Financial Reporting Advisory Board Paper

Public Sector Schools Working Group - update from the Chairman

Issue:	The Public Sector Schools Working Group has considered how local authorities should account for schools in accordance with the new accounting standard IFRS 10 *Consolidated Financial Statements*. The Working Group has concluded that community schools, voluntary controlled schools, voluntary aided schools and foundation schools are separately identifiable entities within local authority control and that IFRS 10 requires that they should be consolidated into local authority group accounts. This paper summarises the technical arguments considered by the Working Group in applying IFRS 10 to schools; these technical arguments still need to be considered on a wider range of applications to avoid creating precedents in central and local government.
Impact on guidance:	CIPFA/LASAAC will need to consider whether any changes are required to the *Code of Practice on Local Authority Accounting in the United Kingdom* as currently the issues considered by the Working Group relate to application of the Group Accounting standards when they are adopted by the 2014/15 Code. As such, for clarity CIPFA/LASAAC may take the unusual step of including application guidance in a future edition of the Code. Consideration of the practical issues that arise from the technical arguments may also require the need to adapt to the Code.
IAS/IFRS adaptation?	No
Impact on WGA?	Yes, may result in a more consistent treatment of school assets by local authorities and therefore improve the accuracy of WGA.
IPSAS compliant?	Yes
Interpretation for the public sector context?	No
Impact on budgetary regime?	No
Alignment with National Accounts	No
Impact on Estimates?	No
Recommendation:	That the FRAB notes the progress of the public sector schools working group and the proposed next steps.
Timing:	2014-15

DETAIL

Background

1. The Public Sector Schools Working Group concluded, at its meeting on 19 November 2013, that community schools, voluntary controlled schools, voluntary aided schools and foundation schools are separately identifiable entities within local authority control and that, in accordance with the requirements of IFRS 10 *Consolidated Financial Statements*, they should be consolidated into local authority group accounts.

2. The Working Group has not yet received a draft report based on the conclusions reached at that meeting. Due to the various time pressures faced by the FRAB and CIPFA/LASAAC, this paper from the Chairman of the Working Group provides the FRAB with a summary of the technical arguments behind the conclusion and the planned next steps.

3. It follows that this paper from the Chairman is not intended to prejudge the final analysis of the technical accounting arguments in the draft report of the Working Group which has yet to be finalised and approved by the Working Group members.

4. The final report of the Working Group will then be considered by CIPFA/LASAAC who will need to decide the basis on which they issue any consultation paper on accounting for schools in local authorities. This will take place at CIPFA/LASAAC's next meeting 20 February 2014.

5. Further analysis will also have to be provided for Welsh local authorities as the draft report has currently only been prepared from an English perspective.

Basis of the assessment

6. The Working Group first considered whether schools can be considered to be entities capable of consolidation, based on definitions within IFRS, IPSAS and the European System of Accounts. The Working Group concluded that schools are separate entities for accounting purposes:

    - ✓ They represent a set of integrated economic activities
    - ✓ Financial information required to produce general purpose financial reports is capable of being separately identifiable
    - ✓ They are capable of being treated legally like a person (although a separate legal identity is not a prerequisite) and of making binding decisions

7. The Working Group then used the steps set out in IFRS 10 for assessing control of another entity:

    i. ***Consider the purpose and design of the entity that is being considered for consolidation in order to determine the relevant activities (those that significantly affect returns)***

8. The Working Group noted that local authorities are required by law to ensure (but not necessarily carry out themselves) the provision of education services. In practice, separate entities are set up with their own Boards of Governors which run the schools. The Working Group also considered the manner in which schools operate, which is to provide education

services with a framework which is defined by legislation. This might imply that in certain respects, a school might operate in a similar manner to a structured entity (the IFRS 10 term for a special purpose entity), in that provided the quality of educational services provided by a school fell within acceptable limits, that school might to an extent be permitted to operate independently with step-in action being required and taken only when something needed to be done or went wrong (for example, poor results). While this would not affect the consolidation conclusion (because, unlike previous IFRS guidance, IFRS 10 has a single control model), it might assist in identifying the relevant activities (that is, those activities that have the most significant effect on the returns from an entity).

9. From the above analysis, the Working Group identified two primary returns:

    - Benefits that accrue from the successful provision by others of primary and secondary education. This will enable a local authority to meet its statutory duties under sections 13 and 14 of the Education Act 1996 (EA 1996) to contribute towards the spiritual, moral, mental and physical development of the community by securing that sufficient, appropriate primary and secondary education is available to meet the needs of the population of their area; and
    - The achievement of the authority's duties under Section 13A1 of the same Act as amended for English authorities i.e. the duty to promote high standards, ensure fair access to educational opportunity and the fulfilment of potential standards to education for children within the local education area.

10. Before identifying the relevant activities, the Working Group also agreed that the primary returns from schools were non-financial and relate to the achievement of educational objectives. The Working Group also agreed that there are other returns such as those relating to residual interests in assets and the achievement of other, non-educational objectives. The Working Group noted that the definition of returns in IFRS 10 is wide, and can be taken to encompass non-financial as well as financial returns.

11. The relevant activities of a school were agreed to be those which have the potential, most significantly, to affect the educational output, which may include:

    - School closure/cease to maintain local authority school
    - Changing the status of a school to become an academy
    - Making other major changes, such as changing size, adding or removing a sixth form, or other changes in category of a school
    - Managing school educational performance, including dealing with serious failure

    The Working Group considered whether, for church schools, the diocese might be viewed as having control over relevant activities. This was felt to be the case for religious activities; however, although these were acknowledged to be relevant activities (as religious education would form part of the output from the school), they were not considered to be the most significant relevant activities for the purposes of the consolidation decision. Instead, these were considered to relate to satisfying the wider duties of local authorities to ensure the provision of education services.

ii. ***Determine how decisions about the relevant activities are made***

and

iii. ***Identify who has the current ability to direct those activities***

12. The Working Group concluded that the balance of control rests with local authorities for community schools, voluntarily controlled, voluntary aided and foundation schools. This was based on consideration of:

    - Local authority powers to close or cease to maintain a school;

    - Local authority powers to make significant changes to a school (although it was acknowledged that some changes, such as changing the religious designation of a Catholic school, cannot be made at all);

    - Local authority intervention powers which exist in the event of poor operational performance. The technical accounting experts confirmed that the existence of powers which are contingent on the relevant event occurring meets the IFRS 10 criteria of those powers being 'currently exercisable', because the focus is on who has the ability to take decisions when these need to be taken, which may be in the future; and

    - The effective existence of 'de facto' control arising from local authorities' monitoring and guidance of schools.

13. The technical accounting experts provided advice on the interaction of controls operated by schools, local authorities and central government. In particular, they considered central government constraints over school operations and reserved powers, local authority controls relating to school performance, and other decisions relating to relevant activities made by schools.

14. As noted above, an analogy was drawn to structured entities in the private sector for which operating arrangements can largely be fixed at inception; they are on 'auto pilot' with few significant decisions (that affect returns) being required after inception unless an event occurs that needs to be dealt with. For those entities, the focus is typically on which entity can take action in the future when an event occurs that needs to be dealt with, because it is that action that will have the most significant effect on returns.

15. Schools and local authorities are each able to direct relevant activities at different times. The Working Group assessed whether schools or local authorities were able to direct the activities which most significantly affect the provision of high quality education and concluded that local authorities do. This took into consideration that schools normally manage many of their own day-to-day operations (while returns remain within an acceptable range) but, in the event of poor educational performance, the local authority has step-in rights. This power to intervene when returns are outside of an acceptable range was seen as key.

16. The Working Group also noted that in practice, local authorities work with schools on an on-going basis with advice being given to (and acted upon) by the Board of Governors. There was agreement that, regardless of which entity or individual might technically have ultimate control, in practice schools comply with suggestions or advice provided by the related local authority, and those parties that might technically be viewed as having ultimate control do not step in. In principle, this was not dissimilar to circumstances in the private sector, in which certain shareholders do not attend company general meetings and do not otherwise vote on resolutions, resulting in those shareholders that do attend/vote having control.

17. The private sector also provides similarities where an ultimate parent may require a subsidiary to manage an entity. The subsidiary can control the entity's relevant activities with

the ultimate parent reserving step-in rights. By analogy to schools, the reserved rights of central government do not prevent local authorities from directing the relevant activities of schools and, in consequence, having control over them.

18. The Working Group also considered central government's role in regulating the education sector and whether this constituted control. The conclusion was that it did not, because it was set for the sector as a whole and not at individual school level.

iv. ***Identify who receives returns from those activities***

19. There are a range of beneficiaries from the activities of a school. These include school children, churches (for faith schools), central government (for meeting their education objectives), local authorities (for meeting their statutory requirements relating to education provision) and others.

Next steps

20. The Working Group has concluded that community schools, voluntary controlled schools, voluntary aided schools and foundation schools are separately identifiable entities within local authority control and, as such, the treatment determined by accounting standards is that they should be consolidated into local authority group accounts.

21. At the conclusion of its meeting on 19 November 2013, the Working Group agreed that a draft final report would be circulated for final approval, at the Treasury/CIPFA Secretariat's earliest convenience, and before the end of December 2013 at the latest.

22. The agreed report would then be passed to CIPFA/LASAAC for its consideration and subsequent deliberation on an appropriate consultation process, the minimum consultation period for CIPFA/LASAAC being eight weeks.

Practical Consequences of the Decision

23. Having determined an appropriate technical answer, the Working Group recognised that there are questions over whether it is desirable for a local authority to split out and re-consolidate schools, given that it is unlikely to alter decision making. At present, it appears that some schools do not prepare their own financial statements, and a substantial amount of time and expense might be required in order to extract amounts from local authority accounting records.

24. The group also recognised an alternative to consolidating schools within local authority group accounts would be to allow them to be included in the core account (effectively as branches of the local authorities). The group understands that this is the approach most commonly used by local authorities at the moment. The Group tasked the CIPFA Secretariat to revisit the arguments considered previously by CIPFA/LASAAC on the usefulness of the financial information to the users of local authority accounts and the final report would seek to address this area.

Assets not within the ownership of local authorities

25. On non-owned assets (for example, buildings provided at no charge by the church for use as a school), the view of the Working Group is that local authorities should assess individual arrangements under IAS 17 *Leases*. This will cover both formal lease agreements and other, informal, 'lease-type' arrangements. The Working Group's general expectation is that in many cases the school may not have the right to continuing use of the assets and the assets

can be taken back by their owners at any point. Therefore they would be accounted for as operating leases.

26. Even if non-owned assets were considered to give rise to a finance lease, no entries would arise as the assets are provided at no charge (there would be no liability, and therefore no asset). This would also apply in the event that the new leases accounting standard that is currently under development was issued in its current form, because the approach is first to determine the amount of the liability for lease payments and to capitalise an equivalent asset. Again, both amounts would be zero.

27. The Working Group noted that a more consistent assessment of school assets may ultimately result in the existing WGA qualification on the exclusion of maintained schools' assets being removed.

28. A further update will be provided at the next FRAB meeting.

FRAB recommendation

29. The Board is requested to note the progress of the Working Group and to agree the next steps.

Mike Hathorn CA, CPFA
13 December 2013