NEW WORLD, NEW NUMBERS

how university financials are changing, and why

Imagine picking up your favourite newspaper one morning, or turning on the radio, and suddenly not being able to understand what had been written or said. Maybe the odd word was the same or seemed familiar, but the rest was gibberish. It would be a bit unnerving and a challenge to the normal order of things.

That's what you could find when you pick up a copy of a university's 2015/16 financial reports. The introduction of new accounting rules means that there are significant changes to the way university finances are measured and recorded. It's the biggest change in university accounting for 20 years.

Confusingly, it means that while the substance of a university's financial performance or its net worth may not have changed one iota, the way the numbers are reported in its financial statements will have.

Why the change?

For over a decade the UK accounting standards setting body, the Financial Reporting Council (FRC), has been on a mission to harmonise UK accounting standards with international standards. This was completed in 2015, with the replacement of 40 different standards (over 2,000 pages in total!) with a new code based on a single, internationally-consistent reporting framework just 250 pages long.

In December 2016 universities will begin publishing their 2015/16 financial results. These will be the first to report under the new accounting standard, known as FRS102, interpreted for the sector by the FE & HE *Statement of Recommended Practice* (SORP).

What will the financial statements look like?

The new accounting code changes the way some income, expenses, assets, and liabilities appear on the financial statements.

Here's an example…

The "USS pension liability" - what the university is predicted to have to pay towards the USS pension scheme deficit - will now appear 'on the balance sheet' (the balance sheet shows the university's overall financial position at the end of the reporting year). Prior to the changes, it would have appeared in a separate note, with no effect on the figures in the financial statements. The inclusion of this item on the balance sheet drives changes to the Statement of Comprehensive Income that could mean a university will show a much smaller annual surplus (or even a loss!) than it would have done under the old accounting rules.

Despite reporting a smaller surplus, the university's underlying financial performance, or the amount of cash it pays out, will not have changed – the only change is the way it is reported.

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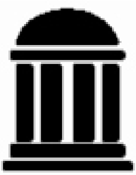
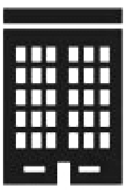
Financial statements always show the prior year's financial results next to the current year's, so that performance can be judged from year to year. To make things clearer, last year's results (2014/15) that appear in this year's (2015/16) financial statements have been re-stated under the new rules (rather than left in the 'old rules' version they were in when they were reported last year). This will enable readers to make a true like-for-like comparison and assess performance more accurately.

The other advantage of doing this is that it enables readers to take the 14/15 figures from last year's accounts (under the old accounting standard), and put them side-by-side with the same (14/15) figures in this year's accounts (under FRS102 – the new accounting standard). When we do this, we see the surprising impact the new accounting rules can have.

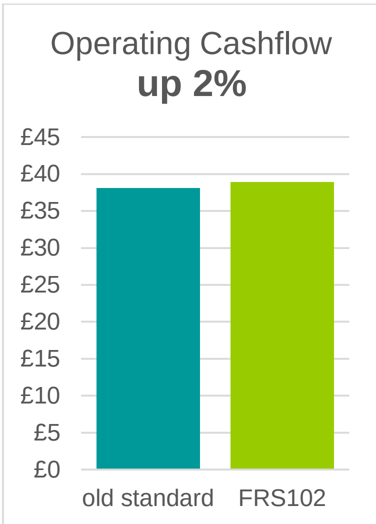
The charts below use figures taken from the last two years' accounts at two real universities, one a Pre-92 university and one Post-92, to show how their reported (annual) **financial performance**, using two different measures**,** has changed under the new standard. All figures are in £millions.



Pre-92 University



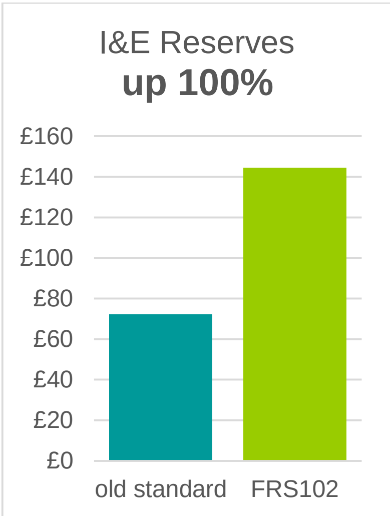
Post-92 University

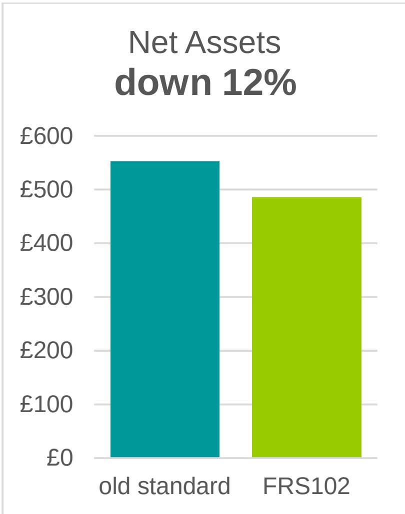


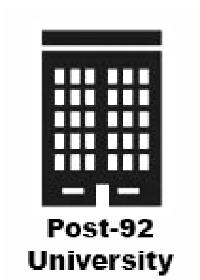
What does this tell us? In both the Pre- and Post-92 HEIs, net surplus was down (78% and 21%) under FRS102, but operating cash flow was up! Both net surplus and operating cash flow are used to measure a university's financial performance - they measure it in different ways (that we won't get in to here), but they're both important.

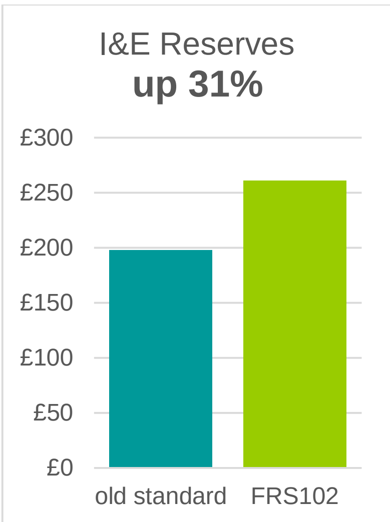
Notice that there were much bigger swings in both of these measures in the older Pre-92 University, compared to the Post-92 University. We shouldn't necessarily expect these swings to be repeated every year, or to be typical of the results similar universities report in 2015/16. That's another quirk of the new accounting rules - there is likely to be continued volatility in the results from one year to the next.

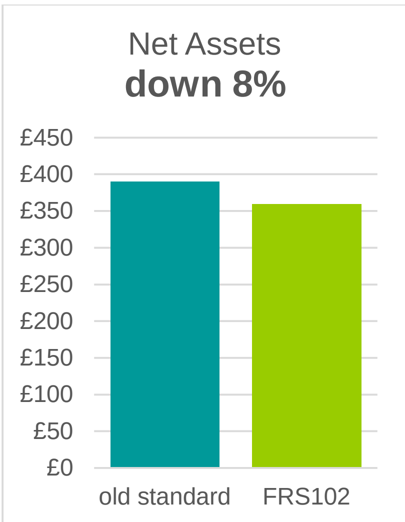
Now let's look at two of the figures that are used to measure an organisation's **financial strength**. Again, all figures are in £millions.











What does this tell us? Once again it's a mixed picture, with I&E reserves up, but net assets down. And once again there are bigger swings in the Pre-92 HEI, with a 100% increase in its I&E Reserves (improving its financial strength), but a fall in net assets by 12% (reducing its financial strength)!

How do we make sense of the changes?

There are lots of reasons why a university's financial metrics might be different this year under FRS102 than they were under the old rules. On top of the treatment of USS pension liabilities mentioned in the example earlier, there are changes to the way grant funding for research is recorded, as well as how universities measure the value of their buildings and estates, and many other things.

Choices, choices…

The extent to which a university's financial statements change will depend on all sorts of factors, including who its pension providers are, its capital financing structure, and its ability to attract philanthropic donations. But it will also depend on the accounting choices that the university has made. Universities have always had choices when it comes to applying particular aspects of accounting policies, and FRS102 is no different. It means that readers shouldn't assume they can compare at quick glance the reports from two universities that are otherwise similar in size and type, because the universities may have applied the new accounting standards in slightly different ways. In addition, different external auditors may hold different views on how their client universities can and cannot interpret the new accounting standards.

To get the full picture, you may have to dig a bit deeper into the financial statements than you have done before. It's also possible that you will need to speak to a university's Finance Director or Chief Financial Officer, or other senior finance colleague, in order to understand some of the finer points.

It's not all up to you though. To help readers, universities have made extra effort to explain the most significant changes in their annual financial reports this year, and many will have included comparison tables showing figures under the old and new systems, or produced additional technical annexes that go into more detail. Some will also have explained the impact of the new standard on perceptions of the institution's long-term financial sustainability, as one of the features of FRS102 will be increased volatility in the numbers from one year to the next.

University financial statements are made publicly available on each institution's website. A directory with links to most universities' financial statements can also be found at: www.bufdg.ac.uk/auditfr/financial-statements/

The FE & HE SORP can be found in full at: www.bufdg.ac.uk/sorp

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