HIGHER EDUCATION INSTITUTIONS AND THE NEW UK GAAP

A comparison of current and future accounting
SESSION 1 - INTRODUCTION AND OVERVIEW
Tier 1
Apply EU endorsed IFRS if required to do so by legislation or regulation
Qualifying entities
Reduced disclosure (FRS101)

Tier 2
Apply FRS 102 if not small and not required to apply EU endorsed IFRS
Qualifying entities
Reduced disclosure (FRS102)

Tier 3
Apply FRSSE if qualify as a small entity by reference to size criteria in Companies Act

May voluntarily apply
THE FUTURE OF FINANCIAL REPORTING IN THE UK

A timeline for accounts preparation

31 July 2014

- Apply current UK GAAP

31 July 2015

- Comparative period income statement and cash flow statement in first FRS 102 accounts

31 July 2016

- Current period income statement and cash flow statement in first FRS 102 accounts
WHAT IT MEANS FOR YOU
Commercial and practical implications

- Tax due
  - Debt covenants
  - Distributable reserves
  - Management agreements
  - Remuneration schemes
  - Share based payments
- Accounting systems
  - Group reporting
  - Staff training
  - Comms with stakeholders
- Budgets
  - Forecasts
  - Tax planning
- Practical
- Tax
- Accounting & commercial

Page 5
SESSION 2 - REVENUE / INCOME
## REVENUE & INCOME

### Summary of differences

<table>
<thead>
<tr>
<th></th>
<th>Current UK GAAP</th>
<th>New UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods / services</td>
<td>No obvious area of difference</td>
<td></td>
</tr>
<tr>
<td>Donations</td>
<td>Matching principle applied</td>
<td>Not matched to expense. Consider “performance conditions”</td>
</tr>
<tr>
<td>Government grants</td>
<td>Matching principle applied</td>
<td>Not matched to expense. Consider “performance conditions”</td>
</tr>
<tr>
<td>Endowments</td>
<td>Recognise in STRGL and “recycled”?</td>
<td>Recognised in I&amp;E. Consider “performance conditions”</td>
</tr>
<tr>
<td>Legacies</td>
<td>Refer to charity SORP?</td>
<td>Refer to charity SORP?</td>
</tr>
<tr>
<td>Knock-for-knock</td>
<td>Silent</td>
<td>Silent - can recognise?</td>
</tr>
</tbody>
</table>
REVENUE AND INCOME

FRS 102’s revenue recognition criteria

- Amount can be measured reliably
- Probable that economic benefits will flow to the institution
- For services rendered, that the stage of completion can be measured reliably
- For sale of goods, that risks and rewards have been transferred
- Costs to date and to be incurred can be measured reliably
REVENUE AND INCOME
Donations, endowments and government grants

• **Performance-related conditions** (if any) affect the timing of income recognition. Implicitly, a performance condition may be sub-divided into “units of output” such that revenue is recognised in line with those outputs

  “A condition that requires the performance of a particular level of service or units of output to be delivered, with payment of, or entitlement to, the resources conditional on that performance”

• **Restrictions** (if any) affect the presentation of the resulting reserves in balance sheet, but NOT the recognition of income

  “A requirement that limits or directs the purposes for which a resource may be used that does not meet the definition of a performance-related condition”
REVENUE AND INCOME
Performance related conditions

• Necessary to determine whether a performance-related condition actually exists.

Some resources are given with performance-related conditions attached which require the recipient to use the resources to provide a specified level of service in order to be entitled to retain the resources. An entity will not recognise income from those resources until these performance related conditions have been met. However, some requirements are stated so broadly that they do not actually impose a performance related condition on the recipient (FRS 102:34B.13-14)
REVENUE AND INCOME
Performance related conditions

• Judgement may be needed to determine whether a performance condition exists and whether it should be divided into “units of output”

Careful analysis of the [donation, endowment and grant] documentation may be needed to identify the relevant performance-related conditions and allocate portions of the grant across multiple performance-related conditions. It may be that employing a researcher (or the cost of that individual’s employment) represents a unit of output. (Draft SORP 17:31)
# EMPLOYEE BENEFITS

## Summary of differences

<table>
<thead>
<tr>
<th></th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB Scheme (interest cost)</td>
<td>Expected return on gross assets less unwind of discount on gross liability</td>
<td>Interest expense / income based on net scheme deficit / surplus</td>
</tr>
<tr>
<td>Multi-employer scheme</td>
<td>Entirely off balance sheet</td>
<td>Liability recognised for deficit reduction plans</td>
</tr>
<tr>
<td>Group DB schemes</td>
<td>Generally DC accounting in each group entity</td>
<td>Surplus / deficit recognised by sponsoring entity (parent?)</td>
</tr>
<tr>
<td>Pension reserve</td>
<td>Presented on b/s</td>
<td>Not presented separately</td>
</tr>
<tr>
<td>Accrued sabbatical leave</td>
<td>Often not recognised</td>
<td>Recognised?</td>
</tr>
<tr>
<td>Holiday pay accrual / asset</td>
<td>Often not recognised</td>
<td>Recognised</td>
</tr>
<tr>
<td>Remuneration disclosure - Who?</td>
<td>Determined by Accounting Direction and CA06</td>
<td>ALSO required for “key management personnel”</td>
</tr>
<tr>
<td>Remuneration disclosure - What?</td>
<td>•Not necessarily a link to expense in I&amp;E</td>
<td>•Amounts charged to I&amp;E</td>
</tr>
<tr>
<td></td>
<td>•Excludes NI Er’s</td>
<td>•Includes NI Er’s</td>
</tr>
</tbody>
</table>
SESSION 4 - FIXED ASSETS
## FIXED ASSETS

### Summary of differences - Property

<table>
<thead>
<tr>
<th></th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policy of revaluation for owner occupied property</td>
<td>EUV</td>
<td>Fair value</td>
</tr>
<tr>
<td>Mixed-use property</td>
<td>Often determined by preponderance of use</td>
<td>Split accounting</td>
</tr>
<tr>
<td>Properties rented to other group companies</td>
<td>Accounted for as owner occupied (i.e. FRS 15)</td>
<td>Classified as investment property</td>
</tr>
<tr>
<td>Measurement basis for investment property</td>
<td>Fair value</td>
<td>Fair value unless “undue cost or effort”</td>
</tr>
<tr>
<td>Changes in fair value of investment property</td>
<td>Revaluation reserve</td>
<td>I&amp;E account</td>
</tr>
<tr>
<td>Transition arrangements</td>
<td>n/a</td>
<td>Fair value as deemed cost</td>
</tr>
</tbody>
</table>
## FIXED ASSETS

### Summary of differences - Lease issues

<table>
<thead>
<tr>
<th></th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classification as finance lease v operating lease</td>
<td>“Bright-line” 90% numerical test</td>
<td>No “bright-line” 90% numerical test</td>
</tr>
<tr>
<td>Lessee disclosure</td>
<td>Annual commitment</td>
<td>Total commitment</td>
</tr>
<tr>
<td>Lessor disclosure (e.g. investment property)</td>
<td>Rents received in year</td>
<td>Total future rents receivable</td>
</tr>
<tr>
<td>Service concession arrangements</td>
<td>Generally concluded off-balance sheet treatment appropriate</td>
<td>Likely to be treated as on-balance sheet finance leases</td>
</tr>
<tr>
<td>Arrangements that contain a lease</td>
<td>No guidance</td>
<td>Analysis of whole contracts could give rise to some cash flows accounted for as finance leases</td>
</tr>
</tbody>
</table>
Service Concession Arrangement

An arrangement where a public body or a public benefit entity (the grantor) contracts with a private sector entity (the operator) to construct (or upgrade), operate and maintain infrastructure assets for a specified period of time (the concession period).

Infrastructure Asset

Infrastructure for public services such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks…. Oh, and student accommodation!
FIXED ASSETS

Service concession arrangements - tests

- Acting as principal?
  - Construction of infrastructure asset
  - Maintenance over a period of time
  - Providing public service
  - Contract terms

- Service concession arrangement?
  - Is there an annual unitary payment made by the HEI?
  - Consider who has debt and void risk

- Control tests
  - HEI must control services provided by operator
  - HEI must control any significant residual interest

- Minimum payment?
  - Minimum payments?
  - Occupancy guarantees?
## FIXED ASSETS
### Summary of differences - Investments

<table>
<thead>
<tr>
<th>Investments in ordinary and preference shares</th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments in ordinary and preference shares</td>
<td>Mixed use of cost or fair value</td>
<td>Fair value (unless FV can’t be “measured reliably”)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Joint Ventures</th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td>JV v JANE (driven by substance of arrangement)</td>
<td>JCE v JCO v JCA (driven by legal nature of arrangement)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Equity-accounted associates and JVs</th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recognise share of losses in excess of cost</td>
<td>Restricted losses to cost of investment</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Equity accounting for “interests” in other not-for-profit entities (including student unions?)</th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td>No guidance</td>
<td>Refer charity SORP? (Based on voting as opposed to equity interests)</td>
<td></td>
</tr>
</tbody>
</table>
## FIXED ASSETS

### Summary of differences - Intangibles

<table>
<thead>
<tr>
<th></th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>In-substance gifts</strong></td>
<td>Not identified - treated as an acquisition giving</td>
<td>Accounted for as a one-off gain equal to net assets acquired</td>
</tr>
<tr>
<td></td>
<td>rise to negative goodwill</td>
<td></td>
</tr>
<tr>
<td><strong>Intangibles on business combinations</strong></td>
<td>Generally only goodwill (or negative goodwill) recognised</td>
<td>Could give rise to recognition of underlying intangibles</td>
</tr>
<tr>
<td><strong>Software costs</strong></td>
<td>Categorised as a tangible fixed asset</td>
<td>Not specified - scope for classifying as intangible</td>
</tr>
</tbody>
</table>
SESSION 5 - PAYABLES AND RECEIVABLES
## PAYABLES AND RECEIVABLES

### Summary of differences

<table>
<thead>
<tr>
<th></th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Classification of payables and receivables</strong></td>
<td>n/a</td>
<td>Basic v non-basic classification</td>
</tr>
<tr>
<td><strong>Measurement</strong></td>
<td>Transaction amount (net of issue costs)</td>
<td>Basic - Transaction amount (net of issue costs)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Non-basic - fair value</td>
</tr>
<tr>
<td><strong>Changes in fair value</strong></td>
<td>Generally n/a</td>
<td>Basic - n/a</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Non-basic - I&amp;E</td>
</tr>
<tr>
<td><strong>Offsetting payables and receivables</strong></td>
<td>Both require legal right of offset and an expectation of simultaneous settlement, but were requirements introduced by FRS 25 well understood?</td>
<td></td>
</tr>
</tbody>
</table>
PAYABLES AND RECEIVABLES
Examples of non-basic payables and receivables

1) Loan with initial interest rate of 2% increasing annually by RPI

2) 25 year loan with initial interest rate of LIBOR+2%, but from year 5 onwards bank has option to fix the rate, as well as every 5 years thereafter.

3) Loan payable/receivable with a return equal to percentage of borrower’s profits

4) Investment in convertible debt of another entity

5) Annual contract for the supply of cleaning fluid where the amount payables is for a fixed price per litre overlaid with an additional amount either paid or refunded based on movements in the spot price of gold.
   • Overage payable on construction contracts
   • Long-term energy contracts
SESSION 6 - SWEEP ISSUES

Other ad hoc differences
First-time adoption including transition exemptions
Reduced disclosure framework
## OTHER AD HOC DIFFERENCES

### Summary of differences

<table>
<thead>
<tr>
<th></th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Derivatives - recognition</strong></td>
<td>Off balance sheet</td>
<td>On balance sheet at fair value.</td>
</tr>
<tr>
<td><strong>Changes in fair value</strong></td>
<td>n/a</td>
<td>Reserves if hedge accounting, otherwise I&amp;E</td>
</tr>
</tbody>
</table>
| **Requirements for hedge accounting** | None - achieved automatically through being off balance sheet and accounting for cash flows only when paid/received | • Available only for certain hedging arrangements  
• Available only if hedge documentation put in place  
• “Effectiveness” of hedge must be tested annually, with “ineffectiveness” recognised in I&E |
STANDALONE DERIVATIVE
Forward contract hedging a future purchase

€1m Euro purchase contract

HEI

Variable cash flows in £ terms

Supplier

Counterparty (usually a bank)

Net payment / receipt on forward

Forward contract
To buy €1m for £800K
STANDALONE DERIVATIVE
Floating to fixed swap linked to variable rate loan

£1m loan contract.
Repayable in 5 years
LIBOR + 2%

Variable rate interest cash flows

HEI

Swap on “notional” £1m.
For 5 years
receive LIBOR, pay fixed 5%

Lender
(usually a bank)

Counterparty
(usually a bank)

Net pay / receive leg on swap
## OTHER AD HOC DIFFERENCES

### Summary of differences

<table>
<thead>
<tr>
<th></th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash flow statement</strong></td>
<td>Changes in cash on demand and overdrafts</td>
<td>Includes cash on deposit (generally of up to 3 months)</td>
</tr>
<tr>
<td><strong>Cash flow statement</strong></td>
<td>Net debt note</td>
<td>Net debt note not required</td>
</tr>
<tr>
<td><strong>Prior year adjustment</strong></td>
<td>Required for fundamental errors</td>
<td>Required for material errors</td>
</tr>
<tr>
<td><strong>Heritage assets</strong></td>
<td>Presented in notes as separate category of fixed asset</td>
<td>Presented separately on face of balance sheet</td>
</tr>
<tr>
<td><strong>Goodwill</strong></td>
<td>If UEL &gt; 20 years must do annual impairment review</td>
<td>Must be a finite period and if unable to make a reliable estimate then must amortise over a period of no more than 5 years.</td>
</tr>
</tbody>
</table>
# OTHER AD HOC DIFFERENCES

Summary of differences

<table>
<thead>
<tr>
<th></th>
<th>Current UK GAAP</th>
<th>FRS 102</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leasehold premiums paid</td>
<td>Treated as a fixed asset</td>
<td>Fixed asset or prepayment of rent?</td>
</tr>
<tr>
<td>Deferred tax</td>
<td>Exemptions from providing on certain timing differences</td>
<td>Fewer exemptions (notably will be required for items carried at fair value)</td>
</tr>
<tr>
<td>Related party disclosures</td>
<td>Name of related party to be disclosed</td>
<td>Relationship needs to be disclosed, but not the name</td>
</tr>
<tr>
<td>Agricultural assets</td>
<td>Accounted for at historic cost</td>
<td>Accounting policy choice: cost or fair value</td>
</tr>
</tbody>
</table>
FIRST-TIME ADOPTION OF FRS 102
Key exemptions from full retrospective application

- Fair value as deemed cost for property assets
- Past revaluations as deemed cost for property assets
- Business combinations
- Lease incentives
FIRST-TIME ADOPTION OF FRS 102
Reconciliations from old to new UK GAAP

• Description of each accounting policy change (distinguishing identified errors from adjustments arising as a result of new UK GAAP)

• Reconciliation of net assets at:
  – date of transition (31 July 2014); and
  – comparative balance sheet date (31 July 2015)

• Reconciliation of the surplus/deficit for the year to 31 July 2015

• See BDO guide Appendix 3 for examples (in your packs)
REDUCED DISCLOSURE FRAMEWORK
Disclosure exemptions for qualifying entities

May voluntarily apply

Tier 1
Apply EU endorsed IFRS if required to do so by legislation or regulation
Qualifying entities
Reduced disclosure (FRS101)

Tier 2
Apply FRS 102 if not small and not required to apply EU endorsed IFRS
Qualifying entities
Reduced disclosure (FRS 102)

Tier 3
Apply FRSSE if qualify as a small entity by reference to size criteria in Companies Act

May voluntarily apply
REduced disclosure framework

Disclosure exemptions for qualifying entities

- Cash flow statement
- Payables, receivables, investments and derivatives ("financial instruments")
- Key management personnel remuneration (companies act requirements or disclosures required by regulators may still apply)
- Related party transactions between wholly owned entities in a group
- [A few others that are highly unlikely to be relevant for HEIs!]
SESSION 7 - UNIVERITY CHALLENGE
SESSION 8 - BRINGING IT ALL TOGETHER
RECAP
Over to you

1) What have you learnt?

2) What will you be thinking about back in the office with regards to preparing for FRS 102?
ANY MORE QUESTIONS
Last Chance!
THE END.
THANK YOU FOR PARTICIPATING.

GIVE YOURSELF A ROUND OF APPLAUSE!