Mr James Dornan MSP  
Convener  
Education and Skills Committee  
The Scottish Parliament  
Edinburgh EH99 1SP

Dear Mr Dornan,

**Accounting standards and long-term financial planning**

I refer to your letter dated 24th November.

As requested I am writing to provide the Education and Skills Committee with additional information in relation to the differences between the accounts of public sector bodies and the Colleges statutory accounts. In addition, I write to provide you with a high level summary of the SFC’s preparation of medium to long term budgets.

**Principles of accounting for public sector bodies**

The Scottish Public Finance Manual (SPFM) sets out the Principles of Accounting for public sector bodies in Scotland. This states that:

“The annual accounts for bodies funded directly from the Scottish Consolidated Fund (SCF) should enable the Parliament (and any other interested party) to compare the overall consumption of resources, the use of income and cash drawn down from the SCF with the overall amounts authorised by the Budget Act and to see the explanation of substantial variances.”

As a general rule, the accounts directions issued by the Scottish Ministers require that public bodies’ annual accounts comply with the accounting principles and
disclosure requirements of the Government Financial Reporting Manual (FReM) and give a true and fair view of the state of affairs of a relevant body as at the end of the financial year, and of the net resource outturn, resources applied to objectives, recognised gains and losses, and cash flows for the financial year.

Under the FReM, the primary accounting statements are the Statement of Comprehensive Net Expenditure (SOCNE), Statement of Financial Position, Statement of Changes in Taxpayer’s Equity and Statement of Cash Flows. The SOCNE includes all income other than Grant in Aid and all relevant expenditure. The deficit that results from this accounting presentation represents the Scottish Government funded activities. The cash to fund these activities is taken directly to the Statement of Changes in Taxpayer’s Equity and is generally not shown on the face of the SOCNE.

The accounts also include a comparison of the expenditure outturn with the Departmental revenue (RDEL), capital (CDEL) and non-cash resource budgets given to the body by Scottish Government.

**College Accounting**

Colleges, as arms-length public bodies (ALBs), are within the government accounting boundary but the FReM states that ALBs with charitable status should comply with the regulations issued under the relevant charities legislation. The Charities Accounts (Scotland) Regulations 2006 states that colleges should follow the Statement of Recommended Practice: Accounting for further and higher education (the FE/HE SORP). This is the accounting practice followed by all further and higher education institutions in the United Kingdom and is intended to improve the quality of financial reporting by institutions and enhance the relevance and comparability of, and ability to understand the information provided, in institutions’ financial statements. It has been agreed that further and higher education institutions have special financial and reporting issues that are different from other organisations that have charitable status and therefore the requirements of the FE/HE SORP take precedence over the Charities SORP for such institutions.

Rather than having a SOCNE (as prepared by public sector bodies) the colleges prepare a Statement of Comprehensive Income (SOCI) as their primary income statement. This differs from the SOCNE in the following ways:

- Grant in aid is included as part of total income
- Total income is then offset against total expenditure to arrive at a net surplus or deficit for the year
- The surplus or deficit is reported on the face of the SOCI whereas for government accounts this is not shown in the SOCNE itself.
In summary, while there are differences in the primary statements, the underlying accounting rules are similar as both the FReM and the SORP incorporate UK financial reporting standards. The key differences are in the presentation of what used to be referred to as the Income & Expenditure Account.

**Long-term financial planning**

At the meeting on 16th November I said I would give you more information on the SFC’s planning for medium and long term budgets. For colleges and universities we set-out in advance of each academic year the funding settlement and budget breakdown. In order to set that one academic year, we have to take account of the current settlement from the Scottish Government for the financial year and make a forecast projection for the next financial year. In doing this we normally project our main core grants for teaching, research and innovation and student support (colleges) over at least a four year period. This is especially relevant for universities where, for example, we provide additional places either to meet skills gaps or to widen access. We have to plan for four years because we have four year degree programmes. So we are planning on the basis of providing places for an intake to first year, then in the next academic year places to allow the continuation of students into second year of their degree and a new intake behind them, and so on.

We also normally agree strategic projects for a time limited period. We set out in the offer of grant the profile of payments over the full life of the programme. We build these into a strategic fund forward commitment schedule. At any point we know therefore the spend to date and the projected spend for all strategic projects.

There are some strategic funds which are on-going commitments. These normally arise where we are providing sector wide facilities or services. These can range from providing funds for the internet services through the Joint Information Systems Committee (JISC) and the Joint Academic Network (JANET) to quality assurance arrangement provided by SQA and Education Scotland.

We therefore have at least four years’ worth of teaching grants and forward commitments on strategic funds. We would then project forward – normally on a flat cash basis other grant lines.

Our engagement with the sectors involves SFC providing high level assumptions and modelling of future commitments, against what we assume will be our available grant-in-aid from Scottish Government. So for example, we may present modelling which assumes SFC receives flat cash from SG over the next four years – against our forward commitments. If our commitments are building up because we have additional student places to fund, this may mean that to achieve a break-even budget we have to find a saving from other budget lines.
So although we do not publish any of the modelling, we do use it in discussions with SG colleagues and our colleges and universities and also in advising our board on budget commitments. In the past, when we have been given a three-year spending review settlement, we have provided a forward look which would set out our priorities for the period of the spending review. However this was always subject to annual confirmation when our budget is confirmed.

Audit Scotland

In your letter you also asked that we reflect on the exchanges relating to the Auditor General’s submission and said that your Committee’s view was that active engagement between SFC and Audit Scotland in implementing the report findings would be of benefit. I strongly support that view. In recent years we have engaged regularly with Audit Scotland on the preparation of their reports and have found that engagement useful. We will endeavour to strengthen that link as will implement the recommendation of the Auditor General’s most recent reports.

I realise quite a lot of the foregoing is fairly complex and therefore it might be better discussed in person. We would therefore be happy to meet yourself and Committee colleagues, if that would be helpful. I will contact the Committee Clerk in a few days’ time to find out if you would like to follow that up.

Yours sincerely

John Kemp
Interim Chief Executive