

Accounting for schools' non-current assets

Response to CIPFA's invitation to comment on 2011/12 code update

Introduction

Activity boundary of local authorities

We consider it important that the review should cover all aspects of schools accounting rather than being limited to asset recognition. We consider that authorities should determine whether schools form part of their activities and then account accordingly. Thus, if a school is considered to be part of the authority's activities it should account for both the property and expenditure within its accounts.

In forming this judgement authorities should consider whether the maintained schools contribute towards meeting the service objectives of a local authority; that is, does the authority obtain service potential from those maintained schools? In relation to this, the statutory responsibility of the local authorities as set out in section 13 of the Education Act of 1996 is relevant:

"A local education authority shall (so far as their powers enable them to do so) contribute towards the spiritual, moral, mental and physical development of the community by securing that efficient primary education, secondary education and further education are available to meet the needs of the population of their area."

In forming our views on schools accounting we have taken into account the current debate relating to the creation of academies and free schools, both of which are said to be moving out of local authority control. In the case of academies this is recognised through the accounting framework, with academies required to produce audited accounts for consolidation into Whole of Government Accounts (WGA). We would expect similar arrangements to be put in place for free schools.

No such provisions exist for any of the categories of maintained schools, which do not currently have to produce accounts and which are only reflected in WGA to the extent that these are recognised in local authority accounts. This indicates that maintained schools are considered to be within overall local authority control and within the local authority accounting boundary.

The lack of any overall accounting framework for maintained schools raises important issues on the accountability and governance arrangements relating to schools and their expenditure. As these are publicly funded we would expect that these are either included within local authority accounts or that separate arrangements should be made for them to prepare accounts for audit which would then be consolidated into WGA. We comment further on this below.

Income and expenditure of maintained schools – current practice

Our understanding is that local authorities account for income and expenditure relating to maintained schools as part of their accounts. The full amount of Dedicated Schools Grant (DSG) received is recognised as income in the accounts and authorities account for the direct cost of running the schools through incorporating expenditure returns into their accounts.

This treatment of expenditure is consistent with the statutory provision that amounts spent by schools under delegated budget arrangements are deemed to be spent on behalf of the authority. We also note here that any unspent amounts are deemed to belong to the authority which is consistent with the Code requirements to account for Schools Balances within General Fund.

We also note that teachers are accounted for as employees of the authority. There are extensive disclosures in the accounts relating to teachers' pensions and head teachers, where in some cases the maintained schools buildings which they run on a day-to-day basis are not in the accounts.

However as noted below depreciation expense is not recognised by local authorities where the buildings of maintained schools are not recognised in the accounts. The income and expenditure position is distorted by significant amounts of maintenance and refurbishment expenditure incurred on schools not recognised as assets currently expensed as Revenue Expenditure Funded by Capital Under Statue (REFCUS), but then adjusted through Capital Adjustment Account (CAA).

Consistency of accounting treatment within local authority accounts

We believe it is very important that the activities and assets of schools should be accounted for on a consistent basis. If the activities of the schools are judged to be within the activities of the local authorities we would expect to see the schools' land and buildings, expenditure under delegated budgets and school balances included in the local authority accounts. It would be inconsistent in our view to include schools' expenditure under delegated budgets within the accounts, if the school land and buildings are excluded from the local authority accounts.

Thus if the current proposals not to recognise foundation, voluntary aided and voluntary controlled schools are adopted on the grounds that the local authorities do not control the activities this raises questions whether this expenditure should be regarded as part of the authority's activities. Consideration would, therefore, have to be given to whether the expenditure incurred in running these schools should also be excluded from the local authority accounts. We note that for one large authority

this would mean £146m of total £325m spent on schools not being directly accounted for.

If schools are not recognised the authority would also have to consider how DSG should be accounted for. If the authority is deemed to be acting as principal it would record the DSG income and record the payment of DSG to the school as expenditure. If it is determined that the authority is acting as agent DSG paid direct to schools would not be included within the authority's accounts.

Accountability arrangements for excluded schools

If voluntary controlled, voluntary assisted and foundation schools are not included in the local authority accounts, each school would need to prepare its own accounts for the purpose of proper stewardship of publicly funded assets and expenditure and for inclusion in the WGA. These accounts would then require separate audit and completion of WGA forms for consolidation.

We consider that accounting arrangements should ensure that the full cost of operating schools, including depreciation, should be included in audited accounts for consolidation within WGA. Currently, local authorities reflect expenditure on maintaining schools and their running costs (including payroll) but not the use of the buildings used to provide the services. As no accounts are produced for maintained schools excluded from local authority accounts, the depreciation charge reflecting the consumption of economic benefits is not reflected in any set of accounts.

The costs of running schools within local authority (and WGA) is also distorted by expensing expenditure on schools buildings as REFCUS (this charge is reversed through CAA for local authorities but, we believe, still reflected in WGA).

No audited accounts are currently produced including the value of any maintained schools not recognised in local authority accounts and this value is consequently not reflected within WGA, resulting in a significant gap in WGA arrangements. This also raises a wider governance issue in relation to the decision making processes for running and maintaining assets which have no visibility and which are not subject to impairment review and periodic revaluation.

Accounting for schools procured under PFI contracts

We suggest that the review should also consider the position on schools procured under PFI contracts.

It is widely accepted that schools should be recognised on balance sheet under PFI, as the authorities have liability to make payment and control the use of the school and its residual under PFI contracts. This is based on the authority controlling both the services provided using the assets and any significant residual interest. However this is inconsistent with the view proposed in this consultation that local authorities do not control foundation, voluntary aided or voluntary controlled schools. The proposed arrangements would result in authorities initially recognising schools' assets and related lease liabilities under IFRIC 12 and then immediately writing these schools off.

We note that most authorities would do this through treating this derecognition as a disposal. However, while a disposal may be correct for schools transferring status, in our view, it would not be correct for a PFI contract entered into for an asset category that is not recognised. In this case we consider that the capital element would have to be expensed through REFCUS, in the same way as other capital expenditure on assets not recognised by the authority.

If control is not deemed to be exercised, and therefore IFRIC 12 tests are not met, PFI schemes would have to be treated as leases. If it is also then determined, as proposed by the consultation, that these do not meet asset recognition tests under IAS 17, authorities would presumably treat these as operating leases with costs being expensed as incurred. We note that further consideration would be required for PFI schemes assessed under IAS 17.

If the argument not to reflect assets is based on the view that the authority does not control the service potential of the schools, we question whether costs should be immediately expensed as an onerous contract which is defined in paragraph 8.2.2.8 of the Code. An onerous contract being a contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.

Where authorities receive PFI grants towards overall cost of PFI schemes, including capital costs, we question whether it remains appropriate for authorities to recognise receipt of the PFI grant as income, when capital and full cost of running these schools is not reflected in their accounts.

Academy Schools

We note that academies are excluded from local authority control and funding. Teachers at these schools are employed by the academy rather than the local authority and each academy prepares its own set of accounts for inclusion in the WGA.

We believe therefore that academies are properly excluded from the local authority accounts.

We anticipate that the same arrangements will apply to free schools who will similarly be excluded from local authority accounts.

Principles governing accounting for schools

We believe therefore that the following principles should govern accounting for schools:

- 1 Authorities should determine whether schools funded should be accounted for as part of the authority's activities.
- 2 Consistency of accounting is required between school assets, expenditure under delegated budgets and school balances.
- 3 Each school needs to be included in the WGA.
- 4 Arrangements should be made for ensuring that there are effective accountability and governance arrangements for schools excluded from local authority accounts.

- 1 **Do you agree with CIPFA/LASAAC's view that IFRICs 4 and 12 and IAS 17 do not have application in relation to the recognition of noncurrent schools assets – unless a specific arrangement exists? If not, why not? What, if any alternatives would you suggest?**

We agree that IFRIC 12 and 4 and IAS 17 are unlikely to apply to arrangements between local authorities and maintained schools as set out in the School Standards and Framework Act 1998 (SS&F Act) in regard to land and buildings. Under the Act there are no payments from the school trustees or the foundation body to the local authority for the land and buildings.

We note that IFRIC 12 and possibly IAS 17 will be relevant in determining the initial recognition of schools procured under PFI arrangements together with the associated liability. Please see our earlier comments in relation to PFI arrangements.

- 2 **Do you consider that there are any additional factors that should be added to the analysis in the Annex to this consultation? Please give reasons why any additional factors suggested should be added to the Annex and how you consider this would impact on the recognition or otherwise of non-current schools' assets.**

Please see main response on our views on taking an overall view on accounting for schools.

- 3 **Do you agree with CIPFA/LASAAC's conclusions regarding the recognition of non-current schools' assets in relation to the different categories of schools? If not, why not? What, if any, alternatives would you suggest?**

As indicated above we believe that community, voluntary controlled, voluntary aided and foundation schools should be recognised in the local authority accounts as they fall within the activities of the local authority, although each school has an independent board of governors the board acts within a framework set by the local authority. Further, in the event of a failing school we note that the local authority will be required to meet the additional expenditure in relation to the school indicating that the risks, as well as the rewards, of the service potential of schools rests with the local authorities.

As outlined in our main response if schools are not recognised within local authority accounts we consider that separate arrangements will have to be made for the preparation and audit of accounts for schools.

- 4 **Do you consider that the Code should include an interpretation in relation to the recognition of land and buildings used by schools in relation to the categories of school? If not, why not? What, if any, alternatives would you suggest?**

We believe the inclusion of an interpretation in section 4.1.1 of the Code covering all aspects of schools accounting is essential in ensuring consistency of treatment by local authorities in this complex area.

- 5 **Do you consider that the interpretation in relation to the recognition of land and buildings used by schools in relation to the categories of school should be applied retrospectively? If not, why not? What, if any, alternatives would you suggest?**

We believe that where following the CIPFA guidance the local authority changes its accounting approach to a type of school this would be a change of accounting policy requiring restatement of opening balances. The activity boundary of local authorities

Who should I contact?

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