



Education  
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Agency

# **Financial management and governance review**

**Energy Coast University Technical  
College**

**March 2017**

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## Executive summary

1. In October 2016, as part of conversations with the EFA regarding the UTC's financial situation, the EFA were made aware by Energy Coast University Technical College (ECUTC) that the trust had concerns with the service level agreements (SLA) it had with its sponsors in relation to the VFM of the contract and the compliance with the requirements of the academies financial handbook (AFH).
2. ECUTC was issued with a warning letter on 03 November due to concerns around the financial management & governance at the trust. A condition of the letter stipulated that the trust was required to commission a review of the two SLAs. The findings of this review have been submitted to the EFA.
3. EFA undertook a subsequent desk based review of the SLAs which identified a number of breaches of the AFH and further potential issues, which were outside the original parameters of the EUTC commissioned review. EFA findings were communicated to the trust at a meeting on 07 December 2016.
4. EFA visited the trust between 18 and 19 January 2017 to undertake a financial management and governance review. The review confirmed a number of historic financial irregularities, procurement weaknesses and inaccurate reporting within the trust's financial statements. Key findings of the review have confirmed:
  - in 2014, members of the trust's Senior Management Team (SMT) approached GEN2 and requested a rescheduling of payments, this resulted in the redirection of expenditure relating to the 2014/15 accounting period into the 2015/16 accounting period
  - capital grant funding was used to account for revenue expenditure via a spurious purchase order for "specialist equipment" generated by the contractor that built the trust's site
  - the trust has failed to comply with its own standing orders and scheme of delegation, the AFH and the academies accounts direction (AAD) in relation to the procurement of the SLAs with GEN2 and Lakes College
  - Some elements of the SLA with GEN2 cannot be considered to have been delivered "at cost" (e.g. charges for materials/tools on cohort size rather than actual pupil numbers) and the trust is unable to evidence that it represents value for money (VFM)
  - ex-gratia payments have been made to staff without prior approval from the EFA
  - the recently appointed senior management team (SMT) and the trust's auditors have identified a number of internal control, financial management and governance weaknesses. The SMT has already acted to rectify the majority of weaknesses and have plans in place to resolve the residual issues

## Background

5. ECUTC is a University Technical College in a sparsely populated rural part of West Cumbria. It has a 14-19 age range with 267 pupils on roll.
6. The college was inspected and passed as ready for opening by Ofsted in July 2014. The trust's first full Ofsted inspection took place on 1-2 February. The outcome has not yet been announced.
7. The trust is sponsored by Gen2 Training, Lakes College, the Nuclear Decommissioning Authority and the University of Cumbria.
8. When the trust was established its physical footprint and workshop facilities were insufficient to provide the specialist technical courses it was intended to deliver. Its original business case was formed on the premise that some facilities, such as workshops and sports facilities, would be provided by its sponsors (Gen2 and Lakes College) which was agreed by the EFA.
9. The trust's site is situated adjacent to one of Gen2's training facilities and within 15 minutes walk of the Lakes College site.
10. Due to irregularities identified within the implementation of the trust's Service Level Agreement's (SLAs) the Senior Adviser for the Northern Division of EFA commissioned a financial management and governance review.

## Objectives and scope

11. The objective of the review was to seek assurances regarding financial regularity, the trust's compliance with the Academies Financial Handbook 2016 and its Funding Agreement.

12. The scope of the review was to review the potential irregularities identified, to assess the adequacy and effectiveness of governance, risk management and control, including propriety, regularity, and value for money. Reviews were undertaken in the following areas:

- all relevant trust policies and procedures pertinent to the potential irregularities, including financial procedures manual, scheme of delegation and the staff recruitment policy
- relevant trust information, including trust Funding Agreement, Articles of Association, Governing Body (GB) and relevant Committee minutes
- financial management information, including bank statements, credit card statements and procurement documentation in accordance with EFA investigation guidelines
- SLA agreements and the costing methodologies used by the trust's SLA partners to establish if the SLAs were delivered in line with the AFH requirements
- review of evidence relating to the potential ex-gratia and novel and contentious payments to establish the nature/value of any irregularities

## Findings

13. Review work undertaken included discussions with key personnel within the trust and its SLA partners, consideration of trust policies and procedures and review of relevant documentation. The testing performed aimed to identify if the SLAs with Gen2 and Lakes College were compliant with the AFH, if the other related party transactions (RPTs) were compliant with the AFH and if action had been taken to address the weaknesses in internal control identified by the trust's auditors.

### Procurement of SLAs with connected parties

14. Since its establishment, the trust's co-sponsors have provided external delivery of vocational courses as outlined in the approved UTC business plan. However, whilst acknowledging the locality and potential challenge in sourcing alternative suppliers, there has been a lack of open and transparent procurement of the SLAs with Gen2 and Lakes College.

15. The trust has recognised that historically it has failed to comply with its own standing orders and scheme of delegation in relation to the procurement of the SLAs, as there is no evidence that a tendering process took place. The SMT is currently taking steps to address this for the 2016/17 contracts.

16. The trust emphasises that this was because the business case agreed at the time that the trust was established included external delivery of vocational courses by its co-sponsors.

17. Whilst accepting that the trust's building has insufficient facilities (e.g. workshops and sports facilities) to deliver its curriculum and the close proximity of the sponsors premises, the introduction of the enhanced requirements when trading with connected parties (established in the September 2014 AFH) supersedes the previous business case.

18. The trust's board at the time were aware of the introduction of the enhanced requirements but failed to document any consideration that the uniqueness of the services provided and/or the locality of the provision prevented an open and competitive procurement. In addition, the trust should have documented how it had ensured the transactions achieved VFM for the trust (for example by undertaking an annual benchmarking review of the SLAs to evidence that they represented VFM).

19. The failure to procure the SLAs through an open and fair process is a breach of section 3.2.14 of the AFH.

20. The failure to apply a competitive tendering policy represents a breach of section 3.1.3 of the AFH, which requires the trust to ensure that "a competitive tendering policy is

in place and applied, and Official Journal of the European Union (OJEU) procurement thresholds are observed”.

## **Potential conflicts of interest**

21. Historically the trust has failed to adequately protect itself from perceived and/or actual conflicts of interest. The minutes of meetings where the SLAs were discussed did not include sufficient declarations of interest and there is no evidence that the conflicted individuals declined to take part in the decision making process in relation to the SLAs.

22. The trust took steps in November 2016 to restructure its governance arrangements to minimise the potential for conflicts of interest and has confirmed that where such conflicts exist, they will be declared and the conflicted individual will take no part in discussions or decisions. The trust has also confirmed that potentially conflicted individuals will not be members of the trust’s finance committee.

23. Whilst recognising that the trust has now taken action to reduce the potential for conflicts of interest, the trust has breached section 3.1.14 of the AFH.

## **Documentation requirements when contracting with connected parties**

24. The trust’s GB previously acknowledged that the requirement in the AFH to establish a statement of assurance applied to the trust. However, the trust has been unable to produce a statement of assurance for either of the SLAs when requested.

25. GB minutes indicate that an open book agreement was in place for both SLAs, but there is no evidence of written documentation to this effect for the Lakes College contract.

26. This inadequate documentation represents a breach of section 3.2.14 of the AFH. The trust has indicated that it is in the process of ensuring that the SLAs for 2016/17 fully comply with the AFH.

## **Compliance with the “no profit” requirement**

27. Until recently, the trust has not had a full breakdown of all costs included within the SLAs. As such, the trust has stated that it was unaware of whether the SLAs met the AFH requirement that contracts with connected parties must not include an element of profit.

28. It is the responsibility of the trust as the signatory of the Funding Agreement to ensure that its SLAs are compliant with the AFH. To satisfy itself that there was no element of profit included within the SLAs the trust should have required the connected

parties to provide a breakdown of the contract costs prior to signing the SLAs. The onus is on the trust to satisfy itself (and retain sufficient documentation to satisfy the EFA) that there is no element of profit within all transactions with connected parties.

29. Failure to obtain sufficient evidence to satisfy itself of this represents a breach of section 3.2.14 of the AFH.

## **Review of costing methodologies**

30. EFA undertook a review of the costing methodologies used by both Gen2 and Lakes College to establish if the SLAs were in line with the requirements of the AFH.

## **SLA with Lakes College**

31. Lakes College is a further education college and a founding sponsor of the trust, which delivers construction and business courses to 39 of the trusts students (2015: 42). The delivery of the courses is on a 1:12 ratio and is based at the Lakes College campus approximately 15 minutes walk away from the trust's site. In addition Lakes College also provide PE facilities and activities to the trust's students.

32. Testing of the costing methodology used by the college confirmed that the SLA in place has been delivered at or below cost. For example, the average "Lecturer cost" used to calculate the hourly re-charge rate is based on the 2013/14 actual staff costs and has not increased since. In addition, the college does not recharge the trust for any facilities charges, utilities costs or for any in-direct overheads.

33. Whilst the college was unable to evidence the methodology used to allocate the "Management cost %" for each of the individual courses/year groups the overall recharge of the management costs is reasonable (£8,241 or 6.83% of contract value) and is delivered below cost. The cost of consumables is recharged at or below cost.

34. The college were able to evidence that in 2015/16 it delivered significantly more teaching hours than it was contracted to provide without additional charges being made to the trust.

## **Provision of additional services by Lakes College**

35. During the trust's formation Lakes College had provided the trust with HR, Payroll and Finance support. This support was required again in 2016 due to a critical business need within the trusts finance team and it is clear that Lakes College did not seek to benefit commercially from the support provided. This support is still in place whilst the trust's recently appointed finance team gains the necessary knowledge of the internal controls to operate them effectively. This arrangement has also provided the finance

team with additional capacity to allow the trust's current financial challenges to be addressed.

36. Lakes College has been able to demonstrate that the delivery of these support services has been at or below cost and the trust has been satisfied with the quality of the services provided. It was evidenced that, to date, there has been no charge in 2016/17 for the additional support services supplied by Lakes College and it is apparent that significant additional support has been provided without additional costs being applied.

37. However, the trust was unable to demonstrate that it has undertaken an open and fair process when procuring these support services. This represents a breach of section 3.2.14 of the AFH.

38. The trust has indicated that it is undertaking a review of the support services including obtaining quotes from alternative providers to ensure that it is fully compliant with the AFH.

## **SLA with Gen2**

39. Gen2 is a not for profit company and a founding sponsor of the trust. It delivers the practical aspects of BTEC certificates or diplomas in engineering to 221 (2015: 274) of the trusts students on a 1:10 ratio from a leased facility adjacent to the trust's site. Gen2 also delivers a significant number of apprenticeships, foundation/ honours degrees, commercial short courses and training to a number of sectors.

40. The detailed costing methodology used by Gen2 to calculate the SLA charge was only provided to the trust on 18 January 2017. It is a relatively complex methodology and includes detailed breakdowns of what has been included with the calculation of labour rates, assumptions on the materials to be used and the cost of facilities to be recharged.

41. Concerns have been raised by the trust over the cost of the SLA with Gen2 including the reasonableness of some of the re-charges incurred. A review of the costing methodologies used over the past 3 years identified a number of questionable charges. A summary of those elements identified by EFA has been provided.

42. There is no evidence that Gen2 deliberately sought to circumvent the AFH requirements.

43. Due to the matters identified by EFA there is sufficient evidence that the SLA with Gen2 resulted in charges in excess of the "full cost" of delivery. This represents a breach of section 3.2.16 of the AFH.

44. Given the rising costs for individual elements of the SLA, the SLA cannot be regarded as representing VFM for the trust. This represents a breach of section 3.1.3 of the AFH by the trust.

## **Failure to adequately disclose RPTs within the trust's 14/15 financial statements**

45. The trust failed to adequately disclose the nature and value of the RPTs with Gen2 and Lakes College within its 2014/15 financial statements. As well as failing to adequately disclose the balances due at the year-end.

46. The failure to adequately control perceived conflicts of interest combined with non-compliance with the trusts own scheme of delegation also undermines the trust's statement (as disclosed within the RPT note) that the transactions were undertaken at arm's length.

47. As set out above the trust did not obtain sufficient evidence that the SLAs were compliant with requirements set out in the AFH when transacting with connected parties. This undermines the trust's statement (as disclosed within the RPT note) that in entering into these transactions the trust had complied with the AFH. This represents a breach of section 7.6.11 of the Academies Accounts Direction and therefore section 1.4.4 of the AFH.

## **Redirection of 2014/15 revenue expenditure into 2015/16**

48. In 2014 Gen2 were approached and requested to re-profile the payments due for the summer term of 2014/15. The trust's former principal agreed to what was termed a "deferment" of payments relating to 2014/15 into the 2015/16 accounting period.

49. An invoice raised by Gen2 on 01/09/15 and described as "Staff and Associated Costs for Years 10 and 12 – 31 August 2015 Charge" was cancelled via a corresponding credit note issued on 30/09/15. A further invoice for the same value was also raised on 30/09/15 but with the description amended to "Staff and Associated Costs for Years 10 and 12 – Autumn Term September 2015 Charge".

50. This resulted in the redirection of expenditure relating to the 2014/15 accounting period into the 2015/16 accounting period. It is accepted by the trust that this expenditure related to the provision delivered in 2014/15. The redirection into the 2015/16 accounting period resulted in the trust's financial performance in 2014/15 being overstated by £50,100 (ex. VAT).

## **Irregular use of capital funding**

51. In March 2015 the trust's former principal requested Gen2 to alter the payment method for the resources cost element included in the 2014/15 SLA with the trust, which was valued at £27,110 (ex. VAT). A purchase order for "Specialist equipment" was raised for this amount by the contractor that built the trust's building and issued to Gen2. Gen2

then raised an invoice to the contractor for the value of the resources element. The trust accounted for this expenditure out of capital funding.

52. The SLA contract with Gen2 was amended in April 2015 at the request of the trust with the description of the associated cost element changed from “Resources” to “Specialist Materials”. Two invoices for “resources”, already raised by Gen2 on 25/11/14 and 20/02/15, were cancelled via corresponding credit notes issued on 28/05/15.

53. A review of the costing methodology for the 2014/15 SLA with Gen2 identified that the “resources” included in the annual SLA cost included expenditure on “printing handouts”, “materials” used in practical sessions (e.g. sheet metal, nuts, bolts etc.) and low value “tools” (hacksaws, hand files, screwdrivers etc.). None of the items covered by this expenditure are in the possession of the trust or included within the trust’s asset register.

54. Given the non-capital nature of these items, the purchase of these resources represents revenue expenditure required for the delivery of the SLA and its reclassification as “specialist equipment” is inappropriate. As such, the expenditure on consumable materials in the 2014/15 SLA within the Gen2 SLA, paid via the contractor, is deemed to be irregular, as capital funding cannot be used to finance revenue expenditure.

## **Accounting treatment of capital expenditure**

55. The trust used £78,897 of capital grant funding to contribute towards the cost of drainage for a 3G sports pitch belonging to Lakes College. EFA were aware that the capital grant funding was to be used to pay for works for an asset the trust did not own.

56. It is recognised that the funding was used to contribute toward the drainage of a sports pitch, that the trust was able to demonstrate that the expenditure represented VFM and the trust’s future use of the 3G pitch has been agreed via a formal agreement for a period of ten years. However, it is the judgement of the EFA that the accounting treatment for this transaction within the trust’s 2014/15 financial statements (i.e. transferring the associated restricted fixed asset funds into restricted revenue funds) was inappropriate.

57. This transfer improved the trust’s revenue position as at the end of the 2014/15 reporting period.

## **Impact on the trust’s reported 2014/15 financial position**

58. The cumulative impact of the actions highlighted within this report was to overstate the trust’s revenue position as at 31 August 2015 by £156,107. If these transactions had been accounted for in 2014/15 in line with EFA’s expectations the trust’s in-year revenue

position would have been a deficit of £42,313, compared to the surplus of £113,794 reported. The trust's cumulative position would have been a deficit of £40,267 compared to the surplus of £115,840 reported.

The significant nature and number of irregular transactions and the impact on the trust's reported financial position of the issues identified has resulted in the 2014/15 financial statements being misrepresented.

## **Ex-gratia and novel/contentious payments**

59. In August 2014 the trust's HR provider made a £10,000 bonus to the trust's principal (recharged to the trust in March 2015), the total cost including on-costs was £11,380. The payment made was in line with the principal's contract although the trust was unable to demonstrate during the visit that the targets included within the contract had been met.

60. Within the minutes of the finance committee held on 22/06/16, attendees were asked to approve a recommendation for an "extraordinary payment" for an employee in recognition of their work in running the trust.

61. A suggested £3,000 retrospective payment was approved along with an uplift to the employee's salary. Whilst recognising that the uplift was justified due to additional duties the employee had undertaken, the trust had no pay policy under which such retrospective payments were permitted. As such, the payment is deemed ex-gratia. As EFA prior authorisation was not sought or obtained for the payment, the retrospective payment is deemed irregular.

62. Making ex-gratia payments without prior EFA approval is a breach of section 3.7.15 of the AFH.

63. The trust's new SMT has confirmed that a pay policy is now in place and provided assurances that any further ex-gratia, novel or contentious payments will be referred to EFA for prior authorisation.

## **Additional findings**

### **Issues raised in the trust's 2015/16 financial statements**

64. A review of the issues identified by the trust's Accounting Officer and external auditors within the 2015/16 financial statements has been undertaken. We are satisfied that the issues identified have been reviewed as part of this report or relate to internal control weaknesses at the trust.

65. Where internal control weaknesses were identified the SMT at the trust have been able to evidence that they have taken remedial action to address the concerns raised or have plans in place to do so in an acceptable timeframe.

66. A review of the policies and financial procedures introduced by the new SMT was undertaken as well as a sample review of expenses transactions. We are satisfied that the policies in place are compliant with the AFH. No issues were identified in the sample of expense claims tested.

## Conclusion

67. Findings from the review identified a number of specific issues including breaches of the AFH, the trust's scheme of delegation/financial regulations and the academies accounts direction (AAD) in relation to the SLAs with Gen2 and Lakes College. In addition, the SLA with Gen2 cannot be considered to have been delivered 'at cost' and the trust is unable to evidence that it represents value for money (VFM).

68. Further issues were identified that were within the original scope of this review. These included a failure of the trust to request prior EFA approval for an ex-gratia payment, the deliberate redirection of expenditure from the 2014/15 accounting period into the 2015/16 accounting period and the use of capital grant funding to account for revenue expenditure.

69. Whilst recognising the progress that the new SMT has made in the short time since their appointment, the scale and nature of the historic irregularities identified are significant.

70. Until recently governance arrangements have been insufficient to ensure compliance with the AFH requirements and prevent the inherent potential for conflicts of interest due to the trust's delivery model. The trust has already taken steps to address these weaknesses and the commitment of the newly appointed Chair of the governing board and AO in ensuring that the trust is fully compliant with the AFH going forward is welcomed.

71. However, a review of the trust's technical delivery is required to establish if the current methods are affordable and can be delivered in line with the requirements of the AFH. The SLA with Gen2 should be reviewed as a matter of urgency as currently it does not provide VFM and there are a significant number of questionable elements within the costing methodology used which build-in significant inefficiencies.

72. The trust must undertake a review of its delivery model, including the issues highlighted during our work and confirm in an action plan to EFA how it intends to ensure that it is fully compliant with the AFH.

73. Whilst the historic items of irregular expenditure are unacceptable of equal concern is the manipulation of the financial position presented in the trust's 2014/15 financial statements.

74. The trust must also undertake a review of the use of capital grant funding to ensure that its restricted capital funds have been used for the purposes intended.



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