THE
FURTHER
EDUCATION
FUNDING
COUNCIL

Responses by
31 December 2000

Supplement A to Circular 00/22

Sector Accounting Policies: Guidance on Accounting Policies

Contents

paragraph

Sector Accounting Policies: Guidance on Accounting Policies

General

Accounting policies and components of the financial statements

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

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

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

3 In accordance with FRS2 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 income and expenditure account or balance sheet
- to indicate any particular circumstances that affect items included in the income and expenditure account
- to provide details of any other matters relevant to an assessment of the college's state of affairs
- to supplement the information given in respect of particular items appearing in the cashflow statement.

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

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

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

- the period of account
- more detailed information relating to the income and expenditure account
- explanation of any exceptional items
- employee numbers and costs

- emoluments of the college's senior postholders and members[1]
- compensation for loss of office paid to senior postholders
- taxation
- details of tangible fixed assets and depreciation
- details of fixed asset investments
- stocks
- analysis of debtors and creditors
- details of all provisions for liabilities and charges[2]
- details of deferred grants
- financial commitments and contingencies[3]
- details of pension schemes
- details of post-balance sheet events
- details of subsidiaries consolidated into the accounts
- the name of any subsidiary excluded from the consolidation and reasons for its exclusion, the aggregate capital and reserves at the subsidiary's most recent financial year-end and its profit or loss for that year
- auditors' remuneration for external audit, internal audit and other services.

Corresponding amounts

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

- particulars of the college's shareholdings in other undertakings
- particulars of fixed-asset additions and disposals, transfers of fixed assets and the depreciation charge
- particulars of amounts transferred to and from reserves and provisions
- overseas travel for the financial year 1998-99.

Accounting standards

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

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

Recognition of income

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

- public funds in the form of allocations from the Council; for example, the annual funding allocation

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

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

[3] *A contingency is a condition 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.*

- education contracts; for example, local education authority contracts and franchise arrangements with higher education institutions
- tuition fees and charges
- other grant income; for example, the European Social Fund (ESF)
- the provision of services such as catering, residences, and farming.

12 College income can be placed in two broad categories:

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

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

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

SORP for the FE and higher education (HE) sectors

15 A SORP for the HE sector was published in 1994. The scope of that SORP has now been widened to encompass both the FE and HE sectors. The new format is a single set of exemplar statements based on the Casterbridge model. The revised version of the SORP (supplements B and C) has been approved by the Accounting Standards Board.

16 The SORP should be adopted for accounting periods commencing 1 August 1999.

17 The revised SORP was developed by a working group of the British Universities Finance Directors' Group (BUFDG) which has been expanded to include a representative of the Council and representatives of the College Finance Directors' Group. The sponsoring body for the SORP is the Committee of Vice-Chancellors and Principals (CVCP) together with the Association of Colleges (AoC) and includes a representative from the Council and the chair of the BUFDG working group.

Restricted reserves

18 Paragraphs 114 to 119 of supplement A to Circular 99/23 refer to the accounting treatment on disposal of assets. In certain circumstances there is a requirement to place the disposal proceeds in a restricted reserve. This requirement was the subject of debate in the preparation of the SORP. Whilst the model accounts included in the SORP make provision for a restricted reserve in further education institutions, it has been decided not to continue with this requirement. Accordingly, colleges no longer need to place disposal proceeds in a restricted reserve. If disposal proceeds for the 1998-99 financial year were accounted for under restricted reserves, these should be moved to general reserves. However, there may continue to be circumstances, such as the need to protect provision in a particular curriculum area, where institutions will be required to hold funds in a separate ring fenced bank account. Where this requirement is in place and where institutions are holding significant funds for reinvestment in capital projects a note should be included to that effect. For example, as an extension to the note on changes in net funds (note 26 in supplement B to Circular 99/23 or note 29 to the SORP model accounts):

> *£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 re-investment in the main site.*

Table 1. Example of the calculation of the value of provision

		Year 1 97-98	*Year 2 98-99*	*Year 3 99-00*	*Year 4 00-01*
		(units)	(units)	(units)	(units)
A	Balance carried forward	0	0	-1,900	-900
B	Target units	92,000	95,000	94,000	97,000
C	Actual units (audited out-turn)	92,000	93,000	95,000	96,000
D	Over/underachievement	0	-2,000	1,000	-1,000
E	Balance after over/ underachievement taken into account	0	0 – 2,000 = -2,000	-1,900 + 1,000 = -900	-900 – 1,000 = -1,900
F	Max. tolerance available (2% of current year's target)	1,840	1,900	1,880	nil (as last year of Council)
G	Recovery for year	0	-100	0	-1,900
H	Balance	0	-1,900	-900	0
	Creditors		100 x £16.80		
	Provision		1,900 x £17.00	900 x £17.00	1,900 x £17.00

Tolerance of Over- or Underachievement against Funding Agreement

19 Institutions will note from Circular 00/16, *Monitoring Growth 1999-2000,* that the application of the 2% tolerance has been clarified. During the period 1997-98 to 2000-01, institutions are able to carry forward each year any under- or overachievement to a maximum of 2% of that year's target units. This is a revision to previous guidance as described in Circular 99/07, which based the 2% on the previous year's target and applied in the preparation of accounts for 1998-99.

20 It was not the intention to allow institutions that underachieved against their funding agreement a 2% credit that would never be subject to recovery. However, it is recognised that the policy has been interpreted that way in some cases. Where this is the case, the Council wishes to be sympathetic where the impact of recovery would be significant.

21 As noted in Circular 00/16, institutions should plan for the Learning and Skills Council to recover any negative balances remaining on the tolerance at 31 July 2001. However, where institutions can demonstrate that their planning assumption, based on advice received from the Council (or through their external auditors), was that no recovery for any net underachievement would be made, the Council will consider allowing a longer period for recovery to take place. Institutions are requested to contact their regional finance director in the first instance to discuss their case.

22 Any other institution which believes it has an exceptional case for relaxing its recovery period into 2001-02 should also contact their regional finance director.

23 In all other cases, at the end of each financial year there is a presumed requirement to repay funds relating to any negative balance on the tolerance at the year-end. Full provision should be made within the accounts for that balance at the institution's average rate of funding for 2000-01. Colleges should not include a debtor for any positive balance on the tolerance account.

24 Recovery of any funds for underachievement in excess of 2% of the current year's target should be included in creditors due within one year.

25 Whilst institutions will plan to make up any negative balance by over-achievement in the following year, account should not be taken of expected future years over-achievement in calculating the level of provision required.

26 An example of the calculation of the value of the provision is given in table 1.

27 Table 1 is a simplified example of how the 2% tolerance works. It should be noted that the Council intends to recover funds associated with any underachievement against the two following categories:

- the total number of units in the funding agreement
- the units allocated for growth in 1999-2000 to 16 to 18 year-old full-time students.

For the 16 to 18 year-old growth target, a threshold of 85% of student numbers before recovery takes place will be used.

28 Recovery against these two categories means that the Council will recover funds from an institution which underachieves in the 16 to 18 year-old growth category (subject to the threshold) even if it achieves or overachieves its total unit allocation. Where the institution overachieves its total unit allocation, it will be able to carry forward any overachievement (up to 2% of that year's allocation) to the following year.

29 A spreadsheet will be provided on the Council's website to enable institutions to calculate their likely recovery position for 1999-2000 based on their most up-to-date data. This should be available by the end of July 2000.

30 It is appreciated that had it been clear that there would ultimately be recovery of the 2% credit, many institutions would have recorded a provision in 1998-99. However, institutions are not asked to make a prior year adjustment.

31 A suggested note under provisions is set out below:

Other provisions include £152,252 relating to an underachievement of 1.8% of the college's 1999-2000 funding allocation (The Further Education Funding Council operates a tolerance account whereby institutions can carry forward to a future year under- or overachievements of up to 2% of the current year's target). The college is planning to exceed its 2000-01 funding agreement by an equivalent amount and so does not expect to be required to repay this sum.

Retirement Benefits

Teachers' pension scheme valuation at 31 March 1996

32 An actuarial valuation of the teachers' pension scheme (TPS) was carried out as at 31 March 1996. A supplementary report on future contribution rates was produced in March 2000. Colleges should take account of these documents in preparing their financial statements for the year ending 31 July 2000.

33 A revised note to the accounts to replace note 24 in the specimen annual report in supplement B to Circular 99/23 is set out below:

TPS

The TPS is an unfunded scheme. Contributions on a pay-as-you-go basis are credited to the exchequer under arrangements governed by the Superannuation Act 1972.

The pensions cost is assessed every five years in accordance with the advice of the government actuary. The assumptions and other data that have the most significant effect on the determination of the contribution levels are as follows:

Latest actuarial valuation	*31 March 1996*
Actuarial method	*prospective benefits*
Investment returns per annum	*8.5% per annum*
Salary scale increases per annum	*6.5% per annum*
Value of notional assets at date of last valuation (estimated future contributions together with notional investments held at 31 March 1996)	*£61,710 million*
Proportion of members' accrued benefits covered by the actuarial value of the assets	*94%*

Following the implementation of the Teachers' Pensions (Employers' Supplementary Contributions) Regulations 2000 the government actuary carried out a further review on the level of employers' contributions.

For the period from 1 April 2000 to 31 March 2002 the employer contribution will be 7.2% plus 0.2% in respect of benefit improvements to the scheme. From 1 April 2002 there will be an increase of 0.95%.

Financial reporting exposure draft 20 retirement benefits

34 The Accounting Standards Board has issued a financial reporting exposure draft (FRED) on accounting for retirement benefits. The requirements will not affect the financial year ending on 31 July 2000 but colleges should discuss the implications outlined below with their auditors and prepare for potential implementation for the year ended 31 July 2001.

35 The FRED proposes substantial changes from SSAP24 reflecting a move towards the market value approach to the valuation of pension schemes and inclusion of an asset or liability, as appropriate, on the employer's balance sheet.

36 Specific changes from SSAP24 are, for defined benefit schemes, that:

- scheme assets would be measured at market value at the balance sheet date rather than at an actuarial value
- scheme liabilities would be discounted at the current rate of return on a long-term AA corporate bond rate (government securities, risk adverse)
- actuarial gains and losses (variations from regular cost) would be recognised immediately in the statement of total recognised gains and losses rather than spread forward in the profit and loss account, resulting in the surplus (subject to a recoverability test) or a deficit in the scheme being shown on the employer's balance sheet.

37 The TPS and local government schemes are defined benefit schemes and *prima facie* colleges would be expected to comply with the requirements of FRED20. However, it is recognised that in a multi-employer scheme such as the TPS, the individual employers may not be able to identify their share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis. In such cases the FRED proposes that the employer should account for the contributions to the scheme as if it were a defined contribution scheme.

38 On implementation of FRED20, colleges should take advantage of this provision for the TPS and will, therefore, be required to disclose:

- the nature of the scheme
- the cost for the period
- any outstanding or prepaid contributions at the balance sheet date.

39 It is anticipated that colleges will be able to obtain sufficient information from local government schemes to comply with the requirements of FRED20 for a defined benefit scheme. Colleges should discuss this with their external auditors and pension scheme administrators.

40 Many local government schemes are likely to give a requirement for a deficit to be recorded due to previous funding requirements. It is anticipated that this will be brought in as a prior year adjustment but colleges should discuss this with their auditors.

41 Any asset or liability on the employer's balance sheet should be recorded separately to net assets and the relevant element of reserves should be recorded separately and not as part of the balance on the income and expenditure account.

42 Where colleges have provisions for future pension benefits, following early retirement, they should continue to be recorded as provisions and the relevant element of reserves should be included in the income and expenditure account. These provisions are provisions under FRS12 *(Provisions, Contingent Liabilities and Contingent Assets)* not expected surpluses or deficits under FRED20.

Financial reporting exposure draft 21 accounting policies

43 FRED21 builds on the fundamental accounting concepts of Statement of Standard Accounting Practice (SSAP2) relating to going concern issues, accruals, consistency and prudence. However, emphasis has now shifted towards giving a true and fair view.

44 FRED21 sets out to achieve the following:

- replacing SSAP2
- identifying objectives and constraints to be considered in setting policies. There is an explicit requirement that a true and fair view would be required for policies
- setting out circumstances where the estimating techniques used to apply policies should be disclosed.

45 There are four main objectives of FRED21, they are:

- **relevance,** to ensure that accounting policies used are relevant to the college
- **reliability,** to ensure prudence and neutrality so that the accounts are free from systematic or deliberate error
- **comparability,** the external auditor would ensure that the college's financial statements are comparable with other information about the college and other institutions. This would be achieved though a combination of consistency and disclosure
- **understanding,** the financial statements should be understandable. The adaptation and compliance in full of the Casterbridge model would meet this requirement.

46 The Council holds the view that colleges should adopt accounting policies, that in the opinion of their governors, are most appropriate to their particular circumstances for the purposes of a true and fair view. Colleges should also agree the appropriateness of their accounting policies with their external auditors.

Corporate governance (recommendations of the Turnbull committee)

47 The Turnbull committee guidance adopts a risk based approach to establish a system of internal financial control and reviewing effectiveness. It is recommended that these measures are adopted by colleges in the college year 2000-01, as early action can result in considerable benefits. These include flexibility, identification of future income generation sources, and new opportunities or partnerships.

48 The Turnbull committee guidance currently only applies to the private sector. It is however likely that it will soon be applied to the public sector.

49 In summary the developments outlined in the guidance includes the following views:

- risk management as the key to effective corporate governance
- the need for a corporate view of risk rather than an operational outlook
- risk being owned by the management of a corporation rather than transferring the responsibility to audit
- a strategic risk management structure monitored by the governing body
- embedding a culture of risk management
- obtaining assurance on how risk is managed within the organisation.

50 The Resource Accounting Manual (RAM) takes account of these recommendations and therefore requires:

- a statement on the system of internal financial control
- a statement of the accounting officer's responsibilities
- disclosure of the accounting officer's remuneration as recommended by the Greenbury code.

51 Colleges should include a corporate governance report in their financial statements in the same format as 1998-99.

52 The Council has produced guidance for governing bodies, and college governors, that provides further information on the recommendations of the Turnbull Committee.

Charities SORP

53 The main points of this SORP, for which the exposure draft consultation period ended on 30 April 2000, include:

- the requirement for a statement of financial activities which reflects economic activity more clearly
- additional reporting requirements on reserves and internal controls
- incorporation of FRS8 to 15
- provides clarification on legacies, gifts in kind and disclosure of grants.

54 Although colleges are not required to comply with this SORP, the Council recommends that elements of good practice outlined within the SORP are adopted by colleges. One example of this is the SORP requirement that a statement of governors' remuneration and expenses be disclosed in financial statements.

Urgent issue task force sheet 34

55 The task force issued UITF sheet 34 on 26 January 2000 that clarifies two matters:

- year 2000 disclosure requirements
- FRS10 goodwill and intangible assets with regard to licensees.

Year 2000

56 The UITF abstract 20, paragraph 11 is still applicable (see paragraph 57).

57 The Council requires colleges to disclose the level of expenditure on year 2000 compliance which has been incurred in the 1999-2000 financial year and to report on any likely costs arising from inadequate preparation or in fixing problems that have, or may, emerge.

58 An extract from the UITF abstract 20, paragraph 11 is set out below.

Entities should also consider the potential impact and extent of the year 2000 problem on their business and operations and should make the following disclosures:

- *the risks and uncertainties associated with the year 2000 problem. If the entity has not made an assessment of this problem or has not determined its materiality, that fact*
- *the entity's general plans to address the year 2000 issues relating to its business and operations and, if material, its relationships with customers, suppliers and other relevant parties*
- *whether the total costs of these plans, including amounts to be spent in future periods, have been quantified and, where applicable, an indication of the total costs likely to be incurred, with an explanation of the basis on which the figures are calculated, for example the treatment of internal costs and replacement expenditure.*

FRS10

59 The UITF sheet 34 confirms that licenses and similar assets do meet the definition of intangible assets.

Mergers

60 A number of institutions have enquired about the requirements for preparation of accounts following a merger. Each of the merging corporations is required to prepare accounts to the date of dissolution. Unless directed otherwise 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 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.

Capital grants

61 Capital grants provided by the Council are usually three-year grants consisting of lump sums. The Council confirms that lump sum grants are to be treated as capital grants. It would be appropriate for colleges to set up debtor accounts depending on the completeness of the project, for example, if a colleges capital is 50% complete then 50% of the grant would be accounted for as a debtor, if no capital grant had been paid by the Council.

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

Leasehold property

63 Institutions are asked to disclose the length of any leases they hold for leasehold property included in fixed assets.

Cover Sheet for the Return of Audited Financial Statements and Finance Record for the Year Ended 31 July 2000

THE FURTHER EDUCATION FUNDING COUNCIL

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(Reference Circular 00/22)

This cover sheet must be completed by all colleges.
Please photocopy, complete and return to the Council's Coventry office by 31 December 2000.

Name of college (*please print*)

FEFC code

Contact for queries

Telephone

Returns enclosed (please tick)

1 One signed copy of the college's audited financial statements for 1999-2000 ❑

2 One signed paper copy of the college's finance record for 1999-2000 ❑

3 One copy of the finance record on disk ❑

4 One copy of each of the college's subsidiary undertaking's audited financial statements for 1999-2000. These have/have not* been signed. ❑

**delete as appropriate*

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