Graham Stuart MP
Chair, Education Committee
House of Commons
London
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14 October 2014

Dear Graham

The Institute of Education Report ‘Conflicts of interest in academy sponsorship arrangements’ – published 17 September 2014

I saw this report which the Select Committee commissioned from the Institute of Education as part of its review of academies and free schools. It refers to a number the Education Funding Agency’s own published reports but I thought there was a major gap in that it did not set out a full description of the accountability framework for academies and free schools. Partly because of that, I thought the report conveyed a lack of understanding of the context of the academy programme and failed to provide evidence for the assertion that the accountability framework is weak.

I thought the Committee might find it helpful, therefore, if I set out the elements of the framework, including how compliance is monitored.

Accountability is at the heart of the academies programme and academy trustees have very specific duties to safeguard their academy trust’s resources to avoid conflicts of interest and to promote transparency through the publication of their accounts (annual report and audited financial statements).

The framework has the following elements:

- **Academy trusts are companies limited by guarantee.** Company status means that the trustees of the trust are company directors and have statutory duties under the Companies Act 2006 – such as the duty to avoid conflicts of interest. Company status also brings responsibilities for exercising reasonable care, skill and judgement and the requirement to produce annual accounts.

- **Academy trusts are charities.** Trusts must operate in the public interest,
rather than for the benefit of owners. And, whilst they are accountable for their activities to the Secretary of State for Education as principal regulator, in a broader sense they are also accountable to their charitable beneficiaries – the pupils they teach and the communities they serve.

- **Academy trusts are public sector bodies.** This means that they need to conform with the expectations and requirements of the Treasury's rules about public money and the framework of accountability set out in the Treasury document 'Managing Public Money' which underpins all public sector spending. These requirements are reflected in the Academies Financial Handbook, and include:
  
  - publishing an annual governance statement;
  
  - appointment of an accounting officer who completes their annual report on 'regularity, propriety and compliance'; and
  
  - assurances over value for money

These arrangements are designed to ensure that there is a chain of accountability for public money from Parliament (through the Public Accounts Committee) to my Permanent Secretary as Principal Accounting Officer for voted funds, through me as Chief Executive and Accounting Officer of the Education Funding Agency to each individual Accounting Officer of an Academy Trust.

- **The funding agreement.** Trusts are funded from the public purse, and the conditions attached to this are set out in a funding agreement with the Secretary of State. Whilst the funding agreement describes some specific financial conditions, such as the duty to prepare budgets and accounts, it contains an overarching requirement for trusts to apply sound financial management and ensure there are effective controls within the trust. Each trust's funding agreement is published on the Department for Education's performance tables website.\(^1\)

- **The Academies Financial Handbook and Accounts Direction.** The funding agreement requires trusts to follow the Academies Financial Handbook. It is through the handbook that the key principles of good financial management are expressed. The handbook also sets out the financial freedoms trusts have and the additional requirements placed upon them by the Department for

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\(^1\) Accessible at [http://www.education.gov.uk/schools/performance/](http://www.education.gov.uk/schools/performance/)
Education (DfE), for example the 'at cost' rule mentioned in the report. In addition we produce an Accounts Direction giving detailed instructions as to how academies should prepare and submit their accounts.

So how do we monitor compliance against this framework? We obtain the assurance that public funds in this sector are being used appropriately and that academy trusts are complying with the framework in a number of ways:

- **Assurance by external auditors** - auditors play a key role in monitoring compliance with the framework. Academy trusts must appoint a registered auditor to review their accounts and provide an audit opinion and a conclusion on regularity.

- **Assurance programme** - each year we plan a programme of work within EFA to provide further assurance over the use of public funds. This includes reviewing audited academy trust accounts, auditor management letters, accounts returns, budget forecast returns and financial management and governance returns. In particular, our annual review of budget forecast returns enables us to identify early at an early stage, trusts at risk of future financial failure. We then decide what level of intervention is required to ensure trusts take mitigating action early. Increasingly we are developing analytical data tools to help us process and assess the large amounts of data we are collecting about academy trusts. We are increasingly able to predict future risk, although we have some way to go to build this aspect fully into our arrangements.

- **Investigation and Intervention** – this is a key part of our work and where it is apparent that there is a risk to public funds then we will intervene in a way that is proportionate to the risk. This could range from a visit to consider the financial management and governance controls within the academy trust to a full investigation. If we conclude that financial management is not up to our expectations, we will issue a Financial Notice to Improve.

We underpin these arrangements through extensive discussions and joint working with academy representatives and with their auditors to develop and publish regular advice and guidance. We recognise the importance of ensuring that all trusts are aware of what is required of them. We issue a weekly e-bulletin highlighting key items to be aware of, there is an email helpline and we provide training in the form of on-line presentations, webinars, seminars and conferences. From time to time I write as Accounting Officer to the Accounting Officers of Academy Trusts to draw their attention to important developments – and indeed to the lessons learned from our
programme of reviews and investigations.

All trust accounts and value for money statements are published on the DfE performance tables website\(^2\) as well as by individual trusts on their websites. We always publish the results of investigations as well as any Financial Notice to Improve, so that everyone is aware when academy trusts have fallen short of our standards. We have published 8 reports of investigations, 12 reviews of financial management and governance and 13 Financial Notices to Improve. This level of transparency provided the source material for a number of the cases which the Institute of Education drew on for their September report.

The issue of related party transactions has come under particularly close scrutiny this year, including in the Institute of Education report. As the Committee will be aware, the disclosure of related party transactions is standard accounting practice across the private and public sectors and is designed to promote transparency and avoid conflicts of interest.

We have reviewed all financial statements prepared by academy trusts for the 2012 to 2013 year. Of the 2,252 academy trusts submitting accounts, 43% set out related party transactions; my staff in the EFA reviewed all these cases and are content for over 98% that the transactions had been properly reported and were satisfactory. We have followed up the remaining small number of cases and taken appropriate action, including publishing reports of investigations.

Our conclusion from this analysis is that the vast majority of related party transactions are established for sound business reasons and are properly managed and disclosed. In the small number of cases where arrangements are not compliant with our policy framework, there are sufficient checks and balances to ensure that they are identified and appropriate action is taken.

The current policy, which we announced in October 2013, requires related party transactions to be "at cost" only, with no profit allowed. For 2014 to 2015, to reduce bureaucracy, we have introduced a 'de minimis' limit of £2500, but transactions above that limit must still be at cost. There are no other comparable sectors of public life of which we are aware where these kinds of transactions are completely banned; and we think that if we were to ban all transactions that it would have unwelcome consequences. These could include placing restrictions on school improvement activity which takes place between trusts; and preventing Church diocesan education authorities from providing support to their academy trusts.

\(^2\) See note 1 above
The Institute of Education report was not clear about the current set of requirements in the Academies Financial Handbook since it set out recommendations which are already in place - for example, that ‘at cost’ services should be procured through a transparent process. This is exactly the requirement in the handbook. All academy members and trustees must:

- manage their relationships with connected parties to avoid both real and perceived conflicts of interest;

- publish on their website the relevant business and pecuniary interests of trustees and members; and

- carry out a fair, competitive procurement process and, if a related party is successful in securing business, then it is at this stage that they must do so at no more than cost\(^3\).

The Institute of Education report also suggested that some academies had not published their accounts. All 2012/13 accounts have been received and published as noted above.

We continually remind trusts and external auditors of their key responsibilities regarding financial and governance matters and manage the risk of non-compliance through a transparent assurance programme. No system of assurance can guarantee it will prevent all wrongdoing, however our work supports the view that academies trusts are complying effectively with requirements that we believe are more stringent than anywhere else in the charities and public sector whilst having the autonomy that they need to deliver excellent education to their pupils and value for money for the taxpayer.

The system I have set out in some detail above is a much more rigorous system of accountability than applies to maintained schools – designed to match the greater freedoms that academies and free schools enjoy. Maintained schools are not subject to company law, they are not charities, there is not a clear published framework for their accountability, there is no system of independent audit of accounts and there is no transparency about publication of investigation reports and financial notices to improve.

To turn to a specific issue in the Institute of Education report, we have a zero tolerance approach to fraud – and if we find cause for concern, we will always refer

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\(^3\) From September 2014 we have introduced a de minimis limit of £2,500 to reduce bureaucracy.
matters to the police. Section 2.3.1 of the Institute of Education report suggests that a head teacher spent £50k on a one day training course that was run by a friend and that the governors were not aware of this. If this allegation is true then there is a potential for fraud and it is important that we investigate this. For this reason we have taken the unusual step of writing to the authors asking for further information. I would ask for your support in this.

Although I have set out the gaps in the Institute of Education report (which we would of course have been happy to explain to the authors if we had been offered a chance to comment on the report), I was however pleased to see the authors’ view that the accountability framework and assurance regime has been significantly strengthened and the vast majority of academy trusts are complying with the requirements. Unfortunately there will always be the possibility of fraud and irregularity, not just in the academy sector, but the world at large. However, it remains rare within academy trusts and where it appears we take a hard line approach, as explained above.

I do hope that you find this letter helpful in setting things out clearly and clearing up any possible misunderstanding. A copy of this letter goes to Margaret Hodge, Chair of the Public Accounts Committee and to Professor Toby Greany at the Institute of Education.

Yours sincerely

[Signature]

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