

Office for
Students



Compliance with the 2017-18 accounts direction

Observations, compliance and areas for improvement

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Summary

1. Providers that are registered with the OfS are required to comply with the accounts direction under ongoing condition of registration E3. It is through registration, and so compliance with the initial and ongoing conditions of registration, that providers can access public funding (when registered in the Approved (fee cap) category and eligible for funding), and that their students are able to access tuition fee loans (all registered providers). The accounts direction ensures that providers disclose information in their financial statements that is important for transparency.
2. This paper is based on our in-depth review of the audited financial statements of approximately 25 per cent of the 133 higher education providers. This in-depth review took place alongside our review of all of the financial statements of all higher education providers that were required to comply with the accounts direction for the financial year ending 31 July 2018. We present our findings and observations from this review and highlight where we have made changes to the new accounts direction.
3. All registered providers may find it useful to understand areas for improvement in compliance and, for senior staff remuneration, the types of disclosures that, in our view, represent effective compliance with our accounts direction. We are raising the areas for improvement to support providers in better complying with the accounts direction in future.
4. We note that the obligation to comply with the accounts direction under ongoing condition E3 constitutes a legally binding requirement and where this requirement is not met, this is likely to constitute a breach of a condition of registration. This year we are dealing with areas of likely non-compliance by publishing themes and feedback on compliance issues in this paper rather than by considering the use of our enforcement powers in relation to an individual provider. The OfS's enforcement powers include the ability to impose a monetary penalty. Where we consider that a provider's practice is non-compliant in future, we are likely to take enforcement action and this may include imposing a specific ongoing condition to require a provider to update the disclosures and re-publish its financial statements.
5. The accounts direction for accounting periods beginning on or after 1 August 2019 (OfS 2019.41) has taken into consideration areas of likely non-compliance with its previous accounts direction. We have clarified the wording where appropriate to make the requirements clearer for providers, taking into account the frequently asked questions to which we responded after the publication of the previous accounts direction.

Compliance with the 2017-18 accounts direction

6. Providers that are registered with the OfS are required to comply with the accounts direction under ongoing condition of registration E3. It is through registration, and so compliance with the initial and ongoing conditions of registration, that providers can access public funding (when registered in the Approved (fee cap) category and eligible for funding), and that their students are able to access tuition fee loans (all registered providers).
7. We have undertaken a review of compliance with the 2017-18 accounts direction for a sample of providers. For this paper, we have focused on the OfS-funded higher education providers as the accounts direction did not apply to providers not funded by the OfS or to further education colleges during 2017-18. However, all registered providers may find it useful to understand areas for potential improvement in compliance and the types of disclosures that in our view represent effective compliance with our accounts direction.
8. The sample of providers for in-depth review comprised 34 providers that were required to comply with the accounts direction (approximately 25 per cent of the total number of higher education providers that were required to comply). This in-depth review took place alongside our review of all of the financial statements of all higher education providers that were required to comply with the accounts direction for the financial year ending 31 July 2018. For some parts of the review, a different approach to sampling was undertaken for particular disclosures and this is noted in the relevant section of the paper.
9. As part of our review of providers' audited financial statements, we have identified instances of likely non-compliance with the accounts direction as well as approaches to disclosure that constitute good practice. Where we have identified likely non-compliance, we have considered whether this increases our assessment of the risk that a provider will breach one or more conditions of registration in future. Where we judge this risk to be increased, we may intervene by formally communicating this to the provider or by imposing enhanced monitoring requirements or a specific ongoing condition of registration.

Signing and publication of audited financial statements

10. The accounts direction requires a provider's accountable officer and chair of the governing body (or other governor) to sign the audited financial statements as confirmation that the financial data are not materially mis-stated. This is part of the accountability for public funding and so part of the responsibility for the financial and other information presented in the financial statements. We note that all the financial statements reviewed in the approximately 25 per cent sample (see paragraph 8) had been signed appropriately.
11. In addition, providers must publish their audited financial statements on their website. This ensures transparency and is an important part of the accountability to students and taxpayers for the public funding and taxpayer-backed student loans from which providers benefit.
12. At the time of our review, all providers that were subject to the accounts direction had published their audited financial statements on their websites. However, we are aware that in several cases, the publication was later than required – the requirement was for publication within two weeks of financial statements being signed by the required individuals and, at the latest, four months after the end of the financial year to which they relate.

13. We note that the future requirement will be to publish audited financial statements on the provider's website within two weeks of signature and, at the latest, five months after the end of the financial year to which they relate. The previous requirement was four months and so we are allowing providers an extra month to prepare, audit, sign and publish their audited financial statements, and to fit within the timetable for governance requirements for approval.

Remuneration disclosures

14. The accounts direction requires providers to disclose certain information about senior officer remuneration and compensation for loss of office; in brief, this included:

- a. The number of staff with a basic salary of over £100,000 per annum, broken down into bands of £5,000.
- b. Full details of the total remuneration package of the head of provider.
- c. A justification for the total remuneration of the head of provider. This was required to:
 - i. include reference to the context in which the provider operates
 - ii. be linked to the value and performance delivered by the head of the provider
 - iii. contain an explanation of the process adopted for judging the head of the provider's performance.
- d. The relationship between the head of the provider's remuneration and that for all other staff expressed as a multiple – ratios of basic salary and total remuneration of the head of the providers as multiples of the comparative figures for all other staff.
- e. The total amount of any compensation for loss of office paid across the whole provider and the number of people to whom this was payable.
- f. The amount of compensation for loss of office paid to the head of the provider, if applicable, including all benefits that formed part of the compensation.

15. We have previously published an analysis of senior staff remuneration¹ (OfS 2019.03) and this paper should be read alongside that analysis.

Issues identified

16. Across the range of providers sampled, we have identified the following areas of likely non-compliance in respect of the required disclosures about senior staff remuneration and compensation for loss of office:

- a. Presenting the head of provider's salary as the amount paid rather than on an FTE basis.

¹ <https://www.officeforstudents.org.uk/publications/senior-staff-remuneration-analysis-of-the-2017-18-disclosures/>

- b. Disclosing the nature of some benefits but not their estimated monetary value (such as the provision of accommodation rent-free to the head of the provider, but not the cost to the provider of providing this accommodation).
- c. Disclosing the value of taxable or non-taxable benefits or both, but not stating what these benefits are.
- d. Disclosing the value of benefits in the narrative note to the financial statements but not disclosing all these benefits in the total remuneration for the head of the provider – this means that the table showing the ‘total remuneration’ is incomplete and the total understated.
- e. Excluding one or more parts of the justification statement, or only providing technical information about the process by which remuneration was determined, rather than the full justification and basis for the remuneration.
- f. Not disclosing severance payments for all staff and the number of employees they affect. Although we recognise that it is possible that the providers did not make any severance payments, we are aware that some of those sampled have implemented severance schemes and so should have disclosed this information in their audited financial statements. Where no severance payments have been made to any staff, then the provider should simply state that this is the case.

Justification statements

17. The accounts direction required providers to publish in their audited financial statements a justification for the total remuneration package for the head of the provider. The focus of our review was not to comment on individual justification statements in this paper, but rather to draw out common themes and core messages across the sample of providers that we have reviewed. It is for a provider to ensure that it complies with the accounts direction. We recommend that providers review their justification statements in the context of the comments below. Where we consider a provider’s practice to be non-compliant in future, we may impose a specific ongoing condition or other intervention to require it to update the disclosures and re-publish its financial statements.
18. All but one of the providers sampled had included a justification statement. Most of these statements were relatively weak. They contained little of the required information that would help students and taxpayers to understand the context of the provider, how the remuneration decision reflected the individual’s value and performance, or how the performance was judged by the governing body. In general, the disclosures that were clearer and more transparent were expressed in a remuneration report, following the Committee of University Chairs’ (CUC) guidance on remuneration. These justifications were set in a context that highlighted the achievements of the provider, and the head of provider’s contribution to those achievements.
19. Common areas of weakness in the justification statements were:
 - Focusing on the mechanics of the process by which a remuneration decision is made – the focus would be better placed on the approach to judging the head of the provider’s performance and explaining why the level of remuneration awarded is appropriate.

- Not explaining the provider's context (such as where it sits in its market, the complexity of the business, what has been achieved in the period of review), and how this affects the level of remuneration that may be expected or appropriate for a head of provider – if these elements were included then it would provide useful framing for the level remuneration awarded and give stakeholders a better understanding of why the level of remuneration is justified.
- Including high-level statements about considering the head of provider's performance without saying what targets they were assessed against or how this related to a performance or appraisal processes – if these elements were included then it would be clearer as to why aspects of remuneration (such as performance-related pay or remuneration increases) had been awarded.
- Providing little information beyond stating that remuneration is below benchmark – if a more open and considered approach were to be adopted, then it would allow stakeholders to understand the benchmark used, why this was appropriate, or whether the head of provider was in fact paid appropriately given their responsibilities, performance and value to the provider.

20. We expect providers to reflect on their justification statements and improve them. We expect them to be more open and transparent, showcase the provider's achievements, and to acknowledge, where appropriate, difficulties that may have been overcome. If the justification statement is treated simply as a compliance matter with an intent to disclose as little as possible, the provider may be missing an opportunity to explain why the remuneration level is appropriate, set it in an appropriate context, and help others to understand why that level of remuneration is justified. Where a provider finds that it is unable to set out a clear justification for the pay of the head of provider, we would expect its governing body to reflect on why this might be the case and whether the remuneration of the heads(s) of the provider is a justifiable use of charity assets and public funds.

Disclosure requirements in the new accounts direction

21. In respect of 16(a) above, we have amended the approach in the recent accounts direction (OfS 2019.41) to match that taken by most providers in 2017-18 financial statements. Consequently, we will in future require disclosure of the amounts paid together with the dates of office so that we can calculate the remuneration in FTE terms.
22. The requirements noted in 16(b) to 16(f) above will continue to be requirements and so providers must ensure that they fully disclose the information as required.
23. In response to feedback about regulatory burden and to ensure proportionality and consistency, we have amended the approach to be taken to calculating the pay multiple such that the comparator staff group should in future comprise all employees who are required to be included in real-time reporting to HMRC. Employees that are not required to be included in real-time reporting to HMRC should be excluded from the calculation of the remuneration of 'all other staff'. The new accounts direction is applicable for accounting periods beginning on or after 1 August 2019, but providers may wish to consider early adoption of this element as it may simplify the calculation by drawing wholly on information that is accessible within the provider's systems.

External auditor's opinion

24. The 2017-18 accounts direction stated that a provider's external auditor must report to the governing body on whether in all material respects:
- a. The financial statements give a true and fair view of the state of the provider's affairs, and of its income and expenditure, gains and losses, changes in reserves and cash flows for the year. They should take into account relevant statutory and other mandatory disclosure and accounting requirements, and the requirements of HEFCE, the OfS and (where applicable) of Research England.
 - b. The financial statements have been properly prepared in accordance with the financial reporting standards (FRS102) or, if applicable, the International Financial Reporting Standards.
 - c. Funds, from whatever source, administered by the provider for specific purposes have been properly applied to those purposes and managed in accordance with relevant legislation.
 - d. Where applicable, funds provided by HEFCE, the OfS and Research England have been applied in accordance with the relevant terms and conditions and any other terms and conditions attached to them.
 - e. The requirements of the OfS's accounts direction have been met.
25. To assess compliance with the requirements about the external auditor's opinion, we reviewed in detail the auditor's opinion in the audited financial statements of all 133 providers to whom the accounts direction applied. For information, we note that 12 different external audit firms carried out the audits across these providers.
26. Our review showed that around half of the external audit reports included all the required elements of the opinion. Of those that did not include all the required elements, at least one of the following elements were missing:
- a. There were several omissions in the opinion that the funds provided by HEFCE, the OfS and Research England have been applied in accordance with the relevant terms and conditions and any other terms and conditions attached to them. The opinion omitted reference to one or more of the funding organisations (see paragraph 27).
 - b. Some opinions did not confirm that the financial statements complied with the OfS's accounts direction (see paragraph 27).
 - c. Some opinions did not confirm that the financial statements gave a true and fair view as per paragraph 24(a) above (see paragraph 27).
27. Where elements of the opinion were missing, we followed up directly with auditors and obtained the assurance that we needed to have confidence around the regularity of the public funding.
28. English higher education funding powers transferred from to the OfS on 1 April 2018 following the abolition of HEFCE on 31 March 2018. Consequently, we note that the required audit

opinion for 2018-19 financial statements will need to be amended to reflect that no funding from HEFCE flowed in that year.

29. Under the new accounts direction for accounting periods beginning on or after 1 August 2019, we have amended the required opinion to obtain more explicit assurances that:
- a. the funds provided by the OfS, UK Research and Innovation (including Research England), the Education and Skills Funding Agency and the Department for Education have been applied in accordance with the relevant terms and conditions.
 - b. a new disclosure that the provider's grant and fee income has not been materially misstated.
 - c. a new disclosure that the provider's expenditure on access and participation activities for the financial year has not been materially misstated.

Statements of corporate governance and internal control

Statement of corporate governance

30. A provider must include a 'statement of corporate governance' in its financial statements. The statement of corporate governance must set out a description of the provider's corporate governance arrangements and a statement of the responsibilities of the governing body. It must explicitly relate to the period covered by the financial statements, and the period up to the date of approval of the audited financial statements.
31. All providers in the sample (see paragraph 8) included a statement of corporate governance that included the elements required by the accounts direction.
32. The requirements of the statement of corporate governance are not changing. However, we had signalled in the previous accounts direction that we may lift this requirement for providers in the future. We have decided to retain disclosure as it provides important transparency over a provider's corporate governance arrangements.

Statement of internal control

33. A provider must include a 'statement of internal control' in its financial statements. The statement of internal control must explicitly relate to the period covered by the financial statements, and the period up to the date of approval of the audited financial statements. The statement of internal control relates to a provider's arrangements for the prevention and detection of corruption, fraud, bribery and other irregularities. It must include an account of how the following principles of internal control have been applied:
- a. Identifying and managing risk should be an ongoing process linked to achieving the organisation's objectives.
 - b. The approach to internal control should be risk-based, including an evaluation of the likelihood and impact of risks becoming a reality.
 - c. Review procedures must cover business, operational and compliance risk as well as financial risk.

- d. Risk assessment and internal control should be embedded in ongoing operations.
 - e. During the year the governing body or relevant committee should receive regular reports on internal control and risk.
 - f. The principal results of risk identification, risk evaluation and the management review of the effectiveness of the arrangements should be reported to, and reviewed by, the governing body.
 - g. The governing body should acknowledge that it is responsible for ensuring that a sound system of internal control is maintained, and that it has reviewed the effectiveness of these arrangements.
 - h. The statement of internal control must set out any significant internal control weaknesses or failures that have arisen during the financial year or after the year end but before the financial statements are signed. Where appropriate, information about actions taken or proposed to deal with significant internal control weakness or failure should be set out.
34. Review of the statement of internal control for a sample of providers (see paragraph 8) identified that all providers stated that the governing body is responsible for sound internal control and that the governing body had reviewed the effectiveness of these arrangements. However, we also identified a number of omissions:
- a. None of the providers had disclosed significant internal control weaknesses or explicitly stated that there were no significant control weaknesses that should be disclosed.
 - b. Several providers failed to cover all types of risk (business, operational, compliance and financial risk).
 - c. Several providers did not explicitly state that the statement of internal control related to the period covered by the financial statements, and the period up to the date of approval of the audited financial statements.
 - d. Some providers omitted (i) a description of how they identify and manage risk and (ii) confirmation as to whether their risk management approach is risk-based.
 - e. Some providers did not explain whether and how risk assessment and internal control is embedded in their ongoing operations.
 - f. Some providers did not include a statement on how the provider reports to the governing body about internal control and risk.
35. The requirements to include a statement of internal control and what this should cover are not changing in the new accounts direction. Given the areas identified above for improved compliance we recommend providers review their statement of internal control and consider whether it is sufficient to meet the accounts direction's requirements.

Exempt charity disclosures

36. All exempt charity providers in the sample (see paragraph 8) had included the required statement about the provider's status as an exempt charity and appeared to have met the

charity law requirements for exempt charities on the composition of annual accounts. The requirements of the accounts direction for exempt charities that are regulated by the OfS are not changing.

Conclusions

37. The review of providers' compliance with the accounts direction in their 2017-18 audited financial statements shows that, while some providers are able to demonstrate compliance, there is some room for improvement. It is a provider's responsibility to ensure that it complies with all of its conditions of registration, and this includes compliance with the accounts direction. We expect providers to review their disclosures in relation to the issues noted above.
38. Where we identify non-compliance with the accounts direction in the future we will, where appropriate, revisit our assessment of the risk that a provider will breach one or both of conditions E2 and E3. This assessment will include a decision about whether further regulatory action is appropriate and proportionate. We note that the obligation to comply with the accounts direction under ongoing condition E3 constitutes a legally binding requirement and where this requirement is not met, this is likely to constitute a breach of a condition of registration. This year we are dealing with areas of likely non-compliance by publishing themes and feedback on compliance issues in this paper rather than by considering the use of our enforcement powers in relation to an individual provider. The OfS's enforcement powers include the ability to impose a monetary penalty. Where we consider that a provider's practice is non-compliant in future, we are likely to take enforcement action and this may include imposing a specific ongoing condition to require a provider to update the disclosures and re-publish its financial statements.



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