

Audit Committee Meeting

Date of Meeting	Monday 31 August 2015
Paper Title	Consolidation of accounts
Agenda Item	7
Paper Number	AC1-D
Responsible Officer	Stuart Thompson, Executive Director, City of Glasgow College
Status	Disclosable
Action	For Noting

1. Report Purpose

- 1.1. GCRB needs to decide whether or not to prepare consolidated accounts for the period to 31 July 2015.

2. Recommendations

- 2.1. The Committee is invited to note:

- management’s current thinking that GCRB should not prepare consolidated accounts for the period to 31 July 2015;
- that management is in active discussion with the external auditors and the Scottish Funding Council about the correct approach; and
- that analysis and conclusion set out in this paper might therefore change.

3. Background

- 3.1. GCRB’s legal status as a corporate entity derives from the Further & Higher Education (Scotland) Act 2005, as amended (referred to as “the 2005 Act” below). On 29 April 2014 the Scottish Government issued an Accounts Direction which stated that “GCRB’s accounts must comply with the accounting principles and disclosure requirements of the edition of the Government Financial Reporting Manual (FRoM) which is in force for the year for which the statement of accounts are prepared”. However, the Scottish Funding Council is currently discussing with the Scottish Government whether that Accounts Direction should be replaced by one which requires GCRB to adopt the same accounting arrangements as the colleges, which encompasses FRS (Financial Reporting Standards) and SORP (Statement of Recommended Practice) pronouncements.
- 3.2. The 2005 Act defines GCRB as a ‘Regional Strategic Body’ (RSB) and within that as a ‘Regional Board’. Scottish Ministers may by order assign colleges to a RSB. Scottish Statutory Instrument (SSI) 2014 No. 80 “The Assigned Colleges (Scotland) Order 2014” assigned the three Glasgow colleges to GCRB: City of Glasgow College, Glasgow Clyde College and Glasgow Kelvin College.

3.3. As a Regional Strategic Body (RSB) and subject to achieving fully-operational fundable body status (see section 6 below), GCRB is accountable for:

- negotiating the annual funding provided by the SFC
- allocating funding within the region
- planning what learning the colleges provide within the region
- achieving outcomes set out in regional outcome agreements
- monitoring how the colleges in the region are performing

3.4. Assigned College Boards will be responsible to GCRB for how they are contributing to achieving the regional outcome agreement and using public money, rather than to the SFC. This means that the College Board may receive direction from GCRB on how it delivers its contribution to the regional outcome agreement. The GCRB will then be accountable to the SFC.

3.5. The College Board continues to be responsible for the governance, financial management, operation and sustainability of the college.

4. Consolidation Consideration

4.1. The objective of consolidated accounts is to extend the reporting entity to embrace other entities which are subject to its control. They involve treating the net assets and activities of the other entities as if they were part of the main organisation's own net assets and activities. The overall aim is to present the results and state of affairs of all the organisations as if they were a single entity. The basic framework is found in the Companies Act 1985 as subsequently amended; and in Financial Reporting Standard (FRS) 2 – Accounting for subsidiary undertakings.

4.2. A 'subsidiary undertaking' is one in which the main organisation (or 'parent'):

- has a **majority of the voting rights**; or
- is a **member and can appoint or remove the majority of the board**; or
- is a **member and controls alone a majority of the voting rights by agreement** with other members; or
- **has the right to exercise a dominant influence** through the Memorandum and Articles or a control contract; or
- has a participating interest and either; **actually exercises a dominant influence** over it, or both are managed on a unified basis.

4.3. The various sources use slightly different definitions:

- i Per the Companies Act, Schedule 7 para 4.1, "an undertaking shall not be regarded as having the right to exercise a dominant influence over another undertaking unless it has a right to give directions with respect to the operating

and financial policies of that other undertaking

- ii Per UK Generally Accepted Accounting Principles ('UKGAAP'), in FRS2 (Accounting for subsidiary undertakings) dominant influence is described as "Influence that can be exercised to achieve the operating and financial policies desired by the holder of the influence, notwithstanding the rights or influence of any other party." (Aligned to the Companies Act.)
- iii Under International Financial Reporting Standards (IFRS) and the Government Financial Reporting Manual (FReM), such terminology is not explicitly used, however, IFRS 10 (Consolidated Financial Statements) states that an investor controls an investee if it has all of the following:
 - Power over the investee
 - Exposure, or rights, to variable returns from its involvement with the investee
 - The ability to use its power, to affect the amount of the investor's returns.

4.4. The term used in the UK legislation is "subsidiary undertaking"¹. The definitions are mainly based on the concept of control which is defined as "the ability of an undertaking to direct the financial and operating policies of another undertaking with a view to gaining economic benefits from its activities".

Majority of voting rights or membership

- 4.5. There are no shares held by GCRB in the colleges, so there is **no consideration over "voting rights" or a "participating interest"**.
- 4.6. **Neither is GCRB a "member" of the colleges.** However, it is arguable that the 2005 Act confers the benefit of being a member. Therefore while the apparent ability of GCRB to exercise control over college board appointments does not in itself make the colleges subsidiaries (because GCRB is not a member) it potentially does influence whether GCRB can exercise dominant influence over a college, which is discussed in the separate section on dominant influence below.
- 4.7. Paragraph 3A of Schedule 2 to the Further & Higher Education (Scotland) Act 1992 details the composition of the Board of an incorporated college. It should contain between 13 and 18 members comprising:
 - the "chairing member" to be appointed by GCRB
 - the principal of the college
 - two elected staff members (one teaching and one non-teaching)
 - two elected student members; bringing a total of 6; and
 - other members appointed by GCRB, being the remaining 7-12 members.

¹ Section 1162 and Schedule 7 of the Companies Act 2006.

- 4.8. It appears from the above that GCRB has the power to appoint the majority of the Board of an incorporated college as it sees fit.
- 4.9. It should be noted however that Scottish Ministers have powers under paragraph 3C(1) of Schedule 2 to the Further and Higher Education (Scotland) Act 1992 Act (referred to as “the 1992 Act”) to issue guidance to RSBs in relation to making appointments (including on the desirability of appointing members with particular skills and experience) and in extending appointments to assigned incorporated college boards. RSBs must have regard to such guidance.
- 4.10. Scottish Ministers issued such guidance in August 2014. Following the requirements set out in the guidance, GCRB established a Nominations & Remuneration Committee (NRC) to oversee this process.
- 4.11. Whilst the Code of Practice for Ministerial Appointments to Public Bodies in Scotland is intended for regulated Ministerial public appointments, Scottish Ministers have determined that the principles of and approach set out by the code are relevant to and should underpin college sector board recruitment and appointment.
- 4.12. It is a requirement of the Code of Good Governance for Scotland’s Colleges for the College Board to keep its effectiveness under annual review and to have in place a robust self-evaluation process. The College Board must agree a process for evaluating the effectiveness of the board chair and the committee chairs. The evaluation of the board chair should normally be led by the vice-chair/senior independent member of the College Board. The Financial Memorandum requires the governing body of the college to comply with the principles of good governance as set out in the Code of Good Governance for Scotland’s Colleges.
- 4.13. In conclusion, GCRB oversees the implementation of a recruitment process which has been determined by Scottish Ministers. **GCRB does not have the power to appoint the majority of the board of an assigned college ‘as it sees fit’.**

Dominant Influence

- 4.14. ‘Dominant influence’ is the exercise of an influence that achieves the result that the operating and financial policies of the undertaking influenced are set in accordance with the wishes of the holder of the influence and for the holder’s benefit whether or not they are for the benefit of the undertaking.
- 4.15. The College Board is responsible for ensuring the financial and institutional sustainability of the college. The College Board will therefore not consent to action which will be detrimental to their own college. It is important to note that College Boards have to be consulted on all matters relating to potential transfers of staff, property, rights, liabilities or obligations.
- 4.16. Clearly GCRB has influence over the assigned colleges but the level of influence is not categorised as “dominant influence” because the College Board Members are responsible for the operation and the financial sustainability of their own college. This point is developed further in the following paragraphs.
- 4.17. With effect from 1 April 2014 incorporated colleges were reclassified as public bodies which has led to greater accountability for the use of public money in the college sector through additional financial reporting and reduced autonomy for incorporated colleges.

Reclassification means that incorporated colleges will operate within the same annual budget control limits as other public bodies and be treated as part of central government for financial purposes. Incorporated colleges must comply with the Scottish Public Finance Manual and this has implications for budgeting, reporting and financial accounting, including:

- One of the most significant implications is that incorporated colleges must now break even, in resource terms, within each Scottish Government financial year. This means incorporated colleges can no longer plan to report surpluses or deficits without considering the need to break even at 31 March.
- Grant payment will not be made in advance of need, as determined by the level of unrestricted cash reserves and planned expenditure. Unrestricted cash reserves held during the course of the year must be kept to the minimum level consistent with the efficient operation of the incorporated college and the level of funds required to meet any relevant liabilities at the year-end. Grant not drawn down by the end of the financial year (31 March) shall lapse. Grant must not be paid into any restricted reserve held by the incorporated college. However, subject to sufficient cash and resource cover being available transfers to arms length foundations are permitted.
- Incorporated colleges must now seek approval from the SFC (via GCRB in future) for specific categories of spending, for example procurement of goods and services over certain thresholds.
- All borrowing by an incorporated college will require the approval of the Scottish Ministers via GCRB and the SFC.
- There will also be future changes to banking and insurance arrangements for incorporated colleges.

4.18. More generally:

- Audit Scotland (not GCRB) appoints the external auditors for the colleges.
- Section 230 of the 2005 Act deals with the transfers of staff, property, rights, liabilities or obligations. Under section 230(3), a transfer by GCRB is only binding on a college that has been assigned to GCRB if GCRB has consulted with the college, the relevant trade unions and the college's students' association.

4.19. In conclusion, **it does not appear that GCRB exercises 'dominant influence' over the assigned colleges.**

5. Current arrangements

5.1. In addition to the foregoing, there are aspects of current arrangements that also need to be considered:

- the transitional arrangements for board appointments to the assigned colleges; and
- the achievement of fully-operational fundable body status.

Board Transitional Arrangements

- 5.2. When the three colleges were assigned to GCRB on 1 August 2014, arrangements were made to continue members in office. These special arrangements only apply to people 'migrated' to assigned college boards as non-executive board members. They do not apply to people appointed to the college boards after the college was assigned.
- 5.3. Legislation does not enable staff and student member appointments to be extended. So at the end of their appointment, normal processes apply: student members are nominated by the students' association and staff members are elected. A migrated member serves until the expiry of their current term of office or one year, whichever comes first. This is the 'migrated period'. However, in the interests of board stability, given that RSBs:
- will assume new responsibilities for incorporated college board appointments;
 - will generally be making appointments to a number of colleges;
 - may in the interests of economy, efficiency and effectiveness, want to advertise for members to college boards at the same time; and
 - may want to appoint a chair of a college ahead of other college board appointments,

Scottish Ministers have allowed for special arrangements to apply for extending the appointment of the chair and non-executive board members at the end of their migrated period. At the end of their migrated period, a RSB may extend the appointment of the chair or a non-executive board member, so that the total transitional period (the migrated period when added to any extended period) is no more than two years. When an appointment ends, whether with an extension as set out above or not, the post is to be filled following the open recruitment process.

- 5.4. Therefore, during 2014-15 **GCRB's ability to control recruitment onto the boards of the assigned colleges was constrained to an even greater extent than described in paragraphs 4.5 to 4.13 above.**

6. Fully-operational fundable body status

- 6.1. For GCRB to exercise all its functions, SFC needs to grant GCRB fully-operational fundable body status, which will include:
- SFC passing over to GCRB responsibility for determining the allocation of the budget SFC has made available for the Glasgow region (including decisions about the amount to be applied to GCRB's own running costs).
 - SFC withdrawing application of its Financial Memorandum in relation to the assigned colleges, with GCRB's Financial Memorandum with the assigned colleges coming into place.
 - SFC passing over to GCRB the control of its own running costs (GCRB's running costs are currently controlled by the City of Glasgow College).

6.2. Therefore, **GCRB does not currently control the funding or grant conditions for the assigned colleges.**

7. Conclusion

7.1. GCRB does not meet the tests set out in paragraph 4.2 and therefore there does not appear to be a requirement to prepare consolidated accounts for 2014-15.

7.2. It should be noted that this assessment will need to be revisited for the 2015-16 accounts.

8. Risk Analysis

8.1. The main risk is that GCRB's external auditors do not agree with this assessment. GCRB management has therefore shared this assessment with the external auditors and is in discussion with them.

9. Legal Implications

9.1. The legal aspects of this matter flow from the accounting requirements to which GCRB is subject, which are addressed in the body of the paper.

10. Financial Implications

10.1. Although it is not a valid consideration in determining whether or not to prepare consolidated accounts, it is the case that having to do so would incur additional cost.

11. Regional Outcome Agreement Implications

11.1. Through the conditions of grant associated with the Regional Outcome Agreement, GCRB and the assigned colleges are required to conduct their affairs in accordance with the expected standards of good governance, which includes preparing accounts in accordance with the relevant requirements.