The Finance Committee

Although there is no requirement to do so, most governing bodies establish committees to have a particular responsibility for financial matters. In many cases, particularly in the post 1992 institutions, such committees also have responsibilities for employment and HR matters.

Typically finance committees are responsible for:

- A detailed review of the draft budget, before it is recommended to the governing body, and annual operating plans;
- Regular monitoring of management accounts and other financial indicators;
- Scrutiny in detail of the annual accounts / financial statements;
- Oversight and monitoring of major capital projects;
- Approving financial regulations and procedures and other financial controls;
- Monitoring the student union accounts and financial reports; and
- Monitoring and advising on investments and any trading activities.

The funding councils do not permit members of an institution’s audit committee to serve concurrently on the finance committee. Some pre 1992 universities have the post of lay Treasurer, who is usually ex officio chair of the finance committee.

Financial Strategy and Planning

The key financial issues facing governors emerge from a consideration of four basic questions:

- What are the institution's current vision and priorities?
- How are they reflected in financial strategies and policies?
- How are they reflected in budgets and capital plans?
- Is the institution sustainable?

The CUC Guide notes that ‘the governing body plays a key role in the strategic development of the institution’ and should be involved in the development and approval of the strategic plan.

The strategic plan should be supported by a number of other strategies and plans, including a robust and credible financial plan. The content of all strategies is important as is the level of consistency. Governing bodies should expect to be invited to approve an annual budget, and operating plan each summer, with longer term forecasts and analyses of risks. Hefce has produced a guide Financial Strategy in Higher Education Institutions - A Business Approach, which may be a useful stimulus for debate.

Monitoring and Control

In maintaining stewardship of the finances of an institution, governors will need to look for:

- A sound system for budgeting and forecasting
- Reliable and timely management accounting and reporting
- Clear and workable financial regulations and procedures

Governing bodies also need to be clear that there is a schedule of delegated powers in place.

As charities receiving substantial public funding, universities and colleges must account for how they use their funds. Moreover, the financial memorandum with the funding council imposes a requirement to show that council grants have been applied for the purposes intended. Charity law imposes an obligation to show that all expenditure has been directed towards realising the institution’s charitable objectives. Ensuring that
these obligations can be met is the role of the financial accounting team, and it is their job to demonstrate the necessary probity, compliance and accountability through the preparation of the annual financial statements and other statutory returns as required to the satisfaction of the external auditors.

The management accounting team is responsible for preparing budgets and forecasts and producing regular reports during the year. The budgeting process usually starts in earnest when the annual grant letter is received from the funding council in March. A major update is normally required when student numbers become clearer much later in the year. Pay settlements may also have a major impact on budgets. During the autumn financial forecasts for the next few years are prepared and submitted to the funding council. The assumptions underpinning these forecasts and the information they contain are important issues for consideration by governors.

Treasury management (the management of cash, both borrowed and deposited) will require a strategy and associated policies. Substantial cash flows occur at various times of the year and can be traps for the unprepared leading to major risks if not effectively controlled, especially in relation to interest rates and the reliability of deposit-takers. The involvement of the finance committee (or equivalent) is essential, and the full board should approve the overall treasury strategy.

Substantial work is now being undertaken on costing and pricing, and institutions have been given strong encouragement to think in terms of 'full economic costing' - looking at all the costs which an activity incurs, including a fair allocation of overheads. The method for doing this is known as the Transparent Approach to Costing (TRAC), and has been designed with the aim of helping institutions to manage their affairs better, as well as providing accountability for spending. Hefce has published guidance on financial sustainability and the role of TRAC.

Governors also need to monitor capital developments whose financial impact may be spread over several years, in particular to make sure that spending plans are compatible with probable funding.

**Measuring Financial Performance**

Ensuring financial health is one of the most important tasks of any governing body. There are numerous indicators which may measure financial performance, so it is vital to focus on those few which give the greatest insight: the Key Performance Indicators (KPIs). It is important to note:

- While no one indicator should be taken in isolation from others and the overall pattern needs to be seen and understood, those relating to cash have become much more important
- One year needs to be taken with another to provide an understanding of underlying trends.

The funding councils typically use 5 indicators to judge the financial health of an institution:

- Surplus or deficit as a percentage of income
- Discretionary reserves as a percentage of income
- External borrowing as a percentage of income
- Ratio of current assets to amounts falling due in one year
- Liquidity (cash plus investments, less overdrafts) against expenditure

Many finance committees also monitor:

- Cash generated
- Forecast surplus (and other indicators) for the next 3 years
- Unfinanced capital investment requirement
- Credit rating
- Relationships with bankers and auditors
It is also important to be aware of value for money. The CUC has published a comprehensive guide to this area, Monitoring of Institutional Performance and the Use of Key Performance Indicators.

Governors may be interested in The Financial Health of the Higher Education Sector by Grant Thornton, using 2010-11 data, summarised in Times Higher Education. The Financial Sustainability Strategy Group has published a report Assessing the Sustainability of Higher Education Institutions which is intended to help governing bodies of institutions to develop and monitor indicators of financial sustainability. HESA publishes Finances of Higher Education Institutions which provides data based on income and expenditure broken down by source and category of expenditure.

See also Hefce's report on the Health of the HE Sector in 2010-11 and its analysis of institutions' financial forecasts to 2014-15. Hefcw also publishes an ‘Analysis of the financial position of the HE sector 2010-11’.

Higher Education Accounts

The annual accounts, or financial statements, are a formal, historical record of the institution's stewardship of its financial resources. They are an important element of accountability, besides being a very useful source of information. They are necessarily an overview - only really significant transactions are set out. The thousands of day to day receipts and payments will have been sorted into like items and summarised. So there will be much more financial information available behind them, some of which governors should see as part of routine financial reporting during the year. But the accounts are the public record and will carry an independent audit certificate to give assurance to readers that they can be relied upon. The standardisation of accounts across the higher education sector enables useful comparisons to be made with peer institutions.

The annual accounts of higher education institutions must conform to a specific format set out in the Statement of Recommended Practice: Accounting in Further and Higher Education (SORP) as well as relevant accounting standards. There are 3 main elements:

- The income and expenditure account
- The balance sheet
- The cash flow statement

Capital items are dealt with by carrying their initial cost on the balance sheet and ‘drip-feeding’ it over the projected life of the asset through applying an annual depreciation charge to the income and expenditure account. Similarly, grants received towards the cost of such items are also carried on the balance sheet and released to the income and expenditure account over the same period. Institutions are also permitted from time to time to revalue their assets.

Income, Expenditure and Capital

Income: The principal sources of income for higher education institutions are:

Funding council grants: For many institutions this will be the dominant funding source, but the position varies widely. There are two main funding components – teaching and research, together with various special funding streams, for example in relation to widening access, and the development of ‘third stream’ income.

Student Fees and Teaching Contracts: Tuition fees and teaching contracts make up an increasingly important component of many institutions’ income, and include fees from international students, an area of income that can be volatile.
Research Grants and Contracts: The main source of research grant income for many institutions is the research councils, but government departments, charities and industry also can be significant.

Other income includes that from student accommodation, conferences and catering, consultancy, donations from alumni (an area which many institutions are working on) and through the exploitation of intellectual property. A small number of institutions also have substantial income from endowments and investments.

Expenditure patterns of higher education institutions vary less than those for income, with the largest component of expenditure – averaging almost 60% in non-specialist institutions – being staff. For most institutions the second heaviest area in the estate, with other significant expenditure on educational support (libraries, IT and educational technology).

Capital: Institutions may have extensive property holdings which they may wish to improve or develop. In addition to core funding for running costs, the government makes special grants available to higher education through a series of initiatives. Particularly in England, there has been an increasing tendency for such grants to be allocated on a formula basis, related to an institution’s volume and pattern of teaching and research.

Property development or acquisition can be a very significant commitment. If it is not wholly grant funded it must be financed by the generation of surpluses or from borrowing. Careful appraisal and risk analysis should be vital parts of governors’ approval processes.

Financial Rules and Regulations

Other than the general law, and for those institutions which are established as companies - company law, there are two key sets of financial rules:

- The Financial Memorandum with the funding council, which is in two parts (see Hefce Model Financial Memorandum)
- Charity law

The key point is that money provided by the funding councils must only be spent on education or research or the provision of facilities in support of those activities. Charity law requires institutions to spend money exclusively on their charitable activities. Many institutions have formed subsidiary companies to carry out work which cannot be regarded as for the ‘public benefit’.

In addition to the financial memorandum, the funding councils also issue each year an Accounts Direction (see for example that of Hefce) specifying certain requirements in relation to the annual financial statements. The funding councils place restrictions on both long-term and short-term borrowing. There are also rules about audit and an increasing emphasis on the importance of proper costing and pricing.

Trading and Subsidiary Companies

There has been increasing pressure on higher education institutions in recent years to develop ‘third stream’ funding, in addition to their income derived from teaching and research. Many institutions have developed various trading activities, including:

- Academic services (e.g. short courses, consultancy).
- On-campus services (e.g. bookshops, gift shops, catering).
- Social and community services (e.g. arts centres, sports facilities).
- Spin out companies, designed to exploit the intellectual property of staff, perhaps with injections of capital from banks or other investors.
- Collaborative arrangements with industries and commercial organisations, eg science parks.
• Conference centres (whether based on vacation occupation of student residences or purpose built).
• Overseas ventures or partnerships

Governors will need to:
• Make sure that robust governance arrangements for trading activities are in place to ensure effective risk management, monitoring and control
• Avoid the institution becoming over-reliant on commercial revenue
• Test that the executive has the necessary skills to support commercial ventures

It is important that tax issues are clearly understood. Also the relationship between commercial ventures and the core business of the institution is important and overseas ventures require particular care.

The governing bodies of some institutions have set up specialist committees to oversee commercial activities, and some have co-opted external members to provide expertise not already available on the board / council.

Find more information and resources on this topic on our website at: www.lfhe.ac.uk/en/governance/ba/committees/finance