Academies Accounts Direction 2018 to 2019

Once again there have not been a significant number of changes in the AAD, but the new requirements and other subtle clarifications are welcome and should help consistency and understanding of financial reporting requirements for academy trusts.

The Education and Skills Funding Agency (ESFA) have published the Academies Accounts Direction (AAD) 2018 to 2019, which is the guidance pack for academy trusts and their auditors to use when preparing their annual reports and financial statements for accounting periods ending on 31 August 2019, or for trusts preparing short period cessation accounts beginning 1 September 2018.

The AAD contains a summary of the main changes – and there are relatively few in this latest edition – however, we have once again produced our own summary of these changes along with our commentary and views on the implications, drawn from our extensive sector knowledge and experience.

What has changed?

The main changes academy trustees and finance staff need to be aware of are:

Presenting the model annual report and accounts and the regularity reporting section as annexes to the document rather than within the document [Annex A; Annex B]

UHY commentary

This really is a presentational change, with the model accounts moved away from the main guidance, which makes sense.

Removing the requirement to include dates of payments made regarding non-statutory/non-contractual staff severance payments [note 10b, S7.5]

UHY commentary

This information seemed superfluous as it is collected in the Academy Accounts Return (AAR) in any case, so this is a welcome minor slimming down of the disclosure requirements.

Removing the table in the funds note which showed current year and prior year 12 months combined position as this is not required [note 19]

UHY commentary

This requirement was only introduced in last year's AAD in order to comply with the Charity SORP on which the AAD is based. The key benefit of the combined funds statement was the ironing out of fluctuations that can occur between two periods, however, following the publication of the AAD 2018 to 2019 the ESFA quickly agreed that the omission of this two year funds note would not cause them any problems, and in our experience most academy trusts opted to simply show the current and prior year fund statements and excluded the combined statement.

Previously it has been acceptable for the subsidiary to 'accrue' the gift aid payment within the financial statements at the company's year-end. The new rules mean that no such gift aid accrual is permitted unless a legal obligation is in place.

Including the requirement that a copy of the annual report and financial statements must be sent to every member of the company and to every person who is entitled to receive notice of general meetings [S1.6.3]

UHY commentary

We often receive questions over the approval process and the annual general meeting (AGM). The annual financial statements should be approved by the board of directors or trustees, usually in December, before the 31 December ESFA filing deadline.

The financial statements are then 'ratified' by the academy trust's members at the AGM, but this is really a formality and is akin to what happens when the shareholders of a large commercial company attend an AGM.

Section 1.6.3 of the AAD has been expanded to make it clear that all members must receive a copy of the annual report and financial statements. This is standard practice for companies in accordance with the Companies Act 2006 but the inclusion of this in the AAD indicates some Trusts have not been performing this duty.

Referencing SORP Update Bulletin 2 section 3 covering income recognition for donations to academy trusts from subsidiary trading companies, clarifying income is only to be accrued where there is a legal obligation to make the payment [S5.1.19]

UHY commentary

We are increasingly seeing academy trusts form trading subsidiary companies through which they channel trading activities. Despite the additional administration and cost of operating the second company the benefits such as keeping riskier trading activities outside the charitable trust and tax advantages make this an attractive option.

Usually any profits generated by the subsidiary company are gift aided to the academy trust, mitigating the corporation tax liability that would otherwise arise.

Gift aid donations paid within nine months of the accounting period end are eligible for tax relief, and previously it has been acceptable for the subsidiary to 'accrue' the gift aid payment within the subsidiary's financial statements at the company's year-end even though the payment was to be made some time after the year-end.

The new rules mean that no such gift aid accrual is permitted unless a legal obligation, such as a formal Deed of Covenant, is in place. It is not sufficient to simply document the board decision to pay profits.

This change of accounting treatment alters the timing of recognition of the gift aid payment and means that academy trust subsidiary companies are likely to report profits. The tax position is not affected, however.

Although the AAD 2018 to 2019 refers to this change the new rules only become effective for accounting periods commencing on or after 1 January 2019, making this change non-mandatory for academy trusts until their 31 August 2020 accounts, although at that point a prior year adjustment would be required. Early application is permitted, however, and the ESFA are perhaps encouraging academy trusts to adopt the new rules during 2018/19 by referencing the change in this year's AAD.

Revising the categories of tangible fixed assets to align these with the Sector Annual Report and Accounts, noting that if any category does not apply it can be omitted [note 14]

UHY commentary

The model accounts now list a number of additional fixed asset categories compared to previous editions. There are now eight separate categories, which means for any trust with most of these categories the fixed asset note will only really fit on a landscape page.

The new categories which were not specifically required under the previous edition were motor vehicles, computer equipment and leasehold improvements. There would be an argument that any categories which are not material could be amalgamated together, if preferred.

The TPS employer contributions will increase to 23.6% from September 2019. The narrative included in the TPS element of the pension note will need to reflect this rather than the wording included in the model accounts.

Including the requirement to disclose the prior year position as a comparative for agency arrangements [note 32] and events after the reporting period [note 37]; disclose comparative with an update where relevant for contingent liabilities [note 28] and that comparatives could be disclosed if helpful to the reader for guarantees, letters of comfort and indemnities [note 27]

UHY commentary

The specific requirement for agency arrangements does make it explicitly clear this is required, although in our experience this disclosure was included by most trusts anyway. The need to disclose prior year information for contingent liabilities and post balance sheet events will be new because non-financial information comparatives are not generally included as standard.

Clarifying the pensions note that Parliament guarantee regarding LGPS liability relates to academy trusts not individual academies. The TPS element has been updated to reflect that revised employer contribution rates are expected to be payable from 1 September 2019 [note 30]

UHY commentary

It has recently been confirmed that the TPS employer contributions will increase to the rumoured 23.6% from September 2019 and so the narrative included in the TPS element of the pension note will need to reflect this rather than the wording included in the model accounts.

The ESFA recently published their pension grant methodology which sets out how they will fund the increase for the period between September 2019 and March 2020. Like the teacher pay grant the funding is to be provided on a per pupil basis, although it comes with a supplementary fund to protect academies if their grant allocation falls short of the actual pension cost increase by more than 0.05% of their overall budget for this period.

Component accounting is common practice but has never been referred to in the AAD previously. The specific examples provided in the detailed guidance are perhaps some of the more common instances where this may apply for academies, but we believe this change should not have a major impact.

Including in accounting policies that where an asset comprises of two or more components which have substantially different lives, for example roof, boilers, lifts, each component must be depreciated separately over its useful economic life [S6.3.13]

UHY commentary

Component accounting like this is common practice but has never been referred to in the AAD previously. The specific examples provided in the detailed guidance are perhaps some of the more common instances where this may apply for academies.

Component accounting is appropriate whenever certain parts (i.e. components) of a fixed asset might require replacement at regular intervals. In such instances that cost of replacing such a component is added to the carrying amount of the asset when the cost is incurred, and the carrying value of the part(s) that have been replaced are derecognised from the accounts.

The depreciation method and rate used to write off the cost of any asset over its useful economic life should always be the one that best reflects the use of the asset. Component depreciation becomes appropriate when the major components of an item of fixed asset have a significantly different useful economic life than the rest of the asset, for example if any major components of a fixed asset have significantly shorter lives than the main asset itself.

What is ‘significant’ is open to debate. There is also an exemption if it is ‘impractical or involves undue cost or effort’ to adopt component accounting.

We believe this change should not have a major impact on academy trusts. It is most likely to be relevant where major material works are completed replacing part of the existing building or another existing asset. With the exception of instances where academy trusts have built completely new buildings, they are unlikely to have a breakdown of the total cost of the building and components which will provide a further challenge where replacement components are capitalised.

Specifying the grants received for capital purposes and that these must be spent on capital projects in line with the terms and conditions of the grant [S7.4.3]

UHY commentary

It goes without saying that capital grant funding should be spent in accordance with the terms and conditions, so this is a slightly strange addition although it is a good reminder. The T&Cs include time limits on spending:

- Devolved capital funding has a three year time limit on spending, with year one being the year (the DfE April to March year) in which payment is made. The same three year limit will apply to the one-off additional capital funding paid in February 2019 for 2018-19.

- Larger MATs receiving a guaranteed School Condition Allowance (SCA) could, for 2017-18, carry over an amount equivalent to 100% of the 2017-18 allocation into the next financial year, 2018-19. Any SCA funding carried over in excess of that amount of carried over beyond, or unspent at, the end of 2018-19 needs to be repaid unless agreed with the Secretary of State.

The AAD makes it clear that the related party note disclosed must explicitly state whether all transactions have been conducted in accordance with the requirements of the AFH.

Including the new requirements from 1 April 2019 to report all transactions with related parties to ESFA, obtain approval where certain limits apply and include confirmation of this in the related party transactions note [note 31, S6.6.13]

UHY commentary

Our recent blog covered the recently published guidance on the new related party requirements. The AAD makes it clear that the related party note disclosed must explicitly state whether all transactions have been conducted in accordance with the requirements of the AFH, including notifying the ESFA of all transactions made on or after 1 April 2019 and obtaining their approval where required.

Including the requirement that if an academy trust wishes to recognise the use of premises, where these are given rent-free, for a remaining notice period it should reflect the future notional donation as a debtor with a corresponding entry for the future rental expense as a creditor [S7.7]

UHY commentary

This is not a new requirement, more a clarification. Most academy trusts hold the title to the freehold land and property, or the long 125-year leasehold interest, of the school buildings they occupy. Rent free occupation of premises is most likely to be relevant to any church academies where the Diocese or a similar body owns the freehold and, commonly, makes the premises available under a licence with a short (typically two year) notice period.

The value of the donation is the amount that the academy trust would otherwise have had to pay to secure premises sufficient for its operations for the period (in effect, to rent them). This value is often not easy to determine, and hence in reality it can often be more appropriate and easier to disclose that such a donation is not reflected because it cannot be reliably measured.

Naming the statements that are included under the heading of "other" in the auditor's report (Annex A auditor's report)

UHY commentary

A minor tweak that auditors will deal with automatically for their clients unless the academy trust is preparing the statutory financial statements themselves and including the audit report.

The new AAD makes it clear that all alcohol – including any purchases made from unrestricted funds, is deemed to be irregular.

Clarifying that irregular expenditure includes all alcohol and any excessive gifts including those purchased from unrestricted funds [Annex B 1.22]

UHY commentary

A welcome clarification on this issue. Last year's AAD introduced the concept that all alcohol is deemed to be irregular, but the wording used was ambiguous, leading to confusion, especially since the 2018 Academies Financial Handbook published after the AAD 2017 to 2018 did not refer to a full prohibition on alcohol.

The new AAD makes it clear that **all** alcohol – including any purchases made from unrestricted funds, is deemed to be irregular.

This means that any academy trusts that have spent money on alcohol for any reason during 2018-19 should flag this to their auditors. If deemed material any expenditure on alcohol would need to be disclosed in the Accounting Officer's report on regularity and propriety.

A reminder that, where a subsidiary company is consolidated into academy trust group accounts the regularity requirements extend into the subsidiary and therefore any trading subsidiaries of academy trusts are prohibited from spending on alcohol.

Disappointingly the AAD does not address specific circumstances such as where the trust itself or a subsidiary has a sports centre with a bar which sells alcohol to the general public as a means of raising additional income.

Including additional areas to consider when testing governance to support the conclusion on regularity [Annex B 4.14]

UHY commentary

This guidance is aimed at auditors and extends the scope of the regularity engagement further. The number of bullet points in the governance section of regularity has increased from two to fourteen.

In reality the inclusion of the additional items is a clarification and auditors would have been expected to review these areas previously. Many of the new points focus on checking whether trusts are compliant in areas the ESFA have been focusing on – such as executive pay – or the new requirements of the 2018 Academies Financial Handbook (AFH), for example the sharing of management accounts with the chair of trustees monthly.

The next step

You can read the full AAD 2018 to 2019 **here**.

Once again there have not been a significant number of changes, but the new requirements and other subtle clarifications are welcome and should help consistency and understanding of financial reporting requirements for academy trusts.

If you have any questions or concerns over our summary, or indeed in respect of reporting requirements for academies more generally, please contact your usual UHY adviser or find your local academy expert on our website at **www.uhy-uk.com/academy-schools**.