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Guidance

Internal scrutiny in academy trusts

Updated 12 January 2021

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1. Who is this good practice guide for?

This good practice guide provides guidance for trustees, audit and risk committees, accounting officers, and chief financial officers (CFOs) in academy trusts.

It aims to provide them with suggestions as to how they can implement internal scrutiny / audit arrangements that meet the requirements of the Academies Financial Handbook (AFH). It also aims to help them to better discharge their responsibilities for ensuring effective stewardship and oversight of their organisation, as well as an adequate governance and control environment, and to provide them with a medium for self-reflection.

2. What is the status of this good practice guide?

The main financial management and control requirements for trusts are set out in the Academies Financial Handbook (<https://www.gov.uk/government/publications/academies-financial-handbook>) (AFH) and the financial reporting requirements in the Academies Accounts Direction (<https://www.gov.uk/guidance/academies-accounts-direction>) (AAD). This factsheet does not replace or modify any of those requirements. Rather it aims to provide suggestions regarding good practice.

3. What the AFH says about internal scrutiny

The AFH requires all trusts to have a programme of internal scrutiny to provide independent assurance to the board that its financial and non-financial controls and risk management procedures are operating effectively. The AFH provides 4 options (<https://www.gov.uk/government/publications/academy-trust-financial-management-good-practice-guides/internal-scrutiny-in-academy-trusts#internal-scrutiny-options>) for trusts to conduct internal scrutiny, and states that the work must focus on:

- evaluating the suitability of, and level of compliance with, financial and non-financial controls. This includes assessing whether procedures are effective and efficient, and checking whether agreed controls and procedures have been followed
- offering advice and insight to the board on how to address weaknesses in financial and non-financial controls, acting as a catalyst for improvement, but without diluting management's responsibility for the day to day running of the trust
- ensuring all categories of risk are adequately identified, reported, and managed

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

The internal scrutineer will:

- give assurance,
- help the trust 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 trust ensure it complies with the AFH (<https://www.gov.uk/guidance/academies-financial-handbook>), 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 trust to trust, with trust size and relative complexity being factors.

4. Is internal scrutiny the same as internal audit?

Yes. The AFH 2020 states that the ESFA considers that the term internal scrutiny should be viewed in the same way as internal audit.

Independence in internal scrutiny is achieved by establishing appropriate reporting lines whereby the scrutineers report directly to the audit and risk committee. An illustrative terms of reference for an audit and risk committee of an academy trust are set out at Annex 1 (<https://www.gov.uk/government/publications/academy-trust-financial-management-good-practice-guides/internal-scrutiny-in-academy-trusts?#annex-1>).

5. What is the link with risk management?

The planning of the programme of internal scrutiny must be a risk-based exercise between the trust board, the audit and risk committee and the internal scrutineer. Each trust will have a distinct risk profile. The programme of internal scrutiny will be informed by the trust's risk register, which is owned by the trust board, with advice from the audit and risk committee. The risk review process is iterative and the findings of the programme of internal scrutiny in turn inform the risk register. Risk scores are influenced by internal scrutiny work and risks are updated accordingly. For further guidance on risk management, please read the ESFA's good practice guide on academy trust risk management (<https://www.gov.uk/government/publications/academy-trust-financial-management-good-practice-guides/academy-trust-risk-management>).

6. Internal scrutiny options

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

- employing an in-house internal auditor
- a bought-in internal audit service from a firm, other organisation or individual with professional indemnity insurance,
- the appointment of a non-employed trustee
- a peer review performed by the CFO, 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 peer reviewer should be independent of the trust.

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

- auditors should be members of a relevant professional body.
- trustees and peer reviewers should have qualifications in finance, accounting or audit and appropriate internal audit experience. Trusts should work towards this position where it is not already the case. The Financial Reporting Council (FRC) regulates auditors and accountants, and publishes an ethical standard applying to audit engagements. Under the ethical standard, in order to minimise threats to objectivity and independence a firm providing external audit to an entity shall not also provide internal audit services to it.

7. Which option should we choose?

Trustees will need to decide the level of internal scrutiny work required that provides appropriate coverage for their size and complexity. Factors to consider in selecting the most suitable option include:

- the auditors/scrutineer's knowledge of the trust
- their qualifications, experience, and skills
- whether they are governed by professional code of ethics and standards
- value for money

Trusts will want to keep their options under review, taking account of the following factors, although many are likely to look to an internal audit specialist:

- the scale, diversity, and complexity of the trust's activities
- whether changes have occurred in the trust's structures, reporting processes or business systems
- the nature of risks, changes to risks and emerging risks
- any increase in the number of unexplained or unacceptable events

8. What is the coverage of internal scrutiny in a trust?

An internal scrutiny programme will have financial control systems at its core and will include the evaluation of controls and some testing of controls by a sample of transactions. Scrutineers will also want to review other key areas including, financial governance and oversight, IT systems and cyber security. Additionally, they 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 financial or non-financial system that impacts on the effective operation of a trust may be included in scope of the review programme if the audit and risk committee agree.

9. What should the internal scrutineer look at?

This will be influenced by the risk profile of the trust, the current position of financial and non-financial controls and the concerns of the audit and risk committee. The internal scrutineer will break down the organisation by each area of operation and then assess the risk of each by considering several factors, such as:

- monetary value (income and expenditure)
- volume of transactions
- complexity of the system
- sensitivity of the system
- stability of the system
- changes in senior management/strategic roles, for example AO, CFO
- 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 assessment 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 the highest scores usually warrant inclusion in the programme of checking for each visit, whereas those with low score may feature less frequently. The schedule of potential work is then presented to the audit and risk committee for consideration, challenge and sign-off.

A suggestion for the business systems and processes that might fall within the scope of an audit is set out at Annex 2 (<https://www.gov.uk/government/publications/academy-trust-financial-management-good-practice-guides/internal-scrutiny-in-academy-trusts?#annex-1>) (this list is not exhaustive). Each of these systems and processes can impact the outcomes for pupils, albeit sometimes indirectly. Both the board, audit and risk committee and senior leadership team (SLT) must ensure that they have an effective internal control environment.

Failure to ensure proper internal control over key business processes may result irregular activity occurring, triggering an intervention by ESFA or a modification of the external auditor's regulatory opinion.

10. Reporting the findings of the programme

The audit and risk committee will require the internal scrutineer to report back on their work. The AFH requires the committee to meet at least 3 times a year and to consider any reports from the internal scrutineer when they meet.

The AFH requires the internal scrutineer to provide the audit and risk committee with an annual internal scrutiny report, and for the trust to submit a copy to the ESFA by 31 December each year. This will summarise the areas reviewed, key findings, recommendations, management response and overall conclusions. Preparing this summary report during the autumn term, at the same time as the external auditor's report, will enable the audit and risk committee to form a holistic picture and the trust to coordinate the returns required by the 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, see Annex 3 (<https://www.gov.uk/government/publications/academy-trust-financial-management-good-practice-guides/internal-scrutiny-in-academy-trusts?#annex-3>).

The trust must also provide ESFA with any other internal scrutiny reports, if requested.

The 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.

11. Summary

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

Trusts must carry out their programme of internal scrutiny, report on it to their audit and risk committee and provide an annual report to ESFA. The AFH provides trusts with options for delivering the programme of internal scrutiny but does not mandate the areas that must be reviewed. This will always be a matter for the trust, to be informed by its risk register and agreed by its audit and risk committee.

An effective independent internal scrutiny function should provide real value to the trust.

12. Acknowledgements

Special thanks to:

ESFA Academies Finance & Assurance Steering Group and working groups.

Annex 1

Suggested terms of reference for the audit and risk committee of an academy trust.

Audit and Risk Committee Terms of Reference

1. Responsibilities

- to maintain an oversight of the Academy Trust's financial, governance, risk management and internal control systems
- to report findings termly and annually to the Trust Board and the Accounting Officer as a critical element of the trust's annual reporting requirements.

2. Authority

- the Audit and Risk 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 and Risk 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.
- employees of the trust should not be audit and risk committee members, but the accounting officer and chief financial officer should attend to provide information and participate in discussions.
- the chair of trustees should not be chair of the audit and risk committee.
- where the audit and risk committee is combined with another committee, employees should not participate as members when audit matters are discussed.
- 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 and risk committee should have recent or relevant accountancy, or audit assurance, experience.
- any trustee may attend a meeting of the audit and risk committee, including those who are not members of the audit and risk committee.

4. Reporting

The Audit and Risk Committee will:

- report back to the Trust Board regularly every term.
- provide an annual summary report provided by the internal scrutineer / auditor and areas reviewed by internal scrutiny / audit covering key findings, recommendations, and conclusions

5. Coverage

The Audit and Risk Committee will:

- advise the board on the effectiveness and resources of the external/internal auditors or scrutineers to provide a basis for their reappointment, dismissal, retendering, or remuneration. Considerations may include:

- the auditor's/scrutineer's sector expertise
- their understanding of the trust and its activities
- whether the audit process allows issues to be raised on a timely basis at the appropriate level
- the quality of auditor/scrutineer comments and recommendations in relation to key areas
- where relevant the personal authority, knowledge and integrity of audit partners and their staff to interact effectively with, and robustly challenge, the trust's managers
- the auditor's/scrutineer's use of technology
- ensure there is co-ordination between internal audit/scrutiny and external audit and any other review bodies that are relevant
- 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 and Risk Committee meetings for review at board meetings

External Audit

- review the external auditor's plan each year
- review the annual report and accounts
- review the auditor's findings and actions taken by the trust's SLT in response to those findings
- produce an annual report of the committee's conclusions to advise the board of trustees and members.

Internal Scrutiny

- 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.
- conduct a regular review of the risk register
- agree an annual programme of internal scrutiny / audit, which is objective and independent, covering systems, controls, transactions, and risks.
- advise the trustees on the adequacy and effectiveness of the trust's systems of internal control, governance, and risk management processes,
- consider the appropriateness of executive action following internal audit/internal scrutiny reviews and to advise the board on any additional or alternative steps to be taken
- oversee the annual review of the trust's risk register

Annex 2

Suggested areas of coverage

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

Cash and Bank

Ineffective monitoring of liquidity and cash and bank balances is a key risk to any business. Cash forecasting needs to be accurate, and the trust needs to be able to ensure that it retains an appropriate level of liquid or near liquid balances to withstand any short-term interruptions to incoming income. Cash itself frequently represents a security risk, and the systems for safe storage, collection, banking and reconciliation need to be effective and secure.

The scrutineer may test a number of transactions and the controls and procedures around the transaction, including:

- whether the trust has a treasury management policy and it is being followed
- review the trust's cash forecasting process to ensure it is effective and accurate
- review the trust's financial procedures for the receipt and banking of income to ensure that they are adequate, and the trust is adhering to them.
- check a sample of income (grant and non-grant) from source records to verify that the income has been correctly accounted for.
- check what action has been taken for any overdue income.
- ensure that monthly bank reconciliations have been carried out, including reviewing validity of reconciling items, and reviewed
- procedures around the administration of the trust's bank account(s) including, the opening, compliance with the bank mandate signing instructions and access to the bank account

Procurement

Poor contract management will result in trusts 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 trusts 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 scrutineer 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 and payroll / personnel data is recorded completely and accurately
- 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 trust with multiple academies. Is there a gap between the trust'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 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 trusts should have preventative controls in place, as well as a fraud risk assessment and counter fraud plan. Low-level fraud may be hard to detect, and one-off checks may be an effective deterrent

Safeguarding and whistleblowing

All trusts should have effective policies, protocols, procedures, and documentation in place. Failure in these areas can damage a trust'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.

Governance structures

Trusts 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.

Business Continuity Plans/Disaster Recovery

The trust must have adequate plans in place to ensure business continuity in the event of any disruption. These plans should be reviewed regularly to ensure they reflect current circumstances and anticipated risks.

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) (not exhaustive list)
 - 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
 - Item 4 (non-financial example GDPR)
 - Overall opinion
 - Recommendations (H/M/L)
 - Management response
- Follow up reviews of earlier work including any outstanding recommendations

- Overall opinion on governance and control environment, based on entirety of scrutiny programme (current level of confidence in effectiveness of internal control, overall)
- Fraud, any fraud identified/reported
- Cost of work (scrutineer/auditor days used)
- Forward look for next year (emerging issues)

Note: If the trust uses more than one individual or organisation to deliver its internal scrutiny work, the trust can only submit one file and therefore will need to amalgamate into a single PDF when submitting to the ESFA.

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