

## Susan Kemp

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**From:** Andrew Strickland [andrew.strickland@scruttonbland.co.uk]  
**Sent:** 27 January 2010 08:47  
**To:** UK Gaap  
**Subject:** ASB Consultation Paper August 2009 [SB.FID209090]

I am responding to the above. I am writing with a special focus on the accounts of further and higher education institutions in the UK. These institutions currently report in accordance with a SORP which is specific to such entities. There are some 148 higher education institutions and at least 400 further education colleges in the UK.

### Conclusions

I recognise the need to move from UK GAAP to IFRS through a convergence process. I also assume that US GAAP will be following a similar path of convergence.

I have given my responses to questions 11, 12 and 13 below

I firmly believe that there is a need for continuing close guidance to the HE and FE sector as provided by the existing SORP. Empirical work that I have undertaken shows that the sectors (and seemingly the auditors in the sectors) are not currently performing well in terms of complying with existing standards and guidance.

Any changes have to recognise the very limited resources available for financial reporting in the sectors. Financial statements are not the main raison d'être of the finance departments - their focus is on management and control.

### The Current Position

UK GAAP is built on the foundation that the investors are the defining class of users (Statement of Principles, paragraph 1.11). However it states that a focus on such interests will also serve the common interests of other users. It is not surprising that thought leadership in the development of UK GAAP has been coloured very largely by the needs of the very largest commercial enterprises, and the large audit firms who report on their financial statements.

The current HE/FE SORP has been most helpful for the sectors and for the auditors in those sectors: it has ensured a degree of consistency in presentation in financial statements in the sectors, and this aids comparison between entities. However the SORP has remained largely chained to the concept of investors as the defining class of users: bold steps away from this concept (and away from the Companies Act requirements, which are very infrequently relevant for the sectors) have not been taken. This is perhaps not surprising in view of the thought leadership referred to above.

Although the SORP has been very helpful and is to be commended, there are weaknesses in its application: I have reviewed the FRS 17 notes of 37 higher education institutions in an empirical study undertaken during December 2009: very few of these notes were free of errors. I am not referring to nuances as to the wording of disclosures: the errors mainly comprised data which was inconsistent within the FRS 17 note or inconsistent with other parts of the financial statements, or patently wrong. My sample of 37 (chosen on an interval sampling basis) represents 25% of the higher education institutions which can be accessed from the website of the British Universities Finance Directors Group.

I am about to start a similar exercise on further education colleges: I am expecting the results to be at least as bad as for higher education. As the further education colleges are generally smaller, with more limited resources, it is very likely that the rate of error will be greater.

Finance directors at such institutions do not have a central purpose of financial accounting. It is far more important for them to possess the skills needed to run the finances of sizeable organisations and to provide management information to the rest of their teams. The preparation of annual financial statements is not a large part of their main purpose. In addition to this, financial accounting is an exercise that is generally undertaken only once each year - there is not a similar but less detailed exercise undertaken at each month end. Finance teams at universities and colleges tend to be relatively small: they therefore need close support from their auditors in the finalisation of their financial statements.

This process is currently not working well, despite the useful support given by the SORP. I do not know why the auditors are not requiring adjustment to the financial statements in respect of these errors; I also do not know

whether the auditors have identified the need for such adjustments.

This exercise has therefore coloured my views as to the most appropriate way forward.

### **The Proposal for Convergence**

The consultation paper states that IFRS has not been framed with public benefit entities in mind. I therefore assume that the authors of the paper envisage a greater challenge for the public benefit sector in applying IFRS than has been encountered in applying UK GAAP.

It is my concern that the convergence of UK GAAP with IFRS will make some form of SORP or other guidance essential for sectors such as higher and further education: IFRS is complex: that complexity is likely to be increased, I suspect, on the convergence with US GAAP, as this is far more rules-based. It is very likely that the body of literature which will be required reading in order to conform will grow in consequence. This will certainly be the case if IFRS develops into both a principles-based and also a rules-based system.

Due to the limited accounting and financial reporting resources in further and higher education there will therefore be a need for some very close guidance given in the form of a new SORP, or in some other material which is applicable to the sector.

Most of the measurement differences between UK GAAP and IFRS are likely to have only very limited application to the higher and further education sectors. (One exception to this is the issue of merger accounting: a ban on merger accounting may well make sense if the investors are the defining class of users. It makes much less sense in further and higher education.)

As the measurement differences are only modest, what are the problems for the higher and further education sector? It is my view that the current imperfections with the application of UK GAAP cannot be ignored. Further problems will be minimised by very specific guidance.

### **Question 11 and Question 12**

For the reasons given above, I therefore favour the development of a public benefit entity standard. I also consider that the standard should cover all the requirements for preparing true and fair view accounts.

I also consider that there is then need for some specific sector guidance, similar to the existing SORPs, for the various constituencies within the public benefit sector, such as charities, HEFE, housing associations, etc.

### **Question 13**

The points raised are all very pertinent to this issue: their inclusion in the Consultation Paper shows that considerable thought has been given to such differences. Their inclusion is therefore welcome. The comment about merger and acquisition accounting is especially pertinent in transactions in which there is no consideration given. The existing tests in UK GAAP do not sit well and the changes in IFRS would not make sense for the sector.

I would add that there is an overriding further difference in that the investor is not the defining class of user in such entities: this therefore means that there is no need to mimic the for-profit sector. By way of example, the balance sheets still tend to focus on the reserves of such entities as being a close equivalent to shareholder funds. More imaginative presentation of the balance sheet should be encouraged. I have proposed the simple change of including the FRS 17 liability as part of the funding of the balance sheet, rather than this liability being deducted from net assets. This is not to challenge its status as a liability, but it is to reflect rather better the underlying economic dynamic.

FRS 17 is very much a live issue in the FE and HE sector: these are large employers and the pension provision is almost entirely defined benefit. Is it possible to consider another step away from existing standards? For the Universities Superannuation Scheme, could the deficit of this multi-employer scheme be included on the balance sheets of participating universities, in proportion to the payroll costs that are represented by each university? It would be relatively simple for the USS to provide figures for a payroll unit cost of say £100,000. These figures could then be scaled as appropriate in order to compute the deficit to be included on the balance sheets of the individual institutions. At present the USS is treated as a multi-employer scheme and its deficit is not allocated, and it is therefore accounted for as a defined contribution scheme. If it was treated as I have suggested, the figures included by such institutions would then be closer to being approximately right, rather than absolutely wrong. The current accounting treatment, compliant with FRS 17, results in the impact on balance sheets in the HE sector being very uneven.

Please let me know if you require any further information.

Yours

Andrew Strickland

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Sanderson House, Museum Street, Ipswich, Suffolk, IP1 1HE  
Telephone: +44 (0)1473 259201 – Fax: +44 (0)1473 231643

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