

LAAP BULLETIN 101

Accounting for Non-Current Assets Used by Local Authority Maintained Schools

December 2014

The Local Authority Accounting Panel issues LAAP Bulletins to assist practitioners with the application of the requirements of the Code of Practice on Local Authority Accounting, SeRCOP and Prudential Code, and to provide advice on emerging or urgent accounting issues. Bulletins provide influential guidance that is intended to be best practice, but are not prescriptive and do not have the formal status of the Code, SeRCOP or Prudential Code.

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INTRODUCTION AND BACKGROUND

1. Local authority maintained schools are those that fall within the category for England and Wales defined by the School Standards and Framework Act 1998¹ (as amended). This LAAP Bulletin focuses on the accounting treatment for the non-current assets used by schools under the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code).
2. The CIPFA/LASAAC Technical Information Note 14 (01) sets out *Clarification of the Relationship between Schools as Entities and the Recognition of Non-current Assets used by Schools*. The *Code of Practice on Local Authority Accounting in the United Kingdom Guidance Notes for Practitioners 2014/15 Accounts* (Code Guidance Notes) include more detail on the recognition of schools' transactions and consolidation issues relating to schools.
3. **CIPFA's position on accounting for schools in local authorities in England and Wales generally and for accounting for non-current assets specifically remains unchanged.** CIPFA has supported the accounting conclusions that were specified in the report of the Joint HM Treasury and CIPFA/LASAAC Working Group *Public Sector for Schools Accounting Working Group, the Accounting Treatment of Local Authority Maintained Schools in England and Wales*. This report is appended to the Technical Information Note issued by CIPFA/LASAAC but is also available by means of the background information set out at the end of this Bulletin.
4. This Bulletin provides additional guidance on the practical application of the decisions.
5. Property used by schools should be recognised in accordance with the asset recognition tests relevant to the arrangements that prevail for the property. The assets should be recognised or not recognised under the relevant sections of Chapter 4 Non-current Assets of the Code.
6. The sections that are likely to be most relevant to the accounting treatment of schools are:
 - Section 4.1 Property, Plant and Equipment (the Code's adoption of IAS 16 *Property, Plant and Equipment*),
 - Section 4.2 Leases and Lease Type Arrangements (the Code's adoption of IAS 17 *Leases* and IFRIC 4 *Determining Whether an Arrangement Contains a Lease*), and
 - Section 4.3 Service Concession Arrangements.

Where assets used by schools are subject to leases or lease type arrangements or service concession arrangements the appropriate asset recognition tests under sections 4.2 and 4.3 of the Code should be used.

7. Guidance for local authorities on the recognition tests under Sections 4.2 and 4.3 of the Code is available in the Code Guidance Notes and it would apply equally to the

¹ ie community, voluntary controlled, voluntary aided, foundation, community special, foundation special and nursery schools

assets used by schools, although this would be applied from the perspective of the schools as entities (See Module 4, Sections F and G).

SECTION B: NON-CURRENT ASSETS USED BY COMMUNITY AND COMMUNITY SPECIAL SCHOOLS

8. Where assets are owned by local authorities (which CIPFA understands is normally the case for community schools) and are used by the schools as entities then CIPFA considers it unlikely that these assets would be outside the local authority reporting boundary. Under the Code's requirements for asset recognition discussed in more detail in Section C below, the economic benefits and service potential are likely to be either within the control of the local authority or of the school that uses the assets. Therefore either directly or by consolidation of the schools' non-current assets the asset would be recognised in local authority balance sheets. It is considered that this represents the accounting policies or treatment currently applied by most local authorities.

Conclusion

9. It is, therefore, likely that non-current assets owned by local authorities and used by community and community special schools would be recognised either directly or by consolidation in local authority balance sheets.

SECTION C: VOLUNTARY AIDED, VOLUNTARY CONTROLLED AND SOME FOUNDATION SCHOOLS WHERE NON-CURRENT ASSETS ARE OWNED BY RELIGIOUS BODIES

10. An important issue identified by the Joint HM Treasury and CIPFA/LASAAC Working Group report was the accounting treatment for assets owned by religious bodies and used by schools. CIPFA understands that these assets are used by voluntary aided (VA), voluntary controlled (VC) and a number of foundation schools.
11. CIPFA understands from the evidence provided by representatives of religious bodies² that it is generally the case that these non-current assets are not owned by the school but by another legal body which for the purposes of this Bulletin will be referred to as the trustees. These trustees might be the diocese or other site trustees which might be individual representatives of the clergy. Where other circumstances exist eg ownership residing with the local authority (as a result of site transfers) local authorities and schools will need to assess these circumstances against the provisions of the Code on asset recognition, this Bulletin and the Code Guidance Notes.

Recognition of an Asset

12. CIPFA considers that the arrangements can be examined under IAS 16 *Property, Plant and Equipment* as adopted by the Code but particularly the definition of an asset provided by *The Conceptual Framework for Financial Reporting 2010* (IASB Conceptual Framework) and included in the Code.
13. The definition of an asset (applicable to both current and non-current assets) included in the Code is:

"a resource controlled by the authority as a result of past events and from which future economic benefits or service potential are expected flow to the authority"
Code paragraph 2.1.2.23.

² Per the representation on the Joint HM Treasury and CIPFA/LASAAC Working Group

14. Paragraph 4.12 of the IASB Conceptual Framework provides more detail in relation to the concept of control over those economic benefits or service potential:

"Many assets ... are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, property held on a lease is an asset if the entity controls the benefits which are expected to flow from the property. Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an entity controls the benefits that are expected to flow from it."

15. This is continued in paragraph 4.13:

"The assets of an entity result from past transactions or other past events. Entities normally obtain assets by purchasing or producing them, but other transactions or events may generate assets; examples include property received by an entity from government as part of a programme to encourage economic growth in an area and the discovery of mineral deposits. Transactions or events expected to occur in the future do not in themselves give rise to assets; hence, for example, an intention to purchase inventory does not, of itself, meet the definition of an asset."

16. An asset therefore requires the entity recognising it, in this case the school as an entity, to have control over that resource, based on rights that are either legal or substantive. Usage of the asset without such rights does not demonstrate control either in form or substance. The IASB Conceptual Framework extracted above sets out that these rights must arise as a result of past events and cannot be established on expectations of events that may happen in the future (however, probable) ie expectations that the schools will be permitted to use the assets by their owners in the future.
17. In the case of a school as an entity where the school or governing body does not have ownership rights of the property it would thus only recognise an asset in the school's balance sheet if on or before the balance sheet date it has secured legal or substantive rights over the resource represented by that property. "Substance over form" is relevant in this situation only in establishing whether other rights exist which override the rights of ownership. "Substance over form" does not allow the existence of rights to be ignored in favour of expectations about how the property might be used in the future. As noted in paragraph 16 above expectations cannot establish rights.
18. What needs to be considered then is to start from ownership of the asset and then to determine whether:
- rights arising from the ownership have been reassigned to another party ie the school as an entity or a local authority, and/or
 - the rights retained by the owner are no longer substantive.
19. The circumstances that CIPFA has been made aware of by the representatives of the religious bodies that own the assets suggests that in most cases there has been no reassignment of rights for property owned by religious bodies and occupied by voluntary aided, voluntary controlled and some foundation schools that would pass control of economic benefits and service potential to the schools as entities or their governing bodies.

20. For the assets owned by religious bodies these assets are understood to be used under “mere” licences³ which pass no interest to the school and which are terminable by the trustees at any time without causal action. Section 30(11) of the School Standards and Framework Act 1998 provides that a reasonable period of notice must be given to allow for this termination ie a period of not less than two years in circumstances where termination of occupation would have the result that it is not reasonably practicable for the school to continue to be conducted in its existing site.
21. CIPFA’s understanding is that a “mere licence” is an authority to do something which would otherwise be inoperative, wrongful or illegal. As noted above a “mere” licence passes no interest, and a mere licence is always revocable. CIPFA’s understanding is that the licensee is given permission to use the land for the authorised purpose and effectively prevents that act from being a trespass. Unlike a lease, a mere licence does not create an estate in land. These licences are often not provided in written form.
22. The legal framework and the agreements that have been entered into between the owners and the schools as entities and their governing bodies do not generally give the schools or the governing bodies’ enforceable rights that would reflect any diminution of the rights that the owners have over their property because they are either not leases under IAS 17 *Leases* or do not contain assignation sufficient for an arrangement containing a lease under IFRIC 4 *Determining Whether an Arrangement Contains a Lease*. The trustees or owners assert their control over the property by permitting it to be used for precisely the purposes that the school as an entity wishes to use the asset. The trustees’ objectives about how the asset is utilised are the same as those of the schools’ governing bodies with both of their objectives being met. However, it is the trustees that must first decide that their asset is to be used for these purposes and who continue to have the rights to the resources in the asset. In practice their continued agreement to permit the schools as entities to use the assets means that the trustees (or owners) are perpetually reasserting this control and this has not been passed to the school.
23. This control might arguably not be substantive if the decision could not be reasonably taken by the trustees to take the property out of the maintained school sector. However, as noted in paragraphs 21 and 22 the (mere) licence can be terminated at will by the trustees; no causal action is required. Section 30(11) of the School Standards and Framework Act 1998 provides that a reasonable period of notice must be given to allow for this termination but does allow termination to take place. In order for this control not to be substantive arguments would need to be presented by the schools as entities that the decision was not exercisable in some way.
24. If property is withdrawn by trustees, compensation may be payable for the government funded investment in the property. This does not create an asset for those who might benefit from the compensation (as this would be subject to a decision by the trustees yet to be taken).
25. The right to terminate the arrangement at any time was established by the Joint HM Treasury and CIPFA/LASAAC Working Group report as providing evidence that the risks and rewards of ownership of the assets have not transferred to the schools under the Code’s requirements for the assessment of leases and lease type arrangements ie under IAS 17 *Leases* (see paragraphs 66 and 68 of the report).

³ A “mere” licence is a revocable authority to do something which would otherwise be inoperative, wrongful or illegal but passes no interest (<http://legaldictionary.lawin.org/licence/>). CIPFA understands that these are also referred to as “bare” licences.

The assets therefore would not be recognised as the assets of the school and not consolidated in local authority balance sheets.

26. CIPFA supported the approach in the Joint HM Treasury and CIPFA/LASAAC Working Group's report as the leasing standards provide an effective list of indicators to measure whether the risk and rewards of ownership have transferred to the school. Consideration of risks and rewards are often seen to be a part of the assessment of control⁴.
27. Looking further at the Code's adoption of IAS 16, paragraph 4.1.2.16 requires that:
- "The cost of an item of property, plant and equipment falling under this section of the Code shall be recognised (and hence capitalised) as an asset on a local authority Balance Sheet if, and only if:*
- *it is probable that the future economic benefits or service potential associated with the item will flow to the authority, and*
 - *the cost of the item can be measured reliably.*
28. It might be possible to conclude that it is probable that service potential will flow to the school as an entity. However:
- the two criteria in paragraph 4.1.2.16 are only relevant if an item also meets the definition of an asset in the Code. CIPFA cannot see that in the general position for assets owned by religious bodies under the circumstances described in paragraph 12 that this applies; and
 - this is only because of the co-operative understanding between the schools as entities and the trustees and then only because the service potential being consumed is in accordance the objectives of the trustees and suits their purposes. If these purposes were to be challenged or, even if they are not, then the trustees remain in a position to end the relationship.
29. The evidence that CIPFA has been made aware of by representatives of religious bodies suggests that in most cases there has been no reassignment or rights for property owned by religious bodies and occupied by voluntary aided, voluntary controlled and some foundation schools that would pass control to the schools as entities or their governing bodies.
30. The new IPSASB pronouncement *The Conceptual Framework for General Purpose Financial Reporting by Public Entities Sector* (IPSASB Conceptual Framework) also includes a definition of an asset which is very similar to the IASB Conceptual Framework. This Bulletin has also analysed the circumstances for the assets used by schools as entities but owned by religious bodies under "mere licences" (see Appendix A). The analysis concludes that the assets are not controlled by the schools in the circumstances described in this section of the Bulletin.

Conclusions

31. The CIPFA analysis under the IASB Conceptual Framework as adopted by the Code does not conclude that the assets owned by religious bodies under "mere licences" under the circumstances described in paragraphs 12 to 30 above are controlled by

⁴ For example the *Summary of tentative decisions* for the IASB Exposure Draft of the Conceptual Framework indicates that "*supporting guidance should identify exposure to the significant risks and rewards of ownership as an indicator of control (but only one factor to consider in the overall assessment)*". It further comments that "*Instead of using the term 'risks and rewards of ownership', the Conceptual Framework should use wording that explains the meaning of that term, ie 'exposure, or rights, to variations in benefits'*" IASB October 2014.

the schools as entities (unless there is evidence that the rights have been substantively passed to the governing bodies of the schools). The HM Treasury and CIPFA/LASAAC Working Group considered under a lease accounting analysis the assets would not be recognised as assets of the school.

32. In addition a third analysis in Appendix A to this Bulletin under the IPSASB Conceptual Framework does not conclude that the assets which schools use free of charge under "mere" licences are within the control of schools. Having considered the three analyses and the circumstances described in paragraphs 12 to 30 of this Bulletin CIPFA does not see that these assets would be within the control of schools and therefore should not be recognised in local authority balance sheets.
33. **Local authorities will need to establish that the situation and analysis exists for VA, VC schools and foundation schools where assets are owned by religious bodies in their area and assure themselves as to the extent to which this situation is applicable.** Where different circumstances exist or where schools can prove that the rights of the trustees/owners are not substantive, authorities and schools may wish to consider the asset recognition criteria and circumstances outlined in paragraphs 12 to 25 and Appendix A to this Bulletin.

Consequential Issues

34. A number of questions have arisen.
- Authorities have questioned whether control decisions effected by the right to terminate the "mere" licence would also have to consider the implication that this would require the closure of the school and be constrained by due process. However, the right to terminate the "mere" licence does not have to be linked to the statutory school closure processes as is demonstrated by the Section 30(1) of the Schools Standards and Framework Act 1998 and therefore is not dependent on those decisions being taken.
 - Other authorities have commented that in some cases the trustees that own the assets do not recognise the assets in their financial statements and have questioned whether this might be indicative of the direction of the control decision on the asset. However, the circumstances that exist described in paragraphs 12 and 30 above are not dependent on the accounting decisions of the trustees.

SECTION D: FOUNDATION AND FOUNDATION SPECIAL SCHOOLS (WITH ASSETS NOT OWNED BY RELIGIOUS BODIES)

35. Foundation school asset recognition is also likely to need to be analysed in accordance with the requirements of the Code and using the tests and criteria outlined in paragraphs 12 to 25 and/or Appendix A to this Bulletin. The analysis would need to consider whether the school or the local authority has control over the resources inherent in the asset as a result of rights that are both enforceable and substantive. CIPFA is aware that there are a number of schools where the assets are owned by the governing body. Unless there are other arrangements in place, it is likely that the rights of ownership are both substantive and enforceable and that these assets should therefore be recognised in local authority balance sheets.
36. CIPFA is aware that there are other arrangements in place for foundation schools where ownership resides with separate trustees. These arrangements would again need to be considered for whether the trust deeds include enforceable rights that are assigned to the governing body or school.

37. CIPFA is aware that some of the assets used by foundation schools may have originated from/or be owned by private sector entities. In these cases it might be less likely that the rights to the economic benefits and service potential are assigned to the governing body and less likely therefore that the assets will be recognised as within the control of the governing body or school.
38. Consideration would need to be given to the terms under which the property is made available to schools. In particular, if the property is held by a trust would the trust deeds comprise an arrangement in the form of a lease? It will also be significant whether the trustees can reasonably alter the arrangements and, if the resources are constrained whether rights to take the property back are substantive.

Conclusions

39. It is likely that assets owned by foundation schools governing bodies will be recognised as the assets of the school (subject to the normal asset recognition tests in the Code). However, other arrangements for foundation schools would need to be assessed to determine whether enforceable and substantive rights to the assets are assigned to the governing body.

Consequential Issues

40. Questions have been raised in relation to the impact of non-current assets used by foundation schools that are owned by other entities and which include restrictions or covenants. This would depend on the nature of these restrictions or covenants. If they pass on the rights to the economic benefits and service potential in the asset to the governing body and cannot reasonably be revoked then this might be an indicator of control by the governing body and thus the school as an entity of that asset.

SECTION E: TRANSITIONAL ARRANGEMENTS FOR NON-CURRENT ASSETS TO BE RECOGNISED WITHIN LOCAL AUTHORITY BALANCE SHEETS

41. The recognition of the non-current assets outlined above will be deemed to be a change in accounting policy if non-current assets are not recognised currently in the local authority balance sheets. Alternatively, it might require assets to be derecognised.
42. CIPFA/LASAAC has agreed to include transitional provisions for the recognition of non-current assets. It has issued a 2014/15 Code Update which includes these provisions providing for schools' non-current assets to be recognised for the first time in accordance with the measurement provisions of Section 4.1 of the Code at fair value (as interpreted in the 2014/15 Code). The transitional provisions permit this valuation to be treated as a deemed cost. The contra entry for the recognition of these assets would therefore be to the Capital Adjustment Account and the Revaluation Reserve for these assets would be zero as at 1 April 2013. From that point on non-current assets deemed to be within the local authority boundary would be treated like any other non-current assets.

RECOGNITION TESTS FOR ASSETS OWNED BY RELIGIOUS BODIES UNDER THE IPSASB CONCEPTUAL FRAMEWORK

A1 The IPSASB pronouncement *The Conceptual Framework for General Purpose Financial Reporting by Public Entities Sector* (IPSASB Conceptual Framework) defines an asset as:

"A resource presently controlled by the entity as a result of a past event." IPSASB Conceptual Framework, paragraph 5.6.

A2 The IPSASB Conceptual Framework paragraph 5.7 further considers the elements of that definition:

"A resource is an item with service potential or the ability to generate economic benefits..."

"Some resources embody an entity's rights to a variety of benefits including, for example, the right to:

- *Use the resource to provide services;*
- *Use an external party's resources to provide services, for example, leases;*
- *Convert the resource into cash through its disposal;*
- *Benefit from the resource's appreciation in value; or*
- *Receive a stream of cash flows."*

A3 As with the IASB Conceptual Framework the definition of a resource is defined by reference to the rights of an entity. The governing bodies of the schools do not have enforceable rights but permission to use the asset which is perpetually renewed.

A4 Service potential is described in the IPSASB Conceptual Framework in paragraph 5.8 as *"the capacity to provide services that contribute to achieving the entity's objectives"*. Both the owners and schools' objectives are being met but the enforceable rights remain with the owners.

A5 The IPSASB Conceptual Framework requires that entities must have control of the resource. Control of the resource entails the ability of the entity to use the resource (or direct other parties in its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives (IPSASB Conceptual Framework paragraph 5.11). It proposes a number of indicators to assess whether control exists:

Indicator	Commentary
Legal Ownership	Resides with the trustees
Access to the resource, or the ability to deny or restrict access to the resource	Both the School and the trustees have access to the resource. The School is not able to deny or restrict the trustees from access to the resource. Substantial decisions on the use of the resource need to be agreed with the

	trustees.
The means to ensure that the resource is used to achieve its objectives.	Both the school and the trustees have the means to ensure that the resource is used to achieve their objectives but see also the arguments in paragraph 23. The trustees are able to take action to ensure that the assets are used in a way to achieve their objectives including the ability to withdraw the asset at will.
The existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource.	This only exists with the trustees. Schools may have future access to economic benefits but only as a result of future events decided on by the trustees eg on disposal.

- A6 The balance of indicators above falls with the trustees and not the school as an entity.
- A7 The IPSASB Conceptual Framework like the IASB Conceptual Framework specifies that the definition of an asset requires that a resource that an entity presently controls must have arisen from a past transaction or other past event. An asset arises when the power is exercised and the rights exist to receive resources.
- A8 As with the analysis in the IASB Framework the evidence that CIPFA has been made aware of is that the enforceable substantive rights lie with the trustees. Under the analysis afforded by the IPSASB Conceptual Framework, the assets owned by religious bodies in the circumstances described above are not controlled by the schools and are therefore not recognised in the local authority balance sheet.

OTHER RESOURCES – ACCOUNTING FOR SCHOOLS

[You may need to cut and paste these links into your web browser if they do not work directly from within this document]

Technical Accounting Alert 3 (Informal commentary and clarification)

<http://www.cipfa.org/-/media/Files/Policy%20and%20Guidance/Panels/Local%20Authority%20Accounting%20Panel/Technical%20Accounting%20Alert%20%20Accounting%20for%20Schools%20Interim%20Clarification.pdf>

FAQ Accounting for schools following the introduction of Appendix E, Accounting for Schools in Local Authorities in England and Wales – what are the main issues that arise?

<http://www.cipfa.org/-/media/files/policy%20and%20guidance/technical%20inquiry%20service%20faq/faq%20treatment%20of%20maintained%20schools.pdf>

Code of Practice on Local Authority Accounting in the United Kingdom Guidance Notes for Practitioners 2014/15 Accounts – see particularly Module 10 Section B

Technical Information Note 14 (01)

<http://www.cipfa.org/-/media/files/policy%20and%20guidance/boards/cipfa%20lasaac/technical%20%20information%20note%2014%2001%20and%20appendix.pdf>

Update to the 2014/15 Code of Practice on Local Authority Accounting

<http://www.cipfa.org/-/media/files/policy%20and%20guidance/boards/cipfa%20lasaac/2014%2015%20code%20update%20with%20tracked%20change.pdf>

Public Sector Accounting for Schools Working Group -The Accounting Treatment of Local Authority Maintained Schools in England and Wales [http://www.cipfa.org/-](http://www.cipfa.org/-/media/Files/Policy%20and%20Guidance/Consultations/Single%20Issues%20Schools%20Consultation%20Feb%202014/Appendix%20A%20to%20the%20ITC%20%20%20Public%20Sector%20Schools%20Working%20Group%20Accounting%20for%20Schools%20Report%20Final.pdf)

[/media/Files/Policy%20and%20Guidance/Consultations/Single%20Issues%20Schools%20Consultation%20Feb%202014/Appendix%20A%20to%20the%20ITC%20%20%20Public%20Sector%20Schools%20Working%20Group%20Accounting%20for%20Schools%20Report%20Final.pdf](http://www.cipfa.org/-/media/Files/Policy%20and%20Guidance/Consultations/Single%20Issues%20Schools%20Consultation%20Feb%202014/Appendix%20A%20to%20the%20ITC%20%20%20Public%20Sector%20Schools%20Working%20Group%20Accounting%20for%20Schools%20Report%20Final.pdf)