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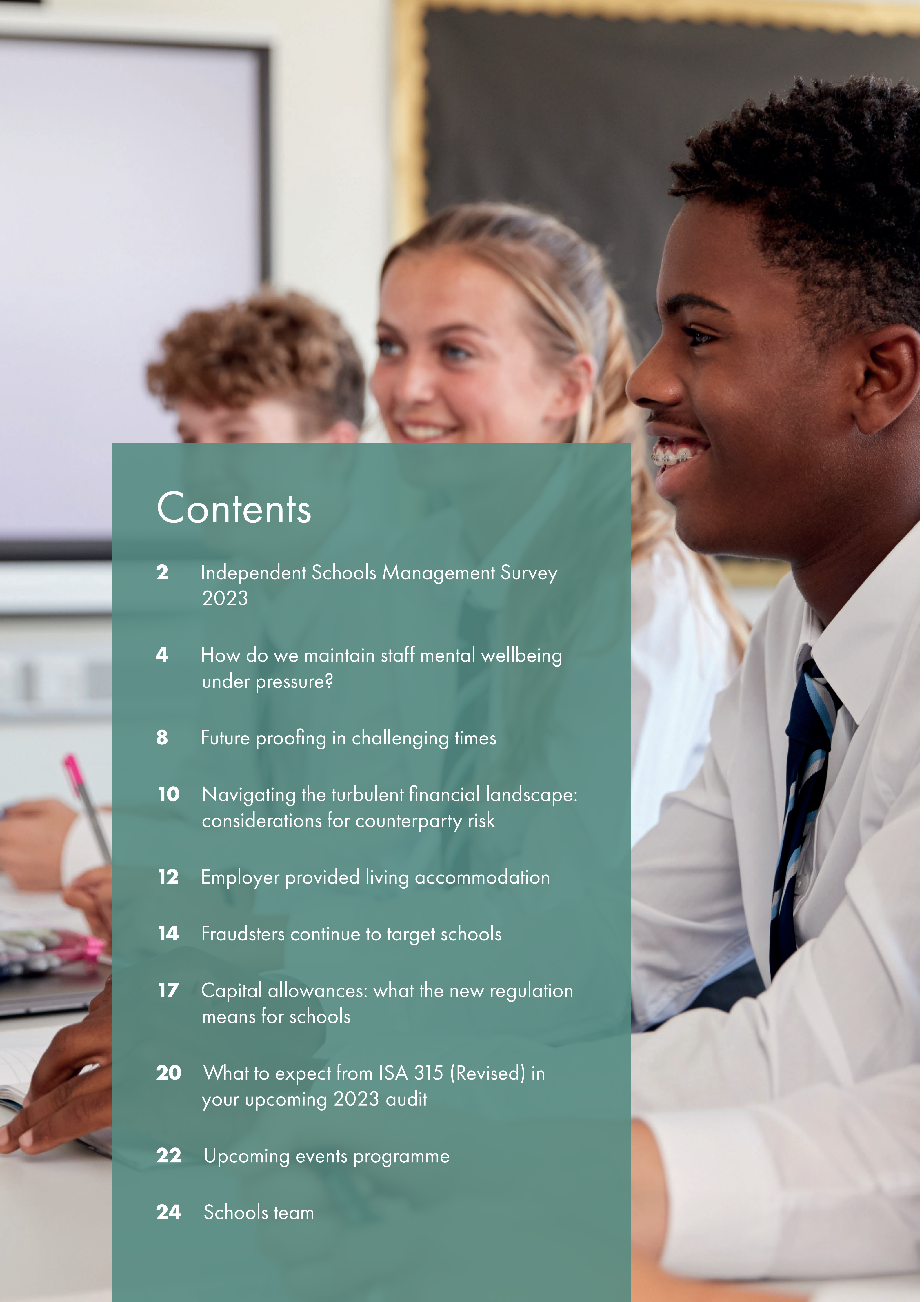
SCHOOLS BRIEFING

ISBA CONFERENCE 2023



Contents

Welcome from the editor

Welcome to the ISBA Conference edition of our Schools Briefing where we provide updates and insights on accounting, tax, reporting and governance for school bursars and governors.

Firstly, Tracey Young, Partner and Head of Education, comments on the results from the latest haysmacintyre *Independent Schools Management Survey*. With a return to operational normality in 2021/22 academic year, new challenges faced independent schools with significant rising costs and cost of living pressures and Tracey considers how schools should focus on building their financial resilience.

Our first guest author, Dr Jake Lovelock, Performance and Wellbeing Psychologist at Cognacity, takes an explorative look into ways to manage staff wellbeing using Cognitive Behavioural Therapy. By highlighting common themes from stress to over exertion, Dr Jake goes on to share a number of useful tips to increase performance, stimulate the brain and manage pressure, to ensure the wellbeing of staff is at the forefront of school's agendas.

With the continuing challenging times, I take a deeper look into ways schools can future proof their financial future. There is an ever-growing need for schools to become financially savvy, and review not only existing income streams, but also additional means of securing income whilst challenging costs. This article suggests the early warning signs to be wary of, alongside key steps to consider and implement now to ensure your schools' financial future.

Our second guest author, Max King, Head of Epoch Consulting, reviews the turbulent financial landscape schools have been navigating. Sharing an indicative forecast as to what the overall approach to bank regulation and governance may be in the coming months, Max provides a helpful outlook for schools and shares useful suggestions as to how counterparty risk should be considered.

Employer provided living accommodation remains a highly topical issue within the schools sector. Nick Bustin, Employment Tax Director, reviews what changes we have seen to existing arrangements within schools, the tax treatments of this provision and exemptions that may be relied upon. Nick highlights the need for independent schools to continue to review their existing living accommodations.

Fraud remains to be an area of concern for schools. Vikram Sandhu, Director, shares various examples of fraud seen within independent schools, ways on how fraudsters are attempting to increase their footprint and target both employees and parents, and ideas on how to best reinforce your school against fraud.

Sally Gatward, Assistant Manager, looks at capital allowances and what it means for schools. Providing an update on changes from the Spring Budget, Sally gives an overview of capital allowances, the new expensing relief and how subsidiaries can effectively Gift Aid their taxable profits.

Finally, Andrew Roberts, Senior Manager, looks at the impact of the revised ISA 315 means for schools and what you can expect from your upcoming 2023 audit.

I hope you enjoy this edition and find these articles of interest. Do feel free to let the authors, me or your regular contact know if you have any questions concerning the matters discussed.

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Independent Schools Management Survey 2023

It was a welcome return to operational normality in the 2021/22 academic year after the lingering disruption of COVID-19 in the previous year. However, the year presented new challenges with significant rising costs putting pressure on budgets and cost of living pressures impacting both parents and staff.

The economic pressures continue in the current academic year, and along with the political threats there remains significant uncertainty and concern for school management and governing bodies. It seems a strong possibility that Labour will be successful in the next election and their commitment to applying VAT to independent school fees will bring further financial challenges to the sector.

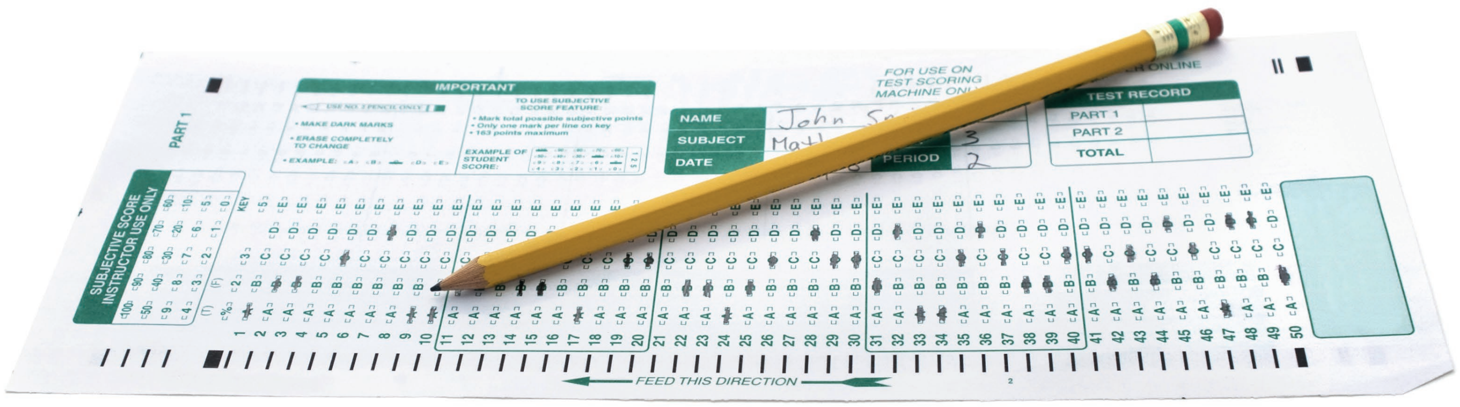
It is imperative that schools focus on their financial operating models now, making changes where necessary, to build financial resilience. Benchmarking information can be a valuable tool to both senior management and Governors when assessing their schools' financial performance and helps to inform the decision making process. This year's survey has given us and our participants some useful data and we set out some of the key findings below.

Overall **pupil numbers** in the schools included in this year's survey increased 3.7% overall from 2020/21 to 2022/23, with growth in both boarding and day pupils. Growth was experienced by all school categories except preparatory day schools which overall saw a decline in pupil numbers of 0.7%.

We continue to see some significant increases and sharp declines in pupil numbers at individual schools which suggests that although the general picture for the sector remains strong, many schools continue to experience tough market conditions. Mergers and closures have continued over the last year. The current challenges of rising costs along with the financial pressures on fee payers means the position is likely to become increasingly difficult for many and impossible for some.

The average **fee increase** for 2022/23 for all schools responding to our survey was 5.25%. This is up from the average in 2021/22 of 3.4% and 0.8% in 2020/21. The average increase in 2022/23 was the largest increase in fees since 2008/09, following a period of relatively modest increases – with the average increase from 2009/10 to 2019/20 ranging from 3.3% to 3.9%.

The average inflationary **pay awards for teachers** has increased from 1.7% in 2021/22 to 3.7% in 2022/23. The increase in 2020/21 was far lower at 0.8% which reflected the fact that many schools held both salaries and fees as a result of COVID-19. Ongoing high inflation levels will put pressure on pay awards, but governing bodies will have to balance this with affordability.



The average inflationary **pay awards for non-teachers** has broadly been in line with that applied for teachers over the last two years. However, many schools continue to experience challenges in filling vacancies in lower paid roles which is resulting in rising costs.

Schools in the survey provided **fee remissions** of 8.9% of gross fees on average, down from the prior year of 9.2% of gross fees. This excludes any COVID-19 discounts or rebates in the prior year. This ranges from 4.3% in preparatory day schools to 14.1% in senior and junior boarding and day schools.

Means tested bursaries (including hardship awards) averaged 4.0% of gross fees in 2021/22 compared to 4.3% in 2020/21. The level of means tested remission provided varies significantly between the school categories with preparatory day schools providing on average 1.9% of gross fees compared with 6.7% at senior boarding schools. **Scholarships** averaged 1.6% of gross fees compared to 1.8% in 2020/21. **Staff fee remissions** (not means-tested) were on average 2.0% of gross fees in 2021/22, which is consistent with the prior year.

It is an established practice in the sector for staff to be provided with discounted fees for their children, although the level of remission can vary from nothing up to in exceptional cases 100%, which can have benefit in kind tax implications. It is a very tax efficient benefit and is expected by many teachers and key support staff and can assist recruitment and retention. For some it can be a key part of their decision-making when accepting a role.

Highlights of our analysis of levels of **remission offered to teachers** across all schools in 2021/22 are:

- 49% offered a remission of 50%
- 17% offered a remission of between 61% and 70%, including 13% providing 66.7%
- Only 5% of schools offered no remission to teachers

Although the levels offered are consistent for most schools over the period, roughly 6% of schools have reviewed this benefit and reduced the discount offered from 2020/21 to 2022/23.

Premises costs averaged 12.8% of net fees, which is in line with the previous year. This is despite the lower net fees in the prior year due to Covid-19 discounts/rebates. Rising inflation, high energy costs as well as challenges in sourcing materials and labour for maintenance projects are adding to the premises costs.

These costs can vary significantly between schools depending on the nature of the school estate, in particular the number and age of the buildings. As expected, boarding schools tend to have greater costs in this area. Repairs and maintenance costs form a significant proportion of these costs, and it is important that both these costs as well as capital projects are costed in schools' strategic plans.

Although it is possible to delay projects, to do so can lead to inefficiencies, deteriorating infrastructure and higher costs in the long run. Many schools commission regular condition surveys to enable them to identify and plan the required works effectively and ensures the funding is available as necessary.

Average **capital expenditure** was £1,552k in 2021/22, up 40% compared to 2020/21. The levels of capital expenditure can vary significantly from school to school and by school type. 25% of schools spent less than £250k which is significantly lower than the 43% in 2020/21. 21% of schools spent between £250k and £500k compared to 17% in 2020/21. 40% of schools spent over £1m compared to 28% in the previous year. There continues to be a small number of schools undertaking very significant projects. Just under a quarter of schools responding to our survey received fundraising income for capital projects, although the value can vary significantly with 18% receiving less than £100k. However, 3% of schools received over £1m for capital projects. The majority have funded projects at least in part by borrowing.

The average **net surplus*** was 10.0% of net fees for 2021/22 compared to 9.4% in the prior year. However, the net surplus varied significantly between schools with some achieving significantly in excess of this level and others far below.

In light of the current economic and political outlook, rising costs and potential impact on pupil numbers as a result of financial pressures on parents, it remains important that schools continue to carefully monitor pupil numbers, debts and bursary and hardship awards for early warning signs of future impacts so prompt action can be taken. Continued cost control remains essential, alongside care taken to challenge the business case and consider the viability of potential capital projects. Schools must focus on financial sustainability and building financial resilience to secure their financial future.

If you would like a copy of this year's publication, then please contact marketing@haysmacintyre.com.

** this excludes investment income, fundraising income and expenditure, borrowing costs or depreciation*

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How do we maintain staff mental wellbeing under pressure?

We're all under pressure. Whether we're stretching an increasingly tight budget, adapting to pension changes, working inconsistent annual schedules, or managing at-risk or disruptive students. 'Pressure' is a psychological phenomenon, it's a human problem, although the education sector seems to be filled with more than its fair share.

Pressure can lead to some unhelpful outcomes, such as a decline in mental wellbeing, reduced performance and job satisfaction, to name just a few. If that's the case, is there a way to effectively manage our own psychological resources when presented with pressure?

Stress

Stress is widely thought to be harmful but short-term stress, such as working to a deadline, can be beneficial. It can help us be more productive, improve our cognitive function as well as our energy levels. However, if this level of stress persists then we become at risk of developing 'chronic stress', often considered the gatekeeper to common mental illnesses (see figure 1).

Stress is not the source of our problems when we're under pressure - it is the way we respond to stress that negatively impacts our mental health and performance. Put simply, when we are under pressure our brains engage in a series of thoughts and behaviours to try to keep us safe whilst at the same time attempting to reduce that pressure. However, in the modern world, many of these thoughts and behaviours are counterintuitive, and only end up increasing our stress, risk of mental illness, and impairing our performance (see figure 2).

One of the most evidence-based methods to improve wellbeing, resilience, and performance for individuals under sustained pressure is Cognitive Behavioural Therapy (CBT) - a popular form of psychotherapy used for treating mental disorders. It provides a framework for understanding how the brain works, and we can apply this framework to solve a wide range of 'human problems', like resilience and performance.

Unsurprisingly, there are two main components of CBT, a 'cognitive' part (related to our thoughts) and a behavioural part (related to what we do). How we manage these variables underpins our mental wellbeing.

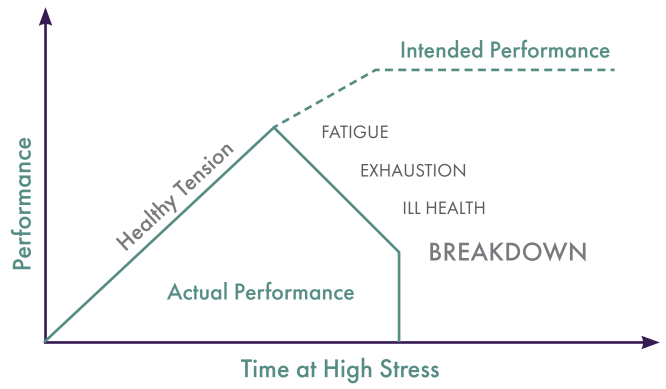

Figure 1. The Stress to Performance curve

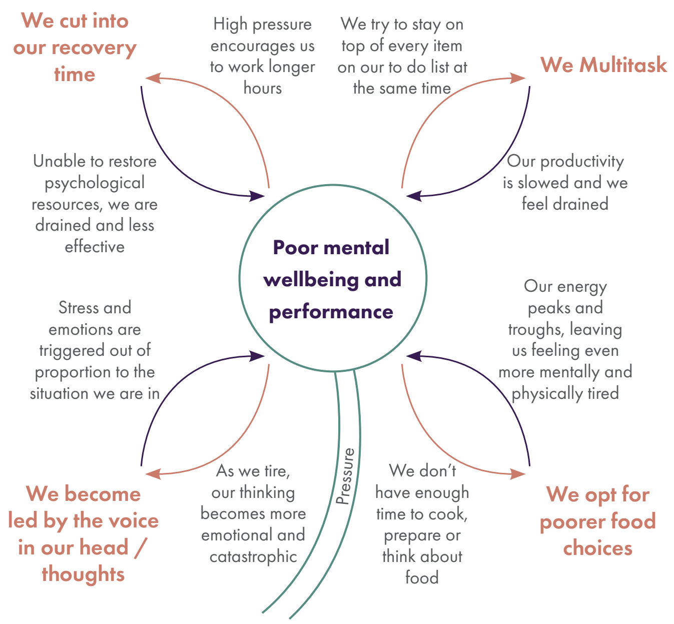

Figure 2. The Vicious Flower

Thoughts

Let's start with the cognitive (our thoughts). Have you ever noticed how the way you think changes when you're tired, hungry or stressed? Maybe you get a little bit grumpier, or maybe you start to worry about problems far into the future. The way we think has the capacity to prevent the stress response from deactivating. The thoughts we have when under pressure can often increase our stress levels without us being aware.

For example, when approaching a deadline, we start to worry about whether we'll get all this work done on time. We become stressed and this stress helps us focus. Later that evening, however, when we try to rest, to allow our body and brain time to recover, we are plagued by thoughts, "What if I miss the deadline?" or "What if I just can't do it?" These thoughts create stress and prevent us from recovering. Simply taking time to notice these thoughts, rather than 'chasing them down the rabbit hole', can significantly reduce their impact.

Next time you're feeling stressed or overwhelmed, try this thought exercise:

1. Write your thoughts on paper in quotation marks, exactly as they appear in your mind – in the example above you may write, "I worry I might miss the deadline"
2. Next, recognise your tendency to think a particular way under pressure, for example, "I have a tendency to think about the worst possible outcome"
3. Once you have found a theme, name the voice that pops into your head. You can call it anything, 'Steve', 'Mary', I call mine my 'inner meerkat' – always looking out for danger
4. Next time a 'worst case scenario' thought pops up, we know to expect the meerkat. We can say to ourselves "there's the meerkat again!" This activity doesn't take the problem away but helps us to detach from the thoughts that may be getting in the way of our goals

Other exercises like 'card carrying' and 'thought records', can also be incredibly helpful.

Behaviours

How we behave is much easier to recognise. For the most part, we know what is good for us, but sometimes high pressure situations cause us to choose bad behaviours, encouraging us to think about the short term gain as opposed to the longer term results. There are lots of examples that we could discuss here, such as opting for 'grab and go' foods that are high in sugars, negatively impacting our energy levels after the initial sugar hit, or multitasking as your brain attempts to manage all your sources of pressure at once.

However, one of the most commonly occurring responses to high pressure that I notice in my work as a psychologist, is the cutting down of recovery time. I often work 1:1 with elite athletes, helping them get the most out of their minds. Interestingly, athletes seem to understand the value of recovery, they see it as part of their journey because they know that if they don't recover, then tomorrow they simply won't be able to perform as well (see figure 3). Why don't we value recovery as highly?

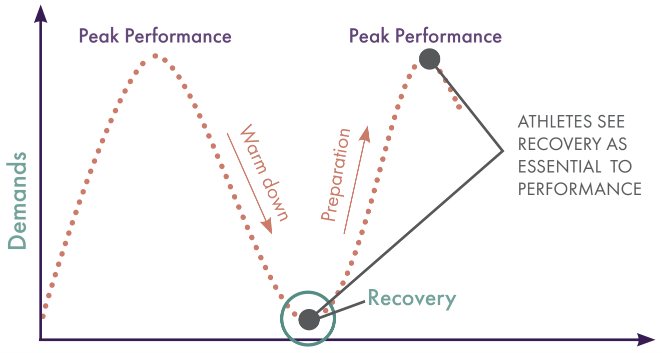

Figure 3. Recovery to performance relationship

Our brains are complex, high-functioning organs. They are constantly learning and processing, using up psychological resources (like dopamine) to function. In order to replenish those psychological resources, your brain must disengage, 'switch-off' from the source of stress. Typically, when our workload increases (a 'stressor'), we work slightly longer hours into the evening and possibly weekends. In the short term, this doesn't do too much damage, but in the long term we negatively impact our wellbeing and our ability to perform suffers.

Recovery is not a luxury - it is a key element that enables us all to perform at our peak.

Therefore, one key method of managing our mental health, in these difficult times, is recognising the things that have a significant impact on our wellbeing and performance and prioritising those behaviours, especially when we're under pressure. We all have the psychological resources to be the best versions of ourselves, the question is – how are you applying them?

Summary:

When under pressure, we often engage in unhelpful thoughts and behaviours. Be deliberate about the things you know improve your wellbeing. Here we discussed:

- Practice recognising the thoughts that frequently generate stress or unhelpful behavioural or emotional responses. Here we discussed 'naming your thoughts', but there are many techniques you can try
- Do not multitask
- Avoid foods that peak & trough your energy levels
- Ensure you are giving your brain adequate time to replenish its psychological resources in between performance episodes

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Future proofing in challenging times

There are challenging times lying ahead for the independent school sector. However, there are options available to secure your school's financial future.

Current challenges

Independent schools are being faced with significant pressures as we continue to recover from the lasting effects of COVID-19. These include rising inflation and energy prices, the expected loss of business rates relief, the need to maintain and develop facilities, challenges of teacher recruitment and continued uncertainties over political factors which could impact the cost base further. In addition to this, there remains concerns over the affordability of fees for parents, who themselves are facing their own cost of living challenges.

However, perhaps the biggest challenge of all for independent schools may arise if there is to be a change in Government at the next General Election, which is expected in 2024. VAT on school fees has been widely talked about for some time in Labour manifestos, and with many commentators predicting them to take over from the Conservative party at the next election, the risk of VAT on fees being implemented appears to be more real than ever before.

This may be the perfect storm for some schools, particularly preparatory schools, but the challenges facing the sector may also present opportunities for potential mergers or collaborations for others. It is therefore important to take steps now to future proof your school.

How can schools future proof?

A key focus is to ensure your school is in as strong a position as possible and ready for the challenges that lie ahead. It will be important to look at a number of different areas which include but are not limited to the following:

- **Challenge your costs** – it may be that in a new environment your policy decisions are no longer viable. You may need to revisit your target class sizes, to consider whether to stay in the Teachers' Pension Scheme or even look at the level of fee remissions you are currently providing.
- **Challenge your offering** – you need to step back and consider the position your school has in the market. What is your school's USP and how will the challenges ahead affect your school?
- **Make sure you are market facing** – in a tough and competitive market, make sure you are market facing – revisit your marketing and ensure your processes are efficient.
- **Seek alternative income streams and sweat your assets where possible** – consider how you may diversify income to help boost surplus and make the most of the assets. Many schools already achieve this effectively but be realistic about what is viable and undertake a cost benefit analysis to manage the risk of any new income streams.
- **Capital projects** – given the current outlook, it is essential to challenge the business case for capital projects. Is this the right project and is it the right time to proceed in the current environment?
- **Consider your schools' position** – whilst it may never have been part of your strategic planning discussions previously, it may be worth considering if a merger or collaboration is the right thing to ensure that your school is a going concern in the longer term. This could strengthen your position in the market and harnesses efficiencies, but these discussions are much better to do from a position of strength rather than when you are at the end of the road.

Given the challenges lying ahead, it will be important to build reserves to give a buffer to weather what is to come and enable you to take the necessary time to make any considered changes rather than make rash decisions.

Financial modelling

Financial modelling is an essential part of this process to understand the financial implications of the potential impacts on your school and the decisions you make. Most, if not all schools, have been undertaking some form of scenario planning since the outbreak of the pandemic to ensure their future sustainability. In the current environment it will also be more important to stress test your financial model – what would it take for your model to break?

Financial modelling should build from your current year budget and look ahead for at least the next five years. Decisions that you make now will impact your future and you need to have visibility of this before taking any important decisions. Normally you would start with your base case for any scenario planning – ie the status quo with no tax changes, but consider what the impact an economic downturn might be on pupil numbers or costs faced.

Then you will need to layer in the other 'what if's', such as loss of business rates relief and VAT on school fees. If you have not done so already, you should start to consider if you can pass on the potential full VAT rate to parents, or could the school absorb some of the burden? Knowing your parent base and their price sensitivity to levels of fee increase will be very important in these considerations.

The scenario planning and forecasting will make it clear that there may be some actions you must take now and others that you may take now to improve financial resilience. Building a war chest now and reducing costs where you can, will help to future proof your school against the significant challenges lying ahead.

Early warning signs

It will be important to monitor carefully the potential changes which will impact your school's financial position so you are ready to take swift action if needed. Looking at the early warning signs will help to future proof your school and will include:

- **Pupil numbers**
  - Registrations - where are you compared to prior years?
  - What are your local demographics – has the birth rate fallen in your catchment area?
  - Obtain feedback for any failures to enrol – is there a common theme?
  - For boarding schools, talk to your agents – this will be a good indicator of parent attitudes
  - Feeder schools – what are they seeing? There may be indications of changes in buyer behaviour

  All these things can help you to profile your pupil roll going forward enabling you to plan effectively and take action if required.
- **Fee debts**
  - Are parents slow to pay debts and are they asking for more time or even financial support? Some schools are seeing issues with parents struggling already but if this is an increasing trend it will have a significant impact on income.
- **Competitors**
  - Continue to monitor your competitors as they are likely to be having similar discussions to you. What action have they taken and how will it impact you?

Key takeaways

We have highlighted some of the key things to think about to future proof your school, but it is not all doom and gloom. For some schools there will be real opportunities to strengthen your position in the market.

Some of the key things to remember include:

- Plan for the worst, hope for the best
- It is important to have prudent financial management
- Plan now for the 'what ifs'
- Effective monitoring and ongoing risk management is essential
- Look out for those early warning signs
- Make the hard decisions before it's too late


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Navigating the turbulent financial landscape: considerations for counterparty risk

"There are decades where nothing happens, and there are weeks where decades happen", is a quote often credited to Vladamir Lenin.

Whether the provenance of it is true or not, many will be nodding their heads to this when considering what March bought to the banking industry.

In March, we experienced a crisis in the banking industry after three regional banks failed in the US and Credit Suisse was forced, by central bankers and regulators, to merge with UBS. Whilst equity markets may not have moved substantially over the month, price swings between asset classes and sectors were significant.

Investors would be forgiven for believing the situation was reminiscent of the 2008 global financial crisis. However, banks are much better capitalised now compared to 2008. Whilst it is clear the risk management at many of these institutions will come under scrutiny, there are also some important distinctions between the financial crisis of 2008, and the stresses in the banking sector we saw.

We may also see the overall approach to bank regulation and governance called into question in the coming months. Whilst we have seen significant regulatory reforms, the banking sector is again a source of anxiety and considered a potential source of crisis for the wider economy. Once this crisis has passed, there may be further questions raised around the position of privately owned banks, and whether there should be greater control from the state.

So, what happened, and should you be worried? Silicon Valley Bank (SVB), the most high-profile failure in the US, had a highly unusual depositor base, predominantly from start-up businesses with large deposits.

These kinds of businesses generally survive by living off large injections of capital that come in funding rounds, which will typically be infrequent. Each round results in large deposits of cash that can then be drawn upon until the business becomes profitable. Many of these funding rounds took place during 2021, during which time SVB's deposits almost doubled.

At the time, readers will recall that interest rates were also very low. SVB sought to achieve a profit from this influx of capital, through the purchase of long-term bonds. As interest rates rose sharply, the prices of these bonds fell significantly. Having to sell early would trigger a loss, which started to happen when depositors began withdrawing money.

SVB's liquidity problem was ultimately triggered by the fast pace of withdrawals, and the only way to meet this was through the selling of the aforementioned securities. Through crystallising these losses, it ultimately ended up wiping out all of the capital, rendering it insolvent.

It is fair to say that most banks do not share the same depositor base as SVB, and most European banks are better capitalised. However, when SVB did fail, all deposits were protected anyway, perhaps an indication that insurance covers all deposits. This may reduce the likelihood of future bank runs.

Credit Suisse's problems were mostly about liquidity, not solvency, and the main purpose of central banks is to lend to solvent institutions suffering liquidity problems. Credit Suisse has also had its fair share of controversy over the years. More recently in 2020, the then CEO resigned after a 2019 spying scandal. The collapse of Archegos Capital and Greensill Capital in 2021 lead to $1bn of losses. Shortly after this, the Chairman resigned over a scandal relating to breaching both Swiss and British COVID-19 quarantine protocols.

In more positive news, there is currently not enough evidence of an economy-wide credit bubble or reckless lending to bad credit, like we did ahead of the Global Financial Crisis.

It does appear that contagion into the broader financial systems from these earlier implosions may have been contained. However, the Federal Reserve, along with other global central banks have continued to raise rates higher. Given the challenges 2023 has bought us, it does now appear we may be close to terminal rates which may be a relief to those with fixed mortgages expiring.

If, however problems continue to spread, we may see central banks return to quantitative easing or they may bring down interest rates earlier than anticipated. There is a fine line to navigate. Whilst inflation is expected to soften towards the back end of this year, much of this is due to high energy costs falling out of the numbers.

It is therefore important to retain a calm manner in navigating this volatile 'new normal' we find ourselves in, and a disciplined approach should be anyone's focus. It may also be worth revisiting investment policies to see if anything needs tweaking.

We have certainly noticed that many clients are considering their counterparty risk, especially given most have their cash with one institution. As a reminder, the FSCS (Financial Services Compensation Scheme) only provides protection of up to £85,000 across all accounts held per bank licence.

Given most schools will normally hold significantly more than this in reserves, we have certainly seen a spike in clients looking at different ways to help manage their counterparty risk. Therefore, if you feel like you need some support in this area, please do get in touch.

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Employer provided living accommodation

Whilst the Government has not made any announcements about recommencing a review of the legislation as it relates to employer provided living accommodation, this remains a highly topical issue within the sector, and we have seen several schools reviewing their existing arrangements.

This can be for many reasons including:

- Changes in the roles at the school for those employees who are provided with living accommodation
- The level of any rent which is being charged to an employee
- How to manage existing living accommodation stock, especially where it is used to help recruit new teachers to the school

The provision of living accommodation is commonplace within the sector and the tax treatment is dependent upon many factors including:

- Why is accommodation being provided?
- What is the employee's role within the school?
- Will there be a tax charge on the accommodation provided?

For an income tax and NI charge to arise, the living accommodation must be provided to a person by reason of their employment. Where the accommodation is provided by the school to a member of staff, it will automatically be deemed to be provided by reason of their employment.

Consideration will need to be given as to whether the provision of accommodation can be considered exempt, which can only apply where it is provided in the:

- Proper performance of the duties; or
- Better performance of the duties and it is customary for accommodation to be provided

The second of the exemptions is commonly relied upon within boarding schools. However, care does need to be taken, even for those roles which HM Revenue & Customs (HMRC) acknowledge fall within the customary category, which includes:

- Headmaster
- House parents
- Matron
- Chaplin
- Bursar

However, it is important to consider each role and not solely rely upon HMRC's guidance.

Independent schools should continue to review their existing living accommodation arrangements to ensure they are applying either of the above exemptions correctly. This could be particularly relevant where employees have been moved to different houses within the school grounds, or there have been changes in the duties an employee may be undertaking.

HMRC have, over recent years, been challenging the use of the better performance exemption within the Further and Higher education sectors. This was on the basis that it is no longer customary for accommodation to be provided. Whilst that is not the case for boarding schools, where it is customary that accommodation is provided to employees with pastoral care responsibilities for boarding students, it does nonetheless highlight the need to review all existing arrangements to help protect the exempt status of the accommodation provided.

If you should have any questions concerning the provision of living accommodation, please do not hesitate in contacting Nick Bustin, Employment Tax Director, via email nbustin@haysmacintyre.com.

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Fraudsters continue to target schools

Following on from my article on fraud in our Autumn 2021 edition of Schools Briefing, we continue to see an increasing number of schools falling victim to fraud, and in particular, invoice fraud and phishing emails to request amendments to bank details for suppliers or employees.

Like any organisation or industry, independent schools can be vulnerable to fraud. The risk of fraud in independent schools can come from a variety of sources, including employees, contractors, vendors, or even parents.

Some examples of fraud in independent schools include:

1. Embezzlement: an employee misappropriating funds for personal use, such as writing cheques to themselves or creating fictitious vendors
2. Falsifying records: an employee altering records to hide fraud, such as inflating enrolment numbers to receive more funding
3. Bribery: a supplier offering kickbacks or gifts to an employee in exchange for preferential treatment
4. Conflict of interest: an employee making decisions that benefit themselves or their family members rather than the school, such as awarding a contract to a company they or a close family member own
5. Cybercrime: unauthorised access to school records or systems to steal sensitive information or funds

Fraudsters are increasing their footprint in cybercrime and in practical terms, this is more commonly taking place in the form of a scam email. The email typically states that the school will, for a short time, offer a discount for full upfront payment of fees - something that may be more prevalent with the increasing risk of a future inflationary increase in fees and potential VAT imposed on school fees - before being detected by either the school or parent as fraud.

Another example is phishing emails to the bursarial team and registrars requesting log in credentials to access target parents. The fraudster may restrict their emails to foreign parents who might be less questioning and, as parents of boarders, they would be paying bigger fees. A proposed deadline also encourages a quick response and a sense of urgency that instinctively removes suspicion.

As a reminder schools should consider including the following:

- Use multi factor authentication so one password alone is not sufficient to gain access to your systems
- Beware of phishing emails
- Question and check invoices for authenticity and beware of special offers and time deadlines
- Provide regular training and updates for all staff to remind them of the continued threat of fraud

Some of this will form part of our increased auditing requirements as ISA 315 becomes effective for 2023 audits, which is discussed on pages 20-21.

Conversely, bursars should also be aware of the source of funds, particularly with respect to fees from overseas parents. In 2020, the National Crime Agency issued a warning to schools stating they can no longer accept money without question. They must be aware of where, and who, the money is coming from. The latest Independent Schools census showed some 4.6% of pupils attend UK based schools and have parents who do not live in this country.

Schools may consider third-party payments received in settlement to be a "red flag". Further enquires or investigation may be required if payments are received in this way. By enhancing your due diligence process, transaction rationale can be better understood. For example, the school fees may be settled by the parents' business or grandparents.

Further areas of risk:

- Donations
- Use of intermediaries
- Overseas payments or those from 'non-co-operative' jurisdictions
- Franchising arrangements
- Fundraising efforts

The message for schools, however, remains the same – manual processes continue to be at risk of exploitation and are also time consuming. Investment in the right IT in due course is an area to consider. However in the meantime, to mitigate the risk of fraud, independent schools should implement strong internal controls, such as segregating duties, performing regular audits, and conducting background checks on employees, parents and vendors. They should also provide training to staff on fraud prevention and create a culture of ethical behaviour and transparency. It's important to note that while no system can completely eliminate the risk of fraud, taking proactive steps to prevent it can go a long way in protecting the school's financial and reputational risk.

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Capital allowances: what the new regulation means for schools

During the Spring Budget 2023, the Government set out new rules for full expensing of certain capital expenditure. The new expensing relief is being introduced to replace the relatively short lived 'super-deduction' relief that is now being phased out. Below we explore what this means for schools and their trading subsidiaries, and how to plan to ensure that the subsidiaries can effectively Gift Aid their taxable profits up to the parent charities.

We also recap the other tax reliefs available for capital expenditure incurred by trading subsidiaries, and how they affect their taxable profits.

Overview of charity tax structuring
Charitable schools generally do not pay Corporation Tax (CT) on their profits, as they claim various charitable exemptions for CT. However, often a school will incorporate a trading subsidiary to carry out non-charitable trading activities that need to be ringfenced from the school's other activities, for example, where the activity does not fall under the charitable exemptions.

In contrast, a school's subsidiary is subject to CT on profits arising and tax relief for capital expenditure may be essential in ensuring that tax and accounting profits are closely aligned. This latter point is crucial when the subsidiary is relying on making a donation payment, also known as a qualified charitable distribution (QCD), to reduce its CT liability. Such donation payments can only be made from the distributable reserves of the subsidiary company.

Where the subsidiary has more taxable profits than accounting profits, in any given year, perhaps due to timing differences arising from tax relief on capital expenditure, the permissible donation payment may not be high enough to reduce the subsidiary's taxable profits to nil. In some instances, it may be possible to use profits from the following accounting period to enable a full payment, where these profits correct the distributable reserves position. However, where this is not possible, taxable profits may remain, giving rise to a corporation tax exposure for the subsidiary company.

Outline of capital allowances
The capital allowances regime allows companies to claim tax relief on expenditure incurred on the purchase of fixed assets used for trading purposes. For CT purposes, depreciation charged in the accounts of a company is a non-deductible expense.

The capital allowance regime is complex and increasingly so, given the recent changes introduced by Government. The CT treatment of an asset will depend on the nature of that asset, with differing treatment for each in the following categories:

- Plant and machinery
- Cars
- Long-life assets and integral features
- Structures and buildings
- Land

Additionally, since the legislation has been changed frequently in the last three years, the CT treatment afforded to each type of asset will also depend on the timing of the capital expenditure incurred.

We discuss the existing rules relating to CT relief for capital expenditure, and the recent changes introduced below.

Main Pool (MP)

Assets deemed to be plant and machinery, and used for qualifying activities, can be pooled in the MP for capital allowances purposes.

The CT balance of expenditure in this pool, the Tax Written Down Value (TWDV), is written down each year at the MP rate (currently 18%). The amount written down is called the Writing Down Allowance (WDA). It replaces any depreciation on these items when calculating taxable profits for the year.

However, there are some other CT reliefs currently available to certain MP assets acquired in the year that should be deducted from the TWDV before the WDA is calculated.

Annual Investment Allowance (AIA)

AIA allows the company to deduct the full value of the asset when the expenditure is incurred. It applies to all MP items, excluding the following items:

- Cars
- Assets owned but not pooled in the year of acquisition
- Assets given to the company
- Assets purchased in the period the business activity ceases

There is a £1m cap on the value of assets that can be expensed like this (made permanent in the 2023 Finance Bill). This cap must be shared with the Special Rate Pool assets (see overleaf).

Super-deduction

This is available for most AIA qualifying assets acquired between 1 April 2021 and 31 March 2023 only.

The following items are excluded from the super-deduction:

- Second hand items
- Bought to lease out

The super-deduction allows companies to deduct 130% of the value of the assets acquired, giving companies an extra 30% relief when compared to the accounting profits. Effectively, the super-deduction gives tax relief at approximately 25% for expenditure incurred during this period, rather than 19% (the CT rate to 31 March 2023).

The purpose of this temporary deduction was to prevent companies from delaying their capital expenditure until after 1 April 2023, when the CT rate increased from 19% to 25%.

However, due to a quirk in how the deduction is calculated, where a company's accounting period straddles the 31 March 2023 date, the effective tax relief dips, potentially significantly, below 25% for assets acquired between 1 April 2023 and the end of the period of account. The rate depends on exactly when the period of account ends, with the reduction being most acute for periods ending just after 1 April 2023.

Since schools and their subsidiaries tend to have accounting periods that end in July or August, this reduction in tax relief can be significant (with the effective tax relief being reduced to approximately 21% or approximately 21.5% respectively).

Therefore, if you are currently considering incurring capital expenditure and can be flexible with the date of acquisition, it may be more beneficial to delay the expenditure to the following accounting period (ie the one following the straddle period) to avoid this reduction in relief.

Full expensing regime

From 1 April 2023, the super-deduction has been replaced with the new full expensing regime for qualifying plant and machinery. This newly introduced regime allows all assets that would have qualified for the super-deduction, to be fully expensed in the period in which the expenditure is incurred.

Full expensing is currently only available for assets acquired between 1 April 2023 and 31 March 2026. In line with the super-deduction, it will provide relief for assets acquired in periods started after 1 April 2023 at 25%. There is no cap on the value of assets that can obtain the super-deduction or the full expensing treatment.

This is a welcome simplification of previous reliefs, and it is more generous than the AIA for qualifying assets, due to there being no upper limit or cap on expenditure incurred. However, in practice we expect this to have little impact on schools and their subsidiaries, since they tend to have levels of capital expenditure already covered by the existing AIA limit.

Special Rate Pool (SRP)

Certain types of capital expenditure must be allocated to the SRP, where the WDA applied each year is given at the lower rate of 6% per annum (rather than the 18% referred to above for main pool items).

The items that must be included in the SRP include:

- Integral features of a building
- Long-life assets
- Solar panels
- Thermal insulation
- Cars with high CO2 emissions

Most of the items in this pool (except cars) can also attract AIA , which is generally a more beneficial way to obtain tax relief when compared to the low rate of WDA. The AIA limit of £1m expenditure must be shared between the SRP and the MP.

Also recently introduced is an equivalent of the super-deduction/full expensing regime for SRP items. This is referred to as the 50% Special Rate First Year Allowance and applies to items purchased in the period from 1 April 2021 to 31 March 2026.

This relief allows a company to claim 50% of the expenditure on a qualifying SRP asset in the year of acquisition (with the same exclusions as the MP super-deduction). The remaining value is then included in the SRP, where the 6% WDA applies going forward.

As AIA gives full relief in the year of acquisition, utilising the AIA first will usually give a more beneficial result for the company.

Other capital allowances (a recap)

1. First Year Allowances - some specific items (electric cars, biogas equipment etc) attract 100% First Year Allowance. These must be new and unused and not leased out.

2. Short-life assets - assets expected to have a short life can be added to a separate single asset pool, where the asset can be written off over the life of the asset. Where the asset is disposed of or scrapped within eight years, a balancing allowance can be brought into account equal to the TWDV of the item, less the proceeds received.

3. Structures and Buildings Allowance (SBA) - allows companies to claim a deduction on certain expenditure on structures and buildings that do not otherwise fall into the MP or SRP categories. The WDA is 3% per year on a straight line basis. This allowance cannot be deferred (unlike WDA) you must use it or lose it, and it lasts for 33.3 years.

Ineligible assets

There are still some assets (such as land) that do not qualify for any capital allowances, where expenditure on such items will not obtain CT relief until they are eventually sold. Rather, the initial value of these items will be brought into the capital gains calculation.

Summary

CT relief, in the form of capital allowances, replaces accounting deductions which are given in the form of depreciation. These differences can give rise to differences between the accounting and taxable profits of a school's subsidiary. Where these differences are large, this can cause issues with the ability to pay a QCD to the charitable parent company, due to company law restrictions on distributions.

Wherever possible, it is certainly advisable to acquire ineligible assets and assets attracting only SBA's directly by the school, to avoid such timing differences arising in the subsidiary company. This will need to be considered in conjunction with the intended use of the asset and charity law restrictions.

For capital expenditure that is eligible for the MP or the SRP, capital allowances are typically more generous than depreciation. As such, and with careful planning, these items can be acquired by a trading subsidiary whilst managing the risk of CT liabilities arising. One added benefit of accelerated capital allowances is the ability to build up reserves, which can also be useful in some cases.

As you can see, capital allowances is becoming an increasingly complex area, with both the nature of the asset and the timing of expenditure affecting the CT relief available. If you would like any further information on any of the areas covered above, please contact your usual haysmacintyre contact.

What to expect from ISA 315 (Revised) in your upcoming 2023 audit

The revised International Standards of Auditing 315 (ISA 315) is effective for all audits of financial statements for periods beginning on or after 15 December 2021 and therefore will be relevant for the 2023 audits of all independent schools. The changes in the standard will require auditors to spend more time understanding the nature of the school and its environment, assessing the risks of material misstatement, and communicating more effectively with the school's management and governance structure. This article will explore these changes in more detail.

1. Greater emphasis on understanding the entity and its environment

The revised ISA 315 places a greater emphasis on understanding the nature of the entity and its environment. Auditors are required to understand the nature of the school including its operations, ownership, and governance structure, as well as assessing the internal and external environments of the school, including regulatory and other external factors that may affect its operations.

Further, auditors are now expected to document, in more detail, the IT environment in which the school operates. For some larger schools with complex systems, this may require the introduction of specialist IT audit resources, and in all cases, will require much more extensive documentation around the hardware and software environment, and the controls in place to ensure the security of the IT systems used.

2. Greater emphasis on risk assessment

Risk assessment is a secondary key emphasis, which is a critical component of the audit process. Auditors are required to identify and assess the risks of material misstatement in the financial statements, including the risks of fraud.

Schools can expect auditors to spend more time assessing the risks of material misstatement and to focus more on identifying the risks of fraud. This revised ISA 315 requires auditors to perform separate assessments of inherent and control risk, combined with a new inherent risk factors framework, which will lead to increased time being spent at the planning stage to identify risks and then to assess these within the new framework.

There is a new concept of the 'spectrum of inherent risk', meaning that risks are assessed in much more detail and with a much larger degree of granularity, which then allows the audit teams to focus their work on the higher risk areas.

3. Emphasis on professional scepticism

Professional scepticism, which is a fundamental principle of auditing, requires auditors to maintain an attitude of professional scepticism throughout the audit process, including when assessing the risks of material misstatement and evaluating the sufficiency and appropriateness of audit evidence.

Schools can expect auditors to be more sceptical in their approach to the audit, and to challenge assumptions and information provided by management. This may require bursary teams to provide more detailed information to auditors; be prepared to answer questions and provide additional supporting evidence. This will build upon the changes brought in by the revised ISA 540, which impacted the 2021 audit season for independent schools.

4. Changes in documentation requirements

The revised ISA 315 includes changes to the documentation requirements for auditors. Auditors are required to document the significant risks identified and the responses to those risks, including the rationale for the audit procedures performed.

Schools can expect auditors to document their work in greater detail, and to provide further information on the significant risks identified and the procedures performed.

5. Impact on smaller schools

The revised ISA 315 will likely have a greater impact on smaller schools that may not have the same level of resources as larger organisations. Smaller schools may find it more challenging to provide the information required by auditors and to comply with the increased documentation requirements. As a result, smaller schools may need to allocate more resources to meet the requirements of the revised standard, to ensure that their internal controls and risk management processes are adequate.

However, it is important to note that the revised ISA 315 is intended to enhance the quality of audits and to provide greater assurance to all stakeholders. By providing auditors with a better understanding of the school's operations and risks, governing bodies can expect a more effective and efficient audit process. Additionally, the increased emphasis on communication can lead to a better relationship between the school and its auditor, which can provide benefits beyond the audit process.

Summary

The revised ISA 315 will therefore have a significant impact on the audit of schools. It will require auditors to spend more time understanding the nature of the entity and its environment, assess the risks of material misstatement, and communicate more effectively with the charity's management and governance structure. Schools can expect auditors to be more focused on risk assessment and professional scepticism, as well as increasing communication throughout the audit process. While smaller schools may face challenges in meeting the increased requirements of the revised standard, the overall aim of the standard is to enhance the quality of audits and provide greater assurance to stakeholders.

Your auditor team will be in touch to discuss the impact on your upcoming 2023 audit at the planning stage but if you wish to discuss the above, please do get in touch.

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Upcoming events programme

We have one of the largest charity and not for profit teams in the country: we act for over 800 clients, accounting for approximately 40% of our annual turnover. Our team of specialists host topical seminar updates and speak at other organisations' events presenting the latest developments within the not for profit sector.

ISBA 2023 Annual Conference
Tuesday 23 – Thursday 25 May
Manchester Central Convention Complex

Quarterly charities update
Tuesday 6 June 2023
15:30 – 17:30
Online

Bi-annual schools update
September 2023
Online

Quarterly charities update
Tuesday 5 September 2023
15:30 – 17:30
Online

AGBIS Finance for Non Financial Governors webinar
Wednesday 27 September 2023
10:00 – 13:00
Online

NFP VAT and Tax Exchange
October 2023
Online

Quarterly charities update
Wednesday 6 December 2023
15:30 – 17:30
Online

To book your place at any of our events, please visit haysmacintyre.com/events

Schools team

If you need guidance on any audit and accounting, financial reporting, statutory obligations, funding, employment tax or direct tax matter you can contact any member of our Schools team as detailed below.

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We are a Living Wage Employer

Committed to Sustainability

Shortlisted 2019 National Firm of the Year

Shortlisted 2019 Tax Team of the Year

Highly Commended Partner of the Year

Winner: Audit Team of the Year

Winner of the Bronze Award for 2018 and 2017

Top adviser to the top 5,000 charities, Charity Financials' league table 2021

Top ten by audit fees in the 2020 Charity Finance Audit Survey