

# INFORMATION PAPER



## Trusts: Understanding the basic principles of annual financial statements

Suitable for school/trust business leaders, trustees, CEOs, accounting officers, headteachers, executive principals, and senior leaders who are new to understanding and analysing trust accounts in strategic decision making.

This paper provides an overview of the terminology and information provided within trust annual accounts. It is an introduction to aid understanding by providing a set of principles on which to build your knowledge and skills.

It should be read in conjunction with the Education and Skills Funding Agency **Academies Accounts Direction** and **Academies Financial Handbook**, and for trustees, the **Governance Handbook**. These documents along with the ESFA's **Good Practice Guides** provide technical sector specific guidance.

### Academies Accounts Direction

The Academies Accounts Direction sets out the requirements and provides guidance for academy trusts to prepare their annual trustees' report and financial statements for accounting periods, usually of 12 months and usually as at 31 August each year. It also provides relevant guidance for academy trusts' auditors.

### Stewardship of public money

Abiding by the principles of managing public money is essential in underpinning effective financial management and reporting in academy trusts. The standards expected of public services are set by HM Treasury in the **Managing Public Money** guidance. Much of the document is about setting out the expectations of Parliament but is equally relevant to all involved in public services and who are responsible for delegated funds.

The principal standards expected of all public servants are honesty, fairness, impartiality, integrity, openness, transparency, accountability, objectivity, accuracy, and reliability. These should be carried out in the spirit of, as well as to the letter of, the law; in the public interest; to high ethical standards; and achieving value for money.

A trust's annual accounts are publicly available information and should be easy to locate, as trusts are required to publish their annual financial statements on their website each year.

### Why is it important to understand accounts?

It is important to understand the financial health of an academy trust and vital as a strategic decision-making skill. Understanding and analysing annual financial statements will enable you to avoid undue risk, make strategic financial decisions and create a window into the financial health and sustainability of the trust.

With these skills you can pose questions to yourself whilst analysing and interpreting annual financial statements, such as:

- Does the income and expenditure balance in-year?
- Are reserves being depleted or increasing?
- Are there any financial trends?
- Have any schools been brought in or taken out in-year?
- Are there any noticeably high or unusual costs?
- Are there any loans in place?

Answers to these questions may result in referring to the board, the trusts auditor or CFO for clarification.

## What is the purpose of the annual financial statements?

The purpose is to provide a stewardship report of the funds entrusted to the trust. Trusts must prepare financial accounts in accordance with the Charities Statement of Recommended Practice (SORP) guide, which in turn is based on the Financial Reporting Standard 102.

When reading the accounts you should consider the context of the trust; think about the following contextual indicators which could impact on finances:

- Is the trust growing?
- Is it dealing with falling rolls in one or more of its schools?
- Does it have diversified income streams?
- What are the community demographic profiles for the trust's schools individually and collectively?
- How well documented is the academic performance and accountability within the trustees' annual report?
- What levels of academic performance and accountability are achieved?
- What is the geographic spread of the schools?
- What is the risk appetite?
- Is there significant income generating opportunities?
- Has there been any material one-off costs?
- Has there been significant structural changes?

Comparisons between trusts must be undertaken with a great degree of care and understanding because you may be comparing two or more trusts with very different financial blueprints.

## Useful terminology explained

**Accruals basis:** transactions are recognised when they occur regardless of whether the cash or money has been exchanged.

**Fund accounting:** an important feature of trust accounting, separated into two main types: unrestricted and restricted.

One of the fundamental principles underlying the format of charity accounts is fund accounting, which requires all incoming and outgoing resources, assets, and liabilities to belong to a fund. It is necessary to track income and expenditure on each fund in the accounts, so the amounts received, expended, and the balances on each fund are visible.

**Unrestricted funds:** cash or assets the trust can use to spend as it wants. Funds can be spent on any purpose of the trust's aims although there are specifics for academies, such as a ban on purchasing alcohol except for religious services.

**Restricted funds:** essentially income streams with strings attached. Monies or assets delegated with a specific purpose or that exist in a way that equity cannot be released immediately, such as property.

**Materiality:** an important concept to understand in financial accounting terms. The materiality concept or principal (sometimes call the materiality constraint) is an accounting rule that states that financial information, items, or transactions are material to the financial statements if it would change the opinion or view of a reasonable person.

## Specific elements of a set of annual accounts

The annual accounts tell us about a trust's financial performance during the year and its financial position at the end of the year.

They must include the following elements:

### Financial statements

- a statement of financial activities (SOFA)
- a balance sheet – signed by a trustee (usually the chair)
- a statement of cash flows
- notes which expand on the financial statements

### Annual reports

- a trustees' report – signed by a trustee (usually the chair)
- a governance statement – signed by both a trustee (usually the chair) and the accounting officer, including a review of value for money
- a statement on regularity, propriety, and compliance – signed by the accounting officer
- a statement of trustees' responsibilities – signed by a trustee (usually the chair)
- an independent auditor's report on the financial statements – signed by the auditor
- an independent reporting accountant's assurance report on regularity – signed by a reporting accountant, who must be the same person as the external auditor of the financial statements

## What is a Statement of Financial Activities (SoFA)?

In business, the Statement of Financial Activities (SoFA) would be known as profit and loss or P&L. The SoFA brings together all the resources available to the trust and shows how these have been used to fulfil the trusts objectives. Showing the cumulative impact of revenue (money in), gains, expenses (money out), and losses for a specific period, which is usually 12 months.

An example of a loss or a non-cash expense is depreciation. Depreciation is an accounting transaction used to reduce the value of assets over time, for example, reducing the value of computer equipment purchased over a three-year period; from the date of purchase the value slowly decreases, until it becomes obsolete.

## What is a balance sheet?

The balance sheet is the financial statement showing the 'book value' at a specific date, usually 31 August annually. It shows the resources available, how a trust is financed, the assets (tangible and intangible items of value) and the liabilities (money owed by the trust).

**Fixed assets** are quantifiable items of material value, for example, land and buildings. Charitable companies are required to state their assets in the balance sheet at fair value.

**Current assets** are more liquid assets of value, for example trade debtors (money owed to the trust).

**Current liabilities** are transactions where money is owed to creditors, for example money will be owed at the year-end to HMRC for payroll expenses for the last month of the financial year.

## What should the trustees' annual report include?

The trustees should provide information on the trust's achievements in its annual report so that readers can understand its performance. The specific requirements for the trustees' report are detailed in the Academies Accounts Direction and must cover reference and administration details; the structure, governance and management of the trust; the objectives and activities of the trust; and a strategic report.

The strategic report should include achievements and trust performance, with specific focus on outcomes. There should also be a financial review that incorporates a review of the financial performance and position, the reserves policy, the investment policy, principal risks, and fundraising activities.

## What can you learn from understanding financial accounts?

From the trustees' annual report, you should learn the trust's type, how it is funded, its key policies on, for example, reserves and investment. It should also explain how it manages risk. Overall, the trustees' annual report should describe what the academy trust is trying to do and how it is going about it, demonstrating how the trust has achieved its objectives during the year and explain its plans for the future.

Annual trust accounts provide a broad range of financial, non-financial and organisational structural information, some of which is specified and some of which can be interpreted through the information.

The sort of information you can find or make a judgement on includes the list below, but be aware that not all trusts will cover topics to the same level of detail or transparency; their primary duty is to meet the statutory requirements:

- Named members, directors, CEO, senior management team, auditors, bankers, and solicitors
- Organisational structures
- Board and committee structures
- Number and individual constituent schools
- Any subsidiary companies
- Related parties
- Summary of academic performance
- Key performance indicators
- The trust's debts and its ability to repay them
- Any academies with buildings under Private Finance Initiative (PFI) contracts
- Surpluses or losses for a given period

- Comparison of financial performance to previous year
- Operational expenses compared to the revenue generated
- Where money has been spent
- Whether the trust is spending more than it received in income – remember there may be a very good reason for this
- Executive pay
- Staff numbers
- Higher paid staff
- Level of reserves held
- Pension valuations
- Range and diversity of income sources
- Evaluation of return on investment
- Impact of resources expended, whether projects and interventions have been effective
- Whether structural changes have been made
- Any redundancy or severance payments have been made
- Analysis of financial trends
- Planned future developments

There is a vast amount of information available, and the depth of information can be supplemented, particularly when compared to previous years and if reviewed in conjunction with other sources of information, such as, the [Schools Financial Benchmarking Service](#) website.

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## Useful information

[Academies Accounts Direction](#)

[Academies Financial Handbook](#)

[Governance Handbook](#)

[ESFA Good Practice Guides](#)

[HM Treasury Managing Public Money](#)

[Schools Financial Benchmarking Service](#)