Department for Education

Area reviews of post-16 education and training institutions

Framework for Due Diligence

October 2016

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Section 1 – Introduction

What should you take away from this section?

- The purpose of this Framework
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1 Introduction

The Government has recently announced the biggest reform of post-16 technical education for over seventy years with the publication of the Post-16 Skills Plan on 8 July[1]. These reforms follow a review led by an independent panel chaired by Lord Sainsbury. There is a need for more highly skilled people; this is essential for our country's economic growth and also for social justice, so that all individuals can get a good job and enjoy higher living standards. Young people should have a choice at 16 between two equally high quality options: academic and technical. The reforms introduce 15 new occupational routes which will lead to skilled employment for both young people and adults.

Colleges are well-placed to play an important role in shaping and implementing these reforms and area reviews will put them in a strong position to do so.

1.1 Who is this Framework for?

This Framework provides guidance for any further education college or sixth-form college (referred to throughout this Framework together as "colleges") **that is considering undergoing restructuring following the area review process**. Sixth-form colleges becoming an academy or joining a multi-academy trust will find the due diligence procedures and considerations detailed here useful guidance, but may require further guidance on specific issues relevant to that process which are not covered in this Framework. Colleges contemplating restructuring outside of the area review process may find this framework helpful, but may require deeper insights into factors that would be considered during the area reviews, such as local needs and curriculum requirements.

Most types of restructuring will require due diligence, although the scope (breadth and depth) will be tailored to the circumstances in each case. Due diligence is an important part of the work needed to satisfy colleges and their stakeholders of the likely success of the proposed structural change. Any applications for funding from the restructuring facility will need to be supported by due diligence, and other lenders will also require due diligence.

[1] Post-16 Skills Plan

This Framework aims to:

- achieve better alignment between the requirements for due diligence by multiple organisations and stakeholders involved in structural change in colleges – "collect once use many times";
- help colleges commission due diligence that is proportionate to need, cost effective and commissioned at the right time to ensure it meets stakeholders' needs; and
- avoid duplication of effort, time and cost where possible.

This Framework is intended to assist colleges in deciding on the due diligence approach that will meet their individual and collective needs. It sets out a range of options and considerations, and does not prescribe or require a particular approach. The approach that is taken – particularly the scope (breadth and depth) of the due diligence process – will depend on the circumstances of the colleges, and is ultimately a decision that college governors must make.

The Framework has been produced following consultation with a wide range of stakeholders likely to be involved in producing, commissioning or using due diligence (see Appendix B). By using the guidance in this Framework to consider all aspects of the due diligence process and by liaising with lenders as a key stakeholder early in the process, it is hoped that due diligence commissioned will often be sufficient to satisfy lender requirements, but this will be considered by lenders on a case by case basis. For the avoidance of doubt, using the Framework as a guide does not restrict or limit in any way the lenders' ability to commission further due diligence, the cost of which will be borne by the college/s.

1.2 How to use this Framework

This Framework gives colleges guidance on due diligence for use as part of any restructuring identified by the area review.

1.2.1 Introduction and overview

Section 1 explains the background to this Framework and the objectives it seeks to achieve.

1.2.2 Due diligence process

Section 2 provides guidance on the purpose of due diligence, including how the scope (breadth and depth) can be tailored to the circumstances of the restructuring. This is likely to be of particular interest to colleges with limited experience of due diligence processes.

1.2.3 Key stakeholders

Section 3 considers stakeholders in a restructuring and how due diligence provides a robust fact base to support them in appropriate decision making.

1.2.4 Considerations when commissioning due diligence

Section 4 explains the key considerations and obstacles to be overcome in commissioning due diligence, including the engagement process, the funding and the selection of professional service providers.

1.2.5 Specific issues for consideration in restructuring requiring due diligence

Section 5 identifies the key risks and considerations that colleges may need to identify, resolve and obtain due diligence on in a restructuring, depending on the depth and breadth of due diligence that colleges decide is appropriate.

Due care and consideration should be given to all issues deemed relevant and material to the decision making process, even if the issue is not identified in this Framework. The issues identified in this Framework are the likely and most common issues expected to occur in restructurings involving colleges, but are by no means exhaustive.

1.2.6 Template scopes and information that may need to be provided

Appendices D to L provide indicative scope for external due diligence and information that may need to be provided once the due diligence is commissioned, depending on decisions on depth and breadth.

The Appendices have been published as a separate document under the title "Framework for Due Diligence following area reviews of post-16 education and training institutions – Appendices". (URN DFE-00244-2016, 19 October 2016).

When using this Framework, ensure that it is the latest version which can be found on GOV.UK.

1.3 When should the Framework be used?

This Framework should be used following the completion of the area review to understand how due diligence can support the implementation process and to ensure common issues are considered in the planning stages. It can also be used by any college contemplating restructuring. Colleges should read the main body of the Framework (sections 2 to 4) to gain familiarity with the process, the considerations and the timing. By using the Framework from an early stage, colleges can steer a course through the assessment of the restructuring option they are taking forward.

Implementation guidance has been produced by Government alongside this Framework and should be read at the same time to ensure understanding of other key aspects of planning a restructuring.

Section 2 – The due diligence process

What should you take away from this section?

- The purpose and benefits of due diligence
- The different types of due diligence and the decision process to choose the right type for the restructuring
- Scope of due diligence required
- Common pitfalls to avoid in due diligence

2 The due diligence process

2.1 What is due diligence?

Due diligence can be defined as the process by which one party conducts inquiries into the affairs of the other party for the purposes of timely, sufficient and accurate disclosure of all material statements/information or documents which may influence the outcome of a proposed restructuring.

Due diligence should:

- identify any key issues or “deal breakers”;
- assist in enhancing the understanding by each stakeholder of:
    - critical success requirements;
    - the legal and operational frameworks coming together;
    - the current financial performance and prospects of the organisation, identifying key risks and sensitivities and how each stakeholder will deal with these;
- consider any post-restructuring integration required to support the delivery of planned benefits from the restructuring.

The due diligence process is an important element of the risk management of any restructuring, with the findings of the work informing the decision making process of respective stakeholders (as identified in section 3).

The procedures for each type of due diligence are discussed in detail in section 5. In order to give themselves the best platform for future success, it is critical that colleges respond to issues identified by the due diligence process and mitigate against the risks identified but also take advantage of opportunities presented by the restructuring.

2.2 Who commissions due diligence?

Typically, colleges will have identified a Transition Board to oversee the restructuring. The Transition Board will have responsibility for identifying the benefits and risks of the structural change and may therefore be the “client” commissioning the due diligence. Alternatively, the college itself may be the client. A key question arises as to who can rely on a due diligence report and this will need to be considered and decided at the outset.

2.3 Type of due diligence

The area reviews may identify a number of different restructuring options depending on the local circumstances. The guidelines set out in this Framework can be applied to a range of currently envisaged options as set out in Appendix A. The type and level of due diligence required to support a restructuring will be dependent on the size, complexity and purpose of the restructuring.

The types of due diligence that colleges and stakeholders may require to support specific types of restructuring may include all or a combination of:

- *Financial* - A key area of consideration for any restructuring is the financial performance of the organisations involved in the proposed restructuring. Ranging from the key metric of Earnings Before Interest, Tax, Depreciation and Amortisation ("EBITDA") to confirming sustainable cash flow, performing due diligence on the financial health of the organisations involved in a restructuring is vital.
- *Legal* – This comprises a review of the key legal agreements governing the operational and physical assets of the college. It helps to identify ownership of assets and any unexpected obligations, commitments or benefits as well as highlight any additional steps required to ensure smooth integration.
- *Other* – Due diligence should not just be focused on financial and legal matters but consideration should also be given to other areas that may involve issues and risks that need to be brought to light early in the restructuring process and be considered as part of the overall decision making process. Other key due diligence areas may include:

  - Human Resources ("HR") (a combination of legal and financial);
  - Pensions (a combination of legal and financial);
  - Estates (space, costs, efficiency);
  - Tax (often included within financial);
  - Information Technology ("IT"); and
  - Operational/pre and post restructuring considerations (review of implementation plan).

This is not necessarily an exhaustive list but represents the key areas that are likely to require due diligence as part of restructuring involving colleges. Indications are that colleges consider all areas of restructuring but may not look at an area in depth if there is clear evidence that there are no material issues. In some cases more or less due diligence may be required.

The area review process is, to a large extent, focused on the securing the long term financial viability of any proposed restructuring when developing options and reaching recommendations. Therefore the focus of this Framework is on the forms of due diligence mentioned above, related to restructuring.

However, it is important that as part of their work to take forward restructuring, colleges also look wider and develop a commercial strategy, in relation to any restructured organisation. This strategy should aim to maximize the opportunities that might be available to enhance the provision for students/employers and generate revenue from a wider range of sources. This will be particularly important where two or more colleges are coming together and where a culture of building in a strong focus on looking for commercial opportunities is not part of the inherent behaviour of all the legacy colleges. Undertaking commercial due diligence, to inform production of a commercial strategy for the new organisation, would be helpful in understanding the wider market and the opportunities, risks and assumptions.

There are numerous resources that can be called upon to assist with commercial strategy and its diligence, many of which are mentioned in this Framework. For example, professional service providers undertaking due diligence may be able to assist, either directly, or by identifying specialist professional services firms specialising in commercial strategy development.

Section 5 of this Framework includes a series of key issues that are common to restructuring scenarios involving colleges. These should be considered and taken into account to inform the decision as to what type(s) of due diligence may be obtained by the college(s) and stakeholders to support the overall decision making for a proposed restructuring.

Under a 'Type B' merger, the college that would dissolve on completion should consider the requirement for due diligence so that the governing body is able to demonstrate that it has fulfilled its governance obligations and that the proposed restructuring is the best way forward to fulfil the college's charitable educational purposes. The due diligence requirements may not be as comprehensive as may be required by the organisation that will retain its identity. Specific areas that the dissolving college may need to consider as part of due diligence may include:

- assessing whether the culture and the strategy of the continuing college will deliver on the needs of existing students and staff of the dissolving college and local employers as detailed in the implementation plan;
- assessing whether the continuing college is capable of taking on the assets and liabilities of the dissolving college; and
- gaining comfort over the viability of the continuing college once it has taken on students, staff, assets and liabilities of the dissolving college. This should be considered over at least the near future (e.g. going concern assessment).

2.4 What are the common issues that arise in due diligence and how can this Framework assist?

Lessons have been learnt from mergers and other restructuring involving colleges. Coupled with the wider experience of professional service providers who have worked on restructuring with colleges, this has identified a number of common issues. This Framework has been developed with these in mind and the most significant learning points are detailed below.

Table 1: Common issues

	Common pitfalls to avoid	How this Framework can assist	Section
1	Issue **Lack of familiarity** with process of commissioning due diligence and the question of reliance. *Why is this an issue?* Inappropriate scopes of work may be commissioned with little consideration of the varying risk levels of proposed restructuring. This could be unnecessarily costly, or too generic.	The Framework sets out the process to work through and matters to be considered. Working closely with the professional service provider will ensure that an appropriate scope is identified, which addresses the key risks and issues, whilst also ensuring it is proportionate to need.	2 & 5 2 & 5
2	*Issue* **Lack of coordination** between due diligence work streams. *Why is this an issue?* Lack of coordination and communication between work streams supporting the restructuring will mean that the impact of key issues identified on other areas may not be considered or raised in a timely way. It is therefore ideal to have an experienced transition lead overseeing the whole process.	Issues should be communicated between work streams by direct linkage. The interaction that should exist between internal work streams and external due diligence activities is discussed in this Framework.	2
3	*Issue* **Lack of clarity** over due diligence scope and stakeholder expectations. *Why is this an issue?*	Tailoring issues that are relevant by reviewing section 5 then selecting the corresponding scope items from the relevant appendices.	5 Appx D-L

	Common pitfalls to avoid	How this Framework can assist	Section
	The circumstances of each restructuring need to be taken into account as there is not a 'one size fits all' due diligence process which can be applied to all organisations. Not giving clarity to the professional service provider risks commissioning too general, expensive and time-consuming due diligence.		
4	*Issue* **Poor quality** of information on which due diligence is requested. *Why is this an issue?* Until due diligence is properly scoped it can be challenging to understand what information may be required. Delays in providing some information can increase the cost of due diligence and lead to delays in the restructuring. Organisations often underestimate the quality of information needed to address specific due diligence requirements, again leading to extra cost and delays.	Identifying key information that may be required to support key issues subject to due diligence. Providing guidance on information gathering so it is done efficiently and storing information already pulled together for area review or development of plans together will minimise any additional effort needed whilst due diligence is performed.	Appx D-L 2.9
5	*Issue* Setting an **unrealistic timetable** *Why is this an issue?* Early dialogue is required with all stakeholders to make sure a realistic timetable is in place so due diligence procedures and governance requirements can be adhered to.	Understanding the restructuring timetable and when to plan due diligence.	2.7

	Common pitfalls to avoid	How this Framework can assist	Section
6	*Issue* **Inadequate estimation of liabilities** being taken on in the restructuring *Why is this an issue?* Seeking due diligence too early in a restructuring process (prior to the form of the restructuring being known) may limit its value and ability to identify key issues. This may result in the need for repeat or top up due diligence.	Understanding the purpose and function of due diligence will help effective commissioning. Reviewing the draft scopes may help identify specific areas for focus.	2 Appx D-L
7	*Issue* **Late identification of key issues** *Why is this an issue?* Failure to identify and resolve issues can result in delays or additional time and cost reworking plans, or even walking away from the proposed restructuring. Identifying issues early is key to understanding whether the restructuring is viable in the current proposition.	There should be continuous dialogue between internal work streams/steering groups supporting the restructuring and any professional service provider to enable key issues to be identified as early on in the process as possible.	2

Late engagement of stakeholders, or not engaging a stakeholder at all, is a common issue. This is discussed more in the implementation guidance[2]**,** which should be read in conjunction with this Framework. The key stakeholders from a due diligence perspective are discussed in section 3.

Other issues were identified as an impediment to the overall success of restructurings during discussions with professional service providers, colleges and other stakeholders, but were identified as implementation issues and are considered in the implementation guidance.

[2] Implementation Guidance

The most common issue identified as critical to restructuring success is a robust post-restructuring implementation plan which addresses all change issues, including those that may not be included in a standard due diligence report. Further information on implementation planning can be found in the implementation guidance and the restructuring facility guidance.

2.5 What depth and breadth of due diligence is required for a restructuring?

In discussions with both professional service providers and users of due diligence as part of the development of this Framework, it was clear that the extent of due diligence undertaken to support structural change can vary considerably.

Those discussions also suggest that, historically, the extent of due diligence undertaken has in most cases been proportionate. Where it hasn't, other stakeholders have had to step in to secure sufficient due diligence for their purposes. This has a cost to the college. There have also been cases of colleges undertaking generic due diligence which hasn't been focused on key risks to aid decision making, leaving themselves vulnerable to the consequences of poorly supported decisions. The environment for restructuring now sees more colleges with financial and operating pressures undertaking a variety of restructuring options. Each restructuring will be different and colleges may take some comfort from their own investigations as regards materiality. However, early engagement with stakeholders is critical (as set out in 2.4) as the specific requirements of each will drive the extent to which external investigation may then be required.

The extent of due diligence should be considered on an individual basis. One size does not fit all; deciding on the extent of due diligence required can be critical to the success of the restructuring. In particular, colleges with loans or proposing to take out loans will want to consult with their lenders to understand the extent to which any external due diligence obtained can meet lenders' needs.

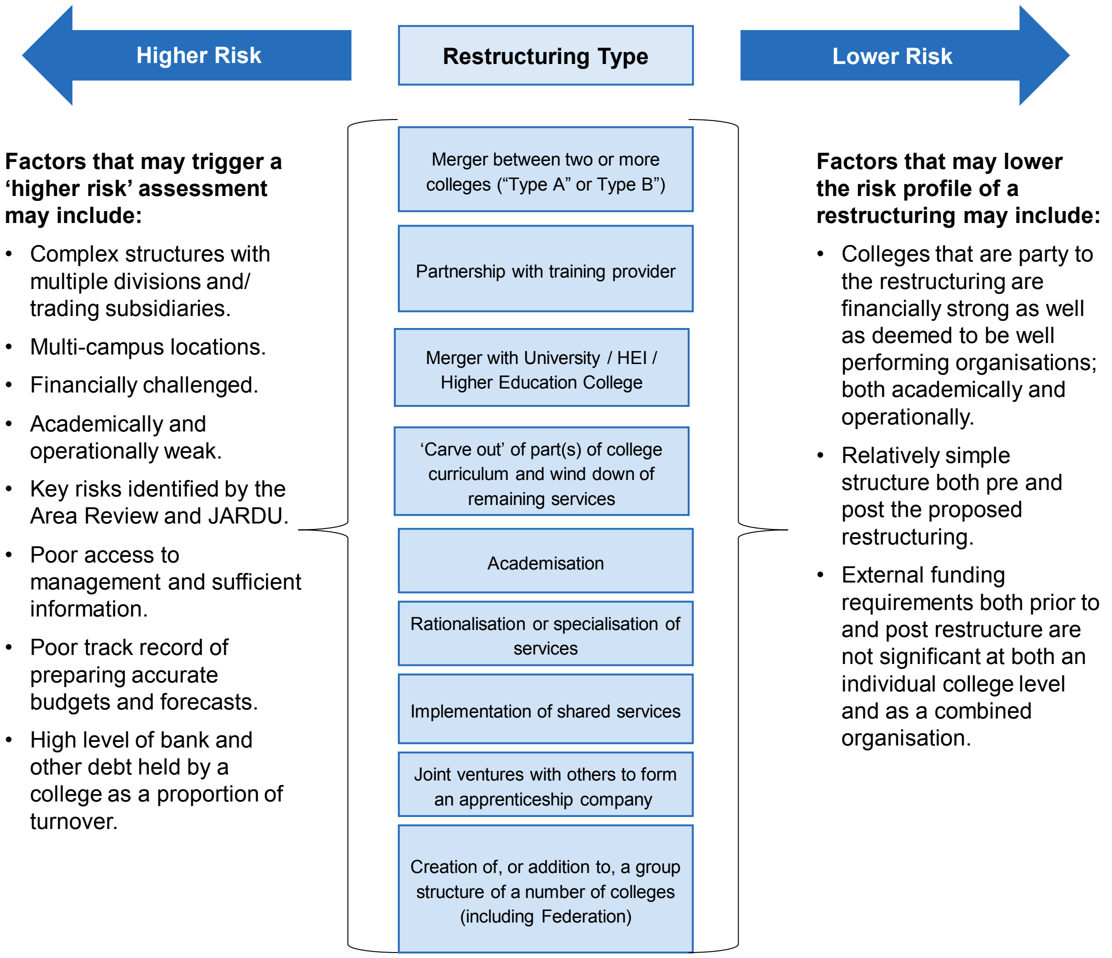
The experience of those consulted for this Framework offers some guidance on how to define materiality in each restructuring:

- how closely the organisations have been working together on the proposed restructuring, and therefore the extent of information already known;
- size of the proposed restructuring (e.g. revenue and learner numbers). The larger and more complex a restructuring, the more detailed the due diligence process will likely need to be;
- any issues identified over the course of the area review;
- the financial position of the respective colleges to the restructuring;

- whether colleges have forecast accurately in the past; and
- the academic strength of the respective colleges.

Figure 1 provides an illustrative example of factors that may be considered as presenting a higher risk to a proposed restructuring as well as those that may reduce or mitigate against risks attached to a restructuring. In addition to considering the type(s) of due diligence required to support a restructuring, colleges and stakeholders should assess the risks attached to a proposed restructuring taking into account the common issues and considerations detailed in section 5 as an aid.

Figure 1: Indicative risk profile of type of the restructuring



In forming a view of the risk profile of a restructuring, consideration should be given to work that has already been undertaken by the organisations and what issues were uncovered, for example outputs from analysis carried out during the area reviews. If the Framework is being used outside of the area review, the sharing of management accounts, business plans and implementation plans with other parties involved in the structural change may be required.

Where an organisation has concluded that a specific area of due diligence is not required or a more 'light touch' approach is appropriate, the rationale for this should be understood and agreed by all stakeholders of the organisation

2.6 Who carries out due diligence?

The due diligence process should be undertaken in a proportionate and cost effective manner to ensure that any savings from the proposed restructuring are maximised. This will likely involve work by a mix of internal staff and external professional advisers. The key considerations when determining the mix of internal versus external due diligence and the benefits of using an external professional service provider are discussed in section 4.1.

2.7 Timing of due diligence

Figure 2 below sets out the key timeline for structural change and where due diligence fits in to this. Following the conclusion of the area review there should be work done prior to commissioning due diligence to:

- assess options and skills and staffing requirements for carrying out due diligence and determine a preferred option;
- develop a detailed implementation plan; and
- assess the level of risk in the restructuring to identify the amount of due diligence that will be undertaken (internally and externally).

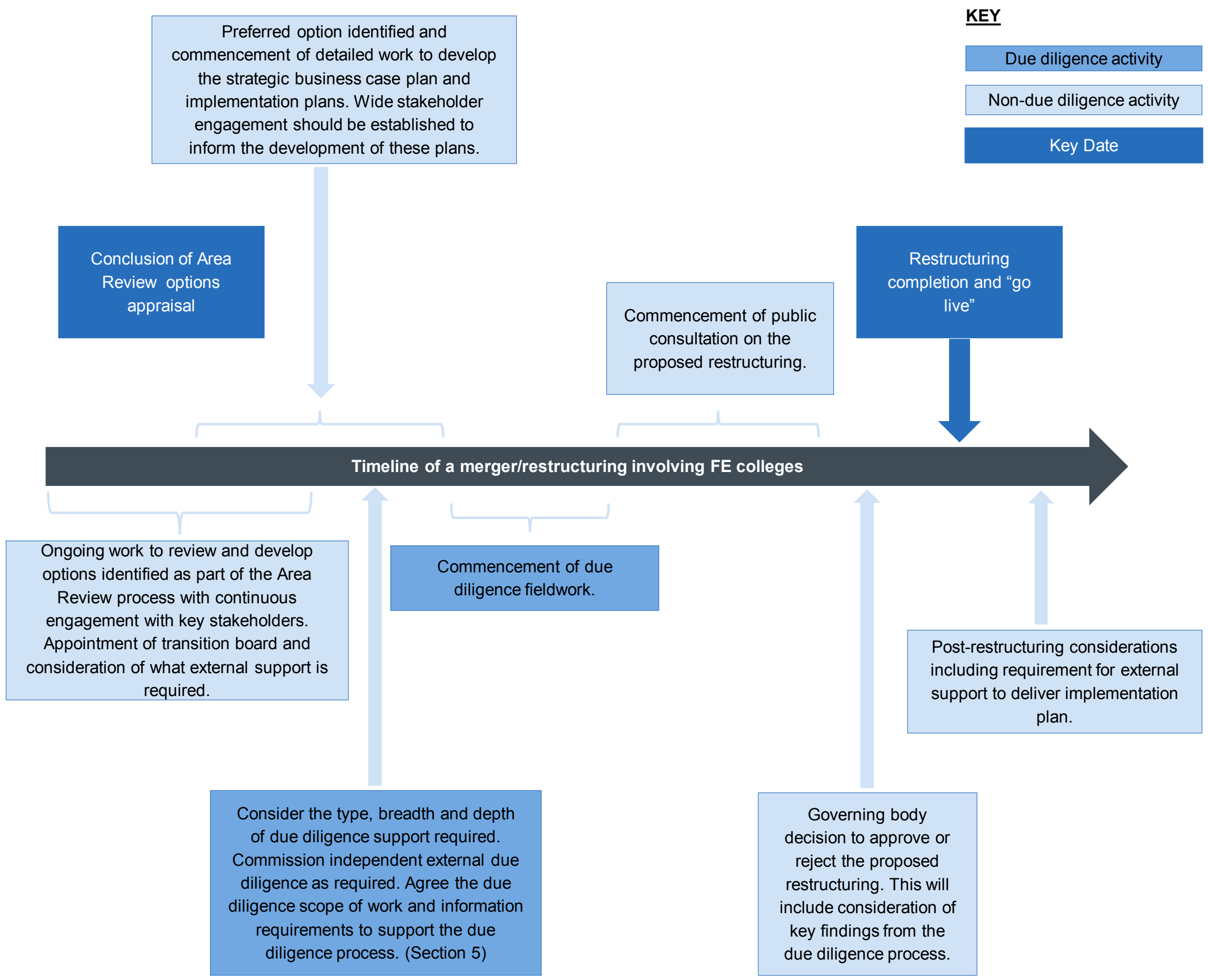
Any applications for the Government restructuring facility (as opposed to a transition grant) will need to be supported by due diligence. Therefore, if a college is applying to the restructuring facility, due diligence will need to be completed before that application is made.

Following the completion of due diligence:

- Public consultation should commence (although in a limited number of cases depending on time available it may be necessary to complete due diligence at the same time as public consultation).
- The governing bodies of both/all organisations involved in the planned structural change should assess the findings of due diligence and the outcome of public consultation and decide whether to accept the proposed change or whether further work is required before the restructuring can proceed.

It is important to allow sufficient time in the restructuring process to undertake the level of due diligence deemed appropriate for the individual circumstances, review findings and have time to mitigate any identified risks before going ahead with the restructure. Delays in either internal or external due diligence activities can give rise to delays, additional costs or potentially other risks in the process as a whole and therefore the timelines of both need to be clear and adhered to.

Figure 2: Indicative college restructuring timeline



Two-phased approach

A two-phased approach to due diligence may be considered more appropriate rather than all due diligence procedures being undertaken simultaneously. A two-phased approach would most likely include:

- an initial review of the proposed partner(s) to identify "deal breakers" to aid the development of the strategic business case and implementation plan; followed by
- a more detailed review of plans at a later date once the strategic business case and implementation plan have been developed.

In a complex restructuring (see section 2.5) where there may be a lot of potential deal breaker issues, this approach could be more efficient, as uncovering key issues later in the process may result in more cost and time delays.

In any case, when deciding on a two-phase approach colleges need to be clear on both the:

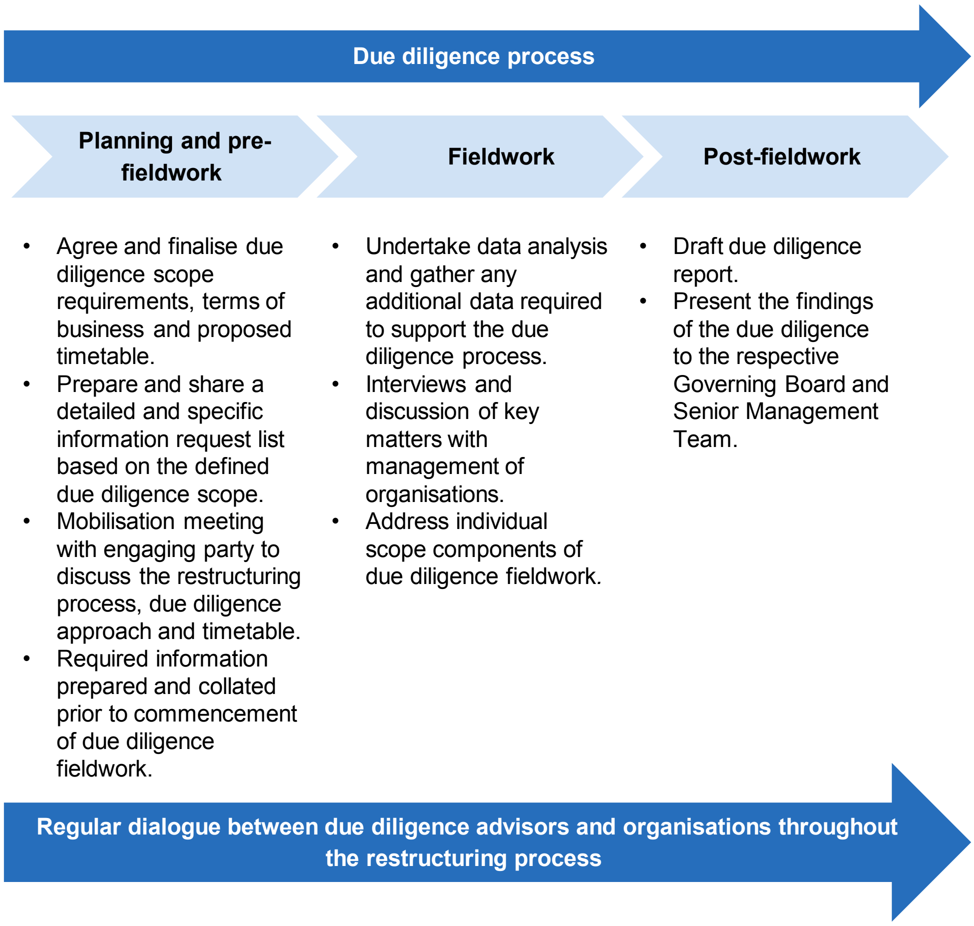
- scope of due diligence work to be undertaken at each phase; and

- timing of each phase of work to ensure it is able to inform the overall decision making process of the respective governing bodies and senior management team.

2.8 What does the due diligence process look like?

Set out below is an indicative outline of the due diligence process. Each due diligence process is different and will depend on the scope and information flow. As a guide it is usual for the due diligence field work up to completion of a draft report to take three to four weeks. The planning and pre-fieldwork and post-draft review can vary significantly, but will usually be determined by how quickly the engaging party (the college) can turn around information (e.g. information requests, comments on draft report etc.).

Figure 3: due diligence process



2.9 Key information requirements to support a due diligence process

Information requirements will need to be tailored to the scope of the work. As part of the area review, data and information will have been collected to support the options analysis and recommendations. Each organisation will need to work with their respective professional service provider to understand:

- the information required to support the due diligence process; and
- how far the information already provided to JARDU to support the area reviews can support the due diligence process.

The appendices include an indicative list of core information that is likely to be required from each organisation to support the respective area of due diligence. This will need to be tailored based on the nature of the restructuring and specific circumstances.

Information sharing arrangements

An information and data sharing protocol for the purpose of supporting the area review will likely be in place. It is worth considering whether this could be extended to professional service providers where there are likely to be significant data sharing requirements e.g. in a complex restructuring.

Use of data rooms

To manage requests for information from multiple parties, organisations should consider the need to setup a central repository or data room which could be:

- **Physical** where the confidential information has been assembled into a secure room.
- **Virtual** where the confidential information resides on a secure server/website. Multiple counterparties can access the information at the same time and it is possible to electronically track which counterparty accesses which documents/pages of documents.

Virtual data rooms can be set up by third party providers quickly and cheaply. However, it is anticipated that this will only be cost effective for larger restructurings.

2.10 Consideration of the findings of the due diligence process

The overall timetable for the restructuring should include sufficient time for the findings of any due diligence process to be reported and for any necessary mitigating actions to be developed and assessed. It is essential sufficient time is planned.

If due diligence identifies hitherto undisclosed material weaknesses in either college and these cannot be satisfactorily mitigated, it may be necessary to extend the proposed restructuring timetable to allow time to identify alternate solutions, source additional funding or revisit the implementation plan in light of the issues identified. The course of action will vary depending on the nature, size and timing of the identified risk.

Generally a due diligence report does not include recommendations as to actions. The decision as to whether or not the planned restructuring should be entered into is for the governors of each college in light of the key findings of all of the work undertaken in relation to the proposed restructuring.

Section 3 – Key stakeholders and due diligence

What should you take away from this section?

- The role of key stakeholders in relation to due diligence
- The responsibilities of each stakeholder
- The interest of each in respect of the due diligence being performed

3 Key Stakeholders

Strong stakeholder management is ***essential*** to achieving a successful restructuring.

Early engagement with all relevant stakeholders is ***strongly*** advised as not engaging early enough will almost certainly lead to issues closer to the restructuring date, see common pitfalls section 2.4. However, not all stakeholders require or will instruct due diligence. Therefore, it is important to note who is likely to require due diligence, and agree early on how it will be provided.

The stakeholders listed in sections 3.1.1 to 3.1.5 below are the ***likely*** stakeholders in a restructuring affecting colleges who may require due diligence but this is not necessarily an exhaustive list. Colleges should assess their own circumstances to ensure they have considered all of relevant stakeholders to a restructuring and the level of due diligence they require (if any); see 3.1 below.

3.1 Assessing the level of reliance on due diligence required by stakeholders

The reliance that any party wishes to put on the due diligence needs to be considered prior to engaging professional service providers as it may be difficult to change once the engagement has been commenced.

The table below shows the stakeholders identified in this section and the reliance they have historically placed on due diligence, or have indicated that they might look to place on it in the current environment. This is a guide and thorough consultation with stakeholders should be undertaken to identify needs in the specific scenario under consideration.

Table 2: Stakeholders and their reliance on due diligence

Stakeholder	Primary Engagement	Duty of Care	Assumption of duty	Hold harmless	Interest only
Colleges	Likely				
Government	Possibly (if lending)	Possibly (if lending)	Possibly (if lending)	Possibly	Possibly
Banks/lenders	Possibly	Likely	Likely	Possibly	Possibly
Pension scheme				Likely	
LEPs			Possibly	Likely	Likely

For definitions of the different levels of due diligence reliance, for example “primary engagement”, refer to Appendix C.

The key to going through any restructuring is to consider the needs of all stakeholders. The needs of learners and employers drive the overarching strategy for a college and are considered extensively by the area review process. These needs, and the needs of other key stakeholders such as Local and Combined Authorities, feed into the implementation plans which would be subject to due diligence. However, in this section, only those stakeholders who may require the due diligence for informing their decision making process on the structural change are considered.

3.1.1 College governing body (and senior management team)

Colleges are autonomous organisations and their governors will need to make the decision on whether to support an area review recommendation and how to proceed with any proposed restructuring independently. Governors will ultimately be the parties responsible for the approval of the restructuring, although they may set up a Transition Board to lead on delivery on their behalf.

It is essential that governors understand:

- the restructuring process;
- the timing and extent of engagement with stakeholders that is required at the outset to facilitate the smooth running of the restructuring;
- the other organisation(s) involved in the restructuring as much as possible to identify potential issues;
- the appropriate level of due diligence required to satisfy them that the restructuring is the right thing for the college and that all key issues have been addressed prior to approving the restructuring; and
- the potential requirements for due diligence of other stakeholders.

Where the members of the future college Board and senior management team are not yet finalised, it is incumbent on the governors of any existing college to document their decision making process robustly.

3.1.2 Government

The financial viability of the proposed post-restructuring organisation will likely still need to be considered by Government along with other stakeholders at the end of the area review. Where the delivery of the restructuring requires funding from Government (i.e. through the restructuring facility) it will be essential that the Transactions Unit is engaged as a stakeholder[3].

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[3] See Restructuring Facility guidance

The Transactions Unit is comprised of financial experts who will undertake their own assessment of the plans provided to them to support a funding application. When a college is applying to the restructuring facility, the financial forecasts being provided in support should be submitted only once they have been endorsed independently by appropriately qualified third party experts as part of due diligence. The implementation plans should also be independently endorsed before submission. The Transactions Unit may also want to view a copy of and rely on the due diligence as a whole; this will need to be agreed with the third party that completed the work.

3.1.3 Lenders (other than Government)

Not all colleges have, or will be seeking, a loan with a third party, such as a bank. However, where debt does exist, it is important to understand that it is not automatically transferred during the restructuring to the new organisation.

Early engagement with lenders is therefore essential to determine:

- Whether a new application is required (where a new organisation is created and others dissolved, loans may need to be repaid and new loans issued);
- The requirements surrounding any new loans being sought;
- Key issues that the lender would like to see resolved through the development of detailed plans; and
- Areas of particular concern where more detailed due diligence may be required.

Lenders need to obtain comfort that the organisation to whom they provide a loan is viable and therefore capable of repaying the loan (together with any associated interest). They also need to consider any security that they may require to help them recover their lending in the event the college is unable to repay the loan through the cash generated.

Lenders to colleges need timely information on the restructuring and robust due diligence to allow them to make their own assessment of the plans and their willingness to support them, and to get agreement to their decision through their own internal sign-off procedures. This needs to include financial aspects of the proposed new organisation and the deliverability of the implementation plan. This is likely to include an assessment of the ability of the proposed governors and senior management teams to deliver the transition and run the new (and likely) enlarged organisation.

Lenders often have panels of professional service providers that they use. They are often bound by their internal policies to commission their due diligence from one of the firms on their panel. In order for them to rely on any work commissioned by the college it may be that the work will need to be completed by a member of this panel. Colleges should seek early engagement from their lender or any proposed new lenders to understand these requirements, including the type of due diligence and breadth and depth. See section 2.4 for common pitfalls in due diligence and section 4 for guidance on the engagement process.

Where lenders' requirements are not taken into account, additional work may need to be commissioned if areas relevant to the restructuring and stakeholder in question (such as the capabilities of the management team) have not been covered by the due diligence performed to date. Additional work may also be required where significant issues have been identified by the initial due diligence that are not satisfactorily resolved or which result in significant changes to the plan. Where fresh funding is required, and the lender cannot place reliance on due diligence already commissioned (e.g. a non-panel firm has been used), that may also require further due diligence.

Further due diligence may include an expanded scope in relation to specific banking aspects and should complement but not duplicate the core due diligence being completed. The additional scope and costs should be agreed by the college and the lender, and costs are payable whether or not the bank subsequently agrees to support the proposed restructuring.

3.1.4 Pension scheme

Colleges are 'participating employers' in a number of pension schemes. The most common schemes are the Teachers' Pension Scheme (TPS) and the Local Government Pension Scheme (LGPS):

- The TPS is a contributory career average salary scheme. It is unfunded, meaning that although benefits accrue to staff who belong to the scheme, a college is not responsible for the liabilities due to those members.
- All staff ineligible for the TPS are eligible for LGPS membership. The LGPS comprises 90 local administering authorities, and the appropriate authority for colleges is usually determined by the college's location. The LGPS is a contributory career average scheme. Each LGPS administrator maintains a fund into which contributions are paid.

LGPS regulations set the rates of member contributions. Employers' contributions are determined in a triennial valuation; the most recent being in 2016, although results are likely to be January 2017. LGPS rely upon the financial health or covenant of the participating employers (i.e. the college). Restructuring in the sector can result in the dissolution of one employer and the transfer of members to another organisation under the same or even a different administering authority.

LGPS regulations permit either a transfer of active members or a direction by the Secretary of State for Communities and Local Government transferring a person or class of persons and any associated assets and liabilities to a new administering authority.

It is likely that the LGPS administrators will need to be consulted on the financial resilience of the proposed post-restructuring organisation, and therefore may request sight of, or even to be party to, due diligence. Pension administrators should therefore be consulted as soon as possible once the proposed structure is identified.

This early consultation will also help to identify what is the best way forward in terms of transferring liabilities and assets.

LGPS funds historically have not required consultation or sight of due diligence. Given the changing financial position of the sector and of pension schemes, this may change. They are a significant creditor and will need to understand how their interests are to be protected.

3.1.5 Local Enterprise Partnerships (“LEPs”)

LEPs help to define and stimulate economic strategy for a specific area. They take a long term view on the businesses, industries and skills that would benefit the local economy and have the support and funding from central Government to take initiatives to make this happen.

Where LEPs have committed to provide future capital funding to a college, they may need to be consulted throughout the restructuring process to ensure that any changes or issues identified are communicated.

Section 4 – Engaging professional service providers

What should you take away from this section?

- When professional service providers should be engaged
- How to identify appropriate professional service providers
- How to choose the right professional service providers for your organisation and the restructuring

4 Engaging professional service providers

Some colleges may not have experience engaging professional service providers. This section gives guidance on various issues that need to be considered in advance of doing so. Section 2.5 provides guidance on how to determine the overall level of due diligence required. The factors which may impact the mix of internal and external due diligence carried out are detailed below.

4.1 External professional service providers

Due diligence can either be carried out internally (through college's own investigations) or externally (using an independent professional service provider) or most likely a combination of the two. The level of risk in the proposed structural change is an important factor in deciding where the balance is struck. In addition, other factors to consider in determining the extent of the need for independent external due diligence include:

- complexity of the proposed restructuring or the organisations party to it (i.e. FE and HEI restructurings may have different risks to FE and FE restructuring);
- costs associated with the restructuring (including any due diligence process) and available budget (including any funds available from transition grants) to support it;
- availability of internal resource to support the work of any internal work streams and steering groups formed to support the proposed restructuring. Where internal capacity to undertake due diligence and other activities supporting the restructuring is limited or restricted, a greater level of external support may need to be considered to support the restructuring;
- the requirements of the governing bodies to enable the governors to meet their respective governance obligations as part of their overall evaluation of the proposed restructuring; and
- the requirements of key stakeholders, particularly lenders and Government (where an application to the restructuring facility is planned).

Key benefits that independent external support may bring to a proposed restructuring include:

- providing a rigorous, independent and objective view on the proposed restructuring;
- bringing challenge to key assumptions and rationale for the proposed restructuring;
- providing appropriate challenge on the more difficult and potentially contentious issues that may hinder the development of trust, strong relationships and collaboration between the senior management teams and governing bodies of the respective organisations that are party to the restructuring;
- providing sufficient capacity where internal resource to undertake the work required is limited or lacks experience of a restructuring process; and

- bringing to bear expertise and experience of a restructuring process, especially where experience of restructuring is limited within the organisation.

4.2 At what stage should professional service providers be engaged?

The timeline in section 2.6 shows when due diligence will typically be considered and whether more than one phase of due diligence could be appropriate in some circumstances. It is critical for efficient commissioning of due diligence that it is not too early, but also that sufficient time is provided for colleges to consider properly issues which due diligence identifies.

Where the restructuring is a merger of two or more entities, stakeholders may want to consider the practicality of joint commissioning of due diligence services from the same professional service providers. This may result in a more efficient due diligence process (see section 4.8 for potential conflicts of interest).

4.3 How to identify appropriate professional service providers

In determining which professional service providers to engage, careful consideration should be given to the users of the due diligence to ensure that it will be relevant to the target audience and meets any criteria they may have for engaging professional advice. Ultimately the choice of professional service provider will rest with those engaging the work (i.e. the colleges) but it can lead to inefficiency and duplication if this is not considered. Section 2.4 details some of the common pitfalls of engaging due diligence.

4.4 Where should I go for advice on which professional service providers to use?

4.4.1 Associations and groups that support colleges

The Association of Colleges (AoC), 157 Group, Education & Training Foundation and The Sixth Form Colleges Association all provide guidance and or support on a range of issues affecting colleges and are all familiar with the restructuring process from previous college restructurings. All will likely be able to recommend suitable professional service providers who have recent experience in the environment.

4.4.2 Funding agencies

The Skills Funding Agency, the Education Funding Agency and specifically the Transactions Unit will have involvement in a wide variety of restructurings across the country. They will have seen examples of effective and less effective due diligence and may be able to provide comment and guidance on the types of firm that a college could use for each type of due diligence. Ultimately the decision on the choice of firm, will, though be for the governors.

4.4.3 Lenders

As discussed in section 3.1.3 lenders will have their own panel firms of professional service providers that they need to use in order to provide due diligence. Speaking to an incumbent lender or proposed new lender about this is essential, but lenders may be another source of guidance on which professional service providers in the market have the right level of expertise and recent experience in the environment.

4.4.4 Specialists brought in to assist the college in the restructuring

Ensuring the right mix of skills is in place to develop and deliver the restructuring is essential. Funding is available to assist colleges with the costs of bringing in individuals with relevant skills in the form of transition grants.

It is likely that any additional resource brought in as part of this process will have experience in commissioning due diligence. Therefore their input should be sought to identify relevant professional service providers. Ultimately, though, the decision on choice of professional service provider will be for the governors.

Colleges may choose to use a professional service provider outside of the bank panels who meets their procurement criteria. In such circumstances, any lender to any party to the restructuring may require additional due diligence, for which the colleges would need to pay.

4.5 How to select and procure professional service providers

All colleges will have a procurement process that complies with UK and EU legislation. This must be adhered to. There are numerous factors that need to be considered in engaging with the most appropriate professional service provider(s) for the college(s) involved in the structural change to ensure that the most appropriate due diligence is commissioned. The key factors for consideration are:

- skills of professional service provider;
- relevant experience with colleges or other similar organisations;
- experience of due diligence on similar sized restructuring;
- independence from organisations involved;
- capacity to deliver project to timelines;
- reputation of professional service provider;
- cost; and

- suitable contingency in case of overruns, illness etc.

All of the above factors and any other additional factors that colleges consider relevant to particular circumstance and restructuring type should be considered.

The cost of the due diligence is a factor for consideration. However, getting the right due diligence is more important to ensure that all potential issues are flagged at the earliest opportunity; this will help reduce the risk of having to commission ‘top up’ diligence at an additional cost.

4.6 Due diligence costs

Fees for independent external due diligence will be dependent on the breadth and depth of scope for each type of due diligence required. This should form part of the procurement process and be discussed with the respective preferred professional provider prior to appointment. Organisations should ensure that they commission professional service providers with an appropriate level of experience and expertise to support them rather than necessarily focusing on the lowest cost provider.

Professional service providers charge on the basis of time spent; organisations should ensure that any fee quote is also supported by a breakdown of staff and time spent on key activities.

Colleges can also seek advice on expectations from any professional assisting with the implementation plan as they may have commissioned due diligence previously.

4.7 Liability caps

In a typical professional engagement, professional service providers will seek to limit their liability in relation to harm or loss arising from or in connection with the engagement contract. This is a standard clause in an engagement contract, although the level of liability cap will vary by professional services firm.

This clause in an engagement contract should be carefully negotiated by the engaging parties to ensure it meets their own risk management requirement before signing an engagement letter with the professional service provider.

4.8 Conflict of interest

Conflicts of interest may exist or arise, as result of which professional service providers would not be able to act for one or more parties involved in the proposed restructuring. This section lists the likely conflicts that may arise in this type of engagement. Care should be taken to confirm with potential professional service providers that they are indeed independent and able to act for all parties who have been identified as needing to rely on the due diligence. Professional firms have a duty to avoid conflicts of interest and all act under ethical guides which identify situations where their independence may be called into question.

Professional service provider has helped or solely developed the business plan or any of the underlying information

In this scenario it would not be appropriate for a professional service provider to provide due diligence services as they would not be independent from the production of the underlying information which is subject to due diligence. Indeed, they would be providing an opinion on a plan which they helped to create.

The professional service provider provides other services (such as external audit) to one or more stakeholders

It is unlikely that a conflict of interest would arise here as there should be sufficient segregation between the teams providing both services. However, for the avoidance of doubt, care should be taken to understand how the professional service providers will ensure that there are no conflicts, and how an ethical wall (see below) would be put in place to avoid any questions on independence.

Professional service provider is also advising the other organisation in a proposed restructure

This may be an efficient way to run the due diligence process, but consideration needs to be given as to whether the professional service provider is sufficiently independent of the other organisation if they are also advising their board.

Potential mitigating actions that can be taken to avoid conflicts of interest

In some circumstances, it may be possible for an professional service provider to use entirely separate teams that have no interaction with one another (often referred to as putting up an 'ethical wall', as if two separate firms are advising). The engaging party needs to satisfy themselves that any mitigation is sufficient for them to feel the conflict is removed. If not, separate professional service providers should be used.

4.9 Freedom of Information Act

The due diligence could become subject to a freedom of information (“FOI”) request either to the commissioning college or to Government. Professional service providers may want to be consulted if their work could become subject to an FOI request at any time and therefore will usually include a specific clause in the letter of engagement. You will need to ensure that professional service providers understand that the FOI Act applies in any event and that Ministers may be required to make statements in Parliament at short notice, so that consultation may not be feasible in all cases.

4.10 Types of professional service providers and their roles

It may be possible to engage a single professional service provider for all aspects of due diligence, or different types of professional service providers may need to be engaged for different aspects of due diligence. It is important that the guidance throughout section 4 regarding appointment of professional service providers has been considered if a college intends an external party to rely on the due diligence.

4.10.1 Accountants

Professional accountants will be the primary providers of financial due diligence services. They have the necessary skills and experience to diligence financial aspects of the plans. Some firms will have specialists who focus solely on due diligence.

Some accounting firms may have, or have access to, the necessary expertise to assess and provide due diligence on other aspects of the implementation plan, such as estates, IT and tax. However, when engaging with a firm of accountants, the college will need to satisfy itself that the firm has the necessary skills in all areas they are being asked to review.

The college (or other engaging party) will wish to obtain as much information as possible about each firm they approach prior to making their final decision on a professional service provider, to ensure that it has sufficient understanding of colleges and sufficient experience of similar restructuring.

4.10.2 Lawyers

Law firms will be the primary providers of legal due diligence. The same considerations of experience and expertise discussed above in relation to identifying suitable accountants are relevant to legal due diligence providers.

4.10.3 Other (e.g. estate agents, valuers, IT specialists)

Other due diligence may be undertaken by a wide range of professional service providers; other due diligence work streams are set out in section 5. For example property expertise may be required from estate agents or valuers to assess certain issues and how they feed into the overall plan.

Specific due diligence on other issues may be either completed in house, or with support from professional service providers in the relevant discipline.

Section 5 – Due diligence issues to be addressed

What should you take away from this section?

- The key issues expected to arise during due diligence across the following areas:

    - Financial
    - Pre and post deal integration
    - Information technology
    - Estates
    - Pensions
    - Human resources
    - Tax
    - Legal

5 Due diligence issues to be addressed

In any restructuring involving a college, there are a number of common issues that should be considered by colleges and stakeholders in forming a view as to the types of due diligence required to support a proposed restructuring as well as the breadth and depth of the due diligence.

This section sets out the key issues and risks that would be expected to arise and how the type of due diligence may help to address them. Where a specific type of due diligence is considered by the college and its stakeholders as relevant to the proposed restructuring, the key issues detailed in this section should be considered in determining the breadth and depth of the due diligence process. Any due diligence process required to support a restructuring should be proportionate to the risks a restructuring presents a college and its stakeholders.

The appendices to the Framework (published as a separate document alongside this) include indicative scopes of due diligence activities to support restructuring involving colleges.

5.1 Financial

Understanding relevant historical trends of each organisation

Colleges may have financial challenges and cash pressures which are contributing to the need to restructure. In order to develop robust commercial operating models for a restructuring, each organisation should understand its own baseline financial position prior to assessing the financial benefits merging or integrating with another entity may bring. Each party to the restructuring will therefore need to present a robust underlying financial position with reference to relevant historical trends. This will be used as a baseline to support the compilation of financial plans and projections for the enlarged organisation.

Key issues that should be taken into account in the financial due diligence process may include:

1. Lack of robustness of the underlying financial trading position with risk of the historical and current financial position being worse than reported. The due diligence process will identify the underlying position of the entity through:

   a. Understanding the actual versus budgeted performance of each college with explanations for key variances and trends in performance as well as key drivers of actual performance from one year to the next.

   b. Identifying any exceptional, non-recurrent or one-off items that may have impacted financial performance (positive and negative) to enable the true underlying performance of each college to be identified (e.g. adjustments relating to provision movements, discontinued parts of the curriculum or the sale of assets as part of previous rationalisation exercises).

c. Understanding of the cost base of each college and operating performance including:

   i. Staffing structures, staffing ratios and student numbers for each course.

   ii. Course and administrative expenditure.

   iii. Curriculum costs.

   iv. Achievement Rates and Individual Learner Records (“ILR”) data supporting the financial performance of the college. This may also identify issues such as potential clawbacks of funding that may be related. Income assumptions for the implementation plan for the restructured organisation will likely be based on historical funding performance and thus needs to be fully understood.

Where a college is deemed to be financially strong, the breadth and depth of financial due diligence on historical performance and cash flows is likely to be more ‘light touch’ and confirmatory in nature. However, where a college is facing greater financial risks or specific financial risks have been identified, any due diligence process is likely to be much more detailed.

2. Where only certain parts of a college’s operations form part of the restructuring, there is a risk that operational budgets, assets and liabilities assumed to transfer are not complete. The due diligence process will look at:

a. Availability and quality of financial information where existing services are being carved out of one organisation and transferred to another – The financial systems and records may not be able to robustly present information for the operations and services that will form the restructuring. In such instances it is key that all organisations work together to determine a basis and rationale to identify the balances (revenue and expenditure) that are within the perimeter of the proposed restructuring.

b. Stand-alone cost analysis – In addition to the direct costs associated with the operations/services forming the restructuring, there are likely to be overhead and other support costs that would be incurred if they were a stand-alone entity. Consideration needs to be given to any additional costs that may be incurred if the operations/services were to operate on a stand-alone basis away from the base college.

c. Allocated (Unallocated) costs – Not all revenue and costs of a college may be directly attributable to the operations of a college. Where operations are to be carved out there will be a requirement to allocate revenue and expenditure to operations that form part of the restructuring. As part of the due diligence process, the basis on which allocations have been made should be considered to ensure that the basis of allocation is reasonable.

d. Shared services – key considerations of such arrangements may include:

i. There needs to be clarity on where such arrangements are appropriate. The rationale for any such restructuring needs to be understood along with the anticipated synergies that are assumed to be delivered by the pooling of resource.

ii. Certain operations and services that form part of the restructuring may be dependent on support services and other functions that are outside the proposed restructuring. The level of any such interaction and costs needs to be understood and factored into any post-merger integration plans. A clear understanding of the existing cost base needs to be understood against which the benefits of any change can be assessed.

iii. Plans need to consider and factor in any investment required in implementing shared service arrangements as well as other restructuring costs that may be incurred including redundancy costs.

Irrespective of the financial and operational strength of the respective organisations, the relative size of the services being carved-out and transferred in proportion to the respective organisations will be an important factor in determining the appropriate breadth and depth of due diligence.

3. There is a risk that the quality of net assets of each college may uncover significant financial exposures. There should be a clear understanding of the balances included under key balance sheet headings at each college prior to the restructuring. This will include gaining an understanding of:

i. Valuation and impairment of fixed assets (including any intangible assets held).

ii. Ownership of key assets, basis of valuation, restrictions and charges on assets.

iii. Quality and ageing of debtors (e.g. age profile, unallocated cash balances, write-offs and provisioning).

iv. Other on/off balance sheet exposures (e.g. pension liabilities, committed capital expenditure and other outstanding liabilities).

v. Understanding of the debt profile of each college including the impact of any break clauses/change of ownership penalties that may be triggered on completion of the proposed restructuring.

vi. Understanding of the debt profile of each college including the impact of any break clauses/change of ownership penalties that may be triggered on completion of the proposed restructuring.

Irrespective of the financial and operational strength of the respective organisations, the relative size of the proposed restructuring and whether individual balances are material will be an important factor in determining the appropriate breadth and depth of due diligence.

4. Cash flows of each college may be insufficient to service existing debt and/or any new bank financing required by any enlarged organisation. There should be a clear understanding of the cash flows of each college as well as the quality of any cash flow forecasts prepared by each organisation, including:

i. The monthly creditor payments cycle of each college for all key creditors including payments to service existing bank finance.

ii. Long outstanding creditor balances and areas where the college may be implementing cash management procedures through deferring payments to suppliers and other creditors.

iii. The monthly cash receipts cycle for all income streams. This will also look to identify any write-off of, and level of provisions held for, debtor balances considered by the respective college to be doubtful.

iv. Capital expenditure requirements of each college.

Where a college is deemed to be financially strong and highly cash generative, the breadth and depth of due diligence on historical cash flows is likely to be a more ‘light touch’ and confirmatory in nature. However, where a college is facing greater financial risks any due diligence process is likely to be a much more detailed.

The combined organisation pre- and post-restructuring

Colleges should not underestimate the level of work required to prepare robust plans reflecting post structural changes. These plans should allow for rigorous cost-benefit analysis of the proposed restructuring to ensure it will create a viable organisation from both a financial and operational perspective. This will also be key in considering and demonstrating whether the proposed restructuring is in the best interests of stakeholders over the long-term.

Key considerations include:

1. Post-restructuring projected trading performance of the newly merged organisation should be supported by robust underlying assumptions with projections which are reflective of the likely circumstances of the individual colleges and the combined organisation. The due diligence process should look at:

a. The extent to which the financial information and underlying assumptions supporting the implementation plan for the enlarged organisation have been prepared on a robust basis with engagement with all stakeholders and are reflective of the most likely circumstances of the combined organisation.

b. Whether the implementation plan needs to reflect any risks that the combined organisation may be exposed to post-merger, with a consideration of any potential sensitivities and vulnerabilities to the underlying position having been undertaken by the leadership teams of each college.

c. Whether the implementation plan has been "stress tested" to ensure the enlarged organisation can withstand a reasonable downside/sensitised case with consideration of any appropriate mitigating actions that could be taken in the eventuality of any of the sensitivities coming to fruition.

d. Whether plans to deliver cost benefits post-integration need to have been developed.

e. The extent to which any planned cost benefits should deliver sufficient benefits on an appropriate and timely basis to support the financial implications/costs of delivering the planned change post-restructuring.

f. Performance against benchmarks set out in the area review guidance along with rationale for any variance from the benchmark. This benchmark analysis will help stakeholders to compile an appropriate business plan for the proposed restructuring.

The breadth and depth of any due diligence process should be informed by the historical track record of preparing robust budgets and forecasts. However, consideration also needs to be given to the requirements of key stakeholders (primarily banks) who may require a more detailed review.

2. Consideration of how synergies are planned to be delivered through curriculum rationalisation across the enlarged organisation may not be fully considered. The due diligence should look at:

a. How proposed changes to the curriculum impact on income generation and whether this has been calculated correctly, with reference to underlying student numbers of each organisation.

b. The impact of any change to the curriculum on the cost base of a college. Whether the implementation plan will sufficiently detail the planned benefits from the rationalisation of curriculum as well as any costs of implementing the change (e.g. redundancy costs, continued cost associated with the wind-down of existing curriculum offering and any additional cost requirements to deliver the revised curriculum).

c. Whether there is a clear understanding of the impact of any changes to curriculum on the status of the college.

d. Whether the impact on course offerings, staff to student ratios and Ofsted quality ratings (as applicable) has been considered.

3. Funding availability for colleges is scarce. The potential cash requirements of the new combined entity need to be understood to ensure sufficient cash headroom is available to operate. Due diligence should consider:

a. Any financing required by the new organisation and how this compares to the funding already in place/available to the individual organisations pre-merger.

b. Whether arrangements for the repayment of existing borrowings of each individual college including any early termination costs have been fully understood, including the implications on cash and cash flows of the new organisation.

c. Whether any restructuring of the enlarged organisation is dependent on the sale of assets and whether the potential risk of delays and realising full market/planned value in a sale process has been considered. How the implications on the financing requirements of the new entity have been addressed.

d. Any financing and the timeline for repayment to ensure it is reflected in the post restructuring implementation plans. Where financing cannot be secured, the implication of this need to be fully understood as to the viability of the proposed restructuring.

e. Whether the restructuring has a requirement for external support (i.e. reliance on funding body support post-merger).

f. The implementation plans that are compiled for the enlarged organisation to test whether they are compatible with the duty to ensure sustainability and solvency of the organisation.

g. Whether the restructured organisation's debt capacity and leverage are acceptable. This will be based on the quality of loan security, track record of income growth (or stability), and strength and predictability of the cash that is generated to service existing or new debt (this is often referred to in the banking industry as Cash Flow Available for Debt Service or "CFADS"). Unlike EBITDA, CFADS takes into consideration the timing of cash flows and payment of taxes, and is a key metric for lenders when understanding debt capacity and repayment criteria of a loan facility.

The breadth and depth of any due diligence process should be informed by the historical track record of preparing robust budgets and forecasts. However, consideration also needs to be given to the requirements of key stakeholders (primarily banks) who may require a more detailed review.

5.2 Pre-restructuring integration and post-restructuring integration

In order to ensure that planned benefits are delivered in a consistent way with that anticipated during due diligence, early engagement and alignment between the respective organisations will be required at the initial stages of due diligence to develop a robust approach to the identification, operational validation and functional sign-off of the benefits anticipated from the proposed restructuring and associated costs.

Furthermore, the early alignment in the approach to integration will support the creation of robust "Day 1" and integration plans, which are owned by divisional heads at each organisation to ensure business continuity is maintained throughout the restructuring. Associated governance structures will support the resolution of issues and validate the delivery of key activities and restructuring benefits.

Key issues prevalent to colleges that should be considered as part of the pre-restructuring integration and post-restructuring integration delivery process may include the following along with actions that can be taken to mitigate them:

1. Synergies and associated one-off costs may not be clearly defined and operational deliverability is not considered prior to Day 1, which results in benefits anticipated to be delivered from the restructuring not being delivered post-completion or requiring additional one-off costs to achieve. Mitigating actions include:

   a. A detailed bottom-up cost benefits model should be developed utilising a consistent baseline to ensure comparability of financial cost, benefit and headcount assumptions.

   b. Department heads should be given responsibility and accountability for developing bottom-up plans to deliver the benefits from the restructuring and cost estimates (recurring and one-off) to ensure operational deliverability is validated and ownership for delivery is established early in the restructuring process.

c. Sufficient contingency should be included within benefits estimates, which is consistent with the level of planning of each initiative to ensure that the full benefit is realised post-completion of the restructuring.

d. The governance structure and operating model should be established to ensure cross-functional dependencies are identified, risks/issues are identified and addressed on a timely basis, implementation plans are signed-off and execution is robustly tracked.

2. Planning and execution of Day 1 tasks may lack detail and pose risks to business continuation. Mitigating actions include:

a. Day 1 and taking control tasks should be planned in detail early in the process to ensure that all critical activities are identified, dependencies highlighted and that sufficient time exists to implement prior to completion.

b. Clear responsibilities should be assigned, including the engagement of department heads to own the development and execution of the Day 1 planning.

c. A robust governance process should be established to validate that the execution of these actions is completed prior to Day 1 and any issues/decisions are resolved on a timely basis.

d. A Day 1 organisational structure should be agreed and communicated to provide clarity over ongoing responsibilities and to inform the approach to retention and transition policies for the combined organisation.

e. A Day 1 readiness assessment should be undertaken in advance of completion to highlight issues and ensure any risks arising are mitigated.

f. A communication strategy should be clearly defined and executed to ensure alignment of all key stakeholders at each stage of the restructuring.

3. Post-restructuring integration plans may not be in place at the “go live” date causing significant disruption to day to day operations. Mitigating actions include:

a. Key stakeholders should be fully engaged at an early stage to identify a vision for the new enlarged organisation, to ensure alignment in the rationale for the restructuring and the functional changes and synergies required post-completion.

b. Detailed plans should be formulated to ensure the successful integration of key operational functions and governance arrangements post-completion.

c. Integration plans should be challenged and tested to ensure that key processes are optimised and fit-for-purpose for the new organisation.

d. Clarity over the approach to integration will help inform internal and external communications to ensure that the integration is delivered smoothly and the impact on business as usual activities is minimised.

4. Planned benefits from the restructuring and any one-off costs may not be tracked post-restructuring, resulting in the planned benefits not being delivered and one-off costs not being controlled. Mitigating actions include:

a. Responsibility for validating and tracking benefits and one-off costs should be given to the Finance Director or equivalent to ensure that robust challenge is provided to the delivery of benefits plans and that 'one source of the truth' exists for the reporting of the status of financial benefits/costs for the enlarged organisation.

b. Each individual benefit should be articulated in detail, showing the value, rationale, key milestones and timing to drive transparency of the value of the benefits and when they should be delivered.

c. Benefits from the restructuring should be included in budgets to drive accountability and ownership for those responsible for the delivery and to ensure that benefits delivery is not offset by changes in the underlying cost base e.g. costs not removed but moved from headcount to non-headcount/third party costs.

5. There is limited attention given in the pre-planning phase to the culture and fit of the organisations - the implementation plans are too scant on the steps required to deliver the strategic direction, growth and integration as needed. Mitigating actions include:

a. The transition management team have responsibility for agreeing the future culture and fit required, and should delegate to each partner in the restructuring the steps to define what changes need to be implemented.

b. Each step should then be articulated in detail, showing the milestones and timing, plus ownership. The transition management team then should consider what risks there are to securing the new vision, and decide on steps to mitigate these.

The breadth and depth of any due diligence process should be informed by the proportionate size of the proposed restructuring relative to turnover as well as track record of successful implementation of significant change programmes over recent historical periods.

5.3 Information Technology

As part of any pre- and post-restructuring consideration, there needs to be an understanding of what systems and controls operate over the key information systems that are in place and of arrangements for the provision of these systems post-restructuring completion (in-house, shared service, outsourced etc.) for the combined organisation. There should not be a presumption that any of the existing IT systems, infrastructure and support are fit for purpose; instead as far as possible there should be a clean sheet approach with IT provision an integral part of the post-restructuring consideration.

Linked to issues identified as part of the consideration of pre- and post-restructuring issues and risks there are a number of IT issues that may need considering as part of a due diligence process, including the following with mitigating actions shown under each:

1. Individual colleges may not have the right IT systems, infrastructure and support arrangements to efficiently operate as a combined organisation post-integration. Mitigating actions include:

   a. Review the robustness and scalability of the current IT applications landscape, infrastructure and IT organisation/support arrangements.

   b. Review current IT license agreements and obtain addendums to ensure compliance and appropriate licensing model post restructuring for the enlarged organisation.

   c. Develop the requirements of the “to-be” IT operating model for the enlarged organisation, including considerations of:

      i. the level of IT systems and infrastructure centralisation/integration;

      ii. the applicability of a shared service centre;

      iii. implications and system requirements of any change in model (i.e. local server to cloud based applications; increase in blended or online curriculum delivery);

      iv. the need for robust and resilient connectivity; and

      v. scalability requirements (including assessment of future student-driven demand).

   d. Determine the requirements for an interim operating model or use of parallel systems/IT solutions during the transition period post-restructuring until appropriate “to-be” IT landscape for the enlarged organisation can be put in place.

   e. Assess opportunities for possible further process automation, technology-enabled business improvements and cost efficiencies for the enlarged organisation.

f. Assess associated IT one-off costs and ensure these are included in the post restructuring business plan.

2. Data quality and security issues may create business continuity and reputational risks during the transition period. Mitigating actions include:

a. Review and understand current controls around data quality and data protection, including processes, methodologies and tools used.

b. As a result of the review, indicate any possible risks to cyber security and ensure remediation steps are identified for the enlarged organisation.

c. Map and classify key sensitive data across the enlarged organisation and identify appropriate controls and protections over the transition period post restructuring.

d. Clarify data ownership and identify necessary consents for possible data migrations.

e. Understand level of complexity and quality as well as data cleansing required for data being migrated to the enlarged organisation.

f. Ensure minimal impact on the systems used by students (and student data) is prioritised and embedded into planning of any transitions and integrations of students' systems.

The requirement for due diligence and the breadth and depth will be dependent on the complexity of any IT systems as well as capacity within the respective organisations to support any integration process.

5.4 Estates

Asset ownership and transfers will be important factors in shaping the process by which a restructuring is progressed. These may well affect the value of the assets involved and how future services are provided for the enlarged organisation. The estates due diligence should be progressed in order to assess the impact on assets of the proposed restructuring and ensure that the future asset base of the organisation supports the future business requirements and course offerings.

Set out below is guidance on the general estates due diligence process. It should however be noted that the specific nature of the due diligence depends on the type of restructuring being considered and should be adapted accordingly (e.g. where no significant estates rationalisation is planned post-restructuring, a more 'light touch' confirmatory due diligence process may be appropriate).

Regardless of the restructuring type, due diligence on core asset information will need to be undertaken in order to inform and support the restructuring decision making process. The due diligence requirements need to be informed by the strategic plans for the new structural form of the enlarged organisation post restructuring with key considerations including:

1. List of all land and buildings – a full list of all land and buildings in the area to provide a clear understanding of the asset base of each college:

   a. Tenure of each site – short leasehold, long leasehold or freehold.

   b. Location of each site.

   c. External area of each site (hectares).

   d. Gross internal floor area of each site (sq metres).

   e. Type and specification of land and buildings.

2. Freehold estates assets – for all assets owned by the college, including any assets held under long leasehold:

   a. Understanding deeds and title information.

   b. Details of any ground leases, restrictive covenants, easements, rights of way, wayleave agreements.

   c. Site plan showing boundaries for freehold ownership and extent of playing fields.

   d. Total site area/floor area/playing field area.

   e. Current complications with statutory building requirements – identifying any enforcement action against the respective colleges.

   f. Details of any unimplemented planning permissions.

   g. Environmental issues and flood risk.

   h. Details of listed buildings and other restrictions/covenants on buildings.

   i. Details of capital expenditure undertaken or planned (both historic and forecast) with justification of value enhancement and/or preservation of value the expenditure will create.

   j. Contracted commitments and other asset management initiatives including any proposals on a site by site basis.

   k. Where assets are surplus to requirement post-restructuring, it is key that the ownership of the assets is validated as well as any restrictions placed on the assets.

3. Leased premises for all assets leased by the college:

a. Details of all leases, sub-leases, over-leases, deeds and title information.
b. Details of all rental information including rent payable, how rent is paid (monthly/quarterly/annually) and any agreed rental incentives.
c. Understanding of any payment plans in place and any monies owed.
d. Total leased area: external site dimensions (ha), Gross Internal Floor Area (sq m).
e. Lease expiry and details of any rent review or break opportunities including associated notice periods.
f. An understanding of other liabilities including utility costs, service charge, rates liability and insurance costs.
g. History of public funding invested in the asset and residual value of the investment.
h. Details of any restrictive lease covenant e.g. restrictions on use or assignment which may impact on estates planning, valuation and potential future transfer of assets.
i. Local planning constraints that would affect disposals.
j. Details of any ground leases, restrictive covenants, easements, rights of way, wayleave agreements.
k. Site plan showing boundaries for freehold ownership and extent of playing fields.
l. Environmental issues and flood risk.
m. Details of capital expenditure undertaken or planned (both historic and forecast) with justification of value enhancement and/or preservation of value the expenditure will create.
n. Contracted commitments and other asset management initiatives including any proposals on a site by site basis.
o. Where assets are surplus to requirement post-restructuring, it is key that the ownership of the assets is validated as well as any restrictions placed on the assets.

4. Third party occupants – a full list of any third party occupants and the subsequent lease liabilities which may restrict future proposals of the college(s):

a. Full tenancy schedules for all third party occupiers with details of all leases/licences/service tenancies and tenant details – e.g. tenant responsible for maintenance and council tax.

b. Details of what property is included in the demised area, total Gross Internal Floor Area (sq m) and site area (ha).

c. Length of term including start date and expiry date as well as details on any break options and the associated notice periods.

d. Income information including rental levels, estimated rental value, additional income.

e. Rent review mechanisms including rental steps, amount and dates.

f. Key lease responsibilities including key covenants, whether the lease is repairing & insuring and any other lease details which could impact on future asset transaction.

g. Covenant rating of tenant in occupation.

h. Consider whether the third party occupier has statutory security of tenure.

i. Details of any disputes with occupiers or adjoining owners both past and present.

5. Capital value – understanding of the market value of all freehold (including long-leasehold) assets in order to establish potential future capital receipts as a result of the restructuring:

a. Latest financial reporting value for land and buildings.

b. Current market value.

c. Basis of valuation for financial reporting.

d. Date of last accounts valuation.

e. If rates are payable, details of rateable value and rates payable in the past financial year.

f. Details of key value considerations which may enhance or negatively impact on the asset value.

6. Property maintenance – an understanding of any maintenance liabilities including backlog building maintenance which maybe high due to historically low investment in planned maintenance. For each building or site:

a. Current condition of each building using Royal Institute of British Architects categories reported by professional surveyor.

b. Running costs of prior years and maintenance budget for the next financial year.

c. Building condition survey.

d. Planned maintenance programme and budget.

e. Planned maintenance programme and budget for plant, electrics, heating etc.

f. Details of any known deleterious or hazardous materials affecting the asset e.g. asbestos, high alumina cement.

7. Grant funding – consider if there are any restrictive grant funding conditions attached to buildings which may affect future disposal, use or transfer of assets:

a. Review and understand any conditions attached to historic (particularly public) funding of new builds or refurbishments.

b. Discuss restructuring proposals and future use of relevant buildings with funders.

c. Engage with grant providers and consider novation of funding conditions to the enlarged organisation.

8. Capital programme – consider whether existing strategies of the individual colleges may have committed the respective colleges to significant future investment requirements which may impact on the delivery of strategies of the new enlarged organisation:

a. Current and planned capital programmes and status of plans for each college.

b. Understand the nature and level of committed capital expenditure prior to restructuring.

c. Understand whether there is any requirement for capital investment to facilitate the delivery of the combined organisation strategy and plans post restructuring.

d. Understand the level of internal and externally generated funds including the timing and value of any planned disposal of surplus assets to fund the capital programme.

e. Asset management commentary of key assets.

9. Suitability and sufficiency – consider how fit for purpose the assets and their component parts are in order to support future space planning and curriculum delivery:

a. Analysis of space required post-restructuring.

b. Whole college space per student after restructuring.

c. Future longer-term (post-restructuring) projects, planning assumptions (i.e. student numbers) and space.

d. Identify any duplication of estates across the enlarged organisation and identify assets that are surplus to requirements.

10. Development Sites – for any sites within the ownership of the college which have been ring fenced for future development or sites which could be unlocked for future development opportunities:

a. Full information on any assets on the proposed development site.

b. A clear understanding of any development proposals including any contract details, heads of terms, funding status and agency comment.

c. Planning information for the development site including any enforcement notices, any residual planning or highways obligations and contributions (S106/S107), confirmation and authority sign off of planning conditions and copies of all planning consents and applications.

d. Full residual site value providing estimated cost to develop the site, including any abnormal build costs.

The level of due diligence required will be dependent on the nature and complexity of the proposed restructuring. Where each college operates from one site, which is well maintained, the level of due diligence may be lighter touch.

5.5 Pensions

There needs to be an understanding of the nature of pension provision which the entities are required to provide to teaching staff and non-teaching support staff. Teaching staff are usually entitled to the unfunded TPS and support staff are entitled to the funded LGPS. These two pension schemes are both career average schemes. However, the associated cash, accounting costs and risks to the employer differs between them both on an ongoing basis and in the event of a staff transfer or restructuring.

There may be instances where colleges have been required to put in place alternative pension provisions which would need to be considered as part of any proposed restructuring. This may include:

- temporary workers who do not meet the eligibility requirements for TPS or LGPS; or
- where colleges have set up shared service companies, the staff in these companies may have different pension provision.

1. Impact on funding and cash. There is no direct impact of a merger on cash contributions to the TPS so the focus should be on the LGPS. The overall impact on funding of two or more colleges participating in either the same or different LGPS Funds for their non-teaching staff should be understood. Any due diligence procedures should include:

a. Review of latest actuarial assessments of funding contributions to the LGPS Fund(s) and differences in existing approach to setting assumptions, recovering deficits and allowing for covenant risk.

b. Consideration of options around running two LGPS participations post-restructuring potentially in different Funds or consolidating liabilities into one section of one LGPS Fund to identify any pension risks, liabilities and deal structure implications.

c. Consideration of impact of affected LGPS Funds requiring new covenant assessment information or security for the new entity and revising its approach to funding.

2. Impact on accounting. TPS is on a cash basis so the focus is on the LGPS which requires full defined benefit pensions accounting disclosures. The impact on the acquiring entity or new entity accounts of participation in the LGPS should be understood with due diligence procedures including:

a. Review of respective actuarial assumptions used for accounting by existing entities and scope to rationalise assumptions in future. The relevant accounting and reporting standards will need to be understood in order to make this assessment.

b. Consideration of impact on Income and Expenditure and on Balance Sheet and any special event items e.g. curtailments.

3. Impact on auto enrolment. The impact of merger on two separate auto enrolment processes should be understood. Due diligence procedures may include:

a. A high-level review of the scope to align monitoring and communication processes and the use of any low cost pension provision for temporary or flexible workers (e.g. National Employment Savings Trust or “NEST”, a defined contribution occupational pension scheme, backed by Government).

b. Assessment of the re-enrolment date for the enlarged organisation.

c. Estimate of potential new costs on re-enrolment of enrolling all existing employees who have opted out into their relevant pension scheme.

4. Early retirement and unfunded promise cost exposure triggers of expensive redundancy and early retirement pensions requiring immediate contributions should be understood. Any other unfunded promises should also be examined with due diligence procedures including:

a. Assessment of early retirement exposure by looking at age and service profile of employees.

b. Review of any unfunded pension promises provided to employees or former employees (in addition to the main TPS or LGPS benefits).

The breadth and depth of any due diligence process is likely to be driven by a number of factors including:

- **the number of employees impacted by the proposed restructuring;**
- **the number of different LGPS of which the employees of the respective colleges are members.**

A greater number of employees impacted by the restructuring and more complex pension arrangements would increase the breadth and depth of any due diligence process.

5.6 Human Resources

There needs to be an understanding of the potential workforce related costs and risks associated with the restructuring. Common challenges include hidden severance costs, cultural incompatibility, TUPE restrictions and safeguarding issues. Key areas of focus for the due diligence process may include:

1. Skills and talent: capability and quality of management, capability of support and particularly academic capability play a big part in the success of a college. The due diligence process should assess whether the right talent is in place to meet the post-restructuring objectives of the colleges. Due diligence procedures may include:

   a. Review Ofsted assessments relating academic personnel. Identify areas of particular weakness prior to the restructuring.

   b. Review key vacant roles or talent gaps in leadership, support staff and specialist academic talent, as well as the suitability of succession and retention plans to ensure that the right talent is in place to deliver the post restructuring objectives.

   c. If part of a college is transferring (i.e. a carve-out restructuring) assess whether the transfer perimeter includes the skills and talent necessary to support the carved-out part of the college.

   d. Review any plans to deliver cost benefits for the colleges and assess whether the required management, support and academic talent is in place to support the objectives of the college post restructuring.

   e. Implications of proposed future operating model on organisation design and employee reporting structures.

2. Severance, relocation costs and headcount reductions can trigger a range of hidden costs including expensive and immediate payments into the LGPS fund and payments relating to individual severance terms which can often significantly exceed statutory minimums at the senior level. Due diligence procedures may include:

a. Model any expected long term employee cost savings from anticipated redundancies or recruitment freezes (if headcount reduction is planned).

b. Review of employee contracts and severance terms to assess complexity and cost of any potential post-restructuring redundancy activity, so these can be factored into cost projections alongside the synergy savings.

c. Modelling the cost of early retirement pension payments so that these can be factored into the cost projections.

d. Identification of any additional barriers (e.g. relationships with unions, reputational challenges, past redundancy activity etc.) so that these can be planned for accordingly.

e. Review relocation polices and assess cost and challenges of any required employee relocation activity.

3. A range of recent legislative changes will have a potential hidden impact on future employment costs. Relevant changes include National Living Wage, Apprenticeship Levy, pensions auto-enrolment and holiday pay court cases. To help address these risks, due diligence procedures may include:

a. Assess potential impact on projected staff costs of recent UK employee legislation and similar changes, in particular focusing on National Living Wage, Apprenticeship Levy, pensions auto-enrolment and holiday pay court cases and comment on possible mitigations being considered or that could be considered.

b. Review details and costs of any self-employed or temporary associated workers e.g. contractors, temporary labour and any implications or obligations (e.g. Agency Workers Rights).

4. Understand any legacy TUPE protections that may be in place. These are quite common due to the significant organisational consolidation in recent years. TUPE considerations may include:

a. Identification of any legacy TUPE protections that may impact ability to change terms and conditions in the future.

b. If not all of an organisation’s operations are to transfer (i.e. a carve-out restructuring), TUPE implications will need to be identified through assessing which shared employees will transfer as part of the restructuring and verify the overall people costs of the carved out entity.

5. There needs to be a clear understanding of the reward and benefit arrangements across the individual entities. Reward attracts significant media attention. Arrangements can vary widely by college and are often difficult to change due to collective bargaining agreements and individual contract terms. To help in identifying such risks, due diligence procedures may include:

a. Side by side analysis of reward and benefits arrangements of each organisation to identify any potential challenges of harmonizing post restructuring.
b. Appropriateness of current pay level versus the market.
c. Impact of collective bargaining agreements.
d. Impact of individual contract terms.
e. Workforce sentiment on reward.

6. HR systems and structure HR systems often vary by college and can be complex to harmonize (for example when there are several incompatible payroll systems). Having an understanding of the differences will be an important part of planning any harmonization activity post restructuring. As a result, due diligence procedures may look to:

a. Review the structure and suitability of the current HR model (e.g. size of function and skills), which often depends on historic relationship with stakeholders.
b. Undertake a high–level side by side assessment of HR systems for each organisation to assess the complexity of any integration needed.

7. Understanding the quality of safeguarding processes is important given the sensitivity of this subject in colleges and the potential for breaches to affect funding and reputation. Due diligence considerations may include:

a. Review of workforce-related safeguarding protocols, processes and training to ensure they are effective and in compliance with law (e.g. recruitment and selection processes).
b. Suitability of training and monitoring processes for ensuring appropriate safeguarding of adults and learners with special education and high needs.
c. Review of safeguarding records and any previous incidents to identify any past or current reputational issues early.

8. Culture incompatible cultures between entities disrupts morale, but also provides inconsistent messages for students and the wider workforce of each college and can lead to reputational issues. Due diligence procedures may include:

a. Side by side review of college cultures to identify any areas of cultural or reputational incompatibility early (assess leadership & management style; collaboration and teamwork; autonomy and involvement; work environment; risk and adaptability).

The breadth and depth of any due diligence process is likely to be driven by a number of factors including:

- **the number of employees impacted by the proposed restructuring; and**
- **the degree of difference in the areas highlighted, in particular the scale of the cultural difference between the organisations.**

A greater number of employees impacted by the restructuring and more cultural differences between the organisations would increase the breadth and depth of any due diligence process.

5.7 Employment taxes

There needs to be an understanding of the potential employment tax risks associated with the restructuring. Key areas of focus for the due diligence process may include:

1. Employment tax compliance – Compliance with increasing reporting obligations in their role as employers means that for many colleges this has become more onerous and they need to have clear policies, processes and systems in place. Due diligence procedures may look to:

   a. Consider how general employment tax compliance issues relating to payroll, expenses and benefits in kind are dealt with in order to ensure that appropriate controls are in place.

2. Real Time Information (RTI) – The advent of RTI means that there is far more interaction with HMRC on a regular basis. Due diligence procedures may include:

   a. Look at the payments process, RTI procedures and any gross payments made to employees/workers.

3. Dispensations and forms P11D – Form P11D dispensations have been withdrawn with effect from 6th April 2016 and have instead been replaced with legislative exemptions. This places the responsibility for ensuring that expenses reimbursed to employees can be made tax free. Due diligence procedures may include:

   a. Review the expenses policy and expenses claims procedures to identify those expenses that fall within the exemption and those where it may be necessary to make payments subject to tax to avoid any compliance failure.

   b. Carry out a “look back” over P11D and PSA reporting, historic dispensation coverage and salary sacrifice arrangements to ensure that there are no previous failures.

4. Issues specific to colleges – During previous mergers of colleges various matters have given rise to potential issues that have required in-depth investigation. Examples of these include:

a. The provision of living accommodation to employees.

b. Employees at multi-site organisations with more than one permanent workplace.

c. Compensation for the buying-out of certain employee benefits such as pensions entitlements.

d. Termination payments.

e. Employment status with regard to the engagement of workers on self-employed terms, particularly teaching/lecturing staff.

f. The private use of the organisation's vehicles (e.g. vans, minibuses, cars etc.) particularly pool vehicles.

g. Travelling and other expenses claimed by any home-based staff.

Investigate whether these issues apply to each organisation and seek further guidance on how to deal with these aspects appropriately.

The level of due diligence required will be dependent on the nature and complexity of the proposed restructuring. Where one or more colleges has a poor history of tax compliance or a number of historical employment tax issues, a more detailed approach to due diligence in this area may be required.

5.8 VAT and other taxes

The following key areas of focus need to be considered within the due diligence process to identify and understand any potential VAT and other tax implications resulting from a

proposed restructuring involving colleges:

1. Compliance

a. Education providers will have complex compliance issues flowing from exemption and non-business activities. Colleges will have negotiated agreements with HMRC that determine their VAT recovery positon. They will also have difficult VAT questions regarding ancillary and non-core supplies. This needs to be reviewed.

b. Certain colleges may be involved with ongoing litigation which could be disrupted by reorganisations. The risks of this need to be reviewed and assessed.

c. The charitable status of many colleges allows certain reliefs from VAT which needs to be reviewed.

d. Many colleges have an increasingly international dimension including on-line provision and procurement of overseas supplies which can create specific VAT compliance issues. This should be considered.

e. Education providers may have been required to file corporation tax returns or be structured such that they have corporation tax obligations (e.g. joint venture or other arrangements with training providers). This should be reviewed.

f. Non-primary purpose of trading would result in corporation tax obligations; whether this applies should be investigated.

g. Consider whether all parties subject to the restructuring have good compliance histories.

h. Consider whether there are any parties carrying any disclosed or undisclosed liabilities.

i. Consider whether there are any unresolved disputes with HMRC over any taxes.

2. Tax status of providers

a. There are a significant and increasing number of training providers operating in FE. Not all providers are exempt from VAT and collaborative arrangements with non-exempt providers could have a significant impact on financial models. These could alter the status of the provider, significantly changing the VAT profile and leading to unanticipated tax liabilities. This needs to be investigated.

b. Consideration should also be given to whether there are any special agreements between any party and HMRC that may be put at risk by the proposed restructuring.

3. Estates

a. Estates represent the major investment for colleges and in particular the most significant VAT cost. Many providers will have sought to minimise this cost through legislative relief and/or tax planning. Consideration needs to be given to how restructuring will impact on the arrangements currently in place.

b. Estates may have been structured using subsidiary companies or partnerships which can create complexity in tax arrangements. This needs to be investigated.

4. VAT treatment of certain assets

This may be dependent on the use to which they are put which may result in unanticipated liabilities post-restructuring. As a result:

a. Any change of use of any asset post-restructuring will need to be understood.

b. Where there is a change in focus post-restructuring (e.g. move towards working with employers to deliver apprenticeships rather than broader FE provision to students), this may result in a cost impact due to losing entitlement to certain reliefs or clawbacks of previously claimed VAT relief. This needs to be investigated.

5. Cost sharing

a. Exploring the possibility of shared back office functions is increasingly popular amongst colleges but can lead to significant VAT costs. Whilst certain arrangements are capable of relief from VAT there are strict operating conditions and not all providers are entitled to the exemption. This will need to be understood[4].

b. Where services are being outsourced, consideration needs to be given to what arrangements are put in place to mitigate costs of additional VAT that such an activity would have under normal circumstances. This will also need to be considered where a federated structure is being considered.

6. Other training organisations

a. Where a proposed collaboration is with another training provider there are a number of VAT issues that will need to be considered including the eligible body status. Many training providers that are not charities will not be eligible and will not be able to deliver exempt education services (i.e. VAT being applied on fees).

b. All FE organisations are exempt charities and will obtain certain VAT reliefs which may not be available to other training providers.

The level of due diligence required will be dependent on the nature and complexity of the proposed restructuring. Where the proposed restructuring will result in changes to the tax status for one or more organisation the more detailed due diligence processes will need to be undertaken.

5.9 Legal considerations

In addition to the matters outlined above, there needs to be an understanding of the potential legal risks associated with the restructuring. Key areas of focus for the due diligence process may include the assets of the college, deal structuring, governance,

[4] See HMRC guidance

restructuring documents, TUPE, assignment/novation of material contracts, property and FE specific legislation and regulation as set out below.

1. Ownership of key assets or rights and restrictions over those assets

a. The structure of a typical merger involving colleges would be for all of the assets of the college being acquired (Party A) to be transferred to the acquiring college (Party B), the nature of the assets of Party A should be considered. In this regard, to assist with an efficient merger, it would be helpful for Party A to keep and maintain an up to date assets register so that Party B is clear as to which assets are being transferred to it as part of the merger.

b. Consideration as to whether the assets are owned by Party A or licenced from third parties will be important as it will determine the legal process of transferring those assets and this needs to be reflected in the legal restructuring documents.

c. Additionally, some assets may not be transferrable without the consent of third parties and/or some assets maybe being used as security and will need the consent of the secured party (e.g. lenders) or the security may be required to be discharged prior to the merger.

2. Ownership structure of the merging entities and relations with third parties including DfE

a. The articles of governance for each college will need to be reviewed and considered to flag the legal challenges of integrating the governing bodies. For instance each college is likely to have different procedures/rules and so a new set of consolidated articles of governance will need to be adopted post-merger. The legal mechanics as to how to do this (e.g. certain resolutions/consents may be required) will be contained in each college's articles.

b. Any current funding/joint venture relationships may be impacted by the merger because the legal entity which is a party to those arrangements (i.e. Party A) will no longer be the contracting party post-merger. Accordingly Party A may have to renegotiate or obtain the consent from funders or from its JV partners prior to the proposed restructure.

c. The board of governors will need to consider their charitable duties, and ensure they are not in breach of those duties as part of the merger.

3. Investigations by regulatory authorities or other litigation that could impact reputation

a. Party A should disclose all current or pending disputes, breaches of regulations, breaches of laws and other similar matters which could give rise to a liability. At law, following the merger, all such liabilities of the Party A will be assumed by Party B.

4. Status of sponsorship licences and visas (particularly colleges with international students)

a. Post-merger, all staff and students of Party A will transfer to Party B. Accordingly, review of Party B's current sponsorship licences and/or review of transferability of Party A's licences to Party B will need to be considered.

b. Both colleges to undertake due diligence review of all student and teacher visas and current sponsorship licences to ensure all visas will be valid with Party B as sponsor post-merger.

5. Novation of contracts

a. As part of the merger process, the contracts of Party A will be novated to Party B. Accordingly Party A will need to assess all of its contracts, including with its subcontractors, to ensure (a) whether these contracts can be novated and/or (b) if they can be novated, what third party consents (if any) are required to approve the novation.

b. To assist colleges with this process, colleges should consider a materiality threshold to limit the number of contracts required to be reviewed as part of the due diligence process (see section 2 for more details on how to set a materiality threshold).

c. The colleges should also check to see if there will be duplications of contracts post-merger and whether some of the existing contracts can and should be terminated prior to the merger subject to the costs associated with early termination.

6. Review of insurance arrangements

a. Party A should assess whether, and to what extent, it can transfer its insurance contracts as part of the restructure. If the insurance contracts are unable to be transferred or if requisite consent to the transfer is unable to be obtained from the insurer, Party A could consider terminating its current insurance contracts and arranging for Party B to update its insurance policies post-merger; however the colleges should be mindful of potential consequences for doing so (e.g. increased premiums/break fees).

7. Employment/TUPE considerations

a. The standard employment contract for the employees of the colleges may be different. A review of both colleges' employees' employment contracts will be required to ensure terms of employment are harmonised across both sets of employees post-merger and that the costs of doing so have been reflected accurately.

b. As a merger triggers TUPE legislation, appropriate notification of the merger must be given to employees and both parties must adhere to all TUPE processes. Failure to do so could result in claims and therefore due diligence will need to consider whether notification has taken place.

8. Finance

a. Check Party A's banking facilities to clarify how a merger will impact on such facilities. It is common to find in banking facilities for colleges, provisions which restrict or require the bank's consent to a merger.

b. It is common practice that banks may consider a merger as an opportunity to renegotiate terms of existing facilities.

c. Check mortgage register for security held by the bank; as Party A will cease to exist at law following the merger, the bank is likely to require replacement security or for the mortgage to be discharged.

9. Equality Impact assessments

Any planned changes post-merger should not adversely impact on the equality and diversity of learners including safeguarding arrangements for students with special education and high needs. Due diligence may include:

a. Check whether equality and diversity have been considered in the implementation plan and safeguards put in place to ensure it is not adversely impacted.

b. The impact both in a legal sense and in a financial sense on the implementation plan needs to be considered if adequate plans are not in place.

10. Intellectual property rights

The nature of technical colleges may result in intellectual property rights needing to be considered as part of the proposed restructuring. Due diligence may include:

a. Determination of ownership and adequate protection of intellectual property (e.g. partly created by students and teachers) because the intellectual property rights of Party A will transfer to Party B as part of the merger.

b. Check to determine if there are any restrictions on the transferability of all intellectual property (registered and unregistered).

c. Check that the college has not infringed any third party intellectual property rights as any such liability resulting from an infringement will be transferred to Party B post-merger.

11. How the college occupies its premises will need to be considered as part of the proposed restructuring

a. If premises of the college are occupied under a lease, the lease will need to be novated to Party B as part of the merger. Obtaining the landlord's consent to the novation may not be straightforward and is often used by the landlord as an excuse to renegotiate the lease.

b. If the college occupies land as freehold owner, the college will need to gather evidence of title to transfer the freehold ownership to Party B as part of the merger.

c. Consider any restrictions on use of premises or any impending development orders which could affect use and enjoyment of the land as a college post-merger.

The level of due diligence required will be dependent on the nature and complexity of the proposed restructuring. Where the proposed restructuring will result in changes to the legal structure and status of an organisation, there may be a requirement for more detailed due diligence processes to be undertaken.

There will be a requirement for legal due diligence to support any proposed restructuring. However, the more complex a restructuring, the greater the degree of any due diligence support that may be required.

5.10 Governance

Post completion, the governance structure of any enlarged organisation needs to have in place appropriate powers and ability to deal with a range of legacy issues that could relate to staff, estates, legal or financial issues. Key areas for consideration as part of due diligence process include:

1. There is a risk that governance arrangements and structures are not appropriately put in place post-restructuring. This can be mitigated by:

a. Early agreement by all parties on the governance arrangements to be put in place post-restructuring. It is unlikely that all the board members of the merged colleges will remain in post within the new enlarged entity.

b. Ensuring appropriate arrangements are put in place to oversee post-restructuring implementation plans.

c. Consideration should be given to the acceptability by stakeholders of any new governance arrangements.

2. As well as the governance structures currently in place and planned post-restructuring, there needs to be an understanding of the current internal control and risk management arrangements at each individual organisation that will form any enlarged organisation post-restructuring. Due diligence procedures may include:

a. Gain an understanding of existing internal controls at each organisation prior to development of processes and control procedures for the new/enlarged organisation. Considerations may include:

    i. Are there any observable weaknesses in internal controls?

    ii. Are there documented policies and procedures?

    iii. Is there evidence that these are being followed?

    iv. Is there adequate segregation of duties?

    v. Are copies of recent external audit reports available? Have any audit reports been ‘qualified’? What do management letters say? Is remedial action in place where necessary?

    vi. If there is an Internal Audit department, is it credible? Does it have a clear mandate, and sufficient budgetary independence? Is it fully resourced? What internal audit reports are available? Are findings agreed and acted upon?

    vii. Is there regular and effective reporting to an audit committee and the governing body?

b. Review existing risk management arrangements at each organisation prior to development of processes and control procedures for the enlarged organisation. Considerations may include:

    i. Is there a corporate level risk framework and associated policy? Is there a risk register that is regularly reviewed? Who reviews it and how often?

    ii. Is there a network of risk owners responsible for day to day management of risks? Is there a challenge process?

    iii. Is there an appropriate escalation process?

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