



## Guidance

# Internal scrutiny in academy trusts

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## 1. Who is this factsheet for?

This Good Practice Factsheet provides guidance for trustees, accounting officers, CEOs, executive leaders and chief financial officers (CFOs) in academy trusts (ATs).

It aims to provide them with suggestions as to how they can implement internal scrutiny arrangements that meet the requirements of the Academies Financial Handbook (AFH) and also enable them to better discharge their responsibilities for effective stewardship and oversight of their organisation and provide them with a medium for self-reflection.

## 2. What is the status of this factsheet?

The main financial management and control requirements for ATs are set out in the [Academies Financial Handbook](#) (AFH) and the financial reporting requirements in the [Academies Accounts Direction](#) (AAD). This factsheet does not replace or modify any of those requirements. Rather it aims to provide suggestions regarding good practice.

The factsheet is one in a series which has been produced, following requests for further guidance from the sector. It should be noted that the AFH and AAD are subject to annual review by the ESFA and so users should always ensure that they are referring to the most up to date requirements.

### 3. What is the purpose of internal scrutiny?

Internal scrutiny is a process that provides independent assurance to the board that its financial and other controls, and risk management procedures, are operating effectively. As a minimum, it involves a series of tests to ensure systems are effective and compliant but goes beyond mere transaction checking. The internal scrutineer is well-fitted to the role of an independent, trusted "critical friend". They give assurance, help the AT improve governance, risk and control arrangements, and provide comfort that the leadership is doing the right things in the right way.

An independent scrutineer not only helps the AT ensure it complies with the [AFH](#), but also conducts their programme of work to contribute to the development of an effective governance and accountability framework. This will help management ensure that its priorities are delivered.

The approach taken to internal scrutiny will vary from AT to AT, with trust size and relative complexity playing significant roles in determining the most suitable option. However, the suggestions set out in this factsheet should provide some context so that ATs of all shapes and sizes can assess how much or how little of the various disciplines and protocols they consider suitable for them.

### 4. Is internal scrutiny the same as internal audit?

It can be, but not necessarily. Internal audit is an independent assurance function providing a type of internal scrutiny, with a focus on governance, risk management and internal control. In some businesses, internal auditors are employees, operating independently of management and reporting directly to the board or audit committee, their work free from undue influence. The AFH does not require ATs to have an internal audit function, but they must select from 4 distinct internal scrutiny processes (see section 7), of which internal audit is one.

The importance of independent reporting is acknowledged by the AFH, which states that independence in internal scrutiny is achieved by establishing appropriate reporting lines whereby the scrutineers report directly to a committee of the board. Since all ATs are required to have one, this will usually be the audit committee. Although the role of audit committees is not the primary focus of this factsheet, an illustrative terms of reference for an audit committee of an AT which has chosen the internal audit option for internal scrutiny and which has decided to have a separate audit committee are set out at [Annex 1](#).

## 5. What is the link with risk management?

Each AT will have a distinct risk profile. The programme of internal scrutiny will be informed by the AT's risk register, which is owned by executive management and overseen by the audit committee. The risk process is iterative and ongoing as the findings of the programme of internal scrutiny in turn inform the risk register. Risk scores of issues rise and fall as the result of the internal scrutiny work, new risks are added, and older ones are relegated. So, the planning of the programme of internal scrutiny must be a risk-based joint enterprise between executive management, the audit committee and the internal scrutineer. For further guidance on risk management, please read the ESFA's factsheet on [academy trust risk management](#).

## 6. What the AFH says about internal scrutiny

The AFH requires all ATs to have a programme of internal scrutiny to provide independent assurance to the board that its financial and other controls and risk management procedures are operating effectively. The AFH provides 4 options (see section 7) for ATs to conduct internal scrutiny, the work focusing on:

- evaluating the suitability of, and level of compliance with, financial and other controls. This includes both evaluating whether controls and procedures are effective and efficient, and checking transactions to confirm that controls and procedures are being followed
- advice and insight to the board on how to address weaknesses in financial and other controls, recommending improvement, but without diluting the responsibility of management for the day to day running of the AT
- ensuring risks are adequately identified, reported and managed

The AFH, therefore, requires that ATs have effective oversight and monitoring of their internal control environment. The internal scrutiny function provides this.

## 7. Internal scrutiny options

The AFH sets out the 4 options open to ATs to deliver internal scrutiny:

- employing an in-house internal auditor
- a bought-in internal audit service, which could be stand-alone or a supplementary programme of work by the external auditor requiring a separate

letter of engagement

- the appointment of a non-employed trustee
- a peer review performed by the CFO or other member of the finance team, from another academy trust. The trust should satisfy itself that the trust supplying the reviewer has a good standard of financial management and governance and should minute the basis for its decision.

The AFH requires that those carrying out the programme of work are suitably qualified and/or experienced:

- internal auditors should be members of a relevant professional body. This might be the [Chartered Institute of Internal Auditors](#) or one of the other 5 accountancy institutes that are members of [Consultative Committee of Accountancy Bodies \(CCAB\)](#) or the [Chartered Institute of Management Accountants \(CIMA\)](#)
- trustees and peer reviewers should have qualifications in finance, accounting or audit and/or appropriate internal audit experience. This encompasses membership of any of the bodies required for internal auditors, but gives ATs the discretion to flex their requirements to a scrutineer who is qualified by experience, holds other finance or business qualifications such as the [Association of Accounting Technicians](#) or the [Institute of School Business Leadership](#), or who has extensive, relevant sector experience

## 8. Which option should we choose?

The AFH sets out 4 broad options for ATs, but as has already been said, the actual option chosen by each trust will be driven by particular factors, especially size and relative complexity. Even within each of the 4 options, trustees will need to decide how much internal scrutiny work they need and whether there is a case for delivery that is more comprehensive. It would be surprising if larger MATs opted for trustee review or peer review. Factors to consider include:

	For	Against
<b>In-house internal audit</b>	<ul style="list-style-type: none"><li>• Thorough knowledge of the AT Appropriate experience &amp; skills</li><li>• Governed by professional code of ethics &amp; standards</li><li>• External auditors may place reliance on their work</li></ul>	<ul style="list-style-type: none"><li>• Fixed overhead cost</li><li>• May be less independent</li></ul>
<b>Bought-in internal</b>	<ul style="list-style-type: none"><li>• Based on established audit disciplines</li></ul>	<ul style="list-style-type: none"><li>• If delivered by the same firm, which provides external audit services, potential conflict of interest with statutory audit role (albeit managed through ethical standards &amp; a separate letter of engagement)</li></ul>

<b>audit</b>	<ul style="list-style-type: none"> <li>• Governed by professional code of ethics &amp; standards</li> <li>• Independent external auditors may place reliance on their work</li> </ul>	<ul style="list-style-type: none"> <li>• The scope between the external audit work and internal scrutiny may become blurred</li> <li>• Additional cost</li> </ul>
<b>Trustee review</b>	<ul style="list-style-type: none"> <li>• No cost</li> <li>• Thorough understanding of the AT</li> </ul>	<ul style="list-style-type: none"> <li>• May not have knowledge and expertise</li> <li>• May be too close to executive management</li> </ul>
<b>Peer review</b>	<ul style="list-style-type: none"> <li>• No cost</li> <li>• Work conducted by someone with relevant insight</li> </ul>	<ul style="list-style-type: none"> <li>• May lack rigour</li> <li>• Can be time-consuming</li> </ul>

## 9. What is the role of internal scrutiny in an AT?

We have already characterised the internal scrutineer as a critical friend. They review policies, systems and operations. The reviews are part of a programme of work overseen and agreed by the audit committee and based on the AT's risk register. They should identify how well risks are managed, whether effective processes are in place and whether agreed procedures are being followed. Reviews also identify areas where efficiencies or change should be made. Trustees that want to know more about risk management may refer to the ESFA factsheet on [academy trust risk management](#).

An internal scrutiny programme is likely to have financial control systems, including procurement, at its core, and will normally involve the evaluation of controls and some testing of controls, by a sample of transactions. It would also be usual to examine financial governance (the effectiveness of financial oversight by the board). Scrutineers may also review the AT's IT systems (including cyber security) but additionally might consider less obvious topics such as organisational culture, management information, or succession planning. Sometimes it may be necessary to work with subject-matter experts in such areas. Any system that impacts on the effective operation of an AT may be included in scope of the review programme if the audit committee agrees.

## 10. What should the internal scrutineer

## look at?

This will be shaped by the risk profile of the trust, the maturity of financial and other systems and the concerns of the audit committee as well as the internal scrutiny option chosen. If an AT contracts with a professional internal audit provider, then it is likely that there will be a cyclical programme of work, which will be informed by an audit needs assessment (ANA). This involves breaking down the organisation by business system and then assessing the risk of each by consideration of several factors, such as:

- monetary value (income and expenditure)
- volume of transactions
- complexity of the system
- sensitivity of the system
- stability of the system
- potential fraud risks
- the strength of management controls
- whether work has been carried out on that system recently.

The process is a form of risk management which results in a list of potential scrutiny areas along with their respective scores. These are then ranked with the highest scoring systems at the top. Those with high scores usually warrant inclusion in the programme of checking every year, whereas those with low score may only feature, say, every third year. The schedule of potential work is then presented to the audit committee for consideration, challenge and sign-off. Not all ATs may feel it necessary to proceed in such a formal way, especially in those trusts where the internal scrutiny option chosen is not internal audit. But in all cases the review programme will be informed by the risk register and agreed by the audit committee.

A suggestion for the business systems and processes that might fall within the scope of an Audit Needs Assessment for an AT is set out at Annex 2 (this list is not exhaustive). All these systems and processes can impact the outcomes for pupils, albeit sometimes indirectly. Both the senior leadership team (SLT) and board have finite capacity and will best deliver their priorities if their scarce resources are focused on educational issues rather than diverted into fixing an ineffective internal control environment.

Failure to ensure proper control over key business processes may lead to an intervention by ESFA or a modification of the external auditor's regulatory opinion.

## 11. Reporting the findings of the programme

The audit committee will require the internal scrutineer to report back on their work. The AFH requires the audit committee to meet at least 3 times a year. A termly report on the internal scrutiny work may make sense for larger trusts, though smaller trusts may consider that an annual report is sufficient. The audit committee can also ensure appropriate liaison between the internal scrutineer and external auditor, with the work of the former providing evidence to assist the latter in forming their audit opinion, so potentially reducing the cost of the external audit.

The AFH requires ATs to submit an annual report, summarising the areas reviewed, key findings, recommendations and conclusions as presented to the audit committee by the internal scrutineer, to the ESFA by 31 December each year. This requirement for an annual report will be applied fully for the 2019/20 financial year. For 2018/19, as a transitional arrangement, the ESFA will accept an AT's latest report (which could be an annual report but does not have to be) for the submission by 31 December 2019. The AT must also provide ESFA with any other internal scrutiny reports if requested. It makes sense therefore for the internal scrutineer to provide the audit committee with an annual report during the autumn term at the same time as the external auditor's report. This will enable the audit committee to form a holistic picture and the AT to coordinate the returns required by ESFA. It will also provide the Accounting Officer with key evidence to enable them to sign off their statement on regularity, propriety and compliance and the board with information for its annual governance statement, both of which are submitted to ESFA with the audited accounts.

## **12. What's the format of internal scrutiny report?**

Termly reports should capture the detail of the work performed, whereas ESFA has specified that the annual report needs to cover the areas reviewed, key findings, recommendations and conclusions. Beyond this, the format of the report would be a matter for the AT and its scrutineer, although those ATs that contract with a third party specialist firm are likely to receive a report in a format that is based on its standard document templates and working practices. For guidance, a typical annual report might comprise the sections set out in Annex 3.

## **13. Summary**

ATs are obliged to carry out a programme of internal scrutiny, to report on it to their audit committee and to provide an annual report to ESFA. The AFH gives ATs 4 options for delivering the programme of internal scrutiny but does not mandate the areas that must be reviewed, which will always be a matter for the AT, to be informed by its risk register and agreed by its audit committee.

ATs may be tempted to adopt one of the "low cost" options permitted by the AFH, such as peer review or review by an independent trustee, but may find difficulty in sourcing an appropriate individual or one that is able to commit to find the time required for the work to be effective. An effective independent internal scrutiny function will provide real value to the AT.

Many ATs are likely to look to an internal audit specialist. In-house internal audit is uncommon in ATs and they are more likely to outsource internal scrutiny to professional external firms, either internal audit specialists or external auditors. The case for a professional internal audit function (either bought-in or in-house) in an AT will depend on several factors relating to its system of internal control, including:

- the scale, diversity and complexity of the AT's activities
- the number of employees – the case for internal audit increases as the number of employees increases and relationships become more complex
- where the benefits of the function outweigh the costs of operation
- when changes occur in the AT's structures, reporting processes or business systems
- the nature of risks, changes to risks and emerging risks
- an increasing number of unexplained or unacceptable events

Whichever option is chosen, the purpose of internal scrutiny is to provide the board (and ESFA) with assurance that the AT's system of internal control is effective and contributes to strong governance, risk management and control arrangements at the AT.

## **14. Acknowledgements**

Special thanks to:

ESFA Finance & Assurance Steering Group, WG3

## **Annex 1**

Suggested terms of reference for the audit committee of an academy trust

### **AUDIT COMMITTEE TERMS OF REFERENCE**

#### **1. Responsibilities**

- To maintain an oversight of the Academy Trust's (AT's) financial, governance, risk management and internal control systems.

- To report its findings termly and annually to the Trust Board and the Accounting Officer as a critical element of the AT's annual reporting requirements.
- The Audit Committee has no executive powers or operational responsibilities/duties.

## **2. Authority**

- The Audit Committee is a Committee of the Academy Trust Board and is authorised to investigate any activity within its terms of reference or specifically delegated to it by the Board.
- The Audit Committee is authorised to
  - request any information it requires from any employee, external audit, internal audit or other assurance provider.
  - obtain outside legal or independent professional advice it considers necessary, normally in consultation with the Accounting Officer and/or the Trust Board.

## **3. Composition**

- The membership of the Committee will comprise a minimum of 3 trustees.
- The chair of the board of the academy trust and the chair of the finance committee shall not serve as chair of the audit committee
- Until otherwise determined by the board of trustees, a quorum shall consist of 2 members of the committee.
- At least one member of the audit committee should have recent or relevant accountancy, or audit assurance, experience.
- Staff employed by the trust may be invited to attend the audit committee to provide information and participate in discussions but should not be members of the committee, will be separate to the finance committee and not have overlapping membership.
- Any trustee may attend a meeting of the audit committee, including those who are not members of the audit committee.
- The chief executive officer/accounting officer and chief financial officer should also attend meetings.

## **4. Reporting**

- The Audit Committee will:
  - report back to the Trust Board regularly every term.
  - provide an annual summary report provided by the internal auditor in areas reviewed by internal audit covering key findings, recommendations and conclusions

## **5. Terms of Reference**

The Audit Committee will:

- oversee the trust's risk register and, on the advice of the CEO/accounting

officer and CFO, conduct a regular review of risks

- take delegated responsibility on behalf of the board of trustees for examining and reviewing all systems and methods of control both financial and otherwise including risk analysis and risk management; and for ensuring the Trust is complying with the overall requirements for internal scrutiny, as specified in the Academies Financial Handbook.
- agree an annual programme of internal scrutiny with the trust's internal auditors for checking financial systems, controls, transactions and risks.
- ensure that the programme of internal scrutiny delivers objective and independent assurance.
- provide assurance to the Trust Board that risks are being adequately identified and managed
- advise the Trustees on the adequacy and effectiveness of the Academy Trust's systems of internal control and governance processes, securing economy, efficiency and effectiveness (value for money)
- consider the appropriateness of executive action following internal audit/internal scrutiny reviews and to advise senior management on any additional or alternative steps to be taken
- advise the Trust Board on the appointment, reappointment, dismissal and remuneration of auditors (both external auditors and internal audit)
- monitor the effectiveness of auditors
- review the findings of the external auditors and agree any action plan arising from it
- ensure there is co-ordination between internal audit and external audit and any other review bodies that are relevant
- ensure that additional services undertaken by the auditors is compatible with the audit independence and objectivity
- consider the reports of the auditors/scrutineers and, when appropriate, advise the Trust Board of material control issues.
- encourage a culture within the trust whereby each individual feels that he or she has a part to play in guarding the probity of the Trust, and is able to take any concerns or worries to an appropriate member of the management team or in exceptional circumstances directly to the Board of Trustees
- provide minutes of all Audit Committee meetings for review at board meetings

## Annex 2

Please note that this list of suggest areas is not intended to be exhaustive. The executive and audit committee should ensure that the internal scrutineer develops a cyclical programme of work tailored to the trust and its risks.

## **Procurement**

Poor contract management will result in ATs paying too much for goods and services, or even paying for services they do not need. Value for money audits can also be used to test accepted practice. The AFH sets out some obligations for ATs in relation to related party transactions and conflicts of interest. There are numerous appropriate operational checks. The following list is not exhaustive:

- check of a sample of purchase orders to delivery notes and invoices to ensure that documentation is complete, has been appropriately checked and authorised
- check of a sample of payments back to invoices, purchase orders and delivery notes to confirm they are legitimate purchases
- review statements from suppliers to ensure they are being checked, investigate any disputed invoices
- review contracts, ensuring proper tendering procedures exist and are being followed
- check purchase of any capital assets (e.g. desk computers, interactive whiteboards, kitchen equipment) for physical existence

## **Monthly financial closedown**

Monthly closedown will follow a set procedure and the auditor may test a number of the relevant steps, including:

- review that monthly bank reconciliations have been carried out, including reviewing validity of reconciling items
- review of the purchase ledger control account reconciliation and/or creditors list against invoices received
- review of the sales ledger control account reconciliation and/or debtors list against invoices issued
- review of the accruals schedule against costs committed but not yet invoiced
- checks of petty cash balances and supporting vouchers
- review of any budget virements and adjusting journals for reasonableness and authorisation
- review of any write-offs of debt or other losses for reasonableness and proper authorisation

## **Payroll and HR**

Ineffective HR systems can lead to low morale and productivity. Effective systems mean staff are properly skilled and can focus on their proper role. Recruitment and training also warrant attention. Payroll will account for the vast majority of the trust's expenditure and so ought to feature in any programme of testing:

- review of a sample of starters, leavers and salary increases to ensure they are

properly authorised

- review of the monthly payroll to ensure that any changes and salary payments have been appropriately authorised
- a reconciliation of payroll to HR records to ensure that leavers and allowances are not paid beyond the appropriate dates
- a check of statutory and non-statutory deductions from pay
- review of a sample of expense claims to ensure there is appropriate documentation to support the claim and that it is appropriately authorised

### **Efficiency, funding and budgets**

Whether the expected economies of scale arising from merging and updating "back office" functions are being realised. Whether there is tension between the need for efficiency and operational autonomy of constituent academies in a MAT. Is there a gap between the AT's educational aspirations and its financial means, including the funding challenge, and is this addressed through the multi-year budget process? Are budgets properly prepared and reviewed / challenged by management and the finance committee and also consistent with the trust's business plan pupil census, human resources and other data?

### **Fraud, theft and bribery**

Fraud can be costly and embarrassing, and the threat is constant. All ATs should have preventative controls in place, but low-level fraud may be hard to detect, and one-off checks may be an effective deterrent

### **Safeguarding and whistleblowing**

All ATs should have effective policies, protocols, procedures and documentation in place. Failure in these areas can be highly destructive of an AT's reputation and, of course, there is hardly an issue of greater importance than pupil safety and welfare. Specialist skills may be required to provide assurance in these areas

### **Management information and reports**

Review the trust's management information to ensure information supplied is consistent with the underlying accounting records and internal management reports, including:

- management accounts
- financial reports to board
- pupil data and census returns
- returns to the DfE/ESFA

Ensure management accounts are properly supported by explanations for significant variances from budget and are subject to appropriate review and challenge by management and the finance committee

### **Data and IT issues**

Good data is the foundation of effective decision making. Business continuity and recovery of key systems such as attendance management systems should also feature.

Data protection (e.g. GDPR compliance) is also likely to be a key issue.

IT systems should be assessed for their resilience in terms of exposure to cyber security risks

### **Premises issues**

Capital projects can be expensive and complex, but consideration should also be given to disaster recovery, business continuity and PFI issues and well as health and safety, fire prevention, asbestos, legionella and so on.

### **AT governance structures**

ATs need governance structures and processes appropriate to their size and structure. These must be regularly reviewed and should include Board and committee, executive and operational structures.

## **Annex 3**

Suggested format for internal scrutiny annual report

- Executive summary (including overall opinion)
- Introduction
- Approach to work and standards
- Classification of opinions (that is the way in which the scrutineer can describe the level of confidence in respect of each business system reviewed and overall)
- Assessment of the work commissioned
- Summary of work undertaken (tabulated)
  - Item 1 (payroll)
    - Overall opinion
    - Recommendations (H/M/L)
    - Management response
  - Item 2 (procurement)
    - Overall opinion
    - Recommendations (H/M/L)
    - Management response
  - Item 3 (budgeting)
    - Overall opinion
    - Recommendations (H/M/L)

- Management response
- Follow up reviews of earlier work including any outstanding recommendations
- Overall opinion on entirety of scrutiny programme (current level of confidence in effectiveness of internal control, overall)
- Other issues (e.g. value for money)
- Cost of work (scrutineer/auditor days used)
- Forward look for next year
- Horizon scanning (emerging issues)

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