Guidance to the Preparation of the Notes to the Financial Statements

Contents

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 a report and financial statements for each financial year, which should give a true and fair view of its state of affairs at the balance sheet date, also of its results and cash flows for the period. The report and financial statements should encompass:

a a members’ report, which must include, as a minimum, the following:

- disability statement;
- college’s planned maintenance programme;
- list of the governors who served on the board during the year;
- statement of the responsibilities of the corporation members;
- statement on the system of internal financial control;
- corporate governance statement;

b income and expenditure (I&E) account;

c statement of total recognised gains and losses (STRGL);

d statement of historical cost surpluses and deficits;

e balance sheet;

f cash flow statement;

g statement of accounting policies;

h notes to the financial statements; and

i financial statements auditor's report.

3 In accordance with FRS 2 *Accounting for Subsidiary Undertakings*, where the college has subsidiaries, it should normally prepare consolidated financial statements.

4 The financial statements should normally 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 I&E account or balance sheet;
- indicate any particular circumstances that affect items included in the I&E account;
- provide details of any other matters relevant to an assessment of the college's state of affairs;
- supplement the information given in respect of particular items appearing in the cash flow statement.

6 The notes to the financial statements should indicate the accounting policies that have been adopted and state whether the financial statements have been drawn up in accordance with the requirements of the Learning and Skills Council (LSC) and *Statement of Recommended Practice: Accounting for Further and Higher Education* (the F&HE SORP). In particular, the accounting policies adopted in relation to the following items should be disclosed:

- recognition of income;
- pension schemes;
- 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;
- foreign currency transactions;
- taxation;
- 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 I&E account;
- explanation of any exceptional items;
- employee numbers and costs;
- emoluments of the college's senior postholders and members;*
- details of pay awards to the principal, senior postholders and other staff;
- compensation for loss of office paid to senior postholders;
- costs in respect of overseas activities by members, senior postholders and other higher-paid staff;
- taxation;
- details of tangible fixed assets and depreciation;
- details of fixed asset investments;
- details of endowment assets;
- stocks;
- details of cash in bank held for future fixed-asset investments;
- analysis of debtors and creditors;
- details of all provisions for liabilities and charges;**

- details of deferred grants;
- financial commitments and contingencies;***
- details of pension schemes, including FRS 17 *Retirement Benefits* disclosures;
- details of post-balance sheet events;
- details of the notes to the cash flow statement;
- details of subsidiaries consolidated into the accounts;
- the name of any subsidiary excluded from the consolidation and the 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;
- details of related party transactions;
- an analysis of the grant and subsequent reimbursement of access funds.

*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 other 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 Skills. Members may receive reimbursement for reasonable expenses.

**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'.

***A contingency is a condition that 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.)

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.

9 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;
- details of pay awards; and
- overseas activities.

Accounting Standards

10 In discharging their obligation to prepare financial statements showing a true and fair view, colleges are required to follow the F&HE SORP which provides guidance on the standards laid down in Statements of Standard Accounting Practice (SSAP), Financial Reporting Standards (FRSs) and Urgent Issues Task Force (UITF) Abstracts. Colleges should agree the appropriateness of the accounting policies adopted with their financial statements auditors. The financial statements should contain a statement as to whether they have been prepared in accordance with the F&HE SORP. Financial statements that depart from the F&HE SORP without adequate explanation or justification may not be considered to be true and fair.

11 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.

Substance over Form

12 Under FRS 5 *Reporting the Substance of Transactions*, a college should report the substance of transactions into 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:

- 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 financial statements auditor.

13 In September 1998, the Accounting Standards Board (ASB) published an amendment to FRS 5 in the form of an application note on transactions subject to the PFI. It sets out guidance on which of the parties to a PFI transaction should record the relevant asset(s) on its balance sheet. Colleges that have entered into PFI transactions, or that intend to do so, will need to comply with this amendment to FRS 5. Colleges may wish to consult their financial statements auditor on this matter.

Financial Reporting Standard for Smaller Entities (FRSSE)

14 The Financial Reporting Standard for Smaller Entities (FRSSE) was revised in December 2001 and became effective from June 2002. Regardless of whether they fall within the scope of the FRSSE due to their size, colleges are required to apply SSAPs, FRSs and UITF Abstracts when preparing their financial statements.

15 Where a college has a subsidiary undertaking (college company) that 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 Supplement C to this circular;

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.*

I&E Account

16 The notes to colleges' financial statements should provide further information about each of the income and expenditure figures shown on the face of the I&E account. Illustrative examples are provided in Supplement C to this circular. Detailed guidance on key disclosures is set out below.

Note 2: Funding Council Grant Income

17 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.

18 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 financial statements auditor's opinion.

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

Adjustments to recurrent funding

20 In some cases, following receipt by the LSC of an audited learner record claim, a college's recurrent funding for prior years may be adjusted in excess of the estimates included in their audited financial statements. Such further adjustment will be included in LSC grants on the face of the I&E account and be separately disclosed in the notes to the accounts where LSC grants are further itemised.

21 Such late adjustments will not be significant or fundamental enough to justify a prior year adjustment in the financial statements.

22 Where an accrual is made for claw-back of recurrent funding, this should be included in 'creditors: amounts falling due within one year' and not in provisions.

Note 8: Senior Postholders’ Emoluments

23 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 £10,000), 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.

24 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.

25 ‘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.

26 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.

27 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.

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

29 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.

30 The disclosure of the principal's and other senior postholders' emoluments set out in note 8 to the model financial statements has been amended to show the analysis between:

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

31 The figures are 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

32 The total number of higher paid staff, including senior postholders, in bands of £10,000 (above a threshold of total emoluments of £50,000), should be disclosed in the interests of public accountability in the staff costs note (the equivalent of note 7 to the model financial statements in Supplement C to this circular). The number of senior postholders within each band should be separately identified within the note.

Pay awards

33 Following guidance from the Department for Education and Skills (DfES), colleges are required to disclose in their financial statements 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 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 principal;
- other senior postholders;
- other higher paid staff as detailed in paragraph 32.

Severance payments

34 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

35 In certain cases, it is deemed justifiable to compensate governors for the costs of childcare and loss of earnings. The governing body will need to consider each case for an exceptional payment on its merits and be satisfied that there is no remunerative element to it. Colleges are required to

disclose full details of any such payments made to governors in their financial statements.

Cost Relating to Overseas Activities

36 College staff and corporation members might travel abroad as part of their duties. As set out in Further Education Funding Council (FEFC) Circular 99/14 *College Companies, Joint Ventures and Overseas Operations,* colleges wishing to undertake overseas activities should have in place a strategy which has been specifically approved, and reviewed at least annually, by the governing body. In addition, colleges should have a clear policy and framework for the approval of all costs relating to overseas activities, including hospitality costs. Therefore, the LSC requires colleges to disclose in their financial statements details of the costs incurred relating to overseas activities.

37 The total costs associated with staff and governors travelling abroad on college business will be disclosed separately for the following:

- members of the corporation;
- senior postholders;* and
- other higher paid staff as defined in paragraph 32.

(*Senior postholders' means the principal and holders of the other senior posts, whom the board has selected for the purposes of the articles of government of the college relating to the appointment and promotion of staff.)

38 The disclosure should be included in the notes on senior postholders' emoluments and staff costs as appropriate. An example disclosure is shown in Supplement C to this circular. 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 will be disclosed. If a college wishes to disclose brief additional information about overseas activities, it may do so in consultation with its financial statements auditors. Comparative figures are not required.

Exceptional Items

39 Exceptional items are material items which derive from events or transactions falling 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.

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

41 The following items, including provisions in respect of such items, should be shown separately on the face of the I&E 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.

42 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 financial statements auditors. An example of such an incidence has been included in the model financial statements in Supplement C to this circular.

Exceptional Support Funding

43 Some colleges may receive exceptional support funding from the LSC in order to assist them in either implementing a college combination, or the delivery of a strategic recovery plan. This funding is provided as a grant, outside the mechanisms of the funding methodology. As with any grant, the accounting treatment should be determined in the light of any terms and conditions agreed between the LSC and the college.

44 In most cases (unless the terms and conditions indicate otherwise), exceptional support funding should be recognised as income in the college financial year in which it is received and disclosed separately in note 2

Funding Council Grants to the financial statements. If the amount is material to a college's financial statements, then it should be shown separately instead on the face of the I&E account in accordance with FRS 3 *Reporting Financial Performance*. Colleges will need to discuss the disclosure of such grants with their financial statements auditors.

45 Exceptional support funding should not be confused with advances of funding from the LSC, which should be treated as a creditor in the balance sheet under 'payments received on account'. (Advances of funding will only be made by the LSC where the college is in financial difficulties and has exhausted all possible means of raising finance.)

Accounting for Fixed Assets

46 Land and buildings inherited on incorporation should be capitalised and 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.

47 A number of colleges (principally voluntary-aided sixth form colleges) occupy premises which are owned by other bodies and for whose 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.

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

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

49 Given the range of colleges in the sector, it would be inappropriate for the LSC 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 financial statements 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

50 FRS 15 *Tangible Fixed Assets* addresses the initial measurement, valuation and depreciation of tangible fixed assets (with the exception of investment properties). Its main objective is to ensure that consistent principles are applied by organisations.

Initial measurement

51 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.

52 If a college wishes to capitalise any labour costs of its own employees, it should consult its financial statements auditor.

53 The initial carrying amount of tangible fixed assets received as gifts or donations should be the current value at the date which 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 which 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.

54 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 necessary to make 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.

55 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 FRS 11 *Impairment of Fixed Assets and Goodwill*).

56 Subsequent expenditure to ensure that the tangible fixed asset maintains its previously assessed standard of performance should be recognised in the I&E 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;
- a component that is treated separately for depreciation purposes is replaced or restored;
- economic benefits that have previously been reflected in depreciation are restored.

Valuation

57 Specific guidance on the accounting policy for valuations is provided at paragraphs 21 to 24 of Supplement A of this circular.

58 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) account	**Income and expenditure (I&E)**
Gain reversing a loss previously recognised in I&E account		Gain less depreciation 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

Depreciation

59 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 I&E account. 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

60 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

61 FRS 11 *Impairment of Fixed Assets and Goodwill* 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.

62 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 that could be obtained from selling the fixed asset (net realisable value), or using the fixed asset (value in use).

63 If it is not possible to test a single fixed asset for impairment because the cash flows 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 – IGU), which produces a largely independent income stream. FRS 11 provides guidance on identifying IGUs. In the context of the further education (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; and
- an asset(s) held for disposal.

64 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, or a significant change in the statutory or other regulatory environment in which the business operates;
- e any 'indicator of value' (for example, turnover) used to measure the fair value of a fixed asset on acquisition;
- f a commitment by management to undertake a significant reorganisation;
- g a major loss of key employees; and
- h a significant increase in market interest rates or other market rates of return that is likely to affect materially the fixed asset's recoverable amount.

65 Examples (c), (d), (e), (f) and (g) above appear to be 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.

66 Other examples of impairment indicators specific to the sector would include a significant under-performance against a college's funding agreement with the LSC (or another major funding source) and a withdrawal from certain areas of provision.

67 Such indicators can exist without having an adverse impact on the measurement of fixed assets. However, if impairment is identified, FRS 11

states that it is appropriate to review the useful economic lives and residual values of the relevant fixed assets, as these may have been affected.

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

69 FRS 11 requires an impairment loss to be recognised in the I&E account unless it arises on a previously revalued asset. An impairment loss on a revalued fixed asset should be fully recognised in the I&E account if it is due to a ‘clear consumption of economic benefits’. Otherwise, the impairment should be recognised in the STRGL until the carrying amount falls to the amount of the asset’s depreciated historical cost, and thereafter in the I&E account.

70 Where 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 will be recognised.

Disposal of Fixed Assets

71 The profit or loss on disposal of a tangible fixed asset will be accounted for in the I&E account of the period when the disposal occurs. It is 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 assets should be shown in accordance with FRS 3.

72 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:

a inherited by colleges on incorporation;

b financed by exchequer funds; and

c financed from colleges’ own resources.

Financial memorandum

73 The LSC requires the board to obtain its consent for land and buildings transactions where the total cost exceeds £1 million or 5% of the college's annual revenue, whichever is the lesser amount. 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 LSC intends to respond promptly to requests for consent under this paragraph.

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

75 The LSC 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.

76 Exchequer funds include any grants from the LSC and other government bodies. They do not include funds from local education authorities (LEAs): 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 LSC support provided under the terms of FEFC Circular 96/11 and Circular 95/25.

77 In giving consent to any disposal, the LSC will consider the potential effect on adequacy and sufficiency of provision. Where there is a potential risk to provision, conditions are likely to be attached to the consent to the disposal. The LSC 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

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

Accounting treatment for financial statements on or after 1 August 2002

79 Colleges must disclose, by way of a note, the amount of disposal proceeds that they hold and for what purpose (almost without exception, this will be for reinvestment in land and buildings). The note should form an extension to the existing note on changes in net funds, and might be worded as follows:

> *£1.5 million of the funds in current asset investments is derived from the sale of the Westwick site and is held [in a separate ring-fenced bank account]* for reinvestment in the main site.*
>
> (*where applicable)

80 If the planned reinvestment of proceeds is part of a complex funding package including, for example, loan finance, future disposal proceeds, etc, it is recommended that the above disclosure is expanded as necessary in order to ensure that users of the financial statements have a clear view of the underlying funds of the institution.

Accounting for Grants

81 Any grants received from public funds (for example, from the LSC or Higher Education Funding Council (HEFCE)) 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 I&E 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.

82 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.

Arrangements for capital support for major works up to March 1999

83 Up to March 1999, colleges could apply to the LSC for financial support towards capital projects costing more than £100,000. If a college's application was 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 LSC. From the second year onwards, 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 LSC does not have the power to guarantee future funding streams to colleges and it cannot guarantee that this funding, nor any other funding from the LSC, 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 LSC support.

84 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.

85 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 I&E 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 I&E account on a straight-line basis over the life of the asset. It would be prudent to reassess the anticipated total receipt each year.

86 Where the grant is used to contribute to lease payments it should be released to the I&E account, in the appropriate proportions, over the lease period. Lease payments should be allocated between capital and finance charges in accordance with SSAP 21 *Accounting for Leases and Hire Purchase Contracts*.

Arrangements for capital support for major works from April 1999

87 Since April 1999 there have been new arrangements under which colleges could apply for LSC support towards capital projects costing more than £100,000. The amount of support available is 35% of eligible project costs, which is usually payable over three years following practical completion.

88 The LSC support should be treated by colleges as capital grant and the rules of SSAP 4 would apply.

89 It would be appropriate for colleges to set up debtor accounts depending upon the completeness of the project. For example, if a college's capital project is 50% complete then 50% of the grant would be accounted for as a debtor, if no capital grant had been paid by the LSC.

90 Capital grant consent letters to colleges should be checked by financial statements auditors for compliance with the financial memorandum.

One-off grant

91 LSC 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 I&E account over the life of the asset.

Significant Donations Used for Capital Purposes

92 A number of colleges have been successful in gaining donations from charitable and commercial bodies, for example through Gift Aid or lottery funding. 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 I&E account.

Accounting for Leases

93 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, which are given in the guidance notes to SSAP 21 *Accounting for Leases and Hire Purchase Contracts.*

94 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.

95 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.

96 Under SSAP 21, the accounting treatment adopted for a lease will depend on whether it 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.

97 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.

Leasehold Property

98 Institutions should disclose the length of any leases that they hold for leasehold property included in fixed assets.

Milk Quotas

99 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 LEA. In practice, therefore, this may have little impact on a college's accounts, other than disclosing that the college has an asset.

Current Assets

100 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 C of this circular. Detailed guidance on key disclosures is set out below.

Stocks

101 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' 1996 accounting recommendation, *Accounting for Goods Sold Subject to Reservation of Title*, should be followed.

Long-term Debtors

102 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

103 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

104 Colleges are required to make investments in accordance with the Trustee Investment Act 1961 (TIA 1961). Under the TIA 1961, 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).

105 Under sections 70 and 71 of the Charities Act 1993, the secretary of state was empowered to regulate in order 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.

Trustee Act 2000

106 Under section 19(4)(d) of the Further and Higher Education Act 1992, colleges have the power to invest any sums of money not immediately required for carrying out their activities.

107 Colleges have been advised that in making investments they were subject to the provisions of the Trustee Investments Act 1961.

108 The Trustee Act 2000 has amended the Trustee Investments Act 1961 and the amendments will apply to colleges who obtained powers to make investments after 1961.

109 The amendments include a new general power of investment, permitting any kind of investment (excluding land) which trustees would be allowed to make if they were the absolute owners of those funds. Power to invest in land is effectively given in a separate section.

110 In making investments, colleges should have regard to the financial memorandum between the LSC and colleges and any other terms and conditions attached to specific grants.

Liabilities

111 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 C of this circular.

Provisions

112 Under FRS 12 *Provisions, Contingent Liabilities and Contingent Assets*, 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'.

113 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.

114 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.

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

116 A restructuring provision should be made only where there is a legal or constructive obligation. A constructive obligation is present only when a college has drawn up a detailed formal plan and has announced, or begun 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.

117 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.

118 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.

119 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 had arisen independently of a restructuring.

Disclosure

120 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.

121 Comparative information is not required.

122 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, in order 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

123 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.

124 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.

125 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.

126 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 charged to the I&E account on an even basis each year. If the payment is a lump sum, then it should be charged to the I&E account immediately. If the lump sum is material it may be appropriate to treat this expenditure as an exceptional item.

127 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 I&E 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' Pension Scheme (TPS)

128 The Teachers' Pension Scheme (TPS) is a statutory, contributory, final salary scheme administered by the Teachers' Pension Agency, an executive agency of the DfES. The regulations under which the TPS operates are the Teachers' Superannuation (Consolidated) Regulations 1997, as amended by the Teachers' Pensions (Amendment) Regulations 1999 and the Teachers' Pensions (Amendment) Regulations 2002. These regulations apply to teachers in schools and other educational establishments in England and Wales, which are maintained by LEAs, and also to teachers in many independent schools and establishments of further and higher education. Teachers are able to opt out of the TPS.

129 The TPS is an unfunded scheme with contributions made on a pay-as-you-go basis.

Valuation of the TPS

130 Every five years, the Government Actuary, using normal actuarial principles, conducts an actuarial review of the TPS. The aim of the review is to specify the level of future contributions. The cost of pensions increases is excluded from the valuation and, consequently, neither teachers nor their employers contribute to this added value.

131 The basis of the notional fund in which the TPS is invested has changed from 1 April 1996. After that date, the cost of pensions increases are

charged to the fund and the fund is deemed to be invested in line with the practice of large real pension funds. Credits are 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.

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

133 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.

134 In March 2003 the TPS published the actuarial valuation of the scheme as at 31 March 2001. The TPS disclosure note in Supplement C of this circular has been revised for this valuation.

Pension provisions

135 FRS 12 *Provisions and Contingencies* 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.

136 Where a decision has been made that an employee will take early voluntary retirement in one accounting period but that the individual will not cease employment until the following period, the charge to the I&E account for any SSAP 24 provision or capital sum payable to the relevant pension scheme should only be made once a written offer has been made to the individual concerned.

Enhanced pensions provisions

137 Enhancements of premature retirement compensation can give rise to two type of additional cost:

- an increase in a member of staff's lump sum payment on retirement; and
- an increase in their annual pension.

138 It is not possible under the TPS or the Local Government Superannuation Scheme (LGSS) to enhance an individual's service so as to provide an enhanced lump sum without at the same time enhancing the annual pension.

139 The actual cost of any enhanced ongoing pension to a former member of staff is paid by a college annually. However, it is a requirement of both SSAP 24 *Accounting for Pension Costs* and FRS 17 *Retirement Benefits*, that an estimate of the expected future cost of any enhancement to the ongoing pension of a former member of staff will need to be made and charged in full to the college's I&E account in the year that the member of staff retires. (This follows the principle that the future costs to a college of an individual's pension enhancement should be fully accounted for during the period that the college benefits from the employee's services.) In subsequent years a provision needs to be made in the balance sheet.

140 Colleges should use the tables in Supplement B of this circular in calculating any provision for enhanced pension. *These tables are mandatory.*

Charge for the SSAP 24 provision to the I&E account

141 The LSC would expect the charge for any movement in the college's SSAP 24 provision to be charged to:

- pay expenditure – staff restructuring: SSAP 24 provision;
- non-pay expenditure – interest on SSAP 24 provision.

142 If the amount charged to the I&E account is material, then the college should separately disclose the 'exceptional' amount on the face of the I&E account.

Post-retirement Benefits other than Pensions

143 Paragraph 75 of SSAP 24 states that the principles of SSAP 24 may be equally applicable to the cost of providing other post-retirement benefits.

144 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 of SSAP 24 are applicable to their measurement and disclosure.

Contingencies

145 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:

- it is not probable that a transfer of economic benefits will be required to settle the obligation; or
- the amount of the obligation cannot be measured with sufficient reliability.

146 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 it is either 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.

147 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.

148 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; and
- the possibility of any reimbursement.

149 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.

150 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 will only be disclosed where an inflow of economic benefits is probable.

Movement on General Reserves

151 The note states that restricted reserves apply only to FE institutions. However, the LSC would now only expect to see a restricted reserve in extremely limited circumstances; for example, in respect of a prize fund.

Post-balance Sheet Events

152 A post-balance sheet event is an event that 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 will be disclosed in the notes to the financial

statements, in addition to disclosure in the members' report. The financial impact of post-balance sheet events will also be disclosed where it is known or can be estimated.

Foreign Currency Transactions

153 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.*

Related Party Disclosures

154 FRS 8 *Related Party Disclosures* requires the disclosure of information on related party transactions.

155 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.

156 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.

157 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.

158 Following the definitions above the members of the corporation would be deemed to be related parties to the college, members of the senior management team and any other staff with significant involvement with major contracts (such as estate manager, or procurements officer) would be presumed to be related parties.

159 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.

160 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.

161 Therefore, transactions with the LSC do not need to be disclosed under the requirements of FRS 8.

Access Funds

162 Access funds (but not other learner support funds) should be excluded from I&E and disclosed only as a note, as illustrated in the F&HE SORP.

Group Accounts Subsidiary Undertakings

163 A full copy of each subsidiary undertaking's audited financial statements will be sent to the LSC with a college's own audited financial statements. If a subsidiary undertaking was dormant during the year, then this will be stated in a covering letter and a copy of these accounts is not required. If a subsidiary undertaking's financial statements were not signed by the return date for college accounts, a draft copy will 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

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

- a link through a trust which controls a company or organisation with which the college has (or has had) dealings; and
- a situation where the college is 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 requires disclosure.

165 In circumstances such as these, the nature of material links will be disclosed together with details of:

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

166 Details of any material contingent liability will be disclosed in the note on contingent liabilities.

Associates and Joint Ventures

167 FRS 9 *Associates and Joint Ventures* 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, and proposes an accounting treatment for ‘joint arrangements that are not entities’ that is broadly similar to proportional consolidation. 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 need to consult their financial statement auditors on accounting for proposed collaborative initiatives.

168 FRS 9 sets out definitions of ‘joint arrangements that are not entities’. An entity would be carrying on a trade or business of its own, not just part of the business of the organisations. The following are examples of joint arrangements that are not entities:

- where the partners derive their benefits from products or services taken in kind rather than by receiving a share in the results of trading; and
- where each partner’s share of the output of the joint activity is determined by supply of inputs.

169 Colleges need to assess whether they are entering into a joint venture or a joint arrangement; most partnerships currently operating between colleges are joint arrangements.

170 Under a joint arrangement each college should account for its own share of the assets, liabilities and cash flows of the arrangement. The share should be set out in the memorandum of understanding between the partners.

171 Where the cash flow for a particular project undertaken by a partnership is via a lead college, then that college will record the cash receipt and outflow in its published cash flow statement as:

- Receipt of grant for partnership £xxx
- Transfer of grant to partnership £xxx

Any sums not transferred at the year-end should be recorded as payments received on account.

172 Paragraphs 170 and 171 apply whether a college is preparing consolidated accounts or single entity accounts.

173 An example might be as follows.

Four colleges have a partnership arrangement to set up a shared network and develop learning materials to deliver over that network.

A grant towards setting up the network is received by a lead college.

Each college contributes, in equal proportions, learning materials and a share of running costs.

Each college will record within its operating activities:

- *its contribution to running cost;*
- *the costs of developing learning materials;*
- *depreciation on its share of assets; and*
- *its share of release of deferred capital grant.*

Each college will record on its balance sheet a quarter of the value of the fixed assets owned by the partnership and relevant proportion on the deferred capital grant.

The lead college will record the receipt and transfer of the grant.

174 If the partnership is deemed to be a joint venture, then the following treatment should be applied in consolidated accounts:

- the share of joint venture income should be shown as a deduction from group income (which will include it);

- the share of operating surplus of the joint venture should then be added back in;
- the share of assets and liabilities of the joint venture should be shown on the balance sheet under investments.

175 Where consolidated accounts are not prepared, the information at paragraph 171 and the effect of including it should be included by way of a note.

Use of College Companies

176 In May 2000, the FEFC issued guidance on college companies and joint ventures in *College Companies, Joint Ventures: A Good Practice Guide.* Guidance is also available in *Related Companies: Recommended Practice Guidelines* by Robson Rhodes (March 1996), based on a study which was commissioned by HEFCE. Colleges need to consult their financial statements auditors before making a decision on whether to establish a subsidiary undertaking.

177 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 also reminded of the amendments to section 19 of this Act made by the Learning and Skills Act 2000. Colleges are given a specific power to subscribe for, or otherwise acquire, shares in or securities of a company, but this power may not be exercised for the purpose of conducting an educational institution. Colleges should not participate in companies for the purpose of the provision of education, if that provision is funded wholly or partly by the LSC, unless the LSC consents. Colleges must ensure that they obtain independent legal advice on the exercise of their power to participate in companies.

College Combinations

178 FRS 6 *Acquisitions and Mergers* indicates that there are two methods of accounting for college combinations: acquisition accounting and merger accounting.

a Acquisition accounting regards the college combination as the acquisition of one college by another; the identifiable assets and liabilities of the acquired college are included in the consolidated balance sheet at fair value at the date of acquisition, and the results from the date of acquisition are included in the profit and loss account. The difference between the fair value of the consideration given and the fair values of the net assets of the entity acquired is accounted for as goodwill.

b Merger accounting treats the entities being combined as equal partners, with the balance sheets and profit and loss accounts being combined without any restatement of net assets.

179 The FRS states that acquisition accounting should be used for all college combinations, except where the following five criteria have been met:

a criterion 1 - neither college is portrayed as acquirer or acquired;

b criterion 2 - all 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;

c criterion 3 - the relative sizes of the two colleges are not so disparate that one college dominates the combined college by virtue of its size. A college would be presumed to dominate if it is judged to be more than 50% larger than each of the other proponents to the merger. However, this presumption may be rebutted if the college can clearly show that there is no dominance;

d criterion 4 - only applicable to the private sector; and

e criterion 5 - only applicable to the private sector.

Mergers involving one or more FE corporations

180 There are two ways in which a merger involving one or more FE corporations can be achieved:

a model A – a new corporation is established, the existing corporation(s) is dissolved and the property, rights and liabilities of the dissolved corporation are transferred to the new corporation; and b model B – a corporation is dissolved and its property, rights and liabilities are transferred to an existing corporation.

For the most part it is not a decision for the LSC as to which model is followed, rather it is a matter for the corporation(s) involved. Either process gives the same result, with two or more corporations becoming one.

181 For the period 1 April 1993 to 1 August 2002, there were:

- 16 model A mergers (31% of all mergers); and
- 35 model B mergers (69% of all mergers).

182 The LSC's reasoning for treating all college combinations as 'mergers' is as follows.

a The accounting standard refers to business combinations. Even though colleges may be run as business entities, they are run for public benefit. College combinations cannot proceed without the LSC's – and ultimately the secretary of state's – consent.

b Two of the five criteria for merger accounting to be used are not applicable to the FE sector.

c Adopting merger accounting throughout the FE sector aids comparability of colleges' financial statements across the sector, as all colleges are following the same basis in their preparation.

d Many colleges have merged because of influence from the FEFC or LSC for them to take over a financially weak college. Indeed, this could be potentially more common in the future where the LSC has conducted an area review and decided that there is no need for a college in the area. If the LSC is saying to two colleges that they will merge, how can one be seen to be an acquirer?

Compliance with FRS 6 *Acquisitions and Mergers*

183 For the reasons stated above, by applying the criteria of FRS 6 it is considered that the most appropriate accounting treatment is merger accounting, where FE college combines with FE college. This also brings the advantage that colleges' financial statements will be comparable and that they will comply with the requirements of FRS 6.

184 Accordingly, for these types of business combinations it is difficult to envisage a circumstance where acquisition accounting would be appropriate under the requirements of FRS 6 and the F&HE SORP.

Accounting disclosures

185 Where the reorganisation is to be accounted for as a merger, the I&E and cash flows of both colleges will 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.

186 Any adjustment necessary to achieve uniformity of accounting policies will 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.

187 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.

188 The combined college should also disclose the following information:

a an analysis of the current period's I&E account and STRGL 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;

b an analysis between the merging colleges of the principal components of the I&E account and a STRGL for the previous financial period;

c the aggregate book value of the net assets of each merging college at the date of the merger;

d 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; and

e a statement of the adjustments to consolidated reserves resulting from the merger.

189 The analysis of the I&E account required above will show, at minimum:

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

190 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.

191 Each of the merging corporations is required to prepare accounts to the date of dissolution. Unless directed by the secretary of state, accounts should not be prepared for a period in excess of a year. The responsibility for completing the accounts rests first with the corporation to be dissolved. If the corporation is dissolved before the obligation can be satisfied, then the obligation passes to the new corporation. In a model B merger, the continuing corporation is not required to prepare a part-year set of accounts.

Acquisition of Private Training Providers

192 A number of colleges have acquired the business of private training providers. Each of these acquisitions should be considered on its own merit and acquisition or merger accounting applied as appropriate. It is presumed that acquisition accounting will apply in the majority of cases.

Preparation of Financial Statements for Audit

193 It is a duty of the members of the corporation to present audited financial statements to the LSC by the relevant date. (For colleges with a 31 July year/(period) end this will normally be 31 December.) To meet this deadline, it will be necessary for the members of the corporation to consider:

- the date upon which the financial statements will receive the approval of the members of the corporation;
- the availability of the chair and principal to sign the financial statements on behalf of members of the board; and
- the timing of the audit itself.

194 With regard to the timing of the audit, it will be dependent upon the following:

- the date upon which the draft financial statements (including lead schedules, supporting detail, etc) are available to the auditors;
- the time necessary to complete the audit;
- the date that the audited interim Individualised Learner Record is available to the financial statements auditor; and
- the target date for approval of the financial statements by the members of the corporation.

195 Therefore, it will be necessary for the college to consult with its financial statements auditor and funding auditor and plan resources to achieve the requisite timetable.