College Finance Directors Group CFD

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Dear Mr Withey

Government accounts consolidation and changing the year-end of FE Colleges

We, the College Finance Directors Group (CFDG), are writing this letter to express our deep concerns regarding the possibility that FE Colleges may be required to change their financial year-end from 31st July to 31st March.

CFDG members are serving Chief Financial Officers in FE Colleges who have been elected to represent colleges nationally in matters regarding financing and resourcing of FE colleges. We are all qualified and highly experienced finance professionals working in the FE sector. We have been in these roles for many years, working with successive funding bodies and building up detailed knowledge of the sector. We get the strong sense that a poor decision is going to be made and we have to raise our voice in these circumstances.

It is essential that decision makers understand how FE Colleges are very different to schools and academies, they are large and complex businesses with multiple income streams and student registrations occurring throughout the year on courses of varying duration. College business models are much closer to Universities than they are to schools. A 'one-size fits all approach' will not work. The FE sector is already financially fragile, this change risks destabilising it further.

We are unanimous in our concerns and CFDG members have signed this letter to emphasise this consensus. The downsides of such a change in year-end are very significant and some appear insurmountable. A disconnect between the academic/business cycle and financial planning/reporting cycle will be created that will swallow more resource to produce and audit meaningless figures with a resultant loss of financial control and detrimental impact on learners and the curriculum.

We have summarised our concerns in this letter below, with detailed information in the appendices.

In our professional opinion a change of year-end is not necessary. There are other ways to address the financial reporting requirements of government which, as a group, we are keen to explore with officials but have not been given the opportunity to do so. We have made the offer to work constructively together but this has not been taken up. We are fearful that decisions will be made behind closed doors by people without a full understanding of the implications.

To date we have been drip-fed information about this change and, if our concerns are being articulated to decision makers, it is indirectly by people who are not dealing with the management of college finances on a day-to-day basis. We understand that DfE officials are meeting some college

CFOs on a one-to-one basis, but there appears to be no intention to formally involve colleges in the decision-making process.

We know from past experience that change implemented without our involvement is often problematic, and that solutions developed jointly and in a constructive manner are far more likely to be successful.

We have two requests:

1. That full consideration is given by all parties to the range of possible solutions, rather than rigid application of one position
2. That college CFOs are actively engaged in the consideration of these solutions

Concerns with changing the college year-end date

We are firmly of the view that, if implemented, a change to year-end will cause very considerable issues for college Governance and, down the line for the DfE, due to the destabilising impact of:

- Increased financial risk in colleges and higher levels of financial volatility
- Reduced efficiency, increased administration and higher costs
- Less reliable financial forecasting

We also think the following could potentially result:

- Increased delays in signing college accounts
- Weaker financial oversight and monitoring
- Increased difficulty in appointing audit firms

And at the moment we cannot see a way in which

- The current 16-18 funding methodology could be applied successfully
- Colleges will be able to set informed budgets
- Colleges will have the capacity to deliver this change

We have addressed the main concerns in Appendix A but they are summarised under the following main headings:

- Budgeting
- Management accounts
- Financial Governance and oversight
- Timing of Reporting
- Technical Reporting complexity
- Audit
- Financing

Appendix B to this letter sets out the background for the current 31st July year-end and the business rationale for this.

Appendix C summarises the experience of a current college CFO in England who previously worked in Scotland when the year-end of Scottish colleges was changed from 31st July to 31st March. After eight months the impact was so bad the year-end reverted to 31st July, but in the process the sector lost three-years of useful comparable financial information.

Appendix D provides a worked example of the difficulties a change in year-end would cause to governors, ESFA/DfE and college managers in understanding and analysing financial performance on just one-line of the management accounts.

Suggestion of a way forward

We offer some thoughts on how the government can achieve consolidated accounts without requiring colleges to change their year-end:

1. Recognise and quantify materiality
2. Identify the information required for consolidation
3. Colleges prepare a separate consolidation return at 31st March (audited if required)
4. Colleges continue with their current financial reporting arrangements
5. Colleges already return monthly forecasts, these can be used to create 'government year' forecasts
6. ESFA continues to fund academic years

We hope to have the opportunity to discuss these suggestions with officials and look forward to hearing from you and hopefully moving this forward to a satisfactory conclusion.

Yours sincerely

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David Moir ACA – Deputy Principal Finance & Resources, Basingstoke College of Technology

Stephen Jones CPFA - Deputy, Cambridge Regional College

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Adrian Ford FCMA – Group Deputy Principal, The Cornwall College Group

Jacquie Carman – Chief Operating Officer and Vice-Principal

Jason Pepper – Group Executive Director: Finance & Resources, Heart of Yorkshire Education Group

Ann-Christine Harland – Vice-Principal, Croydon College

Appendix A

Issues with a change in year-end

We set out below, in overview, the fundamental problems we have identified with a change in year-end and why we are so concerned about this.

Budgeting

- Articles of Association require a budget to be approved before the start of the financial year. Budgets would need to be prepared by February and approved by Boards in March.
- Funding allocations would need to be brought forward by four months – for example 16-18 allocations in November, which is before the R04 data return meaning that source data would be from the previous academic year
- Budgets set in February would need student number and income projections for the following September, eight months ahead and at a time the admissions cycle is not even 50% complete.
- Curriculum plans for the next academic year will not be available in February, so income forecasting will be a best guess, not based on a plan
- Consequently, expenditure forecasts (especially staffing) will not reflect delivery plans
- Curriculum budgets will either not be linked to student numbers or not linked to the college budget. This is particularly problematic when departments plan their annual spend for the students they have enrolled.
- Devolved authorities would need to issue their allocations four-months earlier

These are 'bread and butter' matters in the internal management of a college's finances. Colleges currently operate on very tight margins and anything which causes instability adds risk and volatility. For DFE this is likely to mean more colleges running into financial difficulty and seeking emergency financial support.

Management Accounts

These internally produced documents aid managers, leaders and governors to manage the finances of the college. They are sometimes used outside the college (banks, ESFA, pension schemes etc). They report monthly throughout the financial year. They should be clear, concise and easy to understand. The information should be meaningful. They should contain an updated forecast of the financial outturn for the year.

Management accounts highlight variances between plan and actual. It ought to be a relatively straightforward matter to assess their impact of these variances and adjust the forecast position accordingly.

For most college activities the year to 31st July directly reflects the recruitment and delivery of courses to students. This means that the accounts are meaningful to users and easily understood.

Further, as these feed into the statutory accounts they can include timely outcomes for students and grant funding amounts that reflect the income statements issued by the ESFA/DfE.

In Appendix D we illustrate by, way of example, the problems that will be created in preparing, reporting and analysing a variance between budget and actual in any month. This is an example for one line in the management accounts. This will be repeated multiple times every month. There is no benefit but the problems are clear.

This is an absolutely crucial point, it will apply to every college and will make the task of reporting and managing in-year financial performance unbelievably difficult.

Financial governance and oversight

At the moment management accounts, financial accounts, financial oversight, financial health and financial returns are all based on the financial performance over an academic year.

As illustrated in the example in Appendix D, management accounts will be less useful and less easy to understand. This in turn will make the job of the CFO harder, the Accounting Officer faces increased risk and financial oversight by Governors and ESFA becomes far more complicated.

The principles of the example in the management accounts will extend to the statutory accounts, finance record, financial forecasts and any other financial information provided. Year-on-year performance review will be impossible for the user/reader of these documents.

When a user is looking at the financial information of a college they will not be able to establish what relates to one financial year and what to the another. Direction of travel is a fundamental understanding a user needs, but this will not be possible because the figures are a mix of two academic years. Are finances improving or deteriorating? It will be much harder to tell. This could fundamentally undermine college financial strategy and controls.

Timing of reporting

A 31st March year-end would require, if current timings are mirrored:

- Budgets approved by Governing Bodies before 31st March
- Financial forecasts to ESFA – before 31st March
- Financial statements audited during June/July
- Governing body sign-off August
- Finance record to ESFA by 31st August

There are some obvious problems here.

Staff work to the academic calendar and in most colleges holiday years finish at 31st August. Staff work throughout the academic year and most holidays are taken in July and August. Governing bodies will not be quorate in late July and August. Extending through to September is impractical as this is the busiest time of year in colleges and staff are deployed in other areas.

It therefore seems inevitable that the reporting deadline will be 31st July, which is in effect early July before holiday season starts. This is equivalent to having everything prepared, audited and ready for sign off by early November under the current arrangements. Colleges find the current 31st

December deadline a challenge to achieve audited accounts, taking six weeks off would, in the normal course of events, put more extreme pressure on the sector.

Further, preparing year-end accounts to 31st March will be a more complex task than at present because of the work involved in apportioning income and expenditure over financial years. Whilst we can't really work this through in detail yet, a reasonable assessment of the extra work would place it at a minimum as medium, and more likely towards substantial additional time. It will not be insignificant.

Our assessment is that there will be more to do, it will be more complicated and there will be less time to do it in. For already busy finance departments, often with staff shortages and recruitment difficulties, this will not be deliverable. It can probably be fixed with additional staff but that comes at a financial cost to teaching and learning, unless additional funding is going to be provided. We estimate this additional cost would be between £30,000 and £100,000 per college depending on its size and structure.

Technical accounting complexity

The point above touched on increased complexity of accounting. There appears to be an inevitability in the future being more complex than the past due to required consolidation adjustments and the apportionment of income and expenditure.

This is why we believe materiality is a key consideration.

At an individual college level, apportionment of single budget lines could have a material impact on their financial statements, this work will have to be done to produce accounts to an auditable standard.

When consolidated at sector level though these individual adjustments become immaterial, and it is likely that a simple one-third, two-thirds split becomes sufficient. When the FE sector is consolidated into the government accounts the entire sector is probably immaterial; the apportionment adjustments certainly are.

This then raises the question, what is the benefit or purpose in each individual college is going through this more complex accounting process to produce numbers which do not make a material impact?

If we can operate to a level of materiality that is not onerous, then it is feasible to approach the task of producing a 31st March return which can be audited. College year-ends do not need to change and their statutory accounts can be produced to materiality levels appropriate at that college.

Audit

Following the likely timetable outlined above, the sector will need auditors in June each year. This is a busy time for firms as most companies have 31st December or 31st March year-ends, so the sector will be competing for audit time along with local authorities and other public sector bodies.

There will inevitably be a strain on costs as firms match supply and demand. We are not able to quantify this yet, but whatever the cost, this is more money leaving the public sector and less is left for the core purpose.

We must ask why make a decision that will have this impact when it isn't necessary to do so. Why make colleges less financially efficient and why take funding away from the front line?

We know it will be a challenge to find audit firms because the sector often isn't attractive to them. Firms decline the opportunity to tender and some are reducing their client numbers. Changing the year-end will only make this harder.

Our conversations with audit firms tell us they share our concerns with this change. Actually, we aren't aware of any organisations of finance professionals involved in the FE Sector who think this is a good idea.

Financing

Whilst the sector transitions from its current financing through third -parties to a government loan scheme, it is essential to maintain relationships with current lenders.

Whilst over time we understand there is a desire to replace commercial borrowing with government lending, until that is achieved external finance remains critical to the solvency of the FE sector. There are about 125 colleges who have long-term loans which are subject to annual financial covenants.

It is very likely that the stated ambition to replace commercial debt with government debt will result in banks seeking to exit the sector. A change of year-end will help them accelerate this process by invalidating existing loan covenants, which then cause the loan to become repayable in full. Colleges will need immediate liquidity which will inevitably be from DfE/government.

Appendix B – background to the current year end in English and Welsh FE colleges

When colleges came out of Local Authority control in April 1993 the newly formed sector had an initial 16-month accounting period to 31st July 1994. This aligned the financial year with the academic year and has served the sector well ever since.

It is important to understand why this newly liberated FE sector used the freedoms that became available to it (as did Universities at that time) and immediately took the opportunity to change its year-end from 31st March to 31st July

A college's annual business cycle flows with the academic year. Student numbers are the key income driver and expenditure is flexed as income changes. Funding allocations are made for academic years, funding contracts are aligned with academic years, many service contracts are aligned with academic years and the majority of students study on courses which run over the academic year. Budgets are allocated internally in academic years, linked to student numbers. Financial reporting is in academic years.

It is patently obvious that financial information reported in line with an academic year is going to be easier to derive and more meaningful to report. 31st March has no relevance at all to an educational institution.

It is interesting to note that Academies currently have a 31st August year-end. There are some arguments for 31st August being preferred to 31st July. Academies are relatively straightforward organisations in accounting terms as their student number cohorts are fixed with minimal change during the year.

FE Colleges are complex organisations with multiple income streams – 14-16 contracts, 16-18 programmes of study, adult funding grants, Advanced Learner Loans, apprenticeship funding, fee income, other grants, Office for Students grant, HE loans, bursaries and learner support. All are linked to the academic year. Determining income accurately is already a hard thing to do, apportioning two-thirds to one year and one-third to another will take it to another level of complexity and will inevitably lead to a loss of control over expenditure.

It is clear to us that a change in year-end back to 31st March will be regressive by 'undoing' one of the very early and fundamental changes that FE colleges implemented when they came out of Local Authority control. Whatever is driving this thinking must be challenged.

Appendix C – the experience in Scotland

Comments from a current CFO who previously had this role at a Scottish college when their year-end was changed.

"March was very painful in Scotland. There were major issues.

These were mainly to do with income recognition as income is earned Aug/Sept to May/June for mainstream and other timelines for bespoke shorter courses. Auditors, Gov and Colleges couldn't agree.

How you judge accruals for a college business cycle in April that actually ends in July becomes a lottery and the accounts become close to meaningless?

So, in Scotland we switched to a March year end in 2013/14 to accommodate the classification change (8-month year); they realised that was a mess so then we moved back to a July year end (April 2014-July 2015 – so a 16-month year); and then for 2015-16 moved back to a 12-month year. We then had a 3-year period where comparisons over time and between colleges were almost meaningless, the whole thing was a mess and auditors were paid more to debate things such as holiday accruals at a March year end (which can have a major – and frankly meaningless - impact on numbers). But Scotland learned through that experience a switch to a March year end didn't work and switched back to July. Other aspects – such as existing loan agreements – were also an issue - as colleges had to enter negotiations and at times pay banks to change the dates to align with all of this.

Fundamentally as you outline the argument for a March year end is about aligning with whole of government accounting – but you can still achieve this without needing to change the College year end – and Scotland has done that. So, the notion that not doing this will create a whole of government accounts qualification is debunked and is simply not true.

Creating meaningless figures simply to match a government year-end doesn't improve transparency and governance – it masks it."

Appendix D – an example of the complexity in income apportionment

This example looks at a single line in the management accounts of a college – adult tuition fee income. It is used to illustrate the enormous difficulty that will occur in preparing, reporting and analysing a variance between budget and actual in any month.

Currently (31st July year-end)

- Tuition fee income budget for the year = £3,500,000. Phased over the year, £2,750,000 is expected to have been received by 31st October.
- Management accounts prepared in November show that actual fee income at 31st October is £2,500,000
- After analysing and investigation it is clear there are fewer enrolments at the start of the year than expected, and this is likely to continue to be the case for the rest of the year, so update the forecast year-end income to £3,200,000
- Review staff and delivery expenditure associated with this income. Ensure staff are fully utilised and that contracts have not been issued based on higher numbers etc. Reduce forecast expenditure by (say) £150,000.

In future (31st March year-end)

Tuition fee budget. This will be made up of:

- Forecast new enrolments for the period April to July
- Brought forward from enrolments on courses spanning 31st March date
  - Previous September enrolments ending in June: three tenths of fee
  - Previous October enrolments ending in June: three ninths of fee
  - Previous September enrolments ending before March – none of fee
- Forecast of enrolments for following academic year
  - September enrolments: seven tenths of fee
  - October enrolments: six ninths of fee
  - September enrolments fully delivered by 31st March: all of fee

- This is already difficult, but let's assume this comes out to be a fee income budget of £3,400,000 for the year April to March

At 31st October, the management accounts are reporting an expected fee income of £2,900,000 and an actual fee income of £2,700,000. A shortfall of £200,000. What is this telling the reader?

- Firstly, we have to allocate every tuition fee received to the financial periods it is earned over. We can no longer account on a received basis within the financial year. This could be apportioning the fee by month over the duration of the course, or apportioning some to the beginning month and the balance to April (which is what this example assumes).
- Depending on how a college currently accounts for its tuition fee income this could be a fundamentally new approach requiring systems changes.
- Then, to understand the variance of £200,000, it is necessary to determine how much of it arises from the April to July period and how much from the September and October enrolment period.

- We can do this from the July and August management accounts. Assume that £800k of the budgeted income relates to the April to July period. Actual income was £750k
- Deduct this £50k variance from the October reported variance of £200k tells us that £150k of the variance has occurred in September and October. £2,100,000 was expected in September and October, £1,950,000 was posted.
- Now assess how much this shortfall experienced to date is likely to repeat over the remaining November to March period, remembering to apportion fee from courses starting over the respective financial years.
- The forecast for the year to 31st March can now be updated, in this example let's say it is reduced by £200k
- A governor then asks why is tuition fee lower than expected, which courses are not recruiting well? To answer that the response is a mix of:
    - Some of it relates to last year's courses carried into this year
    - Some of it relates to how income was apportioned between the years
    - Some of it relates to courses that didn't recruit as expected this year, and some of that will now carry into the next financial year
- Matching expenditure reductions to the budget variance will not be possible, at best it might be possible to look at delivery costs in the current academic year and identify if expected reductions have been achieved, but not easy because the academic year and financial year are out of alignment. Last academic year has finished, but continues to affect the current years accounts until March.