Education & Skills
Funding Agency

Guidance

Operating an academy trust as a going concern

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1. What is meant by going concern?

The concept of going concern has both a plain English and a technical accounting meaning, but both spring from the same underlying test: whether or not a business will be able to keep going for a sufficient period of time to carry out its operations and meet its obligations (that is, that it will not be forced out of business in the near future).

It is therefore essentially a short-term view as to whether or not the business will have sufficient funds to pay its obligations, such as payroll, trade creditors, and so on, as they fall due. Even businesses with strong balance sheets and adequate reserves can find themselves in this situation if they have insufficient "liquid" (ie cash or near-cash) assets. The issue therefore commonly manifests itself as a cashflow problem.

2. Accounting and auditing requirements

The Academies Accounts Direction requires academy trustees to produce a statement on the academy trust's ability to continue to operate as a going concern, including disclosure of any financial uncertainties facing it. The requirement derives from Financial Reporting Council's Guidance on Going Concern which states what should happen when a business does not prepare accounts on a going concern basis or when there are material uncertainties casting significant doubt upon its ability to continue to adopt the going concern basis of accounting. Provided this is the case, it is not necessary for assets to be valued on an impaired basis (because it is thought that the business is going to be wound up). By making this judgement, the academy trust justifies deferring recognition of certain expenses (such as payments required to pay down a pension deficit) until a later period when the academy trust will, presumably, still be operational. The threshold for departing from the going concern basis of accounting is very high, as there are often alternatives to winding up. However, it should be emphasised that the decision as to whether the accounts should be prepared on a going concern basis is a matter for the academy trustees. They prepare the accounts and then present them to the auditors who may, or may not, concur.

Auditors must give an opinion as to whether they consider the academy trust's decision to prepare accounts on a going concern basis to have been valid. The basic test is as above; whether the academy trust will remain in business for the foreseeable future and will not be forced to halt operations.

A business may be assumed a going concern in the absence of significant information to the contrary. Academy trusts have long-term funding agreements with the Secretary of State. This is an indicator that, unlike many other businesses, their income is very secure. However, the assumption needs to take into account both income obligations and a business with secure income could still face questions as to its short-term viability if it is unable to address its short-term outgoings, which must be met as they fall due.

Further, if there was a clear plan for an existing academy to be "transferred" into a multi-academy academy trust then, technically speaking, that would amount to a winding up of the existing business. However, provided the core elements of the business are to continue, we would not usually expect to see any impairment of assets (unless they are not going to be used in the future business) as we might in the case of a commercial business. Nevertheless, the academy trust's auditors might be required to disclose a material uncertainty, emphasis of matter or other matter in relation to going concern as part of their audit opinion, depending on the circumstances (International Standard on Auditing (ISA) (UK) 700).

The auditor is required to form a view as to whether the academy trustees have been justified in preparing the accounts on a going concern basis and may need to challenge the academy trustees' assumptions and conclusion. An auditor who formed an initial view that an academy trust may not be a going concern would be expected to discuss the matter with academy trustees before formalising the opinion and it may be possible for an academy trust to modify an auditor's view of its going concern status by providing further information.

In terms of meeting their formal requirement in relation to the accounts, auditors will evaluate an academy trust's ability to continue as a going concern for a period of 12 months from the date of the signing of the accounts. However, this is not an absolute cut-off and if there are known problems in the months immediately following the expiry of this 12-month period, the academy trustees would be expected to have made an appropriate disclosure to that effect. If there is an issue, the auditors are required to consider whether this needs to be reflected in their audit report. If, even after discussions with the auditors, an academy trust ended up with a going concern qualification on its accounts that would be considered a very serious matter and a cause for intervention by the ESFA.

The academy trustees' opinion regarding going concern therefore reflects a short-term view of solvency rather than a medium-or long-term view regarding financial sustainability. Of course, leaders in academy trusts need to be concerned about both and academy trustees should not assume that all is well in the longer term, just because the audit opinion supports the view that the academy trust is, in accounting terms, a going concern. This audit opinion does not take into consideration longer term financial issues that may indicate future financial difficulties, possibly in 2 or 3 years' time, even if they are based on current funding patterns, known salary increases and predicted pupil numbers.

3. Integrating short term and longer term financial planning and monitoring

Trustees should not be taken unawares by difficult conversations with auditors regarding going concern during the annual audit process. It is essential to good financial practice that trustees monitor whether or not the academy trust remains a going concern on an ongoing basis.

The Academies Financial Handbook requires that management accounts "must also be shared with the chair of academy trustees every month irrespective of the size of the academy trust, and with the other academy trustees six times a year. The board must consider these when it meets". It also states that the board and its committees "must meet regularly enough to discharge their responsibilities and ensure strong governance and effective financial management arrangements. Board meetings must take place at least three times a year". It is expected that any academy trust facing a particularly challenging short-term financial situation would meet more frequently than that and not neglect short-term issues like cashflow, analysis of creditors and, especially, the timing of payroll runs.

Academy trustees are therefore subject to a combined duty to consider going concern alongside longer term financial planning as an integral part of their budget-monitoring cycle and need to assess the future viability of the academy trust in greater depth and for a longer period than that considered by the external auditor. These longer-term issues mean thinking at least 3 to 5 years ahead, and devising plans to address forecast issues. Such plans may include cost rationalisation, diversifying income streams, growing/declining pupil numbers and collaboration with other schools or academy trusts. However, even the most finely calibrated long-term plan will be redundant if the academy trust finds itself in a position where, because of poor short-term planning, monthly payroll runs a few days before receipt of the monthly GAG payment and there are insufficient liquid reserves on hand to meet the shortfall in required cash.

It is worth trustees thinking about an issue that might be considered obvious, but which has quite profound implications in terms of financial management. Many local authority (LA) maintained schools do not really need to concern themselves with cashflow, as their budgeted grant income is often simply a notional annual allocation. As such, issues including the timing of payroll runs, creditor payment times or the timely collection of monies from parents really do not factor in terms of managing cashflow, which is essentially for the LA to deal with. However, an academy trust will receive its annual allocation of GAG in instalments and is not permitted to run a bank overdraft. It therefore needs to have controls in place to ensure that there is appropriate choreography of incomings and outgoings and overall cashflow including management of capital projects.

4. The importance of reserves

The AFH also reminds academy trustees that they must approve a balanced budget, but one which can take into account brought forward reserves. Academy trusts, unlike LA schools, are expected to maintain reserves, as they are stand-alone charitable companies. The amount of reserves each academy trust should set aside will depend on the type and size of the academy trust as well as the particular risks that it faces (for instance, if they are locked into a PFI contract). However, most would find it prudent to keep at least one-month's salary cost as a revenue reserve. Academy trustees also need to consider how "liquid" their revenue reserves should be. This is in addition to any reserves academy trustees wish to set aside for any capital projects. A sound reserves policy is therefore essential for all academy trusts. Any deviation from an academy trust's reserve policy should be minuted by the academy trustees and detail what plans are being considered to ensure the academy trust maintains reserves in accordance with their policy.

5. Know your financial situation

The place to start when predicting possible financial and cashflow difficulties is to know your position based on the best and most up to date information possible. As mentioned above, trustees and executive leaders cannot simply rely on the external auditors' going concern opinion. That opinion will be made on the assumption that the academy trust is a going concern in the absence of significant information to the contrary and will not take into consideration longer-term financial health.

As with all business leaders, academy trustees at academy trusts need to "understand the numbers". This is more than simply being able to interpret a budget statement or a balance sheet or to understand the percentages in a spreadsheet. They need to be able to ask the right questions and offer appropriate challenge. Academy trustees should be able to derive comfort in relation to these matters by obtaining regular intelligence on them from their chief financial officer (CFO) and then testing it for accuracy and reliability.

6. Challenging financial information

The volume and depth of financial information that the CFO provides to both the accounting officer and the board will be significantly set by the size of the academy trust and the relative complexity of its organisational structure. It also needs to take into account the current financial position of the academy trust. The main principles are those of quality and proportionality. A large MAT with each constituent academy within operating with a degree of financial autonomy warrants a greater volume of financial management information that reflects what is likely to be a more complex range of financial control issues. For instance, the CFO of such a large MAT may well be required to produce a monthly trial balance or even balance sheet. On the other hand, the academy trustees of a small singleton academy trust with no significant commercial activity and in reasonable financial health may be quite content to management accounts including an analysis of relevant balances like debtors and creditors the minimum of six times a year. Wherever an academy trust sits on this scale, the important point is that the information received is accurate, relevant, timely and is adequately challenged.

The obligation of trustees to challenge should involve appropriate questioning of the CFO and accounting officer on the reliability of the financial information provided. However, it also requires academy trustees to challenge themselves. Do the board consider that they have the right balance of skills and knowledge? Are they receiving the right information? Do they limit their consideration of the longer term challenges facing the academy trust to the annual budget-setting cycle?

Trustees also need to pitch their challenge in a way that achieves an appropriate balance between the shorter term issues that might influence the going concern basis of accounting and the longer term ones that assess financial sustainability. A non-prescriptive menu of potential challenge issues is provided at **Annex A**.

7. Conclusion

Future planning and accurate future financial projections have never been more important for all schools, but accounting officers, finance staff and leaders in academy trusts face a number of challenges regarding shorter-term financial management and control that may not have been such an issue in an LA school.

Any board of academy trustees relying solely on an external audit opinion on going concern runs the risk of missing valuable opportunities to avoid both deficits and negative cashflow by not planning ahead. It is worth considering that, should such a step become necessary, it may take up to 12 months to plan and execute a staffing restructure. The more informed academy trustees are the better equipped they will be to address any financial concerns.

Financial forecasts should always be over at least a 3-year period (preferably 5 years). Financial projections would also usually project various scenarios and be based on the academy improvement plan, best known funding criteria, predicted pupil numbers and staffing profile. However, longer-term financial forecasting does not displace the need for detailed in-year analysis of cashflows and all other matters that could lead to adverse budget variances and diminishing liquidity.

The best step for any academy trust facing a deficit budget or reduced liquidity is early intervention. Sometimes difficult decisions must be made which have longer-term implications, like restructures and the postponement of capital plans. However, to ensure that an academy trust remains a going concern requires detailed and relentless focus on shorter-term issues and especially asking the right questions at the right time.

Should an academy trust find itself predicting a cumulative deficit budget and unable to produce an effective Deficit Recovery Plan, it must notify the ESFA and their external auditors at the earliest opportunity to seek additional advice and support. The ESFA can be contacted by completing anenquiry form.

8. Acknowledgements

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ESFA Finance & Assurance Steering Group, WG3

ESFA will review and update this guide by March 2021.

9. Annex A - financial challenge issues for academy trustees

Short term finances (going concern)	**Long term finances (financial sustainability)**
Is the current year budget in deficit and, if so, how satisfied are you that steps are in place to recover the situation before reserves are exhausted?	What skills does the board have in relation to strategic financial management? What training is undertaken? How does the board ensure it remains up to date on financial issues?
Have we forgotten anything that would increase our outgoings, e.g. rises in TPS employer contribution rates, a rise in NI, the Apprenticeship Levy, etc.?	Do academy trustees understand the financial information they are looking at and how it has been derived? Is there consistency in reports to allow appropriate analysis for trends?
Does the budget for the current year break down into a monthly analysis of all incomings and outgoings?	What benchmarking has the academy trust undertaken both internally, year on year and with other similar schools and academies?
Do you understand the academy trust's scheme of delegation? Who has authority to spend? What measures are in place to monitor spend?	How strong is the challenge within the academy trust?
Has the budget taken into account pay progression (including accelerated progression) as well as any across the board salary increases?	Are the budgets produced broadly accurate over time and when significant variances arise, what actions were taken and were these effective?
Does the board receive cashflow forecasts regularly throughout the financial year showing actual cash surplus against predicted surplus?	Are resources allocated in line with the academy trust's strategic priorities?
Does the academy trust ensure that the CFO prepares a monthly trial balance and analysis of balances as well as income and expenditure?	When were the pupil forecast numbers used in the three or five-year budget forecast last reviewed/checked? How accurate were previous pupil forecasts?
Is there an analysis of academy trust creditors which demonstrates an understanding of when each obligation will need to be met?	Does the academy trust have a clear budget forecast, ideally for the next 3 or 5 years, identifying spending priorities and risks and sets how these will be mitigated?
Do we receive evidence of regular bank statements and always ensure that there are sufficient funds on hand in advance of major outgoings, e.g. payroll?	Do the reserves comply with the reserves policy? Are there sufficient reserves to cover major changes like re-structuring, and any risks identified in the budget forecasts?
Do we have sufficient liquid reserves on hand to ensure that we could meet most unexpected obligations?	Has the academy trust updated its Risk Register to reflect any identified funding issues?
Would we be able to meet the costs of a catastrophic event through either reserves or insurance? How long would it take the insurer to pay out and what would happen in the meantime? Is this noted in the Risk Register?	What does the academy trust spend in respect of staffing when compared to other similar academies? How does the academy trust's outcomes – like value added – compare to other similar schools and academies relative to spend on staffing?
Are we taking full advantage of our suppliers' terms of trade with regard to invoice settlement?	What are the total staffing costs against total income? 80% and above of total income is usually considered high and possibility unsustainable long term.

Do we have a process in place for the ongoing review of all contracts to ensure that they continue to offer best value for money? Have any annual contracts or SLAs been allowed to "roll over" by default?	Is the academy trust making best use of its budget, including in relation to planning and delivery of the curriculum? Is the teaching contact ratio "efficient" and how does it compare to that of other comparable academy trusts?
Are we paying in advance for goods and services in circumstances where it is not obvious that there is any particular benefit to the academy trust (e.g. a discount)?	Does the academy plan its budgets on a "bottom up" (sometimes referred to as "zero-based") basis based on curriculum planning (i.e. the academy trust spending is in accordance with its priorities) or is the budget set by simply making minor adjustments to last year's budget?
-	Are the academy trust's assets and financial resources being used efficiently? What evidence do you have to support this opinion?
-	How can better value for money be achieved?
-	What is the three-year trend regarding our reserves? Are they rising or falling?