



Audit Findings Report – 31 August 2018

Management Letter to Governors following conclusion of the Audit
4 November 2018

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1. Introduction and Management Summary

1.1 Outline

This report has been prepared for the governors of The Gold Rose MAT following the audit of the financial statements for the year to 31 August 2018, and will be presented by Landau Baker Limited at the meeting of the governors on 12 December 2018. The comments and recommendations made in this report arose as a result of our review and are for the sole use of the governors. No responsibility to any third party is accepted as the report has not been prepared, and is not intended, for any other purpose.

Our audit work has been carried out with the express objective to enable us to offer an opinion on the financial statements, thus ensuring that they are compliant with the prevailing regulatory requirement listed below:

- Companies Act 2006
- UK Generally Accepted Accounting Practices (including FRS 102)
- Charities Statement of Recognised Practice (2015)
- Academies Accounts Direction 2017 to 2018

We have also carried out a limited assurance engagement as to whether the expenditure disbursed and income received by The Gold Rose MAT for the year to 31 August 2018 have been applied to the purposes identified by Parliament and the financial transactions conform to the authorities which govern them.

The scope of the above work has been communicated to the governors through our audit planning letter, and our terms of engagement detail the respective responsibilities both Landau Baker Limited and the governors.

We would like to express our thanks to Sandra Sculley, Saranjit Sidhu and Jason Nutkins and the finance team for their assistance during the audit.

1.2 Nature and Scope of the Audit

We set out below an outline of the nature and scope, including where relevant, any limitations thereon, of the work we propose to undertake and the form of the report we expect to make

We have a duty to form an opinion on the financial statements at the end of the audit. We must give an opinion on whether the financial statements give a true and fair view at the year end, whether the financial statements have been properly prepared in accordance with the Companies Acts 2006, we must also state whether all the information and explanations which we consider necessary for the purpose of the audit have been obtained, whether proper books of account have been kept by the

academy and whether the information given in the Trustees' Report is consistent with the financial statements.

We will express an unqualified opinion when the financial statements give a true and fair view in accordance with the financial reporting framework. Any modification to this unqualified audit opinion will be expressed in our auditor's report.

We will conduct our audit in accordance with the International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes an examination on a test basis of evidence relevant to the amounts and disclosures in the financial statements.

We will document the internal controls and the systems of the academy. We will review internal and external operational, financial, compliance and other risks facing the academy, which might affect the financial statements, including the likelihood of those risks materialising and how they are managed.

We will also document and review the control environment within the academy, including the attitude of management to controls and whether management have a process for keeping under review the effectiveness of the system of internal control and, where a review of the effectiveness of internal control has been carried out and the results of that review.

We will also review the actions that the governors' plan to take in response to matters such as developments in law, accounting standards and other developments relevant to the academy's financial statements.

1.3 Audit Opinion

At the date of this report, nothing has been identified which would warrant the issuing of a qualified audit opinion or modified conclusion in our regularity assurance report.

Our specific observations and recommendations have been highlighted in section 4.

1.4 Constituent Academies

We list below the constituent academies within The Gold Rose MAT to which the management letter relates:

- Cippenham Infant School [CIS]
- Cippenham Primary School [CPS]

2. Audit Approach

2.1 Materiality

Our audit work does not attempt to verify that the financial statements are 100% correct. We employ the concept of materiality to decipher whether any error or misstatements found during the audit process require adjustment.

When assessing materiality, we utilise our professional judgement whilst considering the following:

- Whether the omission or misstatement of an individual item would reasonably influence the reader of the financial statements; and
- Whether the adjustment or non-adjustment of individual item would impact on the true and fair view of the financial statements.

The overall level of materiality for the financial statements of The Gold Rose MAT has been set at £84,780. This was set during the planning stage of the audit, using the level of funding received by The Gold Rose MAT, and we are satisfied that it continues to be appropriate.

Any unadjusted misstatements above the trivial level of £1,696 have been recorded on the Summary of Unadjusted Errors [Appendix 5.1].

2.2 Independence and Objectivity

In accordance with the Auditing Practices Board's Ethical Standards we as auditors must ensure that our independence and objectivity is maintained at all times. The following threat and safeguards identified at the planning stage were as follows:

a. Long association with the audit engagement

The engagement partner has not been involved with the audit for more than 10 years. However, there may be a perceived loss of independence due to self-interest, self-review or familiarity (as per APB Ethical Standard 3). In order to address such threats, we applied the following safeguards appropriate to the audit. These are outlined below.

- i. The audit manager has not been involved with the audit for more than 5 years.
- ii. The perceived ethical threats are regularly reviewed.
- iii. A sample of our audit files are subject to review each year by an independent member of the Institute of Chartered Accountants in England and Wales, who specialises in this type of technical review. The audit files selected for review are chosen by reference to the perceived risk associated with those audit files.
- iv. The Quality Assurance Directorate of the Institute of Chartered Accountants in England and Wales, who is our audit regulator,

visits us from time to time and carries out, amongst other things, independent reviews of our audit files.

- v. We use an independently produced audit programme.
- vi. We use an independently produced accounts disclosure checklist.

b. Non-audit services provided to the audited entity

Landau Baker Limited is also engaged by The Gold Rose MAT to provide the following non-audit services detailed immediately below.

- Preparation of Statutory Accounts
- Preparation and Submission of Corporation Tax Return
- Annual Accounts Return
- Teacher's Pension – End of Year Certificate
- Responsible Officer Review

There may therefore be a perceived loss of independence due to self-review and a management threat (as per APB Ethical Standard 5). In order to address such threats, we applied the following safeguards. These are outlined below.

- i. The non-audit services are provided by a separate team from the engagement team, and the team providing the non-audit services avoids taking any action or making any statement that compromises the independence or objectivity of the engagement team, for example, expressing any opinion about the approach that the engagement team might take or the conclusion it might reach when considering the appropriateness of accounting or other audit judgements.
- ii. The audit team is satisfied that a member of management has been designated by the audited entity to receive the results of the non-audit service and has been given the authority to make any judgements and decisions of the type set out in paragraph 34 of APB Ethical Standard 1 that are needed.
- iii. The audit team concludes that that member of management has the capability to make independent management judgements and decisions on the basis of the information provided.
- iv. The perceived ethical threats are regularly reviewed.
- v. A sample of our audit files are subject to review each year by an independent member of the Institute of Chartered Accountants in England and Wales, who specialises in this type of technical review. The audit files selected for review are chosen by reference to the perceived risk associated with those audit files.
- vi. The Quality Assurance Directorate of the Institute of Chartered Accountants in England and Wales, who is our audit regulator, visits us from time to time and carries out, amongst other things, independent reviews of our audit files.

We confirm that, in our professional judgement and having regard to the safeguards in place, the firm is independent within the meaning of the Auditing Practices Board's Ethical Standards and the objectivity of the audit engagement partner and staff has not been impaired during the course of our audit.

We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirement of the Auditing Practices Board's Ethical Standards.

2.3 Qualitative aspects of Accounting Policies and Financial Reporting

During the course of our audit, we consider the qualitative aspect of the financial reporting process, including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the financial statements. We would discuss, as necessary, the following items with the governors:

- The appropriateness of the accounting policies to the particular circumstances of the academy;
- The timing of transactions and the period in which they are recorded;
- The appropriateness of accounting estimates and judgements (e.g. in relation to provisions), including the consistency of assumptions and degree of prudence reflected in the accounting records;
- The potential effect on the financial statements of any uncertainties including significant risks and disclosures, such as pending litigation, that are required to be disclosed in the financial statements;
- Material uncertainties related to events and conditions that may cast significant doubt on the academy's ability to continue as a going concern;
- The extent to which the financial statements are affected by any unusual transactions during the period and the extent to which such transactions during the period and the extent to which such transactions are separately disclosed in the financial statements; and
- Disagreements about the matters that, individually or in aggregate, could be significant to the academy's financial statements or in the auditor's report. These communications include consideration of whether the matters have or have not been resolved and the significance of the matters.

We trust that this more formal approach to the above matters will be helpful to you.

2.4 Governors' Responsibilities

As required by the Companies Act 2006 s418 (2) the Governors' Report is required to include a statement confirming at the date of approval of the financial statements, the governors have:

- taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information; and
- ensured so far as they are aware that there is no relevant audit information of which the company's auditor is unaware.

3. Key Audit Areas

Our audit work undertaken has been focused upon our assessment of the risk of misstatement of balances reported in the financial statements. Summarised below are the significant risks and reasonably possible risks identified at The Gold Rose MAT, and a summary of the specific audit testing undertaken. Any key findings pertaining to the work undertaken are summarised in section 4.

3.1 Significant risks identified (ISA 315)

Significant risks are defined by professional standards as risks that, in the judgement of the auditor, require special consideration. The significant risks identified by the audit team are as follows:

Identified Audit Risk	Audit Approach & Findings
The revenue cycle includes fraudulent transactions	<p>Under ISA 240 there is a presumed risk that revenue may be misstated due to the improper revenue recognition of revenue.</p> <p>We will select 100% of grant income and a sample of non-grant income from the sales ledger and trace these items back to source documentation.</p> <p>We will also review any funding restrictions in place.</p> <p>Walkthrough tests will be performed on all other material income streams to ensure the system is operating in line with expectations.</p> <p>Our audit work undertaken did not indicate any reason why the identified audit risk could not be mitigated.</p>
Management override of controls	<p>Under ISA 240 there is a presumed risk that the risk of management override of controls is present in all entities.</p> <p>We will review accounting estimates, judgements and decisions made by management, test journal entries and review unusual significant transactions.</p> <p>Our audit work undertaken did not indicate any reason why the identified audit risk could not be mitigated.</p>

3.2 Reasonably possible risks identified

Identified Audit Risk	Audit Approach & Findings
Fund Allocation	<p>Review the allocation between funds to confirm that it has been correctly undertaken in accordance with both regulation and precedence. Specifically confirm that income and expenditure allocation is accurate and any transfer between funds has the appropriate authority.</p> <p>Our audit work undertaken did not indicate any reason why the identified audit risk could not be mitigated.</p>
Payroll Costs	<p>Agree the total payroll costs per the reports to the staff costs reported in the financial statements. Agree payments made on a sample basis.</p> <p>Test check a sample of employees to ensure existence and that their individual deductions are correctly calculated.</p> <p>Our audit work undertaken did not indicate any reason</p>

	why the identified audit risk could not be mitigated.
Local Government Pension Scheme	<p>Sense check the assumptions made by the actuaries to ensure that they are comparable with the industry standard. Review the accuracy of the calculation made.</p> <p>Our audit work undertaken did not indicate any reason why the identified audit risk could not be mitigated.</p>
Related Parties	<p>Enquire with management as to the existence of any related parties. Review the accounting records and any other governorships / directorships held, thus confirming that all relevant disclosures have been made within the financial statements.</p> <p>Our audit work undertaken did not indicate any reason why the identified audit risk could not be mitigated.</p>
Accounting Estimates	<p>Consider and document all significant accounting estimates used in the preparation of the financial statements. Review all estimates made for accuracy, appropriateness and consistency.</p> <p>Our audit work undertaken did not indicate any reason why the identified audit risk could not be mitigated.</p>
Governance	<p>Review of the financial procedure manual and the financial systems to ensure that the appropriate level of governance is adhered to. Typical review work concerns the convening of regular meetings, the timely submission of reports and the correct disclosures made as prescribed by the prevailing regulations.</p> <p>Our audit work undertaken did not indicate any reason why the identified audit risk could not be mitigated.</p>

4. Audit Findings

As stipulated by the Academies Accounts Direction 2016 to 2017, all findings detailed below have been given a priority rating as follows:



High Priority – should be addressed as a matter of urgency.





Medium Priority – recommendations to be implemented as soon as practical






Low Priority – recommendations made but little risk – to be dealt with in the future

4.1 Points identified in previous management letters dated 15 June & 22 June 2018.

Findings	Academy	Recommendation	Current position	Priority
<p>1. Purchases</p> <p>We noted the following:</p> <p>a) Certain orders forms were dated after the relevant invoice dates.</p> <p>b) Certain purchase orders are not authorised.</p>	CIS, CPS	We recommend that in order that all purchase orders are committed on the academy's accounting system, enabling the budget to be effectively monitored and overspending avoided, that purchase orders are raised, authorised and submitted to suppliers before goods and services and invoices are received.	Formal response to the interim management letter has not yet been received.	
<p>2. Fixed Assets</p> <p>A prior year adjustment was made in the previous years' financial statements to 31 August 2017 to include the actual valuation received of the land upon conversion to academy status as at 1 April 2012. The adjustment of £1,105,000 is based upon the valuation received for the ESFAs' "Whole of Government Accounts" dated 12 August 2013. To date, this amount has not been adjusted in the accounting records of the academy. Therefore, the Land & Buildings brought forward cost on the trial balance at 31 March 2018, is incorrect by the value of the adjustment made.</p>	CPS	We recommend that the academy makes a journal entry to correct the value of land of on the trial balance, to the figure reported in the financial statements to 31 August 2017.	The adjustment has now been made.	n/a

Findings	Academy	Recommendation	Current position	Priority
<p>3. Census and Pupil Numbers We noted on the Census Day:</p> <p>a) the number of pupils on roll per the census was 809, whereas the internal register showed the number as 807 pupils.</p> <p>b) the number of pupils eligible for free school meal per the census was 79, whereas the internal register showed the number as 78 pupils.</p>	CPS	We recommend that all items on the census are reconciled to supporting information and the reconciliations are retained with the copy of the census. If any figures on the census are inaccurate, the ESFA should be informed as soon as possible.	Formal response to the interim management letter has not yet been received.	
<p>4. Bank Reconciliation We noted that the bank balance as at 31 March 2018 per the nominal ledger totalled £100,729.94 whereas the bank balance per the bank statement at this date was £267,050.85, a difference of £166,320.91.</p> <p>There was no evidence provided to corroborate that the difference highlighted above was exclusively unreconciled items, nor that the bank account was being correctly reconciled and subsequently reviewed.</p>	CPS	Monthly bank reconciliations should be prepared, reviewed and signed to confirm agreement. Long outstanding items should be investigated and details of any findings and/or actions taken noted.	As at 31 August 2018, there was an unidentified amount of £756.00 included within unreconciled items.	
<p>5. VAT Debtor At 31 March 2018, the VAT receivable per the returns submitted to HMRC was £38,832.69, whereas the balance per the ledger was £45,242.58, a difference of £6,409.89.</p>	CPS	We recommend that at the end of each quarter, a reconciliation should be prepared between the refund requested on the VAT return submitted to HMRC and the VAT debtor per the nominal ledger. Any differences should be investigated and explained.	The VAT control account is fully reconciled as at the year end date.	n/a

Findings	Academy	Recommendation	Current position	Priority
<p>6. Payroll Costs The total payroll costs per the nominal ledger as at 31 March 2018 totalled £1,694,195.48, whereas the payroll costs per the external payroll reports totalled £1,677,226.12, a difference of £16,969.36.</p>	CPS	We recommend that the academy should reconcile the payroll costs posted to the ledger to those recorded on the payroll reports every month, and identify and explain any difference.	A small difference of £434,90 was identified when comparing the payroll costs per the nominal ledger to the third party payroll reports.	
<p>7. Register of Business Interests We noted that the register of business interests had not been signed or dated by <u>all</u> the governors.</p>	CPS	The register of business interests should be maintained and kept up to date for <u>all</u> governors and staff with significant financial responsibilities to avoid conflicts of interest arising.	Formal response to the interim management letter has not yet been received.	
<p>8. Building project We noted that Slough Borough Council has reimbursed £461,142.51 for the 'Year 6 Extension' building project. This amount has not yet been updated on the fixed asset register. In addition, the signed agreement and tender relating to this project was not available for us to review during the interim audit.</p>	CPS	The total expensed incurred at the end of financial year needs to be capitalised and supporting invoices relating to the same should be retained. We shall be grateful if the academy could let us have these documents at the final stage of the audit.	The building project has been capitalised at the year end.	n/a
<p>9. Information Outstanding The following information was not available during our interim audit visit:</p> <ul style="list-style-type: none"> - Governance Self-Evaluation - Business Continuity Plan (last updated March 2016) 	CIS	We shall be grateful if the academy could let us have these documents for review at the final stage of the audit.	Formal response to the interim management letter has not yet been received.	

4.2 Matters arising from our final audit work

No further audit findings / recommendations have arisen following our final audit visit.

5. Other Issues

5.1 Schedule of Unadjusted Errors

There were no errors that we noted in carrying out our audit that have not already been adjusted in the financial statements.

5.2 Other communication requirements

- We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit procedure
- We are not aware of any related party transactions which have not been disclosed
- We are not aware of any significant incidences of non-compliance
- Our review of the financial statements has found no material omissions in the financial statements

5.3 Misstatements Identified

There have been no material misstatements identified during the course of our audit work.

5.4 Significant difficulties met

There were no significant difficulties encountered during the course of our audit work.

6.1 Future Developments in the Sector

6.1.1 Teacher’s Pension Scheme

It is anticipated that the employer’s contribution rate will increase from the current level of 16.48%, to a figure upwards of 18%, and likely nearer to 20%, with implementation expected from 1 April 2019.

As staff costs form a large percentage of the academy’s total expenditure, any increase in the pension contributions is likely to have a significant impact to a trust’s budget, as can be seen from the summaries below, and appropriate plans will need to be formulated as to how this additional cost will be funded.

Example Secondary School

	Current level	Projected increase 1	Projected increase 2		
Gross Teacher's Pay	£4,000,000	£4,000,000	£4,000,000		
Contribution Rate	16.48%	18%	20%		
Total TPS contribution	£659,200	£720,000	£800,000		
Annual Increase		£60,800	£140,800		
Monthly Increase		£5,067	£11,733		

6.1.2 Transparency and Value for Money

In his letter to all academy trusts’ chair of governors, the new Parliamentary Under-Secretary of State for the School System, Lord Agnew, stated the following:

“I want to emphasise the priority that I attach to the responsibility you and your boards have to ensure that your executive teams manage their budgets effectively and deliver the best value for money. This is particularly important when looking at the pay of your senior leadership teams -especially the Accounting Officer. I would ask you to scrutinise any related party transactions, ensuring a full and proper procurement process is followed and that the trust is able to demonstrate the services are provided at cost.”

As can be seen from the above, the key areas that Lord Agnew is looking to focus on during his tenure, is to ensure that the ‘best value’ is obtained from the publicly funded money provided, which are demonstrable in the following two ways:

1. Ensuring the pay scales provide to senior staff members in excess of £100k pa have a clear rationale and follow a legitimate process. This point is emphasised by new wording in AFH 2018 [Para 2.4.3], stating that *“the board of trustees must ensure its decision about levels of executive pay follow a robust evidenced-based process and are reflective of the individual’s role and responsibilities. No individual can be involved in deciding his or her remuneration.”*

Trusts paying staff members in excess of £100k pa, would already have had to provide information on the above to the ESFA following a letter they received from the new CEO of the ESFA, Eileen Milner.

2. Ensuring that any related party transactions are fully scrutinised and follow the fit-and-proper procurement procedures laid out in the financial procedures manual. Ensure that the related party transactions are appropriately approved by independent members of the board of governors and/or senior leadership team and are demonstratable to have been provided at cost.

It is anticipated that these requirements, and potentially others too encompassing similar reviews, will continue to be imposed upon trusts, and in particular, their governing bodies.

6.2 Technical Help-sheets

6.2.1 ACADEMY BUDGETING CHECKLIST

As the academy sector faces continued funding challenges, it is imperative that the budgeting exercises carried out are beneficial to the trust and can enhance their financial processes.

We list below some points to consider when budgeting.

Academies should consider:

- ✓ 3 to 5 year budget forecasts
- ✓ Pupil forecasts and the impact on the budget
- ✓ Do the current reserves reflect the Reserves Policy, if not, what action is being taken?
- ✓ Sensitivity analysis – is this recorded as being assessed by the Board of Trustees?
- ✓ Is the academy making best use of its budget, particularly in relation to planning and delivery of the curriculum? Is the Teaching Contact Ratio 70% or below? If so, why?
- ✓ Does the academy have a realistic Deficit Recovery Plan?
- ✓ What percentage of the staff progressed through the salary scale? If 100% - is the academy an 'Outstanding School'? If not, the performance related pay test may not be strict enough.
- ✓ Consider the Apprenticeship Levy. This is not just a cost burden – the Board of Trustees should be mindful of using academy monies appropriately and therefore should put the levy allowance to appropriate use.

If you have any questions relating to these matters, please contact Michael Durst at our office who will be pleased to assist.

6.2.2 CHARITY TAX ISSUES

Charity Tax Exemptions

On the assumption that the academy has complied with the charity tax registration process and been accepted by HMRC as a charity, the following income sources are exempt from direct tax:

- Property (rental) income (s485 CTA 2010). Whilst rental income is exempt, one should note the guidance in HMRC Guidance Annex IV: -

“All rental income received by a charity from land and buildings is exempt tax provided the profits arising are applied for charitable purposes... However, if services are provided along with the use of the land or building, for example provision of caretaker, food or laundry, these services in themselves amount to trading. Letting activity will itself constitute a trade where the owner remains in occupation of the property and provides services over and above those usually provided by a landlord.”

Typically, rentals such as catering, conferencing and sports facility hire will all usually be linked to a service provision i.e. gym/sports equipment, food/beverage.

- Savings and investment income (s486 CTA 2010). This includes non-trading loan relationship credits and dividends/distributions.
- Income from intangible fixed assets (s488 CTA 2010). This includes non-trading gains on intangible fixed assets and annual payments (e.g. royalties).
- Chargeable gains (s256 TCGA 1992).
- Charitable trades (s478/479 CTA 2010.) This relates to either a trade which is the primary purpose of the charity (e.g. arising from provision of education) or a trade carried out by the beneficiaries of the charity (e.g. arising from a café run by sixth form students). The primary purpose exemption also extends to income from those activities which are “ancillary” to the primary purpose. This relates to trading which although not carrying out the primary purpose, is still in the course of carrying it out, i.e. the sale of school uniforms.
- Fundraising events & lotteries (s483/484 CTA 2010).
- Small trades (s482 CTA 2010). The limits for non-primary purpose trading income are:

Charity's gross annual income	Maximum permitted small trading turnover
Under £20,000	£5,000
£20,001 to £200,000	25% of your charity's total annual turnover
Over £200,000	£50,000

It should be noted that this exemption is in respect of income not profit. If an academy has £50,0001 of non-primary purpose trading income, it will need to

calculate a tax adjusted profit for the non-primary purpose trade and submit a Corporation Tax Self-Assessment return.

All of the above exemptions are conditional upon the income or gains arising being applied for the charitable purposes of the academy trust.

Taxable Income

A charity will be subject to tax on its income in two circumstances:

- a) where it fails to satisfy some of the conditions for exemption e.g. applying income for charitable purposes (in which case it will have non-charitable expenditure),
- b) where there is income which is outside one of the statutory exemptions.

Typically, those arise where there is:

- Trading income outside the statutory exemptions (“non-primary purpose trading”);
- Miscellaneous income taxable under s1016 ITA or Part 10 Chapter 8CTA, in excess of the statutory de minimis exemption.

In the case of academies, taxable income usually arises for:

- Letting of sports facilities. This is trading income if supporting services are provided, i.e. caretakers and sports equipment. This is classed as non-primary purpose trading where there is no amateur sport object in the articles. If the academy trust amends its articles, ESFA approval may be required.
- External catering & conferences, i.e. the provision of catering to other academies.
- Provision of maintenance/premises staff to other academies.
- Provision of car park to general public.
- Solar panels. Academies which benefit from the export tariff will be trading in electricity and this income will be classed as non-primary purpose trading. However, it should be noted that the generation tariff or renewable heat incentives are subsidies in nature and are not classed as non-primary purpose trading income.
- Closed courses. Income can only be applied for charitable purposes if the trading is for public benefit, i.e. closed courses are not for the public benefit and are therefore non-primary purpose. An example in the academic sector would be a course which is only open to students who are being funded by one employer, i.e. a vocational training course.
- Property sales connected to development. Such proceeds may be taxable under the Transactions in Land anti-avoidance legislation (CTA2010). Proceeds taxable under this legislation are classed as miscellaneous income which is not covered by any of the charity exemptions.
- Sponsorship. Income received from commercial sponsors in return for advertising would be taxable.

Non-charitable expenditure

The incurring of non-charitable expenditure means that the charity will not have applied all its income and gains for charitable purposes. This will lead to the loss of charity exemption on an equivalent amount of other income (classed as miscellaneous income).

If non-charitable expenditure arises, this can be offset against the miscellaneous income, which may result in no tax being due. This is subject to the normal Corporation Tax rules on losses and on the assumption that the non-primary purpose trade is carried on with a view to a profit.

Non-charitable investments

An academy will be deemed to have incurred non-charitable expenditure if it invests in something which is not an approved charitable investment or loan. This will largely be based on trustees' governance considerations.

Minute keeping and documentation are vital. HMRC would expect decisions to be based on business plans, cash flow forecasts and projections of future profit.

Cash held on deposits, government securities, listed shares, would all be charitable investments. Programme relating investments ("PRI") also qualify. PRI may include a subsidiary company which undertakes one aspect of the charities objectives. Typically for an academy trust this may be a subsidiary operating a nursery school which is charitable under the academy objects but is ring-fenced either for commercial risk or under the requirements of a funding body.

Trading Subsidiaries – When to use?

It is often a misconception that the immediate reaction to a charity incurring more than £50,000 of non-primary purpose trading should form a trading subsidiary because that will mitigate the Corporation Tax it will suffer. Trading subsidiaries are certainly a useful tool used by many charities to generate profit to support their charitable work. But they should not be utilised without significant consideration.

Proper overhead allocation may reduce the profit significantly. Typically, a charity's articles will allow the entity to undertake some non-primary purpose trading as long as it is "non-substantial". "Non-substantial" must be considered in terms of the size of the organisation. Therefore, because a charity has non-primary purpose income in excess of the small trading exemption, it does not automatically mean a subsidiary is needed.

It may however be useful to utilise a trading subsidiary for commercial protection.

The ESFA may also require certain activities to be run via a subsidiary so as to demonstrate that their funding is not being used to support that activity.

In summary, the cost of corporation and administrative time of running a trading subsidiary should be considered. A trading subsidiary should only be used where all other tax relief options have been considered.