Office of National Statistics Reclassification Briefing Note on Change of Accounting Year End

Purpose

This briefing note provides advice in relation to changes impacting on the college sector as a result of the change to the accounting year end following the Office of National Statistics (ONS) reclassification. The note is intended for board members, principals and other college senior managers in order to aid their understanding and provide support for decision making. Colleges Scotland sought and received advice from the CDN Finance Development Network, Scottish Funding Council (SFC) and Audit Scotland in preparing this note.

Background

There are several areas of complexity as a result of the ONS reclassification of colleges. This reclassification brought incorporated colleges within the public sector, with greater accountability to the Scottish Government. These individual colleges are still separate legal entities with their own autonomy, but the financial and management framework in which they operate has changed. For example, central government accounting rules and finance reporting requirements now apply to the sector, for incorporated colleges. However, the existing accounting rules still apply for the preparation of the management accounts, and the formal financial statements will still comply with the Statement of Recommended Practice (SORP) except where government accounting requirements go beyond the SORP.

Scope

This briefing note covers the following topics:

1. Year-end Date Change
2. March 2015 Resource Returns
3. External Audit Review of Colleges’ Resource Return
4. Treatment of Net Depreciation
5. Possible Deficits at March 2015 and July 2015
6. Governance Arrangements

1. Year-end Date Change

Following recent changes, all incorporated colleges now have their financial year-end to match the academic year (AY). That is, colleges’ financial year end will be 31 July each year. College audited financial accounts for 2014/15 will be prepared as at 31 July 2015. Please note, due to this change of date, the accounts for 2014/15 for the non-UHI incorporated colleges will cover a 16 month period (from April 2014 to July 2015).

2. March 2015 Resource Returns

Scottish Government funding is accounted for on a fiscal year that finishes at the end of March each year – hence the need to complete the March resource returns. The resource return captures financial information for each college and is returned to SFC at the end of each quarter (with monthly returns in the final quarter). These are used for government accounting purposes and monitor how
the budget available to the college sector was spent. The returns are important documents which should be completed as accurately as possible. In addition to the normal guidance on the completion of the resource return, SFC drafted a resource return checklist to assist the sector in completing the March returns. This was circulated prior to the Finance Development Network Event on Friday 27 February 2015.

3. External Audit Review of Colleges’ Resource Return

Colleges Scotland, SFC and Audit Scotland have held discussions regarding the level of assurance that will need to be provided to the Scottish Government and HM Treasury in relation to the March resource return.

It is proposed that a limited ‘review engagement’ is undertaken of the 31 March financial information. This would be a system based approach that checks that appropriate and robust processes are in place and which help demonstrate how the management accounts have been used to generate the resource return.

The objective of a review engagement is to enable an auditor to state whether – on the basis of procedures undertaken – that anything has come to their attention that causes them to believe that the financial returns are not prepared, in all material respects, in accordance with the applicable financial reporting framework (negative assurance).

It should be noted that the proposed approach is subject to acceptance by the Scottish Government. Some of the work undertaken by the auditors, as part of the review, will be work normally undertaken by them as part of the college’s interim and final accounts audit.

The procedures required include, but may not be limited to:

- Obtaining an understanding of the college’s business activities and the system for recording financial information and preparing financial statements.
- Obtaining the trial balance and determining whether it agrees with the general ledger and the financial returns.
- Enquiring whether there have been any significant changes in the entity or the accounting policies.
- Obtain the financial returns and discuss them with management.
- Analytical review procedures.
- Obtaining schedules and reconciliations for items such as cash, receivables and property.

The scope of a review engagement is more limited than an audit, and effective engagement with colleges at the planning stage with individual auditors would minimise the audit input required. Whilst there may be some increase in overall audit costs as a result of the introduction of this review, effective planning and working papers would limit any increase. Audit Scotland will liaise with auditors and prepare guidance on the requirements for the review engagement.

Further detailed guidance, including guidance on balance sheet adjustments, will be provided in the near future.

4. Treatment of Net Depreciation

Prior to reclassification, colleges used the funds available to them to cover depreciation charges on their fixed assets and generally used these funds to refresh their capital assets and/or to repay the loan debt related to their existing assets. Following reclassification, colleges have been given a cash budget to cover their costs, including depreciation (and a separate budget for fixed assets). Since depreciation is not a cash cost, this means that without Scottish Government approval, the amount set aside against depreciation is not available to spend by the college sector (even though it is part of the overall budget for the sector).
An arrangement has been agreed between Colleges Scotland, the Scottish Government and SFC to allow this cash balance for depreciation in financial year (FY) 2014/15 to be spent by the college sector within certain parameters. Firstly, the cash released should be used to bridge the student support funding gap. However, the agreement reached provides that once the student support funding gap is covered, the remainder of the cash can be used to address some specific regional pressures already identified in two regions and to pay down debt, where this represents value for money (VfM).

If a college has cash remaining after covering the above costs, then the individual college should contact SFC to discuss the use of the money for items such as spend brought forward from the following year or expenditure that enhances the student environment.

Looking forward to FY 2015/16, a similar arrangement involving use of the cash balance from depreciation to cover the student support funding gap is likely to be put forward by the Scottish Government, as pressure on the funding will continue for the remainder of the academic year (April – July 2015). However, Colleges Scotland has been robust in presenting the view that this arrangement is not sustainable, and we have received a commitment to take forward tripartite discussions between Colleges Scotland, the Scottish Government and SFC to find longer-term solutions to these issues.

5. Possible Deficits at March 2015 and July 2015

March 2015

The spending of the cash balance from depreciation does however impact the management accounts that colleges will prepare, in that it could result in a deficit being posted. However, such a deficit should not give rise to concern or lead to auditors qualifying the accounts as the additional expenditure giving rise to the deficit has been met from Scottish Government’s grant and is being spent in accordance with government accounting and budgeting rules. There is a commitment from all parties involved in this arrangement that a common message will be presented as to the reasons for such a deficit.

The spending of the cash balance from depreciation will – all other aspects being equal – mean that the resource return as at the end of March will balance i.e. that the full cash budget made available to the college sector has been spent. There may be a deficit in the management accounts that colleges will prepare as at end March 2015, but these accounts are not published and are for internal use and to help prepare the resource return. Colleges Scotland understands that the expectation of Audit Scotland is that this will not be an issue raised by auditors, provided the deficit is as the result of the spending of the cash balance from the depreciation, as opposed to another underlying issue. Colleges Scotland also understands that Audit Scotland will be relaying this message to the audit companies during April 2015.

July 2015

The arrangements around the use of the cash balance from depreciation could result in a deficit being posted in the income and expenditure (I&E) account as at the end of July. These accounts are published. There will be the application of other legitimate accounting adjustments during the preparation of these accounts, so it is difficult at this stage to know what the overall surplus or deficit will be. However, SFC and Audit Scotland have confirmed, that providing any deficit is as a result of the use of the cash balance from depreciation or agreed appropriate accounting adjustments, and not due to an underlying issue, then the expectation is that this will not be an issue raised by auditors, and does not impact on the ongoing financial sustainability of the college. Again, there will be a common message agreed between all parties.
6. Governance Arrangements

With regard to the arrangements around depreciation – as with any financial decision – it is important that decisions are made through the appropriate governance channel. In single college regions, the governance arrangement would be for the individual college board to take that decision. In multi-college regions the governance arrangements are more complex as the Regional Strategic Body is responsible for strategic matters, however the individual assigned college board is responsible for the financial management of the assigned college.

7. Finance Development Network Event – Friday 27 February 2015 and Further Assistance

- SFC attended the Finance Development Network event on Friday 27 February 2015 to provide assistance in the completion of the end March resource return. This allowed for specific questions on the completion of the resource returns to be addressed.
- SFC has offered to run a briefing session for college board members at a future date.
- SFC is in contact with each individual college to discuss specific issues around depreciation. If you wish to discuss further, then please contact Andrew Millar (Email: amillar@sfc.ac.uk) or Dorothy Carson (Email: dcarson@sfc.ac.uk) at SFC.
- Further advice can be provided by Colleges Scotland, please contact Andrew Witty, Funding and Finance Policy Lead (Tel: 01786 892058 or Email: andrew.witty@collegesscotland.ac.uk).

Colleges Scotland
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