Board of Management

Audit Committee

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Agenda Item	8
Subject of Paper	Financial Regulations Update
FOISA Status	Disclosable
Primary Contact	Stuart Thompson, Executive Director Finance
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Action	For Noting

1. Recommendations

The Audit Committee is asked to note this report.

2. Purpose of report

The purpose of this report is to provide the committee with an update on the anticipated update of the College Financial Regulations.

3. Context

The College Financial Regulations reflect the SFC Financial Memorandum and any other relevant legislation or guidance. With the implementation of the new accounting standard FRS102 and other governance changes, the College was anticipating a new SFC Financial Memorandum over the summer. SFC however have confirmed that they are still working on a revised draft and recently issued an Accounts Direction (Appendix A). The SFC Accounts Direction contains detailed guidance and instructions on the preparation and content of the College annual report and accounts. The SFC Accounts Direction does not have a direct impact on the content of the College Financial Regulations.

4. Impact and implications

The current expectation is that SFC will issue a new Financial Memorandum before the end of the year and the College will update appropriately the Financial Regulations based on any changes contained within the new SFC Financial Memorandum.

SCOTTISH FUNDING COUNCIL

2015-16 Accounts direction for Scotland's colleges and universities

1 It is the Scottish Funding Council's direction that colleges and universities comply with the 2015 *Statement of Recommended Practice: Accounting for Further and Higher Education* (SORP) in preparing their annual report and accounts.

2 Colleges and universities must comply with the accounts direction in the preparation of their annual report and accounts in accordance with the Financial Memorandum with the Scottish Funding Council (SFC) or the Regional Strategic Body (for assigned colleges).

3 Incorporated colleges are also required to comply with the Government Financial Reporting Manual 2015-16 (FReM) where applicable.

4 Incorporated colleges are reminded that they must send two copies of their annual report and accounts to the Auditor General for Scotland by 31 December 2016.

5 The annual report and accounts should be signed by the chief executive officer and by the chair, or one other member of the governing body.

6 Incorporated colleges should reproduce this Direction as an appendix to the annual report and accounts.

Scottish Funding Council
24 August 2016

Introduction and structure of accounts direction

Mandatory and corporate governance disclosures

1. We draw your attention to the specific mandatory disclosures for higher education institutions and non-incorporated colleges in **Appendix 1** and for incorporated colleges in **Appendix 2.** The corporate governance disclosures required are listed in **Appendix 3.**

Deadlines

2. Universities, incorporated colleges and non-incorporated colleges[1] are required to provide their annual report and accounts, together with the associated audit reports, to us by 31 December 2016. The annual report and accounts should be prepared with a 31 July year-end[2].

3. Non-UHI incorporated colleges should prepare their annual report and accounts for the twelve month period ending 31 July 2016 with comparatives for the sixteen month period ending 31 July 2015.

[1] The term non-incorporated college covers Newbattle Abbey College, Sabhal Mor Ostaig and West Highland College UHI. Orkney College and Shetland College are part of their local authorities and will be included in the annual report and accounts of those authorities.

[2] SRUC prepares its annual report and accounts on a 31 March year end basis

Appendix 1

Mandatory disclosures – Universities and non-incorporated colleges

Listed below are disclosures which universities and non-incorporated colleges **must** include in the financial statements.

Strategic Report[3]

1 A list of members of the governing body and key committees. This should cover all those who served during the period and include any changes up to the date of signing the annual report and accounts.

2 A statement describing the payment practice code or policy adopted on payment of suppliers and performance achieved, together with disclosure of any interest paid under the Late Payment of Commercial Debts (Interest) Act 1998, or a statement that there were no matters to disclose.

3 A statement on the employment of disabled persons where the average number of all persons employed in the year exceeds 250.

Notes to the accounts

4 The audit fees and non-audit fees paid to external and internal auditors.

Corporate governance

5 We require colleges and universities to include in their annual report and accounts a statement covering the responsibilities of their governing body in relation to corporate governance. This statement is required to indicate how the college or university has complied with good practice in this area.

6 It is a condition of the Financial Memorandum (FM) with SFC or the Regional Strategic Body (for assigned colleges) that governing bodies comply with the principles of good governance set out in the 2013 Scottish Code of Good HE Governance or the 2014 Code of Good Governance for Scotland's Colleges. In line with the principle of comply or explain, an explanation should be provided in the event that the institution's practices are not consistent with particular principles.

[3] Further guidance on Strategic reports is given in the 2015 SORP (paragraph 3.19 to 3.22)

7 We recognise that each college or university will have its own system of corporate governance, reflecting its particular objectives and management processes. However, in preparing their governance statement, colleges and universities should give due regard to the guidance contained in Appendix 3.

8 Colleges and universities should be aware that their external auditors will be reviewing the corporate governance statement as part of their audit and will be including a reference to this in their audit report.

9 The following paragraphs provide details of college and university specific disclosures that must be included in the annual report and accounts.

University specific disclosures - Remuneration

10 The actual total remuneration of the head of institution, disclosing separately salary, bonus, employer pension contribution and benefits in kind. Where there is a change of head of institution during the year, details should be given separately for each person, noting the dates each was in post.

11 The total number of higher paid staff, including senior post-holders, in bands of £10,000, above a threshold of total emoluments (excluding pension contributions and compensation for loss of office) of £100,000. Payments funded from external sources, including the NHS, should be included in emoluments. The number of senior post-holders within each band should be separately identified.

12 The aggregate amount of any compensation for loss of office payable to the head of institution and any staff member earning in excess of £100,000 per annum, or where the costs of all elements of a proposed arrangement amount to more than £100,000, together with the number of people to whom this was payable.

University specific disclosures – Sustainability

13 Main principle 1 of the 2013 Scottish Code of Good HE Governance refers to institutions' responsibility for ensuring long-term sustainability. In this context, universities are required to include within their annual report and accounts a description of the sustainability framework within the institution. This should outline the process by which the University Court monitors the overall sustainability of the institution, including the key sustainability measures used.

Non-incorporated college specific disclosures

14 The actual total remuneration of the head of institution, disclosing separately salary, bonus, employer pension contribution and benefits in kind. Where there is a change of head of institution during the year, details should be given separately for each person, noting the dates each was in post.

15 The total number of higher paid staff, including senior postholders, in bands of £10,000, above a threshold of total emoluments (excluding pension contributions and compensation for loss of office) of £60,000. The number of senior postholders within each band should be separately identified.

16 The aggregate amount of any compensation for loss of office payable to the head of institution and any staff member earning in excess of £60,000 per annum, together with the number of people to whom this was payable, or where the costs of all elements of a proposed arrangement amount to more than £75,000.

Appendix 2

Mandatory disclosures – incorporated colleges

1. Colleges are required to comply with the Government Financial Reporting Manual (FReM) for 2015-16 as well as complying with the SORP. The additional disclosures required in colleges' annual report and accounts in order to comply with the FReM (i.e. those areas not addressed in the SORP) are set out in the various disclosures below. In cases where there is a conflict between the FReM and the SORP, the latter will take precedence.

2. The disclosures which incorporated colleges **must** include in the annual report and accounts are outlined below.

The Performance Report

3. It is a requirement of the FReM that colleges include a Performance Report in their annual report and accounts (replacing the Operating and Financial Review). The report will provide information on the college, its main objectives and strategies and the principal risks that it faces. The report should contain an Overview and also a Performance Analysis.

4. As a minimum, the Overview should include;

- A statement from the Principal providing their perspective on the performance of the college over the period;
- A statement of the purposes and activities of the organisation;
- The key issues and risks that could affect the entity in delivering its objectives ;
- An explanation of the adoption of the going concern basis where this might be called into doubt, for example where there are significant net liabilities; and
- A performance summary

5. The purpose of the Performance Analysis is for colleges to report on their most important performance measures and also provide longer term trend analysis where appropriate. As a minimum the performance analysis must include:

- Information on how the college measures performance ;

- A detailed analysis and explanation of the development and performance of the entity during the year; and

- Confirmation of compliance with Scottish Government sustainability reporting in line with the requirements of the Climate Change (Scotland) Act 2009. The Schedule to the 2015 Order sets out the required content for the report to Scottish Government:

  http://www.legislation.gov.uk/ssi/2015/347/schedule/2/made

6. Where the College has incurred a deficit as a result of spending net depreciation cash, an explanatory note and table should be included in the annual report and accounts. **Appendix 5** sets out an illustrative form of words and we recommend that colleges adopt this form of words, supplemented, if it is felt necessary, with more detailed information to reflect local circumstances. Colleges should explain how depreciation cash has been accounted for and the impact on the operating position for the year. We recommend that the form of words and table is included in the Performance Report.

7. Colleges are required to include in their Performance Report details of their financial year resource position for 2015-16. This should include a statement of the year end outturn against both Resource and Capital budgets, together with an explanation of any variances.

8. A statement describing the payment practice code or policy adopted on payment of suppliers and performance achieved, together with disclosure of any interest paid under the Late Payment of Commercial Debts (Interest) Act 1998, or a statement that there were no matters to disclose

9. The Performance Report should be signed and dated by the College Principal.

The Accountability report

10. The Accountability Report is required to have three sections: a Corporate Governance Report, a Remuneration and Staff Report and a Parliamentary Accountability report.

Corporate Governance Report

11. The purpose of the Corporate Governance report is to explain the composition and organisation of the college's governance structures and how they support the achievement of college objectives.

12. As a minimum, the Corporate Governance report must include a directors' report, a statement of the Board of Management responsibilities and a governance statement.

Directors' report

13. The directors' report should set out the membership of the Board of Management and also those members of the senior management team who influence the decisions of the college as a whole. Details should be given of any directorships or other interests which the members have or a link provided to the relevant Register of Interests. Any information on personal data-related incidents reported to the Information Commissioners Office should also be disclosed.

Statement of Board of Management's responsibilities

14. The FReM requires government bodies to provide a Statement of Accounting Officer's responsibilities. However, the SFC Chief Executive is the Accountable Officer for the college sector and is required to provide a governance certificate of assurance covering all colleges to the Principal Accountable Officer of the Scottish Government, based upon certificates of assurance provided by colleges. In light of this unique arrangement, colleges are required to continue to provide a Statement of Board's responsibilities within their Corporate Governance report.

Governance Statement

15. We require colleges to include in their annual report and accounts a statement covering the responsibilities of their governing body in relation to corporate governance. This statement is required to indicate how the college has complied with good practice in this area.

16. It is a condition of the FM with SFC or the Regional Strategic Body (for assigned colleges) that governing bodies comply with the principles of good governance set out in the 2014 Code of Good Governance for Scotland's Colleges. In line with the principles of comply or explain, an explanation should be provided in the event that the college's practices are not consistent with particular principles. The FM also requires

compliance with the SPFM and, in preparing the corporate governance statement, colleges must comply with the guidance set out in the Governance Statement section of the SPFM. (http://www.gov.scot/Topics/Government/Finance/spfm/govstate)

17. We recognise that each college will have its own system of corporate governance, reflecting its particular objectives and management processes. However, in preparing their governance statement, colleges should give due regard to the guidance contained in Appendix 3.

18. Colleges should be aware that their external auditors will be reviewing the corporate governance statement as part of their audit and will be including a reference to this in their audit report.

19. As required by the SPFM , details of the college's estates strategy should also be provided in the Corporate Governance report.

Remuneration and staff report

20. Incorporated colleges are required to include within their annual report and accounts a Remuneration and staff report in accordance with Section 5 (Paras 5.3.15 to 5.3.27) of the FReM. Further information is available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/488328/2015-16_FReM__December_2015_.pdf.

    Colleges should also refer to further guidance contained in Employers Pension Notice (EPN) 452 which is available on the Civil Service Pensions website at:

    http://www.civilservicepensionscheme.org.uk/employers/employer-pension-notices/epn452-revised/

21. Although EPN 452 deals specifically with the Civil Service Pension Scheme it does contain a standard format for disclosure and explanations of what should be included in the report in order to comply with the FReM. The Remuneration report should set out the remuneration and accrued pension benefits of senior officials of the College and this will include those set out in the Directors report (see paragraph 13 above).

22. An example remuneration report is attached at **Appendix 4**. It is important to note that individuals should be informed in advance of the intention to disclose their salary information in this report. There is a presumption that information about named individuals will be given

unless there is specific justification for not disclosing this (see FReM paragraph 5.3.17 for circumstances where non-disclosure is acceptable). In other cases it would be for the staff member to make a case for non-disclosure which should be considered by the college on a case by case basis. Where non-disclosure is agreed, the fact that certain disclosure has been omitted should be disclosed.

23. The Staff report must include the following information:

- The number of senior staff by band (of £5,000);
- Staff numbers and costs distinguishing between permanent contract staff and agency/contract staff;
- Staff composition – the number of persons of each sex who were directors or employees of the company;
- Sickness absence data;
- Staff policies applied during the year:

    (a) For giving full and fair consideration to applications for employment by the college made by disabled persons, having regard to their particular aptitudes and abilities;

    (b) For continuing the employment of, and arranging appropriate training for, employees of the college who have become disabled persons during the period they were employed by the college; and

    (c) Otherwise for the training, career development and promotion of disabled persons employed by the company;

- Expenditure on consultancy;
- Off-payroll engagements; and
- Exit packages (as approved by SFC under Severance Guidance)

Parliamentary Accountability report

24. The FReM requires the inclusion of a Parliamentary Accountability report and, for Scottish government bodies, the requirements are reflected in the SPFM. The disclosures required are:

- Fees and charges for each service where the full annual cost is £1 million or more, or (if lower) where the amount of the income and full cost of the service are material to the financial statements:

    - Financial objective performance against that objective. The standard approach to setting charges for public services is full cost recovery but the SPFM lists some exceptions e.g. subsidised services;
    - Full cost of the service;
    - Income from charging for the service; and
    - Surplus or deficit.

- Disclosure of contingent liabilities, specifically enforceable undertakings given in the form of a guarantee or indemnity which would bind the body into providing the resources in the event of the guarantee or indemnity maturing; or a letter or general statement of comfort which could be considered to impose a moral obligation; and

- Disclosure of total losses exceeding £250,000 and total special payments exceeding £250,000.

25. It is not envisaged that the above headings will apply to most colleges in which case the Parliamentary Accountability report will not require to be completed.

26. The Accountability report should be signed and dated by the Principal and Chair of the Board.

Notes to the accounts

27. The audit fees and non-audit fees paid to external and internal auditors.

28. The total number of higher paid staff, including senior postholders, in bands of £10,000 above a threshold of total emoluments (**excluding pension contributions and compensation for loss of office**) of £60,000. The number of senior postholders within each band should be separately identified.

Appendix 3

Corporate Governance Statement Guidance for Colleges and Universities

1 Colleges and universities are required to include in their annual report and accounts a statement covering the responsibilities of their governing body in relation to corporate governance. This statement is required to indicate how the college or university has complied with good practice in this area.

2 It is a condition of the Financial Memorandum with the SFC or the Regional Strategic Body (for assigned colleges) that governing bodies meet the principles of good governance, set out in the 2013 Scottish Code of Good HE Governance or the 2014 Code of Good Governance for Scotland's Colleges. In line with the principle of comply or explain, an explanation should be provided in the event that the institution's practices are not consistent with particular principles.

3 Colleges and universities are required to demonstrate robust governance, maintain a sound system of internal control and to ensure that the following key principles of effective risk management have been applied. Effective risk management:

- covers all risks – including those of governance, management, quality, reputation and finance – but focuses on the most important risks;
- produces a balanced portfolio of risk exposure;
- is based on a clearly articulated risk appetite, policy and approach;
- requires regular monitoring and review, giving rise to action where appropriate;
- needs to be managed by an identified individual and involve the demonstrable commitment of the governing body and the executive leadership; and
- is embedded into normal business processes and aligned to the strategic objectives of the organisation.

4 Colleges and universities are required to review at least annually the effectiveness of their system of internal control.

Format of corporate governance statement

5 We recognise that each college and university will have its own system of corporate governance, reflecting its particular objectives and management processes, and the corporate governance disclosures in the annual report will differ accordingly. It is expected that each college and university will tailor its corporate governance statement to reflect its own individual circumstances. However, good practice suggests that a corporate governance statement should include the following sections:

- **Introduction**, which shows the context and purpose of the corporate governance statement;
- **Governing body**, outlining the governance structure and the role of college or university committees, and their effectiveness;
- **Corporate strategy**, outlining the arrangements for strategic development;
- **Risk management and internal control**, setting out the arrangements for identifying, evaluating and managing risks and the arrangements for monitoring internal controls;
- **Going concern**, confirming that the college or university is a going concern, with supporting assumptions and qualifications as necessary. This disclosure provides support for the use of the going concern accounting policy and should not be inconsistent with the disclosures regarding going concern either in the annual report and accounts or the auditors' report thereon; and
- **Conclusion**, providing any concluding observations or messages.

Appendix 4

Template for Remuneration Report (for incorporated colleges only)

Remuneration Policy

Colleges should outline here the details of their remuneration policy for the Principal and senior managers and also outline the operation of the Remuneration Committee.

Remuneration including salary and pension entitlements

Salary entitlements[4]

The following table provides detail of the remuneration and pension interests of senior management.

	Year ended 31 July 2016			16 months ended 31 July 2015		
Name	**Salary £'000**	**Pension Benefit £'000**	**Total £'000**	**Salary £'000**	**Pension Benefit £'000**	**Total £'000**
Name A - Actual						
Name B - Actual						

	Year ended 31 July 2016			16 months ended 31 July 2015		
Name	**Salary £'000**	**Pension Benefit £'000**	**Total £'000**	**Salary £'000**	**Pension Benefit £'000**	**Total £'000**
Name A –Annual Equivalent						
Name B – Annual Equivalent						

[4] Note:

a) The salaries in the above table represent the amount earned in the financial period and include salary, bonuses, overtime and other allowances (as applicable)
b) The value of pension benefits is calculated as the real increase in pension multiplied by 20 plus the real increase in any lump sum less the contributions made by the individual. The x20 multiplier aims to bring public bodies in line with other industries in disclosing an assessed cumulative pension benefit for a standard 20 year period which is the estimated life span following retirement.
c) The details in this table are subject to audit

[The above disclosures will be in bands of £5,000. For non-UHI incorporated colleges, given that the table will include prior period salary figures for the 16 months ended 31 July 2015, it will also be necessary to disclose annual salary equivalent for each person noted above based on a pro rata figure for 12 months. This is to enable comparability with other public sector bodies.]

Where applicable, performance pay or bonuses payable, and non-cash benefits should also be disclosed in the above table.

Median Remuneration

Colleges are required by the FReM to disclose the relationships between the remuneration of the highest paid official and the median remuneration of their workforce.

The banded remuneration of the highest paid official in the organisation in the financial year 2015-16 was £xxx (2014-15 £xxx on a pro rata 12 month basis). This was x times (2014-15 x times) the median remuneration of the workforce which was £xx (2014-15 £xx).

Accrued Pension Benefits

Colleges should outline here the pension schemes in operation and give a brief explanation of how benefits accrue for the employees.

Senior Officials Pension

Pension benefits are provided to senior officials on the same basis as all other staff. The accrued pension benefits for senior officials are set out in the table below, together with the pension contributions made by the College.

Name	**Accrued pension at pension age at 31 July 2016**	**Accrued lump sum at pension age at 31 July 2016**	**Real increase in pension 1 August 2015 to 31 July 2016**	**Real increase in lump sum 1 August 2015 to 31 July 2016**	**CETV at 31 July 2016**	**CETV at 31 July 2015**	**Real increase in CETV**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Name A							
Name B							

Cash equivalent Transfer Value (CETV)

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time.

The value of the accrued pension benefits has been calculated on the basis of the age at which the person will first become entitled to receive a pension on retirement without reduction on account of its payment at that age; without exercising any option to commute pension entitlement into a lump sum; and without any adjustment for the effects of future inflation. The pension figures shown relate to the benefits that the person has accrued as a consequence of their total Local Government service and not just their current appointment.

In considering the accrued pension benefits figures the following contextual information should be taken into account:

(i) the figures for pension and lump sum are illustrative only in light of the assumptions set out above and do not necessarily reflect the actual benefits that any individual may receive upon retirement.

(ii) the accrued benefits figures are reflective of the pension contributions that both the employer and the scheme member have made over a period of time.

Real increase in CETV

This reflects the increase in CETV that is funded by the employer. It does not include the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

Compensation for loss of office

xx left under voluntary exit terms on xx/xx/xx. They received a compensation payment of £'xxx.

x left under Voluntary redundancy terms on xx/xx/xx. They elected to take early retirement. The cost to the College of buying out the actuarial reduction on their pension £xx. They did not receive any additional compensation.

The table below summarises the exit packages by cost band.

Exit package cost band	Number of compulsory redundancies	Number of other departures agreed	Total number of exit packages by cost band
<£10,000			
£10,000 - £25,000			
£25,000 - £50,000			
£50,000 - £100,000			
£100,000 - £150,000			
£150,000 - £200,000			
Total number of exit packages			
Total cost (£)			

Salaries and Related costs

	2016	2016	2016	2015
	Directly employed staff	Seconded and agency staff	Total	Total
Wages and salaries	x	x	x	x
Social security costs	x	x	x	x
Other pension costs	x	x	x	x
Total	xx	xx	xx	xx
Average number of FTE	x	x	x	x

The college employed xx females and xx males as at 31 July 2016.

Appendix 5

Deficit resulting from use of depreciation cash – illustrative form of words for 2015-16 accounts (incorporated colleges only)

One consequence of college reclassification as central government bodies is that, from 1 April 2014, while colleges continued to prepare accounts under the FE/HE Statement of Recommended Practice, they are now also required to comply with Central Government budgeting rules. This affects, amongst other things, the way in which non-cash depreciation charges are treated and how the colleges spend the cash funds previously earmarked for depreciation. There is potential for this spend to move the college's Statement of Comprehensive Income into a deficit position.

The impact of the above has resulted in [or contributed £Y to] the reported deficit for the 2015-16 accounting year. However, the Scottish Funding Council has confirmed (*in its letter to the College on 30 March 2015*) that a deficit resulting from the College following its 30 January 2015 guidance should be treated as a 'technical' deficit and should not be interpreted, on its own, as a challenge to the College's ongoing financial sustainability. Audit Scotland accepts that a deficit arising from the use of cash funding originally provided for non-cash depreciation does not indicate an underlying financial sustainability concern.

The impact on the operating position is detailed below.

Table of net depreciation spend	
Revenue	**£'000**
Student support	xx
Pay award	xx
Other (give detail)	xx
Total impact on operating position	**xx**