

## SECTOR DEVELOPMENTS...

### COLLEGE INSOLVENCY REGIME SUPPLEMENT

It has been suggested that some readers might wish to receive more information about the new college insolvency regime, particularly given the far-reaching effects this could have on a college sector already stretched almost to financial breaking point and the number of colleges potentially at risk. Therefore, notwithstanding the danger of 'newsletter overload', below is an attempt to provide a little more information, along with links to websites that will provide more technical detail.

#### *The insolvency legislation*

On 31 January, a new statutory insolvency regime for FE colleges in England came into force. Unlike commercial insolvency procedures, the legislation relating to colleges specifies that before an insolvency procedure can be started, the Secretary of State for Education in England will consider whether 'Education Administration' should be initiated as an alternative to commercial insolvency. If so, the Secretary of State can apply to the High Court for such an order and an 'Education Administrator' will be appointed by the court from a group of approved and licensed insolvency practitioners. A moratorium will then follow, which will prevent creditors from seeking to enforce a liquidation of college assets to recover all or part of the debts they are owed by the college. Education administration is primarily intended to protect students and allow them to continue and complete their courses regardless of the college's financial position. This is known as the 'special objective', which could be achieved in a number of ways, including:

- Allowing the college to be rescued as a going concern.
- Transferring some or all of the college's undertaking to another college.
- Continuing to fund the college until current students have finished their studies, or arranging for students to finish their studies at another college.

Education administration, unlike commercial administration, ends when the special objective has been achieved. The legislation covering college insolvency in England can be found in chapter 2 of the Technical and Further Education Act 2017, a copy of which can be accessed at:

<http://www.legislation.gov.uk/ukpga/2017/19/enacted>

The more detailed 'FE Bodies (Insolvency) Regulations 2019', which accompany the act can be found at:

<http://www.legislation.gov.uk/uksi/2019/138/contents/made>

#### *Role of the Department for Education (DfE)*

In the light of the new regime, the DfE says that it will take steps to help prevent college insolvencies by:

- Reviewing and strengthening the college intervention regime.
- Ensuring that processes are in place to enable earlier identification of quality and financial problems.
- Providing timely intervention and appropriate support as when the need is identified.

Unfortunately, the DfE appears not to have considered the option of helping to prevent college insolvencies by reversing the eye-watering cuts that FE colleges have been subjected to. Just for good measure, the DfE has confirmed that, with effect from April 2019, exceptional financial support for colleges in difficulty will no longer be made available (although a 'range of support will continue to be available from both the ESFA and from the FE commissioner's team'). In addition, the DfE has published a useful 'question and answers' document designed to help explain some of the technical terms and raise awareness of the legal changes and implications associated with the regime. This can be accessed at:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/775531/Regulation\\_of\\_Further-Education\\_Colleges.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/775531/Regulation_of_Further-Education_Colleges.pdf)

### *Existing financial controls*

There were already several forms of college financial control in place prior to the enactment of the insolvency legislation. These include:

- Governing body oversight. (College Corporations have had a statutory duty to ensure the solvency and financial viability of their college dating back to the Further and Higher Education Act 1992).
- The issue of a notice to improve by the ESFA, which also has control of college funding allocations.
- Intervention by the FE Commissioner once an ESFA notice to improve has been issued, or if the Commissioner's own diagnostics suggest that early intervention may be necessary

Even now, insolvency is regarded as a last resort only to be implemented when these controls have failed.

### *The new legal duties and obligations of Governors arising from the Act*

The DfE has published a guide specifically for college governors that outlines their statutory responsibilities and obligations both when a college is deemed to be at risk of insolvency and when a college actually becomes insolvent. The guide is also a useful source of reference for others wishing to learn more about the college insolvency regime. Key points in the guide include the following:

- Governors are advised to take steps (including attending training events) in order to familiarise themselves with financial planning and accounting. They are not expected to be experts, but it is expected that they should be sufficiently knowledgeable to be able to challenge college senior managers on financial issues.
- Governors are advised to recruit a qualified accountant to their board, and to ensure that the college finance director is adequately qualified. The finance director should be of sufficient seniority to (for example) negotiate new borrowing facilities and to have the authority to initiate changes needed to help restore the college to financial health.
- Governors should liaise with their bank and the ESFA immediately when signs of financial difficulty emerge. They are warned not to rely solely on the college's ESFA financial health rating since these are issued only periodically and factors that affect a college's financial position can change rapidly.
- Governors are advised to commission an independent business review (IBR) if the college is exhibiting signs of 'financial distress', for example, if the college is in breach of borrowing covenants or is in need of substantial additional financing as a result of 'operational difficulties'. The guide says that an IBR can be the first stage in the insolvency process and, as such, can be initiated by the DfE, the ESFA, the FE Commissioner or a secured creditor (e.g. the college's bank). However, it goes on to say that the college corporation can also initiate an IBR in order to more accurately assess the financial position of the college. It adds that an IBR does not necessarily always result in insolvency proceedings and, if conducted early enough, the IBR might identify strategic options for the college other than insolvency.
- If the outcome of an IBR is that the college *is* deemed to be insolvent, the Secretary of State can request the high court to appoint an education administrator to oversee the insolvency process. Governors must co-operate with the administrator and comply with a number of legal duties and obligations or face penalties if they fail to do so. These are included in the 'FE Bodies (Insolvency) Regulations 2019' (mentioned above) and governors can be found guilty of a civil offence if they do fail to comply. As an example of this, governors have a statutory duty to 'lay a statement of affairs before creditors' which provides true and accurate details of the corporation's assets, debts and liabilities. If there are 'material omissions' from such statements or for 'falsification of the college's books' that governors are deemed responsible for (which could include failure to exercise sufficient oversight of the process), they could face a fine or a prison term, or both. And as a further example, if governors allow a college to continue to operate when they knew that the college was insolvent, or that insolvency was unavoidable, and in doing so have failed to avoid loss to its creditors, they will be deemed to have engaged in 'wrongful trading'. This is also a civil offence and governors will be individually and collectively liable to make a 'personal contribution to the FE body's assets as the court thinks fit'.

- This applies to the principal and other staff who are governors. However, allowances are made for student governors, who are deemed 'less likely to have as much knowledge of the college's financial affairs than other governors. Nevertheless, the legislation says that student governors 'must take their responsibilities as governors seriously' and that they *can* be held responsible if they knowingly 'give false statements', or have engaged in other activities deemed to be within their control that can be shown to have negatively impacted on the college's financial position.

All of this has resulted in some observers raising the question as to why, given the potential personal financial and reputational risks they now face, anyone would actually want to be a college governor, particularly since, unlike private sector non-executive directors, college governors are unpaid volunteers. A copy of the guidance on the new insolvency regime for governors can be found at:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/774096/FE\\_Insolvency\\_Governor\\_Guidance.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/774096/FE_Insolvency_Governor_Guidance.pdf)

### **Alan Birks – February 2019**

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