

Audit Committee Meeting

Date of Meeting	Friday 7 October 2016
Paper Title	Consolidation of Accounts
Agenda Item	10
Paper Number	AC1-F
Responsible Officer	Robin Ashton, GCRB Executive Director
Status	Disclosable
Action	For Noting

1. Report Purpose

1.1. GCRB needs to consider whether or not the Glasgow college region will need to prepare consolidated accounts for the period to 31 July 2017.

2. Recommendations

2.1. The Committee is invited to:

- note the relevant financial reporting guidance relevant to considering whether the Glasgow college region should prepare consolidated accounts for 2016/17;
- note the GCRB accounts direction from the Scottish Funding Council for 2015/16;
- note the current evaluation as to the extent to which the Glasgow college region meets the criteria which would require it to prepare consolidated accounts for 2016/17;
- note that management is in active discussion with the external auditors and the Scottish Funding Council about the correct approach; and
- that analysis and any conclusions set out in this paper might therefore change.

3. Legal Background

3.1. GCRB's legal status as a corporate entity derives from the Further & Higher Education (Scotland) Act 2005, as amended (referred to as "the 2005 Act" below).

3.2. The 2005 Act defines GCRB as a 'Regional Strategic Body' (RSB) and within that as a 'Regional Board'. Scottish Ministers may by order assign colleges to a RSB. Scottish Statutory Instrument (SSI) 2014 No. 80 "The Assigned Colleges (Scotland) Order 2014" assigned the three Glasgow colleges to GCRB: City of Glasgow College, Glasgow Clyde College and Glasgow Kelvin College.

3.3. As a Regional Strategic Body (RSB) and subject to achieving fully-operational fundable body status (see section **Error! Reference source not found.** below), GCRB is accountable for:

- negotiating the annual funding provided by the SFC
- allocating funding within the region
- planning what learning the colleges provide within the region
- achieving outcomes set out in regional outcome agreements
- monitoring how the colleges in the region are performing

3.4. Assigned College Boards will be responsible to GCRB for how they are contributing to achieving the regional outcome agreement and using public money, rather than to the SFC. This means that the College Board may receive direction from GCRB on how it delivers its contribution to the regional outcome agreement. The GCRB will then be accountable to the SFC.

3.5. The College Board continues to be responsible for the governance, financial management, operation and sustainability of the college.

4. 2015/16 Accounting framework

4.1. GCRB's 2015/16 accounts direction requires GCRB to comply with the 2015 Statement of Recommended Practice: Accounting for Further and Higher Education (SORP) in preparing their annual report and accounts. The direction also requires GCRB to comply with the Government Financial Reporting Manual 2015-16 (FRoM) where applicable.

4.2. The cover letter for GCRB's accounts direction from the Scottish Funding Council for 2015/16 states 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.”

5. Consolidation Consideration

5.1. The objective of consolidated accounts is to extend the reporting entity to embrace other entities which are subject to its control. They involve treating the net assets and activities of the other entities as if they were part of the main organisation's own net assets and activities. The overall aim is to present the results and state of affairs of all the organisations as if they were a single entity.

5.2. Section 4 of The 2015 Statement of Recommended Practice: Accounting for Further and Higher Education sets out the requirement to report consolidated financial statements. Paragraph 4.1 states that FRS 102 (on which the SORP is based) defines a subsidiary as “an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.” The guidance goes on to state that a presumption of control exists where the parent owns, directly or

indirectly, over 50% of the voting power of the entity and that further guidance on what may constitute control is set out in FRS 102.

5.3. FRS 102 is the Financial Reporting Standard applicable in the UK and Republic of Ireland. Section 9 of FRS102 sets out the requirements relating to Consolidated and Separate Financial Statements.

5.4. The FRS102 states that a subsidiary is an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

5.5. As set out within paragraph 9.5 of FRS102:

Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity. That presumption may be overcome in exceptional circumstances if it can be clearly demonstrated that such ownership does not constitute control. Control also exists when the parent owns half or less of the voting power of an entity but it has:

- *power over more than half of the voting rights by virtue of an agreement with other investors;*
- *power to govern the financial and operating policies of the entity under a statute or an agreement;*
- *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; or*
- *power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.*

5.6. FRS102 further states that:

- *control can also be achieved by having options or convertible instruments that are currently exercisable or by having an agent with the ability to direct the activities for the benefit of the controlling entity (para 9.6);*
- *control can also exist when the parent has the power to exercise, or actually exercises, dominant influence or control over the undertaking or it and the undertaking are managed on a unified basis (para 9.6A);*
- *a subsidiary is not excluded from consolidation because its business activities are dissimilar to those of the other entities within the consolidation. Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries (para 9.8); and*
- *a subsidiary is not excluded from consolidation because the information necessary for the preparation of consolidated financial statements cannot be obtained without disproportionate expense or undue delay, unless its inclusion is not material (individually or collectively for more than one subsidiary) for the purposes of giving a true and fair view in the context of the group (para 9.8A).*

5.7. The following sections of this report consider each of the indicators set out in FRS102 para 9.5 and the applicability to GCRB.

Power over more than half of the voting rights by virtue of an agreement with other investors

5.8. There are no shares held by GCRB in the colleges, so there is no consideration over “voting rights” or a “participating interest”.

Power to govern the financial and operating policies of the entity under a statute or an agreement

5.9. ‘Dominant influence’ is the exercise of an influence that achieves the result that the operating and financial policies of the undertaking influenced are set in accordance with the wishes of the holder of the influence and for the holder’s benefit whether or not they are for the benefit of the undertaking.

5.10. Clearly GCRB has influence over the assigned colleges but the level of influence should not be considered as “dominant influence” because assigned College Boards are each responsible for the operational management and the financial sustainability of their own college. Even when granted fully-operational fundable body status, responsibility for the operational and financial management of each college will rest with individual college Boards. As the College Board is responsible for ensuring the financial and institutional sustainability of its college, the College Board will therefore not consent to action which will be detrimental to their own college.

5.11. It is also important to note that College Boards have to be consulted on all matters relating to potential transfers of staff, property, rights, liabilities or obligations. Section 230 of the 2005 Act deals with the transfers of staff, property, rights, liabilities or obligations. Under section 230(3), a transfer by GCRB is only binding on a college that has been assigned to GCRB if GCRB has consulted with the college, the relevant trade unions and the college’s students’ association. However, it should be noted that whilst GCRB isn’t yet in direct receipt of SFC funds, in all other intents and purposes it is fully empowered as set out within legislation.

5.12. More generally Audit Scotland (not GCRB) appoints the external auditors for the colleges.

5.13. It therefore does not appear that GCRB exercises ‘dominant influence’ over the assigned colleges.

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

5.14. Paragraph 3A of Schedule 2 to the Further & Higher Education (Scotland) Act 1992 details the composition of the Board of an incorporated college. It should contain between 13 and 18 members comprising:

- the “chairing member” to be appointed by GCRB
- the principal of the college
- two elected staff members (one teaching and one non-teaching)

- two elected student members; bringing a total of 6; and
- other members appointed by GCRB, being the remaining 7-12 members.

5.15. In line with powers granted within the Post-16 Act Legislation, GCRB does have the authority to appoint or remove the majority of members of the assigned college (these being the “chairing member” and the other 7-12 non-college members). However, whilst this is the case in terms of legislative powers, in terms of actual practice, there is more local autonomy as the arrangements implemented in Glasgow require the assigned colleges to recruit their own board members and seek approval of these decisions by the GCRB Board. It should also be noted again that whilst GCRB isn’t yet a fully-operational fundable body in terms of receiving SFC funds, in all other respects it is fully empowered as set out within legislation.

5.16. It should also be noted that Scottish Ministers have powers under paragraph 3C(1) of Schedule 2 to the Further and Higher Education (Scotland) Act 1992 Act (referred to as “the 1992 Act”) to issue guidance to RSBs in relation to making appointments (including on the desirability of appointing members with particular skills and experience) and in extending appointments to assigned incorporated college boards. RSBs must have regard to such guidance. In addition, Whilst the Code of Practice for Ministerial Appointments to Public Bodies in Scotland is intended for regulated Ministerial public appointments, Scottish Ministers have determined that the principles of and approach set out by the code are relevant to and should underpin college sector board recruitment and appointment.

5.17. It is also a requirement of the Code of Good Governance for Scotland’s Colleges for the College Board to keep its effectiveness under annual review and to have in place a robust self-evaluation process. The College Board must agree a process for evaluating the effectiveness of the board chair and the committee chairs. The evaluation of the board chair should normally be led by the vice-chair/senior independent member of the College Board. The Financial Memorandum requires the governing body of the college to comply with the principles of good governance as set out in the Code of Good Governance for Scotland’s Colleges.

5.18. Therefore, whilst GCRB has authority to appoint or remove assigned college board members, its arrangements to do so must meet guidance set by Scottish Ministers and the requirements of the Code of Good Governance for Scotland’s Colleges.

Power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body

5.19. There are no shares held by GCRB in the colleges, so there is no consideration over “voting rights” or a “participating interest”.

6. Conclusion

6.1. The analysis above suggests that of the four tests for consolidation to be a requirement set out in within the excerpt from the FRS102 guidance in paragraph 4.5 above, GCRB seems to meet only one of these; that is that 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.*”

6.2. It should be noted however, whilst this statement may reflect the legislative powers of GCRB, it does not fully accurately describe the arrangements used within the Glasgow college region for the appointment of assigned college board members.

6.3. Further discussion is therefore required between GCRB members and management, the external auditors and the Scottish Funding Council to agree whether or not the Glasgow college region will need to prepare consolidated accounts for the period to 31 July 2017.

7. Risk Analysis

7.1. The main risk is that GCRB's external auditors do not agree with their assessment as to whether the Glasgow college region should prepare consolidated accounts. GCRB management has therefore shared this assessment with the external auditors and is in discussion with them.

8. Legal Implications

8.1. The legal aspects of this matter flow from the accounting requirements to which GCRB is subject, which are addressed in the body of the paper.

9. Financial Implications

9.1. Although it is not a valid consideration in determining whether or not to prepare consolidated accounts, it is the case that having to do so would incur additional cost.

10. Regional Outcome Agreement Implications

10.1. Through the conditions of grant associated with the Regional Outcome Agreement, GCRB and the assigned colleges are required to conduct their affairs in accordance with the expected standards of good governance, which includes preparing accounts in accordance with the relevant requirements.