

## Cylchlythyr | Circular

# Outcomes of the consultation on the Financial Management Code

**Date:** 16 June 2017  
**Reference:** W17/15HE  
**To:** Clerks to the governing bodies of regulated institutions in  
Wales for the attention of the governing bodies  
Heads of regulated institutions in Wales  
Other interested parties  
**Response by:** No response required  
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This circular provides an overview of the responses received to the consultation on the draft Financial Management Code (the Code) (circular W16/21HE) and the resulting changes made to the draft in arriving at the final Code.

If you require this document in an alternative accessible format, please email [info@hefcw.ac.uk](mailto:info@hefcw.ac.uk).



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## **Overview of consultation**

1. This circular provides an overview of the responses received to the consultation on the draft Financial Management Code (the Code) (circular W16/21HE) and the changes made to the draft in arriving at the final Code.
2. The consultation the draft Code ran between 21 June 2016 and 5 August 2016. In total, eight responses were received. Seven responses were received to the consultation before the deadline and we agreed, by prior arrangement, to accept one further response following the consultation deadline. Six responses were received from Higher Education Institutions (HEIs), one from a Further Education Institution (FEI) and a very comprehensive response was received from Universities Wales.
3. The consultation was circulated via HEFCW's normal circular mailing list across 91 stakeholder organisations. The circular was also brought specifically to the attention of the Higher Education Directors of Finance, the Clerks to the Governing Bodies of all institutions in Wales, Principals of HEIs and directly funded FEIs and Colegau Cymru.
4. Following the consultation and resulting changes made to the document (as outlined below), the Code was submitted for approval by the Cabinet Secretary for Education. This was granted and the Code was then laid before the National Assembly for Wales for a 40 day period in accordance with S30 of the Higher Education (Wales) Act 2015. No resolution was passed by the Assembly in that period, allowing the Code to be published by HEFCW.
5. The Code is published as circular W17/16HE.

## **Summary of consultation responses with HEFCW's analysis**

6. The pages that follow list each consultation question, along with a narrative which summarises the responses received and the resulting response. We have provided an overview of the main themes and significant responses; minor points and clarifications have been omitted.

## **Timetable**

7. The Financial Management Code is now approved and is available on HEFCW's website as circular W17/16HE.
8. The existing Memorandum of Assurance and Accountability will be revised over the coming months.

### **Further information**

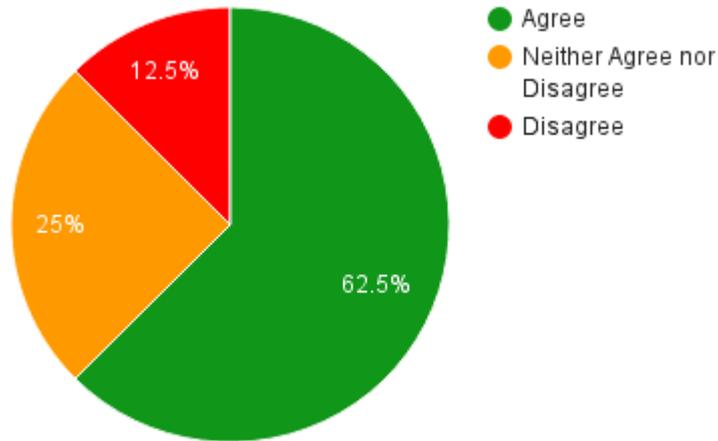
9. For further information, contact Matt Lody (tel 029 2085 9716; email [matt.lody@hefcw.ac.uk](mailto:matt.lody@hefcw.ac.uk) ).

### **Assessing the impact of our policies**

10. We have carried out an impact assessment screening to help safeguard against discrimination and promote equality. We also considered the impact of policies on the Welsh language, and Welsh language provision within the HE sector in Wales and potential impacts towards the goals set out in the Well-Being of Future Generations (Wales) Act 2015 including our Well-Being Objectives. Contact [equality@hefcw.ac.uk](mailto:equality@hefcw.ac.uk) for more information about impact assessments.

1. **Question 1: Do you agree that the code strikes an appropriate balance between institutional autonomy and regulation?**

**Do you agree that the code strikes an appropriate balance between institutional autonomy and regulation?**



- 1.1. Of the eight respondents, five agreed that the Code strikes an appropriate balance between institutional autonomy and regulation, two neither agreed nor disagreed and one disagreed.
- 1.2. Three respondents noted that the relationship between this Code and the existing Memorandum of Assurance and Accountability (MAA) was not clear enough and consequently there was the potential for confusion, arising chiefly from:
  - a. The potential for overlapping/conflicting provisions between the two documents; and
  - b. Confusion as to which document would take preference in various scenarios.
- 1.3. Several objections were received to the inclusion of various provisions in respect of the Auditor General for Wales and the Wales Audit Office. Principally, these related to the requirement to allow the Wales Audit Office access to the books of the institution. Whilst the WAO has such access to institutions' records as a result of 1992 Act funding, it was felt that there was no statutory basis to allow this kind of access under the 2015 Act.
- 1.4. Lastly, one response noted that the reporting requirements contained within the Code were burdensome. The respondent highlighted paragraph 13 (serious concerns about organisation and management), 43 (actions or policies appear incompatible with Code requirements), paragraph 49 (requirement to report violation of Nolan principles),

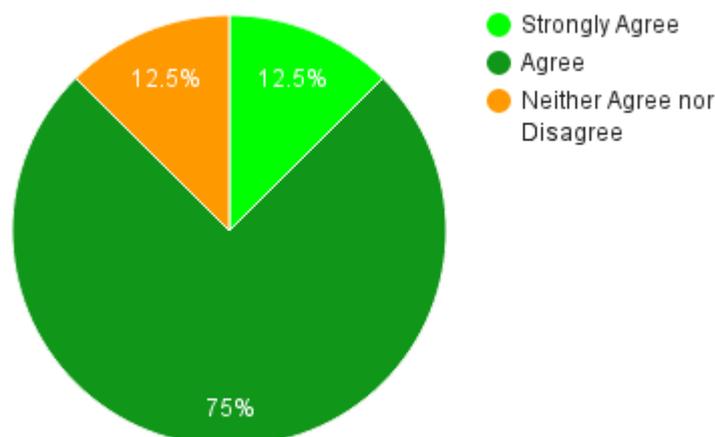
paragraph 61 (requirement to report any event or forecast event with a material adverse impact on the financial position of the institution) as examples. The respondent was of the opinion that the above all have different thresholds and that they should all fall under a uniform test, such as that there is or is likely to be a failure/serious failure to comply with the Code.

- 1.5. **Resulting changes:** We have taken steps in four areas following these responses.
- 1.6. We have already acknowledged that initially we'd have a continuance of the MAA for institutions in receipt of 1992 Act funding and the Code would apply to all regulated institutions under the 2015 Act. Now that the Code is approved and in place, our intention is that the Code will become the primary document, and the Code provisions removed from the MAA to result in a slimmer annual funding agreement document which will set out those extra provisions that apply to 1992 Act monies. Where an institution is in receipt of 1992 Act monies and is a regulated institution, the funding agreement will cross-refer to the Code. The funding agreement will be more comprehensive for those institutions not regulated by the Code.
- 1.7. We have not put a statement within the Code regarding the relationship between the two documents. The Code is a separate document to the MAA, and, as stated, the MAA will, in due time cease to exist in its current form. Consequently, there is no specific relationship between the documents. Furthermore, the Code is already a large document and we have sought to retain its focus where we can.
- 1.8. Secondly, in respect of the responses concerning the Auditor General for Wales and the Wales Audit Office, we removed these provisions from the Code.
- 1.9. In respect of 'burdensome' requirements – the requirements within the Code are consistent with the provisions expected in the MAA and have, historically, provided us with more information than one generic response was able to. However, (and thirdly), to assist the understanding of provisions that are 'must' and 'should' we prepared an appendix to the Code summarising the provisions. In summarising the provisions, there is potential for conflict between the appendix and the main body of text in the Code. For this reason, the appendix clearly states that it is a summary that is intended to be a helpful aid only, and the main text of the Code takes precedent should any conflicts be present.
- 1.10. Furthermore, following legal review of the revised Code, we made two further changes. We removed references to the planning of academic affairs, the inclusion of which within the revised Code was felt to fall outside the provisions of section 27 of the 2015 Act. We also removed provisions of the Code relating to the independence of governing body members and the number of terms that governing body members can

serve, since it was not clear that we could rely on them under the terms of the 2015 Act.

2. **Question 2: Do you agree that the definition of financial viability should be consistent with 'going concern' over the short to medium term?**

*Do you agree that the definition of financial viability should be consistent with 'going concern' over the short to medium term?*



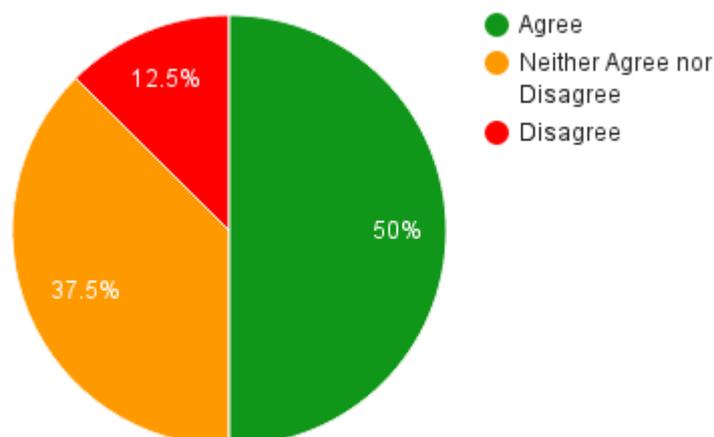
- 2.1. Of the eight respondents six agreed that the definition of financial viability should be consistent with 'going concern', one strongly agreed and one neither agreed nor disagreed.
- 2.2. There was general agreement amongst the respondents that financial viability is difficult to define and HEFCW's linkage of the term with going concern was useful, as the concept is well understood.
- 2.3. Two respondents stated that 'the short to medium term' should be defined. The information accompanying this consultation question stated that the use of 'short to medium term' allowed for consistency with the timescale of financial forecasts, and importantly, this timeline allowed HEFCW to form a view of viability over the length of the majority of educational programmes (i.e. a 3-year degree programme), which we considered would be a key consideration of stakeholders in the HE system. However, we stopped short of specifically defining 'short to medium' term.
- 2.4. Mirroring this steer within our consultation, one respondent stated that it was important that students were suitably protected in the event of an institution ceasing to be a going concern. Consequently, it was proposed that the Code was strengthened to include a requirement for robust exit arrangements for students in the event of an institution ceasing to operate. This, it was implied, would have the related advantage that the system in Wales would be able, to some extent, to mirror arrangements in England, where exit arrangements were being proposed within the Higher Education and Research Bill.

- 2.5. One suggestion was received which suggested that HEFCW use the 'Margin for Sustainable Investment' (MSI) developed by the Financial Sustainability Strategy Group within the threshold calculation.
- 2.6. An FEI respondent stated that FE colleges are not informed of their funding allocation until just before the start of the academic year and therefore any significant change in the funding allocation could change the going concern assumption for a further education institution at short notice.
- 2.7. Finally, one respondent noted that we had used 'going concern' in the context of an institution which ceases to operate due to there being no realistic alternative. However, the common understanding of an organisation that is not a 'going concern' also includes a 'healthy' organisation but for which there is an intent to cease operations. The respondent therefore suggested that HEFCW's definition of 'financial viability' was widened to take into account an intention to continue operations.
- 2.8. **Resulting changes:** We made one change as a result of these responses.
- 2.9. We have defined 'short to medium term' as 'the period covered by the latest financial forecasts supplied to HEFCW by the institution'. This allows us to use existing information to form an opinion on financial viability over the period of the majority of educational programmes, and covers the first two years of a fee and access plan.
- 2.10. We believe that the recommendation concerning exit arrangements has some merit, given the context in England where it is possible that students and stakeholders will expect exit arrangements to be in place. However, unfortunately, we do not consider that this relates to the organisation and management of an institution's financial affairs but instead is concerned with providing safeguards for students in the event of a regulated institution facing financial difficulties. We therefore have concluded that we have no statutory basis on which to include this provision within the Code.
- 2.11. The MSI indicator forms part of the voluntary ASSUR report, and is (in essence) a percentage which represents the surplus that the institution must make annually in order to meet its future investment goals. The recommendation to use this within the financial commitments threshold calculation has merit since it incorporates future investment plans. However, the financial commitments threshold calculation proposed within the draft Code also included planned future financial commitments since it was based upon financial forecasts. Furthermore, the MSI is based upon EBITDA and so is subject to the same variations under FRS 102 as the current measure from which we are trying to depart.

- 2.12. The financial commitments threshold calculation has been based on work undertaken in the sector to come up with a measure that is not subject to the same degree of volatility under FRS 102 as EBITDA is. We have not, therefore, adopted the MSI in the financial commitments threshold calculation.
- 2.13. In respect of the FE response concerning funding allocations, we are of the opinion that uncertainty in respect of future funding doesn't remove the responsibility for ensuring that the institution operates as a going concern; to some extent we would argue that such an environment heightens the need for robust contingency planning. We have not modified the Code as a result of this response.
- 2.14. Though unlikely to be exercised, the response about the intention to remain a 'going concern' has merit. Whilst our consultation circular omitted references to an intention to remain a going concern, the Code itself uses going concern in its broadest sense (that is, it includes the intention to remain a going concern). Therefore, we have not modified the Code.
- 2.15. Following legal review of the revised Code, it was suggested that the requirement to remain financially viable may not be compatible with section 27 of the 2015 Act. It was suggested that financial viability is properly considered at the point at which HEFCW is considering the approval of a fee and access plan, instead of constituting a provision within the Code. Whilst our legal advice suggested that there were strong arguments for including this provision within the Code, it was acknowledged that it was a grey area. For this reason, we modified the emphasis of the code such that institutions must *plan* to remain financially viable, rather than requiring financial viability. We consider that this is firmly within the scope of 'the organisation and management of financial affairs' as not to plan in a financially viable manner indicates demonstrably poor management of financial affairs.
- 2.16. We have also amended the terminology of the Code, changing 'financially viable' to 'sustainable' to better reflect the terminology within paragraph 3.2 of the Full Implementation guidance issued to us.

3. **Question 3: Do you agree that the governing body should appoint an officer to be accountable to HEFCW for compliance with the terms of the Code?**

*Do you agree that the governing body should appoint an officer to be accountable to HEFCW for compliance with the terms of the Code?*



- 3.1. Of the eight respondents, four agreed, with one disagreeing and three neither agreeing nor disagreeing that the governing body should appoint an officer to be accountable to HEFCW.
- 3.2. This question gathered a number of responses. Whilst most responses were supportive of the appointment of an accountable officer, several responses focussed on the proposal for HEFCW to require an institution to appoint a different accountable officer. Accountable officers are usually Vice Chancellors. Whilst the responses noted the Code's proviso that 'in so doing, HEFCW will not seek to influence the employment relationship', it was felt by three respondents that in asking for an institution to appoint a different accountable officer, it would de facto impact upon the employment relationship. One respondent felt that this could amount to constructive dismissal of the accountable officer.
- 3.3. One FEI respondent stated that the institution already had an Accountable Officer with a responsibility to Welsh Government, and given the relatively small amount of income the institution receives from student support, felt it was unnecessary to have another Accountable Officer appointed to HEFCW.
- 3.4. **Resulting changes:** We have made one change as a result of the feedback.
- 3.5. The requirement to have an Accountable Officer is consistent with HEFCW's existing MAA and HEFCE's MAA. This is an 'in-extremis' provision, which in our experience to date has not given rise to any

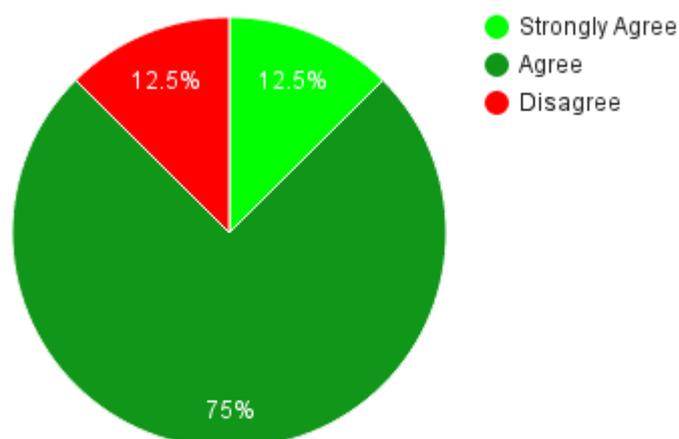
actions for constructive dismissal. In any situation where we may have to exercise an option which asked the institution to appoint an alternative Accountable Officer we would expect to obtain legal advice tailored to the individual circumstances of the case at hand.

- 3.6. We received expert legal advice which has concluded that the requirement to appoint a different accountable officer to HEFCW does not de facto constitute constructive dismissal. This advice informs the opinion that this does not constitute constructive dismissal and consequently, does not indicate control (as defined within the 2016 Manual for Government Debt and Deficit); consequently, such a course of action should not influence any potential ONS classification. We already include the statement that the Governing Body is able to keep the previous accountable officer in post. This approach also mirrors the approach that HEFCE have outlined within their Memorandum of Assurance.
- 3.7. We therefore have not removed the provision allowing us to request a different Accountable Officer to be appointed.
- 3.8. However, following detailed legal review of this area, we recognised that there were difficulties in imposing duties upon an employee or office holder, since it is the governing body that is responsible for duties under the 2015 Act. Therefore we changed the emphasis of the Code such that wherever the Code placed a duty upon the accountable officer it now instead places that duty upon the governing body (where relevant). As noted above, we still require the governing body to appoint an officer to discharge its reporting responsibilities to HEFCW, but it is, in essence, up to the governing body to choose how it does that and the extent to which it wants the accountable officer to act on its behalf.
- 3.9. In respect of the FE objection that there is already an Accountable Officer appointed between an FE institution and Welsh Government, we think this does not reflect the difference in relationships between the accountable officer role to Welsh Government and the role to HEFCW. The Accountable Officer to Welsh Government will be accountable for funding supplied from Welsh Government to the FEI. The relationship therefore derives from different legislation and Welsh Government would not have powers open to them that are open to HEFCW under the 2015 Act.
- 3.10. In practice, institutions will be accountable to a number of different bodies (for instance, the Health and Safety Executive) though these Accountable Officers might not be explicitly defined. We do not think the naming of an Accountable Officer significantly increases burden.
- 3.11. Having said that, we continue to work with Welsh Government to determine whether there are ways that we can streamline our interaction with FEIs through their pre-existing engagement channels with FEIs.

- 3.12. As a consequence of the above, we have not modified the Code such that FE institutions are exempted from the need to appoint an Accountable Officer.

4. **Question 4: Do you agree that the included requirements relating to governance are those that are necessary for the proper organisation and management of financial affairs?**

*Do you agree that the included requirements relating to governance are those that are necessary for the proper organisation and management of financial affairs?*

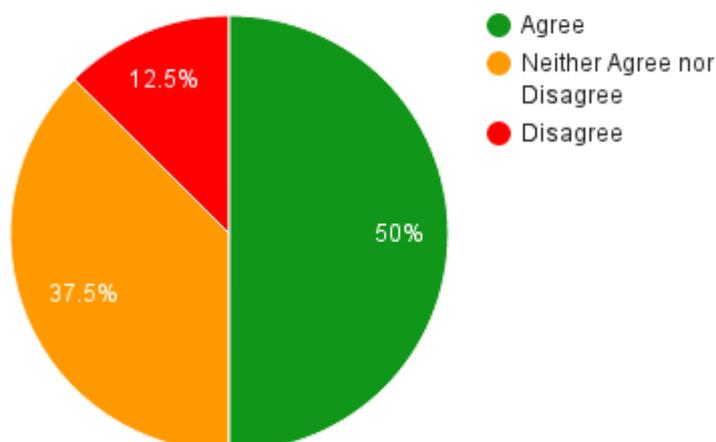


- 4.1. Of the eight respondents, one strongly agreed and six agreed that the requirements relating to governance are necessary, with one respondent disagreeing.
- 4.2. The response to this question was, therefore, largely positive.
- 4.3. A number of respondents, however, noted within their responses to this question that they had concerns in respect of the WAO and Auditor General and their access to the regulatory regime proposed under the Code. We have dealt with this topic under question 1.
- 4.4. One FE respondent noted that FE institutions are already subject to a Financial Memorandum with Welsh Government. This respondent had the opinion that this, in conjunction with FE Audit Code of Practice and Charity Commission's Governance Code that the FE institution is already subject to, ought to be enough to, by default, place them in compliance with this new Financial Management Code.
- 4.5. One respondent felt that the Code may be too prescriptive to accommodate potentially smaller institutions coming under the Higher Education (Wales) Act 2015 ("2015 Act"). This respondent noted, in subsequent discussions with HEFCW, that an institution could technically be very small with a small number of governors and employees and it was difficult to frame some of the requirements of the Code in this context (for instance, the requirement to have an audit committee and finance committee).

- 4.6. **Resulting changes:** We have not made any changes as a result of the responses to this question.
- 4.7. We have dealt with the question of the WAO in the response to question one.
- 4.8. In response to the question of placing reliance on the FE Memorandum and associated Audit Codes of Practice, there are two main points to be made. Firstly, the FE Memorandum covers 1992 Act monies (in a similar fashion to our current MAA) and consequently the provisions within it are not appropriately related to the 2015 Act. Neither has that memorandum been written with the express purpose of allowing HEFCW to rely upon it, and HEFCW has no power to influence its contents. Secondly, we will, as noted above, aim to work with Welsh Government in order to minimise burden where possible. For these reasons, we have not modified the Code to place an expectation of reliance upon any of the documents listed by the respondent.
- 4.9. It is fair to say that the size and composition of regulated institutions could, in theory, be very varied, with very small institutions possible. However, the governance requirements outlined (such as having an audit committee and finance committee) are, we would expect, the minimum standards that we would require and would be unlikely to vary according to the size of the institution. HEFCW approval of an institution's fee and access plan would be required before an institution could become regulated for the purposes of student support, and the size, stability and governance arrangements would be considered as part of the fee and access plan approval.

5. **Question 5a: Do you agree that the proposed approach of setting the threshold to be commensurate with 5x EBITDA (once more data is obtained) is appropriate?**

*Do you agree that the proposed approach of setting the threshold to be commensurate with 5x EBITDA (once more data is obtained) is appropriate?*



- 5.1. Of the eight respondents, four agreed that the proposed approach was appropriate, with three neither agreeing nor disagreeing and one disagreeing.
- 5.2. There was, generally, a positive response to this question.
- 5.3. However, several respondents were keen to point out that EBITDA would be a volatile measure under FRS 102 and therefore would not make a good basis for a financial commitments threshold. This echoes the sentiment and resulting work that has been ongoing in the sector, which is cognisant of EBITDA's shortcomings in respect of revised FRS 102 financial statements and which has aimed at developing a revised, more appropriate financial commitments threshold on which HEFCW's new threshold is based.
- 5.4. Whilst agreeing with the principle that HEFCW should aim to set a new borrowing threshold in accordance with the current 5x EBITDA threshold, two respondents replied that they could not fully form an opinion on this new threshold before the threshold was fully defined. To this end, these respondents stated that HEFCW would need to consult on the final financial commitments threshold before, ultimately, these respondents could accept it. One of these two respondents also suggested that HEFCW may set a threshold and/or give itself the power within the Code to adjust the threshold within predefined margins once greater clarity was known.

- 5.5. In 2010, the Office for National Statistics (ONS), following review of the FE sector decided to reclassify FE institutions from Non-Profit Institutions Serving Households (NPISH) to Central Government, which had significant implications for FE institutions as it brought them onto the books of the national accounts. In so doing, the ONS stated that a factor in its decision was that FE institutions were subject to borrowing consent from government, and therefore were subject to government control. Following this reclassification, and the inherent issues that this reclassification created, legislation was passed [The Further and Higher Education (Governance and Information) (Wales) Act 2014]. This removed the requirement for obtaining borrowing consent for FE institutions, as well as revoking a number of other requirements such as control over appointments and governance structures that the ONS had cited as being factors in evidencing Central Government control.
- 5.6. Three respondents to the consultation noted this review, and wondered whether this review may have implications for imposing a financial commitments threshold as proposed in the draft Code. Chiefly their concern centred on whether, by having a financial commitments threshold, institutions would be put at risk of being reclassified into Central Government. One FE respondent stated that ‘it would appear to be a backwards step’ if, following removal of the requirement for Welsh Government approval for borrowing, HEFCW were to impose a similar requirement. One respondent suggested that this provision ought to be removed unless it was appropriately restricted within the Code to a ‘back-stop’, in extremis measure, should HEFCW be of the opinion that the institution was not viable.
- 5.7. **Resulting changes:**
- 5.8. Generally, there was a positive response to this question.
- 5.9. The introduction of Financial Reporting Standard 102 (FRS 102) and the subsequent translation of that standard into the Statement of Recommended Practice for Further and Higher Education Institutions will result in considerable changes in the way financial statements are presented and recorded, and will introduce greater year-on-year volatility. Consequently, the current way of calculating a financial commitment threshold (as outlined in HEFCW’s Memorandum of Assurance and Accountability) will no longer continue to be valid. However, since the first sets of accounts containing figures based on FRS 102 were finalised in December 2016, HEFCW did not, at the time of consultation, have enough information to determine an exact threshold before submitting the Code to the National Assembly for review. We therefore worded the Code to allow input of the threshold later in the process, and will now take forward a consultation on this threshold.
- 5.10. In its 2010 report into the reclassification of Further Education institutions to ‘Central Government’, the ONS stated that *“UK Universities, which are responsible for higher education, remain*

*classified as private sector as they enjoy considerably greater freedom over their general corporate policy compared to the Further Education sector<sup>1</sup>.*

- 5.11. Furthermore, in the ONS' publication of 'Review of the Non-Profit Institutions Serving Household Sector', published in 2014, they concluded that *"Universities constitute a large part of the NPISH sector, 47% of total NPISH output in 2009. Universities receive Government funding as well as fees from students and other income activities. Although still currently classified as non-market producers, these bodies are not controlled by Government according to the criteria for control set out in the Manual for Government Debt and Deficit and so are classified to the NPISH sector."*
- 5.12. The aforementioned Manual for Government Debt and Deficit that was current at the time of that report <sup>2</sup> set out nine criteria for government control, as well as five relating to non-profit institutions (see pages 13 to 18). In relation to borrowing, it is stated that:
- "To indicate control, government/public sector should play a predominant role in setting the conditions of the borrowing (maturity, rates, forms, location, counterpart, collaterals, etc.) and/or exert a narrow control of the use of the funds by the entity (for instance for a given acquisition of equipment or shares of other companies)."*
- 5.13. Firstly, our financial commitments threshold does not relate to a role in setting the conditions of the borrowing and does not restrict the use of such funds. It is, instead, simply a trigger point for a discussion of the affordability of the borrowing.
- 5.14. Paragraph 21 of the 2016 Manual on Government Debt and Deficit<sup>3</sup> (under section "Control of educational units") states:
- "... government is deemed to control such a unit if approval is needed to... borrow..."*
- 5.15. Secondly, it is important to note that an institution is free to proceed with proposed borrowing without HEFCW's approval if it so wishes, but this will have ramifications for the institution's risk rating, and ultimately, we may issue a direction to the institution to put student exit arrangements in place. In this manner, the financial commitments threshold does not meet the test of control outlined in paragraph 2.6.15 since HEFCW does not have the power to veto the borrowing.
- 5.16. Furthermore, it should be apparent that the financial commitments threshold is dissimilar to the threshold that was previously applied to

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<sup>1</sup> Classification of Sixth Form and Further Education Institutions, ONS, 13 October 2010

<sup>2</sup> <http://ec.europa.eu/eurostat/documents/3859598/5937189/KS-GQ-14-010-EN.PDF/c1466fde-141c-418d-b7f1-eb8d5765aa1d> , accessed 19 September 2016

Further Education colleges by Welsh Government, which we understand had the power to veto borrowing by Further Education Institutions.

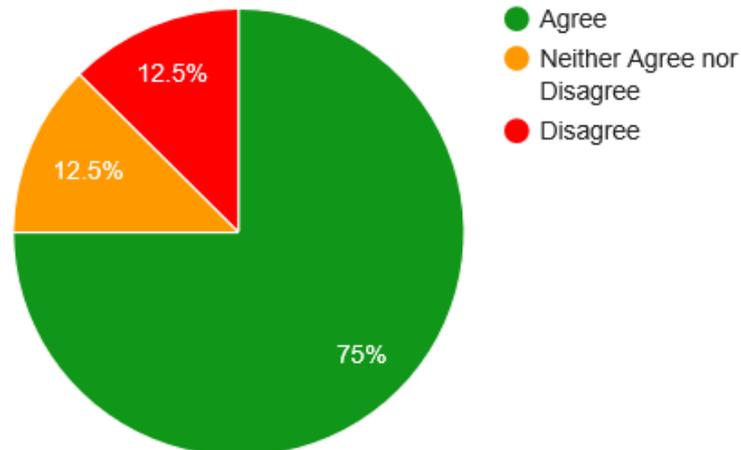
- 5.17. The Manual for Government Debt and Deficit was subsequently updated to the 2016 edition<sup>3</sup>. With the exception of an update with respect to voting rights (which is not applicable to the current case) the relevant sections of the manual and criteria have not materially changed (including, importantly, section I.2.3). We therefore believe that any argument that the new ONS criteria may result in a change of classification has little foundation.
- 5.18. It is worth stressing that the financial commitments threshold that is applied under the draft Code operates on the same principle as the threshold under the current MAA and previous Financial Memorandum (that is, it is a threshold for a conversation on the affordability of borrowing, but does not stop an institution from borrowing without our approval) which was in effect at the time the ONS reached the conclusions above. It therefore seems reasonable to assume at this juncture that the reasoning that led the ONS to its conclusions in 2010 and 2014 continues to remain valid.
- 5.19. Furthermore, in practice, we know from our experience that lenders to the sector, in assessing their credit ratings and risks of borrowings in the sector, expect significant borrowing to have been subject to Funding Council review and the requirements in the Code are the same as those included in the latest HEFCE MAA. In practice we understand that this requirement contributes to the HEIs' ability to secure relatively favourable borrowing terms.
- 5.20. For these reasons, we did not remove the financial commitments threshold.

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<sup>3</sup> <http://ec.europa.eu/eurostat/documents/3859598/7203647/KS-GQ-16-001-EN-N.pdf/5cfae6dd-29d8-4487-80ac-37f76cd1f012> , accessed 19 September 2016

**Question 5b: Do you agree that we should consider maintaining parity with the borrowing threshold in England, provided that the threshold is acceptable to us?**

*Do you agree that we should consider maintaining parity with the borrowing threshold in England, provided that the threshold is acceptable to us?*



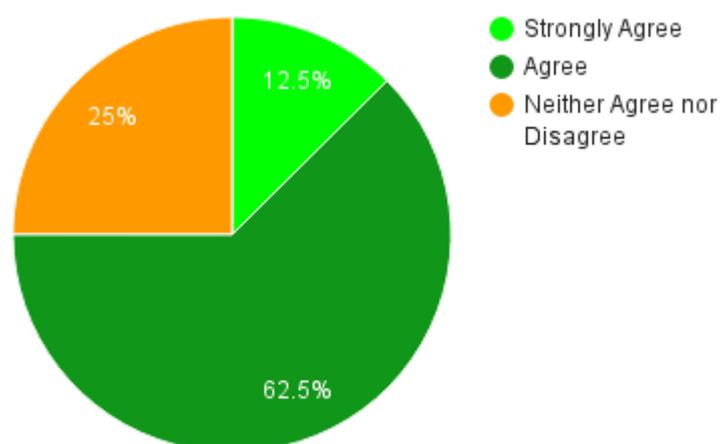
- 5.21. Six of the eight respondents agreed we should consider maintaining parity with the borrowing threshold in England, with one disagreeing and another neither agreeing nor disagreeing.
- 5.22. On the whole, the respondents agreed that where possible and appropriate, HEFCW should aim to keep consistency in the financial commitments threshold with England.
- 5.23. One respondent was concerned that a 'one size fits all' solution in respect of financial commitments did not account for the many different sizes and shapes of institutions and would end up penalising some institutions relative to others. They were of the opinion that in practice, no institution with substantial debt funded Halls assets would be able to borrow without HEFCW consent meaning that an independent review by an accountancy firm must be undertaken and paid for each time the institution wished to borrow. It was stated that as the formula could discriminate against some institutions more than others, HEFCW should consider the level of justification or support it requires to provide its written consent.
- 5.24. **Resulting changes:**
- 5.25. The majority of respondents agreed with the proposal to maintain parity in the borrowing threshold where possible; consequently, we did not modify the Code to change this approach. Part of the reason for retaining the financial commitments threshold was that lenders were familiar with the English system resulting in a beneficial capacity to

access funding. This was reflected in one of the responses to the consultation which stated that “*it is desirable to maintain parity as much as possible to avoid a marginalisation of Welsh HEIs*”. We also know from discussions with lenders that there is value in maintaining the borrowing threshold.

- 5.26. There is no explicit requirement in the Code for independent review of an institution’s proposed borrowing (for example, by a firm of accountants), however, for most significant borrowings we would expect the institution to commission specialist advice to inform their own risk assessments.
- 5.27. It remains for HEFCW to form an opinion, in each case of a request to increase the financial commitments threshold, on the extent to which external review is required; historically, this has been variable.

6. **Question 6: Do you agree that HEFCW has a responsibility to act in the student interest in respect of financial requirements?**

*Do you agree that HEFCW has a responsibility to act in the student interest in respect of financial requirements?*

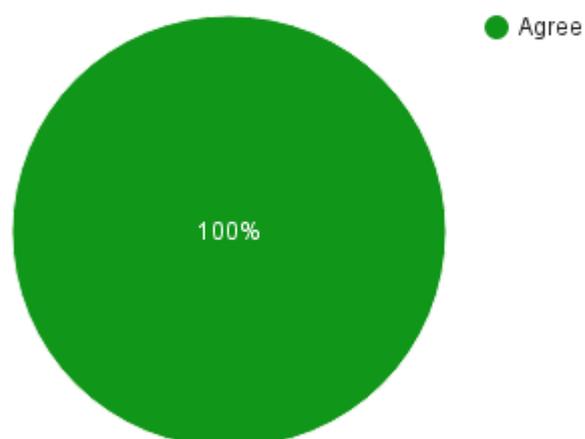


- 6.1. Of the eight respondents, one strongly agreed and five agreed that HEFCW has a responsibility to act in the interest of students, with two respondents neither agreeing nor disagreeing.
- 6.2. There was general agreement that it was correct that HEFCW should act in the student interest where that related to matters of the organisation and management of financial affairs.
- 6.3. Another respondent stated that whilst it would be useful for HEFCW to act in the student interest in appropriate circumstances (those relating to the organisation and management of financial affairs), that this power was not conferred on HEFCW through the 2015 Act and therefore had no legislative footing. This respondent did, however, recognise Welsh Government's steer that HEFCW had an interest in protecting the student interest, as outlined in the Explanatory Memorandum to the Bill. However, the respondent felt that without this function being specifically stated in the 2015 Act, HEFCW should be careful not to 'gloss on the provisions'.
- 6.4. The same respondent was also of the opinion that using the Code to impose a duty to consider the student and public interest in an institution's key decision making processes was potentially problematic in terms of charity law, may extend beyond the scope of regulated activities into more general areas such as research, and came close to specifying an institutions' mission and/or objectives.

- 6.5. **Resulting changes:** We have made one change as a result of the feedback to this question.
- 6.6. All HE and FE institutions agreed with the question. We have made one change to address the issue raised in paragraph 2.8.4, to recognise that charity law requires an institution to pursue its charitable objects, and includes a public benefit test. We have added a statement to the effect of 'insofar as is consistent with the institution's obligations under charity law' to this requirement.

7. **Question 7: Do you agree that the Audit Code of Practice is fit for purpose?**

*Do you agree that the Audit Code of Practice is fit for purpose?*



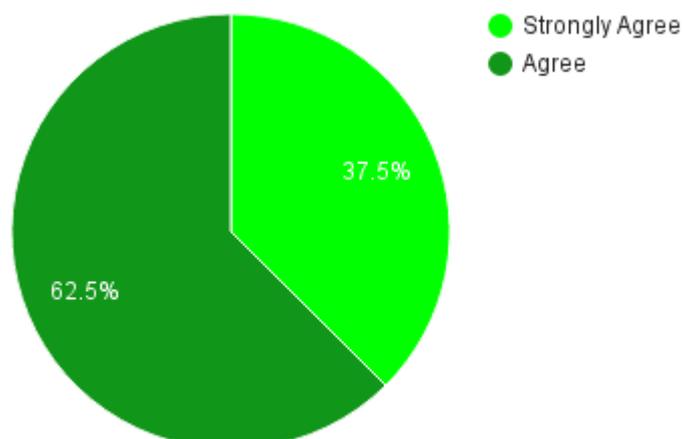
- 7.1. All respondents agreed that the Audit Code of Practice is fit for purpose.
- 7.2. Several respondents within their response to this question reiterated points previously made.
- 7.3. In respect of FE, it was noted that further education colleges are already subject to the FE Code of Practice and therefore they should not have the extra burden of having to comply with a second Code of Practice, though the response did not identify which areas were felt to be burdensome.
- 7.4. One respondent also reiterated an earlier point by stating that the requirement to convene an audit committee makes assumptions about the corporate structure of an institution and that whilst this holds for the moment for universities in Wales, it may not hold in future for all regulated institutions in Wales. This respondent noted that the changing context in England with the introduction of the Higher Education Research Bill may modify the structure of Higher Education Corporations in England and wondered whether this contextual change in England might have ramifications for the future regulatory environment in Wales.
- 7.5. **Resulting changes:** We have taken one action as a result of a review of consultation responses.
- 7.6. As previously stated, we are currently in discussions with Welsh Government to determine the extent to we can rely upon their

assurances within certain areas, in order to minimise unnecessary burden on FE institutions due to duplication. However, we have not removed the requirement for FE institutions to comply with our Audit Code of Practice. This is an integral part of the Code and our view is that an FEI in adherence with the existing Audit Codes of Practice ought to be able to demonstrate adherence to the Code's Code of Practice relatively easily. Furthermore, since the process for modifying the Code is complex and lengthy, a change to the FE Code of Practice (over which we have no influence) could result in a period of several months where we cannot impose necessary audit requirements on FEIs if we have simply made it a requirement to adhere to the FE Code of Practice.

- 7.7. Further review of the Code and Statement of Intervention prompted officers to look again at how the Code differentiates 'failure' from 'serious failure', both of which are defined in the 2015 Act and have different remedies available to them under the Statement of Intervention. We have defined 'serious failure' within the Code; this definition is consistent with the definition within the Statement of Intervention.

8. **Question 8: Do you agree that HEFCW should exercise discretion in respect of breaches of the Code, rather than automatically invoking the Statement of Intervention?**

*Do you agree that HEFCW should exercise discretion in respect of breaches of the Code, rather than automatically invoking the Statement of Intervention?*



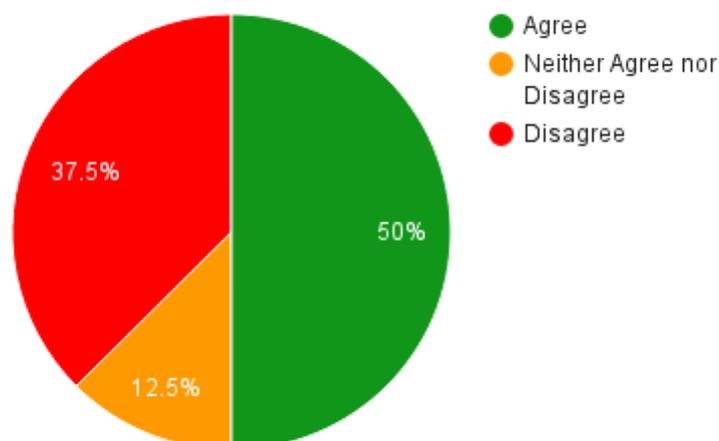
- 8.1. Of the eight respondents, five agreed and three strongly agreed that HEFCW should exercise discretion in respect of breaches of the Code.
- 8.2. There was, therefore, strong agreement that HEFCW should exercise discretion when invoking the Statement of Intervention.
- 8.3. However, it was apparent through a number of responses that the respondents felt that the proposed linkage between the Code and the Statement of Intervention was not clear enough.
- 8.4. One respondent noted that there was a lack of consistency between the approach and the thresholds for intervention as set out in the draft Code and the draft Statement of Intervention. In particular, it was noted that the Statement of Intervention set out a different formula for exercising discretion and intervention to the Code.
- 8.5. **Resulting changes:** We made one set of changes following review of this area.
- 8.6. Through review of the Code in light of consultation responses, HEFCW officers came to the view that the draft Code was not fully exploiting HEFCW's full range of powers available to it under the 2015 Act, which may in part have reduced its ability to intervene as and when required.
- 8.7. In order to preserve clarity and a functional, clean separation between the Code and the SOI, the draft Code made it clear that the SOI procedures would be initiated when an institution was high risk.

However, the responses were clear that in allowing HEFCW the freedom to exercise discretion, this boundary was blurred and it was not apparent when HEFCW might intervene. Furthermore, there may be scenarios in which an institution is low or moderate risk but where HEFCW may wish to use the power of the legislation to issue a direction to comply.

- 8.8. We therefore removed the automatic linkage between 'high risk' and the SOI. We modified the draft Code to the effect that any failure to comply with it, regardless of the institution's risk rating, can lead to HEFCW use its powers under the SOI to issue a direction. We still intend to exercise discretion in these matters, depending upon the impact of the failure to comply. We have made this clear within the revised Code.

9. **Question 9: Do you agree that the linkage between the risk assessment process and the Statement of Intervention is clear and appropriate?**

*Do you agree that the linkage between the risk assessment process and the Statement of Intervention is clear and appropriate?*



- 9.1. Four of the eight respondents agreed that the link between the risk assessment process and the Statement of Intervention was clear and appropriate, with three disagreeing and one neither agreeing nor disagreeing.
- 9.2. We received mixed responses to this question. On the one hand, a number of responses agreed a made no further comment. However, on the other hand, a number respondents identified issues in the drafting of our definitions of risk and linkages to the Statement of Intervention.
- 9.3. One respondent noted an inconsistency in how we define risk. This respondent stated that their reading of the draft Code was that it was possible for an organisation not to be financially viable yet not to have breached the Code. This observation was made on the basis of the fact that high risk within the draft Code was defined as:
- The institution has failed, or is likely to fail, to comply with a requirement imposed by the Code and the effect of this is to give rise to financial viability concerns over the short to medium term.*
- 9.4. This creates the impression that there are two independent factors at play – both compliance and viability. The respondent also noted that HEFCW’s use of discretion in invoking the SOI might be used in cases where the institution was not high risk yet where HEFCW needed to formally intervene. This in effect would mean that the institution was not high risk but would be failing to comply with the Code.

- 9.5. Both of the above inconsistencies, it was suggested, gave rise to issues in the proposed IRR process - chiefly, that that process would then conflate two objectives – the risk of financial non-viability and the risk of non-compliance with Code requirements. The respondent postulated that these were different in nature and non-adherence to one did not necessarily imply non-adherence to the other. In order to avoid confusion for external readers who have historically placed reliance on HEFCW’s risk assessment for financial viability purposes, it was suggested that HEFCW separate the monitoring of compliance with the Code with the review process to assess financial viability.
- 9.6. Lastly, it was noted that, whilst the Code articulated certain circumstances and contexts where a high risk assessment may be made, as well as the ensuing intervention processes, there was no process outlined for reassessing that rating to an appropriate level subsequently.
- 9.7. **Resulting changes:** We made one change as a result of feedback to this question.
- 9.8. We modified the definitions of risk to the effect of the following:

Low risk	The institution is unlikely to fail to comply with the Financial Management Code.
Moderate risk	The institution has, or may fail to comply with the Financial Management Code over the short to medium term, but the impact of this does not lead to financial viability concerns.
High risk	The institution has, or is likely to fail to comply with the Financial Management Code over the short to medium term, and the impact of this leads to financial viability concerns.

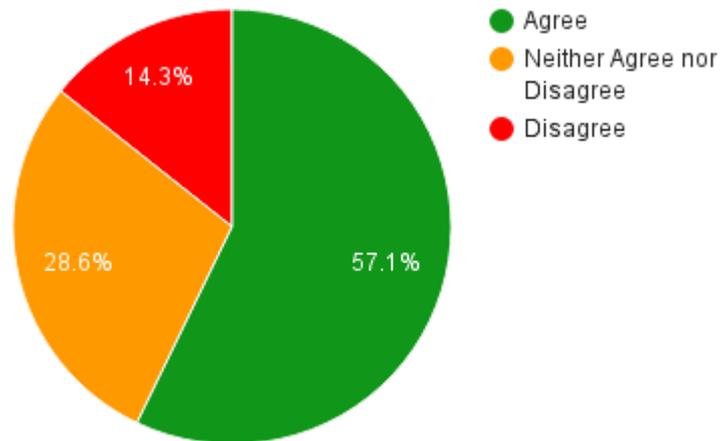
- 9.9. It is already a condition of the Code that an institution must remain financially viable. Therefore, any institution which is not financially viable, or is likely to not be so, is failing to comply or likely to fail to comply respectively with the Code.
- 9.10. However, as noted in the consultation response, a failure to comply with the Code may not necessarily imply a financial viability concern in the short to medium term.
- 9.11. Consequently, the revised definition of ‘moderate risk’ now captures non-compliance which does not result in financial viability concerns, and the revised ‘high risk’ definition captures non-compliance which does

result in financial viability concerns. This, broadly, aligns with our current definitions of risk as set out in the MAA, where, in reality, an institution is only assessed as 'high risk' when it has significant sustainability concerns over the short to medium term.

- 9.12. By maintaining a measure of compliance with the Code within the risk definition, we satisfy the requirement upon us (as set out within the 2015 Act) to form a view as to whether an institution is likely to fail to comply with a requirement of the Code.
- 9.13. In respect of external readers of IRR assessments, we believe that, with the change above, the distinction between compliance and financial viability is lessened. However, perhaps more pertinently, we don't release individual risk assessments until at least three years have elapsed, and even then, only in certain circumstances. In the circumstance that an institution wanted to rely on our risk assessment for providing assurance to potential lenders, the scope of our assessment would be made clear at that point.

10. **Question 10: Do you agree that the Code strikes an appropriate balance between 'must' and 'should' provisions?**

**Do you agree that the Code strikes an appropriate balance between 'must' and 'should' provisions?**



- 10.1. Of the eight respondents, four agreed that the Code strikes an appropriate balance between 'must' and 'should' provisions, two neither agreed nor disagreed and one disagreed. One respondent did not say the extent to which they agreed, but provided written feedback.
- 10.2. On the whole, respondents agreed that the draft Code struck an appropriate balance between 'must' and 'should' provisions.
- 10.3. Concerns were raised around the requirement to subscribe to HESA: in the first instance, because there were no assurances built into the Code around the cost of that subscription; and secondly the Code should not define which particular body provides the service as it reduces the sector's collective bargaining power to arrange for data collection by a different body in future, if required. It was therefore suggested that the Code be revised to be more generic in this regard.
- 10.4. The FE respondent stated that they felt that the current FE regulatory environment should be taken into account. No further information was provided on this.
- 10.5. Lastly, one respondent felt that the Code was not clear enough about what constituted 'guidance'. This respondent stated that the 2015 Act allowed for provisions which institutions must adhere to, and for guidance which an institution must take into account. The respondent noted that the draft Code included a number of declaratory or informational statements but the 2015 Act appeared to provide no middle ground to allow such statements. Their concern, therefore, was

that such declaratory statements would need to be taken into account as guidance by a Governing Body since the Code was only able to set out requirements and guidance.

- 10.6. **Resulting changes:** We made three changes in this area.
- 10.7. We agree, partially, with the suggestions concerning the naming of HESA. It is for this reason that the draft Code contained a statement to the effect of “or successor bodies” where the subscription to HESA was required. However, given the consultation feedback, it is clear that our intention to future-proof this provision did not result in a clear interpretation. We therefore substituted the use of the term ‘relevant data provider’ for HESA and noted that, at the time of publication, the relevant data provider was HESA.
- 10.8. Secondly, we removed the requirement for bodies to subscribe to UCAS, Estyn, the QAA and HESA. We instead replaced this requirement with a requirement that institutions should provide data to HEFCW in a format requested by HEFCW; and that this data should be subject to an adequate assurance regime. This will, in effect, allow us to continue to collect the data we require, in a format that is comparable between institutions and which is also reliable, without the underlying requirement for a subscription.
- 10.9. In addition, we removed conditions relating to the Data Protection Act, following legal review of the revised Code.
- 10.10. In respect of the FE response, we will, as mentioned elsewhere, continue to work with Welsh Government to determine the extent to which we can reduce the burden on FE institutions. We also made one change to the draft Code: to recognise that compliance with Colegau Cymru’s Code of Good Governance Practice was a suitable alternative to compliance with the CUC Code of Governance.
- 10.11. Lastly, we disagree that the 2015 Act ‘provides no middle ground’ between requirements and guidance which the institution has to take into account. Rather, it is our view that it places the onus upon HEFCW to make clear what is a requirement and what is guidance within the text of the Code. The 2015 Act states, at S27(2) to S27(4):
  - (2) The Code may make provision about the following matters (among others)—
    - a. circumstances in which a regulated institution is to enter into a transaction of a class specified in the Code only with the consent of HEFCW;
    - b. accounting and audit arrangements of regulated institutions;
    - c. the provision of information to HEFCW.

- (3) A provision of the Code may take the form of a requirement or guidance.
  - (4) The governing body of a regulated institution must—
    - a. comply with any requirement imposed by the Code;
    - b. take into account any guidance contained in the Code.
- 10.12. Our interpretation of ‘provision’ is a statement that a specific thing must happen or be done, or not happen or not be done. We believe this is consistent with the common legal understanding<sup>4</sup>. Indeed, the definition within the Cambridge English Dictionary is:
- “a statement within an agreement or a law that a particular thing must happen or be done, especially before another can happen or be done.”<sup>5</sup>*
- 10.13. Consequently, our view is that ‘informational’ text within the Code that does not relate to a statement requiring a particular thing to be done (such as something to be complied with, or taken into account), is not, therefore, a provision of the Code. It therefore sits outside the use of the term ‘provision’ in S27 (2). There is nothing within the 2015 Act that states that the Code can solely contain provisions.
- 10.14. For this reason, we have not modified the Code to exclude informational statements.
- 10.15. However, in order to aid clarity, we have included an annex to the code which summarises the ‘must’ and ‘should’ provisions.

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<sup>4</sup> <http://www.translegal.com/legal-english-dictionary/provision>

<sup>5</sup> <http://dictionary.cambridge.org/dictionary/english/provision>

11. **Question 11: Do you have any other comments?**

11.1. We received a range of comments to this question. However, the following were the major themes or issues identified:

1. **Interpretation of the Code** – One respondent questioned whether, given the “quasi-legislative status” of the Code and the “gravity of the implications that could follow from applying different interpretations”, it was appropriate for HEFCW to provide that it shall be the final arbiter on all matters of interpretation. The respondent suggested that this provision be removed or amended including an appeals/resolution process which allowed for independent adjudication.
  - a. **Reason for the submitted terms**– We have not modified the Code. We are of the opinion that it is perfectly normal practice that as regulator, HEFCW is the final arbiter on matters of interpretation. Should an interpretation of the Code lead to an intervention, the initial stages as set out in the Statement of Intervention require constructive dialogue to attempt to resolve issues. Resolution through judicial review is available to all institutions should they disagree with HEFCW’s interpretation.
2. **Financial viability indicators** – Two respondents stated that it would be useful to have exact definitions of thresholds and indicators that HEFCW would consider would show an institution to be financially viable. For example, it was requested that HEFCW supply information on an exact gearing and liquidity level that would indicate financial viability.
  - a. **Reason for the submitted terms**– We have not modified the Code, for two principal reasons:
    - i. **Context** – As we have outlined within the draft Code, we do not intend to be prescriptive about a range of financial indicators as an assessment of financial viability will depend upon the context. An assessment of financial viability using liquidity and gearing indicators should take into account the full context. We would not wish to create an impression that a ‘tick box’ adherence to set quantitative measures represents good financial management and financial viability.
    - ii. **Autonomy** – There is a risk that, by requiring an institution to maintain a HEFCW-defined level of reserves, we are influencing the institution’s financial policy and therefore could be seen to be exerting control.

3. **Adherence to Nolan principles** – It is a requirement of the draft Code to adhere to the Nolan principles. One respondent stated that compliance with Nolan principles could be subjective and that there was a risk of treating these as clear rules. Consequently, it would be unclear at what point HEFCW should be informed of a ‘violation’.
  - a. **Reason for the submitted terms**– We have not modified the Code. Adherence to the Nolan principles is a basic principle of good governance. Were we to remove the requirement we would not want to stakeholders to conclude that non-adherence with the Nolan principles could be acceptable.