



Education
Funding
Agency

Review of financial management and governance at EMLC Academy Trust

Final report

March 2015

Contents

Executive summary	3
Review, objective and scope	4
Background	5
Structure	5
Procurement and related-party transactions	6
Other related-party transactions	8
Academies Financial Handbook issues	9
Business interests – testing identified missing or incomplete declarations	9
Competitive tendering	9
Audit Committee	9
Central charges	10
Disclosures	10
Minutes of Board Meetings	10
Summary	12
Conclusion	13
Annex A – EMLC’s Academy Trust Operation	14
Annex B – Terms of Reference	15
Reason for visit / objectives:	15
Scope of review:	15
Annex C – recommendations to ensure compliance with mandatory requirements	16
Other recommendations	17

Executive summary

1. The EMLC Charity (the Charity) was established in 2003. The EMLC Trust (the MAT) in 2012 and the first two academies opened in September of that year. Third Wave Enterprises Ltd (TWE) was established in 2007 and was already working with the Charity when the MAT was established.
2. Operating under the originally established structure was potentially causing conflicts of interest and breaches of Academy Financial Handbook regulations. This has resulted in a lack of transparency regarding the governance and financial management of the MAT.
3. The MAT CEO and the Chair of the Strategic Board of the Charity recognise and accept the past conflicts and anomalies presented by the current structure and they have begun to resolve the issues. There are further proposals to establish an Audit and Risk Group to strengthen the structure by adding independent challenge.
4. Work over the last 18 months has addressed a number of the governance issues created by the legacy structure. We note that the MAT is currently recruiting a Chief Operating Officer resource to support the governance structure further, which we consider a step in the right direction.
5. Below are the detailed findings and recommendations from the review. While the majority of the issues may be resolved by actions that have already begun there are other areas of non-compliance with the Academies Financial Handbook which were identified and which the MAT will need to take action to resolve outside of any proposed re-structure.
6. We identified a number of areas where the MAT is not operating in compliance with the Academies Financial Handbook. These are detailed in 4.15 and in Annex C.
7. What we did find was while the existing corporate structure and inter-relationship have resulted in a set-up where there is considerable scope for conflicts of interest to arise, we found no evidence that these relationships had worked to the detriment of the MAT or its academies and the trustees are getting to grips with this situation to improve governance.
8. The MAT has provided us with a breakdown of costs for each of the related party transactions reported in its 2013/14 financial statements plus the management fee “top-slice” from the academies.

Review, objective and scope

9. This report sets out the findings arising from the EFA's Risk Analysis Division visit to EMLC on 11 and 12 February 2015.

10. The purpose of our visit was:

- To seek to further understand and assess the governance and accountability for the flow of monies between connected organisations and to individuals from the MAT.

11. The objectives of the visit are to establish the nature of the activities and transactions, then report back to the DfE on:

- The nature of the relationships across the MAT;
- the Charity;
- TWE;
- [REDACTED] and;
- [REDACTED] and how the services have been procured and approved.

12. The MAT is sponsored by the Charity. The EFA has a funding agreement with the MAT and we looked to see if the MAT was compliant with this agreement and its Articles of Association together with the Academies Financial Handbook (AFH).

Background

13. EFA's Risk Analysis Division (RAD) were asked to undertake a visit to the MAT following ongoing correspondence between the EFA and the MAT since June 2014. Letters were exchanged over a number of months which had not resolved all concerns. Concerns were also raised by Ministers regarding transactions with the Charity and the related private company, TWE. There are common directors in each organisation.
14. In addition, the MAT made payments to ██████████ for the services of their Principal. The Principal was listed as a director at the MAT until August 2014.
15. It had also been noted that a firm belonging to the spouse of the Principal of ██████████ had been paid for building work at both ██████████ and the MAT.
16. At the time of writing, the EFA had not received the ██████████ audited accounts to the period 31 August 2014. This issue is being handled by the EFA through its normal business processes.
17. A key objective of the investigation was to establish the substance of the concerns relating to the transactions between the Charity, the MAT, TWE and, if relevant, ██████████ and ██████████ and whether any of these had been to the detriment of the MAT and its academies.
18. We obtained from the Accounting Officer a structure of the linked entities which is reproduced at Annex A.
19. The Charity provides oversight of the operation of the MAT through common directorships and also acts as a service provider, recharging the MAT for a number of central services to the academies. Since the three entities share the same premises, these relate to the MAT's occupation costs, but also elements of the MAT's leadership etc that are shared between the Charity and the MAT on a pro-rata basis. Prior to this review issues had arisen regarding the lack of transparency of these arrangements: in particular the potential conflicts and related party transactions that had arisen as a result of the common directorships and the extent to which the current structure was compliant with the regulatory framework under which MATs should operate. The trustees had already responded to these concerns and, in order to increase transparency, had advertised for additional members for both the charity and the trust.
20. Within the MAT there are four governance sub-groups; Finance Group, Audit and Risk Group, Performance Group and the Development Group who all provide challenge to the Strategic Board.

Structure

21. The current structure was set up on the basis of two pre-existing inter-related organisations, the Charity and TWE with the MAT having being established several years later. However, there have been insufficient steps taken since the establishment of the

MAT to fully regularise the relationships. The Charity was established in 2003; the MAT in 2012, with the first two academies coming on board in September of that year. TWE was established in 2007 and was already working with the Charity when the MAT was established. From the interviews carried out it is clear that the Charity is essential to TWE and vice-versa, and the relationship is close. The Charity is an equity-holder in TWE (as is the MAT's accounting officer) and the common leadership roles across the Charity, the MAT and TWE help and sustain the operational delivery of each element. The core business of TWE is to carry on business as a general commercial company to procure profits and gains for the purpose of paying them to the EMLC charity, though more recently TWE has also made dividend payments to its shareholders. The core business of the MAT is advancing public benefit education in the United Kingdom by establishing, maintaining, carrying on, managing and developing schools ("the Academies") offering a broad and balanced curriculum.

22. There is an acceptance, by the Charity and MAT, that there is a pressing need for some "tidying up" on the governance and separation of duties, though their case is that, due to the pace of growth there has not yet been a chance to "tidy up" the arrangements fully.

23. The Charity provides the oversight of the MAT. This was initially through a common board of trustees between the Charity and the MAT. During this review we became aware that the original joint governance between the Charity and MAT had now changed, and there are now separate boards for the two entities, albeit with substantial overlap in management. Significantly, the MAT has made efforts to appoint a Chief Operating Officer who would assume the role of the MAT's accounting officer and would not have any formal connection with the Charity, but this process has not met with success so far. Both organisations have also advertised in the national press for new Trustees.

24. Our view is that the current triangular structure and ways of working has grown organically from relationships in existence over time and it is clear there are risks in this relationship. The facts are shared premises, common directorships between the two EMLCs and familial and equity relationships between the Charity and the Directors common to the MAT and TWE. This governance need not be inappropriate providing potential conflicts are managed, there is adequate internal challenge, free and open procurement and the "at cost" policy is adhered to (and is seen to be). The upside for the MAT if these risks are managed is that it should benefit from these relationships via shared objectives and specialist knowledge and experience. The establishment of a Chief Operating Officer should indicate a significant move to establish the MAT's autonomy.

Procurement and related-party transactions

25. We have obtained evidence that TWE provides services to the EMLC at cost, allowing for an appropriate level of overhead costs, but without the profit "mark-up" that it

requires from its “external” customers. TWE provided documentation that detailed the make-up of the direct and indirect costs (including the 42% overheads) which show that the services charged to the MAT are “at cost” and cover such items as salaries, marketing and strategic advice, premises and utilities. The chair of the MAT provided us with assurance that the MAT would conduct an extensive review of the documentation that supported the working relationship between the MAT and TWE. This will include a revised Statement of Assurance in relation to cost and refreshed SLAs with TWE, to come into effect from September 2015. The MAT provided a breakdown of the costs for the work carried out by TWE in 2013/14. It shows that the costs were met from a combination of School Improvement Grant funds (provided on conversion), the management fee/top-slice taken from the academies by the MAT, other MAT funds and from individual academy GAG funds. 31% of the total TWE work costs disclosed (minus the VAT element) was met by the academies (School Improvement Funds/GAG) and the remainder by the MAT (through top-slice and other funds).

26. Our visit identified that TWE, which is a separate company and is not a subsidiary of the Charity or the MAT has a number of other commercial customers. Details of some of the larger contracts were provided at the time of the visit. In summary TWE has twelve contracts valued between £950k and £5k. A number of these contracts have been running since 2009. There is a fuller breakdown of TWE turnover and costs since year ending March 2010 showing a consistent turnover of around £800k annually and profitability over these years, though with no dividend being paid until 2012-13.

27. The Charity has a contract with the National College for Teaching and in 2013/14 the value was £1.4m. The Charity is not reliant on the MAT, as evidenced from its company financial report. There is a case in fact that the MAT benefits from the Charity’s commercial work and its consequent financial strength. The Charity provided a donation of £200k to the MAT from 2012/13 onwards of which £180k has been transferred to the MAT so far. The donation (voluntary income) was earmarked for the day to day running of the Trust whilst building its capacity in its early years. There are currently no commitments in place to make available further donations in the future.

28. ██████████ is a company controlled by the spouse of the head teacher of ██████████ (currently contracted through ██████████ on a part-time basis in the role of Leadership Coach to the MAT). In 2013/14 ██████████ did capital work for the MAT totalling £2,419 (we reviewed the invoices list to confirm this). In 2012/13 the MAT expenditure with ██████████ was significantly higher at £135k. We were advised that the appointment of ██████████ by the MAT was a joint decision between the MAT and Navigant (who were DfE capital assessors), there were a limited number of bidders for this work and that Navigant were at the heart of the decision to let the work to ██████████. Though we were not provided with any copy correspondence to corroborate the assurance we were given. The MAT has no plans to use ██████████ from 2014/15 onwards.

29. The Finance Group (which is a finance committee, comprising two members and three trustees) carries out the preparation for any big decisions on behalf of the board. It

also sets and monitors budgets for the MAT and the academies. The management accounts show a line breaking down the management fee. It is at this point that finances are challenged by the Finance Group. A procurement policy has been agreed by the Finance Group but has not yet been signed off by the board. There is also evidence of the challenge to the board of the MAT taking on the free school application. The Finance Group discussed the new procurement policy in the January 2015 meeting.

30. Service Level Agreements (SLAs) are in place between the three entities. Prior to the visit we had seen copies of SLAs between the MAT and its partners which commenced from September 2012. During the visit we saw evidence of an SLA between the Charity and the MAT, dated and signed September 2014. We also saw an SLA between the MAT and TWE, signed September 2014 (which may have come about following enquiries from the EFA). We also saw an SLA between the Trust and [REDACTED], dated September 2013, relating to the contracting of [REDACTED] head teacher to the MAT. Clearly, the relationship between the MAT and TWE ought to have been formalised through a fully contractual relationship, and the MAT leadership acknowledges this.

31. Our view is that the move to more formalised arrangements between the Charity, the MAT and TWE is welcome, however we saw little evidence of a link to deliverables or outcomes e.g. contract monitoring of the services provided by TWE.

32. As the MAT is a relatively immature organisation, there has been a degree of reliance on the Charity which may continue in the short term. The MAT needs to find a way to manage potential conflicts which are likely to arise.

33. We were not presented with any evidence of an SLA for the provision of central services to the academies within the MAT. At this stage, the formalised arrangements are essentially about “head office” matters. However, as the new structure and arrangements would also be operating with common directorships this would not remove the issue of related party transactions and conflicts of interest.

Other related-party transactions

34. A number of payments had been made to related parties and these are detailed in the audited accounts. We were provided with a full breakdown of the related party figures, all of which agreed to the declaration in note 27 to the financial statements, year ended 31 August 2014.

The review identified that there was a contract in place for the Principal of [REDACTED] plus a team of individuals to work with the first two academies in the MAT (Orchard and Shepherdswell) to provide strategic development and support. The contract value was for £150k. This agrees with note 27 to the financial statements. The MAT provided us with a breakdown of the costs for the [REDACTED] work which revealed that the two academies met the costs of the £150k evenly from their GAG funds, which the MAT claims equate to the costs which would ordinarily be attributable to Head teachers at both academies. We

recognise that [REDACTED] is not technically a related party and so is not obliged to provide services at cost to the MAT. The MAT agreed to make an honorarium payment to [REDACTED] (value of £29,618 – one third paid to deputy Heads at the two academies and two thirds to [REDACTED]) which is included in the Analysis of Trust Income and Expenditure summary provided to RAD during the visit. We noted that the MAT reserved the right to award an honorarium as mentioned in the agreement between the MAT and [REDACTED]. However, since at the time of writing [REDACTED] accounts for 2013/14 have not been received by EFA so the figure cannot be independently verified.

Academies Financial Handbook issues

35. We identified a number of areas where the MAT is not operating in compliance with the Academies Financial Handbook:

Business interests – testing identified missing or incomplete declarations

36. The Trust must ensure that all members, trustees, and senior employees, LGB members and Academy Improvement Board (AIB) Members have completed the register of interests and there are measures in place to manage any conflicts of interest. (AFH 3.1.12).

Competitive tendering

37. Testing identified that there had been no competitive tendering for TWE in any year since 2012 (the date the trust was established). The Charity had been using TWE as a supplier since the Charity worked with Leicester City Council, where TWE was a preferred supplier. A review of the SLA showed that it was dated September 2014 but the work was backdated to September 2012.

38. The Trust must ensure that competitive tendering policy and procedures are applied. (AFH 3.1.3).

Audit Committee

39. The MATs have been operating without a separate audit committee although this is now in the process of being established. An independent chair has been identified, who is neither a member nor a director. At the time of our visit this committee had not met.

40. It is a requirement of the AFH that each MAT must establish an audit committee or a committee which fulfils the functions of an audit committee, dependent upon the size of the trust (AFH 2.4.1 – 2.4.3)

41. We also identified the following areas where the MAT should strengthen working practices and controls to ensure a robust control framework is in place across the MAT.

Central charges

42. GAG funds go to the MAT bank account, for cash management purposes. Academies have individual bank accounts and use [REDACTED] to pay suppliers. The process is managed by the MAT and the MAT takes its top slice from the GAG. The payroll provider [REDACTED] is under a contract. Both [REDACTED] and [REDACTED] are common suppliers of finance and payroll in academies.

43. The MAT produces management accounts for each academy and these are reviewed by the AIB or the LGB (whichever is appropriate). The trust also carries out monthly finance reviews.

44. The total of sums paid out by the MAT in 2013/14 to its various related parties was £805k. This included payments to the Charity, TWE, [REDACTED] and [REDACTED]. The funds paid to the Charity (£360k) are in the main salary re-charges. The MAT head office charges its academies for central services (“top slice”). Central services cover HR, financial services, legal services and educational support services. During the visit we obtained a breakdown of this income to the head office which totalled £344k (£229k from the academies’ GAG, the rest from ESG and school improvement grants). This agreed with the figure in Note 13 of the MAT accounts for the year ended 31 August 2014. This central fee was levied on the basis of 8% of pupil-based funding (excluding SEN) for those academies requiring improvement and 5% for those not in this category. As stated in para 4.9, the TWE costs are met from a combination of funds, including (where necessary) an additional charge from the academies’ GAG funds.

Disclosures

The financial statements have been reviewed and this resulted in some areas of concern around the related party transactions. Apart from those which are covered by this report, there are also three very minor additional issues arising from the accounts:

- Resources Expanded note (note 6) section may need expanding in accordance with the accounts direction.
- The approach section of the auditor’s assurance report on regularity is not fully compliant with the Accounts Direction. This is a minor issue but will need to be rectified next year.
- Severance payments are notified, amounting to £18,824. Confirmation is needed if this is contractual or non-contractual.

Minutes of Board Meetings

45. A review of the minutes from MAT Board meetings identified that Declarations of Interest is an item on the agenda and we observed evidence of declarations as noted

above. The Charity board meets regularly. Declaration of interests has started to become a regular agenda item at the strategic board meeting.

Summary

46. There are outstanding issues in relation to the corporate structure which mean that conflicts of interest are likely to continue to be an issue for the foreseeable future, particularly in respect of the relationship between the trustees of the MAT and the management and owners of TWE. The leadership of the MAT recognises this and is beginning to take steps (perhaps later than DfE would want) to mitigate the conflicts as well as strengthen the governance of the MAT as an autonomous entity. However, the EMLC model is highly dependent on the financial and leadership support of the Charity and the school improvement know-how of TWE and it is unrealistic to expect that a complete separation can be effected without fundamentally affecting the character of the MAT.

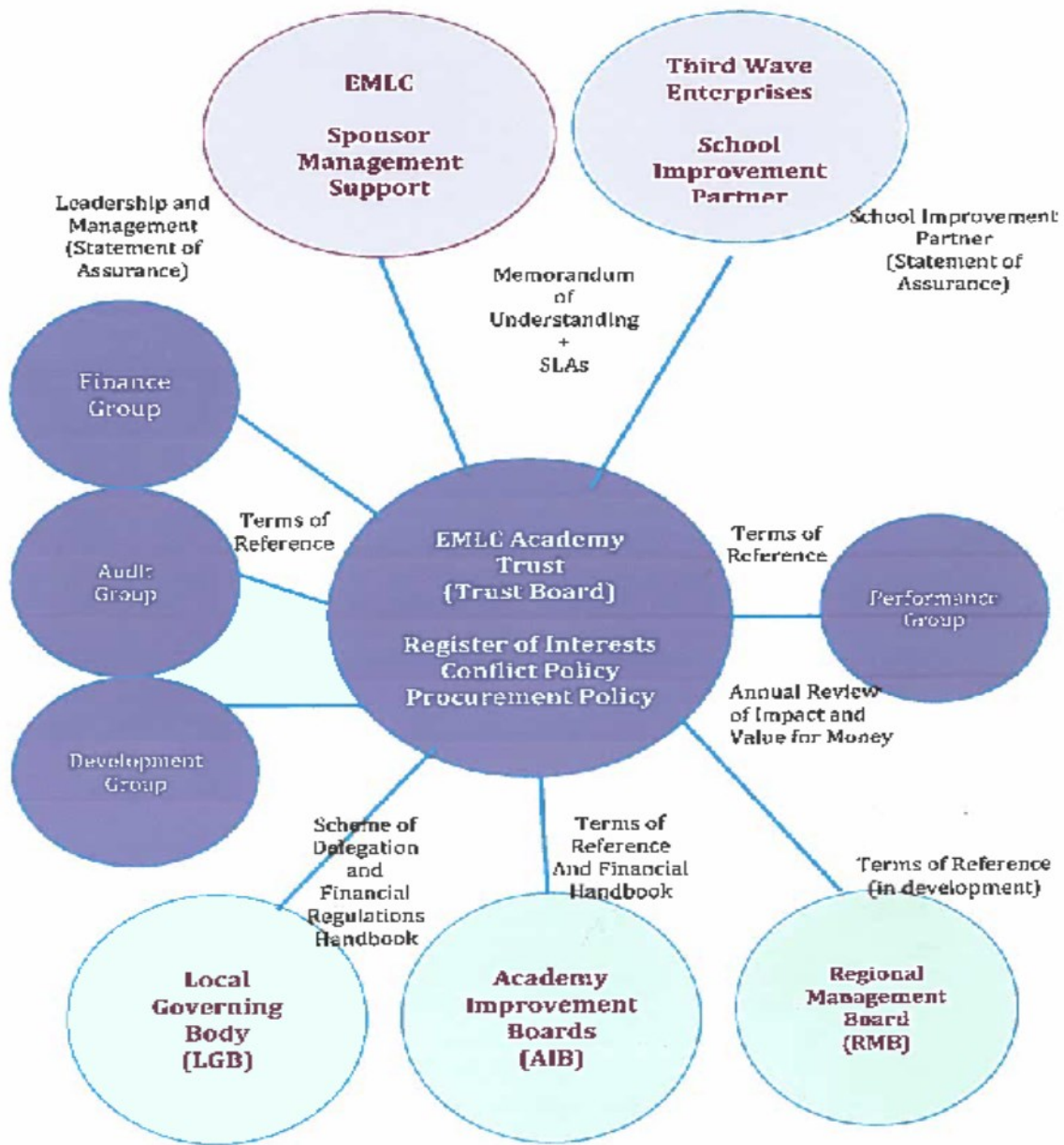
47. The challenge for the MAT is to manage these conflicts by building in the checks and balances that ensure that potential conflicts do not become real ones. However, we found no evidence that the existing arrangements had operated to the detriment of the MAT or its academies. It is worth noting that both the Charity and TWE were both successful businesses operating in the education sector some time before the MAT was formed and both continue to run a diverse portfolio of clients. Neither the Charity nor TWE are in any sense “dependent” on the MAT: quite the opposite in fact, with the Charity providing subsidised accommodation to the MAT head office as well as considerable value in terms of the proportion of management time charged out to the MAT; likewise, the application of the “at cost” policy to the MAT means that it is able to buy the services of TWE at rates it does not provide on the open market. We also found evidence to confirm that the MAT was purchasing services at cost. The MAT trustees accept that, due to the pace of development (which they were keen to stress the DfE pushed for), there are still things to be fixed.

Conclusion

48. The MAT has reviewed its structure over the last 18 months. However, many actions have only recently been completed and there is limited evidence at this stage to indicate that all changes have been fully embedded and are effective.

49. Our review also identified a number of additional actions which the MAT should consider implementing to further improve financial management and governance arrangements. These are noted in Annex C.

Annex A – EMLC’s Academy Trust Operation



Annex B – Terms of Reference

Reason for visit / objectives:

50. The EFA is seeking to further understand and assess the governance and accountability for the flow of monies between connected organisations and to individuals from EMLC Academy Trust.
51. The objectives of the visit are to establish the facts and report back to the DfE on:
- the full nature of the relationships across EMLC Academy Trust, EMLC Charity, Third Wave Enterprises Ltd (TWE) [REDACTED] and [REDACTED] and how the services have been procured and approved;
 - a forensic assessment of the records and decision making for the flow of funds between the organisations;
 - the employment arrangements and remuneration of the individuals that are linked to the charity, the MAT and TWE;
 - the overheads added to TWE charges and how are they arrived at.

Scope of review:

- To obtain a detailed and clear understanding of the related party transactions at EMLC Academy Trust in 2012/13 and 2013/14, including reviewing all relevant supporting documents.
- To review documents and records of related parties using the Trust's open book agreement that should be in place, including the employment arrangements and remuneration of related parties.
- The scope may be extended if required.

Annex C – recommendations to ensure compliance with mandatory requirements

We have identified areas in which the MAT is not yet fully compliant:

No	Areas in which the MAT is not yet fully compliant	Recommendations to ensure compliance
1.	Declarations of interest were out of date or there were details missing. Also inconsistent practice of recording declarations of interest.	<p>The MAT must ensure that all members, trustees, local governors of academies within a multi-academy trust and senior employees of the academy trust have completed the register of interests and there are measures in place to manage any conflicts of interest.</p> <p>There should be a standing item on the board meeting for checking and reviewing declarations of interest.</p>
2.	The Financial Procedures Policy provides details of procurement procedures including the requirement to obtain quotes or tenders depending on the value of the goods or service being purchased. Testing identified areas of non-compliance with this policy in particular the lack of supporting documentation or audit trail to verify that correct procedures had been applied and followed, failure to obtain sufficient quotes or undertake more formal tendering where appropriate.	The MAT must ensure that a competitive tendering policy is in place and applied.
3.	The MAT has been operating without a separate audit committee although this is now in the process of being established.	The MAT must ensure that it establishes an audit committee or a committee which fulfils the functions of an audit committee, dependent upon the size of the MAT (AFH 2.4.1 – 2.4.3)

Other recommendations

While not mandatory for the Academy to implement, we have the following observations and best practice recommendations for the Academy to consider:

No	Other findings	Recommendations for improvement and/or best practice
4.	We saw SLAs in place at the offices of EMLC but saw little evidence of links to deliverables or outcomes	Prepare SLAs for the next round of agreements/SLAs with details in linking performance reviews based on deliverables and/or outcomes.
5.	The MAT retains a top-slice from each academy's GAG funding to cover the provision of a number of central services. However best practice is for the MAT to put in place a formal Service Level Agreement in order that each of the academies can identify what type of services they are receiving for the top-slice.	The MAT should develop a formal protocol or SLA to be agreed with each of the academies within the MAT in order to provide transparency and clarity over what services are to be provided for the 'top-slice'.
6.	Disclosures in the financial statements are not in line with the requirements of the Academies Accounts Direction e.g. Resources Expended (note 6) section may need expanding. The approach section of the auditor's assurance report on regularity is not fully compliant with the Accounts Direction. Minor issue and to rectify for next time. Severance payments are notified amounting to £18,824. Confirmation needed if this is contractual or non-contractual.	The MAT should ensure that future financial statements are fully compliant with all requirements.



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