paid at the convergence rate of £17.22 per unit, the total funding for this student in one year would be £3,203. This is without any additional funding that an individual student might attract for fee remission, childcare support or additional support.

If this student enrolled in September and left the course at Christmas, the college could only claim the entry units and one-third of the on-programme units (as the student has only attended past one census date). The units earned would be 64, and at £17.22 this would be total funding of £1,103. This is a significant reduction on the potential total annual value of the funding calculated above.

Even worse, if this student were to leave before 1 November the college would receive nothing.

This example demonstrates how crucial it is to monitor retention rates, because if just five students drop out of the course at Christmas, the college would lose just over £10,000 of funding for the year. Taken over the number of courses typically offered by colleges, drop-out numbers can quickly accumulate.

No college can realistically expect 100% retention on all programmes, so it is important that a retention factor is taken into account at the planning stage and when making assumptions for the budget. This is an area which governors need to scrutinise carefully before approving the annual budget.

Each year around February, the LSC gives a provisional funding target to each college for the following year. This is based on the existing funding target which is used as a baseline, and various growth 'pots' are then added which are calculated on a formula basis. The priority growth area for the government at the present time is full-time 16–18 year olds. To prevent colleges achieving growth targets by increasing the learning programmes of existing students, any growth allocation has a student number target tied to it. This requires the college to recruit extra students to avoid having to return growth funding. Colleges are normally asked to submit a return by April stating whether they wish to accept the provisional allocation, or to reduce it, or to seek further growth. The college will need to submit supporting evidence if they wish to have their funding target increased.

The LSC makes payments to colleges each month throughout the academic year on the assumption that they will achieve their funding targets. If a college fails to achieve its target, then funds will be clawed back at the full funding rate for any unit shortfall. This can obviously have a significant impact on cash flows. Any clawback will normally take place in the March following the end of the previous financial year. On the other hand, if a college exceeds its target it will not receive extra funds and will have to absorb the cost of the additional provision. The calendar included in Appendix A sets out the key dates in the annual funding process.

Activity Compare your college's predicted and actual retention rates

Find out from your clerk the predicted and actual retention rates for the last financial year then answer the following questions.

1. What assumptions does your college make about retention rates? Does it have a standardised retention rate applied to all courses, or does it have different rates applied to different types of course?
2. If there was a significant difference between the predicted and actual retention rates, what was the reason for this? Were budget predictions unduly optimistic and do you need to make adjustments to the assumptions about retention rates?
3. How do your college's retention rates compare with those of similar colleges, or with post-16 education and training as a whole, on course/student type comparisons?
4. What is happening to your college's retention rates over time – are they improving or declining?

Viewpoint

These are critical questions for governors. We can all probably think of colleges that no longer exist because the governors and managers did not get the correct answers

to these questions. For example, unrealistic assumptions about retention rates may mean that budget predictions are unduly optimistic. If your college's retention rates are declining, urgent action is necessary because of the implications for funding.

Module review

This module has looked at governors' role and responsibilities for the financial management of their college. If you have worked through the whole module you should now be confident that you can:

- explain the role of the governing body in monitoring the financial position of the college and its audit process
- identify the range and purpose of financial documents that will be presented to you as a governor
- explain the broad indicators used by the LSC to evaluate a college's financial health
- describe common areas of weakness in financial target setting and financial monitoring and financial management within post-16 education and training
- explain the use of risk management plans in a college financial forecast
- identify good practice in financial management
- explain LSC funding methodology.

If you are not sure that you have achieved a particular goal, look back at the contents list in the Introduction to the module. You may find it useful to reread the relevant section.

Summary of key learning points

Governors have a number of responsibilities in relation to the financial management of the college. To discharge these responsibilities governors should:

- be aware of the key requirements of the financial memorandum, and of the compliance criteria in the FEFC circulars on *College companies and joint ventures* (99/14) and *Franchising* (99/37)
- establish an audit committee to provide advice on the system of internal controls operated by the college
- approve the annual financial statements
- approve the annual budget and the three-year financial forecast
- ensure procedures are in place and operate effectively to minimise the risk to college assets.

Strategic financial management is a vital part of the overall strategic planning process within a college. Governors will want to ensure that:

- the financial forecast is consistent with the college strategic plan
- appropriate financial targets have been approved by governors that support the solvency of the college
- clear reporting procedures are in place to enable effective monitoring of achievements against targets
- an adequate risk management plan has been prepared, including an appropriate assessment of business risks undertaken, with potential financial implications estimated and realistic contingency plans prepared.

The task of financial management must be part of the routine operation of the college. In order to fulfil their duties, governors must be able to understand the information they are receiving and have confidence in it. To assist in this governors should have a basic understanding of the LSC funding methodology, as in many colleges this constitutes the bulk of their total income.

Funding follows an individual student learning programme, and is financially sensitive to early withdrawals from courses.

Governors should receive clear financial information on a monthly basis in a format that is useful. These reports should be used to assess the financial position of the college. If necessary, the governors should challenge any information that is not clear to them or gives them cause for concern.

Governors should not accept infrequent reports or information that is confusing or meaningless. The governors have a responsibility for ensuring the solvency of the college. The monthly management accounts are a key tool to assist governors in discharging this responsibility.

Where next?

You have now completed work on *Module 5 Financial management*. 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, and how.

Putting it into action

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

APPENDIX A – Annual timetable for funding and finance

February	Provisional funding allocation issued by LSC
	Final ISR* for previous academic year due for submission (with the inclusion of achievement data)
	Financial mid-year update (if requested by LSC)
April	Colleges required to respond to LSC provisional funding
	Budget preparation probably starts
May	Detailed budget preparation continues
	LSC issue guidelines on financial forecasts
June	Completion of budget
	Completion of financial forecast
July	Approval and submission of financial forecast
	Approval and internal issue of budget
	End of financial year
September	External audit usually starts (late Sept/early Oct)
	ISR for previous academic year due for submission
November	Probably complete external audit
	Approval of annual accounts
December	ISR for current academic year due for submission (November from 2002/03)
	Deadline for publication of annual financial statements
	Finance record due for submission to LSC

*The **individualised student record (ISR)** is the return submitted to the LSC detailing activity of all students at the college and is used for calculating the actual funding units earned by the college. There are three returns each year. The first follows the November census, due December (from 2002/03 the census date will be October 1), which gives an early estimate of all-year activity. The second is the position at the end of the year, i.e. 31 July (due September) and is used as the basis for external auditors to sign off the annual financial statements. At this stage everything should be included except exam achievements, as most of these will not yet be known for students sitting exams in the summer. The final ISR will include exam achievements from the previous year and is used as the basis for the final payment of funds from LSC.