College Accounts Direction Handbook 2015 to 2016

Effective for all Colleges' financial statements for periods ending on or after 31 July 2016

Summary

The College Accounts Direction Handbook (the Handbook) is a document commissioned by the AOC in partnership with the College Finance Directors Group (CFDG), which provides advice for Colleges and their auditors on the way in which they can complete their 2015/16 financial statements.

The Handbook provides advice on the implementation of the accounting policies set out in the *2015 Statement of Recommended Practice: Accounting for Further and Higher Education* (the 2015 FE HE SORP) and the *College Accounts Direction for 2015 to 2016 Financial Statements* issued jointly by the Skills Funding Agency (SFA) and the Education Funding Agency (EFA). In a change to the format followed in previous years, the Handbook is no longer provided as a "one stop shop" for Colleges but is intended to interpret the requirements of FRS 102, including the transitional arrangements, for application to an FE College. An example set of financial statements – Casterbridge College – has been created to illustrate the presentation and disclosures that might be found for a typical College.

The Handbook is not mandatory guidance but designed to assist College financial professionals, auditors and reporting accountants with their work.

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This Handbook supersedes the Accounts Direction Handbook published for the 2014/15 financial statements. There are no plans to update the handbook again in 2016 for the 2015 to 2016 reporting cycle but that if there is a need for clarification this will be notified to Colleges.

July 2016

College Accounts Direction Handbook 2015 to 2016

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Chapter 1 Introduction and background

1.1. The purpose of this Handbook is to provide guidance on the preparation of Colleges' financial statements for the year ending 31 July 2016. This Handbook supplements the 2015 *Statement of Recommended Practice: Accounting for Further and Higher Education* (the 2015 FE HE SORP) and the *College Accounts Direction for 2015 to 2016 Financial Statements* issued jointly by the SFA and the EFA and supersedes the Handbook published for the 2014/15 financial statements.

1.2. In publishing this guidance, the CFDG and the AoC have consulted with College financial statements auditors, the SFA and the EFA.

1.3. The accounting policies and guidance set out in this Handbook for the sector are applicable to all Colleges, regardless of their size, constitution or complexity. The policies and guidance are not applicable to external institutions, private training providers or other public bodies in receipt of learning and skills sector funding. Sixth Form Colleges that convert to become 16-19 academies will be required to follow the Academies Financial Handbook 2015 and by that token, the Charities SORP (FRS 102).

1.4. Accounting policies need not be applied to immaterial items.

1.5. In accordance with Charity Commission guidance, **all** Colleges must make their Annual Reports and Accounts available on their websites, and are required to do so by the *College Accounts Direction for 2015 to 2016 Financial Statements* by 31st January 2017, with at least two years of accounts being so presented.

1.6. Colleges with queries on how to apply this guidance to the particular circumstances of their own College should consult their professional advisors or the responsible funding body.

The New UK GAAP - a brief introduction

1.7. On the 22nd November 2012, the FRC issued its first accounting standards under the new UK financial reporting regime:

- FRS 100 Application of financial reporting requirements; and
- FRS 101 Reduced Disclosure Framework

FRS 100 sets out the available reporting frameworks and how an entity works out which it must or may apply. The framework sets out three types of 'Companies Act accounts', i.e., those prepared using any of FRS 101; FRS 102; or the FRSSE.

Those companies that are required to apply EU-IFRS by law or regulation will continue to do so: the new framework does not impose EU-IFRS beyond

the requirements of existing law and regulation but an entity may choose to adopt it. Such accounts are 'IAS accounts' as set out in the Companies Act 2006.

FRS 101 allows qualifying parent and subsidiary entities to apply the recognition and measurement requirements of EU-IFRS but with exemption from some of the disclosures. FRS 101 applies in the **individual** accounts only.

FRSs 100 and 101 apply for accounting periods beginning on or after 1 January 2015 but they may be adopted early with immediate effect. The Companies Act has been amended for periods ending on or after 1 October 2012 to allow companies a free choice to switch back to UK GAAP, so long as they have not previously done so in the last five years.

1.8. The final part of the new UK GAAP, *FRS 102 The financial reporting standard applicable in the UK and Republic of Ireland,* was originally issued on the 5th March 2013 and the latest version published on 29th September 2015, and is available at https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-applicab.pdf . It is effective for accounting periods beginning on or after 1 January 2015 and could not be adopted early by GFE or Sixth Form Colleges.

This means that Colleges are producing full accounts under the new proposals for the first time in 2015/16.

1.9. The new Education SORP (the 2015 FE HE SORP) was approved on the 26th March 2014 and is available at http://www.universitiesuk.ac.uk/highereducation/Pages/SORP2014.aspx#

The 2015 FE HE SORP reflects the changes to UK Generally Accepted Accounting Practice (“the previous UK GAAP”) following the issue of FRS 100, 101 and 102.

Institutions following the 2015 FE HE SORP must apply all requirements under *FRS 102 The Financial Reporting Standard applicable in the UK and the Republic of Ireland*, relevant legislation ***and accounts directions from the Funding Bodies applicable to the reporting institution***.

The 2015 FE HE SORP is intended to:

- improve the quality of financial reporting by institutions;
- enhance the relevance and comparability of, and the ability to understand the information presented in institution’s financial statements;

- provide clarification, explanation and interpretation of accounting standards and their application to sector specific transactions; and
- assist those who are responsible for the preparation of the financial statements.

The 2015 FE HE SORP does not diverge from FRS 102. In certain areas the 2015 FE HE SORP provides an interpretation to aid the practical implementation of FRS 102. The 2015 FE HE SORP also requires a small number of additional disclosures to those required by FRS 102 to be made to ensure consistency and aid understandability.

Each funding body issues an accounts direction. In all cases these accounts directions require institutions' financial statements to be prepared in accordance with the 2015 FE HE SORP. The accounts directions also require disclosures over and above those required by the 2015 FE HE SORP and FRS 102. These disclosures include the emoluments of the Accounting Officer, the number of higher paid staff, and details of any compensation for loss of office paid to higher paid staff. The *College Accounts Direction for 2015 to 2016 Financial Statements* is available on the AOCs website at

https://www.aoc.co.uk/funding-and-corporate-services/funding-and-finance/accounting

and on GOV.UK at

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/491646/College_Accounts_Direction_1516.pdf .

Set out in Chapter 2 are the key additional requirements of *College Accounts Direction for 2015 to 2016 Financial Statements* together with explanatory narrative to assist in the implementation of the requirements.

Small entity reporting

1.10. Whilst not explicitly stated within either the 2015 FE HE SORP or the *College Accounts Direction for 2015 to 2016 Financial Statements*, the presumption in this Handbook is that Colleges will not be taking advantage of the reporting exemptions available within the Financial Reporting Standard for Smaller Entities ("FRSSE"). The 2015 FE HE SORP does state at section 1.4 that "institutions following this SORP must apply all [the] requirements under FRS 102…" which implies that the exemptions will not be available to Colleges.

1.11. The FRSSE was available to be adopted by entities meeting the small companies' size criteria of turnover, total assets and employee numbers for accounting periods ending 31st December 2015. However, the FRSSE has been withdrawn for periods beginning on or after 1st January 2016 and small entities, other than micro-entities, will need to adopt a new framework, in this case FRS 102.

Overall impact

1.12. The concepts and basic principles included within FRS 102 are not significantly different to the previous UK GAAP. Four primary statements are to be presented:

- Statement of Comprehensive Income (SOCI);
- Statement of Changes in Reserves;
- Balance Sheet (also known as a Statement of Financial Position); and
- Statement of Cash Flows

For the purposes of the 2015 FE HE SORP and the requirements of that and the *College Accounts Direction for 2015 to 2016 Financial Statements*, the example accounts - Casterbridge College – make the assumption that Colleges will only wish to present a single Statement of Comprehensive Income, and not to separately present an Income Statement (similar to the previous Income and Expenditure Account), though they are at liberty to consider this if appropriate.

The Statement of Changes in Reserves is a new primary statement and there is no longer a requirement for a note of historical cost surpluses and deficits, which has no equivalent within the new UK GAAP or indeed within IFRS. The statement of total recognised gains and losses has also been combined within the Statement of Comprehensive Income.

In addition the formats and naming conventions are slightly different. In general, the notes to the financial statements are more extensive under FRS 102 which follows the lead set by IFRS. The adoption of FRS 102 proposals will present institutions with an opportunity to consider their accounting policies on first time adoption and also improve some of their business processes.

1.13. Chapter 4 of this Handbook considers the main changes found following the adoption of FRS 102. Not all of the changes are relevant to Colleges, or if they are relevant, only to a relative few and therefore have not been dealt with in this Handbook. Colleges should consult their professional advisors as appropriate.

As this is the first year of adoption of FRS 102 there are a number of additional matters to consider around the transition to the new standard and the additional disclosures that arise. These have been covered in Chapter 3 of this Handbook along with the exemptions available from the full retrospective application of certain requirements.

FRS 102

1.14. FRS 102 is arranged into 35 sections with the 2015 FE HE SORP broadly following the same conventions. The sections range from Section 1, the Scope of the standard, through sections on the concepts and the various primary statements, to sections on specific topics before concluding with a section devoted to transition matters (35).

1.15. Section 1 includes a number of exemptions from disclosures required by FRS 102 that Colleges may wish to take (and referred to again in section 3.3 of the 2015 FE HE SORP) and represent the FRS 102 reduced disclosure framework, including:

- The requirement to present separate cash flow statements for the parent undertaking and the consolidated position. This is predicated on making some additional disclosures though regarding cash balances and a statement on taking the exemption, both of which have been included in the Casterbridge College example accounts; and
- The disclosure of intra group related party transactions.

1.16. Section 5 deals with the Statement of Comprehensive Income. This is similar to the Statement of Financial Activity found in a charity in that the "traditional" items of income and expense are presented in the top part, with the bottom part being reserved for other gains and losses (akin to the previously separate statement of total recognised gains and losses).

As with the previous UK GAAP, FRS 102 permits presentation of additional line items, headings and sub totals when such presentation is relevant to the understanding of an entity's financial performance. This features within the 2015 FE HE SORP in that presentation format. FRS 102 does not use the term "exceptional" though but if an item is of such importance to the user's understanding of the financial statements then it **must** be presented separately (2015 FE HE SORP para 3.6).

1.17. Paragraph 3.7 of the 2015 FE HE SORP builds on Section 5.9 of FRS 102 in dealing with another change to previous UK GAAP being the disclosure of what were known as exceptional items and in particular those under FRS3.20 which were shown "below the line". Paragraph 3.7 states "The disclosure of material items must be made either in the notes or by the insertion of an additional line **within the relevant activity heading** on the face of the Statement of Comprehensive Income.

1.18. Section 10 provides guidance on Accounting Policies, Estimates and Errors. Of particular note here is the change regarding ***prior period adjustments***. Under the previous UK GAAP, a prior period adjustment was required for

fundamental errors, which is generally understood to be a higher threshold than a material error. Under FRS 102 however, the requirement for a prior period adjustment is set at the material error level.

Prior period errors are omissions and misstatements for one or more prior periods where the necessary information was either available or could reasonably be expected to be available when the financial statements of prior periods were approved. Material errors shall be corrected retrospectively by restating prior period comparatives or if the error was before the earliest period presented, the opening balances for assets, liabilities and equity should be adjusted.

1.19. Section 34 deals with the accounting for a number of ad hoc topics including Public Benefit Entity accounting, agriculture and service concession arrangements.

Other sources of information

1.20. In addition to the published standard, there are useful papers prepared by the FRC on FRS 102 – Staff Education Notes. These can be found at https://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/New-UK-GAAP/Staff-Education-Notes.aspx

1.21. The Staff Education Notes are not part of FRS 102 but aim to illustrate certain requirements of FRS 102.

College Accounts Direction Handbook 2015 to 2016

Chapter 2 College Accounts Direction for 2015 to 2016 Financial Statements

2.1 The *College Accounts Direction for 2015 to 2016 Financial Statements* (“ the Direction”) was published at the end of January 2016 and sets out the additional financial reporting requirements for sixth form and other further education colleges, and is available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/491646/College_Accounts_Direction_1516.pdf . The AOC also include the document on their website at https://www.aoc.co.uk/funding-and-corporate-services/funding-and-finance/accounting .

2.2 The Direction includes a number of mandatory additional requirements that Colleges must include within their 2015 to 2016 financial statements (denoted as “must” in the Direction), including for the first time, the requirement to follow the 2015 FE HE SORP.

2.3 Set out in this Chapter is additional guidance on interpreting the mandatory and advisory requirements included within the Appendices to the Direction.

Appendix 1 Statement on Corporate Governance and internal control

Good Governance Code for English Colleges

2.4 In March 2015, the AoC published the Code of Good Governance for English Colleges (“the Code”) which is available at https://www.aoc.co.uk/funding-and-corporate-services/governance/governance-resources/code-good-governance-english-colleges

2.5 The Direction states that a College must **either**:

(a) comply with the Code **or**

(b) (noting that a College is not required to comply with the *Financial Reporting Council’s UK Corporate Governance Code 2014* nor to make a statement on compliance with that Code,) have ***due regard*** to the principles and guidance therein ***insofar as those are applicable to the College sector***.

2.6 The Code contains:

- An initial statement of the core values and expectations that provide the context for the way in which college governance is conducted.
- The 10 governance principal responsibilities that support the values and are vital to successful implementation.

- More detailed consideration of each principal responsibility.
- A list of references and links to source documents and good practice examples.

2.7 The Code is intended to help governing boards meet and exceed basic governance requirements. As autonomous bodies, individual colleges are free to adopt the Code as they see fit. The Code replaces the Foundation Code.

UK Corporate Governance Code 2014 (the UK Code)

2.8 The UK Code, which is updated every 2 years, superseded and replaced the Combined Code issued by the London Stock Exchange in various forms since 1998. A small number of changes had been made to the previous versions of the UK Code but which do not affect the substance of the following text. The UK Code is mandatory for companies that follow the Listing Rules but is seen as best practice for other entities.

2.9 The UK Code's overall aim is to enhance board effectiveness and to improve investor confidence by raising standards of corporate governance. The main features of the UK Code are:

- new definitions of the role of the board, the chairman and non-executive directors
- more open and rigorous procedures for the appointment of directors and from a wider pool of directors
- formal evaluation of the performance of boards, committees and individual directors, enhanced induction and more professional development of non-executive directors
- the separation of the roles of the chairman and the chief executive to be reinforced
- a chief executive should not go on to become chairman of the same company
- closer relationships between the chairman, the senior independent director, non-executive directors and major shareholders
- a strengthened role for the audit committee in monitoring the integrity of the company's financial reporting, reinforcing the independence of the external auditor and reviewing the management of financial and other risks.

2.10 The UK Code incorporates the substance of Derek Higgs' (http://www.ecgi.org/codes/documents/higgsreport.pdf) and Sir Robert Smith's (http://www.ecgi.org/codes/documents/ac_report.pdf) proposals. The main areas of difference are:

- modification of the UK Code's structure to include not only main "principles" and "provisions" but also supporting "principles", allowing companies greater flexibility in how they implement the UK Code
- the board chairman to be able to chair the nomination committee
- clarification of the roles of chairman and the senior independent director, emphasising the chairman's role in providing leadership to the non-executive directors and in the communication of shareholders' views to the board
- smaller companies below the FTSE 350 only required to have a minimum of two independent non-executive directors
- rigorous review rather than special explanation when non-executive directors are re-elected beyond six years.

2.11 The intention is that provisions should be as clearly defined and verifiable as possible, so that companies can report unambiguously whether or not they have followed them. The supporting principles are cast in more general terms and leave the detailed method of implementation up to the College to decide.

2.12 Casterbridge College includes as an example of the interpretation of the requirements both of the Code and of the Direction, a full Statement of Corporate Governance and Internal Control. Colleges should however ensure that where they use this example as a basis for their own statement, they also tailor it according to their own circumstances. The statement has been written for a large general FE college, with a full Internal Audit Service, and assuming that the Code has been formally adopted. With the emergence of different corporate structures in the College sector, it is no longer the case that simply copying the Casterbridge College example text will fulfil the requirements of the Code. Of particular note here will be the responsibility of governors and trustees in the context of large groups with complex subsidiary company relationships including Shared Service Companies.

2.13 The Statement makes the explicit declaration of compliance with the Code but also a clear statement that the College has NOT adopted and therefore does not apply the UK Code. The introductory text is below:

Statement of Corporate Governance and Internal Control

The following statement is provided to enable readers of the annual report and accounts of the College to obtain a better understanding of its governance and legal structure. This statement covers the period from 1st August 2015 to 31st July 2016 and up to the date of approval of the annual report and financial statements. **[To be tailored according to which Code the College follows – points below are alternatives and may not all apply to every College]**

The College endeavours to conduct its business:

i. in accordance with the seven principles identified by the Committee on Standards in Public Life (selflessness, integrity, objectivity, accountability, openness, honesty and leadership); [and]
ii. [in full accordance with the guidance to colleges from the Association of Colleges in The Code of Good Governance for English Colleges ("the Code"); and]
iii. having due regard to the UK Corporate Governance Code 2014 insofar as it is applicable to the further education sector.

The College is committed to exhibiting best practice in all aspects of corporate governance and in particular the College has adopted and complied with the Code. We have not adopted and therefore do not apply the UK Corporate Governance Code. However, we have reported on our Corporate Governance arrangements by drawing upon best practice available, including those aspects of the UK Corporate Governance Code we consider to be relevant to the further education sector and best practice.

In the opinion of the Governors, the College [complies with/exceeds all] the provisions of the Code, and it has complied throughout the year ended 31 July 2016. The Governing Body recognises that, as a body entrusted with both public and private funds, it has a particular duty to observe the highest standards of corporate governance at all times. In carrying out its responsibilities, it takes full account of The Code of Good Governance for English Colleges issued by the Association of Colleges in March 2015, which it formally adopted on [date]. **[Not mandatory - Colleges should only include this statement if they have adopted the Code and if they wish to include their compliance with it as an important element of their Corporate Governance and Internal Controls]**

2.14 Reference should be made to the Casterbridge example statement though for the illustrative disclosures around the composition of and attendance at Corporation meetings, the committee structure and the processes for identifying and managing risks. The headings used and the illustrative text employed are designed to flag up and deal with each of the mandatory requirements of the Direction but also the best practice exhibited in the Code itself. This will include appointments to the Corporation, the frequency at which the Corporation meets and the processes for ensuring that the Corporation is well informed on an timely basis and has the appropriate balance of skills, experience and knowledge to conduct its affairs.

2.15 There are several areas in the Direction requirements that are either new or will be very specific to both the individual College and to the period under review. In the latter cases the example accounts use only “red text” to draw attention to the requirements and do not seek to provide example text. This includes the review of the Corporation performance and assessment of its own effectiveness (which should be able to be located in the annual reporting for the College in any event) and the assessment of going concern.

Going concern

2.16 The going concern related disclosures have become more important in the past few years as funding has tightened and costs have escalated. The Direction now explicitly requires a narrative discussion of the assessment of whether the College is a going concern and **must** set out the supporting assumptions, the qualifications to those assumptions, and any mitigating actions.

2.17 The need to include disclosures around the going concern assumption in preparing the financial statements is not new. On 15 October 2009 the Financial Reporting Council (FRC) issued *Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009*, (https://www.frc.org.uk/FRC-Documents/FRC/Going-Concern-and-Liquidity-Risk-Guidance-for-Dire.aspx) which superseded the 1994 guidance *Going concern and financial reporting: Guidance for directors of listed companies registered in the UK*, the November 2008 U*pdate for Directors of Listed Companies: Going Concern and Liquidity Risk* and the March 2009 *Update for Directors of Smaller Companies.* The guidance continued the point that even where uncertainties are less than “material uncertainties” or “significant doubt” (and hence there is no auditor’s emphasis-of-matter in the opinion), financial statements disclosure of those uncertainties is still required (the November 2008 *Update* example disclosures were retained). The guidance also referred specifically to the need for this disclosure to explain the conclusion on going concern and how it had been

reached, and included a number of examples written according to various scenarios.

2.18 In June 2012 Lord Sharman reported his Panel's recommendations on going concern reporting ("Going Concern and Liquidity Risks: Lessons For Companies and Auditors") and in June 2013 the FRC issued new proposals as part of its response to those recommendations (replacing the proposals issued in January 2013 which were seen as setting too high a hurdle for companies to be able to state that they were an "unqualified going concern"). These proposals along with subsequent consultations, including those relating to unlisted companies, have made their way into documents such as the UK Corporate Governance Code.

2.19 Whilst the guidance is primarily written for listed companies, the basic principles remain sound and applicable to FE Colleges. Casterbridge College includes some basic (entry level) disclosures in the Accounting policies section for an uncomplicated College which should be expanded upon as required. Key amongst these are that the Board of Governors should have carried out a robust assessment of the principal risks facing the College, which will include solvency and liquidity risks. Currently all Colleges are either participating or will be participating in Area Based Reviews which will be a significant factor for some to include in the assessment, particularly where a change of control may be one of the outcomes.

2.20 On the 18th April 2016 the FRC issued further guidance for directors of companies which brings together the requirements of company law, accounting standards, auditing standards, other regulation and existing FRC guidance relating to the going concern basis of accounting. The guidance aims to assist directors of companies that do ***not*** apply the UK Corporate Governance Code in assessing:

- the going concern basis of accounting, material uncertainties, solvency and liquidity risk;
- the periods of assessment; and
- the relevant disclosure requirements.

"Clear & Concise" reporting is paramount and when thinking about disclosures, [directors] are encouraged to consider the application of materiality in providing company-specific information. The guidance is available at https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Going-Concern-Basis-of-Accounting.pdf

2.21 Given the importance of the disclosures around going concern, Colleges should consider this additional guidance alongside the basic disclosures included in Casterbridge College and tailor them accordingly.

Appendix 2 Statement on regularity, propriety and compliance

2.22 Colleges have been subject to a regularity audit since 2004/05, with the framework for that audit being revised and updated several times in the intervening years. The latest iteration (published in August 2015) is found within the Joint Audit Code of Practice (JACOP) and is available at https://www.gov.uk/government/publications/sfa-financial-assurance-joint-audit-code-of-practice

2.23 The August 2015 version of the JACOP was published as a single document for the first time as well as updating the form of reporting for the assurance report on regularity and the associated level of assurance required.

2.24 The changes to the previous versions were otherwise limited, with the content of the supporting Self Assessment Questionnaire (SAQ) - included as Annex C to the JACOP - being maintained albeit with some re-ordering of the sections and updating of references. A new section was added in respect of Value for Money reporting and a new procedure added regarding payments to partner organisations.

2.25 An important change for the 2014/15 year though was that the JACOP now states that Colleges **must** complete the SAQ and have it signed by the Accounting Officer and the Chair of Governors, whereas previously this was described as “should”. A copy of the self-assessment questionnaire **must** be provided to the external auditor (known as a “reporting accountant” for the purposes of the regularity assurance reporting) for review. It is considered to be good practice for the SAQ to be presented to the Audit Committee and Corporation for approval and that this should be completed before the matters relating to the receipt of the reporting accountant’s opinions.

2.26 The JACOP Annex D includes the proforma wording for the reporting accountant’s assurance report on regularity that applies to College Corporations. This reflects the change in the level of assurance provided, from reasonable to limited assurance, and that the regularity assurance engagement is no longer an audit.

2.27 The reporting accountant must undertake the engagement so as to provide limited assurance. Limited assurance engagements are defined as those concluding whether, based on the procedures performed and evidence obtained, nothing has arisen that suggests that information is materially misstated.

2.28 For Colleges, the reporting accountant provides limited assurance that expenditure disbursed and income received have been applied to purposes

intended by Parliament and the financial transactions conform to the authorities which govern them.

Appendix 3 Specific accounting and disclosure matters

2.30 In a change to previous years' versions, the *College Accounts Direction for 2015 to 2016 Financial Statements* now includes a number of specific accounting matters in Appendix 3, where this previously dealt solely with the additional disclosures for senior postholders and higher paid staff. Some of the matters covered in Appendix 3 were originally in the main body of the 2014 to 2015 Accounts Direction.

The paragraphs below look at each of the items in turn where required.

Legal status and Public benefit

2.31 Paragraphs ii and iii of Appendix 3 state that Colleges must include details of their charitable status and a statement about public benefit. These are both essential requirements that are required by the Charity Commission in order to help preserve the College's charitable status.

2.32 GFE and Sixth Form Colleges that are FE corporations are exempt charities. Exempt charities are not allowed to register with the Charity Commission and remain outside of its regulatory jurisdiction. Historically, they were granted this exemption because it was considered that they were sufficiently regulated by another body. Following the implementation of changes included in The Charities Act 2006, universities in England became subject to regulation by HEFCE (the "principal regulator") from 1st June 2010.

2.33 On 1st August 2011, the Secretary of State for Education was appointed as the principal regulator for sixth form colleges in England and their connected charities in their capacity as exempt charities.

2.34 On 1 September 2013, the Secretary of State for Business, Innovation and Skills (BIS) was appointed as the principal regulator of further education colleges in England and their connected charities in their capacity as exempt charities.

2.35 On 17 February 2014, a memorandum of understanding was published setting out how the Secretary of State for Business, Innovation and Skills will work with the Charity Commission on the regulation of further education colleges in England. At the same time, BIS published an information note to colleges setting out the duties of the Regulator and of FE corporations as exempt charities, and the arrangements through which the Principal Regulator's role will be discharged and the implications for FE corporations.

2.36 The requirements for sixth form colleges and GFE colleges in this respect are effectively the same. Casterbridge College includes example text to cover these points as follows:

Legal status

The Corporation was established under the Further and Higher Education Act 1992 for the purpose of conducting [Casterbridge] College. The College is an exempt charity for the purposes of Part 3 of the Charities Act 2011.

Public Benefit

[Casterbridge] College is an exempt charity under the Part 3 of the Charities Act 2011 and is regulated by the **[Secretary of State for Business, Innovation and Skills as Principal Regulator for all FE Corporations in England] [Secretary of State for Education for Sixth Form Colleges]**. The members of the Governing Body, who are trustees of the charity, are disclosed on page 13.

In setting and reviewing the College's strategic objectives, the Governing Body has had due regard for the Charity Commission's guidance on public benefit and particularly upon its supplementary guidance on the advancement of education. The guidance sets out the requirement that all organisations wishing to be recognised as charities must demonstrate, explicitly, that their aims are for the public benefit.

In delivering its mission, the College provides the following identifiable public benefits through the advancement of education:

- High-quality teaching
- Widening participation and tackling social exclusion
- Excellent employment record for students
- Strong student support systems
- Links with employers, industry and commerce.

2.37 It is important that Colleges include the underlined text as a minimum and that they tailor the text regarding how the College has delivered its charitable purposes for the public benefit.

Plans for future periods/reserves policy

2.38 Paragraph iv of Appendix 3 of the *College Accounts Direction for 2015 to 2016 Financial Statements* "*encourages transparency in colleges' annual reports and financial statements*" as well as reminding Colleges that Sections 3.19 to 3.22 of the FE HE SORP set out what Colleges must include in their annual report (referred to as a "Strategic Report").

The Strategic Report replaces the Operating and Financial Review in College financial Statements, though it does not have to be named as such.

Alternatives could include Members' Report, Report of the Governing Body or Trustees Annual Report for example, but the content should still include, as a minimum, the items set out in the 2015 FE HE SORP, as well as any additional items required by the *College Accounts Direction for 2015 to 2016 Financial Statements*. The form of this report is not prescribed but Colleges that are also companies will need to consider the need to sign off a separate Strategic Report and should consult their professional advisers on the implications for the format of their financial statements.

The 2015 FE HE SORP "considers that disclosure of the following items is best practice for all institutions:

- its objectives and strategy for achieving those objectives;
- its development and performance throughout the financial year and position at the end of the financial year;
- its future prospects;
- a description of the principal risks and uncertainties being faced; and
- its key performance indicators."

2.39 Paragraphs 3.20 and 3.21 are effectively identical to paragraphs 26 and 27 of the 2007 FE HE SORP so should not create any problems for Colleges. The illustrative text in Casterbridge College can continue to be tailored to the specific position of the College. The differences now are that the key performance indicators noted above are given greater prominence as are future prospects. Colleges should include the KPIs, and the assessment against them, that the College uses internally as well as the measures assessed externally such as Financial Health, sector specific EBITDA, Minimum Standards, delivery against funding targets, Success rates etc. Due consideration of the emerging benchmarks and measure employed in the Area Reviews and FE Commissioner reports should also be given.

2.40 "Future prospects" is more difficult to apply but should not be ignored by Colleges. The forward looking orientation of the Strategic Report is a key element in complying with the requirements of the 2015 FE HE SORP.

2.41 Paragraph iv of Appendix 3 of the *College Accounts Direction for 2015 to 2016 Financial Statements* also "*encourages Colleges to review their reserves policy, the level of reserves held and [to] set out, where appropriate, how these align with strategic plans*." In accordance with that, Colleges should consider setting out a Reserves policy, stating the reasons for holding reserves, how they will be built up and maintained and the level identified by the Board as being appropriate for the College. The policy should also then compare the actual

level of reserves to this target and set out any relevant plans to bring them in line with each other. In reviewing the level of reserves, Colleges should explicitly consider the levels that are freely available for general purposes as well as those subject to restrictions.

Related parties

2.42 Section 33 of FRS 102 and Section 25 of the 2015 FE HE SORP deal with related party disclosures. In most respects the requirements are unchanged from FRS 8 and the 2007 FE HE SORP. The one key difference now though is that Paragraph 231 of the 2007 FE HE SORP overrode the exemption from disclosing transactions that derived from dealings with government departments and agencies. That override no longer appears in the 2015 FE HE SORP and therefore the narrative in Casterbridge College has been removed accordingly. In practical terms though, the other requirements for disclosure in FRS 102 and the 2015 FE HE SORP mean that the accounts are otherwise unchanged.

There are other changes though in the context of related party disclosures:

- The name of the related party no longer needs to be disclosed, only their relationship to the College
- The total of key management compensation (see below) needs to be disclosed under FRS 102 paragraphs 33.6 to 33.7
- FRS 102 paragraph 33.13 clearly states that a College "*shall not state that related party transactions were made on terms equivalent to those that prevail in arm's length transactions unless such terms can be substantiated.*" This was hinted at in FRS 8 previously and noted as being unlikely to be common in practice, though most companies included such statements.

Remuneration of Key Management Personnel and higher paid staff

2.43 Paragraph 25.8 of the 2015 FE HE SORP defines key management personnel as "*those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity*".

2.44 Compensation is defined in FRS 102 paragraph 28.4 and includes all employee benefits, all forms of consideration paid, payable or provided by the institution or on its behalf in exchange for services to the institution. Institutions are required to disclose this information at an aggregate level, not an individual level. The disclosure should be reported gross of any salary sacrifice arrangements.

2.45 Based on the definition of employee benefits within Section 28 of FRS 102, the total of key management compensation would include the following, where applicable:

- wages and salaries
- ***social security costs such as employer's national insurance contributions***,
- paid annual leave and paid sick leave
- termination benefits,
- profit sharing arrangements and bonuses
- non-monetary benefits (such as medical care, housing, cars and free or subsidised goods/services);
- post-retirement benefits including employer's pension costs and
- long term benefits such as long term paid absences, and
- share-based payments.

The difference here to the previous disclosure requirements will largely be the inclusion of Employers' National Insurance in the aggregate figure. The *College Accounts Direction for 2015 to 2016 Financial Statements* continues to require the disclosure of key management personnel remuneration in the bandings table suggested, as being *excluding* Employers National Insurance.

2.46 The change to "key management personnel" from "senior postholders" will mean that a wider group of staff will need to be considered by Colleges, and indeed a group that will have to be specifically identified by each College according to their own circumstances and structures. A mere comparison with Senior or College Management/Leadership Team definitions will not be enough either.

2.47 Colleges should decide which staff are captured by the definition above and for clarity, disclose the information in the financial statements. Casterbridge College example accounts include a skeleton disclosure in the schedule of Key management personnel, Board of Governors and Professional Advisers.

2.48 The disclosures required by the Direction for key management personnel and higher paid staff are otherwise very similar to those required under the previous Direction. Some additional clarity has been inserted through requiring for example, the start and end dates of the accounting officer if there is more than one in the course of the year and for stating that number of key

management personnel needs to be disclosed in bands of £10,000 with a starting point of £nil.

2.49 A new disclosure, which derives from the requirements in the 2015 FE HE SORP paragraph 25.8, is in respect of salary sacrifice arrangements. These are required to be grossed up for relevant disclosures and the Direction then goes on to require Colleges to describe any such arrangements in place. A formal statement that there are no such arrangements in place is required if applicable.

Compensation for loss of office and severance payments

2.50 Paragraph viii of the *College Accounts Direction for 2015 to 2016 Financial Statements* sets out the disclosure requirements for compensation for loss of office. These are unchanged from previous years and as before, Colleges should consider both these and the Key Management Personnel remuneration disclosures in the context of the annualised rate of pay applicable to those staff i.e. the decision as to whether or not to include them and in which band should be judged against their full year equivalent remuneration.

2.51 Colleges are also required to disclose the amount of severance costs for each year split between contractual and non-contractual payments and to disclose whether the costs were approved by the Corporation or a committee established by the Corporation for this purpose.

2.52 Non contractual severance payments are paid to employees outside of normal statutory or contractual requirements when leaving employment whether they resign, are dismissed or reach an agreed termination of contract.

2.53 Colleges are reminded that there are specific test in the Regularity Framework concerning severance payments including demonstrating that payments in respect of termination are regular and secure value for money and avoid spending funds on settlements where disciplinary action would have been more appropriate.

2.54 The Corporation should be able to demonstrate these matters through advice received, minutes of consideration and notification to reporting accountant.

Transactions with governors or trustees

2.55 Paragraph x of the Accounts Direction notes that in certain cases, it may be deemed justifiable to compensate governors for the costs of childcare and loss of earnings. The Governing Body will need to consider each case for an exceptional payment on its merits and be satisfied that there is no remunerative element to it. ***Colleges are required to disclose full details of any such payments made to governors in their financial statements***

***(which includes the total of such payments and the number of governors or trustees who received the payments) and reminded that they will need to seek express permission from the Charity Commission to effect such payments where appropriate*.**

Chapter 3 Transition and implementation matters

Background

3.1 When an entity transitions from the previous UK GAAP, the basic rule is that the financial statements for both the current period and comparatives are presented in accordance with the requirements of the new regime. In order to present a comparative statement of comprehensive income and cash flow it is therefore necessary to have an opening comparative balance sheet two years' prior to the date of the first financial statements prepared under the new financial reporting framework (***the transition date balance sheet***). For a College this will be at 1st August 2014.

3.2 Section 35 of FRS 102 applies to first time adopters of the standard and will be applied in the first set of financial statements prepared under the standard.

3.3 Recognising that the costs of requiring entities to prepare opening balance sheets on the basis that the entity had always complied with the new framework would exceed the likely benefits, certain exemptions are given from full retrospective application in preparation of the transition balance sheet. The key reliefs are:

- business combinations effected before the date of transition do not need to be restated to comply with the requirements of Section 19
- certain assets (such as property, plant and equipment) can be measured at fair value on the date of transition and used as deemed cost. Additionally, a previous UK GAAP valuation of certain assets at the date of transition can be used as deemed cost. This simplifies matters for entities that have previously revalued such assets but wish to adopt a policy of cost going forward
- the accounting for service concession arrangements only has to be applied to contracts entered into as an operator after the date of transition, with previous UK GAAP able to be applied to such contracts entered into pre-transition
- deferred tax need not be recognised as at the date of transition if it would involve 'undue cost or effort'
- dormant entities need not restate any balances
- entities that previously did not capitalise borrowing costs may adopt a policy of capitalisation on transition to FRS 102 without restating the transition date balance sheet as if such a policy had always been applied
- Assessment of whether an arrangement contains a lease (Section 20) may be made based on facts and circumstances at the date of transition rather than the contract date.

3.4 In addition, there are situations where entities are <u>not</u> permitted to restate the transition date balance sheet. In the context of Colleges, the key situations are:

- accounting estimates made under previous UK GAAP are revised only prospectively
- hedge accounting applied under previous UK GAAP is reflected in the transition date balance sheet with the subsequent accounting considering the rules in FRS 102 on financial instruments (i.e. whether or not hedge accounting should be discontinued).

3.5 There are other instances where entities cannot restate the transition date balance sheet set out in FRS 102 (section 35.9), including de-recognition of assets, non-controlling interest and discontinued operations. If Colleges believe these are relevant to their circumstances they should seek appropriate advice from their professional advisers.

3.6 The following disclosures are required in the first financial statements prepared in compliance with FRS 102:

- a description of the nature of each change in accounting policy
- a reconciliation of net assets determined in accordance with previous UK GAAP and FRS 102 for both the date of transition and the comparative period
- a reconciliation of the income statement determined in accordance with previous UK GAAP and FRS 102 for the comparative period.

Examples of the implementation of these disclosures are given at the end of this chapter.

Planning for transition

3.7 For a College adopting FRS 102 for the first time in 2015/16, its first set of FRS 102 financial statements will include a restatement of the balance sheet as at 31 July 2014 that will form the basis for the opening figures in the FRS 102 financial statements as at 1 August 2014. The FRS 102 balance sheet may include assets and liabilities not previously recognised, and previously recognised balances may be measured according to different requirements.

3.8 In preparing its 2013/14 financial statements the College ideally should have been considering not only the information required for its year-end balance sheet under the previous UK GAAP but also the additional information required to restate the same items under FRS 102. Furthermore, transactions and contracts entered into in 2014/15 although initially accounted for under the previous UK GAAP will need to be restated for the comparative information to be presented under FRS 102. This is particularly important as the exemptions available on transition are not available for transactions entered into after the transition date.

Preparing the transition balance sheet

3.9 As noted the general requirement is that FRS 102 be applied retrospectively and therefore the transition balance sheet must be prepared in accordance with the requirements of FRS 102, with some limited exceptions. Colleges will therefore need to restate their 31 July 2014 balance sheets so that they can prepare a FRS 102 transition balance sheet as at 1 August 2014. Paragraph 35.7 of FRS 102 requires that the transition balance sheet must:

- recognise all assets and liabilities whose recognition is required by FRS 102;
- not recognise items as assets or liabilities if FRS 102 does not permit such recognition;
- reclassify items that are recognised in accordance with previous GAAP as one type of asset, liability, or component of equity, but are a different type of asset, liability or component of equity under FRS 102; and
- apply FRS 102 in measuring all recognised assets and liabilities.

Adjustments on transition are usually recognised in retained surplus (or deficit), or where appropriate another category within capital and reserves at the date of transition.

Summary of Key Changes and Actions

3.10 The key changes applicable to the existing financial reporting regime and related systems for the majority of Colleges will be as below. Many of these issues are explored in more depth in Chapter 4 and were outlined in the previous version of this handbook:

- **Government grants** – The 2015 FE HE SORP gives institutions the option to apply either the accrual model or the performance model when accounting for government grants. The performance model will mean the grant is recognised as income when performance related conditions have been met, whereas the accrual model will allow for the grant to be recognised on a systematic basis over periods to match costs (for revenue grants) and over the expected useful life (for capital grants). Institutions will need to decide whether to:

    - Account for government grants by applying the accrual model with deferred capital grants reclassified as deferred income (in the “top half” of the balance sheet under liabilities); or
    - Account for government grants consistently with other non-exchange income and apply the performance model.

  Institutions will be able to choose separate policies for capital government grants and revenue government grants but must follow the chosen model consistently.

- **Capital grants -** It is likely that most capital grants received by Colleges will have restrictions but not performance related conditions attached to them, although in some cases the construction of the asset may be a performance related condition. Stipulations related to the use of the asset after construction is completed are not performance related conditions. Where the grant is from a non-government source or where the performance model is adopted for government grants, income will be recorded as restricted income immediately on entitlement to the income and transferred from restricted to general reserves once the building is complete, assuming there are no restrictions on the use of that building. The SOCI will be more volatile reflecting immediate recognition of any capital grants. Where the accrual model is adopted for government grants, the deferred balance of capital grants from government sources will be treated as deferred income, reducing the net assets of Institutions. Institutions will need to establish robust records of their capital grants if these do not already exist and each material grant will have to be reviewed for the source of funding and the existence of performance related conditions.

- **Revenue grants from government and non-government sources –** on the good news front, the accounting for funding body grants is unlikely to change for most colleges. The majority of research contracts are though likely to have performance related conditions. For this income, and for government grants if the performance model is adopted, the move to FRS102 is likely to have an impact in terms of revenue recognition. Income is likely to be deferred and recognised when performance conditions are met. Income with no performance related conditions will recognised immediately.

- **Endowments and donations** – Institutions will need to consider the terms of donations and endowments to determine whether they have performance related conditions. It is likely that for Colleges, the majority of donations will not have performance related conditions attached but will have a degree of restriction in their application. Endowments (a form of charitable trust retained for the benefit of the College) do not include performance-related conditions but they may have either permanent or temporary restrictions. It is not expected that many Colleges will have material donations and endowments and therefore the detailed accounting and disclosures of these has not been considered in this Handbook. Colleges should refer to section 18 of the 2015 FE HE SORP for additional guidance and discuss the issue with their professional advisers.

- **Short term employment benefits** - A new liability will need to be recognised for short-term employee benefits (holiday accrual). This is recognised through reserves on first time adoption. Institutions will need to calculate an initial

liability and then develop a robust but pragmatic process within materiality for calculating and updating the accrual on an annual basis.

- **Post-employment [retirement] benefits** – Institutions will also need to provide for contracted past benefits for employees within any funded multi-employer schemes in which they participate: the liabilities relating to LGPS schemes will already be on balance sheet at present. Institutions will need to consider if there are any other such schemes to be accounted for though. Movement on these provisions, each year and as a result of the triennial valuation, will be taken to income and expenditure.

- The calculation of **net interest on the net pension deficit** is different to that under the previous UK GAAP with an impact on income and expenditure and the statement of other comprehensive income.

- **Investment property** -Investment property is held at fair value, but FRS102 requires movement in fair value to be recorded in income and expenditure. Therefore the movement will add additional volatility to the Institution's results. This will equally apply where a College holds other fixed asset investments as well.

- **Tangible Fixed assets ("Property, Plant and Equipment" in FRS 102)** - On first time adoption of FRS 102 Institutions should consider their policy in relation to revaluation of fixed assets as there is a ***once only*** opportunity to change policy and the value used for cost as at 1 August 2014. The conversion to FRS 102 includes a number of options under first time adoption – cost method, valuation method or the deemed cost method under which a previous valuation is used as "deemed cost". The valuation for this transitional purpose (and for this purpose only) can be applied at the asset by asset level, as against the more usual "classes of asset" level which will apply thereafter.

- Whilst a policy of **revaluation** may strengthen the balance sheet and provide coverage against historical pension deficits, the approach also leads to additional administration and costs in the form of impairment reviews and valuation reports. Higher valuations are not always achieved on specialised buildings valued on a depreciated replacement cost basis where impairments often arise on first time valuation. In addition, a policy of revaluation may mean higher depreciation charges which may no longer be offset by the release of deferred capital grant. However, where the revaluation uplift applies to land then there will not be any additional depreciation charges associated with it.

- **Leases** – There is unlikely to be a significant impact upon the classification of leases as either finance or operating under FRS 102 for most Colleges. FRS102 requires lease classification based on a “risk and rewards incidental to ownership” approach. Although the FRS includes indicators of finance leases it excludes the explicit 90% test included in the previous UK GAAP. Institutions will need to review their leases to highlight any particularly complex arrangements which will result in anything other than trivial adjustments. In terms of disclosures, FRS102 requires lessees to disclose *future minimum lease commitments*, analysed by when the payments fall due, as opposed to the previous UK GAAP requirement to disclose annual lease commitments.

- **Embedded leases** – Institutions will need to carry out a review of material service contracts to determine whether any of the current contracts contain “embedded leases” (i.e. whether a contract depends upon the use of a specific asset, and if the arrangement conveys a right to use the asset). The College will need to develop processes to capture any new contracts which may contain embedded leases at contract negotiation.

- **Joint Ventures** - There are three types of joint ventures identified in FRS 102. These are jointly controlled operations, jointly controlled assets and jointly controlled entities. For jointly controlled operations, the assets that are controlled, the liabilities and expenses that are incurred and the share of the income earned is recognised. Jointly controlled assets are accounted for according to the share of the asset controlled. Material jointly controlled operations may require additional disclosures.

- **Service concessions** - Service concessions are arrangements where an institution contracts with a private operator to develop, upgrade, operate or maintain the institution’s plant, property or equipment. Such arrangements might include halls of residence, IT equipment or conference facilities. Where certain control tests are passed, an asset and liability is recognised on balance sheet at the present value of minimum lease payments/guaranteed occupancy.

Key considerations for the College

3.11 Drawing from the above, there are a number of areas that Colleges should already be considering as part of the transition to the new standard:

- **Government grants** – performance vs accruals model choice; identify non-government grants.
- **Fixed assets** – accounting policy choice for carrying value.

- **Employment benefits (holiday pay)** – data capture and process for review of provision.
- **Embedded leases** – review of outsourcing arrangements for lease type arrangements.
- **Service concessions** – review for potential off balance sheet arrangements.
- **Pensions** – impact of revised net interest charge calculation.
- **Investment Properties** – volatility from movements being in the Statement of Comprehensive Income.

Other considerations:

- **Gap analysis and impact modelling** –showing the key changes to reported results arising from the selection of accounting policies, accounting for Holiday pay, re-presentation of capital grants in the balance sheet and so on
- **Selection of new accounting policies and approval by the Board**
- **Timeline for conversion –** split into manageable sections (approving new accounting policies; opening balance sheet; comparative SOCI; first full financial statements)
- **Staff and governor training**
- **Communication with key stakeholders –** banks (loan covenant compliance) in particular

Transition Notes and narrative

3.12 As noted in 3.6 above, there are a number of required disclosures to be made in the first set of financial statements prepared under FRS 102.

3.13 A key disclosure within the 2015/16 financial statements will be the requirement to include a section within the Statement of Accounting Policies and Estimation Techniques regarding the transition to the 2015 FE HE SORP as well as note to the accounts explaining how the College's financial position has been affected by the changes made.

3.14 Casterbridge College example accounts include the following illustrative text to deal with the transition to FRS 102. This will need to be suitably tailored for each College as it was written for the particular circumstances set out for Casterbridge College alone:

"Basis of preparation

These financial statements have been prepared in accordance with the *Statement of Recommended Practice: Accounting for Further and Higher Education 2015* (the 2015 FE HE SORP), the *College Accounts Direction for 2015 to 2016* and in accordance with Financial Reporting Standard 102 –

"The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland" (FRS 102). The College is a public benefit entity and has therefore applied the relevant public benefit requirements of FRS 102.

The preparation of financial statements in compliance with FRS 102 requires the use of certain critical accounting estimates. It also requires management to exercise judgement in applying the College's accounting policies.

Transition to the 2015 FE HE SORP

The College is preparing its financial statements in accordance with FRS 102 for the first time and consequently has applied the first time adoption requirements. Some of the FRS 102 recognition, measurement, presentation and disclosure requirements and accounting policy choices differ from previous UK GAAP. Consequently, the College has amended certain accounting policies to comply with FRS 102 and the 2015 FE HE SORP. The trustees have also taken advantage of certain exemptions from the requirements of FRS 102 permitted by FRS 102 Chapter 35 'Transition to this FRS'.

An explanation of how the transition to the 2015 FE HE SORP has affected the reported financial position, financial performance and cash flows of the consolidated results of the College is provided in note 28.

The 2015 FE HE SORP requires colleges to prepare a single statement of comprehensive income, and not the alternative presentation of a separate income statement and a statement of other comprehensive income. This represents a change in accounting policy from the previous period where separate statements for the Income and Expenditure account and for the Statement of Total Recognised Gains and Losses were presented.

The application of first time adoption allows certain exemptions from the full requirements of the FRS 102 and the 2015 FE HE SORP in the transition period. The following exemptions have been taken in these financial statements:

- **Revaluation as deemed cost – at 1st August 2014, the College has retained the carrying values of freehold properties as being deemed cost and measured at fair value**
- **Lease incentives – the College has continued to recognise the residual benefits associated with lease incentives on the same basis as that applied at the date of transition**
- **The College has taken advantage of the exemptions provided in FRS 102 1.12 and the 2015 FE HE SORP 3.3, and has not included a separate statement of its own cash flows. These cash flows are included within the Consolidated Statement of Cash Flows, and the College balance sheet discloses cash at both the current and preceding reporting dates.**
- **[*expand for other exemptions taken – see FRS 102 section 35*]"**

3.15 The specific exemptions taken as illustrated above are those assumed within the Casterbridge model accounts. Colleges will need to consider their own circumstances and whether these apply in full or in part to themselves.

3.16 Casterbridge College accounts also include example tables in Note 28 to deal with the two basic reconciliations required, of net assets and of the income statement:

28 Transition to FRS 102 and the 2015 FE HE SORP

The year ended 31st July 2016 is the first year that the College has presented its financial statements under FRS 102 and the 2015 FE HE SORP. The following disclosures are required in the year of transition. The last financial statements prepared under previous UK GAAP were for the year ended 31st July 2015 and the date of transition to FRS 102 and the 2015 FE HE SORP was therefore 1st August 2014. As a consequence of adopting FRS 102 and the 2015 FE HE SORP, a number of accounting policies have changed to comply with those standards.

An example of how the transition to FRS 102 and the 2015 FE HE SORP has affected the College's financial position, financial performance and cash flows, is set out below.

	Note	1st August 2014		31st July 2015	
		Group	College	Group	College
		£'000	£'000	£'000	£'000
Financial Position					
Total reserves under previous SORP		71,049	70,920	69,519	69,402
Employee leave accrual	(a)	(2,050)	(2,050)	(2,050)	(2,050)
Release of non-government capital grants	(b)	228	228	150	150
Changes to measurement of net finance cost on defined benefit plans	(c)	-	-	xxx	xxx
Total effect of transition to FRS 102 and 2015 FE HE SORP		(1,822)	(1,822)	(1,900)	(1,900)
Total reserves under 2015 FE HE SORP		69,227	69,098	67,619	67,502

Year ended 31st July 2015	
Group	College
£'000	£'000

Financial performance

Surplus for the year after tax under previous SORP		886	898
Release of non-government grants received	(b)	-	-
Reversal of capital grants amortisation	(b)	(78)	(78)
Pensions provision – actuarial loss		(2,416)	(2,416)
Changes to measurement of net finance cost on defined benefit plans	(c)	**xxx**	**xxx**
Total effect of transition to FRS 102 and 2015 FE HE SORP		(2,494)	(2,494)
Total comprehensive income for the year under 2015 FE HE SORP		(1,608)	(1,596)

a) Recognition of short term employment benefits

No provision for short term employment benefits such as holiday pay was made under the previous UK GAAP. Under FRS 102 the costs of short-term employee benefits are recognised as a liability and an expense. The annual leave year runs to 31st August each year for both teaching and non-teaching staff meaning that, at the reporting date, there was an average of **[xx days]** unused leave for teaching staff and **[x days]** unused leave for non-teaching staff. In addition, certain non-teaching employees are entitled to carry forward up to **[x days]** of any unused holiday entitlement at the end of the leave year. The cost of any unused entitlement is recognised in the period in which the employee's services are received. An accrual of £2.05 million was recognised at 1 August 2014, and at 31 August 2015. Following a re-measurement exercise in 2015/16, the movement on this provision of **£[xx]** has been charged to Comprehensive Income in the year ended 31 July 2016.

b) Non-government grants accounted for under performance model

The College has previously been in receipt of certain capital grants from sources other than those classified as "government" under FRS 102 and the 2015 FE HE SORP. Under the previous UK GAAP and 2007 SORP, these were able to be capitalised and amortised over the remaining useful economic life of the relevant fixed assets. This accounting treatment is no longer available for non-government grants and the grants have therefore been accounted for under the performance model and treated as if they had been credited to Comprehensive Income immediately that the performance conditions had been met. A corresponding adjustment has been made to the income recognised in the 2015 results that related to the annual amortisation of the capital grants involved.

c) Change in recognition of defined benefit plan finance costs

The net pension finance cost recognised in the Income and Expenditure account for the year ended 31st July 2015 under the previous UK GAAP was the net of the expected return on pension plan assets and the interest on pension liabilities. FRS 102 requires the recognition in the Statement of Comprehensive Income, of a net interest cost, calculated by multiplying the net plan obligations by the market yield on high quality corporate bonds (the discount rate applied). The change has had no effect on net assets as the measurement of the net defined benefit plan obligation has not changed. Instead, the decrease in the surplus for the year has been mirrored by a reduction in the actuarial losses presented within Other Comprehensive Income.

d) Presentation of actuarial gains and losses within Total Comprehensive Income

Actuarial gains and losses on the College's defined benefit plans were previously presented in the Statement of Total Recognised Gains and Losses (STRGL), a separate statement to the Income and Expenditure account. All such gains and losses are now required under FRS 102 to be presented within the Statement of Comprehensive Income, as movements in Other Comprehensive Income.

[add other notes as required e.g. for lease incentives, investment property classification changes (for properties leased between two group entities)]

Correction of prior period errors

It is possible that a College may, through the process of restating the existing accounts, identify errors in prior accounting periods. FRS 102 s 35.14 says that if [the College] becomes aware of errors made under its previous financial reporting framework, the reconciliations required by paragraphs 35.13(b) and (c) shall, to the extent practicable, distinguish the correction of those errors from changes in accounting policies."

3.17 As with the narrative included within the Statement of Accounting Policies and estimation Techniques, Colleges will need to tailor this to their own circumstances.

3.18 Colleges should note that the Casterbridge College accounts do not explicitly include the impact of the change in pensions accounting relating to the calculation of the net finance cost, though this has been highlighted as likely to be required for most colleges. It is expected that for most colleges, the change will result in a higher net finance cost than was calculated under FRS 17, with the balancing figure being the reduction in the net actuarial gain or loss (previously included in the Statement of Total Recognised Gains and Losses) which is included in Total Comprehensive Income. The net liability calculated under FRS 102 for LGPS pensions will not change compared to FRS 17.

3.19 The Holiday pay provision (short term employment benefits) has been estimated at £2.05 million at 1st August 2014 for Casterbridge College and also assumed that no re-measurement is required at 31st July 2015 or at 31st July 2016. Such re-measurement would be required where the underlying assumptions for the provision – being numbers of days untaken by category and average [pay in each category in particular) need to be revised. This could be due to changes in over al staffing levels or in pay levels and should be considered by Colleges in their accounts. The actual quantum of the provision will vary by College according to the terms and conditions in place, the holiday year(s) and custom and practice as to the taking of holiday, so may vary from the Casterbridge value. Is it however likely to be a material provision in most Colleges and will therefore be subject to audit scrutiny as to the reasonableness of the assumptions employed.

Chapter 4: Specific topics

Background

Casterbridge College 2016 accounts

4.1 The accounts have been drawn up in the context of a wider request to keep the level of changes to a minimum and to simplify where possible. The Members report ("Strategic Report") in particular has had few changes as a result at this stage. Some language has had to change to comply with FRS 102 but where possible, previous naming conventions have been retained.

4.2 As stated on the front cover of the accounts, these are example accounts and not template accounts – they do not and cannot cover all possible disclosures that Colleges might face in complying with FRS 102 and further reference to the standard and to the2015 FE HE SORP may be necessary as a result.

4.3 FRS 102 is a new accounting standard and the implementation of it is still in its early stages across the UK. As a result, the practical interpretation of the requirements of the standard is still developing and may have an impact on the example disclosures presented here. As and when changes are agreed they will be notified to Colleges together with any relevant explanations.

4.4 A number of baseline assumptions have been made in converting Casterbridge College to the new standard as follows. Where it was thought useful to include an illustration of the likely presentation and disclosures for certain items, without including a full evaluation of those, then these have been included as "red text" additions. These are not exhaustive and therefore reference to both the FRS 102 and the 2015 FE HE SORP will be required where necessary:

- **Accrual model** adopted for government grant accounting
- Capital grants have therefore been reanalysed into deferred income - using the available information in the old Casterbridge to provide the split into less than one year and outside one year and assuming £1.9m for the 2017 release
- Other capital grants are assumed to be non-government, accounted for under the performance model, and hence released into the opening balance sheet (£228k) and into the 2016 figures on further receipt (£162k); reversed out the existing grant amortisation (£81k and £78k) as a result
- Assumed Casterbridge have no government grants for land which would otherwise have to be a performance model approach and be released into the opening balance sheet
- No revaluation of Property, Plant and Equipment but have deemed the cost at the transition date which results in the retention of the Revaluation Reserve

- Operating income analysis reinstated
- Stripped out all of the endowment notes and figures - partly in response to the plea for simplification. It takes a number of lines out of the balance sheet, the related notes and also removes some entries from income (£800k/£690k), expenditure (£850k/£690k) and from the cash flow.
- Gift Aid from the subsidiary companies presented as a donation to the College which helps show the disclosures for donations as a result
- Non-Controlling interests for example will probably be important for those colleges where they have Joint Venture shared service companies perhaps and so these have been added as red text to illustrate the positioning.
- In order to present College only figures too we have had to assume some numbers for the subsidiary companies - Income of £461k (2015 £417k) and costs of £431k (2015 £387k) to leave the £30k net before gift aid and assumed that it is all "other Income" and "non-teaching costs" as well.
- Holiday pay provision set up as a transition adjustment of £2.05m and has NOT been re-measured in the period so no changes throughout.
- **Key management personnel** - no major changes here other than naming conventions as it will depend on each college defining that group appropriately and the need to disclose a single aggregate figure for key management personnel compensation for which the definition of “compensation” includes social security contributions such as Employers National Insurance.
- FRS 102 (28) replaces "FRS 17" as the naming convention for the pensions notes. Further to the plea for simplicity and minimising changes (and in the absence of a full actuarial review report for the current period)we have made some minor changes to the disclosures for the LGPS to make them more compliant with the new wording though this may need to be revised once the actual valuations are received.
- The pensions valuations will amend the net interest cost for 2014/15 in most colleges (which will be a change and will affect the split between the Surplus reported and Other Comprehensive Income) and if so, it will also be included in the transition note at the back of the accounts to show how the previously reported results for 2015 have changed
- The new 2015 FE HE SORP no longer overrides the exemption from including government departments and agencies as Related Parties - the primary statements still lend themselves to the same level of disclosures so we have merely removed the cross reference in the RPT note.

Property, Plant and Equipment (Fixed assets) accounting

4.5 Section 17 of FRS 102 applies to the accounting for Property, Plant and Equipment (“PPE”), previously referred to as Fixed Assets. In the Casterbridge College accounts these are also referred to under “Non-current assets”. PPE are tangible assets held for use in the College and are expected

to be used during more than one period. They will include Investment property, where such property's fair value cannot be measured reliably (though unlikely in practice for most Colleges).

4.6 Section 18 of FRS 102 deals with Intangible assets other than Goodwill (where Goodwill is dealt with in Section 19 along with Business Combinations). We have not covered either of these areas in the Handbook as they have been deemed to be of interest only to a relative few colleges. Colleges should consult with their professional advisers if they believe they are affected by these areas.

4.7 PPE does not include biological assets, heritage assets, and mineral rights/reserves (see Section 34). Individual ***components*** of an item of PPE and the costs of major inspections may need to be recognised as separate items of PPE. Land and buildings are considered to be separable assets even when they are acquired together.

4.8 In many respects, the accounting for PPE is unchanged from previous UK GAAP. As noted in Chapter 3 though, there is a one-time only option on transition to FRS 102 to revalue PPE and adopt that valuation as deemed cost. If a College is currently revaluing its assets it might either freeze the revaluation process at 31st July 2014 and treat that value as deemed cost or revert back to accounting for fixed assets at cost.

If a College is currently holding its assets at cost, the College could either carry out a one off revaluation at 31st July 2014 and adopt that as deemed cost or change to the revaluation approach. In all these respects, Colleges should consider the point made in 4.7 above that land and buildings can be considered as separable assets and indeed that, due to the way that FRS 102 has been drafted, they can consider the revaluation of individual assets separately rather than as a class of assets. This option is though only available for the one off revaluation at transition.

4.9 The benefits of revaluation would include a more up to date position on the value of PPE as well as providing a potential improvement to the net assets position shown by the balance sheet. This may be useful when reviewing for example compliance with certain bank loan covenants. On the other hand though, the revaluation of buildings and equipment will probably result in increased depreciation charges (and since the release of the revaluation reserve is now in the Statement of Changes in Reserves and not the Note of Historical Cost Surpluses and Deficits, will not be able to be directly related to the result for the period) and of course all revaluations will likely incur the professional fees for the revaluation. Colleges should consider the implications of the options carefully as a result.

Where the revaluation model is adopted, Colleges should note that the requirements under the previous UK GAAP regarding the frequency of interim and full revaluations no longer apply. Instead, revaluations must be “sufficiently regular” so that the carrying value of an asset at the reporting date is not materially different from its fair value, which will require at least an annual formal consideration of the carrying values. The expectation of both the 2015 FE HE SORP and FRS 102 is that the valuation would be carried out by professionally qualified valuers with the date, use of the valuer, main assumptions and original cost equivalent being disclosed in the same way as before.

Accounting for land and buildings owned by third parties

4.10 The 2007 SORP used to contain a brief paragraph (number 95) on the accounting for assets used by institutions:

“A number of institutions occupy premises which are owned by other bodies and for which no rental or a nominal rental is made. In some cases there may be no formal agreement to occupy. Where an institution enjoys the use of an asset which it does not own and for which no rental or a nominal rental is paid, whether or not such use is regulated by a licence or lease, the *financial statements* must disclose this and, if practicable, a value should be attributed to this benefit and be capitalised, with a corresponding credit to *deferred capital grants* (which should subsequently be released to the income and expenditure account in accordance with paragraph 54), and thereafter depreciated over the period of use (see also the accounting principles applied to gifts in kind in paragraphs 154 to 156). Where no formal occupancy agreement exists, the institution should consider regularising the position by the establishment of a lease or licence, as this will assist in determining a value for the benefit.”

4.11 The equivalent discussions are absent from the 2015 FE HE SORP and not explicit in FRS 102 either. Many colleges had accounted for such assets under an earlier SORP by taking the credit to the revaluation reserve (in the same way that assets inherited from local authorities had been accounted for) though some either changed their approach following the 2007 SORP or accounted for such assets for the first time, and recognised the credit in deferred capital grants.

4.12 The concept of deferred capital grants no longer exists and as such the balance will need to be recognised in deferred income instead. The whole matter of accounting for assets owned by third parties is currently the subject of legal opinions and discussions between the funding bodies and other parties with further guidance expected in the summer of 2016.

Investment Property

4.13 Investment property is dealt with in section 16 of FRS 102 and Section 10 of the 2015 FE HE SORP. Paragraph 16.2 of FRS 102 provides the definition of Investment Property with paragraph 10.2 of the 2015 FE HE SORP helpfully expanding on the exclusion criteria for educational institutions being for social benefit and therefore not typically classified as investment property. This means that for example, student accommodation should be classified as PPE rather than as an investment property.

4.14 The distinction is important because investment property should be measured at fair value at the end of each reporting period, and any changes in fair value should be recognised immediately in the Statement of Comprehensive Income. This will mean there could be volatility in reported results as a result of the valuation movements.

4.15 The consideration as to whether a property meets the definition of an investment property should be made at the individual entity level as well as at the consolidated level. This could mean there are differences in the way the same property is accounted for between the individual entity level accounts and the consolidated accounts.

4.16 Similarly, “mixed use” property – where for example, the ground floor is leased out for retail units and the upper floors are employed for educational use – will need to be split if possible and accounted for separately. Colleges will need to review their property portfolios and consider the need to reclassify assets according the definitions in the FRS and the 2015 FE HE SORP. The “mixed use” change is likely to generate differences in accounting treatment compared to the previous UK GAAP but also the existence of property leases between group members such as subsidiary companies to the College.

Leases

4.17 One or the more complicated areas of change in the transition to FRS 102 will be in the accounting for leases (section 20 of FRS 102 and section 14 of the 2015 FE HE SORP. The basic understanding of lease accounting under the current version of FRS 102 is in many ways similar to previous UK GAAP but with some important distinctions.

4.18 A lease is classified at inception as a finance lease if it transfers substantially all of the risk and rewards incidental to ownership. All other leases are classified, at inception, as operating leases. For the purposes of this Handbook, we will only look at the Lessee accounting aspects though and transactions involving a sale and leaseback will similarly be deemed to be

outside the scope as well. Any Colleges who have such arrangements should consult with their professional advisers accordingly.

4.19 Examples of situations that individually or in combination would normally result in a classification as a finance lease include:

- The lease transfers ownership of the asset to the lessee by the end of the lease or the lessee has the option to acquire the asset at a price significantly lower than fair value;
- The lease term is for the major part of the economic life of the asset even if title has not been transferred;
- At the inception of the lease the present value of the minimum lease payments amount to at least ***substantially all*** of the fair value of the leased asset;
- Lease assets are of such a specialised nature that only the lessee could use them without major modifications; and/or
- The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

4.20 The phrase "***substantially all***" points to one of the key differences between the previous UK GAAP and FRS 102 and one that Colleges need to at least review for any significant changes. Under the previous UK GAAP a key test of the transfer of the risks and rewards of ownership was the "90% test" – did the Net Present Value of the minimum lease payments under the lease equal or exceed 90% of the fair value of the asset. This led to a substantial number of leases being written to fall just under the 90% limit to qualify as operating leases. These will need to be revisited as part of the transition process, there being no such exemption for leases under section 35.

Arrangements that contain a lease ("embedded leases")

4.21 FRS 102 contains guidance derived from full IFRS on whether certain arrangements, although not in the legal form of a lease, nonetheless convey the rights to use of an asset in return for payments in the same way as a lease. For affected Colleges, IFRIC 4 elaborates on the factors to consider. Typically, they may be found in some outsourcing arrangements. The payments made and the length of the contract mean that assets used to service a contract by a supplier are to all intents and purposes transferred to the customer as if they were leased, only as part of a much wider service contract. In such circumstances it might be necessary for lease liabilities and leased assets to be recognised on inception of the arrangement, with judgement needed to be applied to determine how much of the overall contract payment is in substance lease payments.

Types of arrangements this may affect are catering and IT contracts whereby the contract price covers the cost of specific equipment installed by the third party supplier to provide the contracted services.

Lease incentives

4.22 FRS 102 requires lease incentives to be spread over the lease term, which will generally be to the first break clause (if any) unless it is reasonably certain at inception of the lease that the break clause will not be exercised.

4.23 This contrasts with the previous UK GAAP, which spreads lease incentives over the period to the first market rent review. Therefore, only when the first rent review coincides with the first break clause in a lease will there generally be no difference between the previous UK GAAP and FRS 102. Usefully there is an exemption in Section 35 of FRS 102 (at paragraph 35.10 (k)) regarding lease incentives for those signed before 1st August 2014, and so the previous accounting treatment can be maintained for those leases. Leases signed from the 1st August 2014 will however need to be reassessed accordingly.

Disclosures

4.24 For lessees FRS 102 requires the ***total future minimum lease commitments*** to be disclosed, analysed by when the leases expire. By contrast, the previous UK GAAP required disclosure of the annual lease commitment, analysed by when the payments fall due. In this respect, FRS 102 provides information on the total off-balance sheet finance obtained through operating leases as opposed to the approach in the previous UK GAAP of focussing on the future annual expense and cash outflow.

4.25 Colleges will need to assess whether they have embedded leases, whether they have the lease documentation to classify the leases appropriately and whether they have the information to generate the required disclosures. It is unlikely that the simple answer will be “it is not material” and therefore Colleges will need to at least have completed some reviews of significant leases and those contracts in areas where there is more likelihood of an embedded lease.

Service concessions

4.26 FRS 102 (section 34.12) defines a service concession arrangement as an arrangement where a public sector body or public benefit entity (the “grantor”) contracts with a private sector entity (the “operator”) to construct (or upgrade), operate and maintain infrastructure assets for a specific period of time.

4.27 Colleges may find themselves in this situation if, say, they enter into arrangements with other parties to refurbish, build, or take over student

accommodation at some point in the future in return for payments or guaranteeing liabilities of the operator. The 2015 FE HE SORP clarifies that student accommodation is an infrastructure asset.

4.28 Under the previous UK GAAP, there was guidance on such contracts in FRS 5: Accounting for the substance of transactions. The key consideration under FRS 5 was whether an operator had assets (e.g. a property) used to provide the contracted services, or alternatively a debtor, being the right to receive payments for the contracted services (in which case the property was an asset of the grantor).

4.29 Which of the two contracting parties should have been recognising the asset and related liability was driven by an assessment of who was exposed to the associated risks and rewards of that asset. This led to a number of contractual arrangements being set up that were specifically designed to keep the underlying asset off the balance sheet of the College by adjusting the perceived balance of those risks and rewards.

4.30 The FRS 102 definition has two specific conditions attaching to it to assist in identifying the possibility of a service concession:

- The grantor controls or regulates what services the operator must provide, to whom, and at what price
- Where the arrangement is for a period less than the useful economic life of the infrastructure assets, the grantor controls any significant residual interest in the property at the end of the term of the arrangement.

4.31 Where these two conditions are met, the grantor (the College) rather than the operator will recognise the asset(s) which is (are) the subject of the contract, and a liability for the payments for its obligation under the service concession arrangement, i.e. account for any amounts payable, including any amounts guaranteed as a finance liability.

4.32 Fortunately the 2015 FE HE SORP goes on to provide a decision tree to help determine whether an arrangement needs to be accounted for as a service concession arrangement:

- Is the College acting as principal within the arrangement?
- Does the arrangement meet the definition of a service concession arrangement?
- Does the arrangement pass the control tests set out in FRS 102?

4.33 Only if ***all*** three tests are met will the arrangement be accounted for in accordance with the leasing arrangements in FRS 102 and an asset and liability recognised at the present value of the minimum lease payments.

Future lease payments would be allocated between finance charges, lifecycle costs, service costs and repayment of the liability.

4.34 This is a complicated area whereby each case needs to be judged on its own facts and circumstances. It is not expected that it will affect the majority of Colleges though each should have already reviewed their contractual arrangements for the possible existence of a service concession as part of the preparation for transition to FRS 102.

Government Grants

4.35 Section 24 of FRS 102 deals with what is probably the most complex area of difference between it and the previous UK GAAP, containing as it does some unfamiliar concepts and a host of new terminology. The final version of FRS 102, and indeed the 2015 FE HE SORP, represents a compromise in moving from the previous UK GAAP baseline of matching income and expenditure to the IFRS based equivalents. Section 34 on Specialised Activities, includes a number of PBE prefaced paragraphs on the accounting for non-exchange transactions (donations) as well as a whole Appendix (B) on the same topic. It is not the intention of this Handbook to cover the accounting for donations in any detail and hence Colleges should consult their professional advisers in this respect. In broad terms though – and the definitions follow below – the accounting for the three main types of income will be as follows:

- Revenue accounting ("exchange transactions") – accrual model (essentially no changes to previous UK GAAP)
- Government grants, capital and/or revenue– accrual or performance model
- Non exchange transactions – performance model only

The accruals concept was key to the previous UK GAAP but is less obvious in FRS 102 which, as noted, has its roots in IFRS.

Definitions

4.36 **Government grants** are essentially a specialised type of non-exchange transactions created as part of the development of the standard.

A government grant is assistance by government in the form of a transfer of resources normally for past or future compliance with specified conditions relating to operating activities. Grants are accounted for under one of two models with the chosen model applied to all grants as an accounting policy choice:

- the "**performance model**", whereby grants are recognised in income when there are no specified future performance conditions or when any specified future performance conditions have been met.
  Grants received before the revenue recognition criteria are satisfied are recognised as a liability, i.e. within deferred income which is similar to that under the previous UK GAAP.

- the "**accrual model**", which requires the grant to be classified as ***either*** relating to revenue expenditure or asset expenditure. Grants relating to revenue expenditure are recognised in income "on a systematic basis over the periods in which the entity recognises the related costs for which the grant is intended to compensate". Grants relating to assets are recognised on a systematic basis over the expected useful life of the asset. The accrual model therefore matches the recognition of the grant in the income statement with the related expenditure. Where income on a grant related to an asset is deferred it shall be recognised as deferred income and not deducted from the carrying amount of the asset (as before except that previously the deferred income was called a deferred capital grant and included in a separate balance sheet category).

Colleges can choose one approach for capital government grants and one approach for revenue government grants (except for government grants for land in which case they have to use the performance model). The complication of the accounting policy choices available will be most obvious where a College has a grant for the acquisition and/or constriction of a building on land it does not already own, in which case the grant would need to be allocated between the separable elements. This could become even more complicated if the grant in question is jointly funded by both a government and a non-government body.

Grants that do not meet the definition of a government grant would have to be accounted for as a non-exchange transaction in accordance with section 23 of FRS 102, which only permits use of the performance model. Government grants will come from obvious sources such as the SFA and EFA, HEFCE and local authorities but as the full extent of what could be defined as "government" is not explicitly set out in either FRS 102 or the 2015 FE HE SORP (though the latter does give some high level examples in paragraph 17.2), Colleges should consider carefully the origins of funding received from external parties. The 2015 FE HE SORP goes on to note in paragraph 17.3 that where the external party receives a significant portion of its funding from a non-government source then it would be considered a non-government entity – the reverse of this is obviously true as well and might encompass a charity providing funding to a college but whose own funding in turn is largely derived

from government (essentially a conduit funder from government in the same way that Colleges act as lead for consortium arrangements). Some limited enquiries might be expected from Colleges to ascertain the ultimate funding source of the grants received to satisfy the accounting treatment chosen.

Grants, including non-monetary ones, shall not be recognised until there is reasonable assurance that the entity will comply with the conditions attaching to them and the grants will be received.

When a grant becomes repayable it shall be recognised as a liability when the repayment meets the definition of a liability.

4.37 A **restriction** "is a requirement that limits or directs the purpose for which a resource may be used which does not meet the definition of a performance related condition". This would typically be an all or nothing approach such as the requirement to build a college classroom.

A **performance related condition"** is "a condition that requires the performance of a particular level of service or units of output to be delivered, with payment of, or entitlement to, the resources conditional on that performance". This will not include milestones or administrative tasks such as submitting a grant claim.

4.38 Colleges have been used to the accruals concept under previous UK GAAP and the new models set out in FRS 102 will need careful analysis and consideration of the impacts on reported results. The performance model – as found in most charity accounts already – will likely introduce a level of volatility into reported results when large capital grants are received. For that reason the draft 2015 FE HE SORP introduced a new line into the Statement of Comprehensive Income (repeated in the BUFDG Model Financial Statements) to set a subtotal of income before donations and endowments.

Restricted reserves

4.39 Allied with the accounting for non-exchange transactions is the area of restricted reserves, a concept introduced over and above the basic requirements of FRS 102, by the 2015 FE HE SORP in section 18. This is in part a carry-over from the 2007 SORP and its extensive narrative around endowment accounting but also because of the nature of non-exchange transactions and the restrictions that may apply to them.

4.40 Paragraph 18.17 of the 2015 FE HE SORP requires the disclosure of brought forward and carried forward restricted reserves and the reconciliation of the two, with reserves being analysed by "materially similar types of restriction". Whilst a great deal of this accounting is still aimed at endowments and

donations, which do not materially affect the majority of colleges, it does also pick up on for example, government grants with restrictions.

The balance sheet is required to analyse reserves between restricted and unrestricted elements and the same analysis is to be provided for Comprehensive Income.

Business combinations

4.41 The previous versions of the Handbook included extensive guidance on business combinations ("mergers") between colleges. These distinguished two main operating models (Type A and Type B) for the combinations and in certain respects, little has changed here.

4.42 FRS 102 deals with Business combinations in section 19, with further discussions in Appendix IV (paragraphs A4.30 and A4.30A) and in Section 34 Specialised activities, where the particular circumstances of Public Benefit Entities are explored. The guidance on business combinations is unfortunately spread across several sources including "The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410)" – referred to as "the Regulations "in Appendix IV – and therefore Colleges should exercise caution when contemplating the accounting for, and disclosures associated with, a merger.

4.43 The primary thrust of section 19 is that the purchase method must be used for all business combinations, except for group reconstructions (for which merger accounting may be used) or for certain public benefit entity combinations. Section 34 applies to public benefit entities which involve an entity or part of an entity combining with another entity when combinations are at nil or nominal consideration which are in substance a gift, and combinations which meet the definition and criteria of a merger.

Colleges that are also limited companies cannot take advantage of the merger options in FRS 102. Reference should be made to Appendix IV (paragraphs A4.30 and A4.30A) of FRS 102, where the possibility of exercising the true and fair override is outlined (typically because it has been aligned with a group reconstruction).

4.44 Combinations that are in substance a gift are accounted for in accordance with Section 19 except that the excess/deficit of the fair value of assets received over the fair value of the liabilities assumed is recognised as a gain/loss in income and expenditure. This represents a change to the previous UK GAAP interpretation that was set out in earlier Handbooks, allowing a "true and fair override" to take the balance straight to reserves. This would be the case in "type B" combinations where one college transfers its assets and

liabilities to the other and no new corporation is formed. Colleges that previously included a negative goodwill balance instead and amortised this over an estimated useful economic life, should now recognise that balance in the year of the gift.

4.45 Combinations that are mergers result from the creation of a new reporting entity formed from the combining parties and in which no party of the combination obtains control over the other. This would be the case for “type A” combinations. For a merger to be apparent, the following needs to be satisfied:

- No party to the combination is portrayed as the acquirer or acquiree;
- There is no significant change to the classes of beneficiaries; and
- All parties to the combination participate in establishing the management structure of the combined entity.

Regardless of which incorporation model is selected as part of the merger process, Colleges should review the criteria against their positions to be able to agree the appropriate accounting treatment.

4.46 When accounting for a merger the carrying value of the assets and liabilities are not adjusted to fair value, with the only adjustments being made to ensure uniformity of accounting policies. Any merger costs should be charged as an expense in the period.

4.47 The results and cash flows of the combining entity are brought together into the financial statements of the newly formed entity from the beginning of the financial period when the merger occurs.

Corresponding figures should be restated to show the effect of the combination.

4.48 There are inevitably a number of disclosures to be made in the accounts when using the merger accounting approach, including:

- Name and description of the combining entities and the date of the merger;
- Analysis of the current year’s total comprehensive income to indicate the amounts relating to the newly merged entity for the period after the date of the merger and the amounts relating to each party up to the date of the merger;
- An analysis of the previous year’s total comprehensive income between each college;
- Aggregate carrying value of the net assets of each college at the date of the merger; and
- The nature and amount of any significant adjustments to align accounting policies and otherwise arising as a result of the merger.

4.49 Colleges are reminded that the requirements of the Skills Funding Agency and the Education funding agency are that where a corporation is being dissolved, then it is the responsibility of either the new corporation (the type A combination) or the continuing corporation (the type B combination) to ensure that the audited financial statements of the dissolved corporation(s) are submitted to the main funding body within **five months** of the dissolution.

Employee benefits (pension schemes and holiday pay provisions)

4.50 Many of the provisions of section 28 of FRS 102 regarding Employee benefits will be familiar if not comprehensible to Colleges. There are however some key differences to the previous UK GAAP which will be explained here.

4.51 Employee benefits are split into 4 categories:

- ***Short-term benefits*** – employee benefits (excluding termination payments) which are to be settled in full within 12 months of the year-end. These would include:
    - Wages, salaries and social security benefits;
    - Paid annual leave (holiday pay) and sick leave;
    - Profit-sharing and bonuses; and
    - Non-monetary benefits (e.g. company cars) for current employees.
- ***Post-employment benefits*** – employee benefits that are payable after the completion of employment (and do not meet the criteria for termination or short-term benefits). Captured here would be the typical pension scheme arrangements found in most colleges including the TPS and the LGPS.
- ***Termination benefits*** – employee benefits provided in exchange for the termination of an employee's employment
- ***Other long-term employee benefits*** – employee benefits which do not meet the above criteria for short-term, post-employment or termination.

4.52 To a large extent, the majority of the presentation and disclosures associated with the above will already be included in most colleges' financial statements through their implementation of FRS 17 under the previous UK GAAP. The main differences will be:

- ***Holiday pay*** – under previous UK GAAP this was not required and was typically not accounted for unless an organisation was for example contemplating a sale or was in financial difficulty and therefore the "going concern" basis of accounting was not appropriate. Under FRS 102 however a provision is required to be recognised. Colleges should be considering what holiday pay records they have to assist in this, whether the holiday pay "year" coincides with the financial year, and what different employment contracts they have in place and the associated working patterns.

This will enable Colleges to derive a provision for the calculated liability which can be based on a number of simplifying assumptions around these factors and does not have to be made on a line by line, employee by employee basis (unless there are electronic records in place which easily facilitate that perhaps). The provision needs to be materially correct and able to stand up to audit scrutiny – Colleges should discuss their methodologies with their professional advisers.

Notably, the creation of such a provision will mean a prior period adjustment will be required – there being no transitional exemptions available for this area – and this will be adjusted in the opening (1st August 2014) balance sheet, with the criteria being laid out in the transition note to the accounts.

Colleges should be recalculating the provision at each financial period end, updating the assumptions and base data as required, and considering whether any movements in the provision are material and should be recognised in the Statement of Comprehensive Income.

- ***Actuarial gains and losses*** are now recognised in other comprehensive income whereas they were previously recognised in the Statement of Total Recognised Gains and Losses.

- ***Pensions interest cost under defined benefit schemes*** – under the previous UK GAAP this was calculated as the net of the interest costs and the expected return on assets. Under FRS 102 this is now calculated using the discount rate applied to the opening net pension liability and will generally produce a figure that is higher than that found under the previous UK GAAP. The net liability will not change and hence the balancing adjustment will be made in the actuarial gains or losses recognised in the year in the Statement of Comprehensive Income.

  Colleges will be provided with the figures required by their scheme actuaries in most cases and will need to consider the impact of the changes on any relevant banking covenants and on key stakeholders.

- ***Agreements to fund multi-employer scheme deficits*** are now recognised as liabilities for the contributions payable that arise from the agreement (to the extent that they relate to the deficit). Previously this was not specifically addressed and as a result generally not recognised. For most Colleges this will have little practical difference (the main pension scheme deficit being in relation to the LGPS and this is already on the balance sheets of most Colleges) though, alongside the new requirements to present group plans on at least one balance sheet, if any Colleges do have other pension liabilities such as USS, then there may be some additional liability recognition to take into account.

  The existing accounting for the Teachers' Pension Scheme will ***NOT*** however change as the new rules apply only to funded schemes and the TPS is at present an unfunded, notional, scheme valuation.

- ***Balance sheet presentation*** – whilst the majority of the extensive notes required will be unchanged from those required under FRS 17 (and Casterbridge College has an example of the revised disclosures), the key change will be that Colleges can no longer display a separate pension reserve on the face of the balance sheet. The net Income and Expenditure reserve will be included but without the additional presentation of before and after accounting for the pensions reserve. This will be important for Colleges whose net Income and Expenditure reserve is small or even negative once the pension reserve was deducted under the previous UK GAAP and will need explaining to key stakeholders.

Joint venture accounting

4.53 A joint venture is a contractual arrangement whereby two or more parties ("venturers") undertake an activity subject to joint control, being the contractually agreed sharing of control which exists only when the financial and operating decisions require the unanimous consent of the parties sharing control. Under FRS 102, there are three forms of joint ventures; jointly controlled operations, jointly controlled assets and jointly controlled entities. Under the previous UK GAAP there were basically only Joint Ventures (JVs) and Joint Arrangements that are Not Entities (JANEs), with the definitions not being conditional on whether an entity existed or not.

On balance there are no major changes to the accounting for joint ventures in their various guises though there will be an increase in the level of disclosures required in certain instances.

4.54 ***Jointly controlled operations*** involve the use of assets and other resources of the venturers rather than the establishment of an entity. Each venturer uses its own assets and incurs its own expenses and liabilities and raises its own finance which represents their own obligations. The venturer recognises in its financial statements its share of income, the assets it controls and the liabilities and expenses it incurs.

4.55 ***Jointly controlled assets*** exist where the venturers exert joint control over one or more assets contributed to, or acquired for the purpose of, the joint venture's activity. Each venturer recognises in its financial statements:

- its share of the jointly controlled assets and any jointly incurred liabilities;
- liabilities that is has incurred;
- income from sale or use of its share of the output of the joint venture together with its share of expenses incurred by the joint venture; and
- any expenses it has incurred in respect of its interest in the joint venture.

4.56 ***A jointly controlled entity*** is a joint venture that involves the establishment of an entity (unlike the two previous definitions) in which each venturer has an interest. A venturer which is not a parent shall account for jointly controlled entities using either the cost model, the fair value model or by measuring it at fair value with changes recognised in profit or loss for the period. In practice it is unlikely that many Colleges will be adopting the Fair Value approach unless the investments are held as an investment portfolio.

4.57 Colleges should consider all of their collaborative activities and consortia and identify whether they are jointly controlled operations, jointly controlled assets or jointly controlled entities. Examples may include joint teaching arrangements, joint research contracts and shared service arrangements.

4.58 A number of Colleges have arrangements with non-educational institutions which may include the sharing of resources, including buildings and employees, and the delivery of joint activities such as teaching and research. Colleges should have regard to whether these arrangements include jointly controlled operations, jointly controlled assets as well as having regard to other topics such as leasing and revenue recognition when accounting for these arrangements.