Scottish Funding Council

Promoting further and higher education

Financial Memorandum with Higher Education Institutions

Contents

FINANCIAL MEMORANDUM

Introduction

Purpose of this document

1. This Financial Memorandum (FM) sets out the formal relationship between the Scottish Further and Higher Education Funding Council (SFC) and higher education institutions (HEIs) and the requirements with which HEIs must comply as a term and condition of grant from SFC.

Scope of this document

2. This FM applies to all HEIs in Scotland.

Definition

3. In this document the term 'institution' is used in place of 'higher education institution'. The term 'chief executive officer' refers to an institution's Principal.

Compliance with the Financial Memorandum

4. The responsibility for ensuring that the institution complies with this FM rests with the governing body of the institution. Questions about the interpretation of the FM may be raised with officers of SFC at any time.

5. Where the institution's interpretation of the FM differs from that of SFC, the SFC will seek, wherever possible, to reach agreement in a spirit of partnership with the institution. However, SFC's interpretation of this FM shall be final.

Effective date

6. This FM shall take effect from 1 December 2014.

Structure of this document

7. The FM is in two parts:

   - Part 1: defines the relationship between SFC and the institution and the responsibilities of each for the proper stewardship of public funds.
   - Part 2: contains the general requirements that apply to all institutions.

Part 1: The relationship between SFC and the institution

Responsibilities of the Scottish Funding Council

1. SFC is the national, strategic body with responsibility for funding further and higher education, research and other activities in Scotland's colleges, universities and other HEIs. Its funding decisions support the Scottish Government's national priorities.

2. SFC is a Non-Departmental Public Body (NDPB) of the Scottish Government and undertakes its functions under the terms of the Further and Higher Education (Scotland) Act 2005 (the 2005 Act), as amended, including by the Post-16 Education (Scotland) Act 2013. In particular, SFC may make grants, loans or other payments to the governing bodies of institutions for the provision of further education, higher education, research and related activities.

3. The legislation also confers certain duties and responsibilities on SFC, including securing coherent, high quality further and higher learning provision, and the undertaking of research.

4. Under the terms of the 2005 Act, SFC may attach terms and conditions to the payment of grant made to institutions. It is a term and condition of grant payment from SFC that the institution's governing body and its designated officers comply with the requirements set out in this FM.

Accountability

5. SFC is accountable to the Scottish Ministers for the use of public funds provided to it under the terms of the relevant legislation.

6. The Chief Executive of SFC has also been appointed Accountable Officer under the terms of the Public Finance and Accountability (Scotland) Act 2000 and is responsible and accountable to the Scottish Parliament for ensuring that funds provided to SFC are used for the purposes for which they have been given, and in ways that comply with the conditions attached to them. The Accountable Officer has a personal responsibility for the propriety and regularity of the public finances provided to SFC, and for ensuring that funding is used economically, efficiently and effectively.

Assurance

7. In order to meet his or her responsibilities, the Chief Executive of SFC must be satisfied that the governing body of the institution meets the requirements of this FM as a condition of receiving grant funding from SFC. SFC will therefore seek financial management and other information from the institution but, as far as possible, will rely on data and information that the institution has

produced to meet its own needs. If further information is required, SFC will make a specific request in the context of its commitment to efficient regulation.

8. Where SFC has concerns or insufficient information to provide the assurance required, it will, in the first instance, seek to resolve matters with the chief executive officer of the institution. Where this has not proved possible, or in the case of significant concerns, SFC's Accountable Officer will inform the chair of the governing body and the institution's chief executive officer in writing – and without delay – and will specify what action is required to address these concerns.

9. Where circumstances warrant it, SFC's Accountable Officer may suspend the payment of any or all grants to the institution. SFC may also use its powers to attend and address a meeting of the governing body.

What the institution can expect of SFC

10. SFC will conduct its affairs to high standards of corporate governance and public administration. It will maintain a complaints procedure and a separate appeals process for funding decisions.

11. SFC will act reasonably on the basis of the fullest available evidence and objective analysis. Subject to any legal requirement to observe confidentiality, it will be open and transparent with the institution, and with other stakeholders, and will give, or be prepared to give, a public justification of its decisions.

12. SFC recognises that the institution is an autonomous body. SFC will not substitute its judgements for those which are properly at the discretion of the institution. In particular, SFC will seek to maximise the discretion of the institution to use grants provided to it by SFC.

13. In discharging its responsibilities, SFC will seek to make regulation efficient and meet the principles for Better Regulation of Higher Education in the UK.

14. SFC will seek at all times to work in a spirit of partnership with the institution, including maintaining regular dialogue with the institution and, where appropriate, its representative bodies. The aim of that partnership will be to help the institution deliver its strategic priorities through the agreement of an Outcome Agreement with SFC, and ensure that SFC can deliver its priorities and undertake its statutory and other functions. SFC recognises that the institution may also undertake activities, and have to comply with legislation and regulation, which may fall outside the scope of this partnership.

15. SFC will allocate and pay grant to the institution in accordance with current published policies and procedures. The institution will be consulted in advance

and given reasonable notice of any significant change to these policies and procedures and of significant changes in overall funding levels.

SFC's governance requirements of the institution

16. The SFC must be able to rely on the whole system of governance, management and conduct of the institution to safeguard all funds of the institution deriving from the Scottish Ministers and to achieve the purposes for which those funds are provided.

17. SFC requires the governing body to comply with the principles of good governance set out in the Scottish Code of Good HE Governance. SFC also requires the governing body to ensure that:

    - Public funds are used in accordance with relevant legislation, the requirements of this FM and only for the purpose(s) for which they were given. Strategic, Capital or other grant funding must only be used for the purpose for which it is provided by SFC
    - Subject to any legal requirement to observe confidentiality, the institution will be open and transparent with SFC and other stakeholders, and will give, or be prepared to give, a public justification of its decisions in relation to the use of public funds
    - The institution strives to achieve value for money and is economical, efficient and effective in its use of public funding
    - There is effective planning and delivery of the institution's activities in accordance with its mission and its Outcome Agreement agreed with SFC
    - The institution plans and manages its activities to remain sustainable and financially viable. An institution is being managed on a sustainable basis if, year on year, it generates sufficient income to cover its costs[1] and allow a margin of surplus for investment in its infrastructure – physical, human and intellectual – at a level which enables it to maintain adaptive capacity necessary to meet future demands. However, SFC recognises there could be strategic circumstances that result in the institution making a planned deficit over a short period of time; for example, strategic investment for growth, where the return on investment is not realised immediately
    - The institution has a sound system of internal management and control, including an audit committee, an effective internal audit service, and adequate procedures to prevent fraud or bribery
    - The institution has an effective policy of risk management and risk management arrangements

[1] From 2015-16 onwards, the new FE/HE SORP will bring about changes to accounting treatments in some areas. (e.g. Institutions will no longer benefit from the credit arising from the release of deferred capital grants from non-Government sources.) This will reduce ongoing reported surpluses and may result in some institutions showing on-going operating deficits. SFC will ensure that it takes into account the underlying financial position and the cash generative capacity of all institutions when monitoring financial sustainability.

- The institution has regular, timely, accurate and adequate information to monitor performance and account for the use of public funds. Such information will be made available to SFC on request, as necessary, for the exercise of its functions and to gain assurance
- The institution is engaged actively in continuously enhancing the quality of its activities and involves students and other stakeholders in these processes

18. As well as being accountable directly to the governing body for the proper conduct of the institution’s affairs, the chief executive officer is also accountable directly to SFC’s Accountable Officer for the institution’s proper use of funds deriving from the Scottish Ministers and its compliance with the requirements of this FM.

19. The chief executive officer of the institution must inform SFC’s Accountable Officer without delay of any circumstance that is having, or is likely to have, a significant adverse effect on the ability of the institution to deliver its education programmes, research and other related activity, including delivery of its Outcome Agreement with SFC. He or she must also notify SFC’s Accountable Officer of any serious weakness, such as a significant and immediate threat to the institution’s financial position, significant fraud or major accounting breakdown, or any material non-compliance with any requirement of this FM.

Revisions to the Financial Memorandum

20. SFC will make changes to the requirements in this FM only after consulting institutions or their representative bodies.

Part 2: General requirements

1. Unless otherwise stated, the following general requirements apply to the institution.

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2. It is a term and condition of grant payment from SFC that the governing body of the institution and its designated officers comply with the requirements set out in this FM.

Post-16 Education Body criteria

3. In undertaking its functions, the governing body must keep under review and have in place satisfactory provision in relation to the list of matters set out in section 7 (2) of the 2005 Act, as amended by the Post-16 Education (Scotland) Act 2013.

Outcome Agreement

4. The institution must deliver its Outcome Agreement with SFC.

Payment of SFC Strategic, Capital or other Grants

5. Where the SFC makes a payment to the institution of a Strategic, Capital or other grant, the institution will be required to comply with any additional requirements attached to the grant as well as with this FM.

Research

6. The institution must use the SFC Research Excellence Grant (REG) funds for research purposes only, targeting their REG allocations predominantly on world-leading and internationally excellent research.

Business, Innovation and Skills and SFC research capital

7. Research capital funding from the UK Department of Business, Innovation and Skills and matched funding from SFC should be used by institutions to focus on maintaining excellent departments with the critical mass to compete globally and the expertise to work closely with business, charities and public services. All expenditure should be aligned to the institution’s estate strategy.

Small Specialist Institution Grant

8. In order to continue receiving payment of the SFC Small Specialist Grant, Small Specialist institutions (SSIs) must retain small and specialist status.

Changes to grant payments

9. If the Scottish Ministers revise their payment of grant to SFC, then SFC reserves the right to make in-year adjustments to its payment of grant to the institution. In this case, SFC and the institution may renegotiate the institution's Outcome Agreement.

Repayment of grant

10. If the institution fails to comply with the requirements of this FM, and any other specific terms and conditions attached to the payment of grant from SFC, it may be required to repay SFC any sums received from it and may be required to pay interest in respect of any period during which a sum due to SFC in accordance with this or any other condition remains unpaid.

11. If, in the reasonable opinion of SFC, any provision set out in this FM is not observed by the institution, SFC will be entitled, in respect of the payment of grant from SFC:

    - In the case of funding by way of grant: to require immediate repayment of any and all grants or any part or parts of any grants at any time after the SFC becomes aware of such failure to observe (without prejudice to further demands until the whole of all sums made available by way of grant shall have been paid in full)
    - In the case of funding by way of loan (notwithstanding the terms of any agreement attached to the same): to require immediate repayment of the whole or part of each such loan at any time after SFC becomes aware of such failure to observe (without prejudice to further demands until the whole of all sums made available by way of loan shall have been repaid in full).

12. The institution should also note SFC's guidance on the process for managing outcome-based funding decisions, which is available on SFC's website.

Public sector pay policy

13. The institution must have regard to public sector pay policy set by the Scottish Ministers.

Tuition fees

14. Where applicable, the institution must charge student tuition fees at the levels set by the Scottish Ministers under either the Student Fees (Specification)

(Scotland) Order 2006 or the Student Fees (Specification) (Scotland) Order 2011, whichever is applicable.[2] However:

- the tuition fee levels set by the Scottish Ministers under the Student Fees (Specification) (Scotland) Order 2006 do not apply to students who do not have a relevant connection with the United Kingdom and Islands or are not excepted students within the meaning of the Education (Fees and Awards) (Scotland) Regulations 2007; and
- The tuition fee levels set by the Scottish Ministers under the Student Fees (Specification) (Scotland) Order 2011 do not apply to students who do not have a relevant connection with Scotland or are not excepted students within the meaning of the Education (Fees) (Scotland) Regulations 2011, but any tuition fees charged to students from the rest of the United Kingdom must not exceed £9,000 per year[3].

Capital finance

15. As a condition of SFC's Framework Document with the Scottish Government, SFC is required to "make provision for the monitoring and control of borrowing by institutions to protect the public investment in institutions and to maintain accountability for the use of exchequer funds". In order that SFC can discharge this requirement, it has in place a threshold for capital finance above which the institution requires SFC consent to undertake any new borrowing.

16. The governing body of the institution, in line with the Scottish Code of Good HE Governance, will, as a matter of course, satisfy itself that all of the following requirements on capital finance are met:

- The institution can demonstrate its ability to repay the finance, and to pay interest thereon, without recourse to requesting additional grant from SFC
- The institution can demonstrate that its ability to maintain financial and academic viability will not be impaired as a result
- The institution can demonstrate the value to be generated by the transaction, whether it involves refinancing, or purchase of any new investment or assets, the acquisition of which is to be financed by the borrowing
- The institution can demonstrate that any such new investment or asset acquisition is in accordance with the institution's strategic plan and, where appropriate, its estate strategy

[2] The level of tuition fees in 2014-15 for full-time undergraduate first degree students is £1,820. The same fee applies for PGDE and PGDipCE courses. A higher medical fee of £2,895 applies only to continuing students. For full-time higher education courses at sub-degree level, a fee of £1,285 should be charged.
[3] At the moment, this £9,000 limit is not set by legislation but will be once an order is made under section 9D of the Further and Higher Education (Scotland) Act 2005 (as inserted by the Post-16 Education (Scotland) Act 2013.).

17. For the purposes of this document, ‘capital finance’ includes borrowing, finance and operating leases, and other schemes, such as private finance initiative projects, non-profit distribution projects, loan support projects and revolving credit facilities where borrowing is the substance of the transaction, in line with relevant accounting standards.

When the Council’s formal consent is required in respect of capital finance arrangements

18. The institution must obtain prior written consent from SFC before it undertakes a level of capital finance where the annualised costs of all capital finance (being the sum of the servicing and capital repayment costs of each loan or other arrangements spread evenly over the period of the relevant loan or arrangement) would exceed 4% of

    - Total income as reported in the latest audited financial statements; or
    - The estimated amount of total income for the current year, if that is lower.

19. In assessing total capital finance commitments, the institution must ignore low-value financial commitments, provided that the combined annualised servicing costs of such financial commitments do not exceed 0.5% of total income.

20. A revolving credit facility should typically be considered in the same way as an overdraft facility; for example, in terms of the institution’s maximum exposure over the term of the facility. An even annual cost of capital finance is assumed, unless the institution can demonstrate otherwise. The institution is required to provide the annualised cost of the capital finance calculation with any request to SFC for borrowing consent.

21. The institution must also seek consent from SFC before raising capital finance on the security of assets in which the Scottish Ministers have an interest. For the purposes of this document, such an interest exists where the institution has used funds provided by the Scottish Ministers to acquire an interest in or to develop any land, building or other asset, and where those funds were provided subject to a condition which has the effect of requiring the institution to obtain the Scottish Ministers’ consent before raising capital finance on the security of those assets.

22. The Scottish Ministers have directed that SFC will exercise their functions in relation to any such interests.

23. In seeking SFC’s approval, the institution must demonstrate to SFC, in writing, its compliance with the requirements set out above.

Disposal of exchequer funded assets

24. In disposing of exchequer funded assets, the institution must follow the guidance in the relevant procedure notes on the SFC website as amended from time-to-time.

Granting of security

25. As a result of a condition in SFC's Framework Document with the Scottish Government, the institution is required to seek SFC's prior written consent if it intends to offer as security for a loan any land or property which has been provided, improved, or maintained with the aid of grant.

Contingent commitments

26. The institution must seek SFC's prior written consent if it intends to lend or give a guarantee, indemnity or letter of comfort. The value of the guarantee should be equal to the total contingent liability over the term of the guarantee. In all cases, the institution must take steps to restrict the contingent liability to a minimum and should undertake a careful appraisal of the risks before accepting any contingent liability.

27. The institution must also provide assurance that, in the event of the contingent liability arising, it can be met from within the institution's own resource, or that appropriate insurance cover has been arranged.

28. However, SFC's written consent is not required for such arrangements if:

    - An actual or effective value is less than 4% of total income as reported in the latest audited financial statements or of the estimated amount of total income for the current year if that is lower; or
    - The indemnity is of a standard type contained in contracts and agreements for 'day-to-day' procurement of goods and services in the normal course of business.

Severance payments

29. The institution must adhere to the following principles when taking decisions about severance payments, including settlement agreements:

    - The actions of those taking decisions about severance payments, and those potentially in receipt of such payments, must be governed by the standards of personal conduct set out by the Committee on Standards in Public Life (the Nolan Principles)
    - The governing body must take account of SFC's expectation of the institution in this FM regarding the use of public funds

30. Based on the principles above, the following requirements must be met:

- The institution must have in place a clear policy on severance payments
- Severance packages must be consistent with the institution's policy and take into account contractual entitlements, for example, salary and period of notice, and any applicable statutory employment entitlements. This means that, when entering into employment contracts, care must be taken not to expose the institution to excessive potential liabilities
- The institution's policy must include a formal statement of the types of severance arrangements that should be approved by the Remuneration Committee or equivalent and approved formally by the governing body. These must include any severance package that is proposed for a member of the senior management team, in recognition of the particular level of accountability that is attached to senior management positions, and also any severance package that would exceed a maximum threshold agreed by the governing body
- Where a severance package exceeds the maximum threshold agreed by the governing body, the institution must consult with SFC's Accountable Officer prior to approving the proposed severance package
- The remuneration committee or equivalent, when overseeing and approving severance arrangements for staff, must ensure that all decisions are recorded
- Negotiations about severance packages and payments must be informed, on both sides, by legal advice where appropriate
- When a severance arises following poor performance on the part of an individual, any payment must be proportionate and there should be no perception that poor performance is being rewarded
- Final year salaries must not be inflated simply to boost pension benefits
- Notice of termination of appointments must not be delayed in order to generate entitlement to payments in lieu of notice

31. The institution must ensure its internal auditor includes a regular review of systems for the determination and payment of severance settlements in their strategic audit plan.

32. The institution must seek the view of its external auditor if it plans to make what it considers to be any novel or potentially contentious severance payments, including those that exceed the maximum threshold agreed by the governing body.

33. The institution's external auditor must review severance settlements. Such a review will normally take place after settlements have been agreed (normally as part of their financial statements audit) and should be carried out by senior

audit staff because of the complexity and sensitivity of the issues. If final settlements do not materially conform to the terms of this FM, auditors must report the facts to the institution in their management letter, and inform members of the governing body. The auditors should also recommend that the institution informs the SFC immediately.

34. Where there are settlement agreements, and it is felt that a confidentiality clause is necessary, this must not prevent the public interest being served and must be consistent with the institution's whistleblowing policy.

Audit and accounting

35. The governing body must appoint an audit committee and ensure the establishment and maintenance of effective arrangements for the provision of internal and external audit.

36. The Audit Committee must produce an annual report to the governing body of the institution.

Accounts direction

37. The institution must follow the SFC's current Accounts Direction in the preparation of its annual financial statements.

Internal audit

38. The institution must have in place an effective internal audit service. The operation and conduct of the internal audit service must conform to the professional standards of the Chartered Institute of Internal Auditors.

39. The institution must inform SFC when an internal auditor is appointed and must inform SFC immediately if the internal auditor is removed or departs before the end of their term of office.

40. The internal audit service must provide the governing body and senior management of the institution with an objective assessment of adequacy and effectiveness of risk management, internal control, governance, and value for money.

41. The internal audit service must extend its review over all the financial and other management control systems, identified by the audit needs assessment process. It must cover all activities in which the institution has a financial interest, including those not funded by SFC. It must include review of controls – including investment procedures – that protect the institution in its dealings with organisations, such as subsidiaries or associated companies, students' unions, and collaborative ventures or joint ventures with third parties.

42. The head of internal audit must produce an annual report for the governing body on its activities during the year. The report must include an opinion on the adequacy and effectiveness of the institution's risk management, internal control, and governance. The report must be presented to the institution's audit committee and a copy sent to SFC.

Value for money

43. The institution must have a strategy for reviewing systematically management's arrangements for securing value for money.

44. As part of its internal audit arrangements, the institution must obtain a comprehensive appraisal of management's arrangements for achieving value for money.

External audit

45. The external auditor must be entitled to receive all notices of and other communications relating to any meeting of the governing body which any member of the governing body is entitled to receive. They must also be entitled to attend any such meeting and to be heard at any meeting which they attend, on any part of the business which concerns them as auditors.

46. The external auditor must also be entitled to attend the meeting of the governing body or other appropriate committee at which the institution's annual report and financial statements are presented.

47. The external auditor is expected to attend, as a minimum, any meetings of the audit committee where relevant matters are being considered, such as planned audit coverage, the audit report on the financial statements and the audit management letter. It is the responsibility of the secretary to the audit committee to notify the external auditor of such meetings.

48. The external auditors, notwithstanding responsibilities to their clients, are expected to co-operate fully with any enquiries or routine monitoring that the SFC undertakes.

49. The institution must not in any way limit SFC's access to the institution's external auditors.

External audit reporting requirements

50. The institution must ensure that its contracts for external audit make provision for an opinion on whether the institution has applied income, where appropriate, in accordance with this FM and whether SFC grants have been used for the purposes for which they were received. Guidance on the wording is set out below.

a. The financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the institution's affairs, and of its income and expenditure, recognised gains and losses, and statement of cash flow for the year. They should take into account relevant statutory and other mandatory disclosure and accounting requirements, and SFC requirements.
b. The financial statements have been properly prepared in accordance with the Statement of Recommended Practice (SORP) on Accounting in Further and Higher Education, and the Companies Act, where relevant, and any other legislative or regulatory requirements.
c. Funds from whatever source administered by the institution for specific purposes have been applied properly to those purposes and, if relevant, managed in accordance with relevant legislation, and any other terms and conditions attached to them.
d. Funds provided by Scottish Funding Council have been applied in accordance with the requirements of the SFC Financial Memorandum with Higher Education Institutions.