THE
FURTHER
EDUCATION
FUNDING
COUNCIL

Sector Accounting Policies: Guidance and Explanatory Notes

Supplement A
to Circular 99/23

Contents

paragraph

Guidance and Explanatory Notes on Accounting Policies

General

Accounting policies and components of the financial statements

1 The accounting policies adopted for dealing with material items should be explained in the notes to the financial statements. These explanations should be clear, fair, and as brief as is consistent with clarity.

2 Each college is required to prepare for each financial year a report and financial statements, which should give a true and fair view of its state of affairs at the balance sheet date, and of its results and cashflows for the period. The report and financial statements should include:

- a members' report
- an income and expenditure account
- a statement of total recognised gains and losses
- a statement of historical cost surpluses and deficits
- a balance sheet
- a cashflow statement
- a statement of accounting policies
- notes to the financial statements
- auditors' report.

3 Where the college has subsidiaries, it should prepare consolidated financial statements.

4 The financial statements should be prepared using the historical cost convention as modified by the revaluation of inherited assets and other assets where a college has chosen to revalue them.

Notes to the financial statements

5 The objectives of the notes to the financial statements are:

- to supplement the information given in the financial statements in respect of any particular items that are shown on the face of the income and expenditure account or balance sheet
- to indicate any particular circumstances that affect items included in the income and expenditure account
- to provide details of any other matters relevant to an assessment of the college's state of affairs
- to supplement the information given in respect of particular items appearing in the cashflow statement.

6 The notes to the financial statements should indicate the accounting policies that have been adopted and should state whether the financial statements have been drawn up in accordance with the requirements of the Council. In particular, the accounting policies adopted in relation to the following items should be disclosed:

- recognition of income
- pension schemes
- the capitalisation and depreciation of tangible fixed assets, including the policy in respect of any buildings used but not owned by the college
- leases
- investments
- stocks
- maintenance of premises and, in the case of voluntary-aided (and certain other designated) colleges, the policy on capitalisation of expenditure on the buildings occupied
- subsidiary undertakings.

7 The following items must also be included in the notes to the financial statements:

- the period of account
- more detailed information relating to the income and expenditure account
- explanation of any exceptional items
- employee numbers and costs
- emoluments of the college's senior postholders and members[1]
- compensation for loss of office paid to senior postholders

[1] For this purpose, 'emoluments' include the normal remuneration salary, whether paid by the college or any subsidiary undertaking and contributions paid under any pension scheme, the estimated monetary value of any benefits received otherwise than in cash, and any expense allowances to the extent that they are chargeable to UK income tax. No member of the corporation may receive any remuneration for his or her services, other than as a member of staff, without the written approval of the secretary of state for education and employment. Members may receive reimbursement for reasonable expenses.

- taxation
- details of tangible fixed assets and depreciation
- details of fixed asset investments
- stocks
- analysis of debtors and creditors
- details of all provisions for liabilities and charges[2]
- details of deferred grants
- financial commitments and contingencies[3]
- details of pension schemes
- details of post-balance sheet events
- details of subsidiaries consolidated into the accounts
- the name of any subsidiary excluded from the consolidation and reasons for its exclusion, the aggregate capital and reserves at the subsidiary's most recent financial year-end and its profit or loss for that year
- auditors' remuneration for external audit, internal audit and other services.

Corresponding amounts

8 Corresponding amounts for the immediately preceding year should be given for all items in the financial statements except where corresponding amounts are specifically not required. Corresponding amounts are specifically not required for the following items:

- particulars of the college's shareholdings in other undertakings
- particulars of fixed-asset additions and disposals, transfers of fixed assets and the depreciation charge
- particulars of amounts transferred to and from reserves and provisions.

Accounting standards

9 In discharging their obligation to prepare financial statements showing a true and fair view, colleges are required to follow the standards laid down in Statements of Standard Accounting Practice (SSAP), Financial Reporting Standards (FRS) and Urgent Issues Task Force (UITF) Abstracts, issued or adopted by the Accounting Standards Board in so far as the standards are relevant. Colleges should agree the appropriateness of the accounting policies adopted with their external auditors. The financial statements should contain a statement as to whether they have been prepared in accordance with applicable accounting standards. Financial statements which depart from these standards without adequate explanation or justification may not be considered to be true and fair.

10 All colleges must comply with the financial reporting requirements contained in any UK legislation relevant to their constitution. Where a college is constituted as a company, the financial statements must be properly prepared in accordance with the provisions of the *Companies Act 1985*.

11 Colleges are not required to follow the requirements of the Statement of Recommended Practice (SORP) *Accounting by Charities*. Elements of good practice from that SORP have been included in the model financial statements.

Fundamental accounting concepts

12 The accounting policies adopted must be consistent with the four fundamental accounting concepts identified in SSAP 2 *Disclosure of Accounting Policies*.

13 There are four fundamental accounting concepts identified in SSAP 2 *Disclosure of Accounting Policies:*

- the 'going concern' concept: where the financial statements have been prepared under the 'going concern' concept there is the underlying presumption that the college will continue in operational existence for the foreseeable future. This means in particular that, at the time of preparation of the statements, there is no intention or known necessity to liquidate or curtail significantly the scale of the college's operations
- the 'accruals' concept: revenue and costs are accrued, that is, recognised as they

[2] Provisions for liabilities and charges are defined in the *Companies Act 1985* as 'amounts retained as reasonably necessary for the purpose of providing for any liability or loss which is either likely to be incurred, or certain to be incurred, but uncertain as to the date on which it will arise'.

[3] A contingency is a condition which exists at the balance sheet date, where the outcome will be confirmed only on the occurrence or non-occurrence of one or more uncertain future events. A contingent gain or loss is a gain or loss dependent on a contingency.

are earned or incurred, not as money is received or paid, matched with one another in so far as their relationship can be established or justifiably assumed, and dealt with in the income and expenditure account of the period to which they relate provided that where the accruals concept is inconsistent with the 'prudence' concept (see below), the latter prevails. The accruals concept implies that the income and expenditure account reflects changes in the amount of net assets that arise out of the transactions of the relevant period. Income and profits dealt with in the income and expenditure account are matched with associated costs and expenses by including in the same account the costs incurred in earning or receiving them, in so far as these are material and identifiable. As an example, some special courses may span the end of the financial year: tuition fees received should be matched with the associated costs and expenses of the courses and allocated to the relevant financial year[4]

- the 'consistency' concept: there is consistency of accounting treatment of like items within each accounting period and from one period to the next
- the 'prudence' concept: revenue and profits are not anticipated, but are recognised by inclusion in the income and expenditure account only when realised in the form either of cash or of other assets the ultimate cash realisation of which can be assessed with reasonable certainty; provision is made for all known liabilities whether the amount of these is known with certainty or is a best estimate in the light of the information available.

Recognition of income

14 In general, colleges receive their income from the following main sources:

- public funds in the form of allocations from the Council; for example, the annual funding allocation
- education contracts; for example, local education authority contracts and franchise arrangements with higher education institutions
- tuition fees and charges
- other grant income; for example, the European social fund (ESF)
- the provision of services such as catering, residences, and farming.

15 College income can be placed in two broad categories:

- income which can be applied at the discretion of the college to any of its activities within the terms of the legal requirements: examples include the annual funding allocation from the Council, income from the provision of services and tuition fees; and
- income which can only be used for specific purposes: examples include capital funds from the Council to meet expenditure on land and buildings and grants for specific purposes, such as that from the ESF.

16 Income received for specific purposes, that is, income for which the governors cannot determine the use, should be included in the income and expenditure account to the extent of the relevant expenditure incurred during the period. Restricted income received but not matched to relevant expenditure during the period should be represented by a restricted reserve on the balance sheet. Where payments in advance are received as part of normal trading, they should be included in payments on account.

17 All income from short-term deposits and fixed-asset investments should be credited to the income and expenditure account in the period in which it is earned.

Substance over form

18 Under FRS 5 *Reporting the Substance of Transactions* a college should report the substance of transactions in which it has entered and not simply the legal form. FRS 5 does not change the accounting treatment or disclosure of the vast majority of transactions. Areas that colleges should consider are:

[4] Due to the uncertainty of the payment timetable for certain European funds, some colleges have adopted a receipts basis for recording this income rather than an accruals basis. This treatment should be clearly disclosed in the accounting policies and agreed with the college's external auditors.

- transactions entered into under the private finance initiative (PFI) and major public private partnership (PPP) projects
- quasi-subsidiaries where an entity is in effect controlled by the college but does not meet the legal definition of a subsidiary undertaking
- sale and repurchase agreements
- sales and leaseback agreements.

Where FRS 5 may apply colleges should consult their external auditors.

19 In September 1998, the Accounting Standards Board published an amendment to FRS 5 *Reporting the Substance of Transactions* in the form of an Application Note on transactions subject to the private finance initiative (PFI). It sets out guidance on which of the parties to a PFI transaction should record the relevant assets(s) on its balance sheet. Colleges which have entered into PFI transactions, or which intend to do so, will need to comply with this amendment to FRS 5. Colleges may wish to consult their external auditors on this matter.

Financial reporting standard for smaller entities

20 The Financial Reporting Standard for Smaller Entities (FRSSE) was published in November 1997. Regardless of whether they fall within the scope of the FRSSE due to their size, colleges are required to apply Statements of Standard Accounting Practice (SSAPs), FRSs and UITF Abstracts when preparing their financial statements.

21 Where a college has a subsidiary undertaking (college company) which falls within the scope of and adopts the FRSSE the following additional disclosure is required in the college's consolidated accounts in respect of each subsidiary undertaking:

a. directors' emoluments and staff costs and numbers should be fully disclosed in accordance with the guidance for colleges set out in Circular 99/23 and its supplements;

b. details of any activities which take place outside England and the nature of any transactions with organisations outside England; and

c. full disclosure of the subsidiary undertaking's related party transactions in accordance with FRS 8 *Related Party Disclosures*.

Operating and financial review

22 The Accounting Standards Board has issued a statement on *Operating and Financial Review*. An operating and financial review (OFR) would include a discussion and interpretation of the business and the structure of its financing. Compliance with the statement is voluntary but represents best practice. The members' report in the model financial statements covers the key items that would be included in an OFR and it is not proposed that a separate review is published.

Report of the Members of the Corporation

Members' report

23 A members' report is one of the documents to be included with a college's report and financial statements. The report should be in narrative format and should assist in the interpretation of the college's financial position as shown by the financial statements.

24 Colleges are requested to include the level of disclosure required in the SORP *Accounting by Charities*. Colleges may also wish to include a review of the development, activities and achievements of the college during the year, as well as the important events which have occurred during the year and how the college has responded to them. This may include statistical information to help the reader of the report to gain a fuller understanding of the college's performance.

25 An outline of the levels of disclosure suggested in the charities SORP is given below:

- the full name of the corporation
- an indication of the nature of the governing instrument
- the names of all the members, indicating the method of appointment, for example staff, student and business members of the corporation should be identified as such
- the names and address of any other relevant organisations or persons, including the names and addresses of those acting as bankers, solicitors and auditors
- an explanation of what the corporation is trying to achieve and how it is going about it

- a review of the development, activities and achievements of the corporation during the year. This review should help the reader judge its effectiveness and to appreciate:
  - the general progress of the corporation and what it has been able to achieve during the year, ideally supported by statistical information
  - important events which have occurred during the year, affecting the corporation or the areas in which its works, and how the corporation has responded to them
- a review of the transactions and financial position of the corporation, and an explanation of the salient features of the accounts. This review should put the accounts into an accurate perspective so that they may be readily understood, and should show how the corporation aims to achieve its objectives. It should be sufficiently informative to help the reader appreciate:
  - how the corporation's funds have been applied
  - the corporation's financial position at the balance sheet date in the context of its future plans and commitments, particularly for ongoing items of expenditure, projects not yet completed and outstanding obligations
  - the reason for changes in the accounting policies of the corporation and their effects, as disclosed in the accounts
  - the performance of any subsidiary and associated undertakings whose results are included in the consolidated accounts of the corporation or in the notes to the corporation's accounts
  - the effects on present and future accounts of any revaluations of fixed assets made during the period, other than investments
  - the extent to which the corporation may be financially dependent upon the support of any third parties
  - the nature of any important events affecting the corporation which have occurred between the date of the balance sheet and the date on which the annual report is signed.

26 In addition to the above listed disclosure of members, colleges are requested to disclose for each member:

- date of appointment
- term of office
- date of resignation (if any resignations occurred between the beginning of the accounting period and the date on which the members' report is signed)
- committees served.

Planned maintenance programme: Disclosure in members' report

27 In November 1993, the Council issued its *Guidance on Estate Management*. The guidance offered in that document made reference to a planned maintenance programme (PMP). The PMP is a detailed schedule of costed building works extending over at least five years and preferably 10. Colleges may find that a 10-year period is most appropriate as costs in the first five years can be accurately identified, and both cyclical and major works in the next five years can be realistically estimated. The plan should roll forward each year so that a period of 10 years is always kept in view.

28 The PMP will include any remaining remedial works identified by the condition survey conducted by Hunter and Partners in preparation for incorporation and other works subsequently identified by the college.

29 The costs associated with the PMP should be charged to the income and expenditure account on an accruals basis in the accounting period which they are incurred. However, expenditure on improvements to a fixed asset (enhancement costs), may be capitalised in accordance with FRS 15 *Tangible Fixed Assets*. Such expenditure must be distinguished from expenditure on repairs which should be charged to the income and expenditure account. Expenditure should only be capitalised where:

- the subsequent expenditure provides an enhancement of the economic benefits of the tangible fixed asset in excess of the previously assessed standard of performance

- a component of the tangible fixed asset that has been treated separately for depreciation purposes and depreciated over its individual useful economic life, is replaced or restored
- the subsequent expenditure relates to a major inspection or overhaul of a tangible fixed asset that restores the economic benefits of the asset that have been consumed by the entity and have already been reflected in depreciation.

30 FRS 12 *Provisions, Contingent Liabilities and Contingent Assets* was published in September 1998. FRS 12 states that a provision should be recognised only when there is a legal or constructive obligation to transfer economic benefits as a result of past events. Prior to the publication of FRS 12 in exposure draft form, colleges used to make a provision in their financial statements for planned maintenance costs. However, the planned maintenance provision does not relate to such an obligation.

31 The objective underlying the sector's previous accounting policy for planned maintenance was to require colleges to safeguard and maintain the public assets of which they are the custodians. This objective remains, but a weakness of the planned maintenance provision was that colleges could allow the provision to increase instead of spending in line with their planned maintenance programmes. This worked against the sector's achievement of the underlying objective set out above. Therefore, the sector accounting policy with regard to planned maintenance costs was changed, based on the exposure draft of FRS 12, in order to give a fairer presentation of the performance of colleges and their assets and liabilities. The final version of FRS 12 confirms that the new policy remains appropriate.

32 Colleges were required to release the planned maintenance provisions which were shown in their 1996-97 financial statements and to treat this release as a prior-year adjustment in their 1997-98 financial statements in accordance with FRS 3 *Reporting Financial Performance.* In accordance with UITF Abstract 14 *Disclosure of Changes in Accounting Policy,* the disclosure should also have included an indication of the effect of this change in accounting policy on the current year's results. Any college which did not implement this change in accounting policy in its 1997-98 financial statements should do so in its 1998-99 financial statements.

33 It is recognised that a college may still need to make a provision for certain maintenance works if it has a legal or constructive obligation to transfer economic benefits as a result of past events. Any such provision should be agreed with a college's external auditors.

34 It remains good practice for colleges to develop a planned maintenance programme and to set aside funds for this purpose to enable them to manage their estates effectively. Colleges are required to include a statement in the members' report about the progress made in implementing their planned maintenance programmes and their strategy for dealing with any backlog of works. Further guidance and an example of an appropriate statement are set out in appendix 1 to this annex.

Year 2000 compliance statement

35 UITF Abstract 20 *Year 2000 Issues: Accounting and Disclosures* was published on 5 March 1998. It is effective for accounting periods ending on or after 31 March 1998.

36 Colleges are required to follow the above accounting guidance and to make an appropriate disclosure about year 2000 compliance in accordance with UITF 20 in their members' reports for 1998-99. An illustrative disclosure is set out in appendix 2 to this annex.

37 Since colleges' financial statements for 1998-99 will not be finalised much in advance of 31 December 1999, the Council is collating information about the sector's state of year 2000 compliance from other sources, including:

- a survey (questionnaire) in spring 1999
- disclosures in colleges' financial statements for 1997-98
- internal auditors' reports and external management letters in respect of the year ended 31 July 1998.

38 Where these three sources indicate that a college is not satisfactorily year 2000 compliant the Council will seek further information and assurances from the corporation during 1999 that action plans have been drawn up and key priorities are being addressed.

Income and Expenditure Account

39 The notes to colleges' financial statements should provide further information about each of the income and expenditure figures shown on the face of the income and expenditure account. Illustrative examples are provided in supplement B to Circular 99/23. Detailed guidance on key disclosures is set out below.

Council grant income

40 The analysis of note 2, *Further Education Funding Council Grants,* to the model financial statements has been extended to include all the different types of grant which colleges may receive. The analysis of deferred capital grants received shown in note 21 to the model financial statements and within payments received on account in note 17 has also been extended for the same reason.

41 The purpose of extending this analysis is to ensure that all individual grants given for specific purposes are identified in a college's financial statements and covered by the external auditors' opinion.

42 The required analysis will vary from year to year to reflect changes in grant-funded educational initiatives.

Adjustments to recurrent funding

43 In some cases, following receipt by the Council of an audited student number claim, colleges' recurrent funding in prior years may have been adjusted in excess of the estimates included in their audited financial statements. Any further adjustment should be included in Council grants on the face of the income and expenditure account and be separately disclosed in the notes to the accounts where Council grants are further itemised.

44 Any such late adjustment is not expected to be significant or fundamental enough to justify a prior-year adjustment in the financial statements.

45 Where an accrual is made for clawback of recurrent funding this should be included in creditors: due within one year and not in provisions.

Tuition fees

46 The analysis of tuition fees shown in note 4 to the model financial statements has been expanded to show UK fees separately from other European Union fees. Colleges may wish to use the domicile field in the individualised student record as a basis for this analysis. This amendment means that the analysis is consistent with the analysis shown in the financial statements of higher education institutions.

Staff costs: Senior postholders' emoluments

47 Colleges are required to disclose the following in their financial statements:

- the emoluments of the principal
- the aggregate emoluments of the college's senior postholders
- the aggregate emoluments of the corporation's members
- the emoluments of the highest paid senior postholder, if not the principal
- emoluments due to a senior postholder but waived by the postholder
- the number of senior postholders (in bands of £5,000), including the principal (this information may be combined with similar information for all higher paid staff)
- the aggregate amount of any compensation paid to senior postholders or past senior postholders for loss of office
- the number of postholders who have been paid such compensation.

48 The term 'senior postholders' is defined in the articles of government for each college as 'the principal and holders of other such senior posts as the governing body may determine for the purposes of the articles of government of the college relating to the appointment and promotion of staff.' Colleges may wish to list senior postholders in the members' report, together with their dates of appointment and, where relevant, resignation.

49 'Senior postholders' emoluments' means emoluments paid to or receivable by any person for:

- services as a senior postholder of the college
- services as a director or officer of any subsidiary of the college, during the period of appointment as a senior postholder.

50 For this purpose, 'emoluments' paid to or receivable by a senior postholder include the normal remuneration salary, and the following:

- fees
- any expense allowances (to the extent that they are chargeable to UK income tax)
- contributions paid for the senior postholder under a pension scheme
- the estimated money value of any benefits received other than in cash
- emoluments for any person accepting office as a senior postholder.

51 Senior postholders' emoluments should not include the employer's national insurance contributions. Compensation for loss of office is a category of payment different from an 'emolument'. Consequently, it should not be included in that person's emoluments for banding purposes. Compensation for loss of office includes:

- any amount paid in connection with a senior postholder's retirement
- the estimated monetary value of benefits received or receivable other than in cash and, where compensation is given in kind, disclosure of its nature
- any top-up or enhancement to the pension scheme.

52 The normal remuneration salary of staff governors who are not senior postholders does not need to be disclosed separately.

53 If more than one person has held the post of principal during the year, each such person's total emoluments for the year must be attributed to that part of the year during which they were principal, and these amounts must be disclosed separately.

54 The disclosure of the principal's and other senior post-holders' emoluments set out in note 9 to the model financial statements has been amended to show the analysis between:

- salaries
- benefits in kind; and
- pension contributions.

55 Previously only the total emoluments were shown. The figures have been analysed as above in response to comments from users of colleges' accounts that disclosure of only the total figures gave a misleading impression of the actual salaries of principals and senior postholders.

Staff costs: Higher paid staff

56 The total number of higher paid staff, including senior postholders, in bands of £5,000 (above a threshold of total emoluments of £40,000), should be disclosed in the interests of public accountability in the staff costs note (the equivalent of note 8 to the model financial statements in supplement B to Circular 99/23). The number of senior postholders within each band should be separately identified within the note.

Staff costs: Pay awards

57 Under the conditions of funding for 1998-99 set out in part 2 of each college's financial memorandum with the Council, colleges are required to 'take account of the principles set out in the chancellor of the exchequer's statement on public pay of 17 September 1997 and, in particular, of the need to cover higher pay costs by efficiency improvements'.

58 Following guidance from the DfEE, colleges are required to disclose in their financial statements, commencing from 1998-99, the level and basis of the average pay award(s) made to their staff during the accounting period. If a certain individual or group of individuals has received a pay award based on a different policy from that used for the majority of staff, then details of that policy and the level of the pay award should also be disclosed. Comparative figures are not required. This disclosure should be made in the notes on staff costs and senior postholders' emoluments in respect of the following:

- the princiapl
- other senior postholders
- other higher paid staff as detailed in paragraph 56.

Staff costs: Severance payments

59 Colleges are required to disclose the amount of severance costs for each year and state whether these were approved by the corporation or a committee established by the corporation for this purpose.

Governors' expenses

60 *Accountability in Further Education: A consultation paper* was published by the DfEE on 5 March 1998. In paragraphs 2.16 and 2.17 the DfEE clarified that, in limited circumstances, it would be 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.

Cost relating to overseas activities

61 College staff and members of the corporation might travel abroad as part of their duties. As set out in Circular 99/14 *College Companies, Joint Ventures and Overseas Operations*, colleges which wish to undertake overseas activities should have in place a strategy which has been specifically approved, and which is reviewed at least annually, by the governing body. In addition, colleges should have a clear policy and a framework for the approval of all costs relating to overseas activities, including hospitality costs. Following recent DfEE guidance, the Council will in future require colleges to disclose in their financial statements details of the costs incurred relating to overseas activities. The Council recognises that colleges may not currently be in a position to identify all such expenditure. Therefore, colleges are required to ensure that they have appropriate systems in place by 1 August 1999 to be able to provide an analysis of costs relating to overseas activities in their financial statements for future years.

62 With effect from the year ending 31 July 2000, the total costs associated with staff and governors travelling abroad on college business should be disclosed separately for the following:

a. members of the corporation;

b. senior postholders;[5]

c. other higher paid staff as defined in paragraph 56.

63 The disclosure should be included in the notes on senior postholders' emoluments and staff costs as appropriate. An example disclosure is shown in supplement B to Circular 99/23. If the total costs borne by the college are reimbursed from any source then the total cost, the amount of the reimbursement and the net cost to the college should be disclosed. If a college wishes to disclose brief additional information about overseas activities it may do so in consultation with its external auditors. Comparative figures are not required.

Exceptional items

64 Exceptional items are material items which derive from events or transactions that fall within the ordinary activities of the college and which individually or, if of a similar type, in aggregate, need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view.

65 The amount of each exceptional item should be disclosed separately by way of a note or on the face of the income and expenditure account if that degree of prominence is necessary in order to give a true and fair view.

66 The following items, including provisions in respect of such items, should be shown separately on the face of the income and expenditure account after operating surplus:

- surplus or deficits on the sale or termination of an operation
- costs of a fundamental reorganisation or restructuring which have a material effect on the nature and focus of operations
- surplus or deficits on the disposal of fixed assets.

67 In some instances where staff restructuring has been extensive, the costs have been disclosed as an exceptional item. This is a matter for each college to discuss with its external auditors. An example of such an incidence has been included in the model financial statements in supplement B to Circular 99/23.

Cashflow Statement

68 FRS 1 *Cashflow Statement* was revised in 1996 and the revised FRS applies to accounting periods ending on or after 23 March 1997. The most significant change was the move away from reporting the flow of 'cash and cash equivalents' to a pure cashflow statement. Supporting information is required on the movement in net debt/net funds. The management of liquid resources is separately disclosed.

69 FRS 1 encourages, but does not require, analysis of net cashflows from operating activities on the so-called 'direct method'. The Council supports

[5] 'Senior postholders' means the principal and holders of the other senior posts whom the board have selected for the purposes of the articles of government of the college relating to the appointment and promotion of staff.

the proposals of FRS 1 but recognises that colleges may incur costs which are disproportionate to the benefits in preparing a cashflow statement on the direct method. Colleges may, therefore, adopt the indirect method of reporting operating cashflows. The direct method reports the major classes of gross operating cash receipts and gross cash payments before arriving at the cash generated by operations; the indirect method starts with the cash generated by operations.

70 Cash is regarded as cash in hand, deposits and overdrafts repayable on demand and without penalty (under one working day's notice). Liquid resources are (readily disposable) current asset investments. They should be capable of disposal without disrupting the business and are either traded in an active market or readily convertible into known amounts of cash. Liquid resources would include items such as money-market deposits, listed investments and local authority bonds. Cash inflows would include withdrawals from deposit accounts or disposal of investments. Cash outflows would include the placing of a deposit or acquisition of investments.

71 Net debt is defined as borrowings under FRS 4, plus obligations under finance leases, less cash and liquid resources. This would include any loans, debentures or balances on inherited deficit loans.

72 As a result of the publication of FRS 9 *Associates and Joint Ventures* there were further changes to FRS 1 (revised 1996) in respect of the treatment of dividends received from associates and joint ventures.

Fixed Assets

Accounting for fixed assets

73 Land and buildings inherited on incorporation should be capitalised and should be included in the balance sheet at valuation. Land and buildings acquired after incorporation, whether funded by capital grant or not, should be included in the balance sheet at cost inclusive of any irrecoverable VAT.

74 A number of colleges (principally voluntary-aided sixth form colleges) occupy premises which are owned by other bodies and for which occupancy no rental payment is required. In some cases there may be no formal agreement to occupy. The notes to the financial statements should disclose the full circumstances in order to give the reader of the financial statements an understanding of the college's position.

75 Equipment acquired after incorporation should be valued at cost or, in the case of donated equipment, net realisable value.

76 The inclusion of equipment in the balance sheet requires three matters to be determined:

- the definition of equipment
- the threshold value(s) at which it should qualify to be capitalised and included in the balance sheet rather than being written off in the income and expenditure account
- the basis/bases for depreciation.

77 Given the range of colleges in the sector, it would be inappropriate for the Council to seek to constrain colleges by defining these matters for the sector as a whole. Colleges should determine their own policies in consultation with their external auditors. In setting threshold values for capitalisation, colleges may wish to consider the impact on their inventory records and fixed assets register. For example, all capitalised equipment will need to be recorded and each year it will need to be depreciated.

Tangible fixed assets

78 FRS 15 *Tangible Fixed Assets* should be regarded as standard for accounting periods ending on or after 23 March 2000. Earlier adoption is encouraged and, since FRS 15 codifies much of existing practice and represents best practice, colleges are required to comply with FRS 15 for the purposes of their 1998-99 financial statements. FRS 15 addresses the initial measurement, valuation and depreciation of tangible fixed assets (with the exception of investment properties). Its main objective is to ensure consistent principles are applied by organisations.

Initial measurement

79 A tangible fixed asset should initially be measured at its cost. This includes those costs directly attributed to bringing the asset into working condition for its intended use and may include:

- acquisition costs (for example, stamp duty)
- cost of site preparations and clearance
- initial delivery and handling costs
- installation costs
- professional fees
- labour costs of own employees.

80 If a college wishes to capitalise any labour costs of its own employees it should consult its external auditors.

81 The initial carrying amount of tangible fixed assets received as gifts or donations should be the current value at the date they are received. FRS 15 recognises that in some cases (particularly in the not-for-profit and charity sectors) an entity receives gifts and donations of tangible fixed assets. The cost of such assets is taken to be the value of the assets at the date they are received. The valuation of inherited assets on incorporation at 1 April 1993 therefore represents the initial measurement of these assets and, as such, does not constitute a revaluation which would need to be kept up to date in accordance with the proposals set out in FRS 15.

82 Finance costs that are directly attributable to the construction of tangible fixed assets may be capitalised. Capitalisation of finance costs should cease when substantially all the activities that are necessary to get the asset ready for use are complete. Where an organisation adopts a policy of capitalisation of finance costs it should be applied consistently. The total amount of finance costs capitalised in a period should not exceed the total amount of finance costs incurred during that period.

83 If the amount recognised when a tangible fixed asset is acquired exceeds its recoverable amount then it should be written down to its recoverable amount (refer to FRS11 *Impairment of Fixed Assets and Goodwill*).

84 Subsequent expenditure to ensure that the tangible fixed asset maintains its previously assessed standard of performance should be recognised in the income and expenditure account as it is incurred. There are three exceptions to the above rule:

- where economic benefits are enhanced in excess of the previously assessed standard of performance
- where a component that is treated separately for depreciation purposes is replaced or restored
- where economic benefits that have previously been reflected in depreciation are restored.

Valuation

85 Where an organisation adopts a policy of revaluation it should be applied to an entire class of tangible fixed assets but need not be applied to all classes of tangible fixed assets.

86 Where a tangible fixed asset is subject to a policy of revaluation its carrying amount should be its current value at every balance sheet date.

87 This can be met by a full valuation every five years and an interim valuation in year three. It is expected that a qualified external valuer would carry out the full valuation. The interim valuation may be carried out by a qualified internal or external valuer.

88 Non-specialised properties should be valued on the basis of existing-use value.

89 College properties would normally be regarded as specialised properties and should be valued on the basis of depreciated replacement cost.

90 Properties surplus to requirements should be valued on the basis of open-market value.

91 Revaluation gains and losses should be reflected in accordance with FRS 3 *Reporting Financial Performance* as summarised in table 1.

Table 1. Treatment of revaluation gains and losses

	Statement of total recognised gains and losses (STRGL)	***Income and expenditure account***
Gain reversing a loss previously recognised in income and expenditure account		Gain, less depreciation that would have been charged if loss recognised
Other gains	Gain	
Loss caused by consumption of economic benefits		Loss
Other losses	Loss until carrying amount reaches depreciated historic cost	Balance of loss: unless recoverable amount is greater than revalued amount, then difference goes into the STRGL

92 Where in implementing FRS 15 for the first time an entity does not adopt a policy of revaluation but the carrying amount of tangible fixed assets reflects previous revaluations carried out since incorporation it may:

a. retain the book amounts (it should disclose that transitional provisions are being followed and that the valuation has not been updated and give the date of the last valuation); or
b. restate the carrying amount of the tangible fixed asset to historical cost (less depreciation) as a change in accounting policy.

93 Colleges are expected to follow option a).

Depreciation

94 Depreciation should reflect the pattern in which an asset's economic benefits are consumed. The depreciation charge for each accounting period should be recognised as an expense in the income and expenditure account. FRS 15 supersedes SSAP 12 *Accounting for Depreciation* and SSAP 12 is withdrawn. FRS 15 confirms that subsequent expenditure which maintains or enhances a tangible fixed asset does not negate the need to charge depreciation, since all tangible fixed assets except for land have finite lives.

Disclosure

95 FRS 15 requires the following information to be disclosed separately in the financial statements for each class of tangible fixed assets:

a. the depreciation methods used;
b. the useful economic lives or the depreciation rates used;
c. total depreciation charged for the period;
d. where material, the financial effect of a change during the period in either the estimate of useful economic lives or the estimate of residual values;
e. the cost or revalued amount at the beginning of the financial period and at the balance sheet date;
f. the cumulative amount of provisions for depreciation or impairment at the beginning of the financial period and at the balance sheet date;
g. a reconciliation of the movements, separately disclosing additions, disposals, revaluations, transfers, depreciation, impairment losses and reversals of impairment losses written back in the financial period; and
h. the net carrying amount at the beginning of the financial period and at the balance sheet date.

Impairment

96 FRS 11 *Impairment of Fixed Assets and Goodwill* was published in July 1998. It applies to accounting periods ending on or after 23 December 1998. FRS 11 relates to tangible fixed assets and goodwill. Investment properties and most investments are excluded from the scope of the FRS. However, investments in subsidiary undertakings, associates and joint ventures *are* included within the scope of FRS 11.

97 Impairment is to be measured by comparing the carrying value of a fixed asset with its recoverable amount. The recoverable amount is the higher of the amount which could be obtained from selling the fixed asset (net realisable value) or using the fixed asset (value in use).

98 If it is not possible to test a single fixed asset for impairment because the cashflows on which the calculation is based do not arise from a single asset, then the test may be applied to a group of assets (an income generating unit, or IGU) which produces a largely independent income stream. FRS 11 provides guidance on identifying IGUs. In the context of the FE sector, in many cases the college as a whole may be the only IGU. However, IGUs may include:

- a school or department
- a site
- a management centre
- an asset(s) held for disposal.

99 It is not necessary to carry out an impairment review each year; only if there is an indication that impairment has occurred does a review need to be performed. FRS 11 provides examples of indicators of impairment, including:

a. a current period operating loss in the business in which the fixed asset or goodwill is involved or net cash outflow from the operating activities of that business, combined with either past operating losses or net cash outflows from such operating activities or an expectation of continuing operating losses or net cash outflows from such operating activities;

b. a significant decline in a fixed asset's market value during the period;

c. evidence of obsolescence or physical damage to the fixed asset;

d. a significant adverse change in:

   – either the business or the market in which the fixed asset or goodwill is involved, such as the entrance of a major competitor

   – the statutory or other regulatory environment in which the business operates

   – any 'indicator of value' (for example turnover) used to measure the fair value of a fixed asset on acquisition;

e. a commitment by management to undertake a significant reorganisation;

f. a major loss of key employees; and

g. a significant increase in market interest rates or other market rates of return that are likely to affect materially the fixed asset's recoverable amount.

100 Examples c), d), e), f) and g) above appear relevant to the FE sector. However, a current period historical loss is considered to be a better indicator of impairment for colleges than a current period operating loss (example a). Example b) is unlikely to apply, since the majority of college buildings are specialised buildings, valued at depreciated replacement cost rather than open market value. Other examples of impairment indicators specific to the sector would include a significant under-performance against a college's funding agreement with the Council (or another major funding source) and a withdrawal from certain areas of provision.

101 It is possible for such indicators to exist without in fact having an adverse impact on the measurement of fixed assets. However, if indicators of impairment are identified, FRS 11 states that it is appropriate to review the useful economic lives and residual values of the relevant fixed assets since these may have been affected.

102 In summary, if no indicators of impairment are identified there is no requirement to carry out an impairment review.

103 FRS 11 requires an impairment loss to be recognised in the income and expenditure account unless it arises on a previously revalued asset. An impairment loss on a revalued fixed asset should be fully recognised in the income and expenditure account if it is due to a 'clear consumption of economic benefits'. Otherwise, the impairment should be recognised in the statement of total recognised gains and losses until the carrying amount falls to the amount of the asset's depreciated historical cost and thereafter in the income and expenditure account.

104 If the recoverable amount of a fixed asset increases as a result of a change in economic conditions or the expected use of the asset, then the reversal of any previous impairment loss should be recognised.

105 Colleges may wish to discuss their approach to impairment reviews with their external auditors in advance of their year end of 31 July 1999.

Disposal of fixed assets

106 The profit or loss on a disposal of a tangible fixed asset should be accounted for in the income and expenditure account of the period in which the disposal occurs as the difference between the net sale proceeds and the carrying amount, whether carried at historical cost or valuation. Profit or losses on the disposal of fixed asset should be shown in accordance with FRS 3 *Reporting Financial Performance*.

107 In accordance with FRS 15, colleges should only revalue to open-market value surplus assets held for resale. Assets in use, which the college intends to sell as part of its accommodation strategy, should not be revalued. (In FRED 17 it was proposed that immediately before recording disposal of a tangible fixed asset, the carrying amount of the asset would be adjusted to the disposal proceeds and any gain or loss would be treated as revaluation gain or loss. This treatment has not been adopted in FRS 15).

108 The accounting treatment for disposal of assets will depend on how the acquisition of those assets was financed and how a college intends to use the proceeds. For these purposes assets broadly fall into one of three categories: inherited by colleges on incorporation, financed by exchequer funds, and financed from colleges' own resources.

Financial memorandum

109 The Council requires the Board to obtain its consent for land and buildings transactions where the total cost exceeds £1,000,000 or 5% of the college's annual revenue, whichever is the lower.

Where the transaction is a disposal or the renting or leasing of property to a third party the college should seek to secure the best obtainable value for money. The Council intends to respond promptly to requests for consent under this paragraph.

110 Where the college is proposing to dispose of or lease or rent, land and buildings which have been acquired by exchequer funds the Council may require the college to surrender some or all of the proceeds.

111 The Council would normally expect colleges to apply the proceeds of asset sales to investment in fixed assets. Colleges should seek independent professional advice when disposing of land and buildings.

112 Exchequer funds include any grants from the Council and other government bodies. They do not include funds from local education authorities: inherited assets are not classed as exchequer-funded assets. Funds provided for the completion of capital works under the Hunter survey are classed as exchequer funds, as is Council support provided under the terms of Circular 96/11 and Circular 95/25.

113 In giving consent to any disposal, the Council will consider the potential effect on adequacy and sufficiency of provision. Where there is a potential risk to adequacy and sufficiency of provision, conditions are likely to be attached to the consent to the disposal. The Council would wish to preserve the asset base and would generally require the proceeds to be retained in a separate bank account until they are applied to replacement facilities.

Accounting treatment

114 For assets fully financed by grant and inherited assets the historical cost surplus on disposal will generally be equal to the net proceeds.

Example 1. Inherited assets

	£000s
Historical cost	0
Valuation at 1 April 1993	6,000
Net book value at disposal date	5,640
Disposal proceeds	2,500
Deficit taken to income and expenditure account	(3,140)
Realised gains taken to statement of historical cost surplus and deficit	5,640
Net historical cost surplus recorded on transaction	2,500

Example 2. Assets financed by grant

	£000s
Historical cost	5,000
Net book value at disposal date	4,600
Original grant as deferred capital grant	5,000
Balance on deferred capital grant	4,600
Net disposal proceeds	5,300
Surplus taken to income and expenditure account	700
Deferred capital grant released to income and expenditure account	4,600
Total sum released	5,300

115 The accounting treatment on disposal of inherited assets, exchequer-funded assets and assets financed by a college's own resources is set out in tables 2 to 4.

Table 2. Disposal of assets inherited on incorporation

Use of proceeds	***Income and expenditure account***	***Statement of historical cost surplus and deficit***	***Notes to accounts on reserve movements***	***Cash holding***
Specific use as a condition to consent to disposal	Surplus of excess of proceeds over net book value	Release of revaluation reserve	1 Transfer from revaluation reserve to restricted reserve 2 Transfer from income and expenditure account to restricted reserve	Ring-fenced bank account
Specific use designated by governors	Surplus of excess of proceeds over net book value	Release of revaluation reserve	1 Transfer from revaluation reserve to designated reserve 2 Transfer from income and expenditure account to designated reserve	Cash pool
Use not identified	Surplus of excess of proceeds over net book value	Release of revaluation reserve	None	Cash pool

Table 3. Disposal of exchequer-funded assets

Use of proceeds	***Income and expenditure account***	***Notes to accounts on reserve movement***	***Cash holding***
Surrendered to HM Treasury	1 Surplus of proceeds over net book value, plus release of deferred capital grant 2 Exceptional item for sum to be surrendered	None	In cash pool with equivalent creditor
Held for reinvestment	Surplus of proceeds over net book value plus release of deferred capital grant	Transfer from income and expenditure account to restricted reserve	Ring-fenced bank account

Table 4. Disposal of assets financed from own resources

Use of proceeds	***Income and expenditure account***	***Reserve movement in notes to accounts***	***Cash holding***
Specific use as a condition of consent to disposal	Surplus of proceeds over net book value	Transfer of proceeds from income and expenditure account to restricted reserve	Ring-fenced bank account
Specific use designated by governors	Surplus of proceeds over net book value	Transfer of proceeds from income and expenditure account to designated reserve	Cash pool
Use not identified	Surplus of proceeds over net book value	None	Cash pool

116 Where the use of the proceeds is restricted, the surplus on disposal should be held in a restricted reserve. The restricted reserve may be released to the income and expenditure account over the life of the replacement asset.

117 Where corporations have decided to set funds aside, the surplus may be held in a designated reserve (part of general reserves) until the funds have been applied. When the funds have been applied in the manner decided by the corporation, the designated reserve may be released to the income and expenditure account.

118 If the corporation has no formal proposals for the reinvestment of the proceeds, the surplus may be taken directly to the income and expenditure account.

Accounting for grants

119 Any grants received from public funds (for example, from the Council or training and enterprise councils (TECs)) should be accounted for in accordance with SSAP 4 *Accounting for Government Grants*. This means that the income should be matched to the relevant expenditure. Any capital grant received should be credited to a deferred capital grant account and not deducted from the purchase price of the assets concerned. The amount of the grant should be credited to the income and expenditure account over the useful economic life of the related asset, on a basis consistent with the depreciation policy. If a capital grant is received before the purchase of the relevant asset then the grant should be held in payments on account until spent.

120 Where the conditions attached to an award of a grant state that the grant should be directed towards capital expenditure it should be treated as a deferred capital grant.

Council capital funding allocations

121 In 1998-99 colleges were required to spend a certain percentage of their funding allocation for capital purposes. This element of the funding should be matched against the related purchase. Thus, if the grant is spent on an asset which is capitalised, the grant should be treated as a deferred capital grant and be released to the income and expenditure account over the life of the relevant asset. If the grant is spent for capital purposes but not on an item that would normally be capitalised (for example on an item costing less than the institution's capitalisation limit or certain minor works), it should be released to the income and expenditure account from the deferred capital grant immediately.

122 The above guidance does not mean that a college's capital allocation may be used to finance all minor works, regardless of their nature. The words enclosed in brackets in the above paragraph are only examples of items which are of a capital nature but which would not normally be capitalised. Certain minor works fall into this category whilst others do not. There can be a fine distinction between minor works items which are of a capital nature and those which are essentially repairs and therefore of a revenue nature. It is intended that only minor works of a capital nature should be financed out of the allocations for capital equipment and minor works. Where a college has to use its judgement in determining the nature of a minor works item, it may find it useful to discuss the accounting treatment with its external auditors. Guidance on when it is appropriate to capitalise expenditure is also set out in FRS 15 *Tangible Fixed Assets* and colleges are required to comply with this accounting standard.

123 Colleges may use their capital allocations for the capital and interest elements of new finance leases. The sum charged to the Council's capital allocation should not exceed the actual sum paid to the finance house. (It is feasible under some methods of allocating interest charges to the life of the lease that the combined depreciation and interest charges may exceed the sum paid in early years.) The grant received in any year should be set against the lease payment for that year. Grant should not be set aside to meet future years' lease payments. Any assets acquired under finance leases met by Council grants should be treated as Council-funded assets. Funds identified for capital purposes should not be used to meet operating lease rentals. Whilst, under the guidance above, the cash grant allocation may be used to repay both the capital and interest elements of finance leases, the allocation should still be accounted for as a capital grant in accordance with SSAP 4 *Accounting for Government Grants*.

Arrangements for capital support for major works up to March 1999

124 Up to March 1999 colleges could apply to the Council for financial support towards capital projects costing more than £100,000. If a college's application were supported, the first year's support

was calculated on the basis of a notional annuity loan over 15 years at a notional rate of interest determined from time to time by the Council. The maximum proportion of capital costs for which a college could apply was 42.5%. From the second year the annual payments would decline in line with the core percentage (currently 90% of a college's main funding allocation for the previous year). The Council does not have the power to guarantee future funding streams to colleges and the Council cannot guarantee that this funding, nor any other funding from the Council, will continue after the current year. This means that colleges should not include any debtor due after more than one year on their balance sheets in respect of Council support.

125 The capital support was frequently referred to as loan support as it was calculated by reference to a notional loan. There is no requirement for colleges to borrow if they can finance projects from their own funds.

126 It has been determined that this support was partly a revenue grant and partly a capital grant. The revenue element may be released directly to the income and expenditure account each year. The capital element should be taken to the deferred capital grant account. The total capital support which the college expects to receive over the 15-year notional loan period should be assessed. This sum should then be taken to the income and expenditure account on a straight-line basis over the life of the asset. It would be prudent to reassess the anticipated total receipt each year.

127 Where the grant is used to contribute to lease payments it should be released to the income and expenditure account, in the appropriate proportions, over the lease period. Lease payments should be allocated between capital and finance charges in accordance with SSAP 21.

Arrangements for capital support for major works from April 1999

128 From April 1999 there are new arrangements under which colleges may apply for Council support towards capital projects costing more than £100,000. The amount of support available comprises:

- £50,000 towards the first £100,000 of eligible project costs, and
- 35% of eligible project costs in excess of £100,000, payable over three years.

129 This support will be payable over three years following practical completion of the relevant project and each year's support should be treated as a one-off capital grant in colleges' financial statements. No debtor should be recognised in respect of future years' grant.

One-off grant

130 Council support for major works may exceptionally be given by means of a one-off grant payment. This sum should be treated as a deferred capital grant and be released to the income and expenditure account over the life of the asset.

Significant donations used for capital purposes

131 A number of colleges have been successful in gaining donations from charitable and commercial bodies, for example through Gift Aid. Previous guidance permitted colleges to account for such donations in accordance with the charities SORP. However, the further and higher education sectors are developing their own SORP which will not require colleges to apply the charities SORP. Whilst there is no need to make any prior year adjustment in respect of previous donations, with effect from 1998-99 colleges should account for significant donations used for capital purposes in accordance with SSAP 4. General donations for non-specified purposes may be credited directly to the income and expenditure account.

Accounting for leases

132 A finance lease should be recorded in the lessee's balance sheet as an asset and an obligation to pay future rentals. Rentals payable should be apportioned between the finance charge and a reduction of the outstanding obligation for future amounts payable. The total finance charge under a finance lease should be allocated to accounting periods during the lease term so as to produce a constant periodic rate of charge on the remaining balance of the obligation for each accounting period, or a reasonable approximation thereof. Colleges may use any of the three methods of achieving this given in the guidance notes to SSAP 21 *Accounting for Leases and Hire Purchase Contracts.*

133 An asset leased under a finance lease will be depreciated over the shorter of the lease period or its useful economic life. In the case of a hire purchase contract which has the characteristics of a

finance lease, the asset should be depreciated over its useful life.

134 The rental under an operating lease should be charged on a straight-line basis over the lease term, even if the payments are not made on such a basis, unless another systematic and rational basis is more appropriate. The accounting for inherited leases should follow the recommendations set out in this and preceding paragraphs.

135 Under SSAP 21 *Accounting for Leases and Hire Purchase Contracts,* the accounting treatment adopted for a lease will depend on whether the lease is a finance lease or an operating lease. A finance lease is defined as one which transfers to the lessee substantially all the risks and rewards of ownership; all other leases are classified as operating leases.

136 The underlying concept of SSAP 21 is that the method of accounting for a lease should reflect the commercial substance of the arrangement and the relationship between the parties concerned. A finance lease creates a set of circumstances that from the lessee's point of view is in substance similar to the outright purchase of an asset financed by borrowing from the lessor. As a result, the recommended accounting practice is that a finance lease should be recorded in the lessee's balance sheet as an asset and an obligation to pay future rentals.

137 UITF Abstract 12 *Lessee Accounting for Reverse Premiums and Similar Incentives* was issued in December 1994 and is mandatory for accounting periods ending on or after 23 December 1994 for lease agreements commencing in the current or the preceding period.

138 The main effects of UITF Abstract 12 are:

- all benefits received and receivable by a lessee as an incentive to sign the lease must be spread forward over the full lease term or, if shorter, over the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate. This means that the income and expenditure account will be credited over a number of years and not just the year in which the benefit first arose
- the benefits should be spread forward on a straight-line basis. This treatment is to be adopted whatever the form of the incentive and applies, for example, to rent-free periods, fitting-out costs borne by the lessor, and the assumption by the lessor of the lessee's liabilities under its previous lease.

139 Colleges which have received incentives to occupy leased or rental property will need to make sure that the value of these benefits is spread forward over an appropriate period.

PFI transactions: Amendment to FRS 5

140 Guidance on accounting for PFI transactions is set out above in paragraph 19 of this annex.

Fixed asset investments

141 Fixed asset investments are those investments intended to be held for use on a continuing basis in the activities of the college.

142 Fixed asset investments should be carried at historical cost, less any provision for impairment in their value. Listed fixed asset investments may be carried at historical cost or current market value. Where the latter option is exercised, the amount of any increase should be accounted for as a surplus on revaluation and taken to a revaluation reserve. Where fixed asset investments are carried at market value, the valuation should be updated annually.

Milk quotas

143 The preferred treatment is to show milk quotas in the accounts at cost and depreciated over their useful economic life. In most cases cost will be nil since the quotas were inherited from the college's local education authority. In practice, therefore, this may have little impact on a college's accounts, other than disclosing that the college has an asset.

Goodwill

144 FRS 10 *Goodwill and Intangible Assets* was published on 4 December 1997. It supersedes SSAP 22 *Accounting for Goodwill.* It applies to accounting periods ending on or after 23 December 1998. Earlier adoption is encouraged but not required.

145 Colleges may purchase goodwill or acquire negative goodwill if they acquire the business of a private training provider, for example. It is unlikely that FRS 10 will impact on most colleges' financial statements. The issue of negative goodwill which arises on a reorganisation (college combination) is addressed at paragraph 223 of this annex.

Current Assets

146 The notes to colleges' financial statements should provide further information about each material current asset shown on the balance sheet. Illustrative examples are provided in supplement B to Circular 99/23. Detailed guidance on key disclosures is set out below.

Stocks

147 The value of stocks, such as farm stocks, should be brought into account at the lower of cost and net realisable value in accordance with the principles established by SSAP 9 *Stocks and Long-term Contracts*. If goods are sold subject to reservation of title, the disclosures set out in the Council of the Institute of Chartered Accountants' accounting recommendation *Accounting for Goods Sold Subject to Reservation of Title* (1996) should be followed.

Long-term debtors

148 Debtors due after more than one year should be disclosed in the notes to the accounts in accordance with UITF Abstract 4 *Presentation of Long-term Debtors in Current Assets*.

Current asset investments

149 Current asset investments should be included in the balance sheet at the lower of their original cost and net realisable value.

Trustee Investment Act 1961

150 Colleges are required to make investments in accordance with the *Trustee Investment Act 1961* (TIA) as set out in Circular 93/13 *General Information*. Under the TIA, charities were permitted to divide their investments equally between wider range and narrower range investments (if they chose to invest in wider range investments at all).

151 Under sections 70 and 71 of the *Charities Act 1993* the secretary of state was empowered to make regulations to vary the proportion and types of investments which charities may make. The *Charities (Trustee Investment Act 1961) Order 1995* (SI 1995 No. 1092) allows the value of the wider range part of the investment fund to be three times the value of the narrower range fund.

Liabilities

152 The notes to colleges' financial statements should provide further information about each material liability shown on the balance sheet. Illustrative examples are provided in supplement B to Circular 99/23. Detailed guidance on key disclosures is set out below.

Provisions

153 FRS 12 *Provisions, Contingent Liabilities and Contingent Assets* was published in September 1998. It applies to accounting periods ending on or after 23 March 1999.

154 Under FRS 12 a provision should only be recognised when 'an entity has a present obligation (legal or constructive) as a result of a past event, it is probable that a transfer of economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation'.

155 Provisions can be distinguished from other liabilities such as trade creditors and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement.

156 Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that a transfer of economic benefits will be required to settle the obligation, the provision should be reversed.

157 A provision should be used only for expenditures for which the provision was originally recognised.

158 Specific changes to sector accounting policies as a result of FRS 12 arise in respect of planned maintenance and restructuring provisions. It is no longer appropriate to make a provision for the cost of planned maintenance works except where the recognition criteria in FRS 12 are fully met (see the section on planned maintenance above). This confirms the change of accounting policy implemented by colleges in their 1997-98 financial statements.

159 A restructuring provision should only be made where there is a legal or constructive obligation. A constructive obligation is only present when a college has drawn up a detailed formal plan and has announced or started to implement that plan prior

to the balance sheet date. In practice, a constructive obligation would exist, for example, once a written offer had been made to individuals.

160 A restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both:

a. necessarily entailed by the restructuring and;

b. not associated with the ongoing activities of the entity.

161 A restructuring provision does not include such costs as:

a. retraining or relocating continuing staff;

b. marketing; or

c. investment in new systems and distribution networks.

162 These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

Disclosure

163 For each class of provision, an entity should disclose:

a. the carrying amount at the beginning and end of the period;

b. additional provisions made in the period, including increases to existing provisions;

c. amounts used (that is, incurred and charged against the provision) during the period;

d. unused amounts reversed during the period; and

e. the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

164 Comparative information is not required.

165 An entity should disclose the following for each class of provision:

a. a brief description of the nature of the obligation, and the expected timing of any resulting transfers of economic benefits;

b. an indication of the uncertainties about the amount or timing of those transfers of economic benefits. Where necessary to provide adequate information, an entity should disclose the major assumptions made concerning future events; and

c. the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Pension schemes

Provision for future costs

166 Each college should adopt the accounting objective of recognising the expected cost of providing pensions to its employees on a systematic and rational basis over the period during which it derives benefits from its employees' services. This applies whether it has a legal or contractual commitment under a pension scheme or one implicit in its actions to provide, or contribute to, pensions for its employees.

167 SSAP 24 *Accounting for Pension Costs* requires an employer to recognise the expected cost of providing pensions to its employees on a systematic and rational basis over the period during which it derives benefit from its employees' services. This applies whether it has a legal or contractual commitment under a pension scheme or one implicit in its actions to provide, or contribute to, pensions for its employees. SSAP 24 also addresses discretionary and *ex gratia* increases in pensions and *ex gratia* pensions. The same principles apply whether the scheme is funded or unfunded. An example of the calculation of the provision for pension enhancement was given in appendix 4 to annex A of Circular 95/14. Colleges may wish to obtain an actuarial valuation of their SSAP 24 provision to ensure that it is not over- or under-stated.

168 Where the actuaries have identified that a local government pension scheme is underfunded and have proposed an increase in contributions, colleges may be required to pay the arrears as a lump sum or may be given the opportunity to spread the payment over a number of years.

169 Where the payment is phased it would be normal practice to spread the arrears evenly over the remaining service lives of the current employees. For example, in one area additional payments are being phased in over a 12-year period. The 12 years might be deemed to be equivalent to the remaining service lives of the current employees. The increased payment over those 12 years should be assessed and be charged to the income and expenditure account on an even basis each year. If the payment is a lump sum then it should be

charged to the income and expenditure account immediately. If the lump sum is material it may be appropriate to treat this expenditure as an exceptional item.

170 In certain circumstances, arrears should be recognised immediately. This would be where a major event or transaction has occurred which had not been allowed for in the original actuarial assumptions and is outside the normal scope of those assumptions. If a portion of the arrears has arisen due to a statutory change in funding requirements (for example where a scheme was not previously required to be fully funded) that portion should be charged to the income and expenditure account immediately. Where a stepped approach has been adopted to reduce the underfunding, the arrears may be recognised over the step-up period rather than immediately.

Teachers' superannuation scheme

171 The basis of the notional fund in which the teachers' superannuation scheme (TSS) is invested has changed from 1 April 1996. After that date, the cost of pensions increases will be charged to the fund and the fund will be deemed to be invested in line with the practice of large real pension funds. Credits will be added to the notional fund to match the cost of increases arising from past service to 1 April 1991 and supplementary credits for future years.

172 An additional supplementary credit could be payable as at 1 April 1996. However, the employers' contributions will not be amended to reflect the effect of charging the cost of inflationary rises to the fund until the valuation relating to 1 April 2001 (which is unlikely to be implemented until 2003).

173 The likely effect on the rate of contributions is not known with sufficient certainty for it to be determined whether or not a provision would be required under SSAP 24.

174 For members of the TSS taking early retirement on or after 1 September 1997, part of the mandatory pension will fall to the employer to fund. This sum should be treated in the same way as enhanced pensions under SSAP 24.

175 The value of the SSAP 24 provision held on the balance sheet should be reassessed from time to time. Colleges are advised to seek actuarial advice on the necessary provision. In some cases where colleges have done this they have been able to reduce the level of provision carried.

176 The actuarial valuation of the TSS as at 31 March 1996 is due to be published during spring 1999. It is anticipated that the standard contribution will increase.

Local government superannuation schemes

177 Following the *Finance (Number 2) Act 1997* pension schemes are no longer able to reclaim a tax credit on dividend income. Investment-based pension schemes, such as local government schemes, are directly affected by this.

178 UITF Abstract 18 *Pension Costs Following the 1997 Tax Changes in Respect of Dividend Income* was issued on 2 December 1997. It concludes that the tax changes do not, of themselves, fall outside the normal scope of the actuarial assumptions. Consequently, the loss to investment-based pension funds should be spread forward over the expected remaining service lives of current employees in the scheme whatever the financial position of the scheme and regardless of any additional contributions which are made.

179 This abstract is effective for accounting periods ending on or after 23 December 1997. Colleges may wish to consult their external auditors as to whether there is a need to disclose any contingent liability.

Pension provisions

180 Paragraph 50 of section 2 of the supplement to Circular 97/28 set out guidance that, where a decision was made that an employee would take early voluntary retirement in one accounting period but the individual did not cease employment until the following period, the charge to the income and expenditure account for any SSAP 24 provision or capital sum payable to the relevant pension scheme should be made in the period in which the decision was made that a specific individual was to leave.

181 FRS 12 *Provisions and Contingencies* requires a change to this approach since it requires that provisions for staffing reorganisations should be recognised when and only when the entity is demonstrably committed to the reorganisation. An entity is demonstrably committed when it has a detailed plan for, and cannot realistically withdraw from, the reorganisation.

182 The guidance in FRS 12 confirms that a decision is no longer a sufficient basis on which to make a provision. Instead, a provision should only be made once a written offer has been made to the individual(s) concerned. Colleges were required to

apply this revised approach in their financial statements for 1997-98 and this approach should continue.

Post-retirement benefits other than pensions

183 Paragraph 75 of SSAP 24 *Accounting for Pension Costs* states that the principles of SSAP 24 may be equally applicable to the cost of providing other post-retirement benefits.

184 UITF Abstract 6 *Accounting for Post-retirement Benefits other than Pensions* states that, in principle, post-retirement benefits other than pensions are liabilities which should be recognised in financial statements and confirms that the principles ofSSAP 24 are applicable to their measurement and disclosure.

Contingencies

185 A contingent liability is defined in FRS 12 as follows:

a. a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's control; or

b. a present obligation that arises from past events but is not recognised because:

   i. it is not probable that a transfer of economic benefits will be required to settle the obligation; or

   ii. the amount of the obligation cannot be measured with sufficient reliability.

186 Contingent liabilities are not recognised as liabilities because they are either:

a. possible obligations, as it has yet to be confirmed whether the entity has an obligation that could lead to a transfer of economic benefits; or

b. present obligations that do not meet the recognition criteria in FRS 12 because either it is not probable that a transfer of economic benefits will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made.

187 A material contingent loss not accrued should be disclosed except where the possibility of loss is remote. If the possibility of loss becomes probable then a provision should be recognised.

188 In respect of each contingency which is required to be disclosed, the following information should be stated by way of notes in financial statements:

- the nature of the contingency
- the uncertainties which are expected to affect the amount or timing of the ultimate outcome
- a prudent estimate of the financial effect, made at the date on which the financial statements are approved by the members of the corporation; or a statement that it is not practicable to make such an estimate
- the possibility of any reimbursement.

189 Where there is a disclosure of an estimate of the financial effect of a contingency, the amount disclosed should be the potential financial effect.

190 A contingent asset is defined in FRS 12 as a possible asset that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's control.

191 Contingent assets should not be recognised in financial statements until the realisation is virtually certain and the asset is therefore no longer 'contingent'. Details of contingent assets which are not virtually certain should only be disclosed where an inflow of economic benefits is probable.

Other Disclosures

192 Details of other disclosures required are set out below.

Post-balance sheet events

193 A post-balance sheet event is an event which occurs between the balance sheet date and the date on which the financial statements are approved (as defined in SSAP 17 *Accounting for Post-balance Sheet Events*). Post-balance sheet events should be disclosed in the notes to the financial statements in addition to the disclosure in the members' report (see paragraphs 23 to 26 of this annex). The financial impact of post-balance sheet events should also be disclosed where it is known or can be estimated.

Foreign currency transactions

194 Where a college enters into transactions in one or more foreign currencies, the transactions should be translated into sterling and exchange differences

recognised in accordance with SSAP 20 *Foreign Currency Transactions*.

Preparation for the proposed introduction of the Euro

195 UITF Abstract 21 *Accounting Issues Arising from the Proposed Introduction of the Euro* was also published on 5 March 1998. Colleges need to consider how the introduction of the Euro might impact on their finance systems and they may find it useful to discuss this with their external auditors.

196 Any financial commitments in respect of the proposed introduction of the Euro should be disclosed in the notes to the financial statements.

Related party disclosures

197 FRS 8 *Related Party Disclosures* should be adopted for accounting periods commencing on or after 23 December 1995. The standard requires the disclosure of information on related party transactions.

198 Two or more parties are related parties when at any time during the financial period:

- one party has direct or indirect control of the other party; or
- the parties are subject to common control from the same source; or
- one party has influence over the financial and operating policies of the other party to an extent that the other party might be inhibited from pursuing at all times its own separate interests; or
- the parties, in entering a transaction, are subject to influence from the same source to such an extent that one of the parties to the transaction has subordinated its own separate interests.

199 FRS 8 states that the following are deemed to be related parties to a reporting entity:

- subsidiary undertakings
- its associates and joint ventures
- the investor or venturer in respect of which the reporting entity is an associate or joint venture
- directors of the reporting entity
- pension funds for the benefit of employees of the reporting entity or of any entity that is a related party of the reporting entity.

200 The following are presumed to be related parties (unless it can be demonstrated that neither party has influenced the financial and operating policies of the other):

- the key management of the reporting entity and the key management of its parent undertaking or undertakings
- each person acting in concert in such a way as to be able to exercise control or influence over the reporting entity; and
- an entity managing or managed by the reporting entity under a management contract.

201 Following the definitions above the members of the corporation would be deemed to be related parties to the college and members of the senior management team would be presumed to be related parties.

202 Members of the corporation may have an interest in businesses with which the college trades. It will need to be considered for each case whether that individual can influence the actions of the business to the extent that either the college or the business has subordinated its own separate interests.

203 FRS 8 does not require disclosure of the relationship and transactions between the reporting entity and the parties listed below simply as a result of their role as:

- providers of finance in the course of their business in that regard
- utility companies
- government departments and their sponsored bodies.

204 Transactions with the Council do not, therefore, need to be disclosed under the requirements of FRS 8.

205 Colleges are required to have a member of the corporation nominated by the TEC. This would not necessarily mean that the TEC would be a related party. If the TEC nominee were the TEC chief executive or a TEC member, consideration would have to be given as to whether the college or TEC had subordinated its own interest.

Group Accounts

Subsidiary undertakings

206 Where a college has subsidiary undertakings, it should prepare consolidated financial statements in accordance with FRS2 *Accounting for Subsidiary Undertakings*. Where a college prepares

consolidated financial statements it should also present a balance sheet for the college alone.

208 It is anticipated that the vast majority of subsidiary undertakings will be consolidated in the college's accounts.

208 In accordance with FRS 2 *Accounting for Subsidiary Undertakings*, an undertaking is the parent undertaking of another undertaking (a subsidiary undertaking) if any of the following apply:

- it holds a majority of the voting rights in the undertaking
- it is a member of the undertaking and has the right to appoint or remove directors holding a majority of the voting rights at meetings of the board on all, or substantially all, matters
- it has the right to exercise a dominant influence over the undertaking by virtue of provisions contained in the undertaking's memorandum or articles, or by virtue of a control contract
- it is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking
- it has a participating interest in the undertaking and it actually exercises a dominant influence over the undertaking, or it and the undertaking are managed on a unified basis.

209 A subsidiary undertaking should only be excluded from consolidation where:

- severe long-term restrictions substantially hinder the exercise of the rights of the college over its assets or management
- the interest in the subsidiary undertaking is held exclusively with a view to subsequent resale and it has not previously been consolidated in the college's group accounts
- its activities are so different from those of the college that its inclusion would be incompatible with the obligation to give a true and fair view. FRS 2 notes that it is exceptional for such circumstances to arise.

210 Colleges are expected to include all subsidiary undertakings regardless of materiality.

211 Where any subsidiary undertakings have been excluded from consolidation, the notes to the financial statements should disclose:

- their names
- the reasons why they have been excluded
- particulars of the balances between the excluded subsidiary undertakings and the rest of the group
- the nature and extent of transactions of the excluded subsidiary undertakings with the rest of the group
- for subsidiary undertakings excluded because of different activities, the separate financial statements of those undertakings
- the aggregate amount of the capital and reserves of such undertakings as at the end of the relevant financial year and their profit or loss for that period, unless the subsidiary undertakings are included in the consolidated financial statements using the equity method of accounting
- where equity accounting has not been applied, any amounts included in the consolidated financial statements in respect of dividends received and receivable from the excluded undertakings, and any write-downs in the period in respect of the investment in those undertakings or amounts due from those undertakings.

212 The Council would normally expect a subsidiary undertaking's accounting period to be coterminous with that of the college

213 If a college only has one subsidiary undertaking and this qualifies for exemption from consolidation so that group accounts are not prepared, full disclosure should still be provided as set out in paragraph 40 of section 2 of the supplement to Circular 97/28.

214 A full copy of each subsidiary undertaking's audited financial statements should be sent to the Council with a college's own audited financial statements. If a subsidiary undertaking was dormant during the year then this should be stated in a covering letter and a copy of these accounts need not be provided. If a subsidiary undertaking's financial statements have not been signed by the return date for college accounts, a draft copy should be provided with the college's financial statements

and a signed copy should be provided as soon as it becomes available.

Links with other companies

215 Where a college has links with companies and other organisations these should normally be the subject of a formal memorandum between the college and the company or joint venture in accordance with the guidance set out in Circular 99/14 *College Companies, Joint Ventures and Overseas Operations*. If a college has material business links with any companies or other organisations which are not, for any reason, consolidated or disclosed as subsidiary undertakings, associates or joint ventures then details of these business links and any related potential liabilities should be disclosed in the notes to the accounts. Comparative figures are not required. Colleges should prepare a full list of business links for discussion with their external auditors and agree with their external auditors which are material and should be disclosed. Examples of such links would include:

- a link through a trust which controls a company or organisation with which the college has or had dealings
- a situation where the college was a major or minor partner in a large European grant-funded project. For example, under the terms of an ADAPT project each partner may bear liability in respect of the project as a whole to a varying degree (full, partial, joint and several, or none) and this should be disclosed.

216 In circumstances such as these the nature of material links should be disclosed together with details of:

- the name of the company or organisation
- the principal activity
- any investment by the college
- whether any of the activities take place outside England.

217 Details of any material contingent liability should be disclosed in the note on contingent liabilites.

Associates and joint ventures

218 FRS 9 *Associates and Joint Ventures* was published on 27 November 1997. It supersedes SSAP 1 *Accounting for Associated Companies*. It applies to accounting periods ending on or after 23 June 1998.

219 FRS 9 requires the use of the equity method of accounting for associates and the gross equity method of accounting for joint ventures. It prohibits proportional consolidation, which is currently adopted for some joint ventures, but proposes an accounting treatment for 'joint arrangements that are not entities' which is broadly similar to proportional consolidation. However, FRS 9 requires such arrangements to be accounted for at the individual entity level as well as on consolidation. Many collaborative activities will fall within the scope of FRS 9 and colleges may find it useful to consult their external auditors on accounting for proposed collaborative initiatives.

220 As a result of this new FRS there are changes to FRS 1 (Revised 1996) *Cashflow Statements* in respect of the treatment of dividends received from associates and joint ventures.

Use of college companies

221 In April 1999 the Council issued guidance on college companies and joint ventures in Circular 99/14 *College Companies, Joint Ventures and Overseas Operations*. Guidance is also available in *Related Companies: Recommended practice guidelines* by Robson Rhodes (March 1996), based on a study which was commissioned by the Higher Education Funding Council for England. Colleges are recommended to consult their external auditors before making a decision on whether to establish a subsidiary undertaking.

222 It is the responsibility of each college and its corporation to ensure that the activities of its subsidiary and associated undertakings and those of any joint venture to which it is a party are within the scope of its primary powers under the *Further and Higher Education Act 1992*. Colleges are recommended to confirm this by obtaining independent legal advice.

College Combinations

223 Colleges should seek to comply with FRS 6 *Acquisitions and Mergers* as far as possible. However, if acquisition accounting were used, a reorganisation would generate negative goodwill through one college acquiring the assets of another for no consideration. Strictly, the negative goodwill arising on an acquisition should be shown as a

negative asset and recognised in the income and expenditure account in the periods in which the non-monetary assets acquired are recovered, whether through depreciation or sale, in accordance with FRS 10.

224 Under FRS 6 reorganisations will meet the criteria for a merger when:

- neither college is portrayed as acquirer or acquired
- both colleges, as represented by the corporations, participate in establishing the management structure and management personnel of the combined college: those decisions should be made on the basis of consensus rather than purely by the exercise of voting rights
- the relative sizes of the two colleges are not so disparate that one college dominates the combined college by virtue of its size.

225 Practical experience in accounting for reorganisations resulted in a revision of the previous sector accounting guidance (revised in Circular 98/26). Mergers and acquisitions in the further education sector cannot be compared directly with commercial mergers and acquisitions which take place in the private sector. Following consultation with the major providers of external audit services and sector representative associations it has been agreed that merger accounting should be used in each case.

226 Where the reorganisation is to be accounted for as a merger, the income and expenditure and cashflows of both colleges should be brought into the financial statements of the combined college from the beginning of the financial year in which the merger occurred. The corresponding figures should be restated by including the results for both colleges for the previous period and their balance sheets for the previous balance sheet date.

227 Any adjustment necessary to achieve uniformity of accounting policies should be made. However, the carrying values of the assets and liabilities of both colleges are not required to be adjusted to fair value on consolidation.

228 The following disclosures should be made for the period in which the merger took place:

- the names of the colleges which have merged
- the date of the merger
- whether the ‘merger’ has been accounted for as an acquisition or a merger.

229 The combined college should also disclose the following information:

- an analysis of the current period’s income and expenditure account and statement of total recognised gains and losses into:
  - amounts relating to the merged college for the period after the date of the merger, and;
  - for each college, amounts relating to that college for the period up to the date of the merger
- an analysis between the merging colleges of the principal components of the income and expenditure account and a statement of total recognised gains and losses for the previous financial period
- the aggregate book value of the net assets of each merging college at the date of the merger
- the nature and amount of significant accounting adjustments made to the net assets of either college to achieve consistency of accounting policies, and an explanation of any other significant adjustments made to the net assets of either college as a consequence of the merger
- a statement of the adjustments to consolidated reserves resulting from the merger.

230 The analysis of the income and expenditure account required above should show, as a minimum:

- income
- operating surplus
- exceptional items split between continuing operations
- discontinued operations and acquisitions
- surpluses before taxation
- taxation
- extraordinary items.

231 Where a merger takes place after 31 July, but before the financial statements are published, the merger should be disclosed in the financial statements of both colleges as a significant

post-balance sheet event. The financial statements should be approved by the corporation in existence at the date of approval.

Corporate Governance

232 The Cadbury committee on the financial aspects of corporate governance recommended that directors make a statement in the annual report on an organisation's system of internal control. The Rutteman and Hampel committees supported the recommendation that directors should provide information about the system of internal financial control, but need not report on its effectiveness. *The Combined Code on Corporate Governance* (published 1998) covers the whole system of internal control, not just internal financial control.

233 HM Treasury provided guidance in a letter dated 28 November 1997 on the application of the Rutteman recommendations to central government. Since effective systems of internal financial control are essential to the management of public bodies, the suggested statement on the system of internal financial control retains references to the 'effectiveness' of this system.

234 In February 1999, HM Treasury confirmed that non-departmental public bodies such as the Council are required to make a statement on their systems of internal financial control in their financial statements for the year ended 31 March 1999. The Council, in turn, requires colleges to include a similar statement on their systems of internal financial control in their audited accounts for the financial year 1998-99. The statement is to be made and signed by the principal in his or her role as accounting officer.

235 Changes to the wording of the example statement included in supplement B to Circular 99/23should be kept to a minimum. However, the key areas described in paragraph 3 of that supplement are the minimum features to be expected in the system and accounting officers are encouraged to describe any additional features of the system of internal financial control which are relevant to the effectiveness of the system, such as improvements in control procedures or new accounting systems with additional control facilities. Accounting officers may also wish to mention any special reviews or similar work undertaken to verify or improve the system of internal financial control. Any such information should be given as an additional paragraph. It may also be appropriate to refer to such reviews in paragraph 5 of supplement B to Circular 99/23 which comments on the means by which the accounting officer satisfies himself or herself on the effectiveness of the system.

236 A corporate governance checklist is attached at annex B to this supplement as an aide for colleges to use in preparing their corporate governance statements. Each college will need to identify and document key risks, key controls and how these will be monitored.

237 The HM Treasury guidance indicates that appropriate internal controls would include:

- comprehensive budgeting systems with an annual budget which is reviewed and agreed by the corporation
- regular reviews by the corporation of periodic and annual financial reports which indicate financial performance against forecasts
- setting targets to measure financial and other performance
- clearly defined capital investment control guidelines
- the adoption of formal project management disciplines where appropriate.

238 The corporate governance disclosure requirements for 1999-2000 onwards are not yet known. Colleges should discuss the possible audit arrangements for future years with their external auditors since these will need to be reflected in engagement letters. College audit committees will have an important role to play in ensuring that colleges have in place the necessary controls and supporting evidence.

239 An illustrative statement on internal financial controls is included in the model financial statements in supplement B to Circular 99/23. Colleges are required to include a similarly worded statement in their financial statements for the year ending 31 July 1999.

240 The Nolan committee on standards in public life in its report on *Local Public Spending Bodies* has made a number of recommendations on information made available by colleges, including: individual universities and colleges should be encouraged to set out key information to a common standard in their annual reports or equivalent documents where

they do not already do so. Material on governance should be included in the annual reports or equivalents of further and higher education institutions.

241 The report suggests including items such as a list of members of the governing body, the corporate governance structure of the institution, policies on openness, a statement of objectives and performance against key indicators. The example members' report included in the model financial statements in supplement B to Circular 99/23 addresses these issues.

Planned Maintenance Programme

Example statement in members' report

1 *The cost of the college's planned maintenance programme over a period of five years is estimated to be £1,000,000, resulting in an average annual charge of £200,000. The programme was developed following a survey of the college's estate which was carried out during 1996-97. The programme is reviewed each year.*

The college plans to carry out the works which were outstanding at 31 July 1998, together with the works planned for the following two years, by 31 July 2000 and has set aside funds for this purpose.

Additional guidance

2 A backlog of works at 31 July 1998 would consist of the balance on the planned maintenance provision at 31 July 1997, plus the anticipated annual cost of the planned maintenance programme for the year ending 31 July 1998 (including the impact of any review or new survey), minus the actual cost of planned maintenance programme works carried out during 1997-98. An example of how to calculate whether there are outstanding works at 31 July 1998 and when the college will be in a position to address these is set out in table 1.

Table 1. Calculation of outstanding works relating to planned maintenance programme

Year	***97-98 1 £000***	***98-99 2 £000***	***99-2000 3 £000***	***2000-01 4 £000***	***01-02 5 £000***
Planned maintenance works outstanding at 1 August	70*	50	40	0	20
Average annual charge	200	200	200	200	200
Actual or planned expenditure	(220) †	(210)	(240)	(180)	(200)
Planned maintenance works outstanding at 31 July	50	40	0	20	20

* *this represents the balance on the planned maintenance provision at 31 July 1997*

† *this figure would be taken from the 1997-98 accounts*

Year 2000 Compliance: Illustrative Disclosure

An illustrative example of an appropriate disclosure relating to year 2000 compliance is set out below.

As is well known, many computer and digital storage systems express dates using only the last two digits of the year and will require modification or replacement to accommodate the year 2000 and beyond in order to avoid malfunctions and resulting widespread commercial disruption. This is a complex and pervasive issue. The operation of the college's business depends not only on its own computer systems but also, to some degree, on those of its suppliers and customers. This could expose the college to further risk in the event that there is a failure by other parties to remedy their own year 2000 issues.

[and]

[either]

[The corporation has not yet initiated a project to determine the potential risks to the college's activities arising from the date change to the year 2000. Until this analysis is prepared it is not possible to assess the likely impact on the college's business or develop action plans to deal with the key risks.]

[or]

[The corporation is well advanced in the phase of assessing the risks to the college's business resulting from the date change to the year 2000. Once this phase is completed the corporation can assess the likely impact on the college's activities and develop prioritised action plans to deal with the key risks.]

[or]

[A college-wide programme, designed to address the impact of the year 2000 on the business, has been commissioned by the corporation and is under way. Resources have been allocated and the corporation receives regular reports on progress.

A significant risk analysis has been performed to determine the impact of the issue on all the college's activities. From this, prioritised action plans have been developed which are designed to address the key risks in advance of critical dates and without disruption to the underlying business. Priority is given to those systems which could cause a significant financial or legal impact on the college's business if they were to fail. The plan also includes a requirement for the testing of systems changes, involving the participation of users.

The risk analysis also considers the impact on the college's business of year 2000 related failure by significant suppliers (including computer bureaux) and customers. In appropriate cases the corporation has initiated formal communication with these other parties.

Given the complexity of the problem, it is not possible for any organisation to guarantee that no year 2000 problems will remain, because at least some level of failure may still occur. However, the corporation believes that the college will achieve an acceptable state of readiness and has also provided resources to deal promptly with significant subsequent failures or issues that might arise].

[and]

Much of the cost of implementing the action plans will be subsumed into the recurring activities of the departments involved. The total cost of modifications to our computer hardware and software is estimated at £[ ], of which about [ ] % is new equipment which will be capitalised and the remainder will be expended as incurred. Of this total, expenditure of £[ ] has been incurred and the remaining £[ ] is expected to incurred during 1999-2000.

Reproduced in adapted form, with the permission of Ernst and Young, from *UK GAAP News* No. 9, March 1998.

Corporate Governance: Statement of Internal Financial Control – Checklist

Issue	*Evidence*	*Action Required*
A. Organisational framework		
A1. Roles and responsibilities		
A1.1 How are the Accounting Officer (and Board) responsibilities in respect of internal financial controls defined and implemented?		
A1.2 What mechanisms exist to link corporate and operational objectives with the levels of responsibility and authority delegated to individual staff?		
A1.3 How does the existing college structure support these allocations of responsibility and what procedures exist to ensure individual responsibilities are sufficiently segregated?		
A1.4 How are options for the achievement of objectives evaluated to deliver best value for money (VFM) (for example, activity to be performed in-house or outsourced)?		
A1.5 How are competencies defined and satisfied for key financial posts?		
A1.6 Have the systems of internal financial control been documented? How are they fully implemented across the whole college?		
A1.7 How is responsibility for the implementation and review of the various systems contributing to internal financial control defined?		
A2. Reviewing the effectiveness of systems		
A2.1 What action is undertaken to review the effectiveness of the overall system of internal financial control at regular intervals? What timetable has been adopted?		
A2.2 What process is there to monitor the performance of each element of the overall system of internal financial control and to facilitate the continuous improvement of control procedures?		
A2.3 What procedures are in place to document shortfalls and take corrective action?		
A2.4 What procedures are there to provide reasonable assurance on the reliability of financial information and effectiveness of internal financial controls to the Accounting Officer?		

Issue	***Evidence***	***Action Required***
A2.5 Are the internal financial control systems independently reviewed/verified? How is this achieved?		
A2.6 How is recognised best practice on internal financial control integrated?		
A2.7 How is the strategic and operational work of the internal audit team planned and controlled?		
A2.8 How is independence of audit opinion on the adequacy and effectiveness of the internal financial controls ensured?		
A2.9 Has an audit committee been established and what is its role?		
A3. Reaction to weakness in systems		
A3.1 What arrangements are in place to ensure effective compliance with regulations and other guidance on internal financial control?		
A3.2 How is it ensured that material errors or irregularities are prevented or detected within a timely period?		
A3.3 How does the culture of the college contribute to effective internal financial control?		
A4. Identifying and managing business risks		
A4.1 What effective systems of risk management have been established as part of the system of internal financial control?		
A4.2 How have the systems of internal financial control been developed in accordance withperceived risk?		
A4.3 Is there an established anti-fraud strategy?		
B. Accountability		
B1. Internal financial control environment		
B1.1 What framework of control (for example, delegation limits) exists?		
B1.2 What arrangements exist to ensure all assets are properly safeguarded and controlled (that is, against unauthorised use or disposals)?		
B1.3 What controls are in place to ensure that all resources are used effectively, efficiently and economically? How is VFM measured and achieved?		
B1.4 Are there adequate procedures for disseminating guidance and instructions? What mechanisms are in place to measure whether they have been communicated effectively and adequate support training given?		
B1.5 How responsive is the college to changes in circumstances which have an impact on the system of internal financial control?		

Issue	Evidence	Action Required
C. Comprehensive budget systems		
C1. Planning		
C1.1 What strategic and operational business planning activities take place (for example, setting budgets in accordance with key objectives and targets)?		
C1.2 What internal procedures exist to review and agree budgets?		
C1.3 How are budgets delegated within the college?		
C1.4 How are the agreed budget plans documented and disseminated?		
C2. Monitoring processes: existence and effectiveness		
C2.1 How is financial and other related performance measured?		
C2.2 What types of internal financial report are prepared (for example, forecast out-turn, actuals *v* budget) and how frequently are they issued?		
C2.3 What use is made of these reports?		
C2.4 How is the need for, and benefit of, particular report formats reviewed?		
D. Capital investment		
D1. Planning		
D1.1 What processes are in place to evaluate the need for, and benefits of, any potential capital projects?		
D1.2 What processes are in place to assist with deciding between conventional capital procurement and using private finance initiative (PFI) solutions?		
D1.3 What mechanisms are used to prepare, and then disseminate, capital maintenance plans?		
D1.4 What formal project management disciplines exist?		
D2. Monitoring processes: existence and effectiveness		
D2.1 How are capital investment projects controlled and monitored during currency of contract?		
D2.2 What procedures are there for reviewing capital investments made, and assessing value obtained once the contract has been delivered?		

Issue	***Evidence***	***Action Required***
E. Reliability of financial information produced		
E1. Accounting records		
E1.1 What procedures exist for ensuring proper and accurate accounting records are generated and retained in accordance with relevant accounting rules (for example, original invoice through to entry in ledger)?		
E1.2 What systems are in place to ensure entries into the accounting records are properly authorised?		
E2. Internal reporting		
E2.1 How does the college ensure that information produced is sufficient, relevant and reliable?		
E2.2 What controls exist to ensure the security and accuracy of both systems and data?		
E3. External reporting		
E3.1 How does the college ensure that the information produced complies with any reporting requirements?		
E3.2 How does the college ensure that the information produced is sufficient, relevant and reliable for all potential users?		
E3.3 What mechanisms are there to ensure all published information is timely, objective, balanced and understandable?		
F. Standards of behaviour		
F1. Leadership		
F1.1 How is internal financial control consciousness communicated and encouraged?		
F1.2 What steps have been taken to ensure that managers exercise leadership with competence and integrity?		
F2. Regularity and propriety		
F2.1 Has a formal code of conduct defining the standards of public behaviour to which all staff are expected to subscribe been documented and disseminated throughout the college?		
F2.2 What processes exist to ensure propriety and regularity are maintained?		
F2.3 What mechanisms are there to ensure staff are not influenced by prejudice, bias or conflicts of interest, including the influence of gifts and hospitality?		
F2.4 How do staff appraisal and development training (for example, Investors in People) schemes contribute to maintaining appropriate standards of behaviour?		

Return of Audited Financial Statements and Finance Record for the Year Ended 31 July 1999

THE FURTHER EDUCATION FUNDING COUNCIL

Cheylesmore House
Quinton Road
Coventry CV1 2WT

Telephone 01203 863000
Fax 01203 863100

(Reference Circular 99/23)

This cover sheet must be completed by all colleges. Please photocopy, complete and return to the regional director at the appropriate regional office by 31 December 1999.

Name of college (*please print*)

FEFC code

Contact for queries

Telephone no.

Returns enclosed (*please tick*)

1 Two signed copies of the college's audited financial statements for 1998-99 ❑

2 Two signed paper copies of the college's finance record for 1998-99 ❑

3 One copy of the finance record on disk ❑

4 One copy of each of the college's subsidiary undertaking's audited financial statements for 1998-99. These have/have not* been signed ❑

**delete as appropriate*

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