

Audit Committee Meeting

Date of Meeting	Tuesday 3 October 2017
Paper Title	Accounts Consolidation Progress Report
Agenda Item	8
Paper Number	AC1-D
Responsible Officer	Jim Godfrey, Interim Finance and Resources Director
Status	Disclosable
Action	For approval

1. Report Purpose

- 1.1. This paper provides an update of progress in terms of the Accounts Consolidation and sets out the key actions.

2. Recommendations

- 2.1. The Committee is invited to **note** this report.

3. Report

- 3.1. As members are aware, this matter has been discussed at previous meetings of this Committee. At the meeting on 20 February 2017, the Committee recommended to the Board that the financial statements for 2016-17 should be consolidated. This recommendation was agreed by the Board at the meeting on 22 March 2017. Following the decision, progress has been made to implement this decision.
- 3.2. Several meetings have taken place between the Interim Director Finance & Resources and finance colleagues from the 3 assigned colleges. The purpose of these meetings was to consider issues arising in respect of consolidation and the following items were considered:
- Timetable – Co-ordination of audit fieldwork, accounts preparation and committee meetings;
 - Common accounting policies - for depreciation, pension valuation and property valuation;
 - Accounts template – how to combine the information from four organisations into one.
- 3.3. The Financial Reporting Standard (FRS102) applicable to the consolidation of financial statements is comprehensive and technical in nature. In order to reach a common interpretation of the standard, numerous meetings and discussions have taken place with the external auditors (Scott Moncrieff) and with finance colleagues in the Scottish

Funding Council. Henderson Loggie were also asked to provide an independent view on the application of the standard in respect of the consolidated accounts for GCRB. A copy of their advice is attached as an Annex to this report.

- 3.4.** The interpretation of the reporting standard has significant implications in terms of how the consolidated accounts are prepared. If the accounts are required to be prepared by way of an 'acquisition' then it will involve a significant amount of additional work for the colleges and GCRB. In addition, the date of 'acquisition' will have a fundamental bearing on the information presented.

4. Risk Analysis

- 4.1.** The key risks relating to the consolidation of the financial statements are:

- Under FRS102, there are two different approaches available when consolidating a set of financial statements. In accounting terms, the financial statements can be consolidated as a 'merger' or 'acquisition' and there is specific criteria attached to each. Preparing the consolidated financial statements on the basis of a merger is preferable but meeting the criteria for a merger is not straightforward for the Glasgow Region.
- The consolidated financial statements of the Regional Board are dependent upon the 3 assigned colleges. Any issue arising in respect of an assigned college, for example a delay, will have a direct impact on the ability of the Regional Board to meet its deadlines and obligations.
- There is a very little time available between the date an assigned college completes a task (during the year-end process) and the date when the Regional Board is due to complete the same task.

5. Legal Implications

- 5.1.** There are no legal implications arising from this report.

6. Financial Implications

- 6.1.** Scott Moncrieff has advised that the external audit fee for 2016-17 is expected to be £20,000 (including VAT and a recharge from Audit Scotland). This cost reflects the additional work necessary to audit the consolidated financial statements.
- 6.2.** In addition, there are the additional costs to GCRB, and the Colleges, for preparing the consolidated financial statements.

7. Strategic Plan Implications

- 7.1.** One of the implications of GCRB becoming fully operational was the need to prepare consolidated financial statements. The preparation of consolidated financial statements ensures that GCRB is compliant with one of the key governance responsibilities and helps realise its ambitions.

Action Plan

Finance Meetings with Colleges			On-going. Next meeting October 2017
Accounting Policies	Harmonised as far as possible for 2016/17. Further changes agreed for future years.		September 2017
Accounts Direction	Considered by Audit Committee		October 2017
GCRB accounts	Commentary	Chair/Executive Director	October 2017
	Numbers	Interim Finance & Resources Director	September 2017
	Pensions Note for Executive Director	Glasgow Kelvin College	September 2017
	Pensions Note for Executive Assistant	Actuary for the Strathclyde Pension Fund	September 2017
	Review Systems of Internal Control	Interim Finance & Resources Director	October 2017
Clarify FRS102 – merger or acquisition accounting	Opinions of Colleges, External and Internal Auditor.	Interim Finance & Resources Director	September 2017
Clarify accounts template	With External Auditor	Interim Finance & Resources Director	September 2017
Clarify consolidated notes	With External Auditor	Interim Finance & Resources Director	September 2017
External Audit	Audit Fieldwork in conjunction with GCRB	External Auditor	October 2017
	Final Report	External Auditor	December 2017
Annual Report of the Audit Committee	Considered by the Audit Committee	Audit Committee/Interim Finance & Resources Director	October 2017
	Presented to the Board	Audit Committee	October 2017
Accounts approved by Board		Board	December 2017
Submission of Report of the Audit Committee, Annual Report of the External Auditor and Financial Statements	Documentation supplied to SFC in accordance with the Accounts Direction	Interim Finance & Resources Director	December 2017

1. Introduction

At the request of GCRB management we performed a review of the relevant accounting standards and financial reporting frameworks to determine the appropriate accounting treatment required for consolidation of the Glasgow regional colleges into the GCRB financial statements for 2016/17.

On 21 September 2016, the Scottish Funding Council (SFC) wrote to the GCRB Executive Director to provide the 2015/16 Accounts Direction for GCRB. This required GCRB to comply with the 2015 Statement of Recommended Practice: Accounting for Further and Higher Education (SORP) in preparing its annual report and financial statements. The direction also required GCRB to comply with the Government Financial Reporting Manual 2015-16 (FReM) where applicable.

The SFC stated that:

'Under the relevant accounting standards, and given the wide-ranging powers enshrined in the legislation that RSBs have over assigned colleges, it would appear likely that consolidated financial statements may require to be prepared by GCRB. However, we fully recognise that the decision on whether consolidated financial statements will need to be prepared, based on a review of the specific arrangements which have been in place during the year, rests with GCRB and its auditors.'

As the GCRB was not a fully operational fundable body throughout 2015/16, consolidated financial statements were not prepared in respect of that year.

As its meeting on 27 February 2017, the Board agreed that the Glasgow College Region should consolidate its financial statements for 2016/17 on the basis that GCRB became a fully operational fundable body during the year (later confirmed by the SFC as being effective from 1 April 2017).

The Accounts Direction for 2016/17 was issued by the SFC on 26 July 2017 and again required GCRB to comply with the 2015 SORP and the 2016-17 FReM where applicable.

GCRB is seeking comfort over the most appropriate method of consolidation to ensure that it is in line with the SORP and therefore Financial Reporting Standard (FRS) 102.

FRS 102 allows two options for business combinations, merger accounting or the purchase method (acquisition accounting). This paper examines both options.

2. The Further and Higher Education (Scotland) Act 2005 (as amended by the Post-16 Education (Scotland) Act 2013)

The GCRB is a regional strategic body established by the Further & Higher Education (Scotland) Act 2005 (as amended by the Post 16 Education (Scotland) Act 2013). The GCRB role is to secure the coherent provision of a high quality of fundable further and higher education in the three Glasgow colleges. Its functions include:

- Funding of the three colleges
- Planning
- Performance monitoring
- Promotion of the SFC's Credit and Qualification Framework

- Promotion of collaboration and sharing of good practice
- Efficiency studies
- Improvement of economic and social well-being
- Good governance and compliance
- Appointment of its own Board members (with approval by Ministers)
- Appointment of Board members of the three assigned colleges

3. The FE and HE SORP

13.1 FRS 102 defines a business combination as 'the bringing together of separate entities or businesses into one reporting entity'. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquiree. Institutions must assess, whether a combination of an institution with another institution is an acquisition or merger. *Merger accounting should only be used where combinations are not, in substance, the acquisition of an entity (or another institution) by an institution but the formation of a new reporting institution as a substantially equal partnership where no party is dominant.*

13.5 *Specific guidance to public benefit entities for combinations that are in substance a gift and combinations that are a merger* are set out in Section 34 of FRS 102.

13.7 *A merger is an entity combination that results in the creation of a new reporting entity formed from the combining parties, in which; a) the controlling parties of the combining entities come together in a partnership for the mutual sharing of risks and benefits of the newly formed entity; and b) no one party to the combination is seen to be dominant.*

13.8 Merger accounting must be applied if the following 3 criteria are met.

- a) no party to the combination is portrayed as either the acquirer or acquiree, either by its own board or management or by that of another party to the combination;*
- b) there is no significant change to the classes of the beneficiaries of the combining entities or the purpose of the benefits provided as a result of the combination; and*
- c) all parties to the combination, as represented by the members of the board, participate in establishing the management structure of the combined entity and in selecting the management personnel, and such decisions are made on the basis of a consensus between the parties to the combination rather than purely by exercising voting rights*

13.10 *The use of merger accounting is also permitted where a business combination occurs under common control.*

4. FRS 102

19.1 *This section applies to accounting for business combinations. It provides guidance on identifying the acquirer, measuring the cost of the business combination, and allocating that cost to the assets acquired and liabilities and provisions for contingent liabilities assumed. It also addresses accounting for goodwill both at the time of a business combination and subsequently.*

- 19.2 *This section specifies the accounting for all business combinations except:*
(a) the formation of a joint venture; and
(b) acquisition of a group of assets that does not constitute a business.

A 'joint venture' is defined as: A contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or jointly controlled entities.

HL comment: Based on the above definition the combination of GCRB and the Glasgow region colleges is not considered a joint venture therefore Section 19 is applicable.

A 'business' is defined as: An integrated set of activities and assets conducted and managed for the purpose of providing: (a) a return to investors; or (b) lower costs or other economic benefits directly and proportionately to policyholders or participants. A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. If goodwill is present in a transferred set of activities and assets, the transferred set shall be presumed to be a business.

HL comment: Based on the above definition the combination of GCRB and the Glasgow region colleges is not considered to be the acquisition of a group of assets that does not constitute a business therefore Section 19 is applicable.

- PBE19.2A *In addition, public benefit entities shall consider the requirements of Section 34 Specialised Activities in accounting for public benefit entity combinations.*

A 'public benefit entity' is defined as: An entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members.

HL comment: Based on the above definition GCRB and the Glasgow region colleges are public benefit entities therefore Section 34 must be considered.

- 19.6 *All business combinations shall be accounted for by applying the purchase method, except for:*
(a) group reconstructions which may be accounted for by using the merger accounting method (see paragraphs 19.27 to 19.33); and
(b) public benefit entity combinations that are in substance a gift or that are a merger which shall be accounted for in accordance with Section 34 Specialised Activities.

A 'group reconstruction' is defined as: Any one of the following arrangements:
(a) the transfer of an equity holding in a subsidiary from one group entity to another;
(b) the addition of a new parent entity to a group;
(c) the transfer of equity holdings in one or more subsidiaries of a group to a new entity that is not a group entity but whose equity holders are the same as those of the group's parent; or
(d) the combination into a group of two or more entities that before the combination had the same equity holders.

HL comment: Based on the above definition the combination of GCRB and the Glasgow region colleges is not considered to be a group reconstruction, which rules out the use of merger accounting via this route.

PBE34.75 Paragraphs PBE34.76 to PBE34.86 apply only to public benefit entities for the following categories of entity combinations which involve a whole entity or parts of an entity combining with another entity: (a) combinations at nil or nominal consideration which are in substance a gift; and (b) combinations which meet the definition and criteria of a merger.

HL comment: The combination of GCRB and the Glasgow region colleges is not considered to be in substance a gift. In any case, a combination that is in substance a gift is accounted for in accordance with Section 19 except for matters addressed in paragraphs PBE34.78 and PBE34.79, which relate to any excess of the fair value of the assets received over the fair value of the liabilities assumed or vice versa.

A 'merger' is defined as: *An entity combination that results in the creation of a new reporting entity formed from the combining parties, in which the controlling parties of the combining entities come together in a partnership for the mutual sharing of risks and benefits of the newly formed entity and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant.*

All of the following criteria must be met for an entity combination to meet the definition of a merger: (a) no party to the combination is portrayed as either acquirer or acquiree, either by its own board or management or by that of another party to the combination; (b) there is no significant change to the classes of beneficiaries of the combining entities or the purpose of the benefits provided as a result of the combination; and (c) all parties to the combination, as represented by the members of the board, participate in establishing the management structure of the combined entity and in selecting the management personnel, and such decisions are made on the basis of a consensus between the parties to the combination rather than purely by exercise of voting rights.

HL comment: Based on the above definition it is difficult to find an argument that no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant, given GCRB's functions under the Further & Higher Education (Scotland) Act 2005 (as amended by the Post 16 Education (Scotland) Act 2013) and the fact that it now has fully operational fundable body status. In reaching the decision to consolidate the financial statements it was determined that GCRB has 'control' over the colleges, principally as GCRB has the 'power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body' (Paragraph 9.5 of FRS 102).

PBE34.76 Combinations which are determined to be acquisitions shall be accounted for in accordance with Section 19 Business Combinations and Goodwill.

HL comment: Having failed the merger test above, the combination of GCRB and the Glasgow region colleges should be treated as an acquisition.