Education & Skills Funding Agency

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ESFA-enquiry-form

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To accounting officers in colleges. Copied to chairs of governing boards

Dear colleague

As many of you will be aware, following a review into the classification of the English college sector for the purposes of national accounts, the Office for National Statistics (ONS) has announced today that it has reclassified colleges into the central government sector. This decision has immediate effect.

The ONS decision encompasses providers that operate within the statutory further education sector as defined under section 91(3) of the Further and Higher Education Act 1992, i.e. Further Education Colleges, Sixth Form Colleges, and Designated Institutions. Related subsidiaries of colleges are also covered by the requirements and processes set out below.

Managing Public Money

Following this reclassification, colleges (and their subsidiaries) are now part of central government. They continue to be self-governing charities regulated by the Secretary of State for Education but are now subject to the framework for financial management set out in Managing Public Money (MPM).

MPM sets out requirements for everyone working in central government to manage and deploy public resources responsibly in the public interest, although much of what it requires can be recognised as common sense and therefore in line with how you already run your college. Some of the MPM requirements are already embedded in your funding agreement.

The mission of colleges to deliver the priorities set out in the Skills for Jobs white paper, and enshrined in the Skills and Post-16 Education Act, has never been more important. Our reforms to funding and accountability ensure that colleges have the freedom to focus on and deliver the best outcomes for learners. ONS' decision to reclassify the sector does not alter these strategic aims. Colleges will continue to play a leadership role in England's skills system, and we will work to make sure that they provide the world leading skills infrastructure that our country needs.

Reclassification to the government sector does mean that there will be new requirements for colleges relating to financial management oversight, principally associated with approvals from DfE set out in **annex A**. Alongside these changes, we recognise the importance for colleges of having autonomy over their financial planning and want to reassure you that this will continue. In particular, we want colleges to retain the freedom to carry forward unspent surpluses from one year to the next so that maximum flexibility is given to your longer-term plans. This letter confirms that freedom.

Borrowing

There will be immediate changes affecting borrowing resulting from reclassification which colleges will need to manage carefully. The new requirements to meet MPM rules relate to any new amendments to existing private sector borrowing facilities or future private sector borrowing actioned by colleges. These are complex areas potentially requiring action by affected colleges and further details and guidance are set out in **annex B**.

Colleges should be aware that adherence to MPM requirements mean that any amendments to existing borrowing or any new borrowing which increase private sector interest costs are unlikely to be compliant in most cases. This is due to private sector lenders facing higher financing costs than government, which are passed on to colleges.

A DfE consent process is being introduced to ensure MPM compliance by colleges in the above scenarios. For the reasons set out above, such consents will only be provided in exceptional circumstances (for example, a college otherwise suffering significant adverse financial consequences which more than outweigh higher private sector costs).

Please note that the borrowing guidance in **annex B** excludes finance leases, which are covered in **annex A**.

Next steps

We are committed to working with colleges to minimise any disruption to ongoing operations resulting from reclassification in the current challenging economic climate, both via your local DfE territorial team and the specialist ESFA Finance and Provider Market Oversight teams. Our objective is to help you obtain a good understanding of the new requirements and support you through this period of change.

We will be developing guidance on many of the issues arising from MPM over the coming months, which will be published incrementally on gov.uk. This process will culminate in the development of a new, comprehensive Colleges' Financial Handbook, which we intend to progress in partnership with stakeholders from the sector, including chief financial officers. Some of these matters may require additional disclosure in your financial statements and we will let you know about this later.

This letter should be read alongside today's letter from Robert Halfon, the Minister for Skills, to college principals. You will also be able to read how reclassification will affect specific areas in the full government response document published on gov.uk.

I appreciate that there is a lot of material to consider because of the reclassification of the sector and that many of you will have questions. Your first point of contact is the ESFA enquiry service.

Please share this letter with your chief financial officer and finance teams. You should also bring it to the attention of your governors, especially the chair of the corporation and members of your finance and audit committees, who may wish to consider the implications at their next meeting.

Yours sincerely

David Withey
Chief Executive
Education and Skills Funding Agency

Annex A – Financial transactions

a. Management of surpluses

The default MPM position is that, for grant-funded government bodies, any unspent grant will be clawed back by the funding body at year-end. However, it is essential that longer term financial planning is the cornerstone of the sector's financial sustainability, and so colleges will be able to carry forward any surpluses at year end without limit, including for investment in capital assets. This agreement may require us to collect additional information from you and we will be in touch about this in due course.

Colleges' freedom to carry forward surpluses does not alter existing arrangements for recovering funding due to ineligibility or under-delivery.

b. Asset disposals

Colleges will continue to be able to manage their assets, including their estate, and to retain the proceeds of disposals. However, colleges will be required to ringfence the proceeds for reinvestment in capital assets.

We will keep this approach in place until the end of the current Spending Review period (31 March 2025), when it will be reviewed.

We may also need to collect additional information from you about your disposals.

c. Special severance payments

Special severance payments are payments that are discretionary and additional to those arising from statutory and contractual redundancy or severance terms. MPM's position is that making such payments on top of the normal entitlements does not usually provide good value for money or offer fairness to the taxpayers who fund them. Special severance payments should therefore only be considered in exceptional cases.

However, special severance payments can be an important mechanism to allow employers to reform and react to new circumstances in the workplace. Accordingly, such payments may be permitted when there is a clear, evidenced justification for doing so and when all relevant internal policies and procedures have been followed, and all alternative actions have been fully explored and documented.

Colleges will have delegated authority to make individual severance payments, provided any non-statutory/non-contractual element is under £50k or under 3 months' salary, whichever is the lower. Beyond this, DfE approval will be required. Furthermore, any proposed payments of whatever value that are linked to a non-disclosure agreement will also require DfE approval and, where supported, we will refer them to HMT for final consent.

Additionally, in accordance with current [Guidance on Public Sector Exit Payments](), colleges must obtain prior DfE approval before making a special staff severance payment where:

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

Regardless of the above delegations, any special severance payment which is novel, contentious or repercussive, of whatever value, must be referred to DfE for approval and, where supported, we will refer to HMT for final consent.

It will be important that in those cases where approval is required that colleges refrain from entering into legally binding agreements until that approval has been obtained.

d. Compensation payments

Compensation payments provide redress for loss or injury, for example personal injuries, traffic accidents or damage to property. If a college is considering a compensation payment, it must base its decision on a careful appraisal, including legal advice where relevant, and ensure value for money.

If a college concludes that a compensation payment should be made, it has delegated authority to approve individual payments provided any non-statutory/non-contractual element is under £50k. Where the college is considering a non-statutory/non-contractual payment of £50k or more, DfE's prior approval must be obtained.

e. Ex gratia payments

Ex gratia payments are another type of transaction going beyond statutory or contractual cover, or administrative rules. This could include payments to meet hardship caused by official failure or delay, and to avoid legal action due to official inadequacy. Ex gratia transactions must always be referred to DfE for prior approval, whatever the amount.

f. Write-offs

We recognise that most sums written off by colleges are likely to be relatively small. Consequently, DfE consent to a write-off will only be required if the individual loss/write-off exceeds 1% of annual income or £45k individually (whichever is smaller), or 5% of annual income cumulatively (subject to a £250k cumulative ceiling).

g. Indemnities, guarantees and letters of comfort

Central government bodies should not be entering into liabilities without explicit parliamentary authority, other than those arising in the normal course of business. We recognise that many commercial contracts will, in the normal course of business, include indemnity clauses; these will not be restricted and DfE consent will not be required.

Beyond this, DfE consent will be required in respect of indemnities beyond the normal course of business, guarantees and letters of comfort in excess of:

- 1% of annual income or £45k (whichever is smaller); or
- 5% of annual income cumulatively (subject to a cumulative celling of £250k).

h. Finance leases

As you may know, there are two types of lease: operating leases and finance leases. Whilst finance leases constitute a form of borrowing, colleges will be able to continue with any existing finance leases until they come to the end of their term and will also be able to enter into new finance leases.

i. Senior pay controls

Colleges remain responsible for setting the pay of their workforce. However, reclassification means that they will fall within the scope of HMT's senior pay controls. We will update our existing guidance on senior pay to reflect the principles set out in HMT's guidance, and work with the sector to make sure that colleges are able to seek approval for any new or amended reward packages that fall within scope of the controls.

j. Insurance

Central government organisations should not generally take out commercial insurance because it is better value for money for the taxpayer to cover its own risks. However, there are some circumstances where commercial insurance is appropriate.

We are exploring an alternative to commercial insurance for colleges with the Department's Risk Protection Arrangement scheme. For the moment, colleges can continue with their existing insurance arrangements, and can renew or take out new commercial insurance.

k. Commercial operations and subsidiaries

Colleges will remain free to conduct commercial operations, including through subsidiary companies. However, all subsidiary companies will be subject to the same MPM-based controls outlined in this letter as their parent college. If the purpose of any such subsidiary could be deemed to be novel, contentious or repercussive then the acquisition or establishment of such a subsidiary will also require prior DfE approval.

l. Novel, contentious and repercussive transactions

Novel transactions are those of which your college has no experience or are outside its range of normal business. Contentious transactions are those that might cause criticism of the corporation by Parliament, the public or the media. Repercussive transactions are those likely to cause pressure on other colleges or other parts of the public sector to take a similar approach and hence have wider financial implications.

Transactions by colleges or their subsidiaries that may be considered novel, contentious and/or repercussive must always be referred to DfE for prior approval. If supported, DfE will refer to HMT for final consent.

Annex B - Borrowing

a. Private sector borrowing

Private sector borrowing refers to any borrowing from commercial lenders but also loans from local authorities and any other non-public sector organisations. Existing and future lending from DfE to colleges is excluded.

MPM is clear that from the date of reclassification colleges, as public sector organisations, may borrow from private sector sources only if the transaction delivers better value for money for the Exchequer. Because non-government lenders face higher financing costs, in practice it is very unlikely that colleges will be able to satisfy this condition for future private sector borrowing.

To ensure adherence to MPM by colleges post-reclassification, a consent process by DfE for college requests relating to future borrowing and amendments to existing agreements as detailed below will be implemented. College DfE learner funding agreements will be updated in December 2022 to reflect this consent process as a new condition of funding.

The main commercial lenders to the sector will be made aware of this new consent requirement.

It is recognised that any restriction due to MPM on the availability of borrowing facilities to colleges following reclassification presents challenges to colleges both in respect of existing and future debt funding. New DfE initiatives relating to the learner funding profile and new DfE capital funding are being introduced to the sector to assist with funding areas previously provided by the private sector.

Further guidance on these areas is set out below.

College requests submission

As detailed below, both for existing borrowing and future borrowing, colleges may need to make requests to the DfE. If so, colleges should use the excel form ‘College borrowing requests’ attached.

The declaration, lender contact details and the appropriate request tab should be fully completed by the college and this, together with the supporting documents as detailed on the relevant request tab, should be submitted by email to the DfE at: PMO.Reclassification@education.gov.uk.

Guidance on completion is provided in the first tab in the excel file. Please ensure this is followed to avoid delays in dealing with any request. In particular, separate excel files should be submitted for each request, in the event any college has multiple requests to submit at the same time.

b. Existing borrowing

Existing borrowing is any debt taken out and utilised (drawn down for loans) by the college or a related-subsidiary up to 29 November 2022 in the form of a facilities agreement, senior debt finance agreement, working capital facility, term-loan, overdrafts, revolving credit facility, PFI property finance agreement (whether recognised on the balance sheet or not) and any other financing agreement.

The consent process will **not apply to existing debt balances** at the point of reclassification. Colleges should continue to repay such debt under the agreement terms to maturity. We expect that colleges will be able to ensure that any balances on variable type facilities (overdrafts and revolving credit facilities (RCFs)) are worked down to nil or repaid in full at maturity of the facilities.

Term loan balloon payments (at maturity)

Colleges may have existing term debt with outstanding balances remaining at maturity. If this residual debt cannot be refinanced by a commercial lender compliant with MPM and a college does not have sufficient cash reserves to meet in full, then DfE will consider a request for financial assistance from a college at the relevant time.

If a college has a balance remaining on the loan at maturity - balloon payment due to a lender (at any time in the future) please notify us by email PMO.Reclassification@education.gov.uk subject header '[College name] - Balloon payment due' to provide initial notification to us of the lender, the balloon payment value and the maturity date as soon as possible.

A formal request (Tab: Request 4) for any financial assistance by affected colleges will need to be made at least 6 months before maturity (or immediately for relevant loans maturing in the period to 31 May 2023), using the college requests submission procedure set out above.

Any funding, if approved following a review process, will be made available under a standard DfE repayable loan agreement which will be interest-bearing and potentially secured.

Amendments to existing facility agreements

The college must obtain the written consent of the DfE before entering into any amendment to arrangements for existing borrowing within the scope of MPM and provide evidence how the change meets MPM rules.

Amendments which may be within the scope of MPM include, but are not limited to, changes relating to the term of a loan, repayment profile change, interest rate change outside of the existing agreement terms (including any move between a variable and a fixed interest rate) and providing additional security. If in doubt as to whether within scope or not, please submit a consent request.

The college is required to:

- Submit a formal request (Tab: Request 1) for consent using the college requests procedure set out above.
- Receive written confirmation from DfE of consent.
- As a condition of any consent, supply a copy of the executed new agreement / modification by email (as above) within 2 weeks of completion.

Amendments and other colleges actions related to facilities which are **not** within the scope of MPM and therefore do **not** require the written consent of the DfE include:

- Providing periodic standard written representations to lenders.
- Changes to financial and non-financial covenants.
- Changes to standard clauses following underlying legislation changes or other reasons which are not within the scope of MPM as defined above.

c. Future borrowing

New borrowing refers to any new debt or refinancing of the above existing borrowing types of debt and any new drawdown of existing borrowing facilities from 29 November 2022 onwards.

<u>New borrowing</u>

New finance arrangements or drawdown of funds post-reclassification under existing finance arrangements will be subject to MPM rules and colleges will be required to obtain the written consent of DfE in advance of committing to any new financing arrangements or actioning any new drawdowns of overdrafts, RCFs or loans.

<u>New finance arrangements</u>

The college is required to:

- Submit a formal request (Tab: Request 3) for consent using the college requests procedure set out above.
- Receive written confirmation from DfE of consent.
- As a condition of any consent, if given, supply a copy of the executed new agreement by email (as above) within 2 weeks of completion.

<u>Unutilised borrowing facilities (including undrawn term loans)</u>

Any additional usage of existing overdraft, RCFs or drawdowns of existing term loans, limited to essential operational needs, above levels at the point of reclassification, will be subject to a consent process. The consent will be time limited to the earlier of maturity or 20 months to 1 August 2024 for overdraft and RCFs.

This is to allow time for the following to take effect: a proposed smoothing of the learner funding profile to improve a college's working capital position; and for new DfE capital funding initiatives to be introduced to minimise disruption to capital projects in progress.

The college is required to:

- Submit a formal request (Tab: Request 2a or 2b) for consent using the college requests procedure set out above no later than 16 December 2022.
- Receive written confirmation from DfE of consent for usage in the consent period, if given.

At the end of the consent period for overdrafts and RCFs, we expect that colleges will be able to ensure that such variable working capital facilities and other facilities are worked down to nil or repaid in full at the earlier of the end of the consent period or maturity of the facilities.

Any residual balances remaining on overdraft and RCFs, not able to be repaid by colleges, will need to be the subject of a request to DfE for financial assistance from a college. The college will be required to submit a formal request (Tab: Request 5) for financial assistance using the college requests procedure set out above. A formal request for any financial assistance by affected colleges will need to be made at least 6 months before maturity of the facilities (or immediately for relevant facilities maturing in the period to 31 May 2023).