

Increasing the internal scrutiny of academy trusts

The **Academies Financial Handbook for 2019** ('AFH 2019') came into force on 1 September 2019. Each year, the Education and Skills Funding Agency ('ESFA') update the handbook to ensure effective financial management within the academy sector.

The latest edition has significantly strengthened the requirement for independent assurance to be sought by trustees to ensure that financial controls and risk management procedures are operating effectively within their academy trust. This assurance has now become known as "internal scrutiny" and it applies to all academy trusts.

This guidance highlights the process and steps that academy trusts and boards should take to ensure effective and stringent financial controls and risk management procedures are in place in their organisations. Whilst the new AFH appears to add more regularity burden to an already stretched sector, if employed correctly, the scrutiny undertaken can add significant value to trusts and provide real assurance to trustees that key risks are being mitigated effectively.

Process for effective internal scrutiny

AFH 2019 states that an academy trust must establish an audit committee, appointed by the board, who will direct the work to support internal scrutiny.

An academy trust with an annual income under £50 million can combine the role of the audit committee with another subcommittee (usually finance); otherwise it is mandatory for the audit committee to sit separately and meet at least three times a year.

The audit committee should not include any employees of the academy trust, nor should it be chaired by the chair of the full trust board. Where the audit committee is combined with another committee that includes any of the above employees, they should not participate in any discussion in relation to audit matters.

Part of the role of the audit committee is to review a risk register detailing the risks facing the trust and the steps to mitigate them. A good risk register will help inform a programme of work to be undertaken by those delivering the internal scrutiny. This work, when completed, should then be reported to the full trustee board by the audit committee.

The trust must deliver internal scrutiny in the way best suited to the complexity and requirements of the individual trust. Those carrying out the work could include any of the following:

- An employed in-house internal auditor who is a member of a relevant professional body
- A bought in internal audit service from an appropriately qualified firm or
- A non-employed trustee or a peer review by a chief finance officer from another trust with a suitable finance, accounting or audit qualification.

Link to risk register

The first step for an audit committee in preparing a programme of work which delivers effective internal scrutiny is to begin with the risk register. Trustees should assess and reflect upon the risks identified and ask:

- What are the highest perceived risks to the academy trust?
- How are these risks being mitigated?
- Do we have independent assurance or, can we externally corroborate, that we are sufficiently mitigating the risk?
- Do the controls work effectively?

This will go some way in focusing the work into more detailed areas of the trust. There is no expectation from the ESFA that all risks should have an independent review immediately. It is accepted that this will take time, however, it is expected that a timetable of work is put in place which addresses the risks identified although an expectation is that higher risk areas are reviewed as a priority.

Example

A key risk for an academy trust might be falling into a deficit budget position. The academy trust has sufficient independent evidence to believe that the internal controls are working effectively. The risk has been generated by the general economic environment in the sector and pressures in funding.

The budgeting process is therefore an imperative starting point for trustees to ensure that the trust is viable for the next school year and beyond. There may not be financial expertise on the trustee board and therefore reliance is placed on the finance director to complete this exercise.

The audit committee may commission a piece of work to review the budget setting process at the trust, including testing the underlying assumptions made to the budget, and provide recommendations for how the process could be more robust or identify any areas of omission.

Work to add value

Internal scrutiny has matured considerably through each version of the Academies Financial Handbook. There are, however, still academy trusts who engage an external party to review basic controls by testing a sample of transactions. The limited nature of this work can make trustees feel like internal scrutiny is just another compliance exercise which adds no value.

This type of review could still be appropriate for new academy trusts or those who are experiencing financial or operational difficulties. In these instances, the trustees need an external party to provide assurance that internal controls and procedures are working effectively.

However, for an established well controlled academy trust, the innovative use of qualified trustees / peer reviews may be more appropriate to cover this type of work. This would allow the academy trust to use their budget allocation for internal scrutiny work on topics that will provide trustees with comfort on more strategic aspects of the trust.

An example of what a good internal scrutiny structure sitting alongside the external audit process might look like is illustrated in Figure 1. It identifies that day-to-day transactions are best sampled by peer or trustee reviews. An external party can then assist with higher level areas such as a review of the trust governance structure, the onboarding process for new schools or the scalability of central support services in the trust.

This internal scrutiny work is considered by the external auditor who will use all the information available to provide a risk assessment of the internal control environment. This will then allow for the year end statutory audit to focus testing accordingly to provide the regularity assurance report and a management letter which can support the recommendations picked up during the programme of internal scrutiny work.

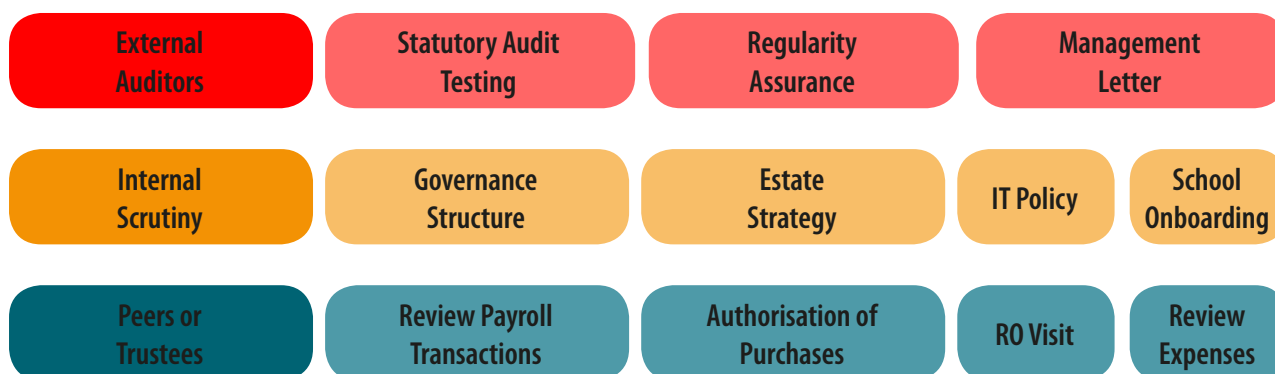


Figure 1

Reporting

The full trustee board needs to be provided with the findings on a timely basis once the internal scrutiny work has been completed. The work will also be reported externally in the governance statement within the annual accounts as it has done in previous years.

For the year ended 31 August 2020, an annual summary report will have to be provided to the ESFA together with the submitted annual accounts and management letter by the usual deadline of 31 December. This is a new reporting requirement and requires the summary report to cover the areas reviewed, key findings, recommendations and conclusions. The ESFA may request individual internal scrutiny reports if required.

Additional information

Academies Financial Handbook 2019, ESFA

<https://www.gov.uk/guidance/academies-financial-handbook>

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