Higher Educational and Other Charities in England

Professor Roger King

Centre for Higher Education Research and Information, Open University (UK)

Paper presented to the Workshop on 'The University of the Twenty-First Century: Emerging Models of Independence', Novi Sad, Serbia, 28-30 October 2005

Introduction

National systems of higher education display different historical pathways in the relationships between the state and institutional autonomy. Across many Continental European countries for example, the movement gradually has been away from close state controls to increased powers for universities as recognised collective entities, where the public interest and accountability tends to be exercised 'after the event' or 'at a distance' by the 'evaluative state' operating through quality assurance, accreditation and other regulators. In England, however, the historical trajectory has been different: traditional high institutional autonomy has been steadily subject to regulatory supervision by the state or its agencies. In the USA, to take a further example, the pattern has been different again: market forces and varying forms of local state governance are becoming increasingly subject to federal or national state forms of regulatory intervention, particularly around student finance. Yet, nonetheless, despite varying historical starting points, a pattern of national

convergence appears to be emerging internationally in higher education systems: rising institutional autonomy but also increasing regulatory supervision, albeit in some cases, such as Europe, in exchange for declining micro-management by the state.

This paper will examine the form of institutional autonomy in England that is provided, in part at least, by charitable status in support of educational bodies that are self-governing, legally independent, and often corporate, entities. Three points are worth making at the outset. First, the operation of charitable status in the conventional or publicly- funded higher education sector differs from that found in the more overtly private, not-for-profit sector. Second, despite the formal independence of charities, this legal freedom may be compromised by a charity's reliance on contracts and funding from one dominant source (such as a governmental agency, or government directly). Such a source may in some circumstances impose onerous contractual or funding conditions that effectively take the substance out of autonomy. Third, it is impossible to discuss institutional autonomy in higher education without also discussing regulation. Indeed, the two appear to go hand-in-hand. As organisations such as universities and colleges attain (or maintain) clear collective identities and freedoms, often as a consequence of looser direct state rules and ownership, they are subject to rising regulatory surveillance (either by state regulators, independent regulators at arms length from government, or by state-endorsed forms of self-regulation, or 'co-regulation').

Such regulation has a number of purposes for government. It may be used to protect the individual consumer (student or parent), including by evaluating

standards and quality on their behalf, and by generally incorporating a public interest in the system to complement a strengthened private institutional interest. But it may be used to promote markets and to enhance institutional autonomy as well, by clearing away obstacles to competition and choice (by allowing in, and to some extent legitimating, private or overseas organisations into a national sector). In many domains, including higher education, regulation is a form of 'meta-regulation', when the internal processes of an institution are turned 'inside-out' for external regulatory evaluation. That is, institutional autonomy and the way in which it is 'self-regulated', becomes the external regulatory object. Broadly, however, in increasing complex societies, direct command-and-control regulation by the state is increasingly replaced by state-sector partnership regulation, and forms of endorsed (by government) self-regulation. That is, governments increasingly recognise the ineffectiveness of regulatory arrangements that do not enrol those being regulated (or their representatives) in the regulatory process (such as by the retention of academic peer review within more formal assessment regimes in higher education).

The Legal Status of Higher Education Institutions in England

The predominantly (if increasingly less so) publicly- funded higher education sector in England is generally divided into two broad groups. In the so-called 'pre-1992' institutions of older universities (referring to the Further and Higher Education Act 1992 that created new universities from the ex-polytechnics, which were distinguished from longer-established universities), the constitution and powers of the governing body are laid down in, and limited by, the charter and statutes of the institution. For the 'post-1992' new

universities, they are laid down in legislation passed by Parliament in the Education Reform Act 1988 (as amended by the 1992 Act), together with instruments and articles of government or equivalent. A third group of colleges of higher education also exists (but with numbers getting smaller as a number attain university designation) which, in some cases, are supported by churches. These churches may have the right to be represented on the governing body, to determine the character of the institution, and in some cases also to have jurisdiction over the institution's assets.

Although these publicly- funded institutions are diverse in origin, size and organisation, they share the following characteristics of being:

- Legally independent corporate institutions
- Bodies with charitable status
- Accountable through a governing body which carries ultimate responsibility for all aspects of the institution

The legal status of particular institutions can take different forms, however, irrespective of charitable standing. Most of the older pre-1992 universities were established by a royal charter granted through the Privy Council, with an associated set of statutes, and this form of organisation is known as a chartered corporation. However, some pre-1992 universities were established by a specific Act of Parliament, the operative part of which is a set of statutes, and this organisational form is known as a statutory corporation. The structure of governance for each of these older universities is laid down in the instruments of its incorporation (the relevant Act, or charter and the statutes).

The post-1992 universities were established as higher education corporations by the Education Reform Acts 1988 and 1992 that were approved by Parliament, with articles of government subsequently approved by the Secretary of State (after being drawn up by institutions with the guidance of illustrative models provided by government). However, four ‘new’ or ‘post-92’ universities are companies limited by guarantee rather than higher education corporations.

Charitable Status

All higher education institutions have charitable status. Some of the smaller colleges are established as charitable trusts under a trust deed or through a scheme made by the Charity Commissioners. The Charity Commissioners (CC) are the state regulator for charities (its employees are civil servants and the Home Office is the responsible government department), and such trust colleges are subject to supervision by the CC, as are those institutions which are companies limited by guarantee. (Some observers would prefer to see the CC become a statutory and independent, rather than a state, regulator).

However, universities and most colleges, under current legislation, are known as exempt or excepted charities (as are some other non-education charitable bodies, such as voluntary housing associations). That is, they are not subject to the jurisdiction of the Charity Commissioners (CC). The Charities Act 1993 – the legislative framework governing charities and the CC - is currently under review, however. A draft Bill was published in 2004 but was lost because a general election was called in April 2005. However, the government has announced that the Bill will be re-introduced. The draft earlier Bill raised the

issue of the exempt status of higher education institutions and suggested that universities that are now exempt charities should, from the date when the new Act comes into effect, not be exempt from charities regulation.

However, to ease the burden of such a change, it is proposed that the 'principal regulator' is the Higher Education Funding Council for England (HEFCE), not the CC, the former which would be obliged to ensure that institutions comply with the requirements of their charitable status. If an institution is not compliant, however, the CC will be able to step in and secure compliance, generally with the support of the HEFCE. An expressed view of the CC is that it is happy to operate with sector or principal regulators in fields such as higher education. This notion of delegation to 'principal regulators' of charities is regarded as easing the burden on the CC as well as allowing sectors to be regulated for charity law purposes by regulators that are closer to the particular requirements and culture of those charities being regulated than would be the case if the CC regulated directly and universally.

The implications of the proposed new Act for members of governing bodies of universities are that they would be formally recognised as trustees of a charity and would be subject to the obligation this imposes under charity law. The style of financial reporting would need to change to fit CC reporting standards, the CC's view of what constitutes acceptability of commercial activities would become important, and greater disclosure of information on endowment and other restricted funds would be necessary.

Benefits

Charitable status confers the following benefits:

- Exemption from capital gains tax, and from income tax and corporation tax on income other than trading income arising outside the course of carrying on the primary purpose of the institution
- Ability to recover income tax deducted from deeds of covenant and receipts under gift aid
- Exemption from inheritance tax for donors to institutions
- Substantial relief on business rates
- Exemption from Value Added Tax on the supply of education and research (although they may be liable for VAT on trading activities)

Members of governing bodies of higher education charities are required

- To apply the assets and income of the institution only for the defined charitable purposes
- To act only within their legal powers
- To take particular care in organising trading activities which may not be regarded as charitable
- To manage and protect the property of the institution
- (After the new Act) To provide information and returns to the appropriate charity regulator (the CC or the HEFCE)

Non-exempt, private not-for-profit charitable bodies

In a number of countries, including England, not-for-profit higher education charitable institutions have been established for religious or for elite reasons,

although in countries with rising demand for higher education there appears an increase in such institutions also being ‘demand-absorbers’. It is not always easy to distinguish private, not-for-profit universities from those in the public sector, particularly in Europe, especially as they may receive public operating grants along the lines of the public bodies. A third and rapidly growing group of institutions, the for-profit (and thus non-charitable) organisations, often also receive public funding (as in the USA) but through a consumerist channel rather than through direct operational or research grants. That is, they benefit from government tax-breaks for parents paying tuition fees for their children, or they gain more directly from government grants and loans made to support students paying tuition and other fees. In the USA, for example, both not-for-profit and for-profit institutions benefit from public funding channelled to the consumer in the form of fees support.

A substantial charitable higher education private sector operates in England as not-for-profit charitable bodies, and they are subject to regulation by the CC, rather than being exempt from external charitable regulation as are the publicly-funded institutions. Some of the larger private colleges may, under recent Ministerial moves, elect to seek degree awarding powers and university designation in their own right. In the absence of public funding from HEFCE, however, they would still be subject to the CC. Private universities will differ from public universities in that their charitable undertakings will be regulated directly by the CC, and not by HEFCE.

Charities broadly are regarded as organisations set up for the benefit of the community (which includes education). However, as we have seen, they enjoy some tax advantages from the government and they cannot trade for profit (to undertake trading as a profitable activity they are required to set up a separate entity). To qualify as a charity, an organisation has to meet strict conditions about its overall purposes, also referred to as its Objects. The organisation also has to be set up with a constitution or rules, which meet certain conditions. These rules are usually referred to as a charity's governing document. The governing document will comprise a Memorandum and Articles of Association, which usually outline Objects, Powers (in furtherance of the Objects) and other stipulations, including appointments and meetings of the Board.

Most charities take one of three forms: the unincorporated association; the trust; or the company. A charity in either of the first two forms is not a corporate body, has no legal personality of its own, and cannot itself enter into a contract. Rather, its Trustees must personally enter into contracts on the charity's behalf. The incorporation of a charity normally protects its directors and members against personal liability to third parties. A corporate body such as a charitable company is considered in law to be a separate entity distinct from its members and directors. This means that legal documents can be signed in the company's own name and the liabilities are those of the company and not of its directors or members. However, incorporation does not reduce the personal responsibility of the directors (who are legally the charity's Trustees) to manage the charity properly. Thus, several kinds of

organisation can qualify as a charity. And, as we have noted for universities, some charities are also set up by special legislation. All are subject to the general principles of charity law.

Charities that are registered companies are also regulated under the Companies Act (as well as by the CC). This brings duties such as the annual filing of directors' reports, accounts and return with the Registrar of Companies (in addition to sending accounts, a Trustee Annual report and return to the Charity Commission). However, all charities employing staff are also regulated by Health and Safety legislation as well as legislation concerning racial equality, disability discrimination, equal opportunities and similar areas.

Charities receive their money in various ways, such as payment for services provided, government grants, public donations, and legacies. The income of a charity, and the accumulation of surpluses, must be applied for its charitable purposes within a reasonable period of receipt. Most charities can sell land, subject to certain conditions, but not if it is part of endowed assets. Generally, a charity can borrow money and give a charge on its assets for security. Charitable institutions generally possess a Board of Trustees, which is responsible for the charity's mission, for its property, its administration and management, its finances and the employment of staff. Trustees are the people who have and must accept ultimate responsibility for directing the affairs of a charity, and ensuring that it is solvent, well-run, and delivering the charitable outcomes for which it has been established. In most large, but also

some smaller charities, personal liability insurance is provided for Trustees and applies, provided that they act prudently, lawfully and in accordance with the governing document. Generally, charities subject to the CC are required to follow a 'Statement of Recommended Practice, Accounting and Reporting (usually referred to as SORP 2005) in preparing accounts. External audit is also required where income and expenditure exceeds (currently) £250, 000.

The exact legal position of Trustees is slightly different in the two main types of charity – unincorporated and incorporated. In unincorporated charities, such as trusts, (see some colleges, above), the property of the charity is usually held by the Trustees or their nominees. For most incorporated charities, which are usually registered companies, the company is the legal entity in its own right, and the trustees are directors of the company. However, all Trustees must act in the charity's best interests, and must not represent the interests of any outside organisation or their own personal interests. Particularly in the case of government contracts, Trustees have to be wary of allowing the priorities of public bodies to exert an influence over their charity's long-term policies and direction. Usually the charity's governing document sets out how Trustees are to be appointed. Most Trustees are unpaid and must not benefit in any way from their connection with the charity, with limited exceptions.

Trading

When a charity trades as way of achieving its charitable purposes any profits resulting from the trade will normally not be subject to tax. The charity may set up a charitable company for this purpose. This exemption from direct tax only

applies if the profits are used solely for the purposes of the charity. For the operation of commerce where the purposes lie outside those of the charity, and the aim is to raise funds by making a profit, a separate non-charitable company is usually set up. However, this company is liable for tax on its profits. Generally, although it is good practice for some Trustees to be directors of its non-charitable company, it is also good practice for some non-Trustee directors to be appointed, to help reduce potential conflicts of interest and to maintain an appropriate level of independence for both the charity and its company.

Regulation

The institutional, self-governing characteristics that charitable status tends to reinforce in organisations, however, is regulated in the public interest by a state regulator – the CC. It aims to give the public confidence in the integrity of charity. Its objectives are:

- to ensure that charities are able to operate for their purposes within an effective legal, accounting and governance framework;
- to improve the governance, accountability, efficiency and effectiveness of charities; and
- to identify and deal with abuse and poor practices.

In particular it:

- maintains a public Register of charities;
- investigates misconduct and the abuse of charitable assets, and takes or recommends remedial action;

- gives advice to charity trustees to make the administration of their charity more effective; and
- where necessary, makes schemes and orders to modernise the purposes and administrative machinery of charities and to give Trustees additional powers.

Consequently, regulation of charities consists not only of public accountability but also through an advisory and guidance role for the development of charities as organisations. Charities are free and independent organisations whose work is regarded as essential to society. But a charity regulator is needed, in the view of government and others, to ensure that charities are run for public benefit and not for private advantage, to ensure that they are independent, to detect serious mismanagement or abuse, and to ensure that charities are equipped to comply with the law. Increasingly, charities regulation is moving in the direction found with other regulators in other domains, namely to focus on both development and accountability, but also to focus resources where there appears to be greatest risk (that is, on organisations with poor track records).

The Charities Act in England is subject to review and a draft Bill is likely to be re-introduced in Parliament shortly. Among some of the issues concerning regulation that are being raised are the following:

- Should the regulator (CC) become more independent of government, perhaps being placed on a statutory footing at arms length from ministers?

- Is there a place for an independent Ombudsman to receive complaints about maladministration in both charities and the regulator (CC)

- Is the government's proposal for an independent tribunal to hear challenges to CC's legal decisions likely to be supported?

- Is there a role for self-regulation somewhere in the overall regulatory arrangements for charities, such as for fund-raising, perhaps, with state or legal regulation in the background as a 'back-stop'?

- Will the government proposal that current exempt charities become subject to charity law, perhaps, as with higher education, through the notion of a 'principal regulator', be sustainable, or will there continue to be demands that all higher education institutions are regulated by the CC?

Conclusion

Charitable status for educational institutions provides a basis for legal independence and self-governance, as well as providing tax advantages.

However, it also imposes limitations as to a charity's powers and activities in the public interest, and charities are regulated accordingly. However, the process of regulation more generally, including in higher education, is becoming more sophisticated and potentially less onerous for the respectable and the law-abiding organisations. Nonetheless, any discussion of the role of charitable status in higher education systems, especially in the context of increasing institutional autonomy, must inevitably be accompanied by a discussion of regulation in both the public, and the charitable organisation's, interests. And that requires investigation of the increasingly sophisticated approaches to regulation, and the growing literature of regulatory scholarship, to ensure that institutional autonomy is matched by appropriate rules and standards. Moreover, sensible regulation of charitable status should be aimed as much at development as at accountability.

October 2005