



National Audit Office

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## **Report**

by the Comptroller  
and Auditor General

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### **Education Funding Agency**

# Investigation into the Education Funding Agency's oversight of related party transactions at Durand Academy

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Education Funding Agency

# Investigation into the Education Funding Agency's oversight of related party transactions at Durand Academy

Report by the Comptroller and Auditor General

Ordered by the House of Commons  
to be printed on 11 November 2014

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National Audit Act 1983 for presentation to the House of  
Commons in accordance with Section 9 of the Act

Sir Amyas Morse KCB  
Comptroller and Auditor General  
National Audit Office

10 November 2014

Our investigation focuses on the Education Funding Agency's oversight of Durand Academy Trust. The investigation reviews the Agency's own work, and examines the nature of the conflicts of interest, the control framework for related party transactions and the Agency's response to issues identified at Durand Academy Trust.

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## **Investigations**

We conduct investigations to establish the underlying facts in circumstances where concerns have been raised with us, or in response to intelligence that we have gathered through our wider work.

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# Contents

**Summary** 4

**Part One**

Background 7

**Part Two**

Related parties at Durand  
Academy Trust 10

**Part Three**

Agency's oversight of related  
party transactions 19

**Appendix One**

Oversight of related party  
transactions 25

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This report can be found on the National Audit Office website at [www.nao.org.uk](http://www.nao.org.uk)

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# Summary

## Background

1 In response to correspondence addressed to the Comptroller and Auditor General and the Chair of the Committee of Public Accounts, the National Audit Office has investigated the Education Funding Agency's oversight of the Durand Academy Trust's compliance with guidance on conflicts of interest and related party transactions. The Academies Financial Handbook (the Handbook)<sup>1</sup> details the rules and guidance with which academies are expected to comply to ensure regular use of public funds.

2 Part One of this report sets out background detail on academy trusts and guidance relating to conflicts of interest and related party transactions. Part Two sets out our findings on related party transactions at Durand Academy Trust, and Part Three our findings on the Education Funding Agency's oversight of Durand Academy Trust.

## Scope of the investigation

3 Our investigation focuses on the Education Funding Agency's (the Agency) oversight of Durand Academy Trust. The investigation reviews the Agency's own work, and examines the nature of the conflicts of interest, the control framework for related party transactions and the Agency's response to issues identified at Durand Academy Trust. We have recently published a report on the wider oversight of schools performance.<sup>2</sup>

4 As part of this investigation we reviewed:

- the nature of the conflicts of interest and related party transactions at Durand Academy Trust;
- the role of the Agency in identifying the risks of related party transactions occurring at Durand Academy Trust; and
- the actions taken by Durand and the Agency to address concerns that have been raised.

1 Available at: [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/255052/Academies\\_Financial\\_Handbook\\_Oct\\_2013\\_FINAL\\_041113.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255052/Academies_Financial_Handbook_Oct_2013_FINAL_041113.pdf)

2 Available at: [www.nao.org.uk/report/academies-and-maintained-schools-oversight-and-intervention/](http://www.nao.org.uk/report/academies-and-maintained-schools-oversight-and-intervention/)

## **Key findings**

### Durand Academy Trust

**5 The structure of Durand Academy Trust and the associations between related organisations were complex.** Durand Academy Trust includes a well-established and successful primary school with strong results and new secondary provision from September 2012. The Trust had a large number of conflicts of interests in the way that it managed its academy and its assets. Some of these were established before the school became an academy and had grown up over time. There were several individuals that were involved in two or more of the associated public entities or trading companies. There were also individuals that sat on the board of the Academy Trust that were directors or staff at companies that the Academy Trust had contracted or purchased services from, and other transactions between individual connected parties. Some contracts had been awarded without competition. Complex structures and governance arrangements are not always transparent, which can increase the perception of any wrongdoing.

**6 The Agency identified undisclosed conflicts of interest at Durand Academy Trust.** After a review of the academy's financial statements for 2012-13 and further follow-up work, in April 2014 the Agency identified an undisclosed related party transaction for the purchase of legal services from a company, Judicium Consulting Limited, where a Durand governor was the Company Secretary. The Agency also found that the Academy Trust had become a party to the contract between London Horizons Limited and GMG in 2012, incurring additional obligations and contingent liabilities.

**7 The Agency has now taken action to address the related party transactions at Durand Academy.** In May 2014, the Agency agreed a series of actions with the Academy Trust to address the problems identified. These actions included re-tendering of contracts on their expiry and the immediate cancellation of the obligations incurred by the Academy Trust when it became a party to the contract between London Horizons Limited and GMG.

### The Agency's wider management of related party transactions in the academy sector

**8 The Agency has a systematic and consistent process for reviewing disclosed related party transactions which is initially desk-based and light-touch.** The Agency reviews related party transactions as part of an overall review of disclosures in academies' financial statements. The Agency's judgement on whether the disclosed related party transactions present a risk to public funds is often founded on other sources of information, such as whistleblowing reports or the Agency's own register of academies of national concern. The Agency does not routinely follow-up with academies to ensure that related party transactions have been disclosed nor do they have the capacity to be able to carry out these checks. It does carry out a more detailed review at academy trusts where there is a cause for concern.

**9 The Agency has changed its guidance on related party transactions in response to concerns, but it has done so incrementally at different stages of its investigation into related party transactions.** The Agency introduced an 'at cost' policy for related party transactions at academies, which applies for new and renewed contracts for goods and services agreed on or after 7 November 2013. The Committee of Public Accounts has recommended that the Agency reconsider its policy on academy trusts' related party transactions.<sup>3</sup> The Committee's report on the Agency raised concerns that related party transactions are always open to accusations of conflicts of interest, even when on a 'no-profit' basis. This view is contrary to the Agency's view that related party transactions are acceptable under some circumstances where value for money and compliance with relevant accounting standards can be demonstrated.

**10 Compliance with the new guidance on related party transactions will be difficult to evidence.** The measurement of 'cost' or 'no profit' is subjective and will be difficult to evidence and audit. For example, different suppliers will absorb their overheads at different rates, making it difficult for an academy to demonstrate whether goods and services it has obtained from a related party were provided 'at cost'. This will become especially difficult when accounting for the purchase of professional services, where the academy is effectively buying-in an expert's time and knowledge rather than goods with an historic cost. The Department has provided additional guidance on auditing this requirement but auditors remain concerned that this will be difficult to apply; and there remains a challenge for the Agency to ensure that academy auditors are able to provide an unmodified opinion on the financial statements.

<sup>3</sup> Available at: [www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/news/publication-of-report-education-funding-agency/](http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/news/publication-of-report-education-funding-agency/)



# Part One

## Background

**1.1** This part of the report sets out the background on academy trusts, Durand Academy Trust, and guidance relating to conflicts of interest and related party transactions.

### **Legal status of academy trusts and their responsibilities**

**1.2** Academies are publicly-funded schools that are independent of local authority control. Each academy school is part of an academy trust, a charitable company limited by guarantee, which is the legal entity responsible for its schools' financial management and governance. A trust can be responsible for multiple schools or only for one.

**1.3** Independence from local authority oversight gives academy trusts greater control over their financial resources than maintained schools. However, academy trusts are directly accountable to the Education Funding Agency (the Agency), an executive agency of the Department for Education (the Department), through their funding agreements with the Secretary of State.

**1.4** The Agency has day-to-day responsibility for monitoring academies' compliance with their funding agreements. In particular, it monitors compliance with the Academies Financial Handbook (the Handbook), which details the rules and guidance with which academies are expected to comply to ensure regular use of public funds. The Handbook takes into account the relevant financial reporting requirements for charities, as well as setting out the standards expected of academies' accounting officers to ensure probity in relation to the use of public funds.

### **Durand Academy Trust**

**1.5** Durand is based in Stockwell, South London, and has over 1,000 pupils. Originally a primary school, it has subsequently extended its activities to include, from September 2010, an Early Years Centre, and, from September 2012, a middle school, providing education to children in years 7 and 8. It became an academy in August 2010. Durand Academy's primary school is well-established and successful, with strong results. The academy was rated by Ofsted as a 'good' school in January 2014.

**1.6** Durand plans to educate pupils in years 9 to 11 in new boarding facilities outside South London. It has purchased a site for this, a vacant boarding school, in West Sussex, which it plans to develop and expand. The Department has agreed to provide £17.34 million towards the cost of this redevelopment, subject to the granting of planning permission for the necessary building works and the approval of a final business case. The National Audit Office has received correspondence which outlines value for money concerns about the boarding school, and the Comptroller and Auditor General has committed to review the business case for the boarding school in due course.

## **Defining conflicts of interest**

What are conflicts of interest?

**1.7** A conflict of interest is a set of circumstances that creates a risk that an individual's ability to apply judgement or act in one role is, or could be, impaired or influenced by a secondary interest. It can occur in any situation where an individual or organisation (private or government) can exploit a professional or official role for personal or other benefit.

**1.8** Conflicts can exist if the circumstances create a risk that decisions may be influenced, regardless of whether the individual actually benefits. The perception of competing interests, impaired judgement or undue influence can also be a conflict of interest.

**1.9** Conflicts might occur if individuals have, for example:

- a direct or indirect financial interest;
- non-financial or personal interests; or
- conflicts of loyalty where decision-makers have competing loyalties between an organisation they owe a primary duty to and some other person or entity.

**1.10** Conflicts of interest are a common and unavoidable part of management which can arise in a range of situations and environments. They can result from policy decisions or systems or can occur naturally in certain management situations. It is therefore not reasonable or desirable to completely eliminate the risk of conflicts of interest. It is better to recognise the associated risks and put measures in place to identify and manage conflicts when they do arise. Departments and other bodies should design a proportionate approach that reflects the nature and scale of conflicts that they are exposed to.

**1.11** Academy trusts are in a similar position. Members of such groups come from different backgrounds, bringing valuable local, specialist or business expertise. However, there are concerns surrounding the lack of transparency in decision-making and the risk that the private interests of members could influence public spending decisions, for example through related party transactions.

## Guidance on managing conflicts of interest

**1.12** A related party transaction occurs when there is a transfer of assets or liabilities or the performance of services by, to, or for a related party irrespective of whether a price is charged. The definition of a related party is broad, and includes corporate entities such as subsidiaries, as well as individuals, such as directors, staff, trustees, and their close family members.

**1.13** Related party transactions are not inherently irregular; however, there have to be processes in place to ensure that conflicts of interest do not affect the decisions taken by an organisation. Academies are allowed to enter into related party transactions if they provide value for money, and guidance in the Handbook establishes a number of conditions to ensure that any conflicts of interest are managed.

**1.14** In addition, the Handbook requires academy trusts to disclose related party transactions in their financial statements. These disclosures include information such as the names of the related parties; a description of the relationship between the academy and the related parties; and the amounts involved. The Handbook in place for academies' financial year ending 31 August 2013 explicitly stated that academies must ensure that, "no trustee, governor, employee or related party has benefited personally from the use of funds".

**1.15** Based on the Agency's review of academies' 2012-13 financial statements, we consider that the total related party transactions reported by all academies was not material by value. However individual high-profile cases risk reducing public confidence in the assurance system that the Agency has in place.

**1.16** Accounting officers of academy trusts have to provide a 'Statement on regularity, propriety and compliance' in the annual report that accompanies their audited financial statements. External auditors provide an opinion on whether this statement, as part of the annual report, is consistent with the financial statements and the findings of their audit. This opinion includes their audit of related party transactions.

### **External audit**

**1.17** In auditing the related parties disclosed in academies' financial statements, audit firms must comply with the International Standard on Auditing 550 – Related Parties (ISA 550). ISA 550 states that, "The significance of [a related party transaction] may not depend solely on the recorded amount of the transaction but also on other specific relevant factors, such as the nature of the [...] relationship".

## Part Two

### Related parties at Durand Academy Trust

**2.1** Durand Academy Trust is the trust responsible for managing the Durand Primary School. The Academy is headed by an Executive Head, Sir Greg Martin, and a Head teacher, Mark McLaughlin. They are supported by:

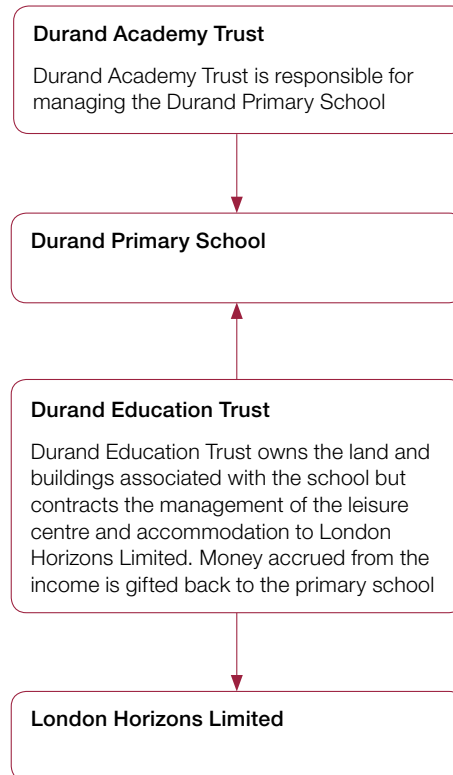
- a head for the infant school (nursery to year 3);
- a head for the junior school (years 4 to 6);
- a middle school team leader (years 7 to 8); and
- a head of boarding.

The governing body of the Durand Primary School is chaired by Victoria Robinson and the vice-chair is Kevin Craig. Some of the governors of the primary school are also directors of the Academy Trust.

**2.2** There is also another, separate trust related to the school, the Durand Education Trust, which was established in May 2010 and therefore predates the conversion of Durand Primary into an academy. The Durand Education Trust is an exempt charity set up to provide wider educational benefits for children at Durand. Durand Education Trust owns much of the land and buildings on which the Academy operates after the school transferred ownership of these to the Trust prior to its conversion to academy status in August 2010. The Trust allows the academy to occupy the premises for a peppercorn rent. The Durand Education Trust also owns a health club, swimming pool and residential property, which brings in income which accrues to Durand Education Trust via a trading company, London Horizons Limited. The structure of the school governance is shown in **Figure 1**.

**Figure 1**

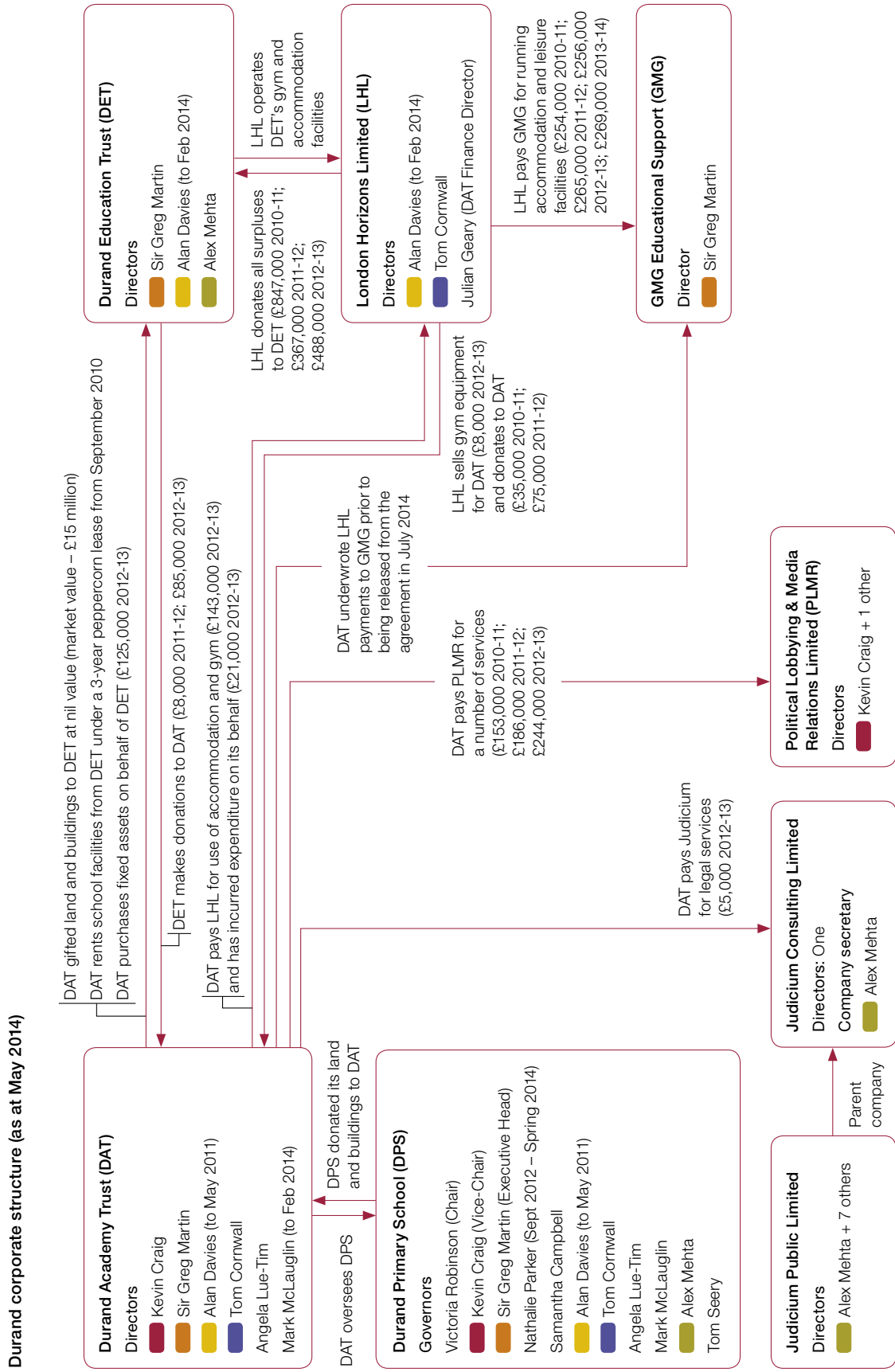
## Structure of Durand School and Durand Academy Trust



Source: National Audit Office

**2.3** Correspondents have raised concerns over the extent to which these arrangements are transparent and the risks from conflicts of interest and related party transactions minimised. In this part we describe the nature of the related party transactions that have been disclosed concerning the Durand Primary School, Durand Academy Trust and Durand Education Trust (**Figure 2** overleaf). We also identify the timeline of events for the creation of these bodies and the related party transactions (**Figure 3** on page 13).

**Figure 2**  
Durand Academy Trust and related parties



Source: Education Funding Agency and National Audit Office

**Figure 3**

## Timeline of events at Durand

<b>1997</b>	Establishment of London Horizons Limited (LHL) as a trading company.
<b>2001</b>	Establishment of GMG Educational Support (UK) Limited (GMG).
<b>2007</b>	Durand Primary School awards a contract to Judicium Consulting Limited for school support services and legal consultancy.
<b>2009</b>	
May	Durand Primary School awards a contract to Political Lobbying and Media Relations Limited (PLMR) for a period of 12 months.
<b>2010</b>	
August	Durand Primary School transfers all of its land and buildings to Durand Education Trust.  Durand Primary School becomes an academy.
Autumn	Kevin Craig, a director of PLMR, becomes a governor and director of Durand Academy Trust.
<b>2012</b>	
February	The Education Funding Agency reviews Durand Academy Trust's financial statements for 2010-11 and is made aware of related party transactions.
September	Durand Academy Trust opens a middle school for Years 7 and 8 pupils on its London site.  After previous discussions, the Education Funding Agency writes to Durand Academy Trust about related party transactions. The Agency recommends that Durand market test for the PLMR contract prior to its extension in November and considers the LHL contract for re-tendering.  PLMR's contract is extended for a further 12 months from September 2012.
November	Durand Academy Trust decides to extend the PLMR contract for a further year, with effect from September 2013, after a market test.  Durand Academy Trust agrees to become a party to the prospective new re-awarded contract between LHL and GMG for the management of the leisure and accommodation facilities.
December	LHL re-awards the contract to GMG for a further five years.
<b>2014</b>	
February	The Education Funding Agency reviews the Durand Academy Trust's financial statements for 2012-13 and identifies related party transactions.
April	The Education Funding Agency carries out an investigation into related party transactions at Durand Academy Trust.
May	The Education Funding Agency Chief Executive writes to Durand Academy Trust, setting out the agreed action for Durand to take to address its concerns about related party transactions.

Source: Education Funding Agency

## **Durand Education Trust**

**2.4** When Durand Primary School transferred all the land and buildings at its site in Lambeth to the Durand Education Trust (paragraph 2.2), it was required to seek the Secretary of State's approval to the transfer, but failed to do so.<sup>4</sup> The Department did not challenge the transfer on learning of it in 2010 as it considered that the public interest in the land was fully protected under Schedule 1 of the Academies Act 2010. It still considers that this is the case in October 2014.

**2.5** The assets transferred in 2010 were estimated at the time to have a market value of £15 million. They included not only the school buildings but also leisure and accommodation facilities (swimming pool, gymnasium and accommodation), which are let out to the general public. The income-generating facilities are operated on the Education Trust's behalf by London Horizons Limited.

**2.6** In its 2012-13 financial statements, Durand Academy Trust disclosed fixed asset purchases of £125,000 on behalf of the Education Trust. This expenditure was for the purchase of new gym equipment for the leisure facilities. The Academy Trust's auditors, Citroen Wells, have pointed out that, since Durand Education Trust holds the freehold for the leisure facilities and the purchased assets are not primarily for the use of the Academy Trust, these costs should have been borne by the Education Trust. Durand Education Trust has therefore agreed to reimburse Durand Academy Trust this expenditure.

## **London Horizons Limited (LHL)**

**2.7** Under a license agreement, the right to operate and let out the leisure and accommodation facilities is held by LHL. Durand Academy Trust funds the ongoing maintenance, modification and development of these assets, and pays LHL for use of the facilities. LHL does not have any staff but contracts out the running of the facilities to GMG Educational Support (UK) Limited. LHL was established in 1997 as a trading company as the most tax-efficient way of covenanting profits from the running of the leisure facilities to Durand Primary School. It now gift-aids profits to Durand Education Trust to support investment in the school and in the boarding school project.

4 Under Schedule 22 of the Schools Standards and Framework Act 1998.



## **GMG Educational Support (UK) Limited (GMG)**

**2.8** LHL contracts the management of the leisure and accommodation facilities to GMG, a company established in 2001 whose sole director is the Academy's Executive Head. This is a long-standing arrangement with the first contract running from December 2001 for 10 years. The contract was re-awarded to GMG without competition in autumn 2012, and runs for 5 years from December 2012. Under the contract, GMG manages and markets the facilities and recruits staff, and receives in return an annual fixed payment of £32,000 plus 15% of the gross turnover from the facilities, excluding any turnover in respect of payments received from Durand Academy Trust. The financial statements for London Horizon Limited show that it paid GMG the following amounts for these services:

- 2011-12: £265,000 (£172,000 management fee and £93,000 recharge of staff costs);
- 2012-13: £256,000 (£161,000 management fee and £95,000 recharge of staff costs); and
- 2013-14: £269,000 (£175,000 management fee and £94,000 recharge of staff costs).

**2.9** Under the 2012 contract, Durand Academy Trust became, for the first time, a contracting party to this arrangement. The contract placed a number of additional obligations and contingent liabilities on the Academy Trust, including carrying out any building works required, and acting as a guarantor of any payments due to GMG from LHL. It also required the Trust to meet any legal costs reasonably incurred by GMG in connection with the contract.

**2.10** There were also considerable increases in the value of the compensation payment due to GMG in the event of the contract's termination. Under the 2012 contract, the amount payable was to be equivalent to 50% of 3.5 times the average previous 3 years' gross turnover, excluding any payments received from Durand Academy Trust. In contrast, under the 2001 contract, the termination sum due was 3% of the total gross revenue over the contract's 10-year period.

**2.11** Durand Academy Trust signed the 2012 contract after discussion by the school's Governing Body in November 2012. According to Durand, the relevant related parties absented themselves from this discussion. According to the minutes of this meeting, a committee of governors, comprising the Chair, Vice Chair and two others, had reviewed the contract and considered that it represented good value.

**2.12** The Governing Body considered that no procurement was necessary for the contract because GMG and LHL were both private companies and the payments were "not made from public funds". However, there was a risk that Durand Academy Trust would have to use the public funds it receives to meet the costs of the obligations it agreed to take on when becoming a party to the 2012 contract. Although governors were aware of the level of compensation they might have to pay in the event of the contract's termination, Durand Academy Trust did not estimate the total extent of its financial exposure from these obligations before it agreed to become a party to the contract.

**2.13** According to Durand Academy Trust, governors agreed to take on the additional obligations and contingent liabilities under the 2012 contract in order to ensure that they had oversight of the operation of both LHL and GMG and thus protect the gift-aided donations to the academy from the income generated by the leisure and accommodation facilities. They felt that the key role of GMG and its Managing Director, Sir Greg Martin, in developing these facilities and the associated accommodation and leisure business had been of great value to the academy, and they believed the payments were fair recompense for this work.

### **Political Lobbying and Media Relations Limited (PLMR)**

**2.14** Durand Academy Trust had a contract with PLMR for the provision of various public relations, communications, project management and administrative services. It originally awarded the contract in May 2009 for a period of 12 months. It subsequently extended the contract's duration a number of times without going out to tender.

**2.15** The Academy Trust's Vice Chair, Kevin Craig, holds a majority interest in PLMR, and has disclosed this in the Trust's register of business interests. Mr. Craig became a governor and director of the Academy Trust in autumn 2010 after the award of the original contract. On his appointment, the Academy Trust published on its website an email from Mr Craig, setting out his previous experience as a school governor and stating that he would absent himself from any discussions about the PLMR contract.

**2.16** In November 2012, governors agreed to extend the contract for a further year with effect from 1 September 2013, with Mr. Craig absenting himself during the discussion of the contract. Governors decided not to re-tender the contract and, instead, carried out a market test prior to this contract extension. In this market test Durand approached 3 companies for quotes of their daily rates of comparable staff. Of the 3 companies approached, 2 provided quotes.

**2.17** Under the terms of this extended contract, PLMR received a fixed monthly fee of £20,000 (excluding VAT) plus reasonable expenses. In contrast, the fixed monthly fee under the May 2009 contract was £8,700. The increase in the fee was due to the increased project management and communications workload associated with the proposed boarding school and other, more minor revisions to the services being provided.

## **Judicium Consulting Limited**

**2.18** Durand Academy Trust pays £1,125 per quarter to Judicium Consulting Limited for legal services under a contract originally awarded in 2007. A governor of the Academy Trust, Mr. Alex Mehta, is the company secretary of Judicium Consulting Limited and also a director (and 3.95% shareholder) of its ultimate parent company, Judicium Public Limited Company. According to the Academy Trust, Mr. Mehta absented himself from discussions regarding the contract and signed the register of business interests.

**2.19** The Academy Trust did not disclose this arrangement as a related party transaction in its financial statements on the advice of its external auditors, Citroen Wells. The auditors did not consider it to be a related party transaction as the governor was only the company secretary of Judicium Consulting Limited and did not have significant influence over this company. It therefore did not qualify the company as related under Financial Reporting Standard 8 – Related Party Transactions.

## **Academy's Finance Director**

**2.20** On its conversion to academy status in 2010, the Durand Academy Trust appointed Julian Geary as its Finance Director on a 5 year contract. Mr. Geary was also appointed as a director of LHL on 28 February 2014. According to the Education Funding Agency, at the time of its investigation in early April 2014, he had yet to declare this in the Academy's Register of Business Interests. Mr. Geary had previously acted as Company Secretary to LHL between 2001 and 2007 and to GMG briefly in 2005.

## **School Head**

**2.21** In September 2012, Durand Academy Trust appointed Nathalie Parker, the ex-wife of the Executive Head, Sir Greg Martin, as acting head teacher of its primary and middle schools, stepping up from her existing role as Senior Deputy Head (Primary), for an annual remuneration in 2012-13 of between £115,000 to £120,000. Ms. Parker was appointed through an externally advertised, competitive process and Sir Greg was not on the panel that appointed her. She was one of 5 candidates shortlisted for the post. According to Durand, Ms. Parker is no longer employed by the Academy Trust as she moved to another school at the end of the spring 2014 term.

## **Remuneration of Durand's Executive Head**

**2.22** The correspondence we received raised concerns over remuneration of the Executive Head. Our examination of the accounts of Durand Academy Trust confirmed that the Executive Head of Durand, Sir Greg Martin, received a pay rise of 56.5% from Durand Academy Trust in 2012-13. This rise increased his annual remuneration package (salary and pension contributions) from £146,415 in 2011-12 to £229,138, making Sir Greg one of the highest paid Executive Heads in the country. Previously, in 2010-11, his annual remuneration package had totalled £158,141.

**2.23** According to Durand Academy Trust, the remuneration package was justified as the Executive Head's role included not only leadership of the primary school but also that of an early years centre and a middle school for children in years 7 and 8. He was also responsible for leading the development of the proposed boarding facility in West Sussex. It also justified the package because of the academy's outstanding attainment results in 2013, although, subsequently, in January 2014 Ofsted rated the Academy as 'Good', down on the 'Outstanding' grade Ofsted awarded it in January 2008.

**2.24** With regard to the Executive Head's remuneration, the Department's position is that remuneration of head teachers is a matter for academy trusts, not the Department or the Agency. However, the Agency is planning to undertake a review of academy heads' salaries, but has yet to finalise the scope of this.

**2.25** In addition to his remuneration as Durand Primary School's Executive Head, Sir Greg Martin also received payments in the form of director's remuneration and/or dividends in his role as a director and shareholder of GMG. The Department has no information on the extent of these payments.

## Part Three

### Agency's oversight of related party transactions

#### **Oversight by the Education Funding Agency**

**3.1** Academy trusts are required to submit their audited financial statements and management letter to the Agency by 31 December each year. The Agency then reviews the financial statements of all academy trusts to identify key issues, risks and any other matters which may require the Agency's intervention.

**3.2** The Agency's level of review is based on a risk assessment of the academy trust. The Agency relies on external auditors' audit opinions to provide assurance that the accounts present a 'true and fair' view, and that transactions recorded in the financial statements are regular. The Agency then follows-up on any potentially contentious transactions, including related party transactions, by obtaining more information or beginning an investigation.

**3.3** In 2012-13, out of a total 2,256 academy trust financial statements that the Agency reviewed, 976 disclosed related party transactions. Of academies' £11,467 million expenditure, as disclosed in the Agency's 2012-13 consolidated financial statements, there was an estimated £71 million in respect of related party transactions recorded by academies. And of these, 54 cases (£8.6 million) were assessed by the Agency as posing a risk to value for money and therefore requiring further follow-up work. As a result of this work, the Agency found transactions at 17 of these trusts to be irregular and/or improper and is taking action to address weaknesses arising from these transactions.

#### **NAO review of the Agency's wider controls on related party transactions in academies**

**3.4** The Agency reviews academies' audited financial statements each year. This is done to identify key issues, risks and any other matters which may require the Agency's intervention.

## Findings from our work

**3.5** We examined the Agency's review of the 2012-13 financial statements and found that the Agency has a systematic and consistent way of performing this review. The review relies primarily on the assurance and findings from the external auditors' reports. The specific procedures performed over related party transactions are, however, limited and do not usually go further than reviewing the disclosures presented in the financial statements. However, in response to specific risks and concerns identified by the Agency, it carried out a more focused review in 2014.

**3.6** Based on the disclosure in the financial statements the Agency expects to make a judgement on whether the related party transaction is irregular or a risk to value for money. The specific question over whether funds are deemed to be at risk is subjective but includes consideration of the nature of the transactions, its value and the parties involved. It also uses other forms of information such as whether the Agency has had previous correspondence, had intervened on other matters or whether the academy is on the register of national concern.

**3.7** The Agency relies on the external auditor to identify if related party transactions had been properly disclosed. Although, in this instance, the Agency carried out a more focused piece of work that sought assurance above and beyond that provided by auditors, resource limitations may impede its ability to carry out such a detailed review on an annual basis.

## **Oversight of the related party transactions at Durand Academy Trust**

**3.8** In line with other academies, the Agency has reviewed Durand Academy Trust's financial statements for related party transactions each year since 2010-11, the first year for which the Trust produced such statements. In February 2012, its review of the 2010-11 statements identified related party transactions involving PLMR and LHL, as well as the transactions between LHL and GMG. The Agency met with Durand in May and September 2012 to seek further clarification around the transactions and to advise on best procurement practice. It wrote to the Academy Trust in September 2012, recommending that it market test the PLMR contract and consider the LHL contract for re-tendering. The Academy Trust conducted a market test for the PLMR contract prior to its extension in November, but it did not re-tender the LHL contract, arguing that the payments under the contract were between two private companies, LHL and GMG.

**3.9** The Agency reviewed Durand Academy Trust's 2012-13 financial statements in early 2014, at about the same time as it received correspondence about related party transactions at Durand. Again, the financial statements disclosed a number of related party transactions, as well as an increased value of the PLMR contract. The Agency therefore carried out significant follow-up work into Durand's transactions, seeking initial clarification from Durand in February and visiting the academy in April. Its work confirmed the increase in the value of the PLMR contract, undisclosed related party transactions involving Judicium Consulting Limited (paragraphs 2.18 and 2.19), the addition of Durand Academy Trust as a party to the contract between LHL and GMG (paragraph 2.9), and the significant increase in the value of the compensation payment payable to GMG in the event of the contract's termination (paragraph 2.10).

**3.10** On 15 May 2014, the Permanent Secretary at the Department and the Chief Executive of the Agency met with Durand's Executive Head, Vice-Chair of Governors and Finance Director to discuss the results of the Agency's investigations and the actions required to address the problems identified. Subsequently, on 23 May the Agency's Chief Executive wrote to Durand Academy's Chair of Governors, setting out the agreed actions to be taken:

- Durand Academy Trust would either end the contract with PLMR when it expired at the end of August 2014, or, if the Trust determined that there was still a need for the service, it would carry out a full open tender for it. If the contract was re-tendered, PLMR would do one of the following: not bid; bid on a not for profit basis; or step down from any involvement in the governance of the academy and bid on a full cost basis, including profits.
- The 2012 contract between LHL and GMG would be terminated early and re-tendered by October 2014 at the latest. GMG would continue to provide the services until the new appointment was made, but Durand Academy Trust was to be released from its obligations under the contract immediately. No company related to Sir Greg Martin or his family members would be allowed to bid, and GMG would not receive any of the compensation payment due under the contract, even though the contract was being terminated early.
- Governance at Durand was expected to be strengthened with the appointment to the Academy Trust of two new governors with experience of the boarding sector. The Permanent Secretary had previously informed the C&AG in December 2013 of the Department's intention to seek such appointments to assist with the boarding school project.

**3.11** Durand would also review its organisational structure by 30 June 2014, to ensure it met the organisation's needs in the future and with a view to making the structure clearer, more transparent and more easily understood.

**3.12** In response, to date:

- The PLMR contract expired on 31 August 2014. The Governing Body has undertaken a tendering exercise and has received a number of expressions of interest. However, the Governing Body is reviewing the need for media and public relations support going forward. Until this review is complete any work undertaken by PLMR is on an ad hoc and no profit basis – and this will be validated through an independent review by the Trust's external auditors.
- Durand Academy Trust had been released from all of its obligations under the contract between LHL and GMG.
- The contract between LHL and GMG will terminate on 31 October and Durand have started a procurement exercise. The Governing Body intend to continue to use GMG on a temporary basis until a new contract is in place.
- Durand Academy Trust had appointed Adrian Richardson, Principal of Cothill Education Trust, as governor on 11 July. It is continuing to seek people for the second governor post.
- As a first step in strengthening its corporate structure, Durand Academy Trust reviewed and made changes to the membership of the companies in the corporate structure – including ensuring no individual is a director of more than one body. It has also now committed to significantly simplifying the structure by making London Horizons Limited a wholly owned subsidiary of the Academy Trust. The freehold of all assets will also be transferred from Durand Education Trust to Durand Academy Trust. These actions are to be completed by 30 November 2014.

### **Further action taken by the Agency**

**3.13** In October 2013, without consulting with external auditors, the Department issued an update to the Academies Financial Handbook for the academies' financial year 2013-14. This included revised guidance on related party transactions and introduced 'at cost' policy for academies for new and renewed contracts for goods and services agreed on or after 7 November 2013. Under this policy academy trusts can pay no more than 'cost' for goods and services from individuals and organisations having a relationship with the trust. Trusts must ensure that any such 'at cost' arrangement is properly procured and supported by a statement of assurance from their relevant contractor that its charges do not exceed the cost of the goods or services. The arrangement should also include an open book agreement with a requirement for the contractor to demonstrate clearly, if requested, that their charges do not exceed the cost of supply. We have spoken to a number of academy auditors who have indicated concerns about auditing this requirement due to the absence of an agreed framework.



**3.14** In addition, in May 2014, the Chief Executive of the Agency wrote to all academy trust accounting officers to remind them of their responsibilities for managing public money. In his letter he reminded academy trusts of the expectations set out for reducing the risks from connected parties, by avoiding conflicts of interest, and by meeting the 'at cost' principles and the expectations for transparent reporting (**Figure 4**).

**3.15** In August 2014, the Agency issued a new edition of the Academies Financial Handbook for the academies' financial year 2014-15. This edition included the introduction of a 'de minimis' limit of £2,500 for related party transactions, below which the 'no profit' policy did not apply, and more detail on the consequences of non-compliance with the Handbook's requirements for such transactions. These consequences included the issue of a financial notice to improve preventing a trust from entering into such transactions without the approval of the Secretary of State.

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## Figure 4

### Letter to academy trust accounting officers

#### Transactions with connected parties

There will be circumstances when your trust may wish to buy goods or services from people who are connected to it, such as members, trustees or employees, and individuals or organisations connected to them. However, before making a decision you should consider your responsibilities, as accounting officer, for regularity, propriety and value for money, and be satisfied that any spending can be defended on these grounds. You should also be aware of restrictions the Academies Financial Handbook places on these transactions. From November 2013, trusts have not been permitted to enter into new transactions with connected parties unless they can be satisfied that those transactions are 'at cost' ie the connected party is not making any profit from their relationship with the trust.

There are some questions at Annex B that you should consider. Your trustees have statutory duties, as company directors, to avoid conflicts of interest and so I recommend that you share these questions with them.

As public bodies, academies must also be transparent about their spending. You must ensure that transactions of this nature are properly disclosed in the trust's annual accounts and that sufficient information is provided to demonstrate that the trust has been even-handed in its affairs. Every year, we publish information in the Academies Accounts Direction about disclosure requirements and your auditors should be able to ensure that this is done correctly.

**While the number of inappropriate connected party transactions is small, they do considerable damage to the trusts concerned and to the wider sector.** Parliament and the media have been particularly interested in transactions of this type; and at the recent hearing of the Committee of Public Accounts, committee members asked the Department for Education to consider whether further restrictions are needed. My staff have been reviewing all such transactions from the last set of academy financial statements and we will be publishing an overview report later this term, as well as considering our response to the committee's views.

Source: Education Funding Agency

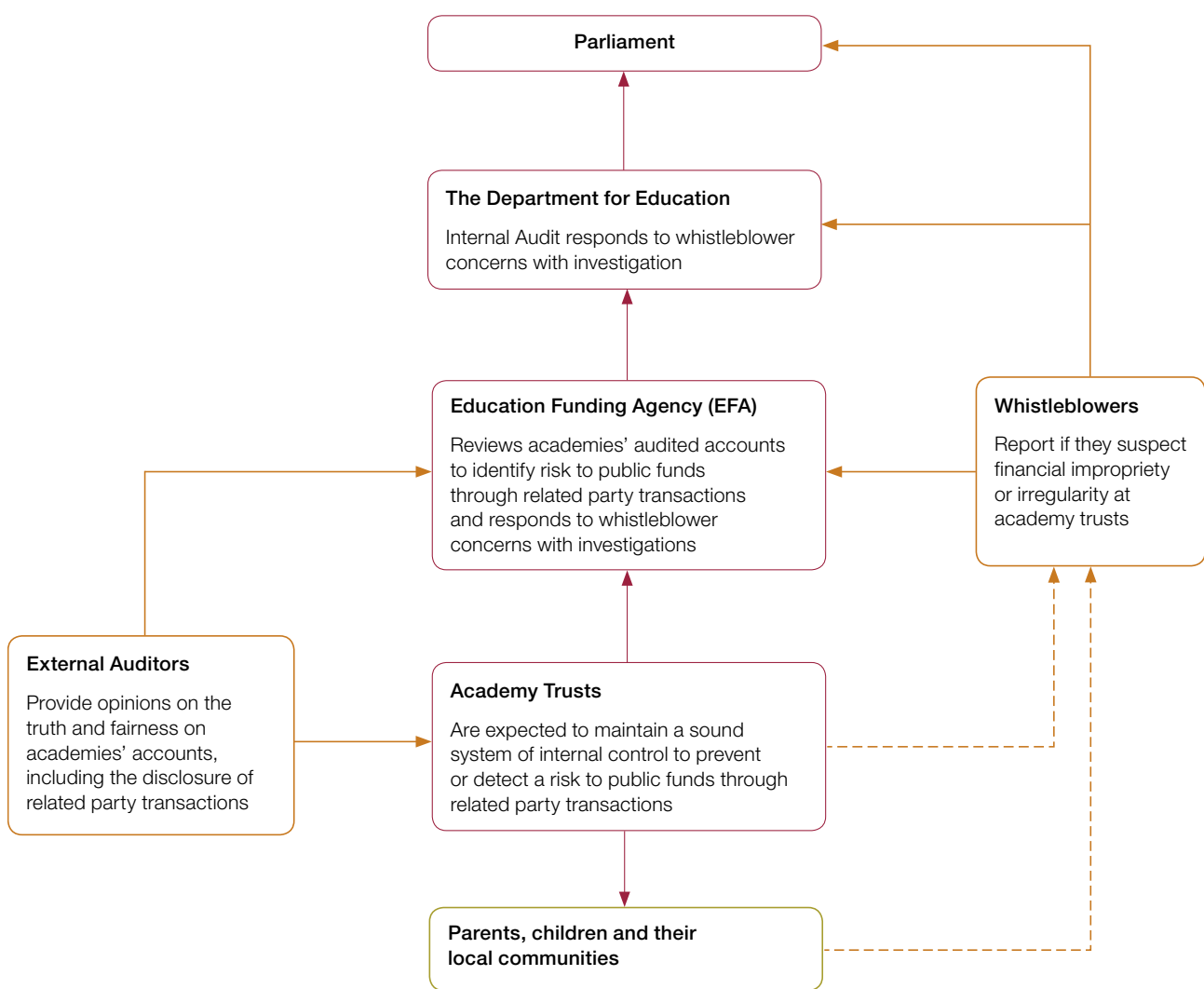
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## Committee of Public Accounts Report

**3.16** The report on *The Performance and Capability of the Education Funding Agency* raised concerns that related party transactions are always open to accusations of conflicts of interests, even when on an 'at cost' basis. This view is contrary to the Agency's view that related party transactions are acceptable under some circumstances where value for money and compliance with relevant standards can be demonstrated. The Committee believes that the Agency must be able to extract and analyse complete information on related party transactions and must then use that analysis to determine risk-based interventions.

# Appendix One

## Oversight of related party transactions



- -> Information
- > Accountability
- > Assurance

Source: National Audit Office

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