Independent schools sector update

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Winter 2023/24

Financial

Independent Schools Council Census 2023

- Pupils in member schools increased by 1.8%
- A 26% rise in the number of schools reporting partnerships (a total of 8,793)
- 29.8% of new pupils came from state-funded establishments
- Pupils whose parents live overseas equate to 5.2% (2022: 5.7%) of all pupils
- 39.6% of pupils identified as UK minority ethnic (increase from 37.7% in 2022)
- 5.6% increase in school fees
- 18.6% of all pupils are SEND (Special Educational Needs and Disabilities)
- Over £9.4 million was raised at ISC schools for charities

VAT and school fees

At the moment, VAT is a cost for an independent school in that most of its income is exempt from VAT and therefore the majority of VAT incurred is not recoverable (if not all).

However, as reiterated at the Labour party conference in October 2023, the outcome of the next election could see a change in VAT policies if the labour government were to claim victory. The party has declared that they would seek to introduce VAT by invalidating the previous exemptions on both supplies to education and closely related food and services. If an election is held in the autumn of 2024, we could see these policies in play from February 2025.

The main area of concern is the added burden on school fees. The increase in fees could result in a fall in demand due to parents no longer being able to afford the education. It has been estimated that 90,000 students could transfer to state-funded establishments as a result.

However, it is unlikely that the exemption would be entirely removed, with the hope that a new government would not seek to levy VAT on school fees for schools dealing with SEN (Special Education Needs) pupils. Hence, they are likely to adopt a policy where "eligible bodies" are required to pay in order to target independent schools.

Schools should budget for this potential VAT levy change and consider whether to provide hardship funds and/or scholarships in order to relieve the pressure of the increased fees to ensure retention of pupils. This will not only benefit the school, but also prevent any added pressure to the state sector by avoiding such transfers.

Schools may want to consider updating terms and conditions relating to school fees to ensure that the school has the ability to charge VAT on school fees. The alternative could be that the fees are effectively deemed to be gross and therefore VAT would need to be deducted.

Business rate relief

Currently, independent schools benefit from a mandatory 80% discount on business rates. The Labour party confirmed at their conference that they intend to remove this if they are successful in the next general election. The impact of this will be a significant increase in costs and therefore, schools will have to budget for this change.

Inflation

Following the COVID crisis, schools now face the current economic crisis where damage may be prolonged further than previously seen through the pandemic. There are a number of impacts of this for schools:

- Rising costs
- Delayed demand
- Debt collection

Rising costs

Schools are likely to see pressure from wages and other costs. The annual wage inflation stands at 6.1% and the CPIH (the government's key inflation measure) currently stands at 3.8% having peaked at 9.6% in October 2022. Teachers want to maintain their standard of living and wage increases remain high due to demands for wages to catch up following the prolonged period of high inflation.

Another significant cost to schools, energy, has seen a government Energy Bills Discount Scheme helping alleviate some financial pressure from schools. However, the assistance will finish in March 2024 when prices will be uncapped and return to normal market levels. This could cause a further rise in costs if energy prices remain high.

Delayed demand

Historically, there is a delayed effect of recessions on schools. The last recession took 15 months for the worst effects to surface within schools. This is due to parents seeing education as a necessity and therefore attempting to persist with fees at the cost of other expenses. This means that the true effects could be seen at a similar time as the announcement for the Teachers' Pension Scheme meaning two financial shocks within the early part of 2024.

Schools may want to allow for greater hardship funding to help alleviate pressures faced with households and to avoid a reduction in retention of pupils.

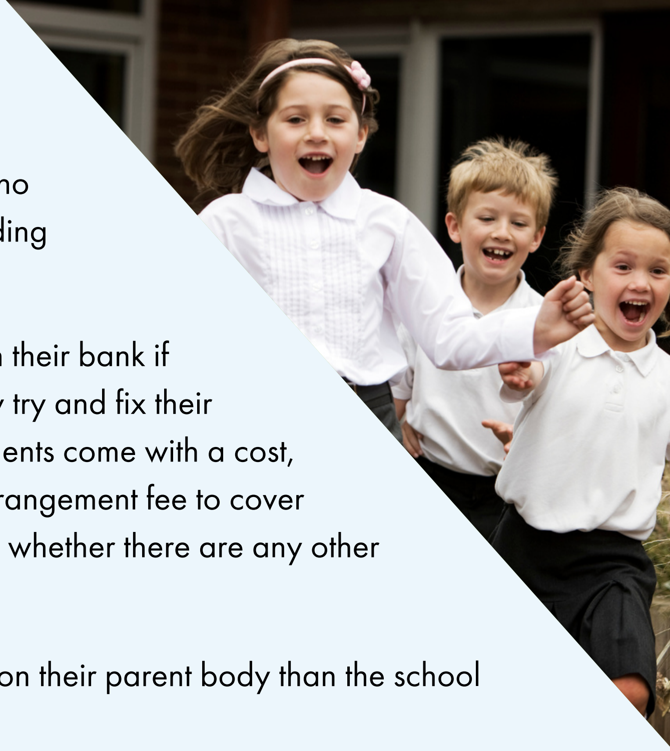
Debt collection

With the rising inflationary burdens comes greater risk of non-payment of school fees by parents of pupils at your school. With the risk profile, it is imperative that schools have good robust policies in respect of debt collection, with agreed timescales for when matters should be referred to outside agencies, where appropriate.

Schools should consider updating terms and conditions relating to school fees to ensure that these are clear at the outset. Regular communication is key: where parents become remote and inaccessible, these can typically be pointers towards needing to take matters to the next level of formal debt collection.

Schools may want to allow for greater hardship funding to help alleviate pressures faced with households and to avoid a reduction in retention of pupils.

Interest rates



The Bank of England have held the official bank base rate at a five-year high of 5.25%. This is a cause of concern for schools who have outstanding loans or those who are seeking new loans, adding further pressure to school budgets and cash flows.

For schools with borrowings, many have had to re-negotiate with their bank if loan covenants are breached or forecast to be breached, or they try and fix their interest rate to manage cashflow. Any changes to loan arrangements come with a cost, whether it's an updated valuation that the bank requires or an arrangement fee to cover their costs to amend a loan agreement. Schools need to consider whether there are any other options for restructuring or refinancing.

For other schools, interest rate rises have had more of an impact on their parent body than the school itself, with pupil numbers declining as mortgage rates are rising.

Governance

Charities Act 2022

The updated Charities Act continues to be implemented, with the most recent changes coming into force on 14 June 2023 and 7 March 2024.

The June changes included updates to the following guidance:

- Selling, leasing or otherwise disposing of charity land
- Using permanent endowment
- Charity names

Changes effective from 7 March 2024 are as follows:

- Making changes to governing documents
- Selling, leasing or otherwise disposing of charity land
- Powers relating to appointments of trustees
- Authorised remuneration of charity trustees
- Charity mergers

If any of these areas impact your charity, we recommend familiarising yourself with the updated guidance to ensure that you remain compliant with the latest Act.

Charity Annual Return changes

The Charity Commission has launched the new Annual Return (for periods beginning on or after 1 January 2023).

The Commission consider the Annual Return improvements to be a key step to improve the data being reported by charities, enabling the Commission to better identify and record risks and problems in the sector. This in turn enables the public to make better informed and confident choices about charities and should grant everyone a clearer understanding of the sector.

The updated question set and a guide to completion was released in December 2022 to give charities some extra assistance as they set about compiling the new information required. The guide can be found here.

The new return is available to charities via the My Charity Commission Account (MCCA) service. MCCA went live on 31 July 2023 and replaced the old online portal. All individual charity trustees are now encouraged to register. The Charity Commission sees this as facilitating a more direct relationship between the regulator and trustees, helping to ensure they are supported in their role and equipped to run their charities well.
If you have not yet set up your MCAS account, the Charity Commission has prepared guidance to help you through the process.

Charity use of social media

In September 2023, the Charity Commission issued guidance to charities on their use of social media. Trustees may not always be aware of the risks which may arise from their charity's use of social media and without sufficient trustee oversight, this could mean that the charity is vulnerable. The guidance is there to help trustees to understand the risks and how their legal duties apply and what to consider if issues arise to help them deal with them effectively.

The full guidance can be viewed here.

The guidance covers several areas including:

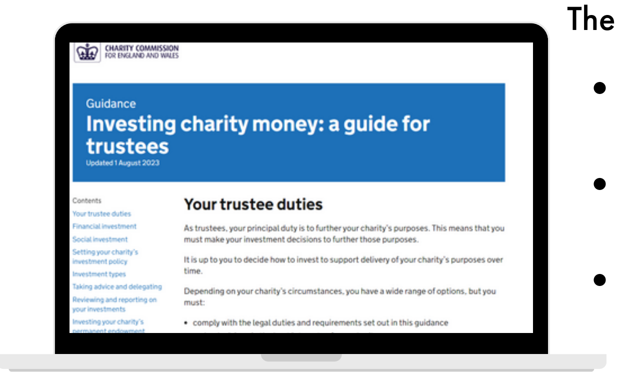
- Trustees understanding of their legal responsibilities when delegating tasks such as social media use.
- An expectation that the charity has a policy in place which explains how social media will help deliver the charity's purpose, including guidance for the conduct of trustees, employees and volunteers using social media on its behalf.
- A checklist to help trustees and employees have informed discussions about the right type of policy for them.
- Have guidelines to manage the risk that content posted by individuals connected to the charity in their personal capacity may have and the negative impact that could have on the charity by association.
- Helpful sources of information for trustees if they wish to improve their knowledge of and social media skills.

Trustees are not expected to be social media experts, but having some level of oversight of the activities taking place is important. This new guidance should hopefully help charities to use social media with much greater confidence in the future and we advise that this guidance and your own charity's social media policy should be reviewed regularly to ensure it is up to date and consistent with your charity's objectives

Investing charity money - update to CC14

The guidance was updated in August 2023 to take account of the rulings from the Butler Sloss case.

CC14 requires all charities to have a written investment policy if the charity is a Trust or if the governing document requires one. It is particularly important where investment managers have powers to make decisions on behalf of the charity and is good practice for other charities to document their approach to investing charity money.



The guidance includes:

- Trustees' duties including principles of good decision making, conflicts of interest, private benefit, delegation and record keeping
- Financial investment – considering diversification, risks, use of external advisors and consideration of conflicts with charitable purposes
- Social investment – guidance and examples on the permitted approaches to invest charity funds to achieve the charity's purpose through investment as well as making a financial return.

Harper Trust v Brazel update:

On 1 January 2024, the government introduced changes to the Working Time Regulations. This clarifies that all workers are entitled to a minimum annual entitlement of 5.6 weeks leave and defines the meaning of irregular hours and part year workers.

Effective for leave years beginning on or after 1 April 2024 the following reforms will apply:

- New accrual method to calculate statutory holiday entitlement for irregular hours and part-year workers being 12.07% of actual hours worked in a pay period.
- New method to calculate how much leave an irregular hour or part year worked has accrued when they take maternity or family related leave or are off sick.
- Introducing rolled up holiday pay as an alternative method to calculate holiday pay for irregular hours workers and part year workers.

If employers choose to use rolled up holiday pay, you should check if this is covered by existing contracts or would be considered a variation of contract. Details of payslip disclosures are set out in the guidance.

Internal Financial Controls - update to CC8

This guidance was updated by the Charity Commission in 2023. Trustees are legally required to responsibly manage their charity's resources and ensure accountability at all times. Whilst certain functions can be delegated to management, the ultimate responsibility falls upon the trustees' shoulders. It is therefore crucial that clear and robust financial controls are designed and implemented, giving the charity's assets the vital protection they need from both internal and external risk factors.

New sections were added to reflect the change to online operating systems in a more digitalised world, primarily:

- **The use of mobile payment systems**
- **Accepting gifts and hospitality**
- **Accepting donations of crypto assets**

Whilst there are no other significant changes to the guidance, the language has also been simplified and the order of the guidance restructured.

Trustees should therefore ensure that they have read and considered how the guidance can be applied to their schools. It can be used, in conjunction with the new accompanying internal financial controls checklist, to identify where clear gaps and weaknesses may exist within their existing processes, thus providing an opportunity to further improve controls moving forwards.

The full guidance and internal financial controls checklist can be viewed here.

Inflationary impact on policies

With the high inflation levels seen since 2021 it will be necessary for School's and their Board's to consider whether the current values included with policies and delegated authorities are still appropriate.This is likely to include as a minimum:

- Do your procurement policy limits need to be updated to save management time on areas which are now lower value? You should consider whether your authorisation limits for purchase orders and approval of invoices still appropriate and similarly review your quote and tender levels for larger purchases and projects.
- Tender processes – are you requesting / obtaining rates that cover more than one year or are you now hoping that the inflation cycle is now on its downward curve.
- Capitalisation policy – similarly, do you need to raise the minimum value at which items are capitalised and depreciated.

IT General Controls

As organisations increasingly rely on IT which become ever more complex, good strong IT General Controls are therefore vital to ensure compliance, reliability of information assets, and enhance effectiveness and efficiency of information management.

With the increased focus on IT General Controls required under ISA 315, we have seen common themes arising from our audit work. These have been summarised below as areas which you may want to consider to enhance and strengthen the IT control environment at your school:

- Ensure that there are strong policies in place for all aspects of IT which are relevant for the school. These should cover not only the security of physical IT assets and IT data, but also now need to include other developing areas, such as the use (or not) of Artificial Intelligence ("AI") and machine learning.

- Incident reporting – where issues occur or mistake are made, there should be a straightforward way for individuals to report issues, both through their device but also by telephone (such as where incidents mean that they are locked out of their device).
- Regular IT training – this should be provided to all staff with IT access in bitesize chunks, to ensure there are regular and relevant reminders to staff. One-off training may not embed good practice and good IT hygiene.

- Passwords should be required to changed with proportionate frequency or supplemented by two factor verification. The school may choose to consider third party authentication products, such as use of Authenticator applications on user's mobile phones to securely login to school systems. Other options include secure single sign in options for authenticated users using trusted hardware. Password policies should also include good basis IT hygiene – not duplicating passwords across different applications (for personal and business use) and not writing these down where they can be easily discovered.
- WIFI – steps should be taken to have an available, but restricted, WIFI for those visiting the school and a more secure wider access for members of staff.

- Unauthorised applications – members of staff may install, deliberately or inadvertently, new applications onto their school device. It is therefore important that there are IT controls that restrict any unknown or unauthorised applications, as these may include malicious malware within an innocuous application that may appear to be 'time-saving' but hides more sinister motives.

- Phishing attacks and spam:

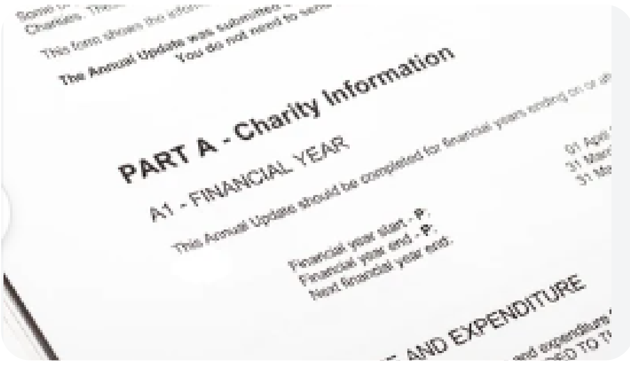
-ensure that staff are aware of potential phishing attacks or spam using highly emotive language and using email address that look very similar to senior members of staff

-ensure any attachments are not opened where there is any suspicion, and seek to verify content of email by checking by alternative means (such as by phoning the person directly or calling up a company using their home page and not using the telephone on the email itself).

Taxation (impacting non-charitable schools)

Capital Allowances

The Government has confirmed that the Annual Investment Allowance (AIA) will be permanently set to £1,000,000, which had been expected to decrease to £200,000 at the beginning of this financial year. The AIA allows businesses to deduct the full value of a qualifying capital item from their profits before paying tax.



However, for companies that have accounting periods that straddle 1 April 2023, a quirk in the legislation may mean that the company does not receive the full allowance, depending on when the expenditure is incurred. Furthermore, the super-deduction, which allows companies to claim 130% of the purchase price of qualifying assets as tax relief, is set to cease on 31 March 2023. The allowance is generous when compared to the AIA, particularly as it has no overall limit.

What should I be considering?

If you are considering significant capital expenditure in the coming months, the timing can be critical in terms of the tax relief obtained and should be carefully managed.

Our charity specialists


Sam Rouse
Partner


Susan Robinson
Partner


Lucy Hammond
Partner


James Peach
Partner


Kimberley Foulkes
Audit Manager


Coral Curtis
Audit Senior Manager


Dan Firmager
Audit Assistant Manager


Simon Webber
Partner


Peter Manser
Partner


Stephen Tanner
Partner

If you have any questions on any of the topics covered in this update please contact us to arrange to speak with one of our specialists in London, Kent and Sussex.

Call: +44 (0)330 124 1399

Email: enquiries@krestonreeves.com

Visit: www.krestonreeves.com