CIPFA The Chartered Institute of Public Finance & Accountancy

SORP Exposure Draft

Accounting for Further and Higher Education

Consultation response

November 2013

the people in public finance

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for accountants working in public benefit organisations as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

For more information on this response contact Kerry Ace, Finance and Policy Manager
kerry.ace@cipfa.org

General Comment

CIPFA welcomes the opportunity to respond to the SORP Exposure Draft Accounting for Further and Higher Education. CIPFA supports initiatives aimed at strengthening accountability and promoting improvements in the quality of reporting.

This response focuses on the questions included in the consultation document.

Responses to questions

1 Do you have any general comments, specific issues or remarks you would like to make on the SORP2015 ED?

No.

FRS102 permits either a single "Statement of Comprehensive Income" or two statements of "Income and Expenditure" and a "Statement of Other Comprehensive Income". The SORP Board is proposing a single performance statement. Whereas the two statement approach appears to be similar to the current I&E Account and Statement of Total Recognised Gains and Losses (STRGL), accounting changes will result in items that were formerly credited to either the STRGL (eg new endowments) or the balance sheet (eg capital grants) now being credited to the income statement. This has led the SORP Board to conclude that there is little merit in retaining the two statement approach so it is proposing a single "Statement of Comprehensive Income".

2 Do you agree with the SORP Board's proposal to adopt a single "Statement of Comprehensive Income"?

Yes. The STRGL separate statement increases complexity and producing a single statement will simplify presentation and improve readers' understanding. However, in our view it would be helpful for readers of the financial statements to be able to identify readily the operating surplus or deficit.

The proposed Statement of Comprehensive Income includes two income lines, one as a sub-total showing income before grants and donations and the other including grants and donations. This is an attempt to separate out large and potentially distorting income items such as capital grants and donations to better judge recurrent income. However, donations can be regular and these would be captured in the grants and donations line rather than in the line that purports to present recurrent income. There is also a cost of having sub-totals on primary statements in that it adds complexity and detracts from understanding.

3 Do you agree with the SORP Board's proposal of having a sub-total showing total income before grants and donations on the face of the Income statement?

Yes.

A significant differentiator between charitable institutions that report under the FEHE SORP and those in the wider charity sector is that the majority of funds/reserves in FE and HE are unrestricted. The Charity SORP presents primary statements in columnar style, reflecting the predominance of restricted income as the main form of activity in that sector. The SORP Board's view is that this style of presentation would not be appropriate for the FE HE sector because unrestricted income comprises the majority of business activity and because the columnar presentation detracts from the focus on single figures for revenue, costs and surplus as the key measures of performance. Instead SORP addresses the issue by analysing comprehensive income for the year into endowment, restricted and unrestricted components at the foot of the Consolidated Statement of Comprehensive Income.

4 Do you agree with the SORP Board's proposal that the primary statements should be based on a single column presentation?

CIPFA agrees with the SORP Board's proposals that the primary statements should be based on a single column presentation. In our view, it is appropriate for the columnar approach detailing restricted income to be retained for the purposes of the Charities SORP. For many traditional charities there would be no real understanding of a charity's true financial position with regard to key funds and related activities if this were not the case. However, for the further and higher education sector, unrestricted income forms the main body of funding and a columnar approach would give the financial statements an unnecessary complexity with no real benefit.

Property, plant and equipment are assets held for use in the supply of services, for rental to others or for administrative purposes. Investment property assets are held to earn rental or for capital appreciation rather than for use in the supply of services. The SORP Board has concluded that student accommodation is an operational asset, ancillary to the provision of education and should be reported as property, plant and equipment in group financial statements. This approach aligns with both the taxation treatment of student accommodation operations as a primary purpose activity and the current 2007 SORP. As a consequence of this proposed approach institutions would have accounting policy choices to record such assets (i) at cost or (ii) at valuation, whereas if such assets were classed as investment property then the valuation model would be generally required.

5 Do you agree with the SORP Board's proposal that student accommodation should be classed as property, plant and equipment rather than investment property in group financial statements?

Yes, this looks reasonable.

FRS102 prohibits gains from the disposal of property, plant and equipment from being recognised as revenue in the Income Statement [FRS102, 17.28]. The SORP Board is proposing to show gains or losses on disposals after total expenditure but before surplus for the year. This proposal removes the possibility that total expenditure could include a large negative value (eg a gain arising on disposal of property).

6. Do you agree with the SORP Board's proposal to show gains and losses on the disposal of property, plant and equipment after total expenditure but before the net surplus for the year?

Yes.

The SORP Board proposes that institutions are not permitted to apply the accruals model for accounting for Government provided grants. This would principally impact on government capital grants as the current practice of releasing capital grants to income over the life of the asset would no longer be permitted. Instead the SORP would require the performance model to be adopted for government grants. This is in line with the FRS102 requirement to recognise income in line with performance related conditions for non-exchange transactions, where no accounting policy choice is offered by FRS102. The proposal also aligns with the Charity SORP as well as public sector financial reporting manuals. The SORP Board considers that if institutions were to retain the accounting policy choice for government grants this could have significant implications for regulators in terms of how they monitor the financial health of institutions and how they construct sustainability KPIs on a comparable basis. It might also impact on TRAC and fEC methodologies for regulated research funding in HE. An alternative approach would be for the SORP to permit the accounting policy choice allowing individual regulators, across HE and FE and across the UK jurisdictions, to come to their own view on whether they considered it necessary to restrict any particular accounting policy choice via their Accounts Directions.

7 Do you agree with the SORP Board's proposal to not permit the accrual model for Government grants, or would you prefer the SORP to not restrict any FRS102-permitted accounting policy choices and leave it to individual regulators to come to their own view on whether or not they wished to restrict accounting policy choices via their Accounts Directions ?

While CIPFA generally considers the performance model to be a better approach to grant accounting, it is not clear whether the SORP Board has provided sufficient justification for its proposals to restrict immediately the application of FRS 102 permitted accounting policy choices for accounting for Government provided grants, without waiting for the outcome of a planned FRC research project in this area.

The FRS 102 standards document includes an explanatory section 'The Accounting Council's Advice to the FRC to issue FRS 102'. On the specific subject of grants, the advice explains that FRS 102 has moved away from the original proposal in FRED 44 which was framed purely in terms of the performance model.

The inclusion of the accrual model in FRED 48 and then FRS 102 followed a general approach adopted by the Accounting Council, which was to allow reporting models which are not included in the IFRS for SMEs, provided that these were supported by UK stakeholders and that the models were allowable under both current UK GAAP, and EU adopted IFRS. In a number of cases, including grant accounting, this was for pragmatic rather than purely conceptual reasons.

In the light of the above factors, the Accounting Council's preferred option for grant accounting would be to develop additional guidance to augment the performance model. However, this was not pursued immediately because of concerns that it would delay finalisation of FRS 102. While recognising there would be an element of inconsistency with the treatment of non-government grants, FRS 102 was issued as an interim solution, pending completion of a research project to develop additional guidance on grant accounting. The next iteration of FRS 102 may thus contain further changes to grant accounting. The Accounting Council advised that FRS 102 include the accrual model to avoid the situation where changes to accounting might be reversed in future.

Against this background, and recognising that many of the stakeholders who requested the continuation of the use of the accrual model were in the public benefit sector, we would advise a degree of caution in restricting the options at this time.

While we agree with the SORP board observations on consistency with non-government grant accounting, we would observe that this is a factor already considered by the Accounting Council.

As regards the effects on the regulatory regime, the regulators already have funding and other arrangements in place that are based on current UK GAAP accounting (i.e. using the accrual model). While adopting the performance model may improve the information available to regulators through financial statements, we are not aware of any particular problems that have arisen with UK GAAP information. Given that the FRC has not yet progressed its project on grant accounting, it may be more appropriate for individual regulators to consider whether to make changes to their arrangements immediately, having regard to the specifics of grant funding and other matters, or to consider making changes over a longer period to allow for any practical implications to be addressed.

The SORP proposes how government grants and non-exchange transactions with performance related conditions are treated. These might include charity-funded research, capital grants and donations. FRS102 requires that such receipts are recognised when performance conditions are fulfilled [FRS102, PBE34.67(b)]. FRS102 defines a performance condition as "a condition that requires performance of a particular level of service or units of output to be delivered". The SORP requires receipts to be treated as deferred income until performance conditions are met, permitting time to be used as a proxy for units of output delivered. For example, a donation that stipulates that the funding is to be used to fund a Chair of Oncology over 5 years would be spread over 5 years upon appointment of the Chair.

8 Do you agree with the SORP Board's proposal that a time condition stipulated by grantors and donors is a performance condition?

Yes.

The SORP proposes that actuarial pension deficits (ie formerly FRS17 type pension deficits) and provisions for funding of multi-employer deficit recovery plans be shown on the face of the balance sheet under a single heading "provision for pension liabilities", with detailed disclosure in the notes to the financial statements. Other, non-pension, provisions for liabilities would be shown in a separate line on the face of the balance sheet. The provision for pension liabilities could include two types of pension liabilities (ie actuarial deficits and provision for multi-employer deficit recovery plans) which are measured on different bases. However, the general reader is likely to conclude that both are pension liabilities. They are also likely to be material, warranting separate disclosure on the face of the balance sheet from other non-pension liabilities. Reporting pension liabilities separately from the provision for other (non-pension) liabilities also helps to distinguish liabilities generated by other entities (ie pension funds) from liabilities arising out of the institution's own operations (eg restructuring-type provisions).

9 Do you agree with the SORP Board's proposal to show two lines on the face of the balance sheet, one capturing provision for pension liabilities, the other showing all other provisions for liabilities?

Yes.

FRS102 requires the disclosure of 'key management personnel compensation' in total, ie as an aggregate figure [FRS102, 33.6-33.7] FRS 102 defines key management personnel as "those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity". While regulators' requirements (via Accounts Directions) to disclose the Vice-Chancellor's/Principal's remuneration, along with the remuneration of higher paid staff are likely to capture all of these costs, such disclosures may also capture other staff costs who are not key management personnel (eg senior professors in Medical and Business Schools), the SORP Board has agreed that for an institution "key management personnel" which would normally be the senior management team.

10. Do you agree with the SORP Board's proposal that the key management personnel compensation disclosure be defined as an institution's senior management team?

Yes, this seems reasonable.

There is an increasing emphasis on accountability and transparency in relation to pay and other benefits in both the corporate and public sector. Listed companies are required to provide "remuneration reports" and the public sector provides fuller disclosures in relation to higher paid staff and non-executives. Within FE and HE the disclosure regime has evolved from a number of sources - the SORP (requiring Principals/VC disclosures, aggregate trustees expenses), Accounts Directions (high band disclosures and compensation for loss of office) and now FRS102 (requiring the total remuneration of key management personnel to be disclosed).

11 Would you support adopting a more comprehensive remuneration disclosure regime for higher paid staff, and for trustees, in the SORP? If so, what disclosures should be made?

Although we support the increasing emphasis on accountability and transparency, we do not support further disclosure for higher paid staff and for trustees through the SORP. The danger is a focus on a few individuals and their circumstances rather than policies, strategy and the performance of the institution. Furthermore, it is unclear that the approach of declaring highest paid salaries is preferable to other approaches. We would suggest that research is needed on the various approaches to reporting staff related costs and the related benefits and costs.

FRS102 requires institutions that have service concession arrangements, such as some student accommodation provided by third parties, to be accounted for as a finance lease [FRS102, 34.12E]. The SORP sets out guidance on identifying service concession arrangements and how the finance lease liability model would be applied. Where a service concession arrangement is identified, the SORP requires the asset and matching liability to be accounted for to the extent that a guarantee, which could be in the form of an occupancy guarantee, is provided - regardless of whether that guarantee is called upon or not. This is likely to result in assets and liabilities that are currently 'off-balance sheet' coming on to balance sheet. Such assets and liabilities are likely to be recorded at less than the fair value of the underlying asset since in most cases the occupancy guarantee is likely to be for less than 100% occupancy. Where the arrangement provides for annually renewable nomination rights, with no minimum requirement over the term of the contract, then the service concession would not be recognised as an asset or a liability as there is no guaranteed payment to account for under the lease liability model. However, disclosures about the nature of the service concession would be required whether the asset/liability was recorded on the balance sheet or not. Note – operators have been given transitional arrangements in implementing accounting for service concession arrangements [see FRS102 35.10(i)] which means operators will not implement the new accounting retrospectively in their opening balance sheets. However, FRS 102 does not apply these transitional arrangements do not apply to public benefit entities as grantees.

12 Do you agree with the SORP Boards interpretation of FRS102 with respect to how service concession arrangements should be accounted for?

Yes.