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2024

Higher Education developments report

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Foreword

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Global unrest, political uncertainty and rocketing costs, culminating in an official period of recession for the UK has created another difficult year. The post-Covid period has not been the time of recovery that was hoped for.

Consequently, the higher education sector continues to face unprecedented challenges: financial sustainability remains a key theme, particularly in relation to international students and the ongoing tuition fee cap; new regulatory requirements are taking more time to prepare, and scrutiny of the sector is increasingly high.

Our 2024 Higher Education (HE) development report considers sector risks, financial reporting and audit changes, as well as the broader education environment.

Whilst income levels remain relatively stable, the reduction in international students for some institutions is forcing diversification. This, alongside rising costs and tuition fees that do not cover all of the higher education institutions (HEIs) expenditure means that more universities are starting to eat into their reserves and see deficits for the first time in years. Financial sustainability is a hot topic for HEIs and assessment on going concern and reverse stress tests is an area of much focus.

Financial reporting is a changing area too: FRS 102 will bring new challenges to the sector particularly around leases and revenue, and possible changes to ISA 250 may mean that universities have to reassess their legal environment in response to audit requirements.

Environmental reporting is another area of particular prominence in the HE sector, despite the lack of clarity on what is expected of universities. Sustainable campuses, green investments and environmental assurance are all emerging areas of significance in the sector.

The full impact of the changing legal and political landscape is hard to predict, and potential changes arising from the upcoming General Election may or may not be impactful on the sector. With a possible change in government, there may be further legislative changes to grapple with, but at present these remain unknown.

We hope you find this publication informative and if there are any matters that you would like to discuss further, please do not hesitate to get in touch with your Grant Thornton contacts.

Financial stability of the sector

In May 2024, the Office for Students (OfS) published their research on the financial stability of HEIs, using data from the latest annual financial returns. Overall, the data shows that financial performance is weaker than it has been in previous years, with net cash flow falling from £4,795 million in 2021/2, to £2,907 million in 2022/3 – a reduction of 39%. 93 HEIs reported a deficit in 2022/3 and this is expected to rise to 108 in 2023/4.

University and college forecasts show increases of between 4.4% and 15.7% of new non-EU students, however the OfS challenge this figure and suggest this is an unrealistic ambition. Home Office and UCAS data show decreases in undergraduate applications and reduction in the number of higher education study visas. Whilst individual institutions may be able to boost their international student numbers through targeted recruitment, the majority of the sector is not expected to attract high numbers. The OfS notes there are signs of overreliance on international students from some institutions and encourages contingency plans are put in place place should numbers continue to fall.

Good financial planning is essential. Strong governance allows appropriate and robust challenges to be made of financial decisions and ensures and effective risk management processes. Institutions should ensure that they have good relationships with external parties, including auditors and bankers, and boards should have oversight of key changes to regulation in those areas.

The OfS have commented on their role in supporting universities to improve their financial sustainability. Early contact with the OfS means that HEIs can be supported to continue to comply with their obligations and conditions of registration and access to data means that publications and intelligence can be shared across the sector.

In the following pages we explore the barriers to achieving financial sustainability, how diversification can create opportunities for new sources of income, and what the future looks like for the sector.

Securing success
The importance of financial stability in Higher Education

Universities in UK are facing a unique set of challenges that threaten their financial stability.

Tuition fee income growth is becoming increasingly difficult. The fee cap for home students has only increased minimally since 2012 and has remained frozen since 2018. They are likely to remain at this level for the foreseeable future. Conservative higher education minister Robert Halfon stated unequivocally that the current government would refuse an increase during a cost-of-living crisis[1]. The July General Election may give rise to a possible change of Government to the Labour party, they are just as unlikely to increase the cap given that they were previously committed to abolishing the tuition fee altogether; a commitment that was dropped in May 2023[2].

Growth of income from international student recruitment is slowing too, through a mix of internal and external factors. Key demographics such as China and India, who made up 27% and 23% of overseas students in 2021/22[3] respectively, are struggling with high levels of graduate youth unemployment[4,5] leading to lower demand from these regions. Nigerian students, who accounted for 8% of overseas students in 2020/21[6], are facing the worst economic crisis in a generation[7] that has led to plummeting value of its currency, the Naira. Internally, immigration reforms effective from 1 January 2024 have tightened the rules around which students are eligible to bring dependents, making the UK a less attractive option to prospective students with spouses/families.

Although CPI has decreased to 3.8% for March 2024[8], the higher levels of inflation throughout 2023 have led to industrial action from academics and administrative staff resulting in higher than planned pay rises in the sector. These wage bills have put pressure on university budgets that were already strained under the increased cost of energy due disrupted supply caused by global conflicts. Those providers with significant ongoing estate plans have also been hit with increasing cost of construction materials as well as labour costs.

In this shifting economic landscape, UK higher education institutions must carefully navigate financial planning solutions that lead to fiscal resilience, without compromising on their individual core values. We have collated a variety of strategies taken by providers to bolster future financial sustainability.

Reduction of departmental and administrative budgets

Often the approach to financial forecasting of departmental or general administrative budgets is performed by taking the historical expenditure in the prior periods and increasing by assumed CPI%. Some providers may then analyse costs and identify areas where cost savings may be available, reducing budgets accordingly. Whilst this may identify some inefficiencies, a different approach is being taken by some institutions to build these budgets from the ground up on an annual basis. This then ensures only expenditure that is strictly necessary is included in departmental budgets via careful cost benefit analysis. This is most impactful where HEIs are clear on what their core values and key priorities include, as they can focus on maximising the outcomes of these in their spending. Consultation with all stakeholders is crucial to minimise disruption and to ensure participants understand the need for change as well as any barriers that management may have overlooked.

Green initiatives to financial gains

The UK is committed to reaching net zero on carbon emissions by 2050 and higher education providers, as public bodies, play a vital role in achieving this aim. By investing in energy efficient technologies, such as LED lighting and smart automated thermostats, some institutions have reduced their energy usage, reduced their utility bills, and minimised their carbon footprint. Through careful assessment of estate plans, investments to update insulation, flooring, windows, and doors, other institutions have managed to reduce these costs further and the cost of future maintenance. Installation of green technologies, such as solar panels and investment in wind farms, have also been used by some to shift reliance away from traditional energy sources such as coal and oil whose prices are affect by global events. These technologies may even generate additional income from the sale of surplus energy to the grid. Prioritising green initiatives not only aligns with universities' commitment to environmental stewardship but presents opportunities to achieve tangible financial benefits by reducing operation expenses and enhancing resource efficiency.

1. Minister rules out lifting cap on student tuition fees in England
2. Labour set to ditch pledge for free university tuition, Starmer says
3. Higher Education Student Statistics: UK, 2021/22 - Where students come from and go to study | HESA
4. Young Indians More Likely to Be Jobless If They're Educated
5. China youth unemployment hits high as recovery falters
6. Why Nigeria's economy is in such a mess
7. Inflation and price indices
8. UK HE shrinking

Efficient estate management and impact driven development

Through proactive asset management, encompassing buildings, infrastructure, and land, some universities have managed to achieve substantial cost savings and long-term financial advantages. This has been most impactful in those institutions where management have a clear understanding of operational objectives and how estate plans are required to achieve these. To assist management in its decisions, successful institutions have leveraged appropriate IT applications to ensure logical categorisation of assets allowing for ease of data analysis. Furthermore, many HEIs are reassessing planned acquisitions or construction works, challenging those projects that do not closely with educational goals and avoiding unnecessary and expensive vanity projects.

Due to recent disruptive events such as Covid-19 and inflationary pressures, many providers paused their estate plans to decrease cash outflows on a short-term basis. However, there are risks to this strategy as delays to routine maintenance and preventative upkeep could result in larger more costly renovations in the future. To mitigate this risk, some providers are performing more regular condition assessments to assist them in allocating appropriate resources via a measured approach that maximises investment value and minimises unforeseen repair expenses.

Additionally, many providers have made the decision to divest underused assets and surplus land to generate immediate cash inflows to invest in more suitable assets or improve the conditions of existing high demand buildings, reducing the financial and time burden of maintaining these assets.

Diversifying teaching provision

Universities are exploring options to diversify their teaching offering by expanding beyond traditional degree programmes to increase income. This is being done by supplementing existing courses with a range of alternative qualifications or by introducing flexibility to existing learning options. In recent years, many institutions have started to offer short courses, workshops, professional certifications, online lessons, or micro-seminars by leveraging their expertise and intellectual capital to tap into new markets. Masterclasses or short courses based upon recorded materials can be particularly impactful as initial costs to produce this type of content is low and once created, the content can be sold to a vast array of online consumers repeatedly with few ongoing costs (except those relating to hosting of digital files).

Some HEIs have developed partnerships with industry stakeholders, corporate clients, and government agencies to create customised training programs, workforce development initiatives and sponsored research projects. These activities generate income as well as benefit the wider society. Recruitment for public services including nurses, doctors, police, firefighters, and teachers has been challenging and institutions have taken these opportunities to support the training of these groups and negotiate grant funding from relevant bodies to supplement their delivery of such relevant courses.

Other approaches observed include using franchise partners, either within the UK or overseas, or opening international colleges/campuses to deliver courses on behalf of the institution. This alleviates some of the financial risk to the provider but also brings new challenges, such as ensuring that the partner or college delivers education at the same high standard that is expected from the institution itself or risk reputational damage.

Streamlining course offerings

Offering a wider range on subjects may seem like a solution to improving the attractiveness of an institution as it makes the provider more accessible to a larger demographic. However, some providers are finding it more beneficial to focus on its key departments and consolidate or eliminate underperforming or redundant faculties. Streamlining academic offerings allows these institutions to focus on high-demand programmes with greater enrolment and benefit from economies of scale. Primarily enacted as a cost saving measure, many institutions hope that an added benefit will also be seen in overall student satisfaction responses leading to improved performance in rankings.

Discerning approach to research grants

The UK is a global leader for academic research within its universities. It is a major draw for attracting international students for postgraduate qualifications through teaching and participation in research, and this is a source of pride for many providers in the sector. The UK government provides a supportive regulatory environment for this activity and continued funding from both public bodies and the private sector sources offers a large marketplace for institutions to compete in.

Although a critical source of income for some providers, many institutions are exercising additional caution in this income stream to ensure that the contracts entered are appropriate for both the university's academic and financial aims. More rigorous assessments are being applied to ensure that the institutions have sufficient resources to achieve the objectives as well as appropriate systems to monitor expenditure against grants in a robust manner. Any extra costs above the level of grant funding agreed may become the burden of the provider directly reducing surpluses or losses further. If performance obligations are not met, payment may be disputed with the potential of leading to costly and time-consuming legal action. Where research assignments relate to private enterprises, institutions are exercising more caution to consider the credit worthiness of these partners alongside the usual concerns for reputational association.

Use of financial instruments to mitigate foreign exchange or interest rate risk

Financial instruments can offer universities various benefits when used prudently as part of their financial management. Some HEIs are using derivatives such as futures, options, and swaps in their strategies to mitigate financial risks associated with interest rates or exchange rates. By hedging against adverse market movements these institutions can protect their budgetary portfolios from volatility. This may be more applicable for providers that have a higher proportion of their operations overseas, or those that have

debt where interest payments are linked to external benchmarks. Caution should be exercised in the procurement of instruments but when employed appropriately, they can bring stability by removing volatility in assumptions in forecasts from external sources.

Improved management information systems

Often an area that is overlooked when institutions are searching for efficiencies is the improvement of management information systems. In the short-term, this may mean capital investment into IT systems and more management and administrative time devoted to analysis of this data. However, once implemented, some institutions have found it beneficial to have more technological advanced internal reporting systems that allow for up-to-date financial. Many providers, that are accustomed to internal reporting half yearly or quarterly, are now being required to analyse actual performance against budget more frequently, monthly for instance, so there is less time between events occurring and management's response to implementing possible mitigations required. Where this is being done, institutions are better able to respond in an agile manner to risks arising and are more able to make timely informed decisions. With quality management data, those charged with governance are better able to assess the efficacy of their other cost saving measures allowing them to prioritise the more impactful solutions.

Other benefits include greater oversight to ensure better compliance and governance overall as well as more frequent and accurate reporting to all stakeholders fostering confidence and trust in management.

Redundancy programmes

Under current economic circumstances, some providers have found alternative cost saving strategies insufficient and have made the difficult decision to pursue redundancy programmes. The purpose is to streamline their workforce by eliminating duplicate roles or positions that are no longer aligned with institutional priorities.

For some HEIs, this is reducing staffing levels by consolidating departments, administrative functions or by closing those departments that are no longer in demand. Many are offering voluntary severance schemes or other early retirement incentives, to try to incentivize employees to depart voluntarily reducing the likelihood of negative media attention and potential legal action against the institution.

While redundancy programmes can yield significant cost savings, it is not a course of actions institutions are taking lightly. The majority are holding consultation with stakeholders, including faculty, unions, and governing bodies to ensure a transparent and fair process and minimise disruption. The University and College Union have collated live voluntary and compulsory redundancy plans here.

Balancing immigration policy and its impact on student numbers

The United Kingdom has long been a hub for international students seeking quality education from its prestigious Universities in a diverse and culturally rich environment. In 2019 the Department for Education (DfE) and the Department for International Trade (DIT) launched the International Education Strategy to increase the total number of international students choosing to study in the UK higher education system each year to 600,000 by 2030. The numbers of these students have subsequently sharply increased and as higher education providers are not restricted to the level of fees charged to these students, they have been beneficial in helping institutions maintain surpluses in the challenging environment driven by global inflationary pressures and the stagnant undergraduate fee cap. However, a recent change to immigration policy for international students has caused a wave of uncertainty for UK Universities.

To study and live in the UK, prospective students must apply for a sponsored student visa and the main applicant is required to obtain a 'Confirmation of Acceptance for Studies' (CAS) from their higher education provider. From 2011-2016 the number of this type of visa granted was around 200,000 per annum, with a further 10,000 dependent visas granted per annum. From 2017 onwards, excluding a dip during Covid-19, these figures have grown sharply with the number of student visas granted at an all-time high of 484,000 in 2022[9] alongside 140,000 dependent visas[10]. During this period, the increase in student visas is attributable to nationals of Indian and Nigerian origin. These two same nationalities accounted for 65% of dependent visas issued during 2023, significantly higher than the 29% issued in 2019[11]. According to the Migration Advisory Committee's 2023 Annual Report[12], there is evidence to suggest that 74% of these international students were studying at a postgraduate level. Due to public scrutiny over steep increases in net immigration, the government announced in May 2023 that it would review which type of students it would allow to bring dependents in an attempt to reduce overall migration into the country.

To qualify to apply for dependent visas, a student must meet the following criteria[13]:

- A government-sponsored student starting a course that lasts longer than 6 months
- A full-time student on a postgraduate level course (RQF level 7 or above) that lasts 9 months or longer

9 Where do HE students come from? | HESA
10 Student Migration to the UK - Migration Observatory - The Migration Observatory (ox.ac.uk)
11 Why do people come to the UK? To study - GOV.UK (www.gov.uk)
12 MAC Annual Report (publishing.service.gov.uk)
13 Student visa : Your partner and children - GOV.UK (www.gov.uk)

From 1st January 2024, the post graduate course must also either be:

- A PHD or other doctorate (RQF level 8); or
- A research-based higher degree

This effectively prohibits all postgraduate students on taught Masters programmes from bringing their spouse or children born outside of the UK with them whilst studying in the UK.

Furthermore, there have been reforms around the point at which those living in the UK on student visas can switch to a skilled work visa. These were announced and made effective on 17 July 2023[14]. There are some exceptions for those students working towards a PhD who can switch once they have completed 24 months of study. Although data suggests that there are few students that currently switch early, the change is still another factor for prospective students to consider when choosing where to complete postgraduate programmes. Another recent amendment, increasing the NHS surcharge paid by students from £470 to £776[15] per year (increase of 65%), add to these considerations.

The full effect of these changes will not be easy to measure. Early analysis performed by Enroly[16], used by around 60 UK Universities to handle student visa applications, suggests that for the January 2024 intake deposits were 35% lower than the same time last year, UCAS/Visa applications were down 33%. This was most notable amongst Nigerian nationals down by 70% and Indian nationals down by 36%. However, it is unclear whether these figures are driven directly by this policy change or by other factors such as the falling value of the Nigerian currency, the Naira[17], the rising rate of graduate unemployment in India[18] or the improving quality of competing Universities globally. Should this initial analysis be indicative of future trends, many higher education institutions will struggle to meet their international recruitment targets leading to a reduction in their tuition fee income at a time where most are also navigating the challenges of continued inflationary cost pressures.

Another policy under scrutiny during 2024 was the Graduate Route. This provides international students, who have been awarded a degree in the UK, a two-year period to either stay in the UK to work or look for work. The Migration Advisory Committee were commissioned to review this route in March 2024[19] and report on how it was being used, by whom and its impact on international student recruitment and its overall effect on the UK economy. The report was issued in May 2024[20] and its main conclusions were that the route was predominantly being used for its intended purpose, that it contributed positively to the UK economy, and that it should continue in its current form. These findings have been well received by HEIs but at the time of writing, no formal response from the Cabinet Office has been provided.

The UK government insist that these reforms are to curtail those using student visas as a 'backdoor' to enter the country, and that it is still committed to the target it set in its International Education Strategy to attract 600,000 international students to study in UK universities per annum. With a general election called to take place on 4 July 2024, net immigration remains a key issue for many voters. Whichever party emerges as victor will need to carefully navigate demonstrating a commitment to reducing net immigration whilst also safeguarding the UK's position as a welcoming global education leader. Failure to do so risks adding further burden to the already financially strained higher education sector, and risks relegating UK universities to the periphery of the international education landscape.

14 Statement of changes to the immigration rules: HC 1496, 17 July 2023
15 Pay for UK healthcare as part of your immigration application
16 CAS and deposits down by a third year-on-year for January intake
17 Naira weakens as dollar liquidity fades in Nigerian forex market
18 https://webapps.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---sro-new_delhi/documents/publication/wcms_921154.pdf
19 MAC commissioned to review the Graduate route
20 Rapid Review of the Graduate Route

Exploring going concern and reverse stress tests

Universities are tacking a difficult landscape with fixed tuition fees for UK students, competition for international students and strict evaluation of budgets where difficult decisions around courses and redundancies have had to be made. As Universities work to navigate these challenges, while operating in the best interests of their students, they must consider how such economic factors and sector risks will impact their viability as management and Council members or Governors prepare their going concern assessments for their annual financial statements.

Universities are required to prepare their assessment as to whether they have the ability to adopt the going concern basis of accounting and will continue their operations for the foreseeable future. As part of this process, those charged with governance, including the university's Council or Board of Governors, must prepare an assessment for a period of at least twelve months from the signing date of their financial statements. Twelve months from the signing date of the financial statements is the minimum review period, and if a key event is due to happen shortly after this period (for example, a loan or revolving credit facility coming for renewal, or a covenant reporting date), management must extend their going concern assessment period to include this key event.

Management should begin by outlining the following considerations within their assessment:

- The process followed to make their assessment;
- The assumptions on which the assessment is based; and
- Management's plans for future actions.

In order to support their going concern assessment and the assumptions used within their going concern assessment, the Council members or Governors and management should also include:

- A budget and detailed monthly cash flow forecast. This budget and forecast should consider the following:
  - Availability of funding (i.e. monthly management accounts, latest bank balances, any facility and funding agreements)
  - The economic environment (i.e. trends with student recruitment within the UK and internationally, tuition fee freezes)
  - Future plans and key events (i.e. planned maintenance and capital spend on estate infrastructure, redundancies, recruitment freezes or planned changes in course offerings and the subsequent impact on the student experience and student numbers)
  - Indications of withdrawal of financial support from lenders
  - Inability to pay creditors on due dates, which would require forecast to have an element of payment stretch
- A reverse stress test

Management are generally familiar with the budget, monthly cash flow forecast requirements and risk factors stated above that could affect their going concern assessment. However, the area generally requiring further consideration is the reverse stress test.

The reverse stress test is an important exercise for universities to undertake as part of their going concern assessment. The reverse stress test considers when management's cash flow forecast or going concern model used in their forecast will "break", which means when the university will run out of cash or experience other types of cash flow issues, when their operations will no longer become viable or when any loan covenants are breached. A reverse stress test needs to be considered for each element, however, it is likely that one element may be more sensitive than another, which could still give rise to a material uncertainty. The reverse stress test begins with the base case model, and applies one or more scenarios into the cash flow forecast or model, until the point is reached where the model breaks. The reverse stress test requires universities to consider what it would take for their university to fail, what event would lead to this outcome and what mitigations could take place to ensure such a scenario does not occur. As a reminder, management should tailor these scenarios to consider the specific risks associated with the university.

Universities cannot function without the students who attend. Therefore, the most significant consideration for universities when preparing their reverse stress test are the number of students. Key questions that management, Council and/or the Board of Governors need to ask themselves are:

- How many students does it take for the model to break?
- What is the proportion of UK and international students? What shift of this proportion of students cause the model to break?
- Have considerations been made for the impact of staff redundancies and retention, pausing capital projects and other methods of saving cash within the projected student numbers?

After management has prepared their reverse stress test, they must engage in a second step, which is considering the plausibility of their reverse stress test scenario occurring. This means considering the likelihood of the scenario occurring that breaks the model. This could be identifying whether the scenario is supported by historical experience, and the extent that such a scenario is supported by current macroeconomic conditions and forecasts. Again, as student numbers are a prominent judgement within the going concern assessments, important questions that management, Council and/or the Board of Governors need to ask themselves is: Do past trends in student numbers reflect that a reduction in students to break the model in the reverse stress test is plausible? Do forecasts or emerging trends identify that this reduction in students is a plausible scenario?

Given the sector risks facing higher education at the moment, as described elsewhere in this report, we would expect that management is able to identify a scenario which breaks the model. Whether or not this break is a plausible scenario is something that management must determine. Management must go through the process of demonstrating that such a scenario does not exist, considering the questions stated above, and clearly document their thought process when drawing their conclusion. After considering the plausibility of the tailored scenarios within their reverse stress test, management must consider the mitigating factors that could be applied.

If there are mitigating factors available, and applying these mitigating factors would result in the model not breaking, then management is in a position to conclude on their going concern assessment. Available mitigations which could be available to universities may include changing how scholarships are awarded, implementing a freeze on staff recruitment, deferring capital spend to a later date, using loan facilities that are available and reducing spend that is considered “non-essential”.

Preparing a reverse stress test as part of the university's going concern assessment helps ensure that Council and those charged with governance are preparing a robust going concern assessment and adhering to a strong risk management process.

In summary, the steps of the reverse stress test are as follows:

1. Apply scenarios over key inputs into base case until model “breaks”;
2. Consider the plausibility of such a scenario occurring;
3. Identify whether mitigations for such a scenario exist; and
4. Conclude on whether there is uncertainty relating to these mitigations and conclude on whether a material uncertainty exists.

Universities are facing risks from enrolment, recruitment and operational pressures in the current sector environment. By identifying how such risks could “break the model” in the reverse stress test, management and Council are able to identify the severity of the risks that they are facing and the adequacy of their mitigations. A proper going concern assessment performed by management and Council will ensure that they are better prepared for any upcoming challenges in the higher education landscape.

Beyond the Bottom Line
Navigating the Landscape of Environmental Reporting

Environmental sustainability, reducing our carbon footprint and 'doing our bit' for the planet, are key themes that we, both as individuals and organisations, are increasingly focused on. As 2050 fast approaches and with it, the net zero deadline date, the momentum for climate-friendly solutions is not slowing down. Whilst we are seeing an increase in ideas, that brings with it more regulation and scrutiny.

The HE sector is at the coal face for the race to net zero. Resources, knowledge and technology mean that HEIs are seen as world leaders in helping to reduce our carbon footprint and protect the environment.

Risk

As finance professionals, we are seeing climate, or climate impact, more and more on risk registers. The risks manifest themselves as very specific environmental issues, such as the changing climate and how it will directly affect the university, through weather events or the need for better heating/cooling systems. Climate impact risks can be wider ranging and incorporate all areas of the organisation including the estate, travel arrangements and students.

There is a problem with international students however. It is inconsistent for universities to have a green action plan and net zero targets, whilst simultaneously attracting and educating a high proportion of international students. Emissions from air travel are difficult to minimise without significantly reducing the student population. Universities with a high reliance on international student income may need to revisit their environmental policies and take more drastic measures in other areas of their estate or operations in order to counter the international emissions.

Reporting

We have produced guidance previously to help the not-for-profit sector report on their environmental targets. The most frequently seen method is Streamlined Energy and Carbon Reporting (SECR) which is mandatory for organisations which are large companies. SECR requires disclosure of:

- UK energy use and associated greenhouse gas emission (and prior year figures)
- An intensity ratio
- Energy efficiency action taken
- Details of methodology used to calculate the emissions.

For HEIs, the main and very real risks facing the sector specifically in relation to climate are:

- Costs: it is a simple fact that decarbonisation, replacement of traditional boilers with heat pumps, and construction using environmentally friendly materials (to name a few) will have a hefty price tag. The longer-term effects of the pandemic, cost increases and rising staff wages has taken a toll on available reserves and the ability to freely embark on development work. The British Universities Finance Directors Group (BUFDG), in partnership with the Association of Higher Education Directors of Estates (AUDE) and the Alliance for Sustainability Leadership in Education (EAUC) have launched a 'cost of net zero calculator' and corresponding report. Providers can use the tool to estimate their costs for the transition to net zero. Although this cannot be exact, it will give individual HEIs a good indicator of expected costs, allowing them to seek investment and financing as appropriate. The stand-out headline from the report was that "decarbonisation of the HE sector is expected to cost £37.1 billion." It's almost an unfathomable figure for a sector that doesn't have the level of reserves it did 5 or 10 years ago.

- Students: students are increasingly savvy about the environment and the "Attenborough effect" means that every year prospective students are prioritising green solutions as part of their future education choices. Anecdotally, we understand that UK students are more interested in a university's plans to mitigate the environmental crisis and choose institutions based on their green credentials.

A choice?

The vast majority of universities in the UK are not companies under the Companies Act 2006 and therefore are not required to make mandatory reports in their financial statements about emissions or progress to reduce the carbon footprint. As auditors and technical people, we would love nothing more than to point to a framework, or a piece of legislation and say to our university clients "apply this" but unfortunately there are no such rules for universities.

But we are in a world where the environment is increasingly important, on the global political stage, and the role of universities within our communities is significant. So, our challenge to you is this: just because universities 'don't have to' report on any environmental matters, does it mean that they shouldn't? Is there actually a moral, or ethical responsibility for universities to 'say something' in their annual report and actually stand up and be counted for their contributions to protect the environment?

We think 'yes,' and for the most part, universities are disclosing something, whether that be some specific project to protect ecology on campus or improve energy efficiency in accommodation. Other HEIs are following SECR methods and disclosing emissions data in some detail. Whilst reporting for the sector is not yet mandatory, we expect requirements to come in quickly and if HEIs understand the existing requirements now, they will be well positioned to adapt to new, sector-specific standards in the near future.

Climate related targets

When disclosing climate related targets, entities are expected to:

Explain what 'net zero' or 'carbon neutrality' terms mean, in the context of the entity, ensuring that disclosures about such commitments are not misleading.

Provide explanations of targets, including relevant information such as the time period, reporting boundaries, the emissions scopes covered and any metrics used to measure them.

Explain areas of significant challenges or uncertainties, such as new technology, required to meet targets.

Ensure that linkages between targets are explained if a number of targets need to be met in order to achieve an overall objective.

Provide comparative information for all metrics alongside current reporting to enable performance against the target to be assessed. If any updates are made to targets, such as restatements or updates to baselines, these should be disclosed and explained.

Link to report - [CRR Thematic review of climate-related metrics and targets (frc.org.uk)]

FRC Thematic Review of Climate related matters and targets

In July 2023 the Financial Reporting Council (FRC) released their thematic review of climate related matters and targets following consideration of disclosures of twenty UK premium and standard listed companies. Although this was not a review of HEI financial statements there are some best practice points noted below which can be taken into consideration when preparing disclosures for climate reporting.

Due to the volume of information which requires disclosure, it can be challenging to present this clearly within the annual report so that the stakeholders can easily locate the most relevant information presented. The FRC note that there are 4 points to give effective communication:

- Entity specific
- Clear, concise and understandable
- Clutter free and relevant
- Comparable

The main areas where the FRC see room for further improvement, which may be relevant to HEIs are:

- the definition and reporting of entity-specific metrics and targets, beyond headline 'net zero' statements;
- better linkage between entities climate-related metrics and targets and the risks and opportunities to which they relate; and
- the explanation of year-on-year movements in metrics and performance against targets.

Insights
A summary of the FRC's thematic reviews

Since our last update in 2022, the Financial Reporting Council (FRC) has completed a number of thematic reviews. Whilst it is important to recognise that these reviews are not specific to the HE sector, many of the findings and themes are applicable to all organisations. Here, we describe the findings from recent key reports and highlight areas for improvement in the education sector.

Reporting by the UK's largest private companies, January 2024

This thematic considers the quality of reporting by large corporate organisations, particularly narrative disclosures. Relevant points for the HE sector include:

- Group structures: good disclosures include a clear description of the group structure and the performance and risks of the individual company (which may be different to that of the group as a whole).
- Strategic report: the annual report should present a fair, balanced and comprehensive analysis of the development and performance of an entity's activities during the year, and its financial position at the year end. References to the income statement, balance sheet and cash flow should be used.
- Risks: disclosures should explain which risks are 'principal' and why. A tabular format can help organisations to present information more clearly, and more succinctly express the key risks.
- Primary statements and accounting policies: where organisations have complex and significant transactions, good disclosures clearly explain these items. The nature of 'other' items is sometimes unclear and continues to be a common finding (other income, other debtors etc.). Accounting policies should be specific and go beyond the wording from the applicable standard (FRS 102, SORP).
- Income: accounting policies and notes for income should be consistent and explain the disaggregated revenue streams.

Thematic review of climate-related metrics and targets, July 2023

Elsewhere in our HE development report we discuss the reporting requirements for HEIs in relation to environmental disclosures. The FRC thematic considers Task Force on Climate Related Financial Disclosures (TCFD), which is primarily applicable to listed entities. That being said, the report highlights some interesting progression in environmental reporting which is particularly relevant to the HE sector, as mandatory reporting is expected in the coming months. Key findings from the FRC report include:

- Many organisations have set their own net zero or other climate-related targets, but disclosures are sometimes unclear whether these targets cover all areas of the organisation, or specific operations. The metrics used to track progress against these targets are not always provided.
- The FRC encourages the use of cross-sector and industry specific metrics to allow for comparability between organisations both within the same sector and with other sectors.
- Organisations could better explain the extent to which environmental targets impact on the financial statements.

What makes a good… annual report and accounts, December 2022

This report is helpful for all organisations and includes hints and tips to make sure that the annual report and accounts are clear and useful for users of the accounts. We recommend that accounts preparers review the findings in full, but we note some key points:

- **Corporate reporting principles:** these principles are applicable for HEIs and we encourage report preparers to consider these principles in generating a good annual report. The principles use the mnemonic '**ACCOUNT**':
  - **Accurate:** information stemming from effective systems and controls and good underlying data.
  - **Connected and consistent:** referring to back end where needed and ensuring that front and back end of the accounts agree.
  - **Complete:** showing a full picture of the year including all relevant information, including the good, the bad and the ugly! Refer to material events or transactions in the year or in the future.
  - **On-time:** gives confidence to users of the financial statements as questions are raised when filing deadlines are exceeded. If the information is old, it is less useful to users. Timetables shouldn't be compressed but work within the limits given.
  - **Unbiased:** balanced. A feature of the true and fair requirement.
  - **Navigable:** report and accounts should make sense in the order of reading, ensure it flows properly. How does the report look on the website - can it be easily found?
  - **Transparent:** be clear on what risks are faced and challenges. Represent substance of transactions including judgements and any additional disclosures

- **4Cs of effective communication:** another easy-to-remember tip in the report which aides in producing a good report.
  - **Company specific:** the reports should be specific to the entity and should not include general narrative or boilerplate disclosures as these do not help the users. Explain key judgements and estimates and provide insight into decision making. Explain the business model.
  - **Clear, concise and understandable**: HEI accounts can be very long in the narrative report and some of this information could be presented more clearly or directly. Use straightforward language, focus on important and relevant information, limit repetition and define specialist terms.
  - **Clutter free and relevant:** avoid duplication include items of relevance for this year's accounts.
  - **Comparable:** KPIs and other metrics should be updated for the current year and compared to the prior year and explain changes.

- **Materiality:** this is a fundamental concept for entities preparing their accounts and annual report. Information is material if omitting it could influence the users of the accounts. This applies to both numerical and textual disclosures and does not apply only to transactions which affect the financial statements. Information in the accounts and report needs to be USEFUL: to be useful it needs to be RELEVANT. Relevant information might be predictive, confirmatory or provide information about the entity's ability to create / lose value and meet its objectives.

Thematic review: judgements and estimates update, July 2022

The FRC produced an update report on judgements and estimates in 2022. Details about significant accounting judgements and sources of estimation uncertainty provide valuable information to users of the accounts, helping them to understand assumptions made about the organisation. Key points include:

- Organisations should state explicitly if estimates have a significant risk of material adjustment to the carrying amounts of assets/liabilities within the next year.
- Sensitivity disclosures should be provided, in a meaningful way.
- Sources of estimation and judgement may change from year to year so organisations should reassess and determine if disclosures made in a prior year are still applicable.
- If organisations choose to make disclosures about lower risk estimates and judgements, these should be distinguished from those which are significant.

Upcoming changes to FRS 102 and the expected SORP impact

At the end of March 2024, the Financial Reporting Council (FRC) released details of the amendments to FRS 102, which will be effective for accounting periods starting on or after 1 January 2026. A summary of the key changes has been issued and can be found on the FRC's website[21], which includes the introduction of some key elements of International Financial Reporting Standards (IFRS).

Minor changes and clarifications

There have been a number of incremental improvements and clarifications in respect of the following areas:

- Section 1A – Small Entities
- Section 2 – Concepts and Pervasive Principles
- Section 2A – Fair Value Measurement
- Section 7 – Statement of Cash Flows
- Section 26 – Share-based Payment
- Section 29 – Income Tax
- Section 34 – Specialised Activities

The majority of these amendments are aimed at further laying the groundwork for additional alignment of UK financial reporting standards to IFRS, providing guidance and allowing for further consistency with international reporting. There is minimal anticipated impact on Higher Education Institutions (HEIs) from these improvements and clarifications.

Significant changes – revenue recognition

There are two key areas that will be changing as a result of the amendments in respect of revenue recognition and leases. The revised standard will amend Section 23: Revenue from Contracts with Customers to bring in the five step model from IFRS 15 for all contracts with customers. This new model will focus on identifying distinct goods and services within a contract and the amount of consideration to which an entity will be entitled in exchange for those goods and services. The five steps will be as follows:

1. Identification of the contract with the customer
2. Identification of performance obligations within the contract
3. Determination of the transaction price
4. Allocation of the transaction price to each performance obligation within the contract
5. Recognition of revenue as (or when) performance obligations are satisfied

As far as the recognition of tuition fees is concerned, this amendment is unlikely to have a significant impact upon the manner in which the revenue is recognised. However, this is likely to have an impact upon the recognition of revenue from performance-related grants and contracts and other similar arrangements into which an HEI may enter and HEIs will need to carefully consider the form and content of all contracts in place. This will involve a detailed assessment of the nature of any separate performance conditions included within a grant or contract, the nature of any goods or services that may be provided (for example, provision of space for external use or the provision of catering services), and how these goods or services may be consumed by the end user of the contract as this will determine the pattern of recognition of those revenues.

Significant changes – lease accounting

In addition to a fundamental change in the manner in which revenue is recognised, Section 20: Leases has also been updated to bring in the requirements set out within IFRS 16. These changes would lead to the removal of the distinction between operating leases, which sees lease costs recognised as an expense, and finance leases, which sees leased assets recognised on the balance sheet with a corresponding liability and a release of depreciation and finance expenses over the term of the lease.

The revised standard will result in all leases and those arrangements that contain a lease being recognised on the balance sheet as finance leases, with two exemptions:

- Short term leases; and
- Low value leases

In preparing for the transition, HEIs will need to consider their leasing arrangements and to calculate the value of both the liability (being the leasing commitment) and the value of the right of access to the asset that is being leased. In preparing these calculations, consideration will need to be given to factors such as incremental borrowing rates, total lease payments, potential break clauses, rental holidays and the expected life of the asset being leased in comparison to the lease term.

This will create additional assets and liabilities on the balance sheet as well as increased levels of depreciation and finance costs. These may have wider implications in respect of KPIs, leverage and similar ratios and covenant compliance. We explore the potential impact of this later on in this report.

Next steps

These amendments will be effective for all accounting periods starting on or after 1 January 2026, which means that it will be relevant for HEIs from years ending 31 July 2027 with retrospective application in the comparatives. Therefore, beginning to understand the key impacts of these changes now is imperative for getting the appropriate systems in place and for ensuring that the transition process is as smooth as possible.

21 Financial reporting standards Periodic Review 2024 (frc.org.uk)

Navigating lease accounting under the new FRS 102

For the majority of universities, the FRS 102 changes will be applicable for the July 2027 year end. Whilst this seems like a distant milestone, universities could consider reviewing their lease arrangements in advance. With leases set to come 'on balance sheet,' the changes for lease accounting may be far reaching for the sector.

One of the most significant changes to the revised standards is to lease accounting. The new standard is based on IFRS 16 and aligns more with the international standard, which means leases are accounted for under an on-balance sheet model. Therefore all leases, other than those that are either short-term leases or leases of low-value assets, will be recognised on the balance sheet. This is a major change from the current standard since management will no longer be required to make the distinction between an operating or a finance lease.

The accounting for leases will look different upon implementation of the new standard. A right of use ("ROU") asset will be recognised in respect of the lease agreement. The ROU asset comprises:

- The present value of the lease liability
- Payments made before commencing the lease
- Direct costs and rectification costs
- Less
- Any lease incentives

The ROU asset will be depreciated over the term of the lease and the depreciation expense will be recognised in the Statement of Comprehensive Income. In effect, operating lease expenses will be replaced by a deprecation change on the ROU asset.

Additionally, a corresponding lease liability will be recognised, which will be the present value of the remaining payments under the lease. Where the lease liability is greater than twelve months then the lease liability will need to be discounted using the interest rate that is implicit in the lease. Simplifications have been incorporated into determining the implicit interest rate in order to make the transition process easier. When an implicit rate is not known, the revised standard will allow the use of an Obtainable Borrowing Rate ("OBR"), which is less complex then determining the Incremental Borrowing Rate ("IBR"). Additionally, in certain circumstances, the standard will allow the use of a "backstop" for organisations to use a gilt rate where neither OBR nor IBR can be determined. The lease liability on the Statement of Financial Position will unwind as cash payments are made to the lessor.

The interest cost will be recognised in the Statement of Comprehensive Income.

The changes to the Statement of Financial Position and Statement of Comprehensive Income are noted above. However, there will also be changes within the Statement of Cash Flows. The changes to the standard will result in changes in classifications on the Statement of Cash Flows. While the actual amount of cash being paid by the organisation will not change, there will be an effect on the classifications of the cash flows. Cash flows from operating activities will increase and cash flows from financing activities will decrease.

The standard includes exemptions for:

1. Instances where the lease term is no longer than twelve months (short term leases); and
2. Leases of assets of low value – The standard has not defined "low value" by providing a monetary amount. However, this may include items such as laptop computers, mobile phones and small items of furniture and equipment after equipment (low value leases).

Leases that meet the criteria above will qualify for exemptions, which means costs can be expensed as incurred.

Why the change?

They key benefit of this change will mean that the users of the financial statements have better insight over the indebtedness of an entity.

Considerations before the transition date

HEIs who lease land, building, vehicles, equipment and other property will be significantly impacted by the changes to the standard. Management and finance teams will need to think about these changes well in advance of the transition date to ensure that they have determined the appropriate borrowing rates and lease terms associated with their lease agreements and have determined the valuation of the ROU asset and lease liability at the transition date. On the transition date (i.e. 1 August 2026),

any differences between the ROU asset and lease liability will be required to be shown as an adjustment to opening reserves. There will be no prior year restatements required before the transition date and any impact of the transition to the revised standard will be posted an adjustment to opening reserves.

Considerations to be made by management are not restricted to the accounting calculations. As noted above, the changes to the accounting for leases will impact financial ratios. In general, total assets and total liabilities will increase, operating expenses will decrease through the elimination of operating lease payments and depreciation and interest expenses will increase. Furthermore, cash flows from operating activities and cash flows from financing activities will change. This results in several changes throughout the primary financial statements.

Below are some key considerations that will need to be made by entities within the higher education sector:

1 Loan covenants or performance metrics – Expenses incurred for operating leases, which would have previously been included in operating income, will be replaced by a depreciation charge and interest expense. Total assets and total liabilities will increase as a result of the on-balance sheet lease commitments. Management and Council will need to review any covenants on borrowings to identify where covenants may be impacted upon the changes to lease accounting. Universities should prioritise speaking to their lender if any of their loan covenants involve measures or other metrics linked to the balances impacted by the changes outlined.

2 Going concern and cash flow forecasts – While the amount of cash being paid from the organisation to a lessor will not change, management and Council must consider how the additional ROU assets and lease liabilities will impact their going concern assessment. Management will need to consider whether changes in their assessments are required to reflect the new standard. For example, current ratios, total assets, cash flows from operating activities and other ratios and metrics will be impacted and may be affected in their going concern assessment.

Management and Council should begin thinking about these changes and the implantation of the changes early to avoid any surprises.

ISA 250
Compliance and change

ISA 250: the consultation

The Financial Reporting Council (FRC) launched a consultation into auditor requirements to detect and report material misstatements from non-compliance with laws and regulations and to clarify instances where/when auditors should report such breaches, and other significant matters, to the relevant regulators. Responses to this consultation closed on 12 January 2024.

Currently, the auditor is responsible for obtaining sufficient appropriate audit evidence regarding compliance with the provisions of direct laws and regulations (those which have a direct effect on the determination of material amounts and disclosures in the financial statements) and for indirect laws and regulations (those which do not have a direct effect on the determination of material amounts and disclosures in the financial statements) the auditor's responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.

The FRC plan to remove the distinction between direct laws and regulations and indirect laws and regulations.

Once the auditor has identified these laws and regulations, they will also be required to:

- determine from the risk assessment and other activities whether there is an indication of a risk of material misstatement to non-compliance with laws and regulations and non-compliance or suspected non-compliance with laws and regulations;
- design and perform further audit procedures which are responsive to the determination above; and
- evaluate whether sufficient appropriate audit evidence obtained indicates there is a material misstatement relating to non-compliance with laws and regulations.

How will this impact the Higher Education sector

Higher Education entities are typically more heavily regulated (such as by the Office for Students) and have activities which are subject to more specific laws and regulations. It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with these laws and regulations. Management are responsible for the preparation of financial statements that give a true and fair view. Accordingly, it is necessary, where identified or suspected non-compliance with laws and regulations has occurred which may result in a material misstatement in the financial statements, for management to ensure that the matter is appropriately reflected and/or disclosed in the financial statements.

In order for the auditor to determine an appropriate risk assessment, inquiries may have to be made with management and other individuals throughout the entity to ensure that a sufficient level of detail has been obtained. This may also require further supporting evidence to be provided by management/Council.

If material non-compliance was identified (by management or the auditor), additional work would need to be undertaken to establish the nature and consequences of the act, which may include inquiries, understanding status of any investigation and confirmation of significant information with appropriate legal counsel.

In order for management and auditors to determine an appropriate risk assessment, they may deem it appropriate to engage experts with the appropriate level of knowledge such as lawyers or sector specific specialists.

With the increased level of work required, Higher Education entities are likely to see an increase in costs, both internally from additional staff time spent to collate and source all information and externally from an increase in audit costs.

The importance of IT audit
Enhancing efficiency and accountability

If a university is subject to audit, the last couple of years has seen auditors undertake additional audit work on IT. This was following the revision of a key Auditing Standard in 2020, ISA 315 'Identifying and assessing the risks of material misstatement'. A significant area of revision for ISA 315 was in the audit requirements around IT and this is due to an appreciation of the increasing dependence on it. Organisations trust the data and reports that are generated by computer systems more and more, however there are a number of high profile cases across all sectors where this data is not accurate. This article considers whether the new requirements of ISA 315 (revised) could provide stakeholders with increased confidence in the information and data extracted from these IT systems. A summary of the main findings from additional IT work is also included.

What is new for IT from ISA 315 (revised) is that the breadth of IT environmental understanding and the level of work required to evaluate the design and implementation of IT General Controls have both greatly increased.

The requirement to understand the IT environment is in ISA 315.25 and expanded in sections A140 – A143. **"The auditor's understanding of the information system includes the IT environment relevant to the flows of transactions and processing of information in the entity's information system because the entity's use of IT applications or other aspects in the IT environment may give rise to risks arising from the use of IT" (A140). There is therefore to be an understanding of the IT applications, which are the computer programs or sets or programs. There is similarly to be an understanding of the IT infrastructure, which support the applications and comprise the network, operating systems, and databases and their related hardware and software. In understanding the IT environment, it is necessary to understand when and how changes are made too. "Changes in the flow of transactions, or information within the information system may result from program changes to IT applications, or direct changes to data in databases involved in processing or storing those transactions or information" (A142).**

The other IT element ISA 315 (revised) develops is the work on evaluating the design and implementation of IT General Controls. This is in ISA 315.26 and expanded in sections A166 – A174. The requirement is to understand **"the risks arising from the use of IT and the general IT controls implemented by the entity to address those risks may affect" (A166).** There could be IT risks relating for instance to payroll, leading to paying staff too much or fictitious employees, or risks relating to any business process subject to the use of IT. The auditor is then to understand and evaluate the general IT controls that are intended to mitigate the risks, whether the controls are appropriately designed and have been implemented. Examples of such controls include access to administer security to the application and supporting infrastructure being appropriately restricted and segregated or access to develop and promote program changes.

The core audit team are usually the ones who gain the understanding and evaluate the controls, but there are of course organisations where the IT systems are too complex, and the specialised IT auditors perform the work. A171 states: **"When an entity has greater complexity in its IT environment, identifying the IT applications and other aspects of the IT environment, determining the related risks arising from the use of IT, and identifying general IT controls is likely to require the involvement of team members with specialized skills in IT. Such involvement is likely to be essential, and may need to be extensive, for complex IT environments."**

Revised procedures since introducing ISA 315 (revised) have led to a more in depth understanding of the controls and procedures applied to the IT systems at the universities we audit. From this work, common themes can be identified which are important for all organisations to consider:

- Individuals with administrator access to key finance applications have been found to be members of the finance team
- Individuals with administrator access to key finance applications but who are outside the finance team have had the ability to (and in some cases do) post journals

Both these scenarios carry a risk. Individuals with administrator rights are able to access all parts of the IT applications and so are able to change programs or master files that could be undetected and impact on the financial records; and add or remove users for each application. An important control for the IT systems is that there is a segregation of duties and different people have the privileged access rights and maintain the IT systems to those who run the finances. If there is an overlap, this is likely to be a control deficiency and it exposes the HEI to increased risk.

Linked to this, another IT control which is sometimes missing is a regular review of the log showing IT access rights and activity of those with these rights, to ensure only the appropriate people have the access and that the login is being used only for appropriate and expected purposes. It is important that someone independent regularly reviews the system log to ensure only appropriate activity is taking place.

With the revised standard, audits are increasingly focusing on the IT, recognising that it is becoming more and more intrinsic to the information system and that the risks from IT have increased, so issues relating to IT should be increasingly challenged.

Effective governance
Managing related parties

HEI must provide relevant disclosures in the financial statements in order to provide the users of the financial statements with relevant information for their decision making. One area, which has had increased focus recently, is the disclosure of related party transactions.

As defined in the Higher Education SORP (FRS 102), "A related party exists where a person or close family member, has control or joint control and has significant influence or is a member of key management personnel of the institution. It is the substance of a relationship, rather than the legal form, that must be considered in determining disclosure requirements". For universities, related parties are likely to include:

- Members of the governing body and their "close family", who hold influential posts in public or private sector organisations with which the institution has transactions;
- Senior staff who hold significant influence on other bodies with which the university has transactions;
- Associates, collaborations and joint venture entities not fully eliminated on consolidation; and
- Pension schemes for the benefit of employees of either the reporting entity or an entity related to the reporting entity.

While considering the related parties above, one type of related party that management and Council should not forget about are close family members. It has become apparent across the sector that a list of close family members is not always maintained by management to determine whether any related party transactions are missing from being disclosed in the financial statements. This can cause a gap in adequate record keeping and from disclosures in the financial statements being complete. The definition of close family members in FRS 102, refers to family members who may be expected to influence, or be influenced by, that person in their detailing with the university including:

a That person's children and spouse or domestic partner;
b Children of that person's spouse or domestic partner; and
c Dependents of that person or that person's spouse or domestic partner.

Therefore, management and Council, must ensure that such parties are considered and the related party information obtained on a timely basis.

As part of the governance process, management should obtain declarations from members of Council which not only identify any conflicts of interest and organisations where they have influence, but also this declaration should list any individuals who meet the criteria above for the definition of close family member. This will allow management to monitor transactions occurring at the university and identify whether certain transactions should be disclosed within the financial statements. Council is responsible for university oversight, which includes ensuring any related party transactions have been adequately identified and disclosed in the financial statements and that there are adequate procedures in place to identify related parties and maintain accurate records of all related parties.

Methods to maintain such records include:

- Accurate minute taking that reflects the conversations of which Council have engaged in;
- A thorough process to identify, declare, manage, and keep records of related parties and conflicts of interest; and
- A policy for Council which outlines when conflicts of interest normally occur, how to declare the conflicts of interest, and what members of Council should do about any conflicts.

The Higher Education SORP (FRS 102), also notes the following relationships are not considered to be related parties by virtue of normal dealings with the university:

- Providers of finance;
- Trade unions
- Public utilities
- A customer, supplier or franchisor with whom an entity transacts a significant volume of business, merely by virtue of resulting economic dependence; and
- Government departments and agencies.

When the university identifies a related party and a related party transaction, they must disclose the nature of the relationship between the university and the identified related party, what the transaction was for, the amount of the transaction, any outstanding balances and commitments, any provisions for uncollectible receivables related to an amount of outstanding balances and any expense recognised during the period in respect of bad or doubtful debts due from related parties. It is important to note that one cannot state that a related party transaction was made on terms equivalent to those that prevail in an arm's length transaction unless such terms can be substantiated.

Related party disclosures provide the readers of the accounts the ability to understand any potential effect of the relationship to the financial statements. Ultimately, members of the university Council must ensure a process is in place for the appropriate identification of all types of related party transactions to have the appropriate information available to conclude on the completeness and accuracy of their related party disclosures in the annual accounts.

Deadlines, reportable events and matters of material significance

Higher education institutions (HEIs) operate under the supervision of the Office for Students (OfS) responsible for regulating the industry. It is a non-departmental public body, accountable for parliament and the Department for Education (DfE) but is independent of the government[22]. There are three key areas of communication obligations incumbent upon UK Universities - data returns, annual financial returns, reportable events.

Many HEIs are also exempt charities and as such, its trustees/members of the governing body have a statutory duty to report serious incidents to their principal regulator. The Charity Commission "does not expect exempt charities to report serious incidents to it directly. Trustees should instead understand and comply with any requirements to report to their principal regulator." For universities, the principal regulator is the OfS and any serious incidents or matters of material significance should be reported alongside any reportable events.

There are also matters that auditors, and independent examiners, of HEIs are required to report to the OfS if the entity is an exempt charity. These are known as matters of material significance and there is a legal requirement for auditors and independent examiners to report these in writing in England, Wales and Northern Ireland. In Scotland, although there is no such legal requirement, it is recommended that reports are made in writing.

With many deadlines and reporting requirements, the following summarises key extracts from the various pieces of published guidance to assist in complying with these regulatory bodies.

Data returns

These refer to the submission of various types of data and information by higher education providers in the UK. These data returns are a crucial aspect of regulatory compliance and are used by the OfS to monitor institutional performance, assess sector-wide trends, and inform policy decisions[23].

Most data returns are centred around provisional course offerings from each HE institution, individual student data including demographic and course details, and how grants or other funding allocations are planned to be used. However, other ad-hoc requests can be made to inform decisions on specific policies.

The OfS writes to each of its HEI providers annually to inform them of specific data returns requested and the accompanying deadlines for these. The letter is published here for 2023-24 and the letter for 2024-25 is expected later this year.

Annual Financial Returns

Each year all HE providers are required to submit Annual Financial Returns (AFR) to the OfS[24] as set out in its Regulatory Advice 14.

The items requested include the audited financial statements, the Annual Financial Return workbook template completed as provided by the OfS including commentary and the management letter from the provider's external auditor. HE providers may be asked to provide a business plan to supplement these documents and where a provider has a legally binding obligation of financial support in place, the financial statements from that legal entity will be required.

The deadlines for institutions to provide these various data returns are directly related to the timing of its financial year end. They are as follows and assuming a year end of 31 July 2024, the dates are given in brackets:

- **Deadline 1** – Four months post year end (30 November 2024) – Submission of initial AFR workbook
- **Deadline 2** – Five months post year end (31 December 2024) – Verification queries relating to the initial AFR submission to be resolved alongside finalised workbook, audited financial statements and all other supplementary items relating to the AFR
- **Deadline 3** – Five months and two weeks post year end (14 January 2025) – Resolution to any additional verification queries must be submitted, return is signed off and sign-off form is submitted

Should a provider foresee an event or matter that may cause it to become unable to meet the above deadlines, it is imperative that they communicate this to the regulator within five working days of discovery per guidance issued in Regulatory Advice 16.

22 https://www.officeforstudents.org.uk/about/

23 https://www.officeforstudents.org.uk/publications/deadlines-and-requirements-for-2023-24-data-returns/

24 https://www.officeforstudents.org.uk/media/dba8ea2f-a2a2-49be-b559-a967ab488843/regulatory-advice-14-guidance-for-the-annual-financial-return.pdf

Reportable events

Certain events or matters are required to be reported to the OfS so that it can fulfil its duties of monitoring providers via a risk-based approach. These are called 'reportable events' and are defined in Regulatory Advice 16 and have been applicable since 1 January 2022[25].

The formal definition can be found within the regulatory advice and covers both events that have occurred and knowledge of events that are likely to occur in the future. Navigating this definition can be difficult given the level of judgement involved in deciding whether the event or matter will negatively or could negatively affect the institution. To assist providers, the OfS have included a non-exhaustive, illustrative list of reportable events within Regulatory Advice 16.

Examples of events that are always reportable include:

- When a legal registered entity ceases to exist or changes its legal form, changes its legal ownership through a sale or merges with a non-registered provider
- Ceasing to carry on its business principally in England or loss of the provider's student sponsor license
- Where a notification has been given to a provider around an investigation relating to the quality and standards of the provider's higher education courses
- Where a provider has received a complaint that it has charged or advertised fees exceeding a statutory fee limit
- The opening or closing of a campus, department/subject area or a termination of a partnership arrangement that results in a contract change for students (UK & internationally)
- A likely drop in the provider's liquidity to below 30 days' average expenditure
- A likely breach of any financial covenant attached to a loan, where that breach has not been waived by the lender
- Where legally binding obligations of financial support are withdrawn from the provider or where there has been an adverse change in a counterparty's financial position providing that support
- Where an external auditor notifies the provider that it may conclude that the provider is not a going concern or where Council conclude that the provider is not a going concern
- Any matter or event that may result in the provider being unable to pay its creditors

Examples of events that may be reportable, depending on the specific circumstances:

- A provider initiates investigations into fraud or financial fraud involving the provider, or is being investigated by a third-party in relation to possible fraud or financial irregularity
- The provider is involved in significant legal or court action
- Material changes in a provider's financial performance, forecasting or financial commitments or borrowings
- Commencement of a redundancy programme
- Significant sale of assets

The full list of examples can be accessed here.

Serious incidents reporting

If a higher education provider is a registered charity or an exempt charity, it has a duty to report serious incidents with its principal regulator (the OfS). Whilst Reportable Events are primarily concerned with the legal form and the financial health and sustainability of the provider, serious incidents have a broader scope. The following matters are relevant to HEIs and should be reported:

- **Protecting people and safeguarding incidents** – any event where an individual connected to the institution has suffered serious harm or any allegations involving any level of staff member and physical, sexual assault or neglectful behaviour.
- **Fraud, cyber-crime and money laundering** – any allegations of management creating false invoices for services, where funds are lost to phishing scams and any incidents involving cyber-crimes or money laundering.
- **Theft** – Where it relates to a pattern of behaviour or significant material loss to the provider.
- **Unverified or suspicious donations** – Donations of over £25k from unknown or unverifiable sources.
- **Links to terrorism or extremism** – This includes incidents involving guest lecturers or speakers where a University event has been used to promote extremist messages either by live speech or social media.
- **Other significant incidents** – If a disqualified person is acting as a trustee, there are ongoing investigations by a regulatory body or a mass resignation of trustees / governors / council members that results in the institution being unable to function.

This is not an exhaustive list and the published examples with full detail can be accessed here.[26]

25 https://www.officeforstudents.org.uk/media/6329/ra16-reportable-events-october2021.pdf

26 RSI_guidance_what_to_do_if_something_goes_wrong_Examples_table_deciding_what_to_report.pdf (publishing.service.gov.uk)

How to report matters to the OfS

Where a provider has identified a matter that is reportable, it should submit relevant information via the online OfS portal within five working days. Where the provider is unable to meet this deadline, the OfS require an explanation around why this was not possible. The OfS state that this is a secure mechanism and that submissions will be treated confidentially when received. They may ask questions in return to obtain sufficient understanding of the event and circumstances and an email confirmation that information has been received is provided.

This is not simply a matter of compliance. By promptly identifying and reporting events under the framework providers are contributing to a culture of transparency, accountability and continuous improvement within the sector, thereby ensuring the regulator has sufficient oversight to ensure quality and integrity of higher education provision.

Further support on submitting information via the portal, providers should contact portal@officeforstudents.org.uk for technical assistance. For other issues, contact should be made to the Compliance and Student Protection team using regulation@officeforstudents.org.uk or 0117 931 7305.

Matters of material significance

Rather than the onus being on the institution, matters of material significant are required to be reported by auditors of registered and exempt charities to the principal regulator (the OfS). Although these are not for the HEIs to determine or report, an awareness of matters that fall into this category is beneficial for management and those charged with governance because of the parallels between the items below, and the serious incident reports.

The following covers the nine areas that are reportable, depending on the circumstances:

1. Dishonesty/fraud leading to significant loss or material risk to assets
2. Failure of Internal Controls & Governance that have led to a material loss or led to funds being at material risk
3. Money Laundering & Criminal Activity such as knowledge or suspicion that the University or its bank accounts have been used for money laundering purposes
4. Support of Terrorism whether actual or suspected by the University, its trustees or its employees
5. Risk to the charity's or University's beneficiaries
6. Breach of law or University's charters or trusts
7. Breach of an Order or Direction
8. Modification to audit opinion
9. Conflict of interest and/or incomplete disclosure of related party transactions

This is not an exhaustive list and the published examples with full detail can be accessed here.[27]

27 20200129_-_Matters_of_Material_Significance_guidance_April_2020__FINAL_.pdf (publishing.service.gov.uk)

OfS launches consultation on Freedom of Speech

On 26 March 2024, the Office for Students (OfS) launched a consultation on its proposed new guidance on free speech[28]. This guidance is to be issued in advance of the implementation of the Higher Education (Freedom of Speech) Act 2023, which places new duties on universities and colleges, their constituent institutions and some student unions with effect from 1 August 2024. Further to these new duties, additional powers and duties will be bestowed on the OfS in respect of regulation of universities and colleges and their student unions on free speech issues.

The consultation seeks to gather feedback on the OfS's proposals in the following three areas:

a Proposed guidance on the duties related to freedom of speech and academic freedom;
b Amendments to the regulatory framework to reflect the OfS's new general duties and general functions; and
c Recovery of OfS costs in connection with the new free speech complaints scheme and the imposition of monetary penalties on students' unions.

Proposal A: Guidance relating to new free speech duties

A document has been published setting out the key guidance that the OfS propose to issue, which covers the new duties relating to:

a Securing freedom of speech within the law (the "secure duties"); and
b The freedom of speech code of practice (the "code duties").

The document can be found on the OfS website[29] and sets out examples of steps which may be considered reasonably practicable for implementation by providers, constituent institutions and relevant students' unions in order to ensure that they are meeting their obligations under the revised legislation. The steps proposed in the guidance cover the following areas:

- Admissions, appointments, employment and promotion
- Codes of conduct
- Complaints and investigation processes
- Free speech code of practice
- Free speech complaints scheme
- Governance
- Research
- Speaker events
- Teaching
- Training and induction

It is expected that the new regulations will place significant weight on freedom of speech and academic freedom, and that there will be limited scope for providers, constituent institutes and relevant students' unions to create restrictions on lawful speech.

Proposal B: Amendments to the regulatory framework

The general duties of the OfS are set out within Section 2 the Higher Education and Research Act (HERA). As a result of the new legislation, Section 2 of HERA is amended to include two additional general duties for the OfS as follows:

a The need to promote the importance of freedom of speech within the law in the provision of higher education by English higher education providers; and
b The need to protect the academic freedom of academic staff at English higher education providers.

In response to this, the OfS are proposing to amend paragraph 10 of the regulatory framework in order to include reference to the additional general duties and to append paragraph 54 of the framework with two new paragraphs to make reference to the new general functions as stated in the updated HERA.

Details of the regulatory framework as it currently stands can be found on the OfS website[30] and the proposed amendments to the text have been included within Appendix C of the consultation.

Proposal C: Cost recovery

The new legislation will result in the OfS being empowered to both recover its costs from registered providers, constituent institutions and related students' unions in the following situations:

a Costs incurred in making a decision that a complaint under the OfS free speech complaints is justified or partly justified;
b Costs incurred in relation to the process resulting in the imposition of a monetary penalty on a relevant students' union in relation to a breach of any of its free speech duties; and
c Costs relating to the suspension or removal of a provider's registration.

The latter point above is already included within section 73 of HERA but will be updated as appropriate to include references to relevant students' union and the governing body of a constituent institution as appropriate. The OfS has proposed that it will apply its published guidance on cost recovery (which can be found in the Regulatory advice 19, paragraphs 46 to 53[31]) to the new circumstances set out within the new legislation. This guidance addresses the calculation of costs, the processes for recovering those costs and the considerations that would be made by the OfS in deciding whether cost recovery is appropriate.

Next steps

The consultation closed on 26 May 2024 and the OfS will be publishing a summary of the responses in the summer. In this publication the OfS will be setting out how and why they have arrived at their decisions. It will also explain how they have addressed any concerns raised by respondents before setting out the next steps in the policy and implementation process.

Once finalised, the new guidance will come into force from 1 August 2024. There are additional requirements in respect of new free speech conditions of registration, on which the OfS will launch a separate consultation in the autumn of this year. The results of this further consultation will be brought into force with effect from 1 September 2025.

28 Consultation on proposed regulatory advice and other matters relating to freedom of speech (officeforstudents.org.uk)
29 Annex B: Regulatory advice on freedom of speech - Office for Students
30 Regulatory framework for higher education in England - Office for Students
31 Regulatory advice 19: The OfS's approach to determining the amount of a monetary penalty - Office for Students

Regulating the Regulator
The House of Lords Industry and Regulators Committee Report

In September 2023, the House of Lords issued their report into whether the Office for Students (OfS) was fit for purpose, titled "Must do better: the Office for Students and the looming crisis facing higher education". The report focused on 7 main sections, in which there were some common themes:

- The OfS' duties and decision making
- Financial sustainability
- Value for Money
- Quality, standards, choice and competition
- The student interest
- Regulatory framework and sector relations
- Political independence and the role of government

Financial sustainability - The Higher education sector faces a number of risks, particularly the freezing of the cap on tuition fees for home undergraduate students, the sector's main source of income, which impacts significantly on their financial sustainability. Institutions often make a loss when teaching domestic students and conducting research. This has led them to become increasingly reliant on international and postgraduate students, whose fees are not capped, although there are also risks associated with relying on this income stream.

The report states that these elements are controlled by the Government and therefore it is vital that a longer term funding model is provided for the sector. The OfS monitors and reports annually on financial sustainability in the higher education sector, however this is more focused on data rather than the communication with institutions to understand specific challenges they may be facing and how they can assist with them.

Value for money – The investigation found that the information students receive when they apply for courses can differ greatly. Given the financial commitment made by each student, the report notes this as unacceptable. They recommend that the OfS provides clear, digestible information from higher education institutions in order for students to be able to judge whether their courses provide value for money.

Regulation – when obtaining evidence from institutions for the report, a common finding was that the OfS had become overly prescriptive and had shown a willingness to direct activities, with insufficient explanation and little regard to the need to protect institutional autonomy. The report noted that it was clear that the poor relationship between the OfS and institutions has been in part because the OfS' approach has been overly distant and combative. The OfS has recently recognised that sector relations are an issue and the report called on the OfS to rebalance its approach and engage more with providers.

In conclusion, the report noted three main considerations

- That the OfS relationship with many of its key stakeholders is not satisfactory: this applies not only to providers and other bodies such as the QAA, but also to students. The OfS does not engage with its stakeholders as well as it should and, when it does, there is a perception that it gives insufficient attention to their feedback.
- The OfS' approach to regulation often seems arbitrary. They are selective in choosing which of its duties to prioritise, expanded its remit into new areas and created the impression that it seeks to control and micro-manage providers.
- When reflecting on the relationship between the OfS and Government, there have been too many examples of the OfS acting like an instrument of the Government's policy agenda rather than an independent regulator. It is vital that regulators have both real and perceived independence from Government, and the report noted that the OfS has a lot of work to do in regard to this.

The Government and OfS responded in November 2023 to the report produced, noting where improvements were due to be made.

The full report can be found at Must do better: the Office for Students and the looming crisis facing higher education (parliament.uk).

The response from Government can be found at Government response.

The response from OfS can be found at House of Lords Industry and Regulators Committee Inquiry into the work of the Office for Students: Office for Students response (parliament.uk)

Economic Activity of Public Bodies (Overseas Matters) Bill

In June 2023, the government introduced the Economic Activity of Public Bodies (Overseas Matters) Bill to uphold its promise to prevent public bodies from carrying out direct or indirect boycotts, disinvestments, or sanctions against foreign countries.

The Bill primarily targets "official boycotts" and "official divestment," but the specific boundaries of these terms are hard to define. To prevent more subtle forms of targeting, the Bill is broadly based on investment and procurement decisions. It would prohibit public authorities, including hybrid public bodies like universities and cultural institutions, from boycotting foreign countries or UK companies based on their overseas moral or political conduct.

The Bill enables the Secretary of State or Minister for the Cabinet Office to designate exempt countries or territories through regulation, except for Israel and the Occupied Palestinian Territories (OPT). Russia and Belarus are anticipated to be exempted as soon as the Bill becomes law. Those found in violation of the Bill would receive written notice and could potentially face undefined monetary fines which is to be detailed in secondary legislation.

Enforcement would be the responsibility of the Secretary of State, Minister for the Cabinet Office or Treasury, while for higher education providers in England, the regulator, the Office for Students, would be in charge. Universities UK (UUK) has recommended the removal of universities and higher education providers from the scope of the Bill.

UUK has expressed its concerns about the bill, stating that it presents a disproportionate solution to the intended problem and has significant unintended consequences for the higher education sector.

UUK has raised widespread reservations regarding the scope, intent, and implications of the Bill. These reservations include:

The potential to impact the ongoing ONS review into universities' status in the national accounts, and whether they should be reclassified as 'public bodies.

Contradictions between Clause 4 of the Bill and the duties placed on universities via the Higher Education (Freedom of Speech) Act 2023 to uphold freedom of speech and academic freedom.

Contradictions with existing government policy, guidance, legislation, and good practice related to establishing international partnerships and collaborations.

The potentially damaging effect on due diligence, inhibiting open discussion and debate and limiting transparency in decision-making.

The significant new powers and functions that would be given to the Office for Students (OfS). The core provisions of the Bill extend and apply across England and Wales, Scotland, and Northern Ireland, but there are contrasting mechanisms for how this is enforced.

UUK recommends the exclusion of universities and other higher education providers from the scope of the Bill. An amendment that sought to exempt Universities as public bodies was tabled at the Report Stage in the House of Commons however this amendment was not put to vote. The Bill is currently at the committee stage in the House of Lords.

Economic Crime and Corporate Transparency Act 2023

The Economic Crime and Corporate Transparency Act 2023 (ECCTA) received Royal Assent on 26 October 2023. The ECCTA is primarily designed to strengthen the data held and presented about UK companies and introduces fines and other criminal liabilities if companies do not take appropriate measures to prevent fraud. The new law has 3 primary objectives:

1. To prevent organised criminals from using companies and other corporate entities to abuse the economy.
2. To strengthen the response to economic crime.
3. To enable Companies House to develop a better service and improve its company data.

So, what does this legislation mean for our universities?

Failure to prevent fraud

The ECCTA introduces a failure to prevent fraud offence. It applies to all large corporate organisations, where large is defined using Companies Act parameters where two out of the three following criteria are met:

- More than 250 employees
- More than £36m turnover
- More than £18m total assets

Under the new offence, an organisation will be liable where a specified fraud offence is committed by an employee or agent, for the organisation's benefit, and the organisation did not have reasonable fraud prevention procedures in place (irrespective of whether management knew of the offence). The failure to prevent fraud offence captures the following fraud and false accounting offences which are most relevant to corporations:

- Fraud by false representation
- Fraud by failing to disclose information
- Fraud by abuse of position
- Obtaining services dishonestly
- Participation in a fraudulent business
- False statements by company directors
- False accounting
- Fraudulent trading
- Cheating the public revenue

The offence is similar to the 'failure to prevent bribery' offence under the UK Bribery Act 2010. Ultimately, it places responsibility on an organisation to have robust systems and controls in place to prevent individuals exploiting them to break the law. The defence to avoid prosecution and an unlimited fine is that organisations must be able to demonstrate that reasonable fraud prevention procedures are place.

Whilst the legislation is now in place, much of the ECCTA is not yet in force, including the failure to prevent fraud offence. The government will need to publish guidance on reasonable fraud prevention procedures, at which point the offence will come into force.

The education sector as a whole is under increased threat from cyber-attacks and more robust controls and training are in place to identify and detect suspicious activity where an external threat exists. The ECCTA forces organisations to think more about their internal policies and increase their preventative measures to reduce risk of attack from inside the entity. Whilst guidance is not yet available, HEIs should consider their current fraud prevention measures, systems and controls to assess if their current practices are sufficiently robust under the new legislation.

It's not easy being green
HE environmental matters

Sustainability reporting and assurance

With the vast number and varied types of stakeholders in the HE sector (students, staff, UK Government, local communities, investors, lenders etc) it's essential that HEIs are reporting the right kind of information that's relevant and important. The scope and breadth of reporting extends far beyond financial information, and with sustainability reporting comes topics like the environment, diversity & inclusion, and gender pay gap.

Managing the risks and exploiting the opportunities that come with the sustainability agenda require organisations to understand and measure their impacts and dependencies on the world around them. It also requires them to manage, use, and report accurately on this information. Sustainability data is different to financial data – it is inherently more challenging to measure and interpret, or even know what to measure.

As stakeholders become more interested in this data, Boards and Exec Committees are focusing more attention on it too – and that's where assurance comes in. This data is intrinsically riskier - and often less well controlled - than financial data, and yet the financial statements come under scrutiny of an external audit every year. Despite this, there is no mandatory requirement for assurance over the non-financial sustainability data. In our experience, many institutions across the sector are starting to think about assurance and the value it brings around credibility and trust in this data.

Green Bonds (or other sustainability linked finance)

Green Bonds and other sustainability linked loans are becoming more common, especially in the HE sector. As lenders look to improve the "green" nature of their investments, they are now often putting sustainability linked covenants or requirements into their financing agreements either as well as, or sometimes instead of, traditional financial covenants. Alongside these new sustainability metrics and targets often sits a requirement to get assurance by an independent third party.

This is something the Grant Thornton team has experience in providing. The key for this is early engagement – there are often time constraints or deadlines by which reporting has to be made and starting a conversation with us in good time will enable us to help you in the most appropriate and effective way.

The added complication of Green Bonds, rather than borrowings from a mainstream lender with sustainability covenants attached, is that they are often raised under a Green Financing Framework. This can add complexity to the assurance of the metrics or targets under the Framework, as there are often additional requirements or areas to think about which go beyond a "standard" financing agreement with a bank – such as the allocation of proceeds to eligible green projects.

If you are refinancing or raising further capital for specific construction or development projects, it is worth engaging with your professional advisers early to ensure any green or sustainability angles are understood and covered – including any mandatory assurance.

Pensions
Progress and planning

Virgin media case

In June 2023, the high-profile Virgin Media pension case was concluded, relating to the validity of certain historical pension changes. The case concerned the validity of benefit changes made to salary-related contracted-out pension schemes without obtaining the necessary actuarial confirmations at the time. The High Court concluded that in the absence of the relevant actuarial confirmation that the benefit changes are null and void. Specifically, this case addressed the absence of confirmations from the Scheme Actuary under Section 37 of the Pension Schemes Act 1993.

It is expected that Virgin Media will appeal, and the judgement may well be subject to government intervention. It may take some time for the impact of the ruling to be fully understood, but in the meantime, Boards should consider seeking their own legal advice as to what steps to take next.

From a financial reporting perspective, the judgement is as it stands – the impact of any future appeal or intervention is not known and therefore not a mitigation at this stage. If a HEI considers that it is likely that a material adjustment may be required to the defined benefit obligation once the effect of the judgement has been determined, then this should be disclosed in the financial statements. The disclosure should acknowledge the legal judgement, describe the potential effect on the pension scheme, explain what action is being undertaken to assess the impact and why a reasonable estimate of change in the defined benefit obligation cannot be made at the reporting date. If the HEI has already determined the effect, and it is material, the expectation is that there would be an adjustment to be corrected as a prior year error correction. It is not acceptable to do nothing and await the outcome from the expected appeal.

USS pension

In January 2024, the Universities Superannuation Scheme (USS) confirmed that it will cut both employee and employer contribution rates, following the December 2023 valuation. The funding level of the USS has improved significantly as a result of rising interest rates and gilt yields – this means that pension benefits will be restored to pre-April 2022 levels. The return to pre-April 2022 levels means that there is a higher accrual rate for the retirement lump sum, an increase in the salary threshold and the removal of the 2.5% a year cap on pension increases.

At the time of writing (May 2024), we understand that the USS is working on a new modeller for 2023/4 to include appropriate discount rates to enable organisations to calculate the split of the unwinding of the pension provision and allow these changes to be understood and represented clearly in the financial statements for July 2024. At the time of writing, this information is yet to be finalised, but HEIs should consider there may be some additional narrative disclosure to consider to help explain the changes.

Employment tax and global mobility

Payrolling of benefits in kind is changing

Employers are currently able to register to voluntarily payroll certain taxable benefits in kind they provide to employees on a monthly basis.

From 6 April 2026, HMRC are to make payrolling of benefits mandatory, abolishing the need for P11D reporting and to collect both the tax and Class 1A National Insurance Contributions (NIC) via payroll.

Whilst all the details have not yet been confirmed, employers should ensure they are aware of the upcoming change and consider whether they might commence payrolling of benefits sooner in order to reduce the administrative burden earlier and get employees and the business used to it.

Construction Industry Scheme ('CIS') changes from 6 April 2024

Following consultation in 2023, changes were introduced to CIS legislation from 6 April 2024. The main changes were:

Inclusion of VAT in the compliance test for obtaining (and keeping) gross payment status as a subcontractor.

Historically, VAT had not been considered by HMRC when assessing if the compliance test for gross payment status has been met. However, from 6 April 2024, VAT will now be within scope. This may lead to some subcontractors losing their gross payment status or preventing it from being granted.

New legislative exemption for landlord to tenant payments.

The existing provisions for exempting landlord to tenant payments from CIS (for example, as reverse premiums) were causing confusion and leading to unnecessary administration for both landlords and tenants. An exemption has been introduced with the aim to provide additional clarity for such payments. Broadly speaking, where a landlord makes a payment to a tenant for construction work to be carried out on the property the tenant occupies, the payment is made in connection with a lease, and the works are primarily for the benefit of the tenant, then the payment will not be within the scope of CIS.

However, we are already finding nuances that mean this exemption is not always straightforward to apply. Professional advice should be sought ahead of relying on this exemption.

CIS is relevant in the sector in several scenarios, including:

- A non-charitable trading subsidiary engaging for construction works to be carried out on land or property
- Any entity receiving a payment for construction works (such as certain funding payments received with respect to planned construction operations)

Off-payroll working remains a challenge

Off-payroll working covers a broad range of situations, including:

- Use of agencies
- Individuals engaged as self-employed
- Volunteers (who may be considered workers)
- Personal service companies ('PSC's)
- Umbrella companies

There is a raft of employment tax legislation, which needs to be applied in a specified order, to determine the correct tax treatment for workers engaged off-payroll.

We find challenges in the sector regarding oversight of who is being engaged off-payroll and who is responsible for managing the tax risk, as well as correctly applying the legislation.

There is also a lack of documented procedures which adequately comply with the updates to the IR35 legislation originally introduced in 2021. For example, having a dispute procedure should an individual disagree with the employment status assessment.

HMRC continues to consult and publish guidance on these matters, particularly in respect of umbrella companies and issues with tax compliance.

Global working

This is a common issue in the sector due to the varied nature of the workforce and the international expansions plans many entities have. This leads to a variety of international working arrangements, such as:

- Employees working overseas to establish and deliver international partnership arrangements
- Academic staff working part-time for a UK institution and part-time for overseas institutions
- Academic staff delivering course content online from an overseas location
- Other staff requesting overseas working arrangements for personal reasons (e.g. family abroad)
- In some cases, individuals working abroad without the knowledge of their employer

From a UK perspective, even one day of work in the UK can trigger a Pay As You Earn ('PAYE') and National Insurance Contribution ('NIC') requirement and it is key that employers have oversight of where their workforce is living and working.

A multidisciplinary approach is required to manage international working tax risks including input from HR / People teams, payroll, finance, and tax. It can be complex to manage UK and overseas reporting requirements in a compliant and equitable manner.

This can also be combined with the challenges of off-payroll working where an individual may be providing services on a self-employed basis and part of this is delivered from abroad.

What's new for VAT?

VAT registration threshold update

On 1 April 2024, the government increased the VAT registration threshold from £85,000 to £90,000, and the deregistration threshold from £83,000 to £88,000.

VAT property updates

Temporary zero rating relief for the installation of energy saving materials

In March 2022, as part of the Government's Spring Statement, it was announced that from 1 April 2022 (1 May 2023 for Northern Ireland) the rate of VAT on the installation of energy saving materials would be temporarily lowered from the reduced rate (currently 5%) to the zero rate, effective until 31 March 2027. This was for certain energy saving materials and applied to residential properties only.

Subsequently, the Government announced in the 2023 Autumn Budget that, from 1 February 2024, it would extend the relief to include additional technologies, including:

- Water-source heat pumps
- Retrofitting electrical battery storage to qualifying energy saving materials or as a standalone when connected to the National Grid
- Diverters retrofitted to energy saving materials such as solar panels and wind turbines
- Certain groundworks necessary for the installation of certain types of heat pumps

In addition, the types of buildings that the works can be done to has also expanded to include buildings used solely for a relevant charitable purpose. We are yet to see in practice how this will be interpreted for buildings which are only partially used for relevant purposes.

Unless there is a further change to the legislation, from 1 April 2027 onwards, supplies of the installation of energy saving materials will revert to the reduced rate of VAT.

Prior to these announcements, the VAT legislation in respect of energy saving materials was narrow in its application, and therefore the reduced rate was only applied in limited circumstances. The introduction of the zero rate, together with the removal of complex eligibility conditions, could present an attractive opportunity for the sector.

If a higher education institution has significant spend on energy saving materials, then it may be worth undertaking a review to ensure that VAT is not being overcharged by suppliers. Additionally, where it is considered that the relief applies to a historic supply, it may be possible to request a repayment of any overpaid VAT.

Furthermore, there may be an opportunity where projects including different VAT rates can be split out to ensure the zero rate of VAT can be applied where possible.

Option to tax notification changes

From 1 February 2023, HMRC stopped issuing option to tax notification receipt letters. When opting to tax a property or land, we recommend that higher education bodies submit a VAT 1614A form via email to optiontotaxnationalunit@hmrc.gov.uk and use the date of the automated response as the date of the notification.

HMRC will no longer confirm the validity of an option unless it is likely to be over six years old or if you've been appointed as a Land and Property Act receiver or an insolvency practitioner to administer the property in question. Therefore, we recommend higher education bodies consider implementing an option to tax register to capture the properties opted and the date of the notification.

Potential change to the self supply charge for buildings with relevant residential or charitable purposes

Where a building is constructed and it has been certified that it will be used solely (more than 95%) for a relevant residential or charitable purpose, but, within a ten-year period, that use ceases or reduces to less than 95%, a self supply charge will arise. For example, this charge will arise where a business disposes of its entire interest in that building less than 10 years after the building was completed.

In the event of a change in use, the tax payer needs to self account for VAT based on the amount that would have arisen had zero rating not applied. This is adjusted for based on the number of complete months that qualifying use has occurred. However, this is a one-way adjustment, i.e. if the amount of qualifying use increases in the 10 year period there is no refund from HMRC.

We understand HMRC are considering amending the self supply charge so that it is more akin to the capital goods scheme. This could mean, amongst other things, if there is a year on year change in the use of a building there could be payments to and from HMRC.

Cladding

In the wake of the Grenfell Tower tragedy in 2017, many existing buildings were found to be in need of remedial work to remove and replace defective cladding. One of the key questions was whether these works were standard rated for VAT purposes or could be zero rated for any reason which would help to reduce costs.

HMRC's view has repeatedly changed on when VAT is due on cladding works, and there are still considerable uncertainties. Generally, we currently expect the following to apply from a VAT perspective:

- Required works - The basic position is that these works are refurbishment of an existing building and standard rated. There is an argument that the remedial works could be zero rated. This is on the basis that the defects were so great that the building should never have been signed off as being complete. HMRC only accepts this where:
  - You were the body that originally constructed the building
  - The works for the original building are zero rated, eg for dwellings
  - The works are connected to the original build, e.g. via a retention clause or ongoing dispute
  - The remedial works are completed as soon as possible

There are disagreements with HMRC about the clauses under which the works can be connected. HMRC consider it needs to be under an obligation to rectify a defect/problem, but advisors have contended that businesses should be able to rely upon latent defects clauses.

- **Optional works** - It is unlikely that any reliefs apply, and the works will be standard rated as default. If the building is used for exempt rental income, then no input VAT will be recoverable on these costs. Even if the building is used for taxable supplies and therefore, VAT would usually be recoverable in costs, HMRC have tried to argue that, as it was optional, these costs are non-business and the VAT should not be recovered. We would contend that optional works are done for the reputation of the business, which supports all its supplies and so should be an overhead of the business, but would need to be considered on a case by case basis.

VAT in the Digital Age ('ViDA') – EU VAT update

For higher education bodies with activities in the EU, they will likely need to get to grips with the EU's new ViDA initiative. In December 2022, the European Commission proposed a series of measures to modernise and digitalise the EU's VAT system. ViDA is an EU initiative regarding the introduction of cross-border e-invoicing obligations and a digital transactional reporting requirement. It aims to:

- Create a real time digital reporting system for e-invoicing
- Update VAT rules for the platform economy, i.e. Amazon, Ebay, etc, so that operators in this sector become responsible for collecting and remitting VAT to tax authorities when sellers do not
- Allow businesses to have a single EU VAT registration and sell to customers throughout the EU

The ViDA reforms currently intend to make e-invoicing the default system for the issuance of invoices from July 2030. Many countries within the EU are starting to implement their own plans to move to e-invoicing in the coming years, therefore updates from Member States regarding their implementation are becoming increasingly common.

In May 2024, the EU Council publicised an amended proposal for ViDA. However, following a vote by EU government, the proposal was not approved. The positive vote of all EU countries was needed to approve the proposal, however, Estonia did not support the proposed deemed supplier rules. Belgium still aims to achieve an agreement before the end of its presidency of Council at the end of June.

The major proposed changes (compared to the initial ViDA proposal of 8 December 2022) are:

Digital Reporting Requirements/e-invoicing ('DRR')

- Delayed from 2028 to 1 July 2030
- There will be an introduction of a new VAT reporting scheme and EU domestic reverse charges
- The aim of these changes is to reduce the administrative burden for VAT of trading in multiple EU member states by reducing the number of separate EU VAT registrations that are required
- DRR deadline for intra-community transactions lengthened from 2 to 10 days
- EU Member States do not have to use DRR for intra-community purchase invoices
- Existing DRR must be harmonized with the EU rules by 2035

Platform Economy - deemed supplier rule

- Delayed until 1 July 2027 for short-term accommodation and passenger transport services

Single VAT Registration

- Delayed until 1 July 2027
- Sellers of second-hand goods via platforms will not be considered deemed sellers under the new proposal

In addition, the following has been delayed and will be considered under 2028 EU Customs Reforms:

- Extension of the deemed supplier rule for all sales of goods via platforms
- Mandatory IOSS for all consignment imports.

Most of the proposed changes under ViDA will affect intra-EU supplies only, so higher education bodies which do not currently have any EU establishments or an EU VAT registration (or a liability to have one) should not be affected by ViDA.

Online learning for overseas students

A common issue we are seeing with our higher education clients is whether overseas VAT registrations are required as a consequence of higher education bodies providing forms of online learning to students located overseas.

Whether an online course is one of education or an electronically supplied service ('ESS') for the purposes of determining the place of supply is quite grey and will generally depend on the level of human interaction, as well as anything else that may be received as part of the supply.

Generally, from a UK perspective, the supply of prerecorded classes and materials only is an ESS, whereas a live online class with support from a tutor is not considered an ESS. Other countries may take a different approach to the UK and consider the supply of even live classes to be an ESS, in contrast to the UK creating a local VAT registration risk.

Higher education bodies will also need to understand who the customer is, i.e. is it an individual/non-business customer (B2C) or a business customer (B2B). This will have an impact on the place of supply and where any VAT may be due. Although supplies of education made by an eligible body for the purposes of the UK legislation are exempt from VAT, this may not be the same in all other countries.

Additionally, for both B2B and B2C supplies of online courses, where these are provided by a tutor/lecturer located overseas, higher education bodies should consider whether this gives it an overseas fixed establishment for VAT purposes. A fixed establishment is one that has the human and technical resources necessary for providing or receiving services permanently present, e.g. if a UK company sets up a branch with staff and an office in France, it has a fixed establishment in France. Where an entity has more than one establishment, it needs to decide which one is most directly concerned with a supply in order to determine the correct place of supply for VAT purposes. There could also be other tax implications.

Furthermore, the recent European Court of Justice ('CJEU') ruling in the Westside Unicat case (C-532/22) highlights the possible VAT registration risk for ESS overseas:

- Westside Unicat, based in Romania, streamed live interactive adult performances. I.e., it created digital content and sold this content to a website operator - 'StreamRay' - based in the USA
- The Romanian tax authority took the view that the creation of the performances constituted an entertainment event that took place in Romania, i.e. a local supply of services, and was subject to Romanian output VAT
- The Romanian tax authority assessed Westside Unicat for underpaid output VAT and Westside Unicat appealed this assessment
- The CJEU ruled that the creation of digital content in the form of live video sessions does not constitute an 'event' i.e and the supply of content to StreamRay, did not take place in Romania
- As such the VAT treatment on the supply of digital content depends on where the customer is located, in the USA, this is outside the scope of EU VAT and no Romanian output VAT was due

Future EU place of supply rule for B2C interactive virtual events

Further to the above, from 1 January 2025, the EU VAT treatment of virtual events and live-streamed activities will be aligned with the tax treatment of ESSs (for those that do not currently qualify as ESSs). The place of supply of a virtual event and livestreaming will be taxable in the EU country where the consumer resides or is established.

This means that the providers of these services will need to charge VAT in the EU Member State where the customer is located. Consequently, the supplier may become liable to register for VAT in all EU Member States in which it has customers. For EU businesses a threshold of €10,000 applies, however no threshold applies for non-EU businesses providing these services.

Alternatively, the business could opt to use the VAT One Stop Shop (OSS). This means that businesses falling in scope of the new rules can register for VAT in one EU Member State as opposed to every Member State where they have consumers.

Although the new rules apply from January 2025, some EU Member States have already made steps to change the VAT treatment of the virtual events.

Interpretation of VAT and excise law

The government introduced legislation in the Autumn Finance Bill 2023 to clarify how VAT and excise law should be interpreted in the light of changes made by the Retained EU Law (Revocation and Reform) Act 2023 (REUL Act). This came into effect on 1 January 2024 and HMRC has published Revenue and Customs Brief 4 (2024): Interpretation of VAT and excise law, which provides further details.

The measure confirms that, in relation to VAT and excise law, in line with the REUL Act, it will no longer be possible for any part of any UK Act of Parliament or domestic subordinate legislation to be quashed or disapplied on the basis that it was incompatible with EU law. It also ensures that UK VAT and excise legislation continues to be interpreted as Parliament intended, drawing on rights and principles that currently apply in interpreting UK law. HMRC has also summarized it by saying that UK VAT and excise legislation has the same meaning as it did on 31 December 2023.

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