Circular 02/11

For Action: Response dates 31 July and 15 October 2002

Planning

Financial Planning and Associated Information

Summary

This circular sets out guidance on providers' financial planning information that the Learning and Skills Council (LSC) wishes to receive by 31 July 2002 and associated risk management information the LSC wishes to receive by 15 October 2002. Although this circular will be of interest to all providers, only further education (FE) colleges are required to provide three-year financial plans and associated information to the LSC.

July 2002

Learning+Skills Council

Contents

Further information

For further information, please contact the appropriate local Learning and Skills Council local office, or write to:

Provider Financial Support Team
The Learning and Skills Council
Cheylesmore House
Quinton Road
Coventry CV1 2WT

Telephone Helpline: 024-7649-3758

Responses

Responses are requested by 31 July 2002 and 15 October 2002

Executive Summary

This circular sets out guidance on providers' financial planning information that the Learning and Skills Council (LSC) wishes to receive by 31 July 2002 and associated risk management information the LSC wishes to receive by 15 October 2002. Although this circular will be of interest to all providers, only further education (FE) colleges are required to provide three-year financial plans and associated information to the LSC.

Main Circular

Annex A

Annex B

Annex C

Supplements (available on the LSC's website: (www.lsc.gov.uk)):

Supplement A

Supplement A Workbook – Financial Plan 2002-05 Proforma

Supplement A Workbook 2 – Mid Year Update Proforma

Financial Planning and Associated Information

Introduction

1 The purpose of this circular is to provide guidance to Further Education (FE) colleges on the financial planning information that the Learning and Skills Council (LSC) wishes to receive by 31 July 2002 and associated information the LSC wishes to receive by 15 October 2002.

Background

2 In 2001, Circular 01/01: *Strategic Plans, including Financial Forecasts and Accommodation Data* indicated that the planning process for this year would be revised. As a result of changes to the LSC's strategic planning process, it is necessary to introduce a discrete requirement for FE colleges to provide the LSC with a three-year financial plan.

3 With the increasing importance of local provider planning, it is essential that colleges' plans are consistent with the LSC's local office strategic plan. Colleges will be expected to demonstrate how their financial plans achieve this.

Information Requested in July 2002 and October 2002

4 One copy of all information should be returned to the executive director at the LSC's appropriate local office no later than the dates shown in Table 1. Colleges that require further clarification, or for whatever reason cannot provide the information by 31 July 2002 or 15 October 2002 as appropriate, should contact the LSC's local office at the earliest opportunity. All FE colleges should complete and return a signed copy of the financial planning cover sheet provided at Annex A.

5 A downloadable template for all financial planning components will be available on the LSC's website (www.lsc.gov.uk).

Table 1. Summary of information requested in July 2002 and October 2002

	FE Colleges	Submission Date	Other providers
Provider Financial Plans			
Financial planning cover sheet	✓	31 July 2002	Not applicable
Three-year financial plan – paper copy	✓	31 July 2002	Not applicable
Three-year financial plan – on disk	✓	31 July 2002	Not applicable
Principal's certificate	✓	31 July 2002	Not applicable
Commentary	✓	31 July 2002	Not applicable
Associated Information			
Risk Management Plan	✓	15 October 2002	Not applicable
Disaster Management Plan	✓	15 October 2002	Not applicable

Financial Plans

6 Colleges are reminded that the governing body should approve financial plans and that budgets for 2002/03 should be approved before 1 August 2002 (Paragraph 10 of annex B to FEFC Circular 99/48: *Financial Memorandum*).

7 Financial planning information will form part of the LSC's provider performance reviews.

8 The LSC expects financial plans to be prepared on a realistic basis, taking account of the financial planning assumptions suggested in Annex B, although colleges will, no doubt, wish to consider their financial plans on a worst-case scenario. The worst-case scenario should be considered in the sensitivity analysis, an example of which was set out in Circular 01/01: *Strategic Plans, including Financial Forecasts and Accommodation Data*. The sensitivity analysis should also address more favourable outcomes than those included in the financial plan, where appropriate. The college's sensitivity analysis is expected to form an integral element of the college's risk management plan.

Three-year financial plan

9 The three-year financial plan should be an integral part of each college's strategic plan as it expresses in financial terms the cost of implementing the strategic plan and shows the income and expenditure associated with the projected levels of activity. The financial plan is intended to help each college's governing body, and the LSC, assess the financial effect of a college's strategic plan. It is important to include in the financial plan the costs of implementing the college's accommodation strategy for the plan period.

10 Although the LSC is not requesting colleges to supply full copies of their strategic plans at this time, the commentary to the financial plan should clearly demonstrate how the financial plan is consistent with the college's own strategic plan and with the LSC's local office strategic plan.

Disk

11 The proformas will be made available on the LSC's website (http://www.lscdata.gov.uk) as Excel workbooks (Excel 97-2000). Disks will not be sent out to colleges unless specifically requested. Colleges unable to use this software should contact the LSC's telephone helpline on the number at the beginning of this document.

Principal's Certificate

12 Form 5 of the financial plan proforma should be signed by the college's accounting officer to confirm that the financial plan and associated information have been approved by the college's corporation.

Commentary

13 A framework for the textual commentary to support the financial plans is set out in Annex C. In addition, colleges should include separate risk management and disaster management plans.

14 The National Audit Office Report *Managing Finances in English Further Education Colleges* highlighted some important issues. In response to this, colleges are requested to use the proforma included in Circular 01/01: *Strategic Plans, including Financial Forecasts and Accommodation Data* to self-assess in the financial plan commentary what systems the college has in place to address these issues.

Guidance

15 Guidance on the completion of the proformas for return to the LSC is given in Supplement A. The proformas themselves are included in Supplement A (Financial Plan 2002-05 Proforma and Mid Year Update Proforma).

16 For further advice on how to complete the financial plan returns disk, or any other matters associated with this circular, please contact the LSC's local office or the national office helpline on the number shown at the beginning of this circular.

Risk Management and Disaster Management Plans

Risk management plans

17 Colleges are requested to include a sensitivity analysis and costed contingency plans within the commentary to their financial plan. In addition to this, previous planning circulars have requested that colleges share risk management and disaster management plans with the LSC. In 2001, the LSC's officers considered that about 85% of colleges prepared adequate sensitivity analyses but that only about 50% prepared adequate risk management plans.

18 Circular 02/07: *FE Colleges: Accounting Policies and Return of Audited Financial Statements* sets out the enhanced requirements for risk management planning to allow colleges to comply with the Combined Code of Corporate Governance (the Turnbull Report). To enable the LSC to be assured that colleges will be able to meet these requirements, colleges are requested to provide risk management and disaster management plans with their three-year financial plans. In the light of the Turnbull Report, the LSC will be increasing its level of review of these plans and it is essential that colleges continue to improve their robustness.

19 It is suggested that colleges' plans should cover the following types of risks:

- Strategic;
- Compliance;
- Operational;
- Financial; and
- Reputational.

20 In practice, these risk 'types' will overlap and even non-financial risks will probably result in a financial impact on the college.

21 From experience, the LSC has previously considered that operational risks were of greatest concern and has provided a sample checklist to assist colleges in developing their plan. This checklist is again reproduced below but colleges are reminded that the list should not be considered to cover all potential areas of operational risk, nor should it be taken to signify that other risks are not as important.

22 Colleges are also requested to reproduce their sensitivity analysis and costed contingency plans from the financial plan commentary within their risk management plan.

Disaster management plans

23 Colleges may wish to integrate disaster management planning with the above risk management plan. However, it may be considered appropriate to have a separate section which deals with more extreme risks. Responses to disasters are likely to require more wide-scale actions which, in turn, impact on other aspects of the college. This 'domino effect' will, of necessity, involve more resources. Conversely, major disasters are far less likely to occur.

24 A structured approach to these eventualities should consider:

- The 'cost' of accepting the risk;
- Actions required to avoid the risk;
- Potential to reduce the risk;
- Actions to contain the risk; and
- Ability to transfer the risk (for example, insurance).

25 Colleges are expected to have in place contingency plans that would be required in the event of major disaster affecting day-to-day operations.

26 In addition to the usual risks of fire, flood or other 'act-of-God', colleges should consider the effects of events such as failure of information technology services, corruption of essential data (either maliciously or accidentally), loss of key staff, or default of

major suppliers.

27 Of major concern should be the identification of the potential severity of the event.

- Does it impact on the college's survival?
- Does it impact on the college's finances?
- Does it impact on the college's image?
- Is it time-critical?
- Does it impact immediately?
- Can the college cope without? (For how long?)
- What alternatives are possible?

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

- Implement immediate emergency reaction;
- Notify and mobilise support services;
- Control central co-ordination;
- Assess actual and potential damage;
- Communicate clear instructions and guidance; and
- Restore essential functions.

29 Colleges should be clear in establishing contingency plans of the need for regular review and assessment of the plans' functionality. Regular testing, monitoring and feedback should ensure the need for updating is considered. Accountabilities within the plans should be reviewed and authority for the implementation of changes should be clear.

Compliance with "Turnbull"

30 Risk management and disaster management plans should clearly demonstrate how they meet the requirements of Circular 02/07. Colleges should indicate whether they will be fully compliant with "Turnbull" by 1 August 2002, and, if not, when they expect to be compliant. The plans should be approved by the college's corporation.

Information Requested beyond October 2002

Financial mid-year update (February 2003)

31 Where the LSC wishes to receive a mid-year update it will be requested by the appropriate local office. This will generally be for those colleges falling into financial health group C (as assessed by the LSC). In any event, those colleges from whom a return is required will be notified by 17 January 2003 for submission before the end of February 2003. The software application for returning this information will be included on the LSC's website. Guidance on the completion of the mid-year update can be found in Supplement A.

Finance record

32 The requirement to submit a Finance Record, previously included in the LSC's strategic planning circular, is now contained within Circular 02/07.

Significant departures

33 Colleges are reminded that they should notify the LSC of any significant departures from their strategic plans at any other time throughout the year. Examples of significant departures can be found in the FEFC Circular 98/16: *Strategic Plans, including Financial Forecasts*.

John Harwood, Chief Executive

Annex A: Cover Sheet for Return of Financial Plans and Associated Information: July 2002 and October 2002

Cheylesmore House
Quinton Road
Coventry
CV1 2WT
T 024 7649 3758
F 024 7649 3590

www.lsc.gov.uk
info@lsc.gov.uk

(Reference Circular 02/11)

This cover sheet must be completed in respect of all returns. Please photocopy (or download from the LSC's website), complete and return it to the executive director at the LSC's local office by 31 July 2002 or 15 October 2002 as appropriate.

Learning+Skills Council

Name of college *(please print)*	
Code	
Contact for queries	
Telephone no.	Fax no.
E-mail address	

Returns enclosed (Please tick)

Return	Tick	Submission Date
Financial plan		
• three-year financial plan	☐	Submission Date 31 July 2002
• principal's certificate	☐	
• disk	☐	
• commentary	☐	
Risk management plan	☐	15 October 2002
Disaster management plan	☐	

Declaration

Signature
Principal/Head of college
Name *(please print)*
Date / /

Annex B: Financial Planning Assumptions 2002/03 to 2004/05

Introduction

1 The LSC publishes national guidance on many aspects of FE funding. Furthermore, it is increasingly important for local priorities to be met. It is the LSC's intention for greater emphasis to be put on local, rather than national, planning. Accordingly, therefore, colleges are requested to agree planning assumptions with the LSC's local office.

2 The following guidance on financial planning assumptions should be taken as general advice rather than specific instructions.

3 For this reason, it is even more important this year that planning assumptions are clearly set out in the commentary to the financial plan and that colleges' sensitivity analyses and risk management plans identify contingency actions where it is felt that the assumptions adopted may not be secure.

FE Participation (main and growth allocation)

4 The guidance in the LSC's draft publication, *Funding Guidance for Further Education in 2002-03*, should be followed in planning the main and growth allocations. The key points to consider are set out in paragraphs 1 to 8 of that publication. The LSC will also be particularly concerned to ensure that forecast growth assumptions are realistic and supported by evidence of local demand.

5 The above publication brings together and further develops the guidance provided in the following recent circulars:

- Circular 01/13: *Post-16 Funding Arrangements for 2002/03;*
- Circular 01/18: *Indicative Funding Rates for Further Education in 2002/03; and*
- Circular 01/19: *Arrangements for Planning and Budgeting for Further Education in 2002/03*.

Base level of funding

6 The LSC set the average level of funding (ALF) for 2001/02 at £17.22. The only exceptions to this policy are where colleges are on individual convergence tracks, through a special agreement with the LSC to offer them support in dealing with financial difficulties.

7 Except where these special arrangements exist in future years, for financial planning purposes, all colleges should assume average funding increases for inflation at 2.5% per annum. This is in line with the Chancellor's April 2002 Budget Statement and the Council Chief Executive's letter of 12 February 2002 to the FE sector in respect of 2002-03 funding. However, colleges should identify and develop plans to offset the opportunity/risk that funding may be higher or lower than this in future years.

8 Where colleges have special funding arrangements agreed with the LSC, they should ensure the impact of the revised funding methodology is clear in developing their financial plans. Further guidance on this may be obtained from the LSC's local office.

Full Time Equivalent (FTE) Learner Definition

9 The funding guidance has established the basis for calculation of FTEs as follows:

- A learner studying a programme of 450 or more planned Guided Learning Hours (GLH) in a 12-month period will count as one FTE;
- A learner studying a programme of less than 450 GLH in a 12-month period will be converted to a fraction of one FTE by dividing the planned GLH of the learner's programme by 450; and
- This definition of learner profile FTEs is the same as that used by the Department for Education and Skills (DfES) and its introduction will promote consistency and comparability in the monitoring of learner numbers.

Learner Funding Rate

10 This circular introduces the concept of a Learner Funding Rate (LFR) for financial planning purposes.

11 The LFR will be calculated from the total FE recurrent grant allocation for the year divided by the total planned FE FTEs for that year. Colleges should ensure year-on-year movements in the LFR are explained in the commentary to the financial plan.

European Funding

12 In 2001/02 and 2002/03 some traditional ESF projects which have been gained through a direct bidding process are being delivered by FE institutions. The LSC is developing its approach to ESF as a co-financing organisation, and will be issuing separate guidance on both this new approach and traditional ESF. In the meantime, colleges should not bid directly as the LSC may already have matched the funds. Where local agreements are in place, colleges should include this level of funding in their plan. Colleges planning a higher level of funding than currently received should address, in their sensitivity analysis and risk management plan, the effect of not achieving the funding.

Work-based Learning

13 Funding for work-based learning in 2001/02 was on the basis of the new national rates. The LSC's recent draft circular (*Funding Arrangements for Work Based Learning for Young People 2002/03*) sets out changes for 2002/03. Colleges should assume for financial planning purposes that rates increase subsequently (on a like-for-like basis) for inflation at 2.5% per annum. Colleges should identify in their sensitivity analysis the effect of future movements in these rates as a result of further reviews by the Rates Advisory Group.

Recovery of Funds and Tolerance Account

14 Arrangements for recoveries of funds for under-achievement and outstanding tolerance account balances at 31 July 2002 will be published by the LSC in the near future. The LSC has previously advised colleges that the tolerance account will cease at 31 July 2002. Any outstanding deficit balance at that time should be treated as a creditor balance, due within one year. Further details in respect of the appropriate accounting treatment are included in Circular 02/07.

15 Colleges should ensure their cash flow planning identifies any repayments due.

Other Funding and Grants Guidance

16 The LSC has published guidance in respect of other funding and grant programmes as follows:

- Circular 02/04: *Funding, Additional Learning Support;*
- Circular 02/02: *Quality Improvement, Standards Funds;*

- Circular 01/14: *Centres of Vocational Excellence*;
- Circular 01/10: *Reorganisations and Rationalisation Fund Support*;
- Circular 01/08: *FE Learner Support Funds (a)*; and
- Circular 01/06: *Capital Project Grant Support*.

(a) Excluding support for HE students at FE colleges, for which the LSC no longer has any responsibility, total learner support funds have increased from £112.5 million in 2001/02 to £134.4 million in 2002/03. Details are shown in the following table:

			2002/03 versus 2001/02	
£m	**2001/02**	**2002/03**	**Amount**	**Percentage**
6th form access	10.013	10.752	0.739	7%
FE access	61.970	71.348	9.378	15%
Childcare - allocation	30.000	36.425	6.425	21%
Childcare - pilot scheme		1.500	1.500	
Residential - designated colleges	10.500	9.369	(1.131)	(11)%
Residential - pilot scheme		5.000	5.000	
Total Learner Support Funds	**112.483**	**134.393**	**21.910**	**19%**

17 Further information and updates to these circulars may also be available on the LSC's web site.

Inflation

18 Her Majesty's Treasury has estimated that the gross domestic product (GDP) deflator, a measure of inflation, over the years 2002 to 2005 will be 2.5% each year. Colleges should use this estimate in calculating movements in the cost of non-staff items unless they have better information about the specific price changes that will affect them.

Pay Costs

19 Colleges should continue to make their own decisions on pay awards based on the institution's individual circumstances.

20 Funding related to the Teaching Pay Initiative (for General FE colleges) and Professional Standards Payments (for sixth form colleges) should be assumed in line with individual communications to colleges.

21 As indicated in the Chancellor's Budget presentation on 17 April 2002, colleges should plan for one per cent extra on national insurance contributions (NICs) paid by employers, employees and the self-employed on all earnings above the NICs threshold of £89 a week from April 2003.

Pension Costs

22 Circular 02/07: *FE Colleges: Accounting Policies and Return of Audited Financial Statements*, confirms the treatment to be applied by FE colleges in respect of the requirements of FRS 17 (Retirement Benefits) for the disclosure of pension fund liabilities. The circular also includes tables for the calculation of provisions in respect of enhanced early retirement pensions. Where any college recognises a need for additional payments to be made into its pension funds, it should clearly highlight this in its commentary to the financial plan and set out the basis upon which the calculation has been made.

Annex C: Commentary to Support the Plan

Introduction

1 The Learning and Skills Council (LSC) asks colleges to provide a commentary to support the financial plan that brings out the following points:

- the college's financial objectives as set out in its strategic plan and a commentary on achievement of those and other objectives within the planning period;
- a statement of the key assumptions used in the plan;
- major movements between plan periods for income and expenditure account and balance sheet headings;
- major variances between the latest out-turn estimate for the current year and the original budget;
- the contribution made by different areas of activity;
- the college's self-assessment of its financial health and an explanation of any variance from the computed financial health group;
- the college's self-assessment of its practices in respect of recommendations contained in the National Audit Office report *Managing Finances in English Further Education Colleges; and*
- a statement of the degree to which the college's risk management and disaster management plans comply with the guidance in the Turnbull report on corporate governance.

2 A checklist is provided below on issues to consider when completing the financial plans and monitoring. The checklist is for colleges' own use and does not need to be returned to the LSC.

Financial Objectives

3 In order to assist the college in achieving its strategic plan, the governing body should set financial objectives or targets. The purpose of setting such objectives is to establish limits within which the college should operate. Governors may wish to set targets for aspects such as solvency, reserves and dependency on certain types of income. Examples of financial objectives are included below. When the LSC reviews colleges' financial plans it considers whether the targets set by a college, particularly for solvency, are appropriate.

Assumptions

4 Guidance on financial planning assumptions can be found in Annex B. However, in view of the increasing importance of local provider planning, colleges are requested to set out clearly the assumptions used in their financial plans.

Sensitivity Analysis

5 The information in the financial plan should reflect the financial effect of the planned levels of activity in a college's strategic plan. However, these plans are based on assumptions containing some degree of uncertainty. The sensitivity analysis is intended to show the financial implications if more

unfavourable conditions apply. Therefore, we ask colleges to examine critically the underlying key assumptions and to assess realistically the effect of failure to meet their plans. The college's sensitivity analysis should be an integral element of the college's risk management plan.

6 Some planning assumptions have critical implications for a college's strategic plan and the consequences of alternative outcomes can be complex. For example, a major project that would not proceed without LSC support could affect a college's growth or the number of staff employed and lead to a very different outcome from the original financial plan. **Where a financial plan contains critical assumptions of this nature, we advise colleges to complete a second plan based on the alternative scenario and share it with the LSC.** Where a college considers that different outcomes have an impact on its financial viability, we consider it essential to produce an alternative financial plan that reflects the impact of those changes.

7 Colleges should identify contingency actions to mitigate the consequences of the identified sensitivities. Colleges should notify the LSC's local office where these actions mean a rationalisation of provision in any programme area or locality.

8 An example of a sensitivity analysis was set out in Circular 01/01: *Strategic Plans, including Financial Forecasts and Accommodation Data*.

9 To appreciate the implications of sensitivities it is important that they are costed.

10 When reviewing colleges' financial plans, the LSC will consider the adequacy of sensitivity analysis and contingency planning carried out by colleges.

Financial Health Self-assessment

11 Colleges are asked to provide a self-assessment of their financial health. The guidance on self-assessment is based upon the following principles:

- the prime responsibility for a college's financial health rests with the college;
- self-assessment provides the impetus to improve a college's financial health and is most effective when it is structured, rigorous and continual; and
- the college's self-assessment and the LSC's assessment of the college's financial health should focus on the same guidelines, at the forefront of which is the robustness of the college's finances, in particular its solvency, the likely risks in the college's environment and the adequacy of the college's contingency plans.

12 When the LSC assesses which financial health group is appropriate for a college, it considers the guidelines for each group, as set out below, the college's self-assessment and a computed health group. Further information in respect of the computed health group is set out below.

13 An indicative health group assessment, derived from the computed health group, is shown on form 5 of the financial plan. Where colleges do not feel that this gives a true representation of their financial health, they need to explain the underlying reasons in the commentary.

14 Each college should insert their own assessment of their health group on form 5, stating which of the following groups most closely identifies with their financial position and supporting the statement by the key analysis and reasons that justify the assessment. Such assessments concentrate on the overall strength of the balance sheet, the cashflow plan and the likelihood of achieving

the college's projection of income and expenditure. The board of governors should confirm the assessment. The definitions of these groups are guidelines and not criteria.

Group A

15 Group A comprises colleges that appear to have sufficiently robust finances to implement their strategic plan and to deal with the circumstances most likely to occur during the planning period. These providers will normally have:

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

16 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

17 Group B comprises providers that show signs of financial weakness that 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 should still have:

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

18 In addition, this group also covers those providers that 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. Some providers may have included income generation without a supporting business plan. In addition, this group also includes providers that are improving from a Group C position.

Group C

19 Group C comprises providers that are financially weak and that 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:

- a cash outflow from operations in one or more years;
- less than 15 cash days in hand;
- net current liabilities (current ratio less than 1.0:1) in one or more years;
- an accumulated deficit on their general reserve account;
- an operating deficit; and
- total borrowing in excess of their general reserve (income and expenditure account).

Computed Health Group and Indicative Health Group Assessment

20 To assist colleges in assessing their appropriate financial health group, the LSC has developed a computed health group model. However, this model does not take account of 'soft' factors such as management style, data management performance, risk management/contingency planning and other intangible factors which may impact on a college's financial health. Consequently, colleges are reminded that the LSC's assessment of their financial health is not based solely on the automatic computed health group.

21 An indicative health group assessment, derived from the computed health group model, is shown on Form 5 and colleges will be expected to comment on reasons for either agreeing with the assessment or why they wish to disagree with it.

22 The indicative health group assessment is based on the following financial ratios:

- cash generation;
- cash days;
- current ratio;
- general reserves;
- operating surplus; and
- total borrowing.

23 These ratios are taken from the plans given by the providers and then allocated a score. The sum total of each year of these scores is then weighted in favour of the first two years and the health group is assessed depending on the final score achieved. A higher weighting is given to earlier years as they can be planned with a greater degree of accuracy than later years. The table that follows sets out the limits for the scoring and shows how these are weighted.

	Provider return	Weighting
Cash generation	>0.02 =>0.00 <0.00	6 3 0
Cash days	>25 >15 >0 =<0	6 3 0 -3
Current ratio	>1.5 <1.5 <1.1 <1.0 <0.5	6 3 0 -50 -100
General reserves	>5% =>0% <0% <-5%	6 3 0 -3
Operating surplus	>3% =>0% <0%	6 3 0
Total borrowing as a percentage of reserves	<50% =<100% >100%	6 3 0

24 The weightings are totalled for each year. The yearly totals are then themselves weighted on the following basis:

- first year's totals (x 3);
- second year's totals (x 2); and
- third and fourth year's totals (no additional weighting).

25 When the final score is known the indicative health group is then assessed:

>168	A
>84	B
All others	C

Confirmation of Financial Health Assessment

26 During the autumn of 2002, the LSC will write to college principals indicating whether it agrees with a provider's financial health self-assessment. The LSC will explain the reasons for any differences in assessment. Principals should share this letter with the board of governors.

Checklist for Commentary

27 The checklist below is for colleges' own use and does not need to be returned to the LSC.

Financial objectives

28 Has the college set detailed financial objectives?

29 Are they set out in the commentary?

30 Has an assessment been included in the commentary of the extent to which they have been achieved?

Strategic plan

31 Is there a clear link between the projected learner numbers included in the college's strategic plan and the growth in funding and full-time equivalent learner numbers recorded on schedule 1A of the financial plan? If not, please explain any changes in the commentary.

32 Do the payroll costs included in form 2B of the plan reflect future staffing plans?

33 Does the financial plan reflect the financial implications of the college's accommodation strategy?

34 Does the financial plan demonstrate that the college's financial objectives are being achieved? If they are not, is this addressed in the commentary?

Statement of key assumptions

35 Does the commentary include assumptions about;

- growth in funding and Learner Funding Rate (LFR);
- income from the LSC other than participation element;
- income from non-LSC sources, in particular: education contracts, tuition fees, European funds, commercial activities, New Deal;
- implementation of accommodation strategy in terms of: capital investment long-term maintenance routine maintenance;
- increases in the pay bill arising from the effects of pay awards made;
- changes in national insurance contributions;
- changes in pension fund contributions;
- incremental drift. Where incremental scales exist, estimate the incremental gain resulting from staff losses at the high end of the incremental scale being offset by new staff at the lower end; and
- any changes anticipated for the local government superannuation scheme?

36 Does the commentary include the general level of pay awards assumed in the plan?

37 Does the commentary state any variation in the general inflation rate for specific items of income or expenditure?

38 Does the commentary state the interest rates assumed?

39 Does the commentary state the assumptions underlying income from all sources and all expenditure cuts?

Approval

40 Has the whole governing body approved the plan?

Self-assessment of financial health

41 Has the governing body made regular assessments of the college's financial health?

42 Has a review of the strategic plan and financial plan taken place to assess whether the college is able to support its plan with the resources identified?

43 Have the underlying strengths and weaknesses of the college's financial position been examined to assess the extent to which the college is likely to be vulnerable to adverse variances?

44 Does the commentary explain the college's rationale for its financial health self-assessment?

45 Does the commentary give reasons for any variance from the indicative health group assessment, if applicable?

National Audit Office recommendations

46 The National Audit Office report *Managing Finances in English Further Education Colleges*, published in May 2000, raised some very important issues.

47 In response to this, colleges are asked to include as part of the commentary to support the financial plan a self-assessment of their own practices in respect of the recommendations from the report.

A suggested format was published in Circular 01/01: *Strategic Plans, including Financial Forecasts and Accommodation Data*.

Supplementary information required in the commentary

Form 1

48 Does the commentary give a detailed explanation of all significant transfers to and from reserves?

49 Does the commentary explain significant year-on-year movements?

50 Does the commentary explain any variances between the latest estimate of out-turn for the current year and the original budget?

51 Does the commentary give the sources of grant income?

52 Does the commentary give the nature of any repayment of European Social Fund (ESF) funding.

53 Does the commentary give the sources of income from franchising provision?

54 Does the commentary give the main income-generating activities?

55 Does the commentary give the names, and nature of business, of all subsidiary companies?

Forms 2A and 2B

56 Does the commentary give details of any provisions included in expenditure?

57 Does the commentary explain large year-on-year movements?

58 Does the commentary give details of any remaining Hunter funds claimed, analysed into priority 1(a) and 1(b)?

Form 3

59 Does the commentary identify significant asset purchases and disposals, including consents and purposes?

60 Does the commentary give the details of any loans, including consents and background?

61 Does the commentary explain significant year-on-year movements in debtors and creditors?

Form 5

62 Has the reconciliation of movements between years been completed?

63 Has the self-assessment been completed?

64 Has the budget statement been completed?

65 Has the risk management plan been completed and approved by the board of governors?

66 Has the principal signed the form?

Planned maintenance

67 Does the commentary give details of the college's planned maintenance programme, if applicable?

Risk management

68 Has the college attached a risk management plan that is approved by the governing body?

69 Does the risk management plan cover disaster planning, risk analysis, sensitivity analysis and contingency planning?

70 Does the risk management plan comply with "Turnbull"?

Sensitivity analysis

71 Does the sensitivity analysis deal with:

- shortfalls in recruitment;
- tariff changes;
- changes to fee structures;
- larger than expected pay increases;
- higher costs of borrowing;
- lack of LSC support for capital schemes; and
- the effect on all income sources?

72 Is the risk analysis consistent with the sensitivity analysis, in particular in the assessment of projected learner numbers?

73 Does the commentary to support the sensitivity analysis identify expenditure that could be shed, if necessary, within the next three years? Is this linked to the contingency plan?

74 Where a reduction in the range of provision is proposed, was this discussed and, if necessary, agreed with the LSC?

75 Where the assumptions are pessimistic and likely to push the college towards insolvency, does the commentary to support the sensitivity analysis set out the contingency measures necessary to restore the situation? Is this also addressed in the strategic plan?

76 Does the commentary to support the sensitivity analysis include any changes that result from more pessimistic assumptions than those made above?

77 Does the commentary to support the sensitivity analysis include the results of any changes in capital funding?

78 Does the commentary to support the sensitivity analysis include any remedial action to be taken to moderate the financial effects of more pessimistic assumptions?

79 Does the commentary to support the sensitivity analysis address all items included in the risk analysis within the strategic plan?

Other information

80 Does the commentary give the name and telephone number of the contact person for all enquiries?

Examples of financial objectives adopted by colleges

80 The following examples are suggested for colleges to consider in setting financial objectives.

81 The college wishes to remain financially sound so as to:

- protect itself from unforeseen adverse changes in enrolments; and
- generate sufficient income to enable maintenance and improvement of its accommodation and equipment.

82 The college wishes to maintain, or attain, the confidence of funders, suppliers, bankers and auditors.

83 The college wishes to raise awareness of college staff of the financial environment under which it operates.

84 Specifically these objectives will be achieved by:

- maintaining a sound financial base (solvency and liquidity);
  - we will have a general reserve of ☐ % of income by 31 July ☐ and YY% by 31 July ☐;
  - we will maintain cash days of ☐ or more at all times;
  - we will achieve breakeven by 31 July ☐ and have an operating surplus by 31 July ☐;
  - we will generate a cash inflow from operating activities by 31 July ☐;
  - we will reduce borrowing to ☐ % of general reserves by 31 July , and YY% by 31 July ☐; and
  - we will have a current ratio of more than ☐ :1 by 31 July ☐ .
- improving financial management:
  - we will produce management accounts on a monthly basis incorporating an income and expenditure account, balance sheet, 12-month rolling cashflow plan, capital expenditure, financial performance indicators, staffing information and funding information (including plans);
  - we will strengthen procedures for testing the desirability and affordability of any proposals which have a financial implication by 31 July ☐ ; and
  - we will introduce post-implementation review procedures to assess the success or otherwise of major investments (building, information technology, staffing, marketing, etc) exceeding £ ☐ by 31 July ☐).
- maintaining the confidence of funding bodies, suppliers and professional advisors;
  - providing financial and non-financial returns on time and in the agreed format;
  - ensuring all returns requiring certification by auditors are unqualified; and
  - adhering to the college's policy to pay all suppliers within ☐ days of receipt of an invoice.
- raising awareness of financial issues; and
  - providing advice, guidance and training to staff, management and governors on funding, funding methodologies, budgeting and the college's financial procedures;
  - providing adequate information to ensure staff, management and governors are kept up to date with

the financial position of the college.

- improving the stock of college accommodation and equipment:
    - generating sufficient funds to ensure the college's specified programme of planned maintenance can be undertaken;
    - generating sufficient funds to ensure the college can invest in new technology and equipment required to support learning programmes and college administration; and
    - ensuring adequate procedures are in place to protect assets from loss, theft and neglect.

Notes

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