Accounting for local authority maintained schools

February 2015

Background

Following the adoption of the new International Financial Reporting Standards on group accounting, the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the Code) for 2014/15 includes new accounting requirements for schools in local authorities in England and Wales.

It was hoped that these requirements would provide a solution to address concerns in relation to inconsistency of schools accounting including the qualification of the Whole of Government Accounts.

However, due to the varied and sometimes complex arrangements for use of school buildings, the accounting treatment of schools will still require significant judgements, based on the circumstances for individual schools, to be made by the chief financial officer in the preparation of the statement of accounts. This will involve consideration of the school as an entity and any rights held by the local authority.

What does the Code say?

Code of Practice on Local Authority Accounting in the United Kingdom for 2014/15

Appendix E to the 2014/15 Code concluded that schools are separate entities and that under IFRS 10, maintained schools (but not free schools or academies) meet the definition of entities controlled by local authorities which should be consolidated in group accounts.

However, rather than requiring local authorities to prepare group accounts, the 2014/15 Code requires local authorities to account for maintained schools within their single entity accounts. This includes school income and expenditure as well as assets and liabilities.

The Code also includes disclosure requirements on any significant restrictions (eg statutory, contractual and regulatory restrictions) on the local authority's ability to access or use the assets and settle the liabilities of consolidated entities.

Update to the 2014/15 Code

In December 2014, CIPFA issued an Update to Appendix E of the 2014/15 Code. This states that "The recognition of non-current assets used by schools shall be determined in accordance with the relevant standards adopted by Chapter Four Non-Current Assets of this Code as appropriate to the arrangements for the assets. These assets shall be recognised in a local authority's balance sheet if they meet either the

appropriate recognition criteria (see Chapter Four) for the local authority or for a school within the local authority area".

The Update includes transitional provisions where authorities are required to recognise non-current assets for the first time as a result of a change of accounting policy resulting from the changes to accounting for schools. Under these transitional provisions non-current assets recognised for the first time should be accounted for at their 1 April 2013 valuation as "deemed cost" with the credit entry recognised in the Capital Adjustment Account. This means that there will be no need to identify historic valuation movements prior to 1 April 2013.

There is currently no reference in the Code update to the possible de-recognition of schools as a result of changes to schools accounting under the 2014/15 Code.

CIPFA guidance

LAAP Bulletin 101 Accounting for Non-Current Assets Used by Local Authority Maintained Schools

The Bulletin provides application, clarification and interpretation but is secondary to the Code and accounting standards. It states that "property used by schools should be recognised in accordance with the asset recognition tests relevant to the arrangements that prevail for property". It goes on to consider the impact for different types of schools as follows:

Community schools – the Bulletin considers that either directly or by consolidation of the school as an entity, it is likely non-current assets would be recognised on the local authority balance sheet.

Voluntary aided, voluntary controlled and foundation schools where non-current assets are owned by religious bodies – the Bulletin considers that where schools use assets under "mere licences" these are not within the control of the school and should not be recognised by the school or on the local authority balance sheet.

Foundation schools with assets not owned by religious bodies – the Bulletin concludes that where assets are owned by the governing body these assets would be recognised by the school and consequently on the local authority balance sheet. Where other arrangements exist, such as ownership by private sector entities, the arrangements need to be assessed to determine whether or not assets used by schools would be recognised.

However the Bulletin emphasises that "Local authorities will need to establish that the situation* and analysis exists for VA, VC schools and foundation schools where assets are owned by religious bodies in their area and assure themselves as to the extent to which this situation is applicable".

* CIPFA's understanding that *generally* assets owned by religious bodies are used under "mere licences" which pass no interest to the school and that religious bodies' rights to control the asset are substantive

From discussions with clients we are aware that there may be a wide range of arrangements in place under which schools use assets. It will be important to establish the particular circumstances for individual schools on a case by case basis.

Practical implications

The first stage in accounting for schools is to consider the school as an entity. The income, expenditure, assets and liabilities of each school will be consolidated into the local authority single entity accounts. The key consideration is whether the non-current assets should be recognised by the school.

Chief finance officers will be required to form judgements on a case by case basis once they have established the rights and obligations of all parties relating to the use of buildings and underlying land. These judgements should be discussed and agreed with Those Charged with Governance at the authority.

From discussions with clients we understand there is a wide range of arrangements in place ranging from no written agreements whatsoever (what CIPFA calls "mere licences") to formal arrangements in the form of leases. This could mean that there may be differing recognition judgements in relation to land and buildings and also within the types of school. These judgements should apply the relevant accounting standards.

In understanding the arrangements, local authorities need to consider both the legal ownership of the assets and the circumstances under which schools occupy them, including rights and obligations. Assessing the substance of the arrangement under IAS 16 may require separate consideration of land and buildings as to whether it is probable that service potential associated with the item will flow to the authority.

In considering the rights of the legal owners and the schools, local authorities will need to consider whether those rights are substantive or protective.

Local authorities should therefore:

- establish and document the facts, rights and obligations relating to the arrangements for the use of the assets on a case by case basis (with reference to formal documented arrangements, experience of and communications with legal owners)
- in considering the rights and obligations, consider the substance of the arrangement in addition to the legal form including whether the rights of the legal owner are substantive or protective, for example:
  - the circumstances in which the third party could and would have any rights to take back the school buildings
  - indicators that the third party is likely to exercise its rights to take back the buildings
  - any rights obtained by either the school or local authority in respect of expenditure on the premises or the provision of funding for the premises
- prepare an accounting judgement on the recognition of the non-current assets used by the school (distinguishing between land and buildings) based on the arrangements in place with clear reference to the Code and relevant accounting standards
  - where IAS 17 applies, the factors to consider in determining whether the school has a finance or operating lease
  - where IAS 16 applies, application of the recognition criteria (whether it is probable that the economic benefits and service potential of the assets will flow to the school)
- where schools will need to be recognised, obtain relevant valuations
- disclose that judgement in the statement of accounts.

These are complex issues involving judgement and there is the potential for inconsistency in the recognition, or otherwise, on local authority balance sheets. It is therefore important to ensure judgements are robust and well documented as auditors will be required to consider whether these are reasonable and supported by appropriate evidence.

Other matters

The work required to identify and consider the arrangements over the use of schools may be significant and from discussions with clients, progress to date has been variable. Local authorities will need to consider the availability of resource to identify and review arrangements and requirements and timing of valuations. Good project management arrangements will need to be in place to ensure the requirements of the Code are met.

Whilst much of the debate has been around the recognition of non-current assets, treating a school as an entity means that local authorities will need to be satisfied that, for each school, they have captured all the financial information relating to the school as an entity. This will include obtaining assurance over the completeness of school:

- income (including voluntary donations to the school)
- expenditure (including salaries expenditure made out of voluntary donations)
- cash flows
- assets (including office equipment, minibuses etc)
- liabilities (including locally agreed leasing arrangements and any claims against the school)

in so far as these might be material.

In addition local authorities should :

- have arrangements for eliminating transactions between the local authority and schools in preparing aggregated accounts
- consider the extent of disclosures required
- consider governance implications that should be disclosed in the Annual Governance Statement.

We suggest that local authorities discuss progress with their auditor early and share judgements prior to the preparation of the financial statements.