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Accounts Direction to Higher Education Institutions for 2014-15

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This circular provides information on the HEFCW's requirements for the format of Welsh higher education institutions' audited financial statements.

If you require this document in an alternative accessible format, please telephone us on (029) 2068 2225 or email info@hefcw.ac.uk.

Introduction

1. The purpose of this circular is to inform institutions of the HEFCW's requirements for the format of their audited financial statements for the year 2014-15.

Background

2. In October 2007, the Accounting Standards Board approved a revised version of *'Statement of Recommended Practice: Accounting for Further and Higher Education'* (SORP), which was both sponsored and published by Universities UK. The SORP provides the essential framework for the presentation and content of institutions' financial statements.

Accounts Direction for 2014-15

3. Higher education institutions (HEIs) are required to follow the 'Statement of Recommended Practice: Accounting for Further and Higher Education' 2007 (the SORP) when preparing their financial statements. A copy of the SORP (2007) is available from the Universities UK website at www.universitiesuk.ac.uk/highereducation/Documents/2007/SORP.pdf. In the case of an institution which is also a company limited by guarantee, this direction is subject to the requirements of the Companies Act. The financial statements shall be signed by the designated officer and by the chair or one other member of the governing body appointed by that body. Institutions should note the guidance provided by the Financial Reporting Group (FRG) of the British Universities' Finance Directors' Group (BUFDG) in its May 2015 newsletter with regard to the reporting of Research and Development Expenditure Credit (RDEC) claims in order to conform with the HE 2007 SORP.

4. Institutions should note that the formats of the primary accounting statements (income and expenditure account, statement of historical cost surpluses and deficits, statement of total recognised gains and losses, balance sheet, cash flow statement and reconciliation of net cash flow to movement in net funds) included in Appendix 2 of the SORP must be followed. The British Universities' Finance Directors' Group (BUFDG)'s latest model financial statements (a spreadsheet entitled FRG MFS May 2010.xlsx held at www.bufdg.ac.uk/Resources/Documents), should also be referred to as guidance, but not as a pro-forma for the format of an institution's financial statements.

5. The notes to the accounts should contain analyses of income and expenditure and balance sheet items consistent with recognised good accounting practice and should be sufficiently detailed to enable users to obtain a clear understanding of how the institution is performing financially.

In addition to the requirements of the SORP, HEFCW requires that institutions' audited financial statements be prepared in accordance with all current and relevant Financial Reporting Standards (excluding early adoption of FRS 102), Statements of Standard Accounting Practice and Urgent Issue Task Force Abstracts issued or adopted by the Accounting Standards Board. The financial statements should further comply with any relevant requirements of the Charities Act 2011 in so far as it relates to an institution.

6. HEIs should also:

- Ensure that the contracts for external audit make provision for an opinion on whether the institution has applied income, where appropriate, in accordance with the Financial Memorandum, and whether Funding Council grants have been used for the purposes for which they were received. Guidance on wording is available in paragraph 89 of the Audit Code of Practice.

- Provide detailed analysis and disclosure within the financial statements of audit and other fees paid to external auditors, in accordance with Statutory Instrument SI 2008 No 489 - *The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008*. This came into force for financial statements for financial years commencing 6 April 2008 and is required for those HEIs to which company law applies from financial year 2008-09 onwards. The Statutory Instrument can be viewed at the *Office of Public Sector Information website* (www.legislation.gov.uk).

Going concern and liquidity risk

7. The members of the governing body must confirm in the annual report that the financial statements are prepared on a going concern basis. They must also confirm that they have carried out a robust assessment of the principal risks and material uncertainties facing the institution, including those that would threaten its business model, future performance, solvency or liquidity. The report must describe those risks and explain how they are being managed or mitigated.

Sustainability reporting

8. The Financial Sustainability Strategy Group (FSSG) established a pilot scheme for sustainability reporting in 2013. A number of institutions voluntarily submitted their Annual Sustainability Assurance Reports (ASSUR) for 2012-13, and the overall response to the pilot scheme led to a number of modifications to the report, and the pilot scheme was run again for 2013-14. An evaluation of the results has taken place and the FSSG is currently in further dialogue with the CUC and with BUFDG, particularly with respect to the ASSUR process itself and the definition of earnings

before interest, taxes, depreciation and amortization (EBITDA). Institutions are encouraged to submit ASSUR reports for the 2014-15 year, on the basis of the most up to date, agreed format for the ASSUR statement at that time.

Corporate governance and internal control

9. The Committee of University Chairs' (CUC's) 'Higher Education Code of Governance' published in December 2014 (www.universitychairs.ac.uk/wp-content/uploads/2015/02/Code-Final.pdf) recommends that HEIs include in their annual audited financial statements a statement which sets out the institution's governance arrangements and which confirms that they have had regard to the CUC Code in adopting those arrangements. Where an HEI's practices are not consistent with particular provisions of the Code, an explanation should be published in the governance statement. Institutions are reminded that adoption of the CUC HE Code (with the principles of the Code adapted as appropriate to each institution's character) is an important factor in enabling HEFCW to rely on self-regulation within HEIs and hence reduce the accountability burden.

10. In relation to corporate governance, risk management and systems of control:

    a. Institutions are required to ensure that they maintain a sound system of internal control and that *the following key principles of effective risk management have* been applied.

       Effective risk management:

       - covers all risks - governance, management, quality, reputational and financial. However, it is focused on the most important key risks.
       - produces a balanced portfolio of risk exposure.
       - is based on a clearly articulated policy and approach.
       - requires regular monitoring and review, giving rise to action where appropriate.
       - needs to be managed by an identified individual and involve the demonstrable commitment of governors, academics and officers
       - is integrated into normal business processes and aligned to the strategic objectives of the organisation.

    b. Institutions are required to review at least annually the effectiveness of their system of internal control.

    c. Institutions are required to include in their annual accounts a statement on internal control (corporate governance). In formulating disclosure statements it is recommended that institutions refer to good practice guidance, including any relevant guidance from BUFDG. As a minimum these disclosures should include an account of how the following broad principles of corporate governance have been applied (see also Annex C):

- The identification and management of risk should be an ongoing process linked to the achievement of institutional objectives.
- The approach to internal control should be risk-based, including an evaluation of the likelihood and impact of risks becoming a reality.
- Review procedures must cover business, operational and compliance as well as financial risk.
- Risk assessment and internal control should be embedded in ongoing operations.
- The governing body or relevant committee should receive regular reports during the year on internal control and risk.
- The principal results of risk identification, evaluation and management review of its effectiveness should be reported to, and reviewed by, the governing body.
- The governing body acknowledges that it is responsible for ensuring that a sound system of control is maintained, that it has reviewed the effectiveness of the above process.
- Where appropriate, set out details of actions taken or proposed, to deal with significant internal control issues.

d. Institutions should include in their financial statements a statement covering the responsibilities of their governing body in relation to corporate governance. The statement is required to indicate how the institution has complied with current good practice in this area. Guidance on how institutions can comply with this requirement is available in *the CUC Higher Education Code of Governance(see paragraph 9 above).*It is recognised that the guidance may need to be adapted to more accurately reflect the different internal structures and systems in place in each individual institution.

e. All institutions are required to make a full disclosure statement on corporate governance covering the period 1 August to 31 July each financial year and up to the date of approval of the annual accounts.

f. External auditors might consider whether to report by exception in the opinion section of their audit report. This might be appropriate if, for example, the auditors had grounds for believing the statement did not reflect their understanding of the process undertaken. In most circumstances the reporting by exception would result in an ‘other matter’ paragraph and would not qualify the audit opinion.

g. However, in other circumstances it could qualify the opinion, since by not complying with the Accounts Direction the institution would be in breach of the Financial Memorandum (see ‘Revised Financial Memorandum and Audit Code of Practice’, HEFCW circular W08/36HE). This could be the case if, for example, no statement on corporate governance was included. Furthermore, a qualification could be made if weaknesses in the internal control and risk management arrangements were such that the auditor was unable to provide a view on the truth and fairness of the financial statements.

Remuneration of higher-paid staff

11. Institutions are urged to pay particular attention to the disclosure requirements for higher paid staff as detailed below, particularly in respect of the definition of ‘remuneration’ and the analysis of salary, benefits in kind and employer’s pension contributions.

12. HEIs are required to disclose the following:

    - The actual total remuneration of the head of institution including bonuses. Further details are given at Annex A.

    - The remuneration of higher paid staff in bands of £10,000 from a starting point of £100,000. Further details are given at Annex A.

    - Details of any compensation paid or payable to the head of institution and to staff whose annual remuneration exceeds £100,000 in accordance with Annex B.

13. The date for submission of institutions’ 2014-15 financial statements is 31 December 2015, with earlier submissions welcome from those able to provide them.

Charities Act 2011

14. Institutions are advised that under the Charities Act 2011 the following information should be included in their audited financial statements and related reports:

    a. The charitable status of the HEI.

    b. The trustees who served at any time during the financial year and until the date the financial statements were formally approved.

    c. A statement that the charity has had regard to the Charity Commission's guidance on public benefit.

    d. A report on how the HEI has delivered its charitable purposes for the public benefit.

    e. Information about payments to or on behalf of trustees, including expenses; payments to trustees for serving as trustees (and waivers of such payments); related party transactions involving trustees.

15. The Accounts Direction is reviewed annually. This Accounts Direction will remain in force unless institutions are notified otherwise. We recommend placing a copy of this circular and its annexes before your Finance and Audit Committees for information.

16. For further information, contact either Neil Hempstead or Bethan Owen. www.hefcw.ac.uk/about_us/staff_directory/staff_dir_con_details.aspx.

Annex A

Remuneration of heads of institutions and higher paid staff

Disclosure requirements:

1. A higher paid employee is defined as the head of institution and any employee whose total remuneration during the accounting period under review exceeds £100,000.

2. Institutions are required to disclose the following in their audited financial statements:

    a) The total remuneration of the head of institution disclosing separately:
    - salary
    - performance-related and other bonuses awarded for the financial year, including any deferred payment arrangements and separate disclosure of amounts waived
    - any sums by way of expenses allowances (in so far as those sums are charged to UK income tax)
    - the estimated money value of any other taxable benefits received by the head of institution, other than in cash (in particular company cars, subsidised loans including mortgage subsidies, and subsidised accommodation)
    - contributions for relocation costs
    - any sums paid in respect of the head of institution under any pension scheme.

    The HEI must show a sub-total excluding pension contributions and a total including them. Salary sacrifice arrangements should be described.

    Where there is a change of head of institution (including an acting head of institution) either between years or during a year, details are to be shown separately for each person, and relevant start and finish dates given.

    b) The remuneration bands of higher paid employees (including the head of institution), giving the number of such employees that fall into each band. The width of each remuneration band should be £10,000 from a starting point of £100,000. Disclosure in the banding is not required for those staff who joined or left part way through a year but who would have received remuneration in the disclosure bands in a full year.

    c) The aggregate amount of any compensation paid to any head of institution and higher paid employee for loss of office (see Annex B) and the number of employees who have been paid such compensation.

3. ‘Remuneration’ means remuneration paid to or receivable by any person for:

- Services to the institution.

- Services as a director or officer of any subsidiary of the institution.

4. For this purpose, ‘remuneration’ paid to or receivable by an employee includes their normal salary, and:

   a) Fees. External payments should be included within the remuneration disclosed. Payments received from the NHS will normally be in connection with the management of the affairs of the university or college and should therefore be included as an external payment. There may, however, be cases where royalties or other payments are received which are regarded as outside the affairs of the institution.

   b) Bonuses (but not details of bonuses earned).

   c) Any expense allowance (to the extent that they are chargeable to UK income tax).

   d) The estimated money value of any benefits received other than in cash (in particular share options, company cars, subsidised loans [including mortgage subsidies] and subsidised accommodation). Best commercial practice is to interpret the money value of benefits in kind by reference to the market value of the facility provided. Where it is not practicable to use market values, taxable values should be used.

   e) Guidance on the treatment of cars and subsidised accommodation is as follows:

<u>Cars</u>

5. Where an HEI provides a leased car the market value could be calculated with reference to the lease payments and additional running costs borne by the HEI. If the HEI purchases a car for (say) the head of institution then the sum disclosed could be calculated by reference to annual running costs including depreciation and associated interest costs. This may involve distinguishing between private and business mileage and require the head of institution to keep a record of private and institutional mileage.

Subsidised accommodation

6. Where the HEI owns the property, the benefit derived by the head of institution is the difference between the rent paid (if any) and additional running costs borne by the institution and the estimated market rent for that property which the HEI would receive if it were to lease the premises on a commercial basis. If the HEI leases the property, the benefit could be assessed as the difference between the rent and other expenses paid by the HEI and that paid by the head of institution. Private and institutional use of the accommodation will need to be apportioned on a fair and consistent basis, and the head of institution should keep a record of institutional use to help with the calculation of a fair apportionment.

   For the avoidance of doubt, employers' National Insurance contributions are excluded from remuneration.

7. Compensation for loss of office is a category of payment different from 'remuneration'. Consequently, it should not be included in that person's remuneration for banding purposes.

8. If more than one person has been head of institution during the year, each such person's total remuneration for the year must be attributed to that part of the year during which they were head of institution, and these amounts must be disclosed separately.

Annex B

Compensation for loss of office

Disclosure requirements:

1. The disclosure requirements are detailed below and relate to heads of institution or any higher paid employee whose remuneration exceeded £100,000 in the reporting year and/or in the year immediately preceding the reporting year.

2. Institutions shall show the aggregate amount of any compensation paid or payable to the head of institution or higher paid employee in respect of loss of office.

3. This amount disclosed must also include and distinguish between compensation paid or payable for loss of:

   - Any other office in connection with the management of the institution’s affairs.

   - Any office in connection with the management of the affairs of a subsidiary undertaking or any other office of the institution.

4. Compensation disclosed shall include the estimated monetary value of any non-cash benefits paid or payable and the disclosure will also describe the nature of such compensation.

5. References to compensation for loss of office include compensation paid or payable in consideration for, or in connection with the retirement from office of a head of institution or employee whose remuneration exceeded £100,000 in the year.

Annex C

Significant internal control issues

This annex is derived from guidance produced by the Auditing Practices Board (now the Audit and Assurance Council of the Financial Reporting Council).

1. Where appropriate the governing body should set out in the statement of internal control details of actions taken or proposed to deal with significant internal control issues. This is to deliver assurance that significant internal control issues are being addressed.

2. Although it is not possible to provide a definition to suit all contexts, because the significance may change depending upon the circumstances, the following indicators of a significant internal control issue should be considered:

    a) Does it seriously prejudice or prevent achievement of a principal objective of the institution?

    b) Does it result in the need to seek additional funding to enable it to be resolved, or in a significant diversion of resources from other parts of the institution?

    c) Does it lead to a material impact on the financial statements?

    d) Does the audit committee advise that it is significant in this context?

    e) Does the head of internal audit report on it as significant for this purpose in his (her) annual opinion?

    f) Does the issue or its impact attract significant public interest, or has it seriously damaged the reputation of the institution?