An Introduction to FRS102 for Higher and Further Education
December 2014
Introduction

The Financial Reporting Council (FRC) published Financial Reporting Standard (FRS) 100 'Application of Financial Reporting Requirements' in November 2012. This outlines the standards that make up the new financial reporting framework applicable on a mandatory basis for the majority of UK entities for reporting periods starting on or after 1 January 2015. Higher and Further Education (HE and FE) establishments will be required to apply FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' which was issued in March 2013.

FRS 102 addresses some of the specific reporting issues faced by HE and FE providers and other public benefit entities, including the basis for recognising government grants, business combinations and the recognition of income from various sources.

HE and FE providers will be required to adopt the new financial reporting regime for accounting periods starting on or after 1 January 2015, with the comparative balance sheet and opening comparatives requiring restatement. For most organisations this will mean a 1 August 2014 transition date, a 31 July 2015 comparative balance sheet and the first FRS 102 compliant accounts being prepared for 31 July 2016.

However, it is not too soon to start considering how you will address the transition process. From our extensive experience in assisting clients with transition to EU-adopted IFRS, good planning is key to success. Timely actions and the right support will ensure that the process goes as smoothly as possible.

There are also operational matters which may need to be addressed in preparing for transition, such as training requirements for your finance and operational teams, systems changes to ensure relevant information is captured, education of your stakeholders, and the potential need for additional resources.

This factsheet provides a summary of the key changes brought about by the FRS 102 compliant SORP (SORP 2015), our interpretation of the practical effects of implementation, together with suggested actions. Most actions involve conducting a review of accounting policies.
Planning for transition

Transition timeframe

There is no doubt that the transition will require time and has the potential to cause disruption to your finance function. However, this should not just be viewed as a change to your financial statements. The impact on the business as a whole must also be considered carefully. Our experience from assisting our listed clients with the transition to IFRS has shown us that starting to think about the issues early can save time and reduce problems later. With thorough planning and the right support, the process can be made as smooth as possible.

A smooth transition will require careful planning and a plan for an organisation with a July year end might look something like this:

Planning ahead will allow you to address issues such as negotiating bank covenants and having the right amount of resource available
Key areas of impact

We set out below the key areas and issues we have identified as being relevant for the sector. We also provide a high level consideration of actions to include in a transition plan and the potential impact on the financial statements and resources. Unless otherwise stated, the financial statements will need to be restated retrospectively on transition to FRS 102, as if it has always applied. Retrospective adjustments will be reflected in the opening balance sheet reserves.

**Impact:** The assessment for each issue below reflects the potential impact on transition to FRS 102 based on two separate criteria, whilst recognising that some issues may impact different providers to a varying extent. Grading of high, medium or low is represented by red, amber and green.

<table>
<thead>
<tr>
<th>£:</th>
<th>Potential impact on the financial statements either in terms of the balance sheet or performance statement. High reflects a potentially significant impact on the results and/or position for the provider.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resource:</td>
<td>Potential impact on resources during the transition process. High reflects areas that may be complex and/or resource intensive.</td>
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</tbody>
</table>

### Intra-group loans

Intra-group loans that are not currently on open market terms are deemed to be financing transactions and will be recognised initially at fair value. Fair value means estimating the expected cash flows and discounting at a market rate. This includes any long-standing 'trading' balances.

For some groups, the impact could be significant if loans are not made on market terms and could result in different values being recognised in each entity within the group.

**Potential approach**

- Review intra-group balances to determine treatment.
- Key elements are the rate of interest charged (is it equivalent to the rate that would be available to that entity in the open market) and whether it is repayable on demand.
Key areas of impact (continued)

Financial instruments

Under FRS 102, the treatment of financial instruments is different to current UK GAAP. There are now two categories of instrument, 'basic' and 'other', or non-basic. Non-basic instruments, including all derivatives (eg forwards, swaps, options) are reported at fair value which may be a significantly different position from the current amortised cost. Measuring at fair value will impact net assets and is likely to introduce more volatility into the results each year.

FRS 102 allows entities to account for financial instruments under IAS 39 or IFRS 9 (full IFRS). This policy choice may be beneficial to entities with certain non-basic instruments as it could result in reduced volatility. However, the policy choice must be applied to all financial instruments.

Volatility in the surplus or deficit may also be reduced, in appropriate circumstances, by applying hedge accounting. Documentation will need to be prepared to demonstrate the hedge has been designated, how the effectiveness will be measured and the effectiveness tests completed to demonstrate that it is effective.

<table>
<thead>
<tr>
<th>Potential approach</th>
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<tbody>
<tr>
<td>- Undertake a review of the financial instrument agreements to determine classification.</td>
</tr>
<tr>
<td>- Consider basis for determining fair value for any non-basic instruments (eg open market value, discounted cash flows etc).</td>
</tr>
<tr>
<td>- Consider whether applying full IFRS could provide a better result in terms of volatility where there are non-basic instruments.</td>
</tr>
<tr>
<td>- Note that hedge accounting is available in certain circumstances and will need separate consideration. If hedge accounting is applicable, we recommend seeking advice early on in the transition process.</td>
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</table>
### Key areas of impact (continued)

**FRS 102 issue**

<table>
<thead>
<tr>
<th>Revenue from government grants</th>
</tr>
</thead>
<tbody>
<tr>
<td>The SORP follows FRS 102 in allowing a choice in accounting policy between the accruals model or the performance model, but the policy choice must be consistently applied to each class of grant.</td>
</tr>
<tr>
<td>Under the accruals model, grant revenue will be shown as deferred income and recognised on a systematic basis eg over the useful economic life of the related asset.</td>
</tr>
<tr>
<td>Under the performance model, a grant is recognised in income when performance related conditions are met. A grant with unfulfilled performance conditions is held as deferred income until conditions are met, at which point the income will be released to the Statement of Comprehensive Income.</td>
</tr>
<tr>
<td>Note, capital grants for land must be accounted for under the performance model, which will result in a release of on-balance sheet deferred capital grant balances to retained earnings as a transition adjustment. In subsequent years, there will be no release of grant to offset against depreciation.</td>
</tr>
</tbody>
</table>

**Potential approach**

- Understand the definitions within SORP 2015.
- Review impact of each policy on your government grant revenue streams and select the most appropriate policy.
- Calculate impact of release of current deferred capital grant balances.
- Assess impact on covenants.

<table>
<thead>
<tr>
<th>Impact: £ - High</th>
<th>Resource - High</th>
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<tr>
<td>£ - High</td>
<td>Resource - High</td>
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</table>
Key areas of impact (continued)

**FRS102 issue**

**Service concession arrangements**

This is an arrangement where a University/College (the grantor) contracts with a private operator to develop, operate and maintain infrastructure assets eg student accommodation.

Under current UK GAAP, many of these arrangements have been accounted for as 'off balance sheet' as a result of the assessment of the risks and rewards relating to the use of the asset. However, under FRS 102, there are different assessment criteria, which are likely to result in more arrangements being recognised on balance sheet.

The SORP provides additional guidance and sets out three tests, which if passed, will result in the scheme being recognised in line with the treatment for leases. The tests are:

1. Does the institution act as a Principal in the arrangement?
2. Does the arrangement meet the definition of a service concession arrangement?
3. Does the arrangement pass the control tests set out in FRS 102?

**Potential approach**

- Identify any service concession arrangements.
- Review the terms of the arrangement to determine whether the arrangement should be treated as 'on' or 'off balance sheet'.
- Discuss your intended accounting treatment with your auditor at an early stage. This is a technically challenging area and an early conclusion on the accounting treatment is recommended.
- Consider impact on existing loan covenants.
An introduction to FRS 102 for education providers | December 2014

Key areas of impact (continued)

FRS102 issue

Retirement benefits

Multi-employer schemes, such as USS, can be accounted for as defined contribution schemes if sufficient information is not available to use defined benefit accounting.

There will, however, be a need to recognise any contractual obligations with the pension scheme. This will include any agreements to pay additional contributions to fund the deficit. This contractual obligation will need to be included at its net present value.

Group defined benefit schemes

Under current UK GAAP the deficit or surplus on a group defined benefit scheme might only be shown in the consolidated financial statements if the available exemption is taken on the basis that it is not possible to split the share of assets and liabilities between the group companies.

Under FRS 102, such a deficit or surplus must be recognised in the individual accounts of at least one group entity. By default this will be the entity that is legally responsible for the plan (this is often the parent). This could have a significant impact on that entity’s accounts.

The default treatment may be avoided where a group has a stated policy or contractual agreement for charging the net defined benefit cost as calculated under FRS 102 to one or more individual group entities.

Impact: £ - High  Resource - Medium

- Consider what agreements are in place with the pension fund.
- Consider impact of additional liability on the net asset position.
- Assess overall impact on net incoming resources, including the unwinding of the discount and any year on year movements in the provision.
- Consider information from the pension scheme as the next review date approaches and factor any expected increases in obligation into the relevant forecasts.
- Consider the impact of the additional obligation on bank covenants.

Impact: £ - High  Resource - Medium

- Consider whether the requirement to apply defined benefit accounting in an individual entity’s financial statements may apply.
- Consider introducing a stated policy or contractual agreement to allocate the liability amongst group entities.
- When introducing such a policy or agreement, take care over the wording and its impact on the allocation of the liability.
- If applicable, this issue should be considered early in the transition process as any stated policy or contractual agreement cannot be retrospectively applied.
Key areas of impact (continued)

Non-exchange revenue transactions

These are transactions where the organisation receives value but does not necessarily give equal value in exchange. Examples include donations and endowment income, gifts in kind, donations of assets, grants from private or charitable individuals.

Where such transactions have performance related conditions attached, the performance model must be used to recognise revenue.

Endowments and donations are unlikely to have performance related conditions but may have restrictions. They will therefore be recognised on entitlement to the income, with appropriate movements to restricted reserves if appropriate.

On the balance sheet, endowments will be presented for each class of asset and not as a separate category.

Leased assets

Under FRS 102, there is no rebuttable presumption that where the present value of the minimum lease payments is 90% or more of the fair value of the asset, then the lease is a finance lease. Therefore greater judgement may be required to distinguish between a finance and an operating lease.

Lease incentives are released over the lease term as opposed to the period up to the first rent review, although transition relief is available.

Review all privately funded grants to identify performance conditions and determine whether any adjustments required on transition to defer balances.

Ensure all donation and endowment income is accounted for correctly following transition date.

Impact on covenants.

Leased assets

Under FRS 102, there is no rebuttable presumption that where the present value of the minimum lease payments is 90% or more of the fair value of the asset, then the lease is a finance lease. Therefore greater judgement may be required to distinguish between a finance and an operating lease.

Lease incentives are released over the lease term as opposed to the period up to the first rent review, although transition relief is available.

Review lease arrangements to determine treatment.

Calculate delayed recognition of lease incentives for any leases contracted after the transition date (eg 1 August 2014).
Key areas of impact (continued)

**FRS102 issue**

Financial statement presentation

Based on SORP 2015, financial statements consist of the following:

a. Statement of comprehensive income (SCI)
b. Balance sheet
c. Statement of cash flows
d. Notes, including accounting policies.

Key changes include:

- designated reserves are no longer allowed in the financial statements
- under the accruals model, unamortised grants are no longer shown at the bottom of the balance sheet as deferred capital grants, but held as deferred income within creditors
- reduced number of headings on the face of the cash flow statement
- cash flow statement to be reconciled to the total of 'cash and cash equivalents'.

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<tr>
<th>Impact:</th>
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<tr>
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<tr>
<td>• Review the mapping of the nominal ledger to ensure the trial balance reflects changes to the presentation in the financial statements.</td>
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<td></td>
</tr>
<tr>
<td>• Review accounting policies to ensure they are FRS 102 and SORP 2015 compliant.</td>
<td></td>
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</tr>
<tr>
<td>• Prepare skeleton accounts in advance of the first year end in sufficient time to allow input from the Board and in order to obtain any information that is not readily available.</td>
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<td></td>
</tr>
<tr>
<td>• Consider impact of changes on bank covenants, if applicable.</td>
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<tr>
<td>• Communicate changes to stakeholders.</td>
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</table>

Creditors

Additional liabilities may be required for short term employee benefits such as holiday pay or accumulating sabbaticals. For example, an accrual may be required for those holidays not taken at the year end – where the year end is not in line with the holiday year this may require detailed calculations.

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<thead>
<tr>
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<tr>
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<tr>
<td>• Review systems to capture information on holidays carried forward.</td>
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<tr>
<td>• Consider the alignment of the holiday and financial year ends, bearing in mind any impact on HR issues.</td>
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<tr>
<td>• A calculation for the opening balance sheet at the date of transition will be required.</td>
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## Key areas of impact (continued)

### FRS102 issue | Potential approach

<table>
<thead>
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<tr>
<td><strong>Taxation</strong></td>
<td></td>
</tr>
<tr>
<td>For entities that are subject to tax, changes to accounting treatments may have a knock on effect on the tax treatment. For example valuation of intra-group loans will result in imputed interest charges being recognised in the results, and which may not be allowable for corporation tax purposes. The changes may also impact the level of profits available to be gifted to the parent entity.</td>
<td><strong>Impact:</strong> £ - Medium</td>
</tr>
<tr>
<td>• Assess potential tax implications of changes to the accounting policies.</td>
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</tbody>
</table>

| Defined benefit schemes | |
| The net finance charge includes the interest income on the plan assets and the interest expense on the plan liabilities. Under FRS 102, the interest income will be calculated using the discount rate applied to the pension liabilities rather than the expected return on the assets. This is likely to result in an increase in the net finance charge. | **Impact:** £ - Medium | Resource - Low |
| There is no longer a requirement to have an independent actuarial valuation each year. | • Consider the impact on the surplus/deficit. |
| • Consider impact on covenants. | |
Key areas of impact (continued)

**FRS102 issue**  

**Debtors**

No significant impact on transition although any extended credit arrangements (eg payment plans) for debtors need to be discounted to the net present value using an appropriate market rate of interest.

**Investments**

Investments in subsidiaries are measured at cost or fair value. Fair value movements can go through either net incoming resources or other recognised gains or losses, rather than through other recognised gains or losses under current UK GAAP.

Investments in joint ventures and associates are measured at cost or fair value, as above, in the individual accounts and using the equity method in the group accounts.

**Related party and remuneration disclosures**

Related parties – the definition of a related party includes key management personnel, and therefore, additional disclosure is required for the total remuneration for those responsible for the operating and financial decisions of the provider.

Disclosures are likely to be in relation to members of the governing body and their ‘close family’, with which the institution has transactions.

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**Potential approach**

- **Debtors**
  - Consider whether any arrangements may be material.
  - If so, determine the market rate of interest to be applied to the net present value calculation.

- **Investments**
  - Determine accounting treatment for each investment.

- **Related party and remuneration disclosures**
  - Review information held about related party transactions for missing information
  - Consider impact of additional disclosures relating to remuneration of higher paid staff and the head of institution
  - Additional consideration as to whether or not bodies such as students’ unions and separate development trusts are related parties in the context of FRS 102
Key areas of impact (continued)

FRS102 issue

**Property, Plant and Equipment**

Investment property will continue to be held at fair value (not cost) with the only difference being movements will now be recognised in the net surplus/deficit, instead of the STRGL.

The option to hold other properties (PPE) at cost or valuation is still available and there is also an option to take revalued amounts as deemed cost on transition.

The SORP makes reference to component accounting. If the major components of a tangible fixed asset have significantly different useful lives, they should be recognised and depreciated separately.

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**Concessionary loans**

FRS 102 allows a policy choice for certain loan arrangements made to or from a public benefit entity or group. These have to be made to further the public benefit and be at a below market rate.

If the conditions are met, the provider can elect to follow the accounting for a financial instrument, or hold at amortised cost as per current UK GAAP.

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</tr>
<tr>
<td><strong>Concessionary loans</strong></td>
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<td>FRS 102 allows a policy choice for certain loan arrangements made to or from a public benefit entity or group. These have to be made to further the public benefit and be at a below market rate. If the conditions are met, the provider can elect to follow the accounting for a financial instrument, or hold at amortised cost as per current UK GAAP.</td>
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<table>
<thead>
<tr>
<th>Impact: £ - Low</th>
<th>Resource - Low</th>
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</thead>
<tbody>
<tr>
<td>* If revaluation to be newly adopted, a valuation would need to be carried out, the impact on the balance sheet and income statement would need to be considered and consequent impact on covenants.</td>
<td></td>
</tr>
<tr>
<td>* Assess whether splitting significant tangible fixed assets into components is appropriate.</td>
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<table>
<thead>
<tr>
<th>Impact: £ - Low</th>
<th>Resource - Low</th>
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</thead>
<tbody>
<tr>
<td>* Determine if any loan arrangements meet the criteria of a public benefit entity concessionary loan</td>
<td></td>
</tr>
<tr>
<td>* Select the appropriate policy for accounting.</td>
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</table>
How Grant Thornton can help

Grant Thornton has depth and strength across the Firm so your transition review will be performed by a relationship-led education specialist engagement team, supported by a dedicated, project based education accounting and financial reporting technical team that specialises in SORP 2015 conversions and training.

- We will work closely with you to ensure that your SORP 2015 accounting policies are understood and applied appropriately in the context of your organisation and that the implications of these policies are understood (for example the impact that new sources of income will have on reported financial performance and how best to report this both internally and externally).

- We will provide you with practical interpretations of existing and new accounting standards, to ensure that you are fully SORP 2015 compliant, as well as adopting accounting policies and practices that are relevant to your establishment.

- We will provide you and your finance teams with on-going support throughout this process and after completion, so you always have someone to support the practical implementation of SORP 2015 after the initial conversion period. We are ideally situated to provide all of the support you require.

- We are at the forefront of development in the sector specific guidance. A member of our FRS 102 specialist team was seconded to the Accounting Standards Board and we are represented on the FRC’s Technical Advisory Group (TAG) so Grant Thornton directly influenced the formation of the new UK reporting framework.
Full, 'hands-on' assistance

Providing full, 'hands-on' assistance would include the following:

- spend time meeting relevant, different teams/individuals to understand your organisation
- hold an impact assessment workshop with you to understand the key areas of difference arising from adoption of FRS 102 and SORP 2015
- formal, documented review of accounting policies noting any potential differences under SORP 2015
- formal, documented review of your 2013-14 transactions, balances and financial statements identifying potential SORP 2015 differences
- through discussion with you, understand future transactions (particularly those post your 2014 transition date – assuming a 31 July year end) which may be accounted for differently under SORP 2015 and the impact thereof – from both an organisational and an accounting perspective, eg changes to any intra-group loan arrangements
- assessment of actual transactions in 2014, 2015 and 2016 considering the impact of SORP 2015
- papers would then be prepared with calculations and supporting documentation covering the identified areas for the years 2014, 2015 and 2016
- a financial statements template (including all the relevant notes) would be prepared in accordance with SORP 2015 which would then be populated
- review of your financial statements, prepared under SORP 2015, by our education technical team.

Acting as reviewer

Acting in a review capacity we would propose to assist as follows:

- spend time meeting relevant, different teams/individuals to understand your organisation
- hold an impact assessment workshop with you to understand the key areas of impact from SORP 2015
- through discussion with you, understand future transactions (particularly those post your 2014 transition date) which may be accounted for differently under SORP 2015 and the impact thereof – from both an organisational and an accounting perspective, eg changes to any intra-group loan arrangements or treatment of future business combinations.
- assess your review of accounting policies under SORP 2015 noting any potential omissions
- assess your review of the 2014 (transition balance sheet) 2015 and 2016 transactions, balances and financial statements identifying potential SORP 2015 differences
- through discussion with you, understand future transactions (particularly those post your 2014 transition date – assuming a 31 July year end) which may be accounted for differently under SORP 2015 and the impact thereof – from both an organisational and an accounting perspective, eg changes to any intra-group loan arrangements
- assessment of actual transactions in 2014, 2015 and 2016 considering the impact of SORP 2015
- papers would then be prepared with calculations and supporting documentation covering the identified areas for the years 2014, 2015 and 2016
- a financial statements template (including all the relevant notes) would be prepared in accordance with SORP 2015 which would then be populated
- review and comment on your financial statements.

Impact assessment

Our impact assessment involves the following:

- spending time meeting relevant, different teams/individuals to understand your organisation
- through discussion with you, understanding future transactions (particularly those post your 2014 transition date) which may be accounted for differently under SORP 2015 and the impact thereof – from both an organisational and an accounting perspective, eg changes to any intra-group loan arrangements or treatment of future business combinations
- preparing an impact assessment detailing key differences between the existing SORP and SORP 2015 – that assessment will also highlight what needs to be done and by when.
Using our sector experience to add value

1. Sector specialists
   Through our sector focused approach we have established a strong reputation as HE and FE specialists with the result that we now work with over 160 education clients, providing a full range of audit, tax and consulting services.

2. Not for profit technical
   Our substantial client base has enabled us to develop a strong national not for profit technical function to support our teams and clients in meeting the changes to accounting standards, legislation and taxation.

3. Accounts production
   Our accounts production software will be FRS 102 compliant, enabling efficient production of the primary statements, and notes, including new disclosures.

4. Understanding developments
   We take an active role in the sector and some of our key activities include:
   • responding to consultation documents from government and funding bodies
   • participating in major conferences and events
   • producing briefings on key issues
   • running seminars to address issues in the sectors
   • supporting key higher education sector events such as the BUFDG Annual Conference

5. Access to a specialist team
   Grant Thornton’s established and dedicated, project based Financial Reporting Advisory Group (FRAG) specialises in IFRS and FRS 102 conversions and IFRS and FRS 102 training. Our specialists are qualified in IFRS and UK GAAP and now FRS 102, including for educational providers. Members of our FRAG team members hold the advanced diploma in IFRS and are experienced IFRS practitioners.
   We have worked with various AIM listed and public sector bodies as they transitioned to IFRS based standards and understand the key issues around the management of such a project.

6. Wide technical expertise
   Our National Assurance Services (NAS) team also responds to the latest technical developments and issues in the profession by providing commentary on the firm’s views. They produce thought leadership material for emerging themes on topics such as auditing, financial reporting and ethics.
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