Review of SFC Accounting Policies

Purpose

1. The purpose of this paper is to update the Audit and Compliance Committee on the SFC's accounting policies to be applied in preparation of the Financial Year (FY) 2022-23 Annual Report and Accounts.

Recommendation

2. The Committee is invited to **approve** the SFC's accounting policies for FY 2022-23.

Financial implications

3. Where we are making changes to our accounting policies, we have set out the financial implications in the relevant section below.

Risk assessment

4. This paper is designed to mitigate the risk of misstatement of our Annual Accounts.

Impact assessments

5. There are no direct Equality or Diversity, Island Communities or Carbon Reduction implications of this paper.

Review of accounting policies

Background

6. It is a requirement of Government's Financial Reporting Manual (FReM) that the Annual Accounts are produced in accordance with proper accounting practices. The SFC's accounting policies are the specific principles, conventions, rules and practices that are applied in preparing and presenting the Annual Accounts. Accounting policies need not be applied if the effect of applying them would be immaterial. These accounting policies need to be disclosed as a note to the Annual Accounts.

7. The full accounting policies are contained at Annex A – the relevant sections are explained below.

New accounting policies

8. There is one new accounting policy to be used in the preparation of the FY2022-23 accounts: IFRS 16 *Leases*. HM Treasury had previously deferred the implementation of this standard because of the circumstances caused by COVID-19.

9. The purpose of IFRS 16 is to improve the financial reporting of leases. IFRS 16 replaces the previous leases standard IAS 17 and related interpretations. The new standard requires lessees to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing obligations to make lease payments.

10. SFC has two property leases, one for its main office and a pepper corn lease with Scottish Enterprise for the right to use meeting room space. We have set out our draft accounting policy on pages 5-6 of Annex A.

Current accounting policies

11. There are two accounting policies subject to review: (i) financial instruments and (ii) grants receivable.

Financial instruments

12. We have undertaken an in-depth review of whether the loan cost to institutions (historic cost) continues to be a reasonable estimate of the carrying value of loans. We consider that the historic value of loans continues to be the most appropriate policy to adopt – this is set out on page 5 of Annex A.

Grants receivable

13. We undertook a review of whether an accruals policy should be used for European Social Fund (ESF) and European Regional Development Fund (ERDF) income, instead of the current cash basis. As there are still significant uncertainties associated with both the timing and value of any future ESF income we consider that the cash basis of accounting continues to be the most appropriate policy to adopt. The accounting policy is set out on page 4 of Annex A.

Publication

14. This paper will be published on the Council website.

Further information

15. Contact: Tiffany Ritchie, Deputy Director Finance & Operations (email: tritchie@sfc.ac.uk).

SCOTTISH FUNDING COUNCIL Annex A

Accounting Policies for FY2022-23 [DRAFT]

BASIS OF ACCOUNTING

The accounts have been prepared under the historical cost convention and in accordance with UK adopted International Accounting Standards as adapted and interpreted by the Government Financial Reporting Manual (FReM). The accounts have been prepared under a direction issued by Scottish Ministers in accordance with paragraph 17 of Schedule 1 to the Further and Higher Education (Scotland) Act 2005. The Accounts Direction given by Scottish Ministers is produced as an appendix to these accounts.

The accounting policies contained in the FReM apply UK adopted International Accounting Standards as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be the most appropriate to the particular circumstances of the SFC for the purpose of giving a true and fair view has been selected. The particular policies adopted by the SFC are described below. They have been applied consistently in dealing with items that are considered material to the accounts.

ADOPTION OF FReM AMENDMENTS

There have been only a few changes in FReM requirements in 2022-23, the main change is in the inclusion of IFRS 16 *Leases* which is considered below.

GOING CONCERN

The Scottish Government's estimates and forward plans include provision for the SFC continuation and it is therefore appropriate to prepare these accounts on a going concern basis.

SIGNIFICANT JUDGEMENTS AND ESTIMATES

In preparing these accounts the SFC makes certain judgements on key areas of income, expenditure and assets which are detailed in the Accounting Policies stated below. Where estimates have been made, for example in the useful life of an asset, the SFC considers that none have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

RECOVERY OF GRANTS

The SFC's policy is to recognise funding adjustments as recoverable grants only when there is sufficient certainty of recovery. Recovery is made through adjustments to institutions' future grant funding.

The SFC has powers under the Further and Higher Education (Scotland) Act 2005 to determine amounts of grant to recover from institutions where the terms and conditions of grant have not been met. In exercising these powers the SFC Executive may in some cases decide not to seek recoveries from institutions for periods prior to a certain year. In such cases the decision is taken on an individual basis with due regard to the overall financial position of the institution and the circumstances giving rise to a potential recovery.

FINANCIAL TRANSACTIONS

SFC accounts for financial transaction loans to HEIs at cost rather than amortised cost. The impact of the recognition of the loan values at 31 March 2023 correctly (if accounted for at amortised cost in line with International Reporting Standard (IFRS) 9) would be to change the value of the loans. This is not a material amount for the SFC annual accounts. However, we anticipate continuing to receive this form of funding from the Scottish Government and so we will keep this decision under review to determine whether adjustment would be appropriate at some future date.

EUROPEAN SOCIAL FUND INCOME

SFC Policy is to recognise income from the European Social Fund on a cash basis rather than accrued income. Due to the continued risk and uncertainty associated with these funds and the audit of claims that support them, it is decided that the current accounting policy should be that European Social Fund (ESF) income is recognised on a cash basis, i.e. when the monies are received.

PROPERTY, PLANT AND EQUIPMENT

Additions to assets over £5,000 are capitalised. Using the straight-line method, depreciation is provided on all tangible non-current assets at rates calculated to write-off the cost, less estimated residual value, of each asset over its useful life. Given their low value, depreciated historic cost is used as a proxy for fair value.

The useful lives are as follows:

- Furniture and Fittings 5 years
- Information Technology and Other Equipment 3 years

INTANGIBLE ASSETS

Intangible assets are carried at fair value. They are amortised on a straight-line basis over estimated useful lives of three years.

TAXATION

HM Revenue and Customs does not consider the activities of the SFC to be a trade and the grant income received is not therefore liable to corporation tax. The SFC is currently registered for VAT and, although most of the SFC's activities are outside the scope of VAT, tax is levied on consultancy income including staff secondments. VAT payable is included as an expense to the extent that it is not recoverable from HMRC and non-recoverable VAT is included in the capitalised purchase cost of non-current assets.

GRANTS AND LOANS

GRANTS RECEIVABLE

Grant-in-aid received for revenue, capital and running costs purposes and other Government grants are regarded as financing and are credited to taxpayers' equity. Grant-in-aid received is treated on a cash basis. European Social Fund (ESF) and European Regional Development Fund (ERDF) income are treated on a cash basis in view of the uncertainty over the level of income the SFC will receive. Recoverable grants are recognised at the dates agreed with the organisations concerned.

GRANTS PAYABLE

The SFC pays grants on the basis of: monthly instalments which take into account the pattern of the institution's receipts and payments; or on agreed profiles; or on receipt of claims from institutions. This largely reflects the pattern of need at institutions. Funds to institutions are distributed on an academic year basis as a result of which there may be prepayments at the end of the financial year. Clawback and penalties are recognised when the amount of the funding adjustment has been established and approved by Council. Recoverable grants are recognised at the dates agreed with the organisations concerned.

FINANCIAL INSTRUMENTS

IFRS 7, IFRS 9 and International Accounting Standards (IAS) 32 require an organisation to present and disclose information on the possible impact of financial instruments on its financial position and performance, and on the extent of its risk exposure. As a non-departmental public body (NDPB) funded by the government, the SFC is not exposed to any liquidity or interest rate risks.

SFC has no overseas operations and does not operate any foreign currency bank accounts. It is not subject to any foreign currency, credit or market risks. Loans to institutions are charged at nominal interest rates over a period of 10 to 20 years and are repayable by deduction from future grant in aid. As a result, SFC considers there to be minimal impairment risk from these transactions.

In accordance with IFRS 9 the loans should be initially recognised at fair value and thereafter at amortised cost. However, the loan cost has been used as a reasonable estimate of the carrying value of loans as the amortised cost would not be materially different.

LOANS

Interest free loans are payable to staff for the purchase of season travel tickets or bicycles for use in travel to work. Any other loans are payable under the terms set out in the Further and Higher Education (Scotland) Act 2005.

STATEMENT OF COMPREHENSIVE NET EXPENDITURE

All operating costs relate to the SFC's continuing activities. There have been no acquisitions or discontinued activities during the period.

OPERATING LEASES

IFRS 16 requires lessees to recognise nearly all leases in the balance sheet which will reflect their right to use an asset for a period of time and the associated liability for payment. SFC has two property leases, one for its main office and a pepper corn lease with Scottish Enterprise for the right to use meeting room space.

The lease liability is measured at the present value of the lease payments, discounted at the rate implicit in the lease or, if that is not readily determinable, the HM Treasury discount rate promulgated in the PES papers as an incremental borrowing rate. The lease liability is subsequently measured at amortised cost using the effective interest rate method. It is remeasured, with a corresponding adjustment to the right of use asset, when there is a change in future lease payments.

The right of use asset is initially measured at cost, comprising: the initial lease liability; any lease payments already made less any lease incentives received; initial direct costs; and any dilapidation or restoration costs. The right of use asset is subsequently depreciated on a straight-line basis over the shorter of the lease term or the useful life of the underlying asset. The right of use asset is tested for impairment if there are any indicators of impairment.

Leases of low value assets and short-term leases of 12 months or less are expensed, as are non-lease service components.

PENSION COSTS AND OTHER POST-RETIREMENT BENEFITS
Past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS), which is an unfunded multi-employer defined benefit scheme, but the SFC is unable to identify its share of the underlying liabilities.

The scheme is accounted for as a defined contribution scheme under the multi-employer exemption permitted in IAS 19 'Employee Benefits'. The expected costs are accounted for on a systematic and rational basis over the period during which the SFC benefits from employees' services by payment to the PCSPS of an amount calculated on an accruing basis. Liability for payment of future benefits is a charge on the PCSPS. Payments to the defined contribution schemes are expensed as they become payable. Early severance payment obligations are expensed in the year in which the employee leaves.

SHORT-TERM EMPLOYEE BENEFITS
A liability and an expense is recognised for holiday days, holiday pay, bonuses and other short-term benefits when the employees render service that increases their entitlement to these benefits.

FINANCIAL GUARANTEES
In accordance with IFRS 9, financial guarantees are considered for recognition as liabilities. The likelihood of a liability occurring is considered to be remote therefore the financial guarantees have been treated as a contingent liability in line with IAS 37 and are not recorded on the balance sheet.

IFRS ISSUED BUT NOT EFFECTIVE
International Accounting Standard (IAS) 8 on Accounting Policies requires organisations to disclose details of any IFRS that has been issued but is not yet effective. At 31 March 2023, there are none such to declare.