

# 4: Commentary to the Plan

## Introduction

- 4.1 We ask colleges to provide a commentary to support the financial plan. The commentary is an important component of the plan. The commentary should clarify the following points:
- how the financial plan is consistent with the college's own strategic 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
  - 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 (Turnbull Report).
- 4.2 A suggested checklist is provided at the back of this chapter on issues to consider when completing the financial plan and commentary. The checklist is for colleges' own use and does not need to be returned to the appropriate funding body.

## Financial Objectives

- 4.3 In order to assist the college in achieving its strategic plans, 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. When the appropriate funding body reviews colleges' financial plans they consider whether the targets set by those colleges are appropriate, particularly for solvency.
- 4.4 To assist colleges in reviewing financial objectives and plan results, a variety of trend analysis for a number of key ratios is provided in Section 5 of this Handbook.

## Assumptions

- 4.5 Guidance on financial planning assumptions is provided in Section 3 of this Handbook.
- 4.6 Colleges should complete schedule 6 of the financial planning template to state their key assumptions. It is not mandatory for the

supporting commentary to contain a statement of key assumptions, however we recommend colleges use the commentary to clarify the assumptions used.

## **Sensitivity Analysis**

- 4.7 The information in the financial plan should reflect the financial effect of the planned levels of activity described in a college's strategic and three-year development plans. However, these plans are based on assumptions containing some degree of uncertainty. This uncertainty has been exacerbated in the current year with the continued economic downturn, the continued pressures on public sector funding and the recent change in Government. . This will require colleges to adopt an even more rigorous approach to the preparation of their plans, risk assessment and sensitivity analyses. The sensitivity analysis is intended to show the financial implications if more unfavourable conditions apply. Therefore, we require colleges to examine critically the underlying key assumptions and to assess realistically the effect of adverse circumstances and failure to meet their plans.
- 4.8 Colleges should complete schedule 5 of the financial planning template to perform a sensitivity analysis. It is not mandatory for the supporting commentary to contain comments on the sensitivity analysis, however we recommend that colleges should use the commentary to highlight the results of their analysis and to expand or clarify the contents of schedule 5.
- 4.9 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 third party support could affect a college's growth or the number of staff employed, leading to a very different outcome from the original financial plan.
- 4.10 Where a financial plan contains critical assumptions of this nature, colleges are advised to complete a second plan based on the alternative scenario and to share it with the appropriate funding body. Where a college considers that different outcomes have an impact on its financial viability, it is considered essential that an alternative financial plan is produced that reflects the impact of those changes.
- 4.11 Colleges should identify contingency actions to mitigate the consequences of the identified sensitivities. Colleges should discuss with the appropriate funding body where these actions lead to a rationalisation of provision in any programme area or locality.
- 4.12 To appreciate the implications of sensitivities, it is important that they are costed.
- 4.13 Colleges are reminded that their sensitivity analysis should be an integral element of their risk management plan.

- 4.14 When reviewing colleges' financial plans, the appropriate funding body will consider the adequacy of the sensitivity analysis and contingency planning that has been carried out.

## **Risk Management Plans**

- 4.15 The LSC published guidance for risk management planning to allow colleges to comply with the Turnbull Report on the Combined Code of Corporate Governance. This guidance is available on the LSC website:  
<http://readingroom.lsc.gov.uk/pre2005/funding/providers/circular0405-fecolleges-financialplansandriskmanagement.pdf>
- 4.16 Colleges are not required to submit copies of their risk management and disaster management plans with their 3-year financial plan, however colleges are still expected to update these documents on an ongoing basis.
- 4.17 Where a college is either submitting a capital project, recovery plan or undertaking a reorganisation, the appropriate funding body will reserve the right to ask for a copy of the college's risk management plan.

## **Disaster Management Plans**

- 4.18 Colleges may wish to integrate disaster management planning with their risk management plan. However, it may be considered appropriate to have a separate section that deals with more extreme risks. Responses to disasters are likely to require more far-reaching actions that, in turn, have an impact on other aspects of the college. Of necessity, this "domino effect" will involve more resources. Conversely, major disasters are far less likely to occur.

## **Good practice self-assessment checklist**

- 4.19 In Circular 05/03, the former LSC published a self-assessment checklist to assist colleges in reviewing their risk and disaster management plans. This checklist is repeated at paragraphs 4.20 to 4.25 below for ease of reference. It is not considered that all elements of the checklist would apply to all colleges. Colleges should select those items considered to be important to them and establish an appropriate review process.
- 4.20 ***"Senior management supports and promotes risk management."***
- A formal risk policy has been developed and is documented, endorsed by the corporation and the Principal, is readily available to all staff and is subject to regular review.
  - Senior management has a good understanding of the key risks facing the organisation and their likely implications for service delivery to the public and the achievement of programme outcomes.

- The college has systems in place to help ensure that key risks are identified and kept up to date so that review management is routinely in a position to be aware of the key risks.
- The college has contingency arrangements in all offices to maintain standards of service to the public and the delivery of programmes in the event that risks result in adverse circumstances.

4.21 ***“The college’s culture supports well thought through risk taking and innovation.”***

- There is an explicit policy to encourage well managed risk taking where it has the potential to realise sustainable improvements in service delivery and value for money, and this policy is actively communicated to all staff.
- The college has provided clear guidelines to all staff when developing its working culture through its policy guidelines on “Ways of Working”.
- All senior management and risk champions are encouraged to look at risks in failing to follow up opportunities as well as threats.
- The defined ways of working clearly state that the college wishes to avoid a blame culture.
- Staff are encouraged to take responsibility for risks when they are best placed to do so rather than transferring the risks to other organisations. Very few of the risks are transferred.
- Staff are encouraged to report bad news to senior management as well as good with a view to resolving problems rather than allocating blame.
- Staff are encouraged to challenge existing practices, to identify new ways of doing things and to be innovative.

4.22 ***“Risk management policies and the benefits of effective risk management are clearly communicated to all staff.”***

- There are clear statements that set out the college’s risk policies and its approach to risk taking and innovation, and all staff are encouraged to read them.
- Risk champions have been identified in all college offices and directorates and have received comprehensive training on risk management. There is a standard risk management system on which all risks are recorded in a prescribed format, thus ensuring consistency in the definition of risks and how they should be managed. There is detailed guidance on how the risk management process operates.

- Risk management, policies, guidelines, definitions and recording are clearly communicated to all staff.
- Appropriate staff have been appointed with clearly assigned responsibility for assessing, reporting and managing identified risks and their responsibilities are regularly reviewed.
- Staff have received appropriate guidance and training on the typical risks which the organisation faces and the action to take in managing these risks.

4.23 ***“Risk management is embedded in management processes.”***

- There is an established process for identifying risk, assessing the risk and reporting the risk which is understood by staff.
- The internal audit reviews, the risk management process and benchmarking will be a key feature of our risk management continuous improvement process. The college is aiming to be a benchmark for risk management in the FE sector.
- Management has sought advice from internal and external audit, as well as partner agencies, on good practice in the development, implementation and maintenance of robust risk management processes and systems.
- The college has taken some professional advice to ensure that the most appropriate tools and techniques are used to assess risk and the likelihood of it maturing.
- The college’s aim, whenever practicable, is to place a monetary or other numerical value on the risk to emphasise the potential loss or misused opportunities which could occur if risks are not managed. Where no monetary or numerical value is used the level of impact will be stated.
- Impact on learners and other customers is monitored as part of the risk management process to ensure that the provision of services remains appropriate, sufficient and cost effective.
- Risk management is ongoing and integrated with other procedures so that staff accept it as a standard requirement of good management and not a one-off or annual activity. Risk assessment is built into all papers submitted to the college senior management board, programme boards and corporation. Consideration is being given for inclusion of risk management as part of the college’s “Ways of Working”.

4.24 ***“Management of risks is closely linked to the achievement of objectives.”***

- All key targets and objectives are considered during the risk management process to help ensure that they are achieved, that the level of risk is identified and that appropriate actions are planned.

- The potential risks for key stakeholders are taken account of in the development of the risk management register.
- Each risk is assigned to a lead person; that lead person is responsible for ensuring an action plan is developed to address the key causal factors and is also responsible for monitoring progress so that senior management can be alerted to problems such as quality of service and increase in customer demand not being met.
- There is a business continuity plan in place in every college office and directorate to deal with contingencies should problems arise so that key targets, objectives or programme outcomes are not affected.
- There is a communication strategy in place so that if risks mature those most affected by the potential adverse consequences fully understand and have confidence in the remedial action that the college may need to take.

4.25 ***“Risks associated with other organisations are assessed and managed.”***

- A list of third party organisations has been identified as having or likely to have an influence over the success of college programmes and services.
- Consideration will be given to the need for a consistent and common approach to managing risks that cut across partner boundaries.
- Risks associated with joint working will be jointly identified and assessed and those involved in the joint working or partnership clearly assigned and understood.
- The college will be proactive in ensuring risk management arrangements are in place on joint working projects.
- The college will review the extent to which risks for joint projects can successfully be transferred to other organisations, both public and private.
- The college will proactively ensure that reliable and regular information to monitor the risk management performance of all the organisations involved in a joined-up programme and partnership is available for effective risk management.
- The college will ensure that there are contingency arrangements to minimise the adverse effects on public service delivery of one or more parties failing to deliver.

## **Suggested Checklist for Commentary**

- 4.26 The suggested checklist below is for colleges' own use and does not need to be returned to the appropriate funding body.

### **Financial objectives**

- 4.27 Has the college set detailed financial objectives? Are they set out in the commentary?
- 4.28 Has an assessment been included in the commentary of the extent to which they have been achieved?

### **Strategic and/or development plan**

- 4.29 Is there a clear link between the projected learner numbers included in the college's strategic plan and the movement in funding and standard learner numbers ('SLN') recorded on Schedule 1b of the financial plan? If not, please explain any changes in the commentary.
- 4.30 Do the staff costs included in Schedule 1d of the plan reflect future staffing plans?
- 4.31 Does the financial plan reflect the financial implications of the college's property strategy?
- 4.32 Does the financial plan demonstrate that the college's financial objectives are being achieved? If they are not, is this addressed in the commentary?

### **Approval**

- 4.33 Has the governing body approved the plan?

### **Self-assessment of financial health**

- 4.34 Has the governing body made regular assessments of the college's financial health?
- 4.35 Has a review of the strategic plan and financial plan taken place in order to assess whether the college is able to support its plan with the resources identified?
- 4.36 Have the underlying strengths and weaknesses of the college's financial position been examined in order to assess the extent to which the college is likely to be vulnerable to adverse variances?
- 4.37 Does the commentary explain the college's rationale for its financial health self-assessment?
- 4.38 Does the commentary give reasons for any moderation from the automated health group assessment, if applicable, and are the grounds for moderation appropriate?

### **Supplementary information**

#### **Principal's Statement**

- 4.39 Has the financial health self-assessment been completed?
- 4.40 Has the budget statement been completed?

- 4.41 Has the risk management plan been completed and approved by the board of governors?
- 4.42 Has the efficiency savings statement been completed?
- 4.43 Has the College agreed to publication of the data?
- 4.44 Has the Principal signed the form?

**Table 1**

- 4.45 Does the commentary explain significant year-on-year movements?
- 4.46 Does the commentary explain any variances between the latest estimate of out-turn for the current year and the original budget?

**Tables 2 and 3**

- 4.47 Does the commentary identify significant asset purchases and disposals, including consents and purposes?
- 4.48 Does the commentary give the details of any loans, including consents and background?
- 4.49 Does the commentary explain significant year-on-year movements in debtors and creditors?

**Schedules 1a, 1b and 1c**

- 4.50 Does the commentary include the sources of grant income?
- 4.51 Does the commentary include the nature of any repayment of European Social Fund (ESF) funding?
- 4.52 Does the commentary include the sources of income from franchising provision?
- 4.53 Does the commentary include the main income-generating activities?

**Schedules 1d and 1e**

- 4.54 Does the commentary give details of any provisions included in expenditure?
- 4.55 Does the commentary explain large year-on-year movements?

**Schedule 1f**

- 4.56 Has the reconciliation of movements between years been completed?

**Schedule 4**

- 4.57 Have the capital uplift (where appropriate) and self-assessment boxes been completed, including the narrative box (where appropriate)?

**Schedule 5**

- 4.58 Has the sensitivity analysis been completed?

**Schedule 6: Key assumptions**

- 4.59 Does schedule 6 or the commentary include assumptions about:
- Movements in funding and learner funding rate
  - income from the LSC's successor bodies other than the main funding streams

- income from other sources, in particular: education contracts, tuition fees, European funds, commercial activities etc
  - implementation of property strategy, in terms of capital investment, long-term maintenance and routine maintenance
  - increases in staffing costs 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 gain resulting from staff losses at the high end of the scale being offset by new staff at the lower end
  - any changes anticipated for the local government pension scheme?
- 4.60 Does schedule 6 include the general level of pay awards assumed in the plan?
- 4.61 Does schedule 6 state any variation in the general inflation rate for specific items of income or expenditure?
- 4.62 Does schedule 6 state the interest rates assumed?
- 4.63 Does schedule 6 state the assumptions underlying income from all sources and all expenditure cuts?

#### **Planned maintenance**

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

#### **Risk management**

- 4.65 Has the college's risk management plan been approved by the governing body?
- 4.66 Does the college's risk management plan cover disaster planning, risk analysis, sensitivity analysis and contingency planning?
- 4.67 Does the risk management plan comply with the Turnbull Report?

#### **Other information**

- 4.68 Does the Principal's Statement give the name and telephone number of the contact person for all enquiries?

### **Financial Objectives Adopted by Colleges**

- 4.69 Colleges should set clear financial objectives that support the achievement of their strategic objectives. Whatever objectives are set, progress against them should be monitored and reported on a periodic basis through a series of performance indicators. Examples of such indicators are set out in paragraph 4.70 below. These should be tailored to the college's circumstances/needs.
- 4.70 Example indicators might include:

- a maintaining a sound financial base (solvency and liquidity) based on the following:
  - i we will have a general reserve of XX per cent of income by 31 July XXXX and YY per cent by 31 July XXXX
  - ii we will maintain cash days of XX or more at all times
  - iii we will achieve break-even by 31 July XXXX and have an operating surplus by 31 July XXXX
  - iv we will generate a cash inflow from operating activities by 31 July XXXX
  - v we will reduce borrowing to XX per cent of general reserves by 31 July XXXX, and YY per cent by 31 July XXXX
  - vi we will have a current ratio of more than XX:1 by 31 July XXXX)
- b improving financial management by producing management accounts on a monthly basis, incorporating an income and expenditure account, balance sheet, 12-month rolling cash flow forecast, capital expenditure, financial performance indicators, staffing information and funding information (including plans)
- c strengthening procedures for testing the desirability and affordability of any proposals which have a financial implication by 31 July XXXX
- d introducing post-implementation review procedures in order to assess the success or otherwise of major investments (building, information technology, staffing, marketing and so on) exceeding £XX,XXX by 31 July XXXX)
- e maintaining the confidence of funding bodies, suppliers and professional advisors by:
  - i providing financial and non-financial returns on time and in the agreed format
  - ii ensuring all returns requiring certification by auditors are unqualified
  - iii adhering to the college's policy to pay all suppliers within XX days of receipt of an invoice
- f raising awareness of financial issues by:
  - i providing advice, guidance and training to staff, management and governors on funding, funding methodologies, budgeting and the college's financial procedures
  - ii providing adequate information to ensure that staff, management and governors are kept up-to-date with the financial position of the college; and

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