Communication with Academy Trust Auditors 2021

Sector Annual Report and Accounts:
Consolidation of Academies

Our Audit Approach - Introduction

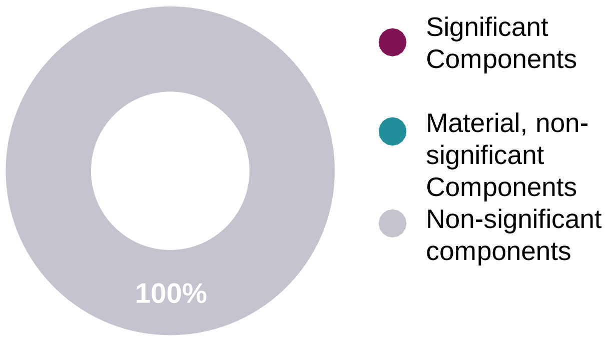
The Department for Education (DfE) is required to consolidate academy trusts into a dedicated Academies Sector Annual Report and Accounts (SARA). The Comptroller and Auditor General (C&AG) is the appointed auditor of the SARA. The National Audit Office (NAO) performs the audit on behalf of the C&AG.

This communication sets out:

- Our responsibilities as auditors of the SARA, in accordance with International Standards on Auditing (UK) (ISAs (UK));
- The requirements of academy trust auditors in relation to the group opinion; and
- Our assessment of the risks of material misstatement in the group financial statements.

The NAO is responsible for the audit of the consolidated accounts, and this communication is issued in accordance with paragraph 40 and 41 of the Financial Reporting Council's ISA (UK&I) 600 *Special Considerations –Audit of Group Financial Statements (Including the Work of Component Auditors).* Based on our planning work, and consistent with prior years, we have determined that the SARA does not currently contain any significant components as no individual academy trust's income, expenditure or assets is above our thresholds, set in accordance with ISA 600. For the 2020/21 financial statement audit, as in previous years, we do not require academy trust auditors to perform additional procedures for us to form our group audit opinion. We continue to request that academy trust auditors notify us as soon as possible where there is a qualified audit opinion or a modified regularity opinion on the academy trust's financial statements, in accordance with the Academies Accounts Direction 2020-21 .

Group Coverage



This document represents our communication with component auditors within the academy sector in accordance with ISA 600. It is intended to explain the role of the NAO as group auditor, group risks relevant to the academy trust auditors, and our expectations of academy trust auditors in completing:

- the audit of academy trust financial statements for the period to 31 August 2021, including the regularity opinion; and
- assurance work on the accounts return.

We also perform a review of a sample of academy trusts, to support our continuous risk assessment and substantive testing of significant balances within the group financial statements, and to enable us to develop our more granular insights into the sector. This is a continuation of our inquiries with a sample of academy trust auditors in the prior year.

Requirements of academy trust auditors

As non-significant components, we do not require academy trust auditors to perform specified procedures for the purposes of our group audit opinion.

Academy trust auditors are required to conduct their audit and assurance work as follows:
- Conduct their audit of academy trust financial statements in accordance with ISAs (UK&I);
- Comply with the requirements of the Education and Skills Funding Agency's (ESFA) accounts direction with regards to the independent auditor's report on regularity. The accounts direction draws upon Institute for Chartered Accountants in England and Wales (ICAEW) Technical Release TECH08/12AAF Regularity Reporting for Academies and Practice Note 10 *Audit of Public Sector Bodies in the UK* (October 2010);
- Conduct any other assurance work with due regard to the ICAEW Assurance Sourcebook, applicable guidance from ESFA and the SORP; and
- Comply with the Financial Reporting Council's Ethical Standards.

We request academy trust auditors to notify us, by exception in the following cases:
- Non-compliance with the requirements in paragraph 8;
- A modified opinion on the independent auditor's report on the financial statements or on regularity;
- Identification of significant risks of material misstatement to the group financial statements, whether through fraud or error, other than those set out in this document. Our materiality assessment for the group can be found on page 5. Academy trust auditors may contact the group auditors to discuss significance; and
- Post-balance sheet events: we request auditors to assess whether there are any events within academies that could create a post-balance sheet event of significance to the group accounts. Such events are most likely to be, but are not limited to, identification of irregularity material to the academy trust, including fraud, or an academy trust ceasing to be a going concern.

The ESFA requires academy trusts to provide a copy of the auditor's communication to management under ISA 260 *The Auditor's Communication with Those Charged with Governance.* We do not anticipate requiring additional documentation from auditors.

When setting a threshold for clearly trivial misstatements in accordance with ISA 450 *Evaluation of Misstatements Identified During the Audit*, we request auditors to consider the nature of the misstatement and its context to the group financial statements. We would not expect such a threshold to exceed £300,000 in monetary terms, and ask auditors to contact us if a threshold above this is being applied.

We welcome academy trust auditors to contact us in line with the guidance set out above, or to seek clarification on any of the aspects contained within this document. We can be contacted us on: **academy.returns@nao.org.uk**.

Review of a sample of academy trusts

As part of our continuous risk assessment we intend for the 2020/21 financial audit to review a judgemental sample of academy trust auditor's audit files. This review will be performed on a cyclical basis, in order to:

- Develop our wider understanding of the Sector;
- Develop our insights to support our reporting to those charged with governance and wider stakeholders where relevant;
- Support our risk assessment in specific audit areas.

We will not be performing a quality review of auditor files, nor we will be providing an opinion based upon the results of our work. We are primarily seeking to understand and validate the assurances relied upon in the collation of group annual report and accounts data. We may use the insights gained to form recommendations to improve processes impacting the group. Such recommendations will not refer to any individual academy trust our audit firm.

We will communicate formally to the auditors of the academy trusts selected as part of our judgemental sample, including further details of the scope of our work and our areas of focus.

Our sample is selected to provide reasonable coverage of the Sector, allowing us to develop more granular insights over time through a cyclical review of different academy trusts over a number of years. Factors considered in our sample selection process include but are not limited to: type, size, location and growth of the academy trust; and the significance of key balances. Whilst our inquiries are focussed on the academy trust selected as part of the sample, we also hope to gain a broader understanding of the work of different academy trust auditors across the range of trusts which they audit.

Group risk assessment - materiality

In line with generally accepted practice, we have set our quantitative materiality threshold for the consolidated account as approximately 1% of Land & Buildings including AUC. These levels are comparable to those used in prior years. Land & Buildings dominate the SARA and are a key consideration for users of the account in viewing the performance of the sector. Given the size of the Sector compared with any individual academy trust (with each being non-significant to the Group), materiality levels applied for each individual academy trust audit is expected to be significantly below our Group materiality threshold.

A matter is material if its omission or misstatement would reasonably influence the decisions of users of the financial statements. The assessment of what is material is a matter of the auditor's professional judgement and includes considerations of both the amount and the nature of the misstatement.

We also consider materiality qualitatively, in areas where users are particularly sensitive to inaccuracy or omission, we may treat misstatements as material even below the principal thresholds. These areas include:

- The remuneration report;
- Disclosures about losses and special payments;
- Prior year comparatives;
- Our audit fee;
- Irregular income and expenditure.

Our response to the significant risks

Presumed risk of management override of controls

Why we have identified this as a risk

Under International Standards on Auditing (UK and Ireland) (ISAs) 240, there is a presumed risk of management override of controls for all bodies. The presumed risk focuses on three areas:

- Manual journal entry: the consolidation process for the SARA requires significant manual journals across the account. Management could manipulate the financial reporting process and year-end outturn through manual journals.

- Bias in significant estimates: management are responsible for making a number of material judgements in the preparation of the accounts, notably in respect of Land & Buildings and LGPS balances, which could be used to manipulate the financial statements.

- Significant or unusual transactions: significant transactions outside the normal course of business may be indicative of fraudulent financial reporting.

This risk is pervasive and could affect all areas of the consolidated accounts. We have not identified any heightened risk in relation to management override within the SARA audit as part of our initial planning work.

Work we plan to undertake in response

Our controls work will include:

- Updating our assessment in relation to the design and implementation of controls around the creation and approval of journals, estimates, and the identification and approval of any new significant or unusual transactions. This includes any changes arising from the implementation of the new consolidation tool.

However, under ISAs the presumption is that management will be able to override controls and therefore assurance is obtained through substantive work:

- Testing of manual journals. Our testing is performed based on a risk-based analysis of journals that could indicate management override.
- Reviewing accounting estimates for indication of bias. In addition, we retrospectively review estimates made in the prior year for reasonableness compared with outturn.
- Analysis of the consolidation pack for transactions outside the normal course of business or which otherwise appear unusual. We test the appropriateness of any that appear unusual or significant.

Our response to the significant risks

Land & Buildings - Valuation

Why we have identified this as a risk

Land & Buildings within the SARA dominate the Statement of Financial Position and involve significant management judgement to value under a Depreciated Replacement Cost methodology in accordance with HM Treasury's Financial Reporting Manual (FReM). The DfE continue to commission professional surveyors to undertake the valuation of the Sector's Land & Buildings. The valuation of Land & Buildings is a significant accounting estimate and we employ our own auditor's experts to challenge the Department's approach.

Work we plan to undertake in response

Our controls work is expected to include:

- Assessment of the valuation methodology.
- Assessment of the design and implementation of DfE's processes for ensuring the methodology has been appropriately and consistently applied to valuations undertaken during the period.
- Reviewing the basis for the proposed rolling programme of valuations, considering the sufficiency of this for valuing the portfolio and the level of local additions.

Our substantive work is expected to include:

- Consideration of the appropriateness of the Depreciated Replacement Cost valuation by our auditor's experts, including the obsolescence factors used.
- Consideration the appropriateness of significant assumptions, including the quality of data on which these assumptions are based.
- Testing the consolidation process to ensure valuations provided by academy trusts have been removed from the accounts data where these have been replaced by a DRC valuation.
- Ensuring the valuations have been correctly entered into the accounts.

Our response to the significant risks

Land & Buildings - Records

Why we have identified this as a risk

The SARA has an assets base of over £56bn composed of over 40,000 individual land and building holdings. The volume and diversity of these assets make them complex to manage with a high volume of adjustments between the expert valuations and the value included within the accounts.

A Fixed Asset Register will be fully implemented for the first time in 2020/21. The Fixed Asset Register is expected to reduce the level of manual intervention required to manage the complex data set, and be used to inform recognition decisions as well as to calculate depreciation, indexation and valuation movements. Given the changes in the process for calculating a number of the key adjustments there is a somewhat increased risk of error in the 2020/21 accounts although in the longer term we anticipate this risk will reduce.

We see the introduction of a Fixed Asset Register as a positive step forward in the management of Land & Buildings in the SARA.

Work we plan to undertake in response

Our controls work is expected to include:

- Review of the implementation of the Fixed Asset Register, including an assessment of the design and implementation of controls by DfE to ensure the Register is complete and accurate.
- Review controls over the model such as access rights and quality assurance processes.
- Assess the integrity of the Fixed Asset Register, engaging with our IT audit team as appropriate.
- Review of the design and implementation of the End to End Reconciliation which supports the overall appropriateness of adjustments made between valuations and the figures included within the accounts

Our substantive testing is expected to include:

- Reconciliation of the Fixed Asset Register to closing asset balances and the LBCT.
- Testing the logical integrity of the Fixed Asset Register.
- Reconciliation of the balances in the Fixed Asset Register to the financial statements.
- Review of the calculation End to End Reconciliation and consideration of the appropriateness of the differences identified

Our response to the significant risks

Local Government Pension Scheme (LGPS) – Valuation & Allocation of Assets & Liabilities

Why we have identified this as a risk

Academy Trusts are required to offer LGPS membership to non-teaching staff, and therefore each Trust will have membership of one or more funds. Each Academy Trust obtains valuations from the LGPS funds which they are members of and these are aggregated in the SARA consolidation. There is no single stated policy for allocating each Academy's share of assets and liabilities and therefore there is an enhanced risk of misstatement or uneven allocation. The nature of the LGPS assets and liabilities mean there is inherent uncertainty due to the actuarial assumptions applied in the valuation. Risks also arise for the SARA from the potential for systematic discrepancies or biases in the assumptions used, the processes to value assets and liabilities, and the attribution of assets and liabilities to Trusts as small employers.

In addition, there is a risk due to the difference in reporting date between the asset valuations and the SARA year end, although we expect assurance over this risk to be gained through the work of AT auditors.

There are also ongoing legal challenges, including GMP and Goodwin, which may require adjustment in the 2020/21 account.

We understand DfE are continuing to employ its own actuarial expert to validate the processes and assumptions applied in the valuation of LGPS assets and liabilities, and to support the IAS 19 disclosures required by the FReM.

Work we plan to undertake in response

Our controls work is expected to include:

- Assessing the design and implementation of controls in place by DfE to ensure LGPS balances are materially accurate, including processes around the consolidation and DfE's use of management experts.
- Reviewing processes in place for identifying and assessing the impact of special events and other factors that may impact the LGPS balances such as legal cases.

We expect our substantive work to include:

- Employing our own auditor's expert to assess the reasonableness DfE's management expert's assessments.
- Using our auditor's experts to assess the appropriateness of the pension valuation methodology and assumptions applied.
- Reconciling the IAS 19 disclosures to consolidation schedules and management expert's report.

Our response to the significant risks

Adaptive – Implementation of new consolidation system NEW

Why we have identified this as a risk

The 2020/21 accounts will be the first set of accounts prepared using the new Adaptive consolidation system as opposed to the HFM system which has been used since the inception of the SARA.

During the first year of implementation we have identified a significant risk due to the need to migrate account balances and other data from other systems into Adaptive and increased risk to the consolidation as a result of the first time use of a new system.

Work we plan to undertake in response

Our controls work is expected to include:

- Engaging our IT audit experts to review the design and implementation of the new system including the governance of the change programme and the change and access controls in Adaptive as well as the controls over data transfers between systems that occurred in year
- Update our understanding of the design and implementation of the consolidation process and the manual journals process to ensure our assessment of the risks and controls in place over these key systems is appropriate

We expect our substantive work to include:

- Reconciliation of key data imported into Adaptive to previously audited sources, in particular ensuring account balances have been appropriately imported from HFM

Our standard testing procedures for gaining assurance over the consolidation include a full reperformance of the consolidation using a sample of accounts returns which are reconciled to published AT financial statements through to the final consolidated financial statements and therefore we do not anticipate any additional work over the consolidation process itself being required. However, we will review this further during the fieldwork stage.

Areas of audit focus

The following are matters which we consider have a direct impact on the financial statements but do not represent significant risks of material misstatement as defined by ISA (UK) 315.

Title	Audit Area Affected	Audit Response
Covid-19 – Disruption to Local Assurances	Pervasive	Covid-19 has resulted in significant disruption to the Sector, with schools closed for a portion of the 2020/21 reporting period. Despite schools being closed for a significant portion of the 2019/20 period, we concluded that the impact of Covid-19 on the sector did not have a significant impact on the production of the 2019/20 consolidation. In 2019/20, the accounts returns were provided across almost all academy trusts within the required timeframes and the audit opinions provided across academy trusts did not give rise to a material issue at the Group level. We remain cognisant of the impact of Covid-19 and the potential disruption to the local assurances, but we no longer deem this to be a significant risk. We understand financial statement and Accounts Returns return rates are consistent with prior periods.
Grant Regularity	Regularity	There is known irregularity in relation to spending of grants by academy trusts however this has historically been below our audit materiality threshold. In 2019/20, we escalated the risk around grant regularity to a significant risk due to the impact of Covid-19. In order to support education providers through the Covid-19 pandemic there has been an increase in funding from the ESFA and DfE in 2019/20 and 2020/21, from new funding streams and alterations to existing funding, each with their own conditions, mechanisms and timings. We note that higher levels of Covid-19 funding are expected to be recognised in the 2020/21 SARA. In the prior year, we concluded overall that grant expenditure had been incurred in accordance with the purposes intended by Parliament, with no material irregularity identified through our work. As a result of our conclusions last year and greater understanding of the Covid-19 funding streams we have deemed grant regularity to be an area of audit focus in 2020/21.

Areas of audit focus (continued)

Title	Audit Area Affected	Audit Response
IFRS 16 Preparatory Work	Property, Plant & Equipment Lease liabilities	IFRS 16 is expected to be effective in 2022/23 for the SARA, with an anticipated significant impact on the accounts. Preparatory work commenced in 2018/19 and continued into 2019/20 with the key focus on recognition judgements (determining occupation routes that are within scope of IFRS 16), to allow for the more complex measurement approaches to be established in advance of opening balances being required. We will also use our engagement with Academy Trust Auditors to assess the completeness of management's IFRS 16 considerations.
Assets under construction	Property, Plant & Equipment	There continues to be significant volumes of Assets under Construction (AuC) being delivered across the Sector and our approach uses data collected by the Department to substantively test AuC. We have historically identified low levels of error through our testing.
Annual Report Improvement	Disclosures	We expect Covid-19 to be a significant feature of the 2020/21 SARA and note that some disclosures such as qualifications and educational achievements will remain more challenging to produce. We anticipate the Public Accounts Committee will make recommendations following the recent SARA session that may impact annual report disclosures.
Whole of Government Accounts	N/A	Work by the Department and HM Treasury remains in progress in relation to removing the IFRS 10 qualification within the WGA. We will continue to work with the NAO WGA audit team, DfE and HMT to support progress in removing this qualification.

Other matters to bring to your attention

Regularity

Academy trust auditors play an important role in providing the ESFA Accounting Officer with assurance that the income and expenditure incurred by Academies has been applied in accordance with the relevant legislation. ESFA has established a framework of authorities within the funding agreements – the Academies Financial Handbook (now known as the Academy Trust Handbook) – which derives the principles of regularity from HM Treasury's Managing Public Money.

The main assurance mechanism to the Department and ESFA is the independent reporting accountant's assurance report on regularity for each academy trust. The format for this report is set out in the Academy Accounts Direction.

The Academies Financial Handbook, the funding agreement with the Secretary of State and charity law make up the framework of authorities over Academy activities. This includes a number of delegated limits for certain transactions, including a requirement from 1st April 2019 for related party expenditure over £20,000 to be approved by ESFA. Failure to obtain approval would result in that expenditure being irregular.

We consider the main areas of risk relating to our regularity opinion include, but are not limited to, the following:

- Lack of approval from the Secretary of State not being sought for certain transactions above delegated authorities, outlined in the Academies Financial Handbook;
- Related-party transactions entered into by academy trusts which may not be on an 'arms length' basis or adhere to the 'at cost' principles set out in the Academies Financial Handbook; and
- Fraud or misappropriation of funds, such as misuse of funds by senior teaching staff or inappropriate expense claims, especially at the trust level in a multi-academy trust.

Academy trust auditors should also be aware of the investigations into irregularities conducted by ESFA. These are available on ESFA's website.

Definitions

The following table provides our understanding of responsibilities within the group in accordance with ISA 600.

ISA 600 definitions	Interpretation
Group	All academy trusts that were open for all or part of the year between 1st September 2020 and 31st August 2021. These are consolidated into the Sector Annual Report and Accounts
Group Auditors	National Audit Office, on behalf of the Comptroller & Auditor General
Group Financial Statements	The consolidation of Academies, prepared in accordance with the MH Treasury's Financial Reporting Manual (FReM), which is an IFRS-based framework
Components	Academy trusts, who prepare accounts under the Companies Act 2006
Significant Components	No academy trusts have been identified as significant components
Group Audit	Conducted by the NAO in accordance with the International Standards on Auditing (UK), including a regularity opinion using APB's *Practice Note 10 Audit of the Financial Statements Public Sector Bodies in the United Kingdom*
Regularity	Defined by Practice Note 10 as income and expenditure being applied, in all material respects, for the purposes intended by Parliament, that is, transactions comply with: • Primary legislation; • Regulations issued under governing legislations; • Parliamentary authorities; and • HM Treasury authorities. Further details of financial reporting and regularity requirements for the academy sector are set out in the Academies Financial Handbook (now known as the Academy Trust Handbook)