Insolvency regime for further education and sixth form colleges: technical consultation

Barclays response

Question 1: When considering the normal insolvency procedures outlined above (Company Voluntary Arrangement, administration, creditors' voluntary winding up, winding up by the court and receivership), are there any specific modifications that you believe are required in order to apply them effectively to FE bodies? Please provide explanations for any of these.

Comments:

We are aware that The Education Act 2017 clarifies that normal insolvency procedures will apply to FE bodies in England & Wales. The existing Insolvency regime within England & Wales and the procedures outlined above are sufficiently broad and we cannot immediately see why they would need to be modified to include FE bodies however, we consider that Insolvency Practitioners and Insolvency Lawyers will be better placed to respond to this question.

Question 2: Who do you believe should be specified to receive:
a. Notice of an education administration application;
b. Notice of an education administrator's appointment;
c. A copy of the education administrator's proposals?
Please provide justification for your answers.

Comments:

a. application – secured creditors, including holders of land charges
b. appointment – all creditors
c. proposals – all creditors

A secured creditor will often be a major stakeholder and its security over the asset(s) brings with it an expectation that it will have an influence in the asset over which it is secured and any strategy for dealing or realisation given the extent of its financial interests. As such a secured creditor would require early notification of an education administration and also to be given the opportunity to engage with the intended administrator to understand the proposed strategy and the impact that it may have on its financial exposure.

Question 3: Is there any specific information that you would expect the education administrator's proposals to contain? Please provide an explanation for your answer.

Comments:

We would expect the proposals to meet the requirements of para 3.35 of the Insolvency rules 2016. We consider that it will be important for the proposals to contain information about the arrangements that have been made to fund the administration process, any agreements that have been reached about the continuation of the facility as a going concern and the anticipated duration of the process.

Question 4: Do you have any other comments or views on the process of education administration?

Comments:

None.

Question 5: Do you have any comments about how the Companies House filing process could work for FE bodies?

Comments:

We consider that it will be important to have a public notification of the appointments and similar publication of information aligned to the requirements of the Insolvency Act 1986. Companies House may not be the appropriate forum for publication if the entities are not incorporated however, we note that this is under consideration.

Question 6: What particular aspects or issues would you find it useful for the guidance for governors to cover?

Comments:

We consider that guidance equivalent to that currently available to directors of Corporates, explaining the various insolvency options, detailing their role(s), obligations and responsibilities and how these change as the likelihood of insolvency increases would be important.

Details of trade bodies that could suggest suitable professional advisors may be also be beneficial to Governors.

Question 7: Do you have views on how monitoring and intervention can be further improved to identify cases of financial distress and work with those colleges to improve their financial position and avoid insolvency? (Please be clear whether you are responding in relation to colleges in England or colleges in Wales).

Comments:

Colleges in England produce a number of pieces of financial information that can help monitor their performance and help identify potential cases of financial distress.

Audited financial statements and rolling forecasts are produced in statutory format annually. These are often supplemented by management accounts on a more frequent basis (usually quarterly and sometimes more frequently than that).

This information is used by college managers to plan and monitor performance and also by other stakeholders (including college governors, the Education and Skills Funding Agency ('ESFA') and lenders) to ensure the college remains on track with the plan that they have supported.

Colleges will often use a set of Key Performance Indicators ('KPIs') to help with the monitoring of their performance. This usually includes the sector's financial health grading system and any financial covenants included in borrowing arrangements with lenders.

Improving the quality of this financial information (and the KPIs contained within) will help all stakeholders better identify potential financial distress.

Update the financial health grading system to have a greater emphasis on liquidity, cashflow and the capacity to service financial obligations

- The ESFA's financial health grading system takes financial inputs from a college to allocate scores against profitability, solvency and gearing.
- Of these, a greater emphasis should be placed upon solvency. This should include the current liquidity (cash available) of the college, its cashflow (how income and expenditure relates to cash) and how that cashflow is available to service financial obligations.
- A profitable college with low gearing could still run out of cash and the financial health grading system should reflect this.

- Any gearing measure should be operational and not asset based. Gearing should measure borrowing as a ratio against cashflow, not income.
- Currently, a lot of emphasis is placed on historic financial health. A college could be viewing itself as having Outstanding financial health based on the last published audited financial statements. These could be up to 17 months old and in the meantime the college could have depleted cash and now be facing financial distress.
- A forward looking financial health grading system would be a better way to identify cases of potential financial distress. Trend analysis could also be applied to highlight a deteriorating position.
- Ideally the financial health grading system should factor in the headroom to compliance with loan covenants. A breach of loan terms could result in a lender making demand for repayment in full which could create an immediate issue of solvency. Such breaches (actual or forecast) should be considered as an automatic referral trigger to the ESFA.
- The financial health grading system should also include a measure of a college's capacity to raise additional finance as this often addresses solvency issues. This measure should take into consideration factors such as available unencumbered assets available for security and restrictions in existing borrowing arrangements.
- Overdrafts and working capital facilities are indications of a liquidity issue and so agreement of these facilities could be a trigger for ESFA approval as could borrowing of any facility that would take gearing over a pre-specified level.

Subject financial plans to sensitivity and stress testing with an emphasis on liquidity, cashflow and the capacity to service financial obligations

- The financial plan should set out the college's strategy in financial terms. Plans should have a focus on liquidity, ensuring that a College has access to the cash it needs to fund its operations at all points through the annual cycle and with an acceptable degree of headroom to cope with unforeseen headwinds.
- All financial plans should be subject to sensitivity analysis and stress testing. This should involve flexing the key assumptions around income and expenditure to see at what point issues of solvency arise.
- College managers should build this into their plans (if the statutory format of the plans is not set up to allow it). Where sensitivity highlights solvency issues college managers should have mitigation strategies in place which are articulated and modelled in the plan.

Encourage adoption of more effective management accounts and rolling 12 month cashflow forecasts

- Effective management accounts provide a clear view of performance against an approved plan and provide updated forecasts based on that performance.
- Effective management accounts should be straightforward for the users of those accounts to read and interpret (for colleges this includes senior managers, governors, the ESFA and lenders). Usually this involves a single-page dashboard which clearly shows where the college is on or off track and highlights any risks (particularly around liquidity). Commentary and more detailed financials usually then support this dashboard. Readers should not have to interrogate the detail to find issues or risks, these should be highlighted clearly on the dashboard.
- Frequency of management accounts production should be proportionate for the position the college is in. A college with liquidity issues or undergoing significant transformation should produce accounts with greater frequency (at least monthly and should be refreshing cashflow forecasts more frequently than that).
- The lag between a period end and production of management accounts should be as short as possible. The fresher the data the more effective management action will be as a result.
- Management accounts should contain key performance indicators that allow the college to assess performance vs the approved plan. Some of these will be leading indicators (such as enrolment numbers) but ultimately the focus should be on liquidity and cashflow. From the planning process a

college should know what sensitivities lead to liquidity issues and they should build triggers into their KPIs to spot these early so they are able to take the appropriate mitigating actions.
- Colleges should use rolling 12 month cashflow forecast to ensure that any issues expected to arise are identified at the earliest opportunity.

Question 8: How could ESFA and FEC work with and support colleges in England to help them self-identify financial difficulties at an early stage?

Comments:

In addition to the comments in response to question 7.

- Training for managers and governors will help improve financial planning and monitoring.
- A greater focus on liquidity will help all colleges.
- This includes an understanding of the contribution made by each element of the curriculum, together with the associated cashflows. This information should be actively used to inform decision making around the delivery of learning and assist colleges in considering the options available in the event of under recruitment in a particular area.
- Where mitigating action needs to be taken colleges should act quickly and take actions based on forecasts, not historical positions.
- There should be a focus on the preservation of liquidity with a move away from reliance on working capital facilities for operational requirements.

Question 9: Do you have views on how the Independent Business Review process for an FE college should work, and who should be consulted?

Comments:

- Early engagement of an appropriately experienced firm to undertake the IBR is critical.
- Lenders would expect to be consulted and would also expect other creditors and college stakeholders to be consulted. Lenders would expect to have input into the IBR scope and occasionally a joint duty of care may be appropriate.
- A key question that needs addressing is: who funds the insolvent college during this potentially lengthy IBR process (and a question for the IBR to address is who funds the various options available to protect the interests of the learners at the insolvent college).

Question 10: Do you have any further comments on any aspects of our proposals (including our impact or equalities assessments)?

Comments:

None