**Earnings Before Interest, Taxation, Depreciation and Amortisation (EBITDA)**

**Clarifying the Definition for the HE Sector**

**What is EBITDA?**

It is a measure of operating surplus, excluding the major accounting adjustments and finance charges. It measures operating performance before local decisions on accounting and financing policies are taken into account. It provides a good indicator of financial capability to service debt and/or fund capital expenditure from internally generated cash.

**Why does EBITDA need a standard definition?**

There is no authoritative definition of EBITDA and HE has some unique features which are different from those faced in the corporate sector:

* Capital expenditure funded by capital grants results in deferred income. As well as adding back depreciation charges to arrive at EBITDA, the release of deferred capital grants should also be excluded as these are a consequence of a financing method and a product of an accounting policy.
* PLCs account for finance charges on a net basis, ie finance are based on the net of interest payable and interest receivable and EBITDA excludes these net finance charges. However, the HE SORP grosses up finance income and expenditure on the face of the I&E, reflecting a business model where, in substance, endowment income funds operating expenditure in the form of endowed posts, scholarships and prizes – even though such funding is legally separate from university reserves. In HE endowment investment income should not be excluded from EBITDA (as it matches operating expenditure) but interest and investment income from fixed and current asset investments (eg short term deposits) *could* be considered a legitimate deduction. However, it is proposed that general interest and investment income is not treated as an EBITDA adjustment on grounds of materiality (HEIs are essentially *not for profits* with small operating margins – we are different from the corporate sector).

**Why is this clarification being issued?**

The previous definition (May 2012) created some confusion because its starting point was ‘historic cost’ surplus but it ignored some historic cost adjustments such as release of revaluation reserves for example. It is important that a consistent accounting basis is used throughout the calculation.

The revised EBITDA definition starts with the operating surplus for the year reported on the face of the I&E. This means that if a HEI adopts modified historic cost accounting, all other things being equal, its surplus will be lower than a HEI that adopts historic cost accounting as a result of bearing a higher depreciation charge based on higher carrying value of its assets. The resultant EBITDA calculation will however be identical for both HEIs once depreciation is added back to the operating surplus.

Other historic cost adjustments, shown in the memorandum note on the face of the I&E, such as release of revaluation reserves on disposals are ignored. HEIs that record high ‘book profits’ on asset disposals compared to those reporting lower profits on disposals arising from modified historic cost accounting are not advantaged as the definition of EBITDA excludes FRS3 exceptional items as profits on disposals.

The definition of EBITDA will need to be revisited in the light of FRS102. BUFDG will review the impact on EBITDA following the adoption of a new SORP.

**EBITDA Definition (revised November 2013)**

|  |  |  |
| --- | --- | --- |
|  | **Surplus for the Year retained within general reserves** | Taken from the face of the I&E Account, this measure addresses the funding of expenditure from accumulated or expendable endowment funds, an intrinsic part of the HE business model. *Note: this measure of the surplus is NOT the measure used by HESA which captures the surplus before transfers to funds and is based on historic cost memorandum information.* |
| + | Interest payable | Interest payable on debt + FRS17 finance charges/(credits) .  |
| + | Tax charges/(credits) |  |
| + | Depreciation | The gross depreciation charge based on asset carrying values, regardless of whether assets are revalued or not. This would include impairment charges. |
| - | Release of deferred capital grants | Release of deferred grants from all sources, eg. Funding Councils, Research Councils, former RDAs. |
| + | Amortisation | Including release of goodwill/(negative goodwill) |
| - | Exceptional items as defined in FRS3 | Excludes one-off exceptional items such as profits/losses arising from the disposal of fixed assets, profits/losses arising from the sale or termination of an activity or costs of a fundamental restructuring (defined by FRS3).*Note: this approach reduces the room for interpretation. Many HEIs isolate what they consider exceptional items that don’t meet FRS3 definitions – eg in narrative reporting or by introducing separate lines ‘above the line’ on the face of the I&E. However, such an approach is open to inconsistent interpretation and should not be carried through to the EBITDA metric.*  |
| + | FRS17 staff charges/(credit) | The FRS17 adjustment, which could be a debit or a credit, that is reported through the ‘staffing cost’ line in the face of the I&E. Its exclusion mirrors the treatment of the FRS17 finance charge/(credit). |
| **=** | **EBITDA**  |  |

Andrew Connolly

Chair, BUFDG Financial Reporting Group

Chief Financial Officer, University of Exeter

November 2013