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Reporting and accounting update for Higher Education Institutions ('HEIs')

"The new HE SORP presents HEI's and their auditors with a series of fresh challenges for July 2008 year ends."

Introduction

The year ending 31 July 2008 brings with it fresh compliance challenges in the form of the new Statement of Recommended Practice ("SORP") for Higher Education Institutions ("HEIs"). In this issue we cover some key areas of the new SORP as well as other matters of interest to HEIs in their preparation for year end and beyond, including:

- Heritage Assets;
- Operating and Financial Review;
- Donations and Endowments;
- Pension scheme valuation changes;
- Implications of the Charities Act 2006;
- Taxation Considerations;
- Implications of the Companies Act 2006 for subsidiaries of HEIs; together with our
- Supplementary financial year end checklist.

Heritage assets

This controversial topic in the HE SORP enforces new requirements on HEIs. The Accounting Standards Board ("ASB") has recently issued a second exposure draft ('FRED 42') on accounting for heritage assets, following lengthy consultation on the earlier exposure draft ('FRED 40') published in December 2006. The main changes from FRED 40 are "the removal of the need to consider the accounting approach at the level of an individual collection" and "the requirements for the recognition and measurement of heritage assets are now based on FRS15 'Tangible Fixed Assets'".

The current exposure draft highlights that heritage assets should be reported in the balance sheet where information on cost or valuation is available even though this may not cover the entire portfolio of an HEI's heritage assets. The view is that the enhanced disclosure requirements around an HEI's holding and stewardship of such assets will make this clear and, therefore, it is better to show some assets recorded in the balance sheet rather than none. It is worth noting that HEIs will be allowed to use internal valuations without the need to perform full valuations every five years. Donated heritage assets should be reported in the income and expenditure account at current value at the date they are received.

The ASB have requested further comments on this new exposure draft by 10 October 2008, particularly in the areas of enhanced disclosures, the applicability of FRS 15, the relevance of impairment reviews and the costs involved with valuations. Although not set in stone, FRED 42 may assist some HEIs in applying the Heritage Asset section of the HE SORP.

Firstly, HEIs should be attempting to identify their heritage asset population. They should then look to value these assets unless 'reliable cost information is not available and conventional valuation approaches lack sufficient reliability' or 'significant costs are involved' as noted in paragraph 103 of the SORP. The disclosure requirements of paragraph 104 of the SORP and the potential for prior year adjustments will also need to be considered.

Operating and Financial Review ("OFR")

HEIs will now have to put more thought into the 'front-end' of the financial statements to provide a comprehensive, balanced and neutral analysis of the Institution's finances and operations. We would urge HEIs to give early consideration to this area and not underestimate the amount of work required in considering the format and content of this review. In particular, we highlight the requirement that the review should be 'comparable over time' (SORP paragraph 26(g)) and as such, when considering key performance indicators for the organisation, HEIs should be mindful of how their financials will look in future periods as well as the current year.

Our "Written to order" publication which surveys OFRs, Enhanced Business Reviews ("EBRs") and narrative reporting in annual reports can be found on our website www.deloitte.com under United Kingdom > Services > Audit.

Whilst aimed primarily at listed companies, the above publication does provide useful guidance and background on the reporting requirements of an OFR. The above publication also includes a useful disclosure checklist in Appendix 1 which is based on the UK Accounting Standard Board's "Reporting Statement: Operating and Financial Review" which was published in January 2006 as a statement of best practice on OFRs. Paragraph 25 of the HE SORP makes reference to this best practice reporting statement.

Donations and endowments

The new HE SORP now includes much more detailed guidance on accounting for donations and endowments. This clarification means that HEIs are now having to revisit previous policies and accounting treatments in order to check that items have been classified correctly as either income, deferred income or endowments to ensure compliance with the new SORP.

In establishing the correct classification between account balances the SORP refers to FRS 5 Application Note G. This "requires that revenue should be recognised only when a right to consideration exists and states that a right will exist only to the extent that performance of the contractual obligation has taken place".

The wishes of the donor are of primary importance here in determining conditions and restrictions placed on donations. As such, HEIs should be making reference to underlying records held and, if considered necessary, (and possible), making contact with donors. HEIs need to be careful of the distinction between a condition (which determines when the revenue should be recognised) and a restriction (which relates to how the income should be used) although the two terms can often be interrelated.

For donations, other than those identified as endowments or those which relate to fixed assets, there will be an assessment around when to take the donation to income, depending on the conditions attached to its receipt. In making these assessments, it is important that HEIs ensure they apply a consistent policy from one year to the next.

Pension scheme valuation changes

The method of valuing investments under UK GAAP for pension schemes has changed from 'mid-market value' to 'current bid price' for accounting periods commencing on or after 6 April 2007. This change is applicable for both FRS 17 and the Pensions SORP and is a change in accounting policy and so prior year figures should be restated where applicable.

In practice, there have been issues where the actuaries cannot provide the prior year opening and closing balances at the then current bid price, so it is worth HEIs liaising early on this matter to address any potential disclosure issues.

Implications of the Charities Act 2006

The Charities Act 2006 extends the Charity Commission's monitoring, investigation and enforcement powers to exempt charities. Under the Act, the relevant legislation for HEIs is expected to cover the appointment of HEFCE as a principal regulator and the granting of exempt status to HEIs which are currently registered as charities.

Many provisions of the Charities Act were implemented in 2007 with further provisions brought in during early 2008. However, it should be noted that for exempt charities, which includes many student unions, further time is needed by the Charity Commission and HEFCE to prepare for changes brought in by the Act and as such, we are advised not to expect further implementation of the Act in this area before 2009.

The detail of these provisions can be obtained from the Charity Commissions own website:
http://www.charity-commission.gov.uk

Taxation considerations

Following the issue of new guidelines between HMRC and BUFDG on taxation, HEIs should be reconsidering what steps they have taken in this area to ensure that they are in compliance with relevant tax guidance and legislation. In particular, HEIs should consider whether they have appropriate processes in place; i) to identify non-primary purpose ("NPP") activities including any new activities taken up in the year; and ii) to allocate costs fully to NPP activities, as where trading activities are performed wholly outside that of the Institutions primary purpose or objects, a liability to tax can arise.

Furthermore, where an HEI makes an investment that is not a qualifying investment within Sch 20 ICTA 1988, the amount of the investment is treated as non charitable expenditure and can result in a tax liability.

> "New guidance in respect of donations and endowments has the potential to generate significant adjustments to previously reported results."

HEI financial year end checklist 2007/08

Task	SORP REF	Check '✓'
Donations and Endowments		
Analyse all endowments to determine whether they have been correctly treated in light of the guidance given in the HE SORP, i.e. consider whether a prior year restatement is required to income, deferred income or general reserves.	132 to 158	
Check endowment classifications are disclosed appropriately as unrestricted or restricted and supported by underlying records.	133 to 136	
Check endowment classifications are disclosed appropriately as permanent or expendable and supported by underlying records.	145 to 148	
Check the endowment splits between capital and accumulated income are accurate and supported by underlying records having analysed movements back over an appropriate period.	152	
Consider the disclosure requirements of the HE SORP.	148 & 149, 152 157 & 158	
Deferred Income and Deferred Capital Grants		
Review deferred income balances at 31 July 2006 and 31 July 2007 for amounts that should now be classified as endowments or included directly in the income statement and consider whether prior year restatements are therefore required.	132 to 158	
Review deferred capital grants for restricted donations given in respect of land purchases. Consider where the deferred capital grant has already been applied to the purchase of the land, whether a prior year adjustment is required to release the deferred capital grant to general reserves.	153	
Operating and Financial Review		
Consider the individuals who will have input into this review and notify them of the new requirements.	25 to 27	
Consider the disclosure requirements of the HE SORP and perform a gap analysis to the prior year governance report.	25 to 27	
Heritage assets		
Identify your heritage asset population and ensure recent acquisitions have been appropriately accounted for at cost.	100 to 102	
An assessment of other heritage assets should be made and a value included in the accounts, except where 'reliable cost information is not available and conventional valuation approaches lack sufficient reliability' or 'significant costs are involved'.	103	
Additional disclosures should be checked.	104	
Other		
Reconsider scope of consolidation and reconfirm appropriateness of any excluded entities (e.g. student unions).	210	
Confirm the availability of appropriate pension scheme information with the actuary.	177 to 205	

Implications of the Companies Act 2006 for subsidiaries of HEIs

Almost ten years ago the Government decided that the time had come to embark on a fundamental review of the framework of company law. The object of the review was to put forward proposals for a modern law for the modern world which would promote the competitiveness of UK companies. The Act is the largest piece of legislation to pass through Parliament and runs to almost 1,300 sections. It is an amending and reforming statute that seeks to consolidate existing company legislation, to restate the previous law into clearer and simpler language and to introduce new provisions.

Some of the key changes to emerge from the Act, which may be relevant to subsidiaries of HEIs are as follows:

- directors' duties have been codified in statute for the first time;
- shareholders are given a new statutory right to sue directors in a derivative action on behalf of the company for negligence, default, breach of duty or breach of trust;
- private companies will no longer be required to make a statutory declaration when providing financial assistance for the purchase of their own shares. It will also be simpler for private companies to reduce their share capital;
- auditors will be able to limit their liability through a contractual arrangement ("a limited liability agreement") with their client;
- under a new protection, a director would be held liable only to the company itself for a statement in, inter alia, the directors' report if the director knew that the statement was untrue or misleading, or was reckless as to whether this was the case; and
- the time for private companies to file their accounts with the Registrar of Companies has been reduced from 10 to 9 months from their year end.

The Government has adopted a staggered implementation timetable for the Act, however generally the requirements on the form and content of accounts and reports in Part 15 of the Companies Act 2006 and new regulations to be made under it will be commenced with effect for accounts and reports for periods beginning on or after 6 April 2008. Accounts and reports for periods beginning before then will continue to be prepared in accordance with the Companies Act 1985 or the Companies (Northern Ireland) Order 1986.

For a useful summary of the new provisions and answers to commonly asked questions, please consult our Deloitte publications, "CompAct – Q&As on the 2006 Companies Act" and "Reporting CompAct – More Q&As on the 2006 Companies Act", both of which can be found at **www.deloitte.co.uk/corporate governance**

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