20 January 1993

CIRCULAR

THE FURTHER EDUCATION FUNDING COUNCIL

To

Principals of colleges

Subject

Accounting matters

Summary

Advice on accounting policies, tangible fixed assets, VAT, trading companies and insurance

Reference number 93/01

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93/01

ACCOUNTING MATTERS

INTRODUCTION

1 Many of the issues raised in discussions on the help line which was introduced in July last year have sector-wide implications. This circular presents some of the most frequently sought items of guidance on accounting matters. A separate circular, 93/02, gives an update on financial matters.

ACCOUNTING POLICIES

2 Under Schedule 4 of the Further and Higher Education Act 1992, the instrument of government will require each further education corporation to prepare in respect of each financial year a statement of accounts.

3 The Council's financial memorandum with colleges, a draft of which will be circulated separately for comment, will state that the accounts should be prepared in accordance with guidance to be issued by the Council.

4 The Council will consult colleges later this year on accounting policies including the format of the statement of accounts. In formulating its proposals, the Council will take account of Statements of Standard Accounting Practice (SSAPs), Financial Reporting Standards (FRSs) and the Statement of Recommended Practice (SORP) for accounting in higher education institutions.

5 Colleges seeking guidance on required accounting practices may find it useful to refer to the format required for financial forecasts, included in Circular 92/21.

TANGIBLE FIXED ASSETS

6 As part of the balance sheet, it will be necessary to show the value of holdings of tangible fixed assets. These assets are in two categories:

- land and buildings,
- equipment.

Land and Buildings

7 Land and buildings should be valued in accordance with the Advice Notes of the Royal Institute of Chartered Surveyors (RICS) on the basis of asset valuation. The normal basis of valuation is open market value for existing use. This basis will not be appropriate for many buildings in the sector because no market value is readily obtainable. The RICS notes provide for an alternative valuation on the basis of depreciated replacement cost.

8 Colleges will no doubt wish to employ professional surveyors to carry out this valuation. However, if appropriate qualified expertise exists within the college, external advisers may not be required. The surveyors should be able to advise on the remaining useful life of each building and the college may find this a helpful basis for calculating depreciation. Guidance on the depreciation of land and buildings will be included in the Council's guidance on accounting policies.

Equipment

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

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

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

11 Equipment acquired after 1 April 1993 should be valued at cost or, in the case of donated equipment, net realisable value.

12 Colleges should consult their external auditors about the valuation to be applied to equipment acquired before 1 April 1993. By way of comparison, in similar circumstances in the PCFC sector, many polytechnics entered these assets into their accounts at a single global estimated value.

Inventories and fixed asset registers

13 Many colleges may find it necessary to maintain a computerised register of their land, buildings and equipment. There is likely to be a large number of items in the inventory, even for a small college, and keeping a manual register up to date can be laborious. For example, each capitalised item will need to be depreciated each year and records kept of acquisitions and disposals. The scale of the administrative task will depend on the value at which items are capitalised, but colleges may wish to maintain control records also for lower value items such as cameras and personal computers which are attractive and therefore at risk of being stolen. Inventories should be subject to periodic checking to ensure that the items noted exist and are within the college's control.

VALUE ADDED TAX (VAT)

14 Most colleges will need to be registered for VAT. The rules governing registration for VAT are set out in VAT leaflet 700/1. "Should I be registered for VAT" which is available from local VAT offices. Colleges must register for VAT as soon as the value of their taxable supplies exceeds the VAT registration limit in any twelve-month period or if they believe they will make taxable supplies whose value will exceed the VAT registration limit in the next 30 days. The VAT registration limit is currently £36,600.

15 Colleges may apply for VAT registration now to their local VAT office. Where a college knows that it must register for VAT, it will be able to incorporate its VAT registration number in its sales invoice from the outset and it will not have to change its accounting treatment for VAT during the first year.

16 To determine the value of its taxable supplies a college will need to analyse its sources of income into four categories:

- outside the scope of VAT, eg, donations
- exempt, eg, most tuition fees and, in most cases, meals sold to students
- standard-rated, eg, seconded staff, sales of second-hand equipment to the public and, in most cases, meals sold to staff
- zero-rated, eg, sales of books.

17 Sometimes a college can make taxable supplies without receiving any income, for example, in certain cases donating goods or services to another charity. A college can also make taxable supplies to itself, for example, where a college prints its own stationery. In this particular case, the college should obtain a copy of VAT leaflet 706/1 'Self supply of stationery'.

18 The annex gives HM Customs and Excise's ruling on a number of specific issues which have VAT implications for the sector under current legislation. The rulings, which were obtained with the help of specialist advisers from Coopers and Lybrand, and KPMG Peat Marwick, are beneficial to the sector in that they exclude from VAT liability all property transfers under the Act from local authorities to colleges, and they put the sector on the same footing for VAT purposes as higher education institutions.

19 HM Customs and Excise state that further education corporations may apply the 'Higher Education Concordat' to their business. This publication by the Committee of Vice Chancellors and Principals (CVCP) contains an agreement by HM Customs and Excise to allow higher education institutions to apply simplified procedures in certain circumstances. The Council is arranging for colleges to be sent a copy of this concordat. If colleges use the concordat, the fees for most short courses which they intend to run at a profit, can be treated as exempt from VAT. Colleges using the concordat may elect not to keep records of input VAT for most of their purchases.

20 Colleges which need to register for VAT will be required to make periodic VAT returns, normally on a quarterly basis. It is the college's responsibility to ensure all returns are accurate and submitted on time. Colleges may be charged interest and penalties on late and inaccurate returns.

21 Unless a college is certain it will not need to register for VAT, it should seek appropriate professional advice and make contact with its local VAT office.

Trading Companies

22 Many colleges are considering creating subsidiary trading companies. The advantages usually cited for this step are as follows:

- a trading company may minimise a college's liability to corporation tax where the company profits are covenanted back to the college
- the limited liability status of the company

- may safeguard the college from losses
- a separate management structure may improve decision making
- collaborative arrangements with other companies and organisations may be facilitated.

In a restricted range of circumstances, VAT advantages might accrue from a trading company. There may be other particular reasons why it would be beneficial for a college to establish a trading company.

23 The creation of a trading company will have a financial cost and represent a further call on the time and attention of senior staff. The formation of a company is normally dealt with by an external professional adviser in return for a fee. Once the company is created the college should keep separate financial records for it, produce audited accounts and make returns to Companies House and the Inland Revenue. A company may complicate a college's VAT affairs.

24 Colleges are advised to secure their basic financial systems and to take appropriate professional legal and financial advice before setting up a trading company.

INSURANCE

General

25 It will be the responsibility of each college to ensure that it has the appropriate insurance cover in place from 1 April 1993 when it achieves independent status and its assets are transferred to it by its local education authority.

26 These guidance notes identify the types of cover that colleges should consider for the period after vesting day.

27 The notes are intended to assist colleges with their preparations for independence. They should not be regarded as authoritative professional advice. Colleges are advised to consult professional insurance specialists before committing themselves to a particular course of action.

Statutory Requirements

Employers liability insurance

28 This is compulsory under the Employers Liability Act 1969 and covers the legal liability for bodily injury or disease suffered by any person under a contract of service or apprenticeship with an employer arising out of and in the course of their employment.

Public liability insurance

29 This covers the legal liability for death, accidental bodily injury, illness, disease to third parties or accidental loss of, or damage to, third party property arising out of any of a college's usual activities.

Motor vehicles insurance

30 Each college will have a statutory duty to ensure that its vehicles are covered for accidents involving third parties. Colleges have the option of extending the policy to fully comprehensive cover if they wish.

Other Types of Insurance Cover

Buildings and contents insurance

31 Each college will be expected to provide cover for all the buildings it owns. The cover should be based on replacement or rebuilding cost. Cover is usually considered necessary for fire, including explosions and lightning, and additional perils including storm, tempest, burst pipes, overflowing of water tanks, aircraft (and things dropped from them), impact by vehicles, riot, malicious damage, subsidence and earthquake.

Additional expenses and loss of revenue

32 In the event of serious damage to property, additional expenditure will be incurred in order to continue providing education. Such additional expenditure might include:

- renting alternative premises, hiring portable cabins
- relocation, overtime and travelling costs for employees
- possible temporary catering facilities for students and/or employees.

33 Insurance can be taken out against such additional expenses and also against loss of income from student fees, catering or any other revenue-producing activities in which a college is engaged.

Professional negligence

34 Professional negligence insurance covers legal liability for claims by third parties arising from errors and omissions by college employees in carrying out any research or consultancy work for

other bodies. Cover for professional negligence may well be included in the public liability insurance arrangements but it is emphasised that professional negligence cover is not a statutory requirement. Colleges should be aware that the cover may have to be specifically extended to cover judgements obtained outside the United Kingdom.

Libel and slander

35 Libel and slander insurance covers legal liability for libels appearing in any publications of the college by college employees or governors and slanders uttered by employees or governors in the course of their official duties. Cover is likely to include the costs and expenses incurred in the defence of a claim.

Fidelity guarantee insurance

36 Fidelity guarantee insurance provides cover in respect of the loss of money or property belonging to, or in the trust or custody of, the college as a result of fraud or dishonesty on the part of any college employee.

Engineering and plant inspection services

37 Colleges will have a statutory requirement to ensure that certain plant and machinery, including pressure vessels, lifts, lifting apparatus and other machines, are regularly inspected. It is not a statutory requirement for such plant and machinery to be insured although colleges may decide that it is appropriate to insure these items and that they are regularly inspected.

Other types of insurance

38 There are other items for which colleges may feel it appropriate to obtain cover:

- computers
- agricultural risks
- legal expenses
- marine activities
- employee sickness
- travel

Excess of Cover

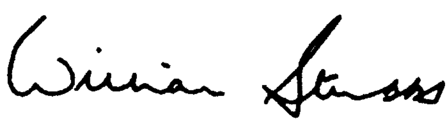
39 Colleges should pay particular attention to their policy regarding the excess levels within insurance policies. Too low a level of excess may lead colleges to pay unnecessarily for insurers' administration costs, and a large string of small claims may have an impact on a college's insurance rating. Too high a level of excess may expose a college to losses it cannot easily finance.

The Purchase of Insurance Cover

40 The Council is concerned to ensure that colleges receive the best possible service from the insurance market. Discussions have taken place with a number of insurance experts who have all emphasised the importance of the concept of risk management. Risk management is a key factor in determining insurance requirements. Insurance need not be taken out against risks which can be eliminated by better management or potential losses which can be borne by colleges.

41 Colleges may wish to approach an insurance broker to assist them in preparing risk management policies. Most brokers seeking college business are prepared to work on a fees basis rather than receiving commission from insurance companies. The fees approach reduces a possible conflict of interest.

42 Some insurers and brokers are offering a 'packaged' premium for all of the insurance business a college may require. 'Packages' may lead to a lower premium but they can have disadvantages. Should a particular type of insurance cause an unusual number or size of claims, the premium may rise very significantly overall in the following year. It may therefore be in a college's best interest to ensure that it receives individual ratings for each class of business and that each quotation is 'stand alone'.



ANNEX

EXTRACT FROM LETTER FROM HM CUSTOMS AND EXCISE. FURTHER AND HIGHER EDUCATION ACT 1992: VAT IMPLICATIONS

I can now confirm that Customs have reached the following conclusions.

1. All bodies which receive funding from the Further Education Funding Council will become "eligible institutions" whose provision of education will be exempt under item 1 of Group 6, Schedule 6 of the VAT Act 1983. This is, of course, still subject to Ministerial approval.
2. Recreational evening courses will be included within the scope of the exemption if they provide vocational training or education. This is not an easy judgement to make and, as I explained at our meeting, this is one of the 'grey' liability areas to which we hope to bring greater clarity during our forthcoming comprehensive review of Group 6 exemption. In the meantime I would not propose to challenge these Further Education Colleges (FECs) which automatically apply exemption to those evening courses which currently enjoy 'VAT free' treatment. However, FECs should understand that this is an area where VAT liability may be subject to change in the future.
3. If they consider it to be to their best advantage, FECs will be entitled to apply the Higher Education Guidelines (also known as the "Concordat") agreed between Customs and the Committee of Vice-Chancellors and Principals of the Universities of the United Kingdom, and the representative bodies for the other "eligible institutions".
4. The transfer of assets from local authorities to the new FECs will be a non-business disposal by the authorities and therefore outside the scope of the tax.
5. The liability of FECs to register for VAT will be subject to the normal rules. Where the governing bodies of institutions have already been incorporated by Act of Parliament, they are regarded as separate legal entities and may register as intending traders, on condition that they provide appropriate evidence of an intention to make taxable supplies in the course or furtherance of business after 31 March 1993.
6. Any VAT incurred by local authorities on purchase for FECs during the transitional period will be recoverable under Section 20 of the VAT Act 1983. However, if the governing body of a FEC incurs VAT on expenditure met from the preliminary funding made available to it by the FEFC, neither it nor the Local Authority will be entitled to recover input tax under Section 20 procedures.
7. There will be no requirement for FEC Colleges to make capital goods adjustments on assets transferred on 1 April 1993, since no input tax will be incurred by them. Moreover the VAT incurred by local authorities on acquiring these assets is in respect of a non-business activity and is therefore not input tax. Any capital items acquired by FECs after 1 April 1993 will be subject to the provisions of the Capital Goods Scheme as set out in VAT Leaflet 706/2/90.
8. In the context of property transferred to FECs by local authorities we accept that the FECs are not the developer as defined in the VAT Act 1983 Schedule 6A paragraph 5(5) because they neither constructed or ordered or financed the construction of the buildings. Thus the occupation of these buildings by the FEC will not trigger a self-supply charge. However any buildings subsequently constructed on the land by or under the direction of the FEC, or any significant enlargement or reconstruction of the existing building, could potentially fall within the self-supply provisions. Of course this will not have any real effect where the FEC acquired the land without payment. As far as the Capital Goods Scheme is concerned any input tax incurred by FECs after 1 April 1993 on partly built or ongoing projects will count towards the limits set out in VAT leaflet 706/2/90 and if these limits are exceeded adjustments under the scheme will be necessary.
9. If a Local Authority has elected to waive exception on any of the property transferred, the FEC Corporation will not be bound by that election once the transfer has taken place.

Roger Cleaver
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HM Customs and Excise, London
October 1992