ONS Reclassification Consolidated Question and Answer Document

This document contains two sections. Section 1 gives a background briefing on the college reclassification project and Section 2 lists questions and answers about the reclassification project. The questions have arisen either from colleagues in colleges or as a result of discussions in SFC's reclassification project team. We will update this document regularly as the project progresses.

If you have a question about the project please email it to ONS-Reclassfication@sfc.ac.uk

Section 1: Background briefing

1.1 What is the issue?

The UK Office of National Statistics (ONS) has reclassified all incorporated colleges as central government entities, to be referred to as Arms-Length Bodies for the purposes of accounting and budgeting.

1.2 How has the ONS reclassification arisen?

Following the creation in England and Wales of Sixth Form College Corporations on 1 April 2010 (which are classified as Local Government entities) ONS decide to review the classification of all FE colleges in the UK. The key factors examined by ONS are the 'public sector powers' held by government Ministers, and their public agencies (e.g. SFC) over FE colleges. Against this criteria the ONS assessed that all FE colleges should be classed as public sector bodies. The decision was made on the basis of current legislation (i.e. before the current Post-16 Education (Scotland) Act 2013).

UK Ministers accepted the basis of the ONS decision.

1.3 What does that mean for colleges?

This has wide implications for colleges who will need to change their budgeting, reporting and accounting practices to align with those that apply to central government organisations.

Colleges currently budget and account on an academic year basis – in line with their business – but will need to adopt the same financial year basis used across the public sector (April to March).

1.4 When will the change occur?

UK Government Ministers have insisted that reclassification must be implemented with effect from the financial year 2014-15 – from 1 April 2014.

It is hoped that colleges can defer the full implementation of International Financial Reporting Standards (IFRS) for producing annual accounts until 2015-16. This is currently the proposed implementation date for the IFRS compliant FE/HE SORP. The 2015-16 implementation date would have been the expected date for first set of financial statements to be prepared under the new SORP irrespective of the reclassification of colleges.

See also Communication number 4.

1.5 What will the incorporation status of colleges be from 1 April 2014?

For the purposes of budgeting and reporting, colleges are classified as public bodies. For all other purposes, colleges, regional boards and regional strategic bodies are incorporated under the relevant Education Acts.

1.6 What will be the impact of ONS reclassification on the charitable status of colleges?

The Office of the Scottish Charity Regulator (OSCR) has written to the SFC confirming that the charitable status of colleges will be unaffected by the ONS reclassification.

The letter to the SFC from OSCR can be found here.

1.7 What support will the SFC/Scottish Government offer to colleges to implement Government Accounting and Budgeting changes that occur as a result of the reclassification?

With input from the sector and the Scottish Government, SFC has assessed (and will continue to assess) the sectors support needs. Training and training materials have been developed and are in the process of being delivered to colleges.

See also Communication number 5 and Communication number 9.

1.8 What mitigation of the reclassification is being offered to the sector?

Scottish Ministers have committed to trying to mitigate the impact of the reclassification on colleges to enable colleges to continue to operate, as far as is possible, as they do now.

SFC and the Scottish Government will work with colleges to find ways of managing the deployment of existing reserves within government accounting and budgeting rules.

SFC is currently exploring using its own year-end flexibility and the use of arm's length charitable foundations. Arms-length foundations were covered in Communication number 1, Communication number 3 and Communication number 7

1.9 How incorporated colleges' income and expenditure is treated within UK-wide government budgeting arrangements?

For the purposes of HM Treasury budgeting, incorporated colleges will be classified as 'Arms-Length Bodies' (ALBs). The budgeting requirements this places on them is analogous to that for NDPBs. The detailed arrangements are set out in chapter 9 of HM Treasury's Consolidated budgeting guidance 2013-14.

The key points to note from that document are as follows:

- Incorporated colleges' own 'resource consumption' (i.e. their recurrent expenditure) and their own capital expenditure will be counted as part of the Scottish Government's spending. Therefore, since there is an annual ceiling placed on each area of government expenditure (referred to as 'Departmental Expenditure Limits' or 'DEL'), incorporated colleges will also have to control their expenditure so that it does not exceed pre-set limits
- Even if expenditure is financed from incorporated colleges' own reserves or borrowing, it is still included as part of overall government expenditure and therefore has to be allocated an equivalent amount from the Scottish Government's overall budget (even though the Scottish Government would not actually have to pay for or fund the expenditure). This is referred to as 'budget cover'
- However, if the expenditure is financed from colleges' other /commercial income, budget cover is not required

With regard to the year-to-year position, the Scottish Government's expenditure is controlled on an annual basis with only very limited scope to manage any under or over spent budget beyond the financial year end. From 1 April 2014 the incorporated college sector will be subject to the same annuality, including limitations on end year flexibility. The Budget Exchange Mechanism (BEM) offers the Scottish Government some ability to manage funds over the year end. The limits of this are 0.6% of the total Scottish Government resource budget and 1.5% of the total capital budget. This equates to around £150m of resource and £50m of capital for the whole of the

Scottish Government. Any future college budget management across the year end will have to be managed, along with all other Scottish public bodies, within these narrow limits.

Essentially what all this means is that:

- All income and expenditure by incorporated colleges, including that funded from either reserves or borrowing, counts as part of the Scottish Government's own income and expenditure for budgeting purposes (there is no intention to consolidate colleges from an accounting perspective)
- All expenditure by incorporated colleges (net of income) requires budget cover from within the Scottish Government's own budget limits
- From 1 April 2014 onwards, any expenditure funded from incorporated colleges' own reserves would be considered as additional within the context of the Scottish Government's budget, and require corresponding budget cover. From 1 April 2014 there is likely to be no scope for incorporated colleges to carry forward surpluses to future years other than through the use of an arms-length foundation.

1.10 Will Colleges be able to generate and retain non-SFC sources of income?

Incorporated colleges will still be able to engage in activities to generate other income – indeed Ministers expect this drive to continue to support direct public investment. Projected additional external income will effectively be matched against the additional expenditure which it supports, leaving the net amount of expenditure that is supported by SFC grant and similar income. There is no intention to revisit previously indicated levels of college funding in light of reclassification.

1.11 What will the impact of reclassification be on colleges' ability to generate and retain surpluses?

Any surplus can be transferred to an arms-length foundation. Those not transferred will not be able to be used the following year as there will be no budget cover to enable the expenditure to take place.

1.12 Can colleges spend existing reserves from 1 April 2014?

Colleges have been advised that they should consider the amount of cash backed income and expenditure reserves that can be transferred to an Arms-Length Foundations ensuring that sufficient cash is retained to meet working capital requirements, as it is very unlikely that additional resource cover will be given to enable these reserves to be spent in future years.

See also questions 2.4, 2.5, 2.7, 2.17, 2.34 and 2.36 below.

1.13 What will the impact on access to capital and commercial borrowing be?

As now, the college sector has access to Scottish Government capital funding along with all other public sector bodies. However, from 1 April 2014 onwards they will not be able to augment that capital funding by using reserves or commercial borrowing without the requisite budget cover from the Scottish Government. See also question 2.11 below and question 12 in Communication number 6. See also Communication number 8 on this issue.

1.14 What will the impact on non-profit distributing projects be?

Careful consideration will be required on the use of college reserves and other sources of income in terms of the affordability of the projects and their unitary charges. However, Ministers remain fully committed to all three college projects, and will work to mitigate any risks to affordability. In particular Ministers are committed to securing the continued use of accumulated reserves for the purpose defined within the college business cases.

See also Communication number 8 on this issue.

1.15 What will the reporting cycle for government look like?

Prior to the start of each financial year (some of which will also be required in the run up to 1 April 2014)

- Individual incorporated colleges prepare draft full budgets by July for the following April to March year
- Scottish Funding Council prepares a collated position and ensures it is consistent with current information about the budget position for the relevant year, before submitting to the Scottish Government
- Scottish Parliament considers draft Scottish Government budget between September and February for the following April to March year

Monthly throughout the year

- Incorporated colleges will prepare a projection of their likely income, expenditure and cash requirements
- The projections will be collated by the Scottish Funding Council for reporting to the Scottish Government
- The Scottish Funding Council will pay individual incorporated colleges their cash requirement for the month ahead

Mid-year Scottish Government budget updates

- Enhanced returns will be required in July and November to feed into the Scottish Government's budget revision processes. The November return is particularly important since it represents the Scottish Government's last opportunity to adjust all budgets across its portfolio and ensure there is adequate 'budget cover' in place for all planned expenditure

Prior to the year-end

- Incorporated colleges will prepare an updated projection of any under or over- shoot of their previously agreed net expenditure limits by the end of February.
- These projections will also be collated by the Scottish Funding Council and will be used to determine whether the total position will be within acceptable limits.
- As long as the total position is within acceptable limits, the Scottish Funding Council may also use that information to manage underspends and overspends at individual college level.

This issue is also covered in **Communication number 4**

1.16 What are the financial reporting requirements?

Change to the financial year end

Strictly speaking, incorporated colleges could continue to prepare annual accounts on an August to July basis. However, they would also need to prepare separate accounts for Scottish Government and HM Treasury purposes on an April to March basis. In practice, therefore, incorporated colleges will need to move towards an April to March financial year. It is recognised that this will impose a transitional burden on colleges and introduce an imbalance between financial and academic year. The reclassification implementation project will seek to find ways of minimising the negative impact of that mismatch.

Financial reporting framework

Central Government bodies are required to follow the Government Financial Reporting Manual (FReM) available at: www.hm-treasury.gov.uk/frem_index.htm

This is essentially a version of International Financial Reporting Standards (IFRS), adapted for the government sector. It is anticipated that this will operate in conjunction with the HE/FE Statement of Recognised Practice (HE/FE SORP). It is anticipated that colleges will continue to report under the HE/FE SORP from 1 April 2014, though this has yet to be formally confirmed with HM Treasury.

The current financial reporting framework for incorporated colleges, the HE/FE SORP, is based on UK Generally Accepted Accounting Principles (UK GAAP). Government accounts (and the FReM) are prepared under International Financial Reporting

Standards (IFRS) and incorporated colleges' accounts will ultimately have to be consistent with IFRS as interpreted for public bodies.

The HE/FE SORP is intended to be revised in line with IFRS for 2015-16, one year after the impacts arising from the ONS reclassification of incorporated colleges is meant to take effect. However, it is currently anticipated that financial reporting for the sector **will continue to follow the HE/FE SORP throughout** and therefore IFRS compliance is likely to be for 2015-16 financial year onwards

The changes to incorporated colleges' financial reporting framework will essentially only be those which were going to happen anyway

However, it should be noted that this position still needs to be confirmed by HM Treasury. Also, it may be that the budgetary impact of IFRS compliance will need to be assessed for 2014-15 as part of the ONS reclassification implementation exercise dependent on the outcome of on-going HM Treasury negotiations.

Summary of financial reporting changes

Bringing together the change in year end and the move to the new HE/FE SORP, the annual accounts which will be prepared throughout this period, for colleges not involved in mergers, are expected to be as follows.

- **1 August 2012 to 31 July 2013** (twelve months), using the **current** HE/FE SORP
- **1 August 2013 to 31 March 2014** (eight months), using the **current** HE/FE SORP
- **1 April 2014 to 31 March 2015** (twelve months), using the **current** HE/FE SORP (and also taking account of the FReM, where required).
- **1 April 2015 to 31 March 2016** (twelve months), using the **new** HE/FE SORP. This will also require revised comparative figures to be prepared for 1 April 2014 to 31 March 2015
- Opening balance as at 1 April 2014 (which might also require some associated reworking of prior year income and expenditure)
- **1 April to 31 March** for each subsequent year, using the new HE/FE SORP.

With the exception of the move to a 1 April to 31 March reporting period and the additional FReM disclosure, **all the above would have taken place anyway**, as a result of the implementation of the new HE/FE SORP.

This issue is also covered in Communication number 4. See also question 23 of Communication number 6.

1.17 What would the impact be on financial reporting for Colleges involved in mergers?

Financial reporting changes for colleges involved in mergers

Again, with the exception of the move to a 1 April to 31 March reporting period from 1 April 2014 onwards and the additional FReM disclosure, all the financial reporting changes that might impact on the accounts preparation processes of colleges involved in mergers were already going to happen. The following table uses an example of a merger with a 1 November 2013 vesting date.

Current arrangements		**Revised arrangements**	
College which will be the host	**The other colleges in the merger**	**College which will be the host**	**The other colleges in the merger**
1 August 2012 to 31 July 2013 (twelve months), using the current HE/FE SORP		1 August 2012 to 31 July 2013 (twelve months), using the current HE/FE SORP	
1 August 2013 to 31 July 2014 (twelve months), using the current HE/FE SORP and incorporating the 1/8/13-31/10/13 results of the other colleges in the merger	No accounts prepared	1 August 2013 to 31 March 2014 (eight months), using the current HE/FE SORP and incorporating the 1/8/13-31/10/13 results of the other colleges in the merger	No accounts prepared
1 August 2014 to 31 July 2015 (twelve months), using the current HE/FE SORP		1 April 2014 to 31 March 2015 (twelve months), using the current HE/FE SORP	
1 August 2015 to 31 July 2016 (twelve months), using the new HE/FE SORP		1 April 2015 to 31 March 2016 (twelve months), using the new HE/FE SORP	

However, it needs to be emphasised that the accounting for 1/8/2013 to 31/10/2013 or similar periods for non-host colleges will be subject to agreement between the relevant colleges and their auditors.

See also question 23 in Communication number 6.

1.18 What are the potential mitigating actions under consideration?

Reclassification of Incorporated Colleges – Communication number 1, Communication Number 3 and Communication number 7 indicated Arms-length foundations as the primary form of mitigation. However, we would continue to welcome any suggestions that might suit the specific circumstances of your college or more generally.

Section 2: Questions and Answers

The following questions have arisen either from colleagues in colleges or from discussions in the ONS project team. We have tried to answer questions as fully as we can at this stage, but in some areas there are still some unknowns. In such areas we will update the answers and also add to the Q and A as more questions and issues are identified.

Basis for accounting

2.1 What is the basis for accounting?

Colleges will account as before on an accruals basis and not cash accounting. Resource accounts and the associated returns are prepared on an accruals basis. See also question 1 in Communication number 6 and question 2.30 below.

2.2 What are Resource and Capital Department Expenditure Limits (DEL) and Annually Managed Expenditure (AME)?

Resource and Capital Department Expenditure Limit

Colleges will be set an overall resource budget (resource (i.e. revenue) and capital DEL) this resource limit is set currently at the £522m funding floor for colleges. All college resource scores against this figure (with the exception of movements on some provisions e.g. pensions) and colleges will be expected to work towards a balanced budget at the year end.

Total Department Expenditure Limit (Total DEL) is arrived at through the following calculation: Total DEL = Resource DEL+Capital DEL-Depreciation/Impairment DEL.

Annual Managed Expenditure

The movement on items such as pension provisions is covered by Annual Managed Expenditure (AME). AME covers the non-cash fluctuations in these items. Use of AME is to cover such items is dependent on its availability and compliance with the Consolidated Budgeting Guidance.

The sum of the resource and capital DEL and AME is Total Managed Expenditure (TME) this is total public expenditure.

2.3 Could Colleges be treated, for accounting purposes, in the same way as local authorities?

Colleges could only be treated in the same way as local authorities if they were transferred to local authority control.

Reserves

2.4 What is meant by reserves?

In practical terms, cash reserves refer to the cash and near cash (e.g. term deposit accounts) which colleges hold and spend.

Revaluation reserves and pension reserves (non-distributable) will remain the same after the ONS reclassification.

2.5 What will happen to existing college reserves?

Any accumulated reserves that have not been utilised at the point the reclassification comes into effect would require additional budget cover to allow them to be spent. In other words, colleges would have these funds but be unable to spend them without additional budget cover being made available from the Scottish Government.

In order to overcome this problem Scottish Ministers have agreed that arms-length foundations can be set up and cash backed college income and expenditure reserves can be transferred to them to enable colleges to access these reserves in future years to assist in delivering their strategic plans.

2.6 How would merging colleges apply reserves earmarked to support merger costs from 2014-15 onwards?

We are currently looking, on a case by case basis, at options around the use of reserves to meet some merger costs.

2.7 What reserves will be moved to arms-length foundations?

Only cash reserves can be moved to arms-length foundations. The likely impact of the transfer of surplus cash would be the generation of a deficit and a consequent reduction in the College's income and expenditure reserves as a result of the transfer via gift aid. However, both Scottish Government finance and Audit Scotland have raised no concerns with the impact of this approach.

See also question 5 in Communication number 6.

Working capital

2.8 What level of working capital is allowed?

Any movement in working capital will impact on the resource outturn position for colleges. In establishing a working capital position colleges will be expected to broadly maintain that position at subsequent year ends, although the position can fluctuate over the course of the year.

Working capital should therefore be the minimum necessary to manage cash flow over the course of the year, bearing in mind that, as part of the central government cash management arrangements, the Scottish Government can tailor the cash payments for colleges to help manage any peaks and troughs in that cash requirement over the course of the year. Cash balances within central government bodies tend to be low. You should be aware that the Scottish Government operates a policy that no organisation should draw down cash in advance of its needs.

This issue is also covered in Communication number 6.

2.9 Are there any specific sector issues, for example how are SAAS fees to be accounted?

Income such as SAAS, other commercial and fee income that spans beyond the new March year-end will be accounted for in line with accruals accounting. The working capital movement to match them would occur in the period to which the income or expenditure relate. This issue is also covered in Communication number 6.

2.10 How will multi-year projects funded in advance be accounted for after reclassification?

Activities that span more than one academic/financial year will be accounted with as now, through accruals accounting covered by associated working capital movements. However, plans to apply reserves to such projects will be affected. This issue is also covered in Communication number 6.

Capital investment and borrowing

2.11 How would a college fund capital investment after reclassification?

Colleges would need to compete with other public sector organisations for capital funds. The college sector would need to make a continued and robust case for investment in the College estate. This process for capital investment does not differ from the process currently used in relation to large capital projects in the sector.

As a general rule, Colleges would require budget cover to invest in capital projects, unless these projects were funded in their entirety by external income. See also question 1.13 and 1.14 above, and question 12 in Communication number 6.

2.12 Do depreciation and amortisation impact on a college's resource budget?

Depreciation and amortisation score against the College resource budget and requires resource budget cover annually. The cover comes from Resource DEL. HM

Treasury has committed to release additional non-cash budget cover to match depreciation. This means that current levels of depreciation will have the non-cash resource budget cover required to ensure the funding floor of £522m.

Items such as provisions and FRS 17 pension provisions are generally processed through an adjustment using Annual Managed Expenditure (AME). This does not impact on colleges' resource budgets.

Communication number 8 contains further detail on this issue.

2.13 What is the impact on existing college borrowing?

Current borrowing can be carried forward post-April 2014. New borrowing cannot be added to after 1 April 2014.

Discussions are ongoing with HM Treasury as to how existing borrowing will be accounted for. The current working assumption, subject to confirmation, is that interest payments would score and that capital repayments would be outwith the scope of budgeting.

See also Communication number 8 on this issue.

2.14 How would revaluations of College fixed assets be treated?

In respect of an upwards revaluation, the impact is on the balance sheet only and as a result there is no budgetary impact. If a college recognises an impairment then the Scottish Government would look to secure AME cover for the movement through the year.

2.15 What will happen to College's Lennartz liabilities after reclassification? How will repayment be treated?

Discussions are ongoing with HM Treasury as to how this will be treated.

The current working assumption, subject to confirmation by HM Treasury, is that capital repayments would be outwith the scope of budgeting. See also question 17 in Communication number 6 and question 2.46 below.

2.16 What happens to existing SFC debt?

The debt (as a form of borrowing) will continue. Current arrangements for repayment of the SFC borrowing will also remain in place. The repayment of this debt by colleges will not count against the resource budget.

2.17 Should College use reserves prior to 1 April 2014 to repay existing debt?

Colleges could opt to repay borrowing early; however, most banks would charge College's an early repayment penalty that could make this option less attractive. As stated above, College debt at 31 March 2014 will be covered as part of the baseline and be serviced from 1 April 2014 to the loans maturation. Furthermore, repayment of debt as a means of reducing/using cash reserves would need to be considered on a VFM basis and in the context of the alternative options that are available, for example, the use of arms-length foundations.

2.18 How will capital projects that span the period after 31 March 2014 be funded?

SFC and Scottish Government will make every effort to ensure that such projects as committed to that span 2013-14 and 2014-15 are able to be completed.

The Scottish Government and SFC has already contacted those Colleges that are have NPD projects on the issue of the impact of the ONS and will also take steps to mitigate the impact in respect of these projects.

VAT

2.19 How will the Classification impact on the VAT status of colleges?

The VAT status of colleges will not change or be impacted as a result of the reclassification. This means that colleges will still apply the partial exemption regulations after the 1 April 2014.

Colleges will need to inform their local HMRC office of the change in status.

Communication number 8 contains further detail on this issue.

SFC Funding

2.20 Can SFC continue to manage its main grants on an academic year basis?

The SFC will continue to manage our main grants on an academic year basis, not least because colleges' own planning cycles will almost certainly continue to be based on academic years. However, we recognise that other aspects of the new arrangements will have to be fully examined before we decide the best approach.

2.21 Are student support funds to be treated as part of income and expenditure?

Student support income and expenditure funded by the SFC should not be included in income and expenditure. This is because allocations are made to Colleges on the assumption that such funds are spent, reallocated or returned if unspent. The colleges own expenditure and overspend would be that which normally appears in FFRs and College financial statements.

Colleges are to treat childcare funding as they have done before.

2.22 Does the ONS reclassification impact on SFC interventions with colleges in financial difficulty?

SFC will continue to monitor colleges' financial sustainability and seek to provide cash support where this is deemed appropriate and necessary.

The key issue here is the impact of annuality for both the colleges and the SFC's budgets.

Budgeting and reporting

2.23 What balance sheet impacts will there be as a result of moving towards a 31 March year end?

Leaving aside the impacts that will flow from changes that are already planned (such as implementation of the expected new FE/HE SORP), no specific impacts have been identified from using a 31 March year end rather than a 31 July year end. However, both we and individual colleges will want to keep this under review.

2.24 What would the comparator period be for Colleges 2013-14 financial statements?

The comparator period for 2013-14 will be as follows: Balance sheet at 31 July 2013; income and expenditure account for the period 1 August 2012 to 31 July 2013 (twelve months).

2.25 Would the sector position be aggregated for reporting and budgeting purposes? Would surplus and deficits be transferred between colleges?

The net whole-sector surplus/deficit will be aggregated for reporting to Government. However, colleges are responsible for delivering their individual resource targets and these will be monitored by the SFC to ensure that the targets are achieved.

Aggregating individual results to report a net position would not involve cash or budget transfers between colleges. It would simply involve the Scottish Funding Council aggregating the individual college results into one return for the purposes of Scottish Government budgeting and reporting.

2.26 Will Colleges need to adopt a uniform capitalisation threshold going forward or any other standardised accounting treatment?

The standardisation of any accounting policy/treatment would need to be considered in the context of College's requirement to comply with the SORP and the FReM.

A paper on the impact and interaction of the FReM and the SORP is being prepared as part of the ONS project and will be circulated to colleges. We will also reflect these changes in our Accounts Direction for 2014-15 and future accounts directions.

Trading subsidiaries

2.27 What impact will the ONS classification have on colleges trading subsidiaries?

Colleges can continue to operate trading subsidiaries after reclassification. Trading subsidiaries will be consolidated and therefore become a part of the same annuality and resource limits as the college.

Subsidiaries will fall within the accounting boundary of the College and as such their surplus/deficits will score for budgeting purposes. Any expenditure of reserves held in subsidiaries would also score against college resource limits.

Procurement

2.28 What is the impact of the classification on EU procurement thresholds?

For the foreseeable future, there will be no impact on the procurement status of Scotland's colleges.

2.29 APUC as Procurement centre of expertise for incorporated colleges?

The Scottish Government's Procurement Directorate has indicated that it expects colleges to continue to use the services of APUC.

Forecast preparation

2.30 Should future forecasts be prepared on a cash or accruals basis?

Colleges should continue to prepare forecasts on an accruals basis. See also question 2.1 above.

Capital grants

2.31 How should deferred capital grants be treated in 2014-15?

Colleges should continue to treat deferred capital grants per the current FE/HE SORP in 2014-15.

2.32 Should capital grants be treated per draft FE/HE SORP?

Colleges should continue to treat capital grants per current FE/HE SORP for the 2014-15 financial year and in line with the new FE/HE SORP from 2015-16.

See questions 2.60 and 2.61 below for further discussion of deferred capital grants.

Holiday pay accrual

2.33 Should a holiday pay accrual be included in the forecasts per draft FE/HE SORP?

No, though it is recognised that the impact of holiday pay accrual is likely to be significant, there are ongoing discussions between the Funding Council and Scottish Government Finance in this area.

Reserves and transfers to foundations

2.34 Should cash reserves or net current assets be transferred to arms-length charitable foundations?

Only cash reserves can be moved to arms-length charitable foundations. In making this transfer, colleges should ensure that they have sufficient working capital available to meet their liabilities and have regard to their solvency. It is important that cash balances are minimised as far as possible and a positive working capital balance maintained. See also question 2.4 above .

2.35 What is the accounting treatment for surpluses generated and subsequently transferred into and out of arms-length charitable foundations?

It is anticipated that such transfers will require adjustments to colleges' income and expenditure which in turn should be factored into colleges' cash flow projections.

2.36 What is the accounting treatment for cash reserves transferred into arms-length charitable foundations before 31 March 2014?

The gift aid to the foundation will appear below the operating surplus line in the income and expenditure account as it is a distribution of profit. The transfer needs to be carried out prior to the 31 March 2014 year-end.

2.37 Treatment of surpluses generated from grant-funded activity, how will these be treated in practice?

Our current understanding is that all surpluses, regardless of the source of the surplus, will be able to be transferred to the arms-length foundation with the proviso that the funds held within the foundation will eventually be used in line with the college's strategic plan. This should not require the disaggregation of surpluses between commercially generated and publically generated surpluses.

2.38 Is it acceptable to transfer title of surplus property to an arms-length charitable foundation?

Transfer of the title of surplus property to an arms-length foundation would require Ministerial consent. Transfer of proceeds to an arms-length foundation for reinvestment in future years is a more complicated issue in respect of the accounting treatment, we are currently looking into this in conjunction with Scottish Government colleagues. However, it is more straightforward if colleges can reinvest disposal proceeds in-year.

Under and overspends

2.39 How will under/overspends will be calculated?

A college overspends when it exceeds its resource budget (limit) for the year. An overspend would be classified as an excess of expenditure over income. A college with a deficit on all activities will have exceeded its resource limit and overspent. It is the responsibility of the college to monitor carefully its year-end position to ensure that either a breakeven or surplus position is achieved. An underspend equates to an excess of income over expenditure on all of colleges activity. This surplus can be transferred to the arms-length foundation prior to the 31 March year-end.

Treatment of severances

2.40 What is the budgeting and accounting treatment for severances?

This issue was covered in detail in the working capital guidance that formed part of Communication number 6.

Capital Funds

2.41 Is there a formal process for application for capital funds?

Colleges will need to compete with other public sector organisations for capital funds. The college sector would need to make a continued and robust case for investment in the College estate. There is no separate process and the process for capital investment does not differ from the process currently used in relation to large capital projects in the sector. It is likely that further information on colleges' 2014-15 capital plans will be requested in due course. See also questions 1.13, 1.14 and 2.11 above.

UHI

2.42 Are UHI colleges affected by the reclassification?

The five incorporated UHI colleges (Inverness, Lews Castle, Moray, North Highland and Perth) are affected by the reclassification. All incorporated colleges are required to adopt the 1 April to 31 March financial year as a result of the reclassification. Colleges are required to adopt this year end as a result of HM Treasury's reporting requirements which include audited information at 31 March each year. UHI partner colleges' individual financial statements may require consolidation by UHI, this is currently under review.

Overdrafts/Loans and Lennartz facilities

2.43 Will colleges be allowed to operate an overdraft facility?

It is possible for colleges to operate an overdraft facility but our current understanding is that it is unlikely that colleges will require an overdraft facility as the Funding Council should be able to meet the cash funding requirements of colleges subject to this not exceeding the overall cash and resource limits for the college. Colleges will need to remain within their resource budget and avoid overspends on both a resource and cash basis.

2.44 Will colleges be allowed to generate loans from corporate banks?

Colleges are technically still able to borrow with the consent of Ministers. It is felt that such consent is unlikely to be forthcoming and the capital funding process highlighted above will be followed. Given the resource limits that colleges are required to operate within, even if they did borrow they would not be able to use these funds without additional resource cover as spending the funds raised would breach the resource limit. So, in short, colleges will not be able to generate new loans from commercial providers.

2.45 How should colleges deal with potential challenges in relation to their existing bank covenants?

The Council is currently collecting information through the FFR returns on current lending and banking covenants. The Council will engage with colleges that have existing borrowing and covenants to work with them to reach a resolution on these issues. Any colleges that anticipate challenges in relation to their existing covenants from 1 April 2014 should contact us at an early stage.

2.46 How will the Lennartz liability be treated after 1 April 2014?

Discussions are on-going with HM Treasury in relation to the treatment of the Lennartz liability. The current working assumption, subject to confirmation by HM Treasury, is that capital repayments will be out with the scope of budgeting. See also question 2.15 above.

See also question 17 in Communication number 6.

Commercial activity

2.47 Is there any guidance on costing/pricing commercial activity that colleges need to comply with?

Colleges should refer to the Scottish Public Finance Manual which states that at least the full cost of services must be recovered.

2.48 Will SDS funding be classified as commercial activity?

We understand that SDS should be classified as commercial activity.

Expenditure by other public bodies

2.49 What consideration has been given to ensuring that there is no double counting of college expenditure by other public bodies?

Any double counting will be eliminated as part of the consolidation process for Whole of Government Accounts.

See question 2.55 below on Whole of Government Accounts.

Efficiency

2.50 How can colleges be incentivised to spend funding as efficiently as possible?

Colleges will be expected to comply with the duty of Best Value in their use of public funds.

Deficit Funding

2.51 Confirm that colleges will not be subject to deficit funding

The Funding Council will agree a volume of activity and pay a price for that activity in line with current arrangements. It is anticipated that colleges will transfer overall surpluses to arms-length foundations.

Reporting requirements

2.52 Is there further clarity on overall reporting requirements?

The overall reporting requirements will be clarified soon and training/workshops will be provided on the information requirements. Communication number 4 highlighted that Aberdeen College has agreed to pilot the work on the '2014-15 FReM disclosures, this work is underway and we expect to be in a position to circulate the outcome of this exercise to the sector when completed. See also questions 1.16 and 1.17 above.

Support for Colleges

2.53 Clarify support to be provided by SFC to colleges

The SFC will continue to assess the support needs of colleges.

See Communication number 5 and Communication number 9.

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Accounting Framework

2.54 Will Colleges be able to use the UK GAAP based FE/HE SORP in 2014-15 and what is the implementation date for IFRS?

HM Treasury have confirmed that College's will be able to continue to use the current FE/HE SORP for the 2014-15 financial year with the required additional FReM disclosures. IFRS will be implemented, in line with the forthcoming FE/HE SORP, for the 2015-16 financial year and subsequent periods.

Colleges will therefore be expected to follow the new IFRS based FE/HE SORP and the required FReM disclosures for 2015-16. This is still subject to Treasury Agreement.

This issue was also considered at question 1.16 (see above) and in Communication number 4.

2.55 When will colleges need to prepare Whole of Government Accounts (WGA) Returns?

Our current understanding is that Colleges will not need to begin to prepare Whole of Government Accounts (WGA) returns for the 2014-15 financial year. The first year that colleges will need to prepare WGA returns will therefore be 2015-16. This is subject to confirmation by the Scottish Government.

Guidance on how to fill in the WGA return will be provided to colleges in 2015-16.

See also question 2.49 above on Whole of Government Accounts.

Accountable officer

2.56 Who will be the accountable officer for Colleges after the reclassification?

The Chief Executive of the SFC will remain, as now, the accountable officer for the College sector. Further detail on this issue was provided in Project Board Update 2. The Scottish Funding Council is currently revising its *Financial memorandum* with the sector and will consult on the revised *Financial memorandum* in due course.

Pension deficits

2.57 What happens if, as a result of reclassification, a college does not have sufficient reserves to 'cover' their pension deficits?

The pension deficit reserve will remain in the balance sheet and need to be covered by other reserves. A statement will be included in the annual financial statements under Accounting Policies, Going Concern, similar to the one below.

"To the extent that the pension deficit is not met from (College name) other sources of income it may only be met by future grants or Grants from the Scottish Funding Council. This is because, under the normal conventions applying to parliamentary control over income and expenditure, such grants may not be paid in advance of need. The Board of (College) has no reason to believe that either the Scottish Funding Council grant or future Ministerial approval will not be forthcoming or will only provide a reduced support to (College). Given the above it has accordingly been considered appropriate to adopt a going concern basis for the preparation of these financial statements."

The exact wording of the statement to be included in the financial statements is being considered. Communication number 8 contains further details on this issue

Arms-length foundation: Legal form

2.58 What is the appropriate legal form for an arms-length foundation?

There are two legal forms available to foundations, the Company Limited by Guarantee (CLG) and Scottish Charitable Incorporated Organisation (SCIO). The main difference is that company law does not apply to a SCIO as it does for a CLG. The umbrella foundation will be set up as a company limited by guarantee.

Colleges/regions that set up their local arms-length foundations should seek advice on the most appropriate legal form for the arms-length foundation. Colleges should note that ensuring the independence of the foundation is critical.

Further information on arms-length foundations is contained in Communication number 1, Communication number 3 and Communication number 7 and in questions 2.7 and 2.34 to 2.38 above

Government Pay Policy

2.59 Will Colleges be part of Scottish Government Pay Policy?

The Scottish Government have confirmed that Colleges should not be part of the public pay policy process.

Deferred Capital Grants

2.60 In 2015-16, what would the accounting be for deferred capital grants should they need to be released in bulk to comply with the FE/HE SORP?

In 2015/16, the Deferred Capital Grants (DCG) would be merged with the Income & Expenditure reserve account on the balance sheet. There would be an increase the depreciation charged to the Income & Expenditure account as a result of the removal of the DCG offset. However, additional non-cash budget would be given to match the depreciation charge increase.

This assumes that the new SORP is applied as currently stated in the consultation, which is the accruals model of grant recognition is disallowed and the performance model is favoured.

See also questions 2.31 and 2.32 above on the accounting treatment of deferred capital grants.

2.61 For 2014-15, what is the interaction between Deferred Capital Grants and non-cash budget cover?

In 2014-15, as colleges will still be releasing deferred capital grants in their income statements to offset depreciation, colleges will be given/apply for sufficient budget cover to cover the net impact of depreciation on the Colleges Income statement.

For example:

If a college had depreciation of £700,000 and deferred capital grant release of £600,000 in 2014-15, it would be able to apply £100,000 of non-cash budget cover to match depreciation impact.

If a college had depreciation of £700,000 and deferred capital grant release of £700,000 in 2014-15, it would be able to apply £0 of non-cash budget cover. This is because the impact of depreciation has already been covered by the release of deferred capital grants.