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editorial



Welcome to the Autumn 2009 edition of schools' briefing.

The newspapers over the summer holidays have been awash – as I found Cornwall – with letters and reports on the charity status of independent schools; this following the publication of

the results of the Commission's public benefit assessments of five schools. We include a summary of the results and consideration of what schools should now do.

We also continue the theme commenced in our last newsletter concerning how schools should combat the effects of the recession. Commentators expect the first significant effects on pupil rolls and fee payments to be felt by most independent schools in the next academic year. Cost control was one of the principal topics at our recent seminars and we are grateful to the three bursars who shared with us their approach to tackling it. We include a paper on the key areas to consider in the financial management of schools in such challenging times.

There has already been an increase in the number of school closures, though perhaps not by as much as has been hyped in the press. We expect more and so we are delighted to include an article from Veale Wasbrough on the subject of mergers.

We at haysmacintyre have much experience in carrying out the necessary due diligence assignments on schools facing structural change. We enjoy the challenge of examining not just a school's financial issues, but also the wider issues of the overall business, with the aim of giving governors comfort through the quality of our work.

We include a summary of the benefit of having a written code of conduct for governors, a trend which is growing in the voluntary sector. We also include three articles exploring issues affecting employment taxes, the gift aiding of trading profits and VAT.

I hope you find this edition interesting and trust that you will contact us if you have any issues that you wish to discuss.

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public benefit - the latest news



Further to our previous updates, the Charity Commission has now published the results of its pilot assessments, which included five independent schools. The findings have sparked intense criticism of the Commission and calls that they

are clearly out of touch.

the results

Details of those selected and the Commission's findings are given below:

- Manchester Grammar School Pass
- Pangbourne College Pass with good practice recommendations
- Manor House School Pass with good practice recommendations
- Highfield Priory School Fail
- S. Anselm's School Fail

Not only did two of the schools fail the public benefit test, the Commission also highlighted that whilst Pangbourne and Manor House were operating for the public benefit, the following additional steps should be taken to ensure they comply with good practice:

- publicising more clearly details of means-tested awards
- increasing the level of higher percentage awards
- reviewing the extent to which opportunities to benefit are taken up by people who are unable to afford the fees, including those in poverty.

what this means for the sector

Despite their promise to take a proportionate approach, the Commission appears to have taken an extremely hard line, irrespective of the financial position of the school.

Guidance issued by the Commission suggested that schools should be creative in displaying public benefit; but the results of the pilot assessments indicate that the focus is on means-tested bursaries. It appears that without a material level of means-tested bursaries being made available, which include 100% bursaries, schools will not pass the public benefit test.

Unhelpfully the Commission has not provided a benchmark of what is deemed enough, however based on the pilot assessments informed commentators are inferring that means-tested bursaries of 5% of fee income is the level needed.

In many cases current parents would suffer higher fees in order to fund bursaries; which does not seem fair.

what now?

Detailed below are the actions that the Charity Commission now consider to be best practice:

- set up a **bursary scheme**:
 - have a means-tested scheme which sets an income level below which full funding can be offered, and a sliding scale above this where part-funding is provided
 - set budgets and targets for the number or amounts of fee assistance to be offered
 - offer a significant level of bursaries, although take-up can be less
 - publicise/advertise your bursary scheme ensuring that it will reach those who might not be able to afford the fees and that it clearly indicates the opportunities to benefit
 - have dedicated funds for fee assistance
 - continue with **other public benefit activities**.

However, it should be noted that certain umbrella bodies are advising schools to not make any costly changes to their activities for the moment.

the future

This is not the end of the story. We will only learn whether any of the Commission's guidance, or indeed the removal of the presumption of public benefit, will stand up when a case goes to the Charity Tribunal (or even, on a point of law, to the High Court). Only then will we have a definitive yardstick against which schools can measure themselves and perhaps put an end to some of the unfortunate publicity and uncertainty affecting the sector.

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Companies Act 2006 – matters of pertinence to schools



The following matters are in force for accounting periods commencing on or after 6 April 2008 and are therefore relevant for your last financial year.

filing deadline for accounts

The period for a school which is also a company to file its accounts with Companies House is reduced from ten months to nine.

late filing penalties

New penalties apply for accounts filed after 1 February 2009 irrespective of the year-end date of those accounts. For schools that are charitable companies the applicable rates will be:

Length of late period:	Fine:
Less than 1 month	£150
1-3 months	£375
3-6 months	£750
More than 6 months	£1,500

The above penalties are doubled if the accounts were late in the previous year.

The deadlines for filing with the Charity Commission do not in fact change so the legal deadline will remain at ten months and, therefore, differ from the Companies House deadline. In practice, the Commission has for some time encouraged schools to file their accounts as early as possible, though it has no legal power to enforce this.

audit thresholds

The threshold over which an audit of a company's accounts is required by company law increases to where any two of the following apply: income exceeding £6.5 million; balance sheet total exceeding £3.26 million; and aggregate average number of employees of 50 or more. However, lower thresholds apply for companies which are also charities due to charity legislation, but the accounts will still need to be prepared in accordance with company legislation.

Company legislation now requires auditor's reports to be signed by the "senior statutory auditor". This means that your next audit report will be signed by your audit partner in his or her own name. This has no effect on the work performed or the respective responsibilities of the auditor and the charitable company audited.

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code of conduct for governors



Many school governors will have experience of similar roles from their working lives or as trustees of other charities, and may therefore wonder whether there is a need for their Board of Governors to have a formal code

of conduct. With the new public benefit reporting regime having come into effect for schools' 2009 financial years, governors may feel that this is an opportune time for introducing a code as a means of ensuring that their boards are fully focused on these new requirements.

Establishing a code of conduct can also have benefits for governors who are new to trusteeship by clarifying the responsibilities and expected behaviour of the trustees individually and as a board, and setting out the relationships between the board and the management of the charity.

More experienced trustees, who are familiar with their own individual and collective responsibilities, may still benefit from a formalisation of policies such as those relating to management of conflicts and dispute resolution. Setting out such policies before they become necessary will assist the smooth running of the board by ensuring that they are formulated in a fair and equitable manner, rather than in the heat of the moment.

Accordingly, your code of conduct should reflect the size and complexity of the charity which your board governs. A small organisation, with a small board of governors, might only need a relatively simple code, whereas a larger and more diverse board might need a more extensive code.

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managing in challenging times



In the last year we have seen the collapse of the banking sector, dramatic declines in the property market and unemployment at its highest level since 1995. The question is whether this will be a short lived recession with a swift

recovery or long and protracted with a slower recovery. Unfortunately, irrespective of the length of the recession, independent schools are likely to suffer for longer, recover later and feel the repercussions for many years to come.

The sector generally experiences a delayed reaction to economic downturns and the concern is that more marked effects will be experienced from September 2010.

Key areas to consider when managing your school in these difficult times include:

monitoring

The availability and monitoring of up to date, accurate information is crucial. The cash position, debts, results and pupil numbers (both current and prospective by year group) should be reviewed regularly and forecasts updated to reflect the revised position.

Consideration should be given to key performance indicators and benchmarking these against trends and similar schools.

planning

Preparation of reliable forecasts looking 3 to 5 years ahead is essential. These should be updated for changes and actual figures during the year so the expected outturn is known.

Actual results should be regularly compared to budget to identify significant variances so these can be investigated, action taken and forecasts adjusted where appropriate.

sensitivity analysis

Performing sensitivity analysis on forecasts illustrates the impact of reduced pupil numbers on results and cash levels. Longer term forecasting illustrates the impact of lower intake sizes over a sustained period. Contingency planning for the 'worst case' enables the school to consider the required action and long term viability.

half a child better than none?

Where parents experience financial difficulties and are unable to pay full fees the school should consider whether they can fill the place now or in the future. In some cases, it may be better to support a parent and receive a contribution towards fixed costs with the aim that in the long term the parent will return to paying full fees.

non-charity trading



Although charities enjoy exemption from tax on many sources of income, it is not uncommon for the pursuit of income to lead them to carrying out activities that generate non-exempt income. A detailed discussion of the types of income

that would not be exempt is beyond the scope of this article, but this would typically include trading other than in the direct furtherance of a primary purpose (e.g. the supply of business conference facilities by a body concerned with the education of children). Further information is available in our other fact sheets.

Where such activities are carried out directly by a school, there is a risk that a tax liability can arise regardless of its charitable status. Because a company's gift aided donations to charity are deductible from their taxable profits, it is common practice in such cases to

route the potentially taxable activities through a subsidiary company, which would then donate its profits to the school.

A word of caution – although this is acceptable tax planning in the eyes of the HMRC, the minutiae need to be observed. HMRC take exception when charities fail to maintain a level of separation to the perceived detriment of the school and schools should be wary of paying their subsidiary's debts or otherwise funding them without taking advice. Care also needs to be taken to ensure that the required gift aid donations are physically paid within nine months less one day following the end of the year (i.e. by 30 May 2010 for a 31 August 2009 year end). Failure to do so can result in the profits becoming fully taxable and HMRC is not inclined towards leniency even for small and third party errors (e.g. by the bank) when they come to light.

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costs

Costs should be reviewed in detail and areas for savings identified and made where necessary. Where pupil numbers have dropped significantly and replacement is deemed unlikely, it is essential that action is taken quickly to reduce costs.

improving cash flow

Consideration should be given to implementing measures to improve cash flow, such as:

- Improving debt collection, for example, prompt chasing of overdue debts, enabling payment by monthly direct debit, charging interest on overdue fees and offering early payment discounts
- Changing due dates for fees
- Increasing deposit levels
- Encouraging payment of fees in advance
- Delaying payments to suppliers
- Delaying non-essential repairs and capital spending
- Leasing assets
- Entering sale and leaseback agreements

loans

Schools must be aware of their loan covenants and ensure the position is monitored to ensure they are not breached. Where a school is unable to keep up loan repayments they should communicate with their bank and negotiate a revised repayment plan.

Schools should consider retaining loans where possible to reduce pressure on cash and provide flexibility should they experience a downturn in results.

competition

Despite pressure on spending schools need to remain competitive. Many have made the decision to apply conservative fee increases for the coming academic year, but some may be unable to maintain this.

collaborations

For some schools it may not be possible to survive the recession in their current form. In such cases, once the school has explored all possible avenues, it is essential action is taken promptly to either close or merge. Governors have a duty to protect the assets of their school and must act prudently in administering its financial affairs.

conclusion

The next few years will inevitably be tough for many schools. However, we should remember that the sector has experienced tough times before and come out stronger. If management are vigilant in monitoring activities and are willing to act decisively, then there is every reason for schools to do so again.

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VAT update



Education supplied by a school is exempt from VAT, and since making exempt supplies does not in itself confer any right to reclaim VAT on costs, or indeed the right to register for VAT, many schools are not VAT registered.

Schools often make some supplies which are taxable such as the sale of school uniforms, tuck, sports equipment, etc. The value of such sales is usually small and may not require a school (or its trading subsidiary) to be registered for VAT; but the school may decide to register on a voluntary basis (or as part of a VAT group with its trading subsidiary) so as to recover some VAT on costs.

An organisation making both taxable and exempt supplies is partly exempt, and must adopt a partial exemption calculation to determine how much VAT it can reclaim. Typically a school would only enjoy a recovery rate of circa 1% and the amount of effort involved in calculating this may not make it worthwhile.

Some relief may now be at hand because for VAT return periods commencing on or after 1 April 2009 instead of carrying out a partial exemption calculation each quarter, the school can simply apply the apportionment percentage calculated in the previous year's annual adjustment. In other words it need only carry out one annual calculation instead of four quarterly calculations, followed by an annual adjustment.

In addition to this, under the old rules the annual adjustment had to be declared in the first quarter of the following year, i.e. Quarter 5. For VAT years ending on or after 30 April 2009, the annual adjustment can now be shown on the final return of the relevant VAT year, i.e. it brings it forward one quarter.

Whilst these changes are modest, they are likely to simplify partial exemption for organisations, such as schools, where the amount of recoverable VAT is small, compared to the compliance costs involved.

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employment tax on staff expenses



The current economic climate is taxing most of us and the last thing you'll want is an unexpected PAYE and National Insurance Contribution (NIC) liability arising from a failure in compliance. For example - you provide season ticket loans to your employees but fail to monitor those which exceed £5,000 - a taxable benefit will arise where the loan or loans exceed £5,000 at any point in the tax year.

A good starting point is to ensure that you have robust policies and procedures in place and that they are effectively communicated to those who need to know. Employee expense management is a good place to begin. Your expenses policy should attempt to cover the full range of possible expenses claimed. You will not only need to decide which expenses you are prepared to reimburse, but also understand: the tax effect; what

your reporting obligations are, and determine whether they may simply be reimbursed or whether they should be processed via the payroll under deduction of PAYE and NIC. I shall take as an example, reimbursement of telephone expenses. Sounds simple?

Home telephone expenses may include the cost of telephone calls and line rental. Reimbursement of business calls incurred on a private home phone may be made to an employee on production of an itemised bill. The reimbursement is however reportable on the employee's P11D unless it is covered in a P11D reporting dispensation. If, instead, you reimburse a round sum of say £10 per month (as this is roughly what the employee incurs every month) it counts as earnings and you are required to pay this via payroll under deduction of PAYE tax and NIC. If you reimburse any amount of the home phone rental, then again it counts as earnings and must be processed via the payroll under deduction of PAYE tax and NIC.

guest article – planning to merge



planning to merge

Even in a hardening market, businesses that are efficient, well-run and flexible tend to prosper. Of those it tends to be businesses that monitor their own market position and performance and react quickly and decisively to threats and opportunities, that are really successful. Businesses that are complacent and do not continually challenge the accepted way of doing things often find that they lose their competitive advantage.

Independent schools are no different and we have seen a number of schools close over the past few years whilst others have gone from strength to strength.

business strategy

In the current economic environment all schools should monitor the key aspects of their business. By doing so they will be able to spot fundamental trends and issues and react accordingly.

Those aspects will cover certain key performance indicators as well as more fundamental issues, such as the school's market position and the performance of its competitors, and are likely to fall within ten broad categories:

- pupil numbers
- fees
- staff
- facilities
- funding
- demographics
- competition
- PR
- strategic
- governance

Where an employer reimburses any mobile phone costs and the contract for the phone is in the name of the employee, it is important to ensure that the employee can produce an itemised call charge statement showing that an additional expense has been incurred. The reimbursement is reportable on the employee's P11D unless it is covered in a P11D reporting dispensation. Reimbursements of an employee's monthly mobile phone tariff count as earnings, you must deduct and pay PAYE tax and Class 1 NICs using your usual payroll procedures. For example, an employee pays £50 per month for a mobile phone and receives 500 minutes of calls, it is only those calls which exceed the first 500 and for which a separate charge is made which can be reimbursed as expenses; again a P11D report is required for them.

To further complicate matters, if you pay the mobile or land line phone company direct for an amount which counts as earnings (home phone rental or monthly mobile phone tariff), rather than by reimbursement to the employee, you must account for Class 1 NIC on the amount paid at the time of payment and then report it is also on the employee's P11D at the year end.

The point of the above example is to demonstrate that minor differences can completely alter the landscape and it is crucial that you consider very carefully what you are doing.

Not so simple...

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All schools should also undertake some level of strategic review and planning in order to ensure that their business model is fully sustainable, both in the short and long term. One strategy may be to open merger talks with another school.

merger discussions

Mergers between schools have taken place regularly over the years. Although some of these have occurred when one school has been faced with deteriorating pupil numbers and possible closure, most have been undertaken for positive strategic reasons. When this has occurred, one school will have recognised the need to consolidate its position by merging with a suitable merger partner.

Many mergers are "horizontal" (ie. between schools of the same type) but there has also been a trend, particularly in recent years, for "vertical mergers"/"bolt-ons" and a growth in the number of small schools groups.

The former where, say, a prep school acquires a pre-prep/nursery or a senior school acquires a feeder prep school, can make sound strategic and commercial sense.

The latter trend for consolidation has meant that the resulting school groups (in both the charitable and commercial sectors) can

benefit from the advantages of economies of scale, shared best practice, access to shared resources and the financial protection that a larger group structure affords. In some cases we have seen that a group's "critical mass" means that it is able to provide facilities that an individual school could not offer alone. In addition charitable groups of schools may find it easier to comply with the new public benefit requirement.

conclusion

When advising schools we always urge them to plan ahead. From our experience it is clear that merger discussions which have been well planned and follow a measured timetable tend to be the most successful. In addition there are clear advantages to completing a merger transaction in time for the start of a new academic year and announcing a merger during the Spring Term, allowing adequate notice to be given to staff and parents.

In any event every school should, like every successful business, think strategically, be pro-active and take decisions quickly.

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future events

2009/2010 training courses for trustees:

- trustee refresher session 27 October 2009
- understanding charity accounts 17 November 2009
- what every new trustee should know 24 November 2009
- managing cash and investments 12 January 2010
- charity law update 19 January 2010
- good governance 26 January 2010
- charities and their property 10 February 2010
- charities and their people 23 February 2010

annual conference for independent schools:

03 February 2010

ISBA conference:

12 & 13 May 2010

For further information on these events please contact Juan Mugerman on 020 7969 5668, juanmugerman@haysmacintyre.com or visit www.haysmacintyre.com



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