National Audit Office

Financial Management in the Department for Children, Schools and Families

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 267 Session 2008-2009 | 30 April 2009

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22 April 2009

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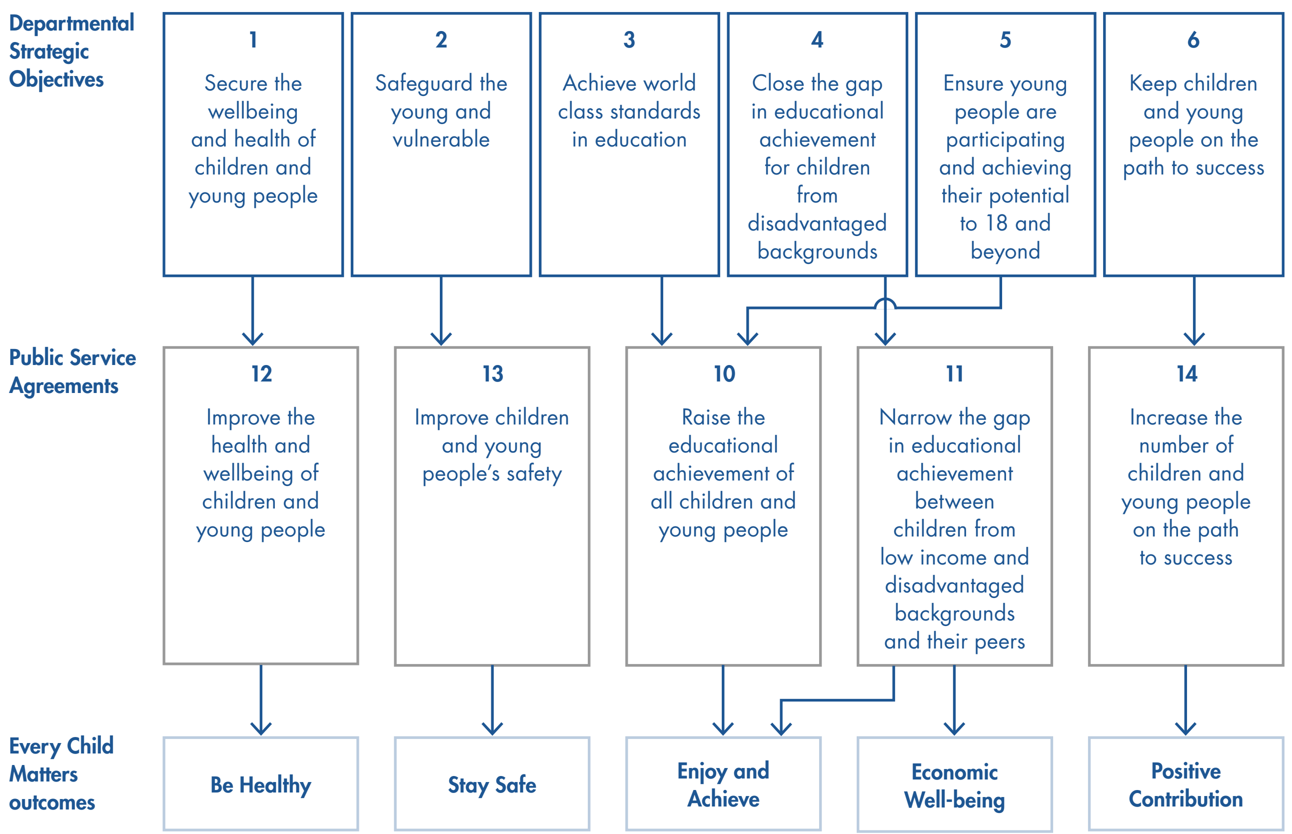
SUMMARY

Introduction

1 Financial management is the system by which the resources of an organisation's business are directed and controlled to support the organisation's goals. Good financial management is an essential element of strong corporate governance. It forms part of the foundations of an organisation, underpinning service quality and improvement, and is the basis of accountability to stakeholders for the stewardship and use of resources. Effective financial management helps an organisation: manage its budgets; allocate resources and make decisions supported by an understanding of the relationship between costs and performance; and deliver its services cost-effectively.

2 The Department for Children, Schools and Families (the Department) has the responsibility in England for education and services for young people up to the age of 19. The Department has six strategic objectives over the 2007 Comprehensive Spending Review period up to 2010-11, which link to the five *Every Child Matters* green paper outcomes and to 17 Public Service Agreements, for five of which the Department has the lead responsibility **(Figure 1)**. The strategic objectives and Every Child Matters outcomes are set out in the *Children's Plan*, published in December 2007, which includes aims to improve services for young people up to 2020. The Department reported progress against the Public Service Agreements in its Autumn Performance Report published in December 2008.

1 Relationship between Departmental Strategic Objectives, Public Service Agreements and Every Child Matters outcomes



Source: Department for Children, Schools and Families

NOTE

Every Child Matters was the green paper published by the Government in response to the Climbié review. Following the consultation, Parliament passed the *Children Act 2004*, providing the legislative background for developing more effective and accessible services focused around the needs of children, young people and families. The five outcomes were identified in the green paper as those that are most important to children and young people.

The Department also contributes towards the following Public Service Agreements with Senior Responsible Officers in other departments:

PSA 1 – UK productivity	PSA 4 – Science and innovation
PSA 8 – Employment	PSA 9 – Child poverty
PSA 15 – Equal opportunities	PSA 16 – Adult social exclusion
PSA 17 – Tackling poverty	PSA 20 – Housing
PSA 22 – Olympics and sport	PSA 23 – Safer communities
PSA 25 - Alcohol and drugs	PSA 27 – Climate change

3 The Department develops policies in response to national priorities determined by Government, such as the five Every Child Matters outcomes. The Department's financial management flexibility is set within a devolved delivery model and its budget is distributed to its delivery partners (schools, colleges, children's centres, local authorities, non-departmental public bodies and other bodies delivering services on behalf of the Department), which implement the policies. Funding to local authorities and other partners is fixed to a great extent over the period of the Comprehensive Spending Review. Some funding routes are indirect. For example, funding for sixth forms goes through the Department for Innovation, Universities and Skills, and the Learning and Skills Council, before reaching schools and sixth-form colleges. The Department influences its partners through a combination of grant distributions, regulation and agreements on priorities and performance targets. For 2007-08 from the Department's total net expenditure of £59.5 billion (which includes £10.7 billion relating to the funding of teachers' pensions which is excluded from the scope of this report), local authorities received £38.3 billion, of which £35.6 billion was allocated to schools. Children's Centres received £1.5 billion, Academies received £0.9 billion and executive non-departmental public bodies received £8.2 billion.

4 The Department faces many challenges in managing its financial resources. For example, the complexity of service delivery across the sector it has responsibility for; the changing needs of its customers and demand for its services; and changing priorities in response to national developments. Such challenges emphasise the need for good financial management to make best use of the available resources. The Department and the sector are facing pressures and constraints as a result of the economic downturn. For example, the Department is being asked in response to the downturn to accelerate its capital programme by bringing forward £924 million of capital expenditure from 2010-11 to 2009-10 to support the Government's fiscal stimulus, despite a slowdown in the availability of credit for Private Finance Initiative schemes in its Building Schools for the Future programme, which represents some 40 per cent of the overall programme.

5 This report presents the findings and recommendations from our examination of financial management within the Department for Children, Schools and Families and across the sector. The Department was created from its predecessor department, the Department for Education and Skills, on 28 June 2007. Some functions of the Department for Education and Skills passed to the Department for Innovation, Universities and Skills. Part 1 of this report sets out how the Department is organised and how accountability arrangements operate across the sector. Part 2 describes the financial setting within which the Department operates and the financial performance of the sector. Part 3 presents our detailed assessment of financial management within the Department and the sector it has responsibility for, against the widely accepted five aspects of good financial management.

Findings

6 The Department has made progress on integrating financial planning with its strategic and corporate planning. The Department has produced a business plan linking budgets to Departmental Strategic Objectives for 2008-09 and the subsequent two years of the Comprehensive Spending Review 2007 period. The Department's financial planning has the major elements needed to support the business when the Children's Plan, business plan, capital plans and asset management strategy are taken together.

7 The Department reports expenditure, other than the Dedicated Schools Grant, against its Strategic Objectives as a year end exercise for the Department's Resource Accounts, but such reporting does not form part of the Department's ongoing financial management during the year. Delivering mainly through partners makes it difficult for the Department to report and manage expenditure during the year against its strategic objectives or other outcome indicators. Requiring front-line providers such as schools to provide meaningful information would be burdensome and would not be practical as most costs relate to the salaries of teachers and support staff that cut across objectives. The Department therefore needs a straightforward system to gain a better understanding of costs against its Strategic Objectives during the year. A pragmatic solution would require certain entities, such as other Government departments and non-departmental public bodies that directly receive funding from the Department to provide in-year information on expenditure against its Strategic Objectives. The situation is more challenging and complicated with respect to local authorities where the Department will need to consult further to find a workable solution. Without such a system the Department is unable to cost its objectives, monitor against these costs, and identify the impact on outcomes of changes in the allocation of resources, which would inform decision making and allow it to practise better financial management. Any solution needs to be devised collaboratively to ensure that it provides the appropriate level of information without imposing undue burdens on the delivery partners. The Department needs relevant and accurate financial and performance information from delivery partners on a timely basis to make difficult strategic decisions on priorities and emerging needs.

8 The Department has less influence over the financial management of its delivery partners because of partners' accountabilities. Although the Department has overall accountability to Parliament for the resources it has been voted, many front-line providers of services are not accountable to Parliament. For example, schools are accountable to local authorities which are in turn accountable to their electorate. Nevertheless, the Department is able to exert influence over financial management of schools and other local authority services, for example, through the Financial Management Standard in Schools and through its regulatory and inspectorial functions. Academies are accountable to the Department through their Funding Agreements, but there is currently no reporting of the financial performance of the Academies sector to Parliament.

9 The Department's corporate governance structure lacked sufficient non-executive challenge at Board sub-committee level to address fully the financial management issues it faces. The corporate governance structure usefully encourages the Departmental Board to focus on strategy and performance. External challenge is provided by two non-executive Directors on the Board and independent members of other committees. The Department introduced a new structure of sub-committees supporting the Board including a separate Finance Strategy Board with one member being a non-executive director from the start of the 2009-10 financial year. Previously, the Executive Management Board, which had no non-executive input, managed the departmental resources and advised on the allocation of financial and human resources.

10 Two recent high profile examples of risks materialising at delivery partners suggest the need for the Department to require partners to improve the way in which relevant risks are reported. The risks (which related to national tests and the payment of Education Maintenance Allowances) have had reputational and financial consequences, and one of these incidents was not properly escalated to the Department. The Department has strengthened its risk management arrangements with its partners so that it is made aware of potential issues at the earliest opportunity by introducing a new Delivery and Risk Assurance Board with the specific remit to oversee major delivery initiatives through its area of influence.

11 The quality of financial information in policy submissions is not consistent across the Department. Procedures are in place to ensure that policy proposals contain consideration of financial implications. Our analysis of all policy submissions that the Department could locate made in the six months between November 2007 and April 2008 found that around 10 per cent either did not have an assessment of financial implications, or had an assessment that was insufficiently detailed. Findings from two recent National Audit Office Value for Money studies[1] on the Building Schools for the Future and 14-19 education reform programmes also found that assumptions made by the Department on which financial modelling and forecasting are based are not always robust, necessitating changes to funding after the start of the programmes.

12 Financial management systems are being further enhanced to improve monitoring and forecasting. Although the vast majority of the Department's expenditure is funding allocated to delivery partners fixed over the period of the Comprehensive Spending Review, which is relatively easy to forecast, there have been problems with the accuracy of forecasting of other types of expenditure. Reporting timetables for directorates and non-departmental public bodies do not align with the Board reporting timetable. In 2007-08 the Department lost the ability to access £122 million of budget carried forward from previous years which had been drawn down but was not in the event required. In 2007 the Department was one of three which had not implemented monthly accruals based accounting and budgeting systems[2], and information on accruals and forecast expenditure currently has to be collected manually from directorates. Accruals accounting allows departments to understand better their consumption of resources, and should help improve the accuracy of forecasting. The Department implemented a new system to identify accruals over £100,000 on a monthly basis during 2008-09, and intends that the system will be fully implemented for the start of the 2009-10 financial year. The Department has started a training programme to support the introduction of full accruals accounting, with over 180 staff trained since August 2008.

13 The Department is moving to a shared service arrangement with the Department for Work and Pensions for finance, procurement and personnel support, which is currently experiencing some delay. There are also some consequences for several of its non-departmental public bodies. The Department is engaging with the Department for Work and Pensions to take advantage of its shared service infrastructure and capabilities to deliver a fully integrated financial, planning, budgeting and reporting system which aims to improve support services and lead to efficiencies. The programme received an Office for Government Commerce Gateway Review red rating in June 2008 and is at high risk. The roll-out of the shared service was put back to autumn 2009 because of changes to the Cabinet Office plans. The Cabinet Office is also moving to a shared service arrangement with the Department for Work and Pensions and is scheduled to precede the Department. When the Cabinet Office implementation was put back, the Department delayed its plans. Going live in April 2009, the date originally

1 NAO Reports. *The Building Schools for the Future programme: Renewing the secondary school estate* (HC 135, 2008-09), and *Partnering for success: Preparing to deliver the 14-19 education reforms in England* (HC 99, 2007-08).

2 NAO Report. *Managing financial resources to deliver better public services* (HC 240, 2007-08).

planned for the Department for Children, Schools and Families, would put operational pressure on the Department for Work and Pensions and increase the likelihood of service problems, but the delay has reduced the business benefits to the Department. Because the service is not cost effective for smaller organisations, the Department is withdrawing payroll and human resources support to several of its non-departmental public bodies. This step was taken after discussion with the affected bodies which are now in the process of making separate arrangements that will involve some extra costs.

14 The Department had built up a large capital underspend of around £2.4 billion by 31 March 2009, and has an extensive long-term capital expenditure plan that will need to be carefully managed in the current economic climate. The Department has built up a large capital balance carried forward each year, primarily due to over-optimistic assumptions on the rate of progress made in the early stages of the Building Schools for the Future programme. In 2007-08 the balance increased by £654 million to £1.9 billion and rose to around £2.4 billion by 31 March 2009. The Department will need to ensure that its long-term capital expenditure plans remain realistic given the difficulties private sector partners may find in securing funding in the current economic climate. To address some of these difficulties, the Treasury announced in March 2009 that the Government would lend funding to Private Finance Initiative projects where this funding cannot be raised from the private sector, funded from unallocated funds and departmental underspending.

15 The national total of school revenue balances stood at a net surplus of £1.9 billion as at 31 March 2008 and has almost tripled over the last nine years. Despite efforts to encourage the reduction of excessive surpluses, the Department announced in February 2009 that the total balance at 31 March 2008 had increased by £250 million from the previous year. The total balance is almost six per cent of total revenue funding for schools and is deemed too high by the Department, which defines an excessive surplus as being greater than five per cent of annual budget for secondary schools and greater than eight per cent for nursery, primary and special schools. The allocation of Dedicated Schools Grant does not currently take into account the cumulative net surplus position of school revenue balances in each local authority. The Department wrote to local authorities in November 2007 asking them to work with schools to reduce excessive balances and make use of available claw back mechanisms. Additionally, the Department has introduced an annual one per cent efficiency saving into the Dedicated Schools Grant over the period 2008-09 to 2010-11, which the Department expects will lead schools to utilise some of their cumulative surpluses from 2008-09 onwards. The efficiency saving equates to around £1 billion over the three-year period. Only one in five local authorities have been successful in reducing their total net school surplus in 2007-08, with the overall balance having increased by around 15 per cent.

16 Ofsted performance ratings of schools with excessive cumulative surpluses are similar to schools with small surpluses, whilst a correlation exists between schools with cumulative deficits and lower performance ratings. At the end of the 2007-08 financial year, around 20,500 of England's schools had revenue balances that were in surplus and around 1,700 schools had balances that were in deficit. Schools should not be aiming for a zero revenue balance but to retain a small surplus from year to year as a part of sound financial management. In 2007-08 secondary schools with excessive cumulative surpluses were found to be similar in performance to schools with small cumulative surpluses, suggesting excessive cumulative surpluses could be reduced without impacting on performance. However, a significantly greater proportion of schools with cumulative deficits obtained an 'inadequate' Ofsted rating. Schools with cumulative deficits agree recovery plans with their local authority to eliminate the deficit, normally over three years.

17 The Department has plans for securing improvements in the financial management capability of the Department, but there is still some way to go. The proportion of professionally qualified finance staff within the Department as a percentage of total finance staff has been significantly lower than the average across public sector organisations. As part of its corporate services transformation programme, the Department has reviewed its central finance function and a recruitment exercise is in train to significantly increase the number of qualified accounting staff in central finance. Also, over the last 12 months the Department has recruited a qualified finance professional to each of the three policy directorates at Deputy Director (Grade 5) level, and all three posts will be filled by May 2009.

Conclusion on Financial Management

18 The Department meets many of the requirements of sound financial management and has demonstrated its commitment to further progress through its investment in new information technology systems, improved business processes and an upskilling of its finance workforce within its central finance function and throughout its policy directorates. There remain, however, aspects of its financial capability and its ability to influence financial management in organisations on which it depends to deliver services which, as yet, do not meet accepted good practice. In particular, financial and costing information is not easily related to the Department's strategic objectives. This information is needed for decisions on spending priorities and emerging needs, and to assess the financial implications of new policies. Risk management is not sufficiently developed so that emerging risks in partner organisations are escalated early enough for remedial action to be taken. The strategic management of its large capital programme has not been responsive enough to avoid large underspends, and it has not been successful in encouraging local authorities to persuade schools to avoid retaining excessive surpluses from year to year. The following recommendations are intended to improve the management of finances across the sector the Department oversees.

Recommendations

19 Responding to unforeseen events such as the need to find savings to fund the requirements of the Children's Plan currently requires a major exercise to identify savings within each Directorate, as budgets are not routinely prioritised during the planning process making it difficult to redirect resources at short notice. The Department has used the 2009-10 business planning process to identify the scope for prioritisation of budgets. The Department should identify where it has flexibility over areas of expenditure. It should routinely prioritise budgets during the planning process to enable decisions to be made quickly on where programmes can be scaled back, delayed or abandoned to release budgets for emerging priorities.

20 Although the majority of the Department's expenditure is funding allocated to delivery partners fixed over the period of the Comprehensive Spending Review, and is therefore relatively straightforward to forecast, forecasting of more volatile budgets is less accurate and has led to problems such as the loss of resources relating to underspends carried forward under End-Year Flexibility arrangements. The planned introduction of the shared service arrangement with the Department for Work and Pensions aims to align reporting from directorates, to support up to date forecast information and explanations in the Board finance report. The reporting timeframes for delivery partners should also be aligned with the timeframe for reporting to the Board, so that the latest forecasts in these areas are available for inclusion in the Board report. To improve forecasting, particularly of more volatile budgets, financial management should be assessed explicitly in budget managers' performance appraisals and greater challenge of forecasts should be introduced for budget managers who consistently produce inaccurate forecasts during the year.

21 As at 31 March 2008 nearly 40 per cent of schools had excessive cumulative surpluses and 22 per cent had held an excessive cumulative surplus as defined by the Department for at least the last three years. The national total of cumulative net surpluses has increased by £250 million or 15 per cent in 2007-08 and only one in five local authorities have been successful in reducing their total cumulative net surplus. The Department should liaise with local authorities to determine the trend of cumulative school surpluses for 2008-09. Where excessive, uncommitted surpluses are continuing year on year the Department should encourage local authorities to make use of existing claw back powers to re-distribute funds to other local schools in line with priorities and needs. In the longer term the Department should also take into account the cumulative surplus position of each local authority and critically review the definition of an excessive cumulative surplus when it introduces a single more transparent formula for allocating Dedicated Schools Grant to local authorities from 2011-12. The Department should make use of relevant information contained in the audited accounts of local authorities and should introduce a pragmatic solution for obtaining relevant in-year information from local authorities to help exercise its strategic financial management role on a more timely basis.

22 There is little or no association between excessive cumulative surpluses and secondary school performance, whereas there is a correlation between secondary schools with cumulative deficits and lower performance. The ability of a school to accumulate a surplus as opposed to incurring a deficit is an important indicator that appears to be linked to the overall effectiveness of a school. The Department should investigate the reasons for any correlation between cumulative surpluses and deficits and Ofsted performance ratings in secondary schools and extend the analysis to primary and other schools. The percentage of schools with cumulative deficits has shown a downward trend over the last five years. Given the correlation between schools with cumulative deficits and lower performance, however, the Department should proactively work with local authorities to further reduce the number of schools with cumulative deficits.

23 There are two non-executive directors on the Departmental Board but the degree of external challenge of financial plans, policy and expenditure decisions at Board sub-committee level is limited. From 1 April 2009 the corporate governance structure has changed with the Board supported by a number of new sub-committees including a Finance Strategy Board with one member being a non-executive director, to examine financial matters in detail. The Department in completing its review of the corporate governance structure should have sufficient independent non-executive member representation to constructively challenge and scrutinise financial management decisions.

24 In some cases the assessment of financial implications in policy proposals is not sufficiently robust. The Department should strengthen the guidance on presenting financial implications contained in policy proposals and expenditure decisions and introduce a system for recording the clearance and submission of proposals.

25 There is a lack of clarity and understanding of the role of Financial Advice and Challenge Teams in the three policy directorates. The teams are not being used to their full potential, and have insufficient financial skills. The Department plans to raise the profile of Financial Advice and Challenge Teams, better define their roles, and formalise the existing network between them to allow sharing of best practice and secure consistency of advice. The Department should use its existing financial expertise to support non-departmental public body sponsor teams to enable them to provide relevant financial advice and support to non-departmental public bodies and to challenge proposals with risk or financial implications for the Department. The Department should also consider how to improve communication and information sharing across the non-departmental public body finance community.

26 Academies are directly accountable to the Department, but there is currently no reporting of their financial performance to Parliament. The Academies sector is growing at a significant rate, with the number of Academies planned to increase from 132 as at January 2009 to a final number of around 400. Local authorities do not have responsibility for Academies and if they encounter financial difficulties, the risk falls directly on the Department. As part of the Apprenticeships, Skills, Children and Learning Bill, the Department plans to move the funding of Academies to a new agency, the Young Person's Learning Agency. The Department's new agency should prepare an annual report for Parliament on the performance of the Academies sector, including an audited consolidated account for Academies.

PART ONE

Organisation and accountability

Introduction

1.1 The Department for Children, Schools and Families (the Department) is responsible for education and children's services for young people up to the age of 19 in England. It has six strategic objectives (Figure 1) intended to support the achievement of the Government's aims, set out in the green paper *Every Child Matters* (published in September 2003) that every child should receive the support he or she needs to be healthy, stay safe, enjoy and achieve, achieve economic well-being and make a positive contribution. Linked to these aims are 17 Public Service Agreements for which the Department has lead responsibility for five (Figure 1). The *Children's Plan* published in December 2007 sets out a broad strategy for improving services for children.

1.2 The Department was created from its predecessor department, the Department for Education and Skills in June 2007, with some functions transferring to the Department for Innovation, Universities and Skills. It is the first time that a single department has had responsibility for all children's services. It has direct responsibility for services such as children's education, but in other areas affecting children, such as health and poverty reduction, it has to work with and rely on other departments.

1.3 The Department develops policies in response to priorities set by Government. For the implementation of policies, however, it relies on a wide range of local and intermediary organisations such as maintained schools, Academies, children's centres and bodies responsible for support activities such as advice, training and standard setting. The Department seeks to influence the organisations on which it depends through a combination of grants, regulation and agreement on priorities and performance targets. Responsibility for further education, currently shared with the Department for Innovation, Universities and Skills, is set to change from 2010-11 with the planned wind-up of the Learning and Skills Council, and allocation of funding for 16–19 year olds to local authorities through the Young People's Learning Agency which will report directly to the Department.

1.4 Against this background, this part of the report examines the Department's accountability and governance arrangements.

Organisation

1.5 Geographic responsibility. The Department covers England. The education systems in Wales and Northern Ireland are broadly the same as in England, although are diverging in some areas. The education system in Scotland has been separate from the English system for many years and is substantially different. **Box 1 overleaf** describes the main differences in funding arrangements.

1.6 Staffing. In 2007-08 the Department employed 2,899 staff, a reduction of two per cent from 2006-07.[3] The Department's nine executive non-departmental public bodies (including the Children's Workforce Development Council which became an executive non-departmental public body in April 2008) together employ nearly 3,500 staff. The Department, together with the Department for Innovation, Universities and Skills, met its target to reduce the total number of civil service full time equivalent posts by 1,465 by 2008 from the base-line number of 4,660 as at October 2003, a target set when the two Departments comprised the former Department for Education and Skills.[4]

3 Department for Children, Schools and Families Resource Accounts 2007-08.
4 Department for Children, Schools and Families Autumn Performance Report 2008.

BOX 1

Main differences between the education finance systems of the home nations

England	All state maintained schools funded through local authorities, except Academies. The amount of school funding each local authority receives is determined by formula, (paragraph 2.7).
Wales	School funding system essentially the same as that in England. The Welsh Assembly Government determines the overall level of education funding.
Northern Ireland	Range of types of school is very different to England. State maintained schools are managed and funded in different ways and through different public bodies, mainly along religious lines.
Scotland	Central funding for education is not ring-fenced, unlike in England, and decisions on the allocation of funding to schools are made by local authorities. The Education and Lifelong Learning Directorate of the Scottish Executive does not produce separate accounts. It is difficult therefore to compare education spending directly with England.

Source: National Audit Office

1.7 Estate. Although the sector as a whole comprises a very large number of assets, ownership is dispersed across many organisations. There are around 3,200 maintained secondary schools and around 17,400 primary schools, mostly owned by local authorities. As at December 2008 there were around 2,900 children's centres owned by local authorities, concentrated in areas of relative deprivation, and the Department plans to increase their number to 3,500 by 2010 to cover the whole of England. There were 132 Academies in January 2009, and the buildings are owned by the charitable trusts that manage them which must seek permission from the Department to dispose of the asset. The Department itself has a small asset base. It is based in three freehold properties in Sheffield, Runcorn and Darlington and in one leasehold building in London. The Department also owns the National College of School Leadership building in Nottingham and the European School in Abingdon. The combined value of the Department's estate was £49.9 million as at 31 March 2008.

Accountability

1.8 Corporate governance structure. The Departmental Board, chaired by the Permanent Secretary (the Departmental Accounting Officer), David Bell, manages the Department. Its membership comprises the Director Generals of the Department's three policy directorates (Children and Families; Schools; and Young People) and Corporate Services Directorate, the Director of Communications, and two non-executive directors who provide external challenge and perspective. Since 2001 one of the two non-executives has been from a local authority background. The Audit and Risk Assurance Committee, chaired by a non-executive director, reports to the Departmental Board. Until 31 March 2009, the Departmental Board was supported by the Executive Management Board, which acted as a sub-board and had the same membership as the Departmental Board without the non-executive directors **(Figure 2)**. The Department revised its corporate governance structure at the start of the 2009-10 financial year, replacing the Executive Management Board with six new sub-committees, including a Finance Strategy Board with one member being a non-executive.

1.9 Schools and other front-line providers. Non-departmental public bodies operate at arms length from the Department and have their own boards with responsibility for financial management. Front-line providers of services for which the Department has overall oversight are typically accountable to local authorities, or in some cases non-departmental public bodies. For example, maintained schools are fully funded or part-funded through local authorities and are run by either the governing body or the local authority. Academies are, however, accountable directly to the Department. Overall funding and accountability arrangements are complicated and not everywhere aligned, and as a result the Department is not able to influence the detail of how the funds are spent by schools and other front-line providers. **Box 2 on page 14** summarises the accountability, audit and inspection arrangements for the Department's delivery partners.

2 Departmental boards and committees 2008-09

The Departmental Board

Comprises the Permanent Secretary (chair) and the three policy directorate Director Generals, the Director General of Corporate Services, the Director of Communications, and two non-executive directors.

Responsibilities

1 The Department's performance.
2 Taking forward the Department's strategic aims and objectives.
3 Managing resources.
4 Monitoring the achievement of performance objectives.
5 Maintaining a transparent system of prudent and effective controls.
6 Assessing and managing risk.
7 Leading and overseeing the Department's reform programme.
8 Taking forward key issues from the quarterly Corporate Performance Report.

Activities

It convenes monthly. Most Board actions relate to Departmental Strategic Objectives and the Corporate Performance Report.

Executive Management Board

Comprises same membership as the Board without the two Non-Executive Directors. Chaired by the Permanent Secretary.

Activities

It convenes monthly, usually one week ahead of the Board meeting. It considers detailed issues, including some aspects of strategy, advising and deciding on the allocation of financial and human resources to achieve the Department's aims and objectives.

The Executive Management Board has been replaced by the following six new sub-committees from 1 April 2009:

- **Delivery Assurance and Risk Board**
- **Finance Strategy Board**
- **Culture Programme Board**
- **People Strategy Board**
- **Policy Delivery Board**
- **Joint Delivery Forum**

Audit and Risk Assurance Committee

Comprises independent members and is chaired by a Non-Executive Director on the Board.

Activities

It reports to the Board on potential risks and reviews risk management. The Committee also reviews the Department's governance structure and internal controls.

Source: Department for Children, Schools and Families

BOX 2

Financial accountability, audit and inspection

Organisation	Financial accountability	Audit	Inspection
Department for Children, Schools and Families	Accountable to Parliament.	The National Audit Office certifies the Department's accounts and undertakes value-for-money studies of its activities. The Department has its own internal audit function.	Not applicable.
Non-departmental public bodies	Operate at arms length and accountable to Parliament.	The National Audit Office certifies the accounts of non-departmental public bodies (except Partnerships for Schools)[1] and undertakes value-for-money studies of their activities. Internal audit services are provided by private sector audit firms.	Not applicable.
Academies	Accountable to the Department through a Funding Agreement. Academies are run by charities that prepare an annual report for the Charity Commission.	The Charities Act requires that Academies' accounts are independently audited by private sector firms. Academies do not have internal audit functions.	Inspected by Ofsted.
Local authorities	Accountable to their elected members. Local authorities prepare an annual outturn statement regarding education.	The Audit Commission is responsible for appointing the external auditors of local authorities. Local authorities either have their own internal audit functions or outsource to private sector firms.	Ofsted inspects the services provided by local authorities and their partners for children and young people.
Schools	Accountable to local authorities.	School expenditure is audited as part of the audit of the local authority accounts. Schools do not have internal audit functions but may be inspected by local authorities' internal auditors.	Inspected by Ofsted.
Children's Centres	Accountable to local authorities.	Expenditure is audited as part of the audit of the local authority's accounts. Children's Centres are not required to have internal audit functions.	Inspected by Ofsted.
Further Education Institutions	Accountable to the Learning and Skills Council.[2]	Further Education Institutions are responsible for appointing their own external auditors, and independently audited accounts must be provided to the Learning and Skills Council. Further Education Institutions are required to have internal audit functions by their Financial Memorandum with the Learning and Skills Council.	Inspected by Ofsted.
Initial Teacher Training Providers	Accountable to the Training and Development Agency for Schools.	Initial Teacher Training Providers are responsible for appointing their own auditors, and independently audited accounts must be provided to the Training and Development Agency for Schools. Initial Teacher Training Providers are not required to have internal audit functions.	Inspected by Ofsted.

Source: National Audit Office

NOTES

1 The C&AG became the auditor of the Department's four non-profit making companies (the Children's Workforce Development Council, National College for School Leadership, BECTA and the School Food Trust) from 1 April 2008.

2 It is expected that the Learning and Skills Council will be dissolved by the Apprenticeships, Skills, Children and Learning Bill currently before Parliament. In 2010-11 the new Young People's Learning Agency for England will support and enable local authorities to provide education and training for 16–19 year olds.

PART TWO

Financial performance

2.1 This part of the report looks at the funding of the Department for Children, Schools and Families; how this money is utilised in keeping with the Department's key aims and objectives; and the Department's financial management of its running costs.

2.2 Funding for children, schools and families. In 2007-08 the Department's expenditure was £48.9 billion[5], of which £196 million was for its own running costs and £62 million for communications and research. The remaining £48.6 billion was allocated to the sector **(Figure 3 overleaf)**. Excluding the Dedicated Schools Grant, which the Department became responsible for distributing from 2006-07 (previously schools funding had been included within the Revenue Support Grant paid to local authorities), the Department's total expenditure has increased at an average annual rate of 6.8 per cent in real terms between 2002-03 and 2007-08 **(Figure 4 on page 17)**, with the Department's administration costs decreasing at an average annual rate of 1.9 per cent in real terms. Total expenditure including the Dedicated Schools Grant is forecast to increase in real terms at an average annual rate of 3.4 per cent between 2007-08 and 2010-11 and Departmental administration costs to decrease at an average annual rate of 4.8 per cent in real terms over the same period.

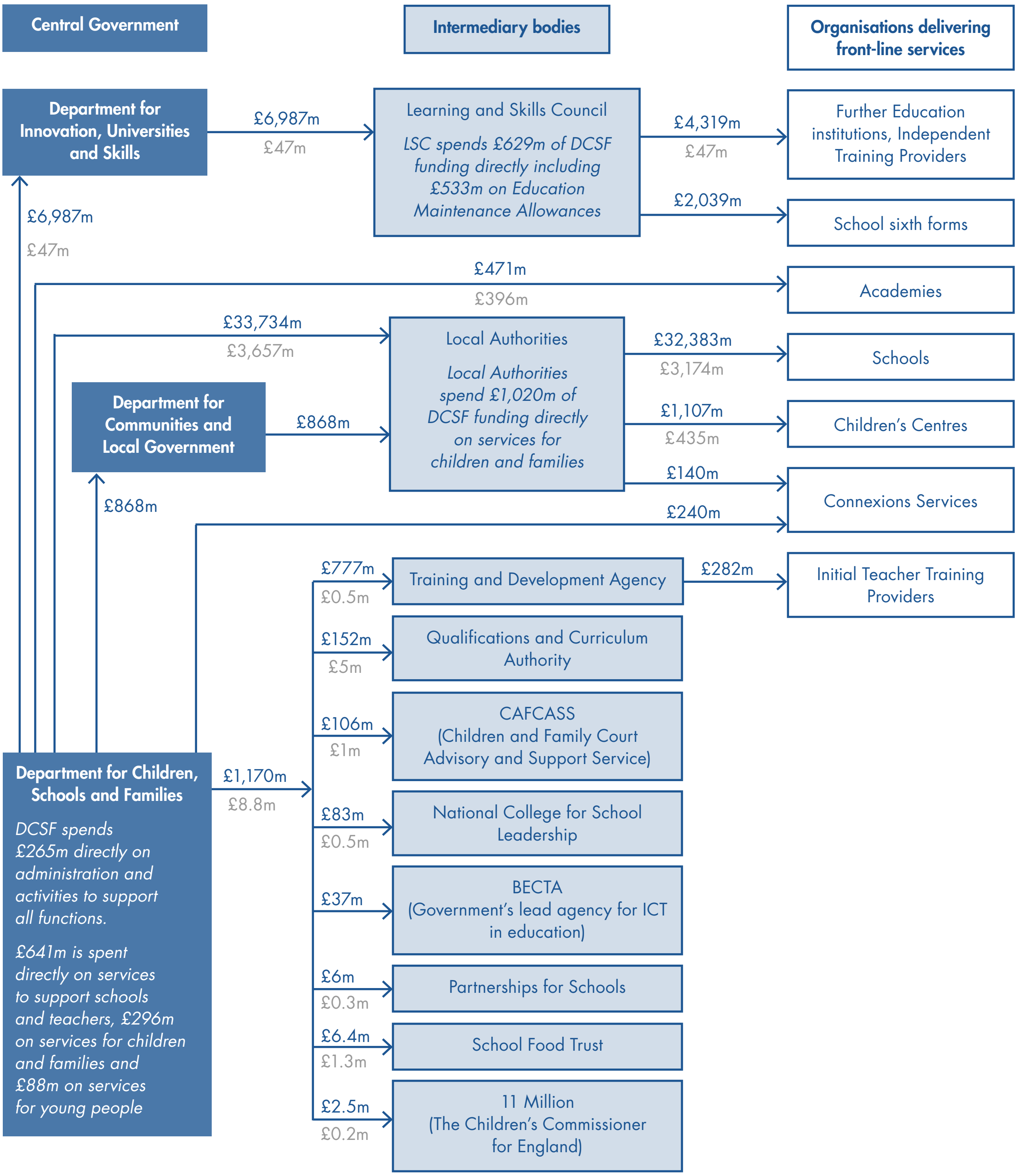
2.3 Revenue expenditure. The Department's revenue expenditure over the last four years has been close to budget with underspending ranging between one and four per cent. In 2007-08 the Department's total revenue budget was £44.7 billion **(Figure 5 on page 17)**. This included:

- £36.6 billion for schools, of which £28.1 billion was Dedicated Schools Grant;
- £5.4 billion on services for young people; and
- £2.5 billion on services for children and families.

How this funding is spent is examined in more detail later in this part.

5 Gross expenditure of £48.9 billion excludes expenditure relating to teachers' pensions which is excluded from the scope of this report.

3 How funding for children, schools and families reaches those responsible for delivery



Sources: Department's and NDPB's accounts 2007-08

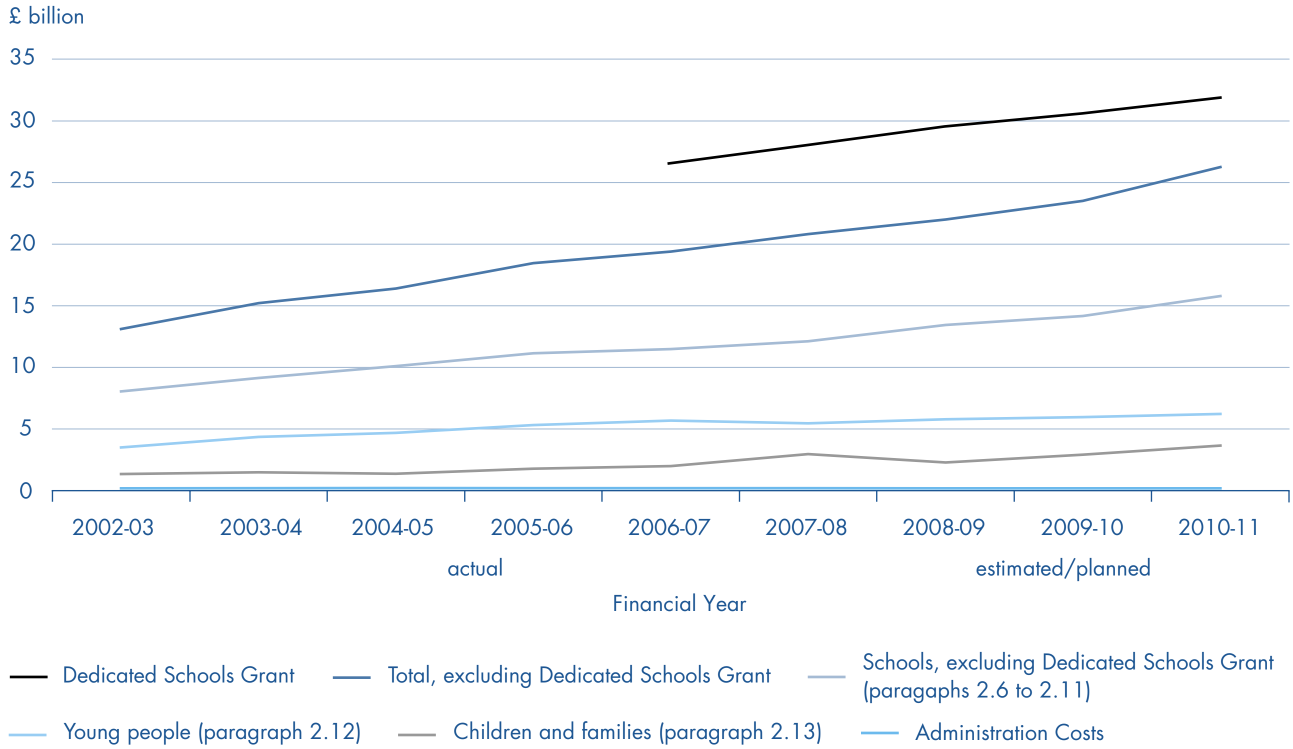
NOTES

Funding amounts relate to 2007-08, revenue in dark blue, capital in grey.

The Children's Workforce Development Council became a non-departmental public body on 1 April 2008 and is excluded from this figure.

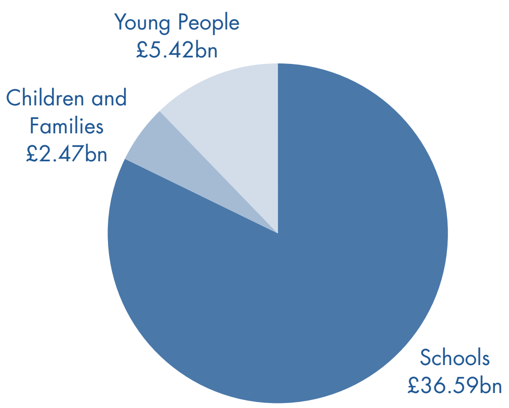
Partnerships for Schools (PfS) manages the Buildings Schools for the Future and Academies capital programmes but the funding currently goes directly from the Department to local authorities. This may change in the future as the Department's schools capital function is expected to transfer to PfS.

4 Departmental actual and planned expenditure 2002-03 to 2010-11, revenue and capital



Source: Department for Children, Schools and Families (2002-03 to 2006-07 actual expenditure and 2008-09 to 2010-11 estimated/planned expenditure from Departmental Report 2008; 2007-08 actual expenditure from Departmental Resource Account 2007-08)

5 The Department's revenue expenditure 2007-08

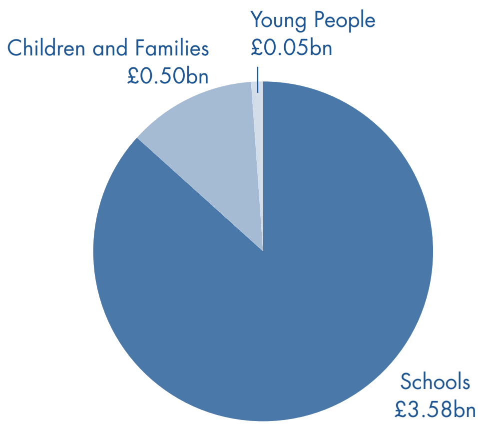


Source: Department for Children, Schools and Families

2.4 Capital expenditure. In 2007-08 the Department's capital expenditure was £4.1 billion **(Figure 6)**. The Department's main capital programmes are the Building Schools for the Future programme **(Figure 7)**, which aims to renew the entire secondary school estate, the Academies programme **(Figure 8)** that is establishing new state-funded independent schools managed by sponsors, and the Sure Start programme **(Figure 9)** that is establishing Children's Centres run by local authorities.

2.5 The Department has built up a large year-end capital balance which it is able to carry forward to the following year. Some £888 million of the £1.3 billion balance brought forward from 2006-07 related to the Building Schools for the Future programme. A capital underspend in 2007-08 of £654 million increased the balance carried forward to £1.9 billion, representing a third of the Department's capital allocation for 2007-08 and rose to around £2.4 billion by 31 March 2009. The Department announced in March 2009 that £924 million of capital expenditure would be brought forward from 2010-11 to 2009-10 to support the Government's fiscal stimulus.

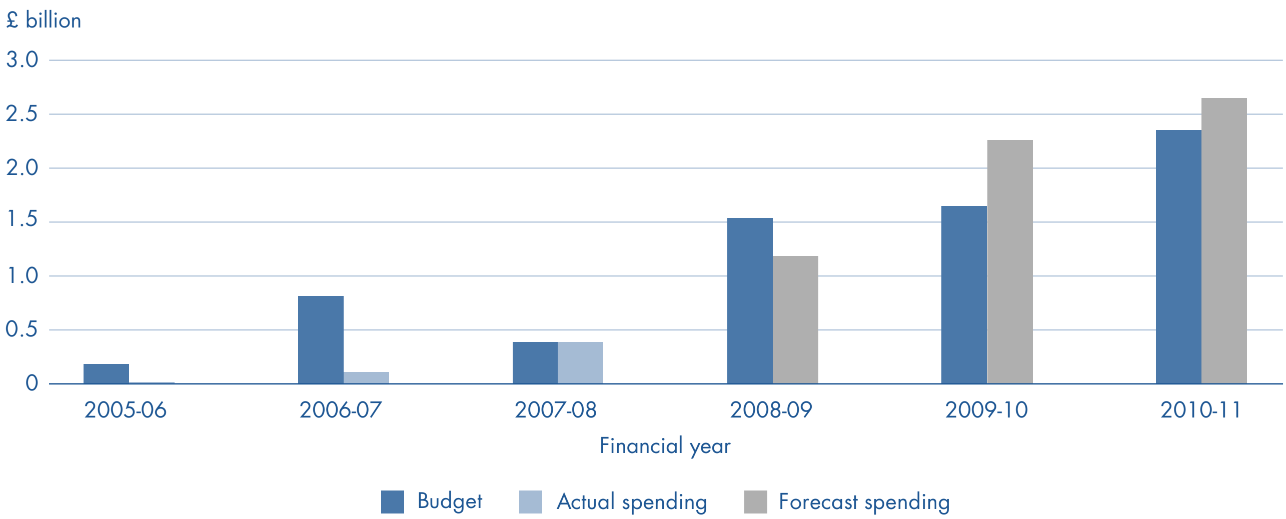
6 The Department's capital expenditure 2007-08



Source: Department for Children, Schools and Families

7 Building Schools for the Future Programme – conventional (excluding Private Finance Initiative) capital expenditure

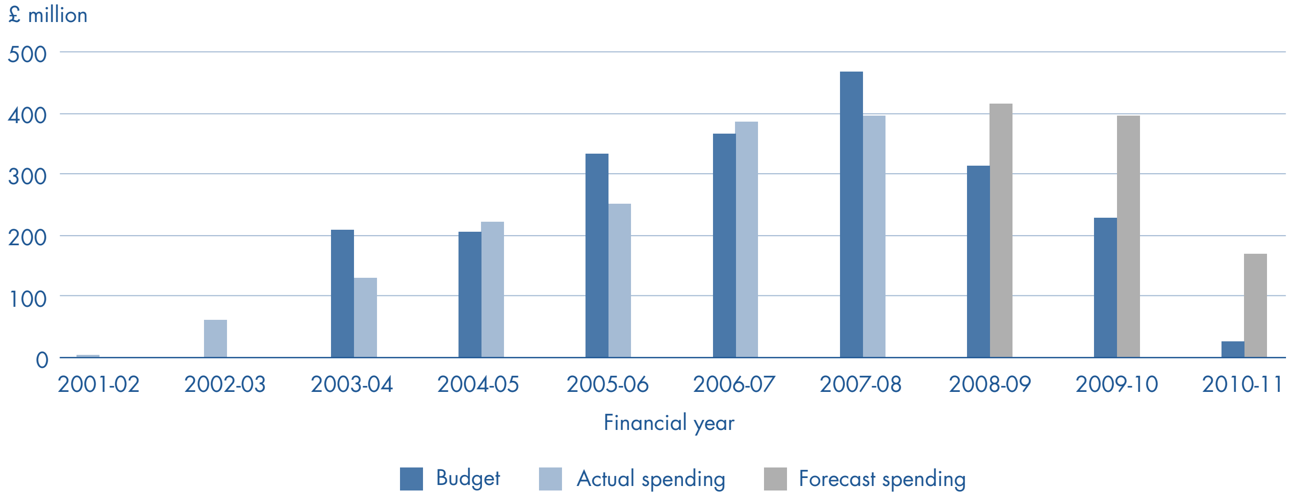
Actual expenditure was below budget for the first two years of the programme. Expenditure is forecast to increase significantly over the three years from 2008-09, and the Department expects it to exceed the original budget in the final two years and so utilise much of the carried-forward capital balance.



Source: Department for Children, Schools and Families

8 Academies Programme capital expenditure

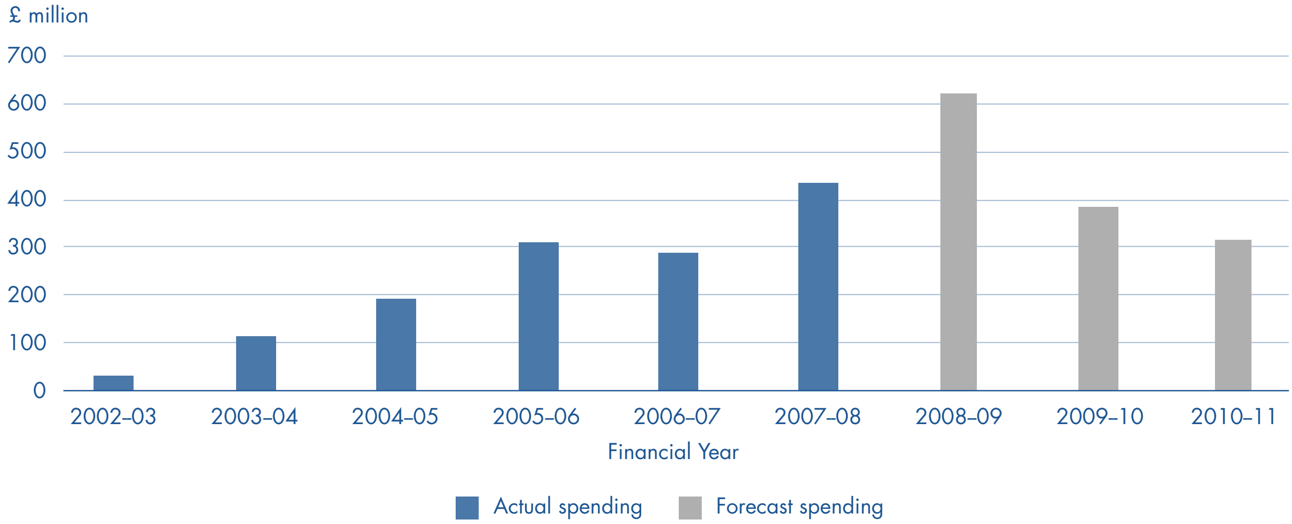
Annual expenditure increased significantly over the first six years of the programme as the number of Academies opening each year increased. Forecast spending over the period 2008-09 to 2010-11 exceeds budget by £410 million, which will be partly met by £210 million brought forward from 2007-08 because of earlier slippage in the programme.



Source: Department for Children, Schools and Families

9 Sure Start/Early Years Programme capital expenditure

Annual expenditure increased over the first four years of the national programme as more local sure start programmes were initiated. Expenditure peaks in 2008-09, including some slippage from 2007-08, and is forecast to decrease as the Department approaches its target of 3,500 children's centres. Details of budgets have not been included as they are not available from the Department due to reclassification of budgets between years.



Source: Department for Children, Schools and Families

2.6 Schools. State-funded education for 4-19 year olds in England is provided through:

- Around 17,400 primary and around 3,200 secondary schools. In 2007-08 total revenue funding was £32.4 billion.
- Academies, of which there were 132 open in 67 local authorities in January 2009. The Government plans to establish at least 400 Academies. In 2007-08 total revenue spending on the 84 Academies open in that year was £471 million.
- School sixth forms. In 2007-08 total revenue funding was £2.0 billion.

2.7 The Department allocates funding for schools to local authorities through the Dedicated Schools Grant, which was £28.1 billion in 2007-08 or around 57 per cent of the Department's spending. It was introduced in 2006-07 as a grant to be spent by local authorities solely on education and is allocated on the basis of the 2005-06 schools' budget per pupil for each local authority with a minimum increase in funding per pupil (the Minimum Funding Guarantee) each year. The calculation of the Dedicated Schools Grant is a two-stage process with initial allocations based on projections of pupil numbers at local authority level and then finalised using actual January pupil numbers. Additional funding is distributed through the Grant to reflect deprivation, exceptional circumstances and ministerial priorities using a formula.

2.8 Responsibility for allocating the Dedicated Schools Grant to schools lies with local authorities. The Department is not able to direct how schools spend their money. Local authorities allocate funding using a local formula which is based upon the Department's national formula and is approved by Schools Forums – local committees comprising headteachers and schools governors. The School Finance Regulations limit the types and amounts of expenditure which local authorities can deduct from the Dedicated Schools Grant for central spending.

2.9 In addition to Dedicated Schools Grant, local authorities receive a number of specific grants, such as the School Standards Grant (£1.6 billion in 2007-08). Since the start of the 2008-09 financial year many of the smaller grants from the Department for specific policy areas have been consolidated into Area Based Grants distributed to local authorities by the Department for Communities and Local Government and allocated for a three-year period.

2.10 The average annual cost of a primary school place in England in 2007-08 was £3,580, and of a secondary school place was £4,620. There was some regional variation across England with London having the highest average cost places for both primary and secondary schools **(Figure 10 on pages 22 and 23)**. The average cost of a secondary school place in 128 (86 per cent) of local authorities was between £3,950 and £5,300 **(Figure 11 on page 24)**. Of the remaining 20 local authorities with an average cost above £5,300 (excluding the Isles of Scilly and the City of London which have no secondary schools), 19 were London boroughs. There was less variation in the average cost of a primary school place. The average cost of a primary school place in 128 (86 per cent) of local authorities was between £3,100 and £4,000 **(Figure 12 on page 24)**, and 18 of the 20 local authorities with an average cost greater than £4,000 were London boroughs.

2.11 The cost of places varies between schools because of differences in local costs and schools' circumstances. The Dedicated Schools Grant to local authorities is determined by a formula which includes factors such as local living costs (which affects teachers' salaries), proportion of pupils in receipt of free school meals, proportion of pupils without English as their first language, and relative deprivation. Similarly, individual local authorities apportion the Grant across their schools using formulae which include the same factors, locally agreed by Schools Forums on which headteachers sit.

2.12 Young People. In 2007-08 the Department spent £5.4 billion on services for young people, an average annual increase of 6.6 per cent over the five years since 2002-03 in real terms. Of this amount, £4.9 billion was spent by the Learning and Skills Council on services for 16-18 year olds, principally the provision of education and training through, for example, further education colleges (but excluding the £2.0 billion funding for school sixth forms). Some £533 million funded Education Maintenance Allowances, which are payments to young people from low income backgrounds to help them stay on in education. The Connexions Service, which provides young people with information, advice and guidance on education, employment and all aspects of a young person's life, received £380 million.

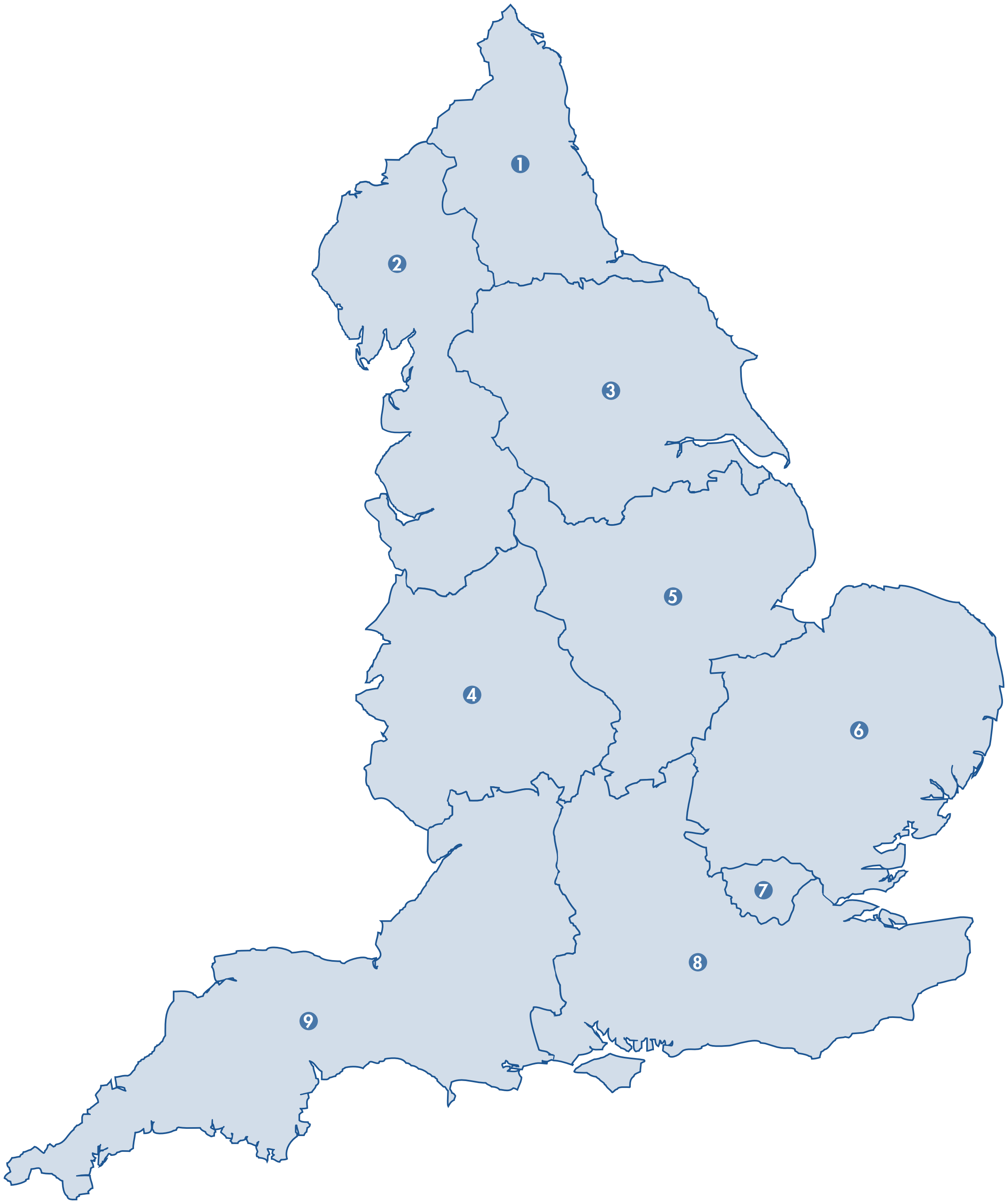
2.13 Children and Families. In 2007-08 the Department spent £2.5 billion on services for children and families, an average annual increase of 10.8 per cent over the five years since 2002-03 in real terms. Of this, £1.2 billion was spent on the Sure Start Programme (Children's Centres), which includes funding for childcare and nursery education, £0.1 billion on the Children and Family Court Advisory and Support Service (CAFCASS), and the remainder on a range of initiatives to address the *Every Child Matters* outcomes.

2.14 Efficiency savings. The former Department for Education and Skills aimed to achieve £4.35 billion in annual efficiency gains by March 2008. Against the Department for Children, Schools and Families element of this target (£3.91 billion), the Department has reported achieving £3.99 billion worth of efficiency gains by the end of March 2008.[6] The Department's declared efficiency savings span the sector and include £1.0 billion saved through improvements in the use of information and communication technology including e-learning in schools, £632 million through improving school's financial management, £496 million through changes to teachers pay restructuring and pension modernisation in addition to efficiency savings relating to local authorities and non-departmental public bodies. The National Audit Office reviewed a sample of the interim savings reported in 2006.[7]

2.15 The Department is in the process of entering into a shared services arrangement for support services (financial, human resources and procurement) with the Department for Work and Pensions as part of its Corporate Service Transformation Programme, primarily to achieve efficiency savings. This arrangement is in line with the National Audit Office's recommendation in its report 'Improving corporate functions using shared services', that newly formed departments should be encouraged to adopt shared services. But there are risks to establishing shared services. A National Audit Office review of the implementation of shared services in the Department for Transport and its agencies found that poor planning and programme management contributed to significant problems and failure to achieve savings.[8] The Department has considered the lessons learned from the Department for Transport's implementation and built these into the risk and planning process for the project.

6 Department for Children, Schools and Families Autumn Performance Report 2008, Chapter 3.
7 NAO Report, *The Efficiency Programme: A Second Review of Progress* (HC 156-I, 2006-07).
8 NAO Report. *Shared services in the Department for Transport and its agencies* (HC 481, 2007-08).

10 Number of schools, Academies and children's centres, and primary and secondary school based expenditure per pupil, for each region of England



Source: Department for Children, Schools and Families

NOTE

Numbers of schools and Academies as at January 2009. Numbers of children's centres as at December 2008. Costs of school places relate to 2007-08 and are presented as ranges of local authority averages. The range of costs of primary school places for the South West excludes the Isles of Scilly, and for London excludes the City of London, because both authorities have only one primary school and consequently the costs are anomalously high.

1 North East

Maintained primary schools	909
Cost of primary school place	£3,380 – £3,810
Secondary schools	202
Cost of secondary school place	£3,970 – £5,430
Academies	6
Children's Centres	182

2 North West

Maintained primary schools	2,526
Cost of primary school place	£3,110 – £4,020
Secondary schools	462
Cost of secondary school place	£4,250 – £5,250
Academies	16
Children's Centres	416

3 Yorkshire and the Humber

Maintained primary schools	1,855
Cost of primary school place	£3,290 – £3,800
Secondary schools	311
Cost of secondary school place	£4,140 – £4,900
Academies	12
Children's Centres	335

4 West Midlands

Maintained primary schools	1,813
Cost of primary school place	£3,210 – £3,950
Secondary schools	394
Cost of secondary school place	£4,130 – £5,230
Academies	14
Children's Centres	302

5 East Midlands

Maintained primary schools	1,680
Cost of primary school place	£3,220 – £4,030
Secondary schools	300
Cost of secondary school place	£4,140 – £5,270
Academies	10
Children's Centres	234

6 East of England

Maintained primary schools	2,037
Cost of primary school place	£3,280 – £3,800
Secondary schools	419
Cost of secondary school place	£4,090 – £4,960
Academies	8
Children's Centres	284

7 London

Maintained primary schools	1,814
Cost of primary school place	£3,300 – £5,500
Secondary schools	391
Cost of secondary school place	£4,570 – £7,510
Academies	42
Children's Centres	475

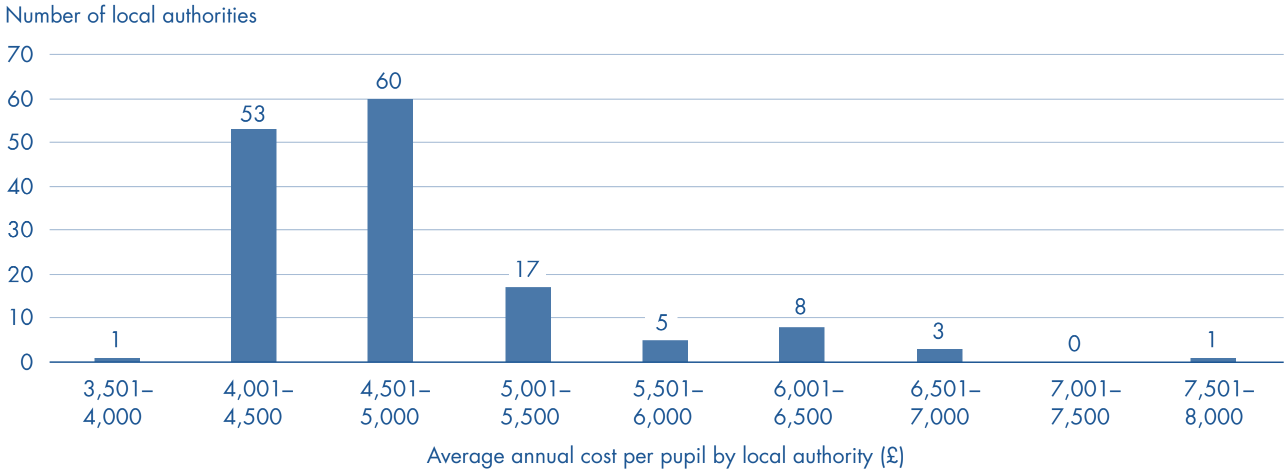
8 South East

Maintained primary schools	2,653
Cost of primary school place	£3,220 – £3,830
Secondary schools	495
Cost of secondary school place	£4,220 – £5,130
Academies	15
Children's Centres	414

9 South West

Maintained primary schools	1,918
Cost of primary school place	£3,200 – £3,460
Secondary schools	321
Cost of secondary school place	£4,110 – £4,990
Academies	9
Children's Centres	271

11 Average cost of secondary school place per local authority for 2007-08

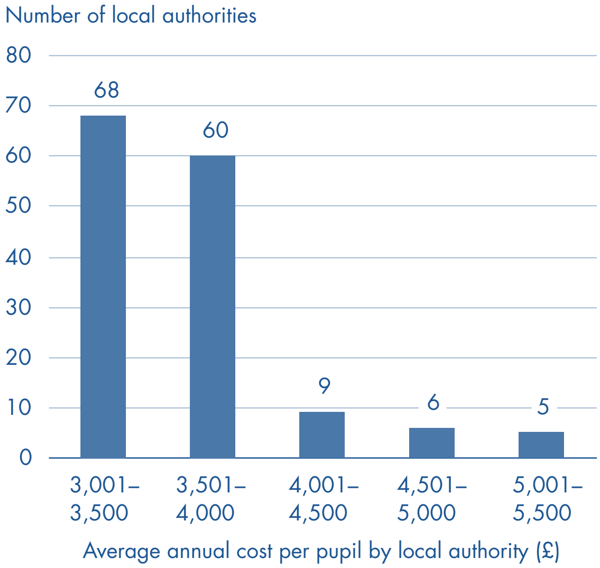


Source: Department for Children, Schools and Families

NOTE

The Isles of Scilly and the City of London are not included as neither have any secondary schools.

12 Average cost of primary school place per local authority for 2007-08



Source: Department for Children, Schools and Families

NOTE

The average costs of primary school places for the Isles of Scilly and the City of London are excluded, because both authorities have only one primary school and consequently the costs are anomalously high.

PART THREE

Financial management

Introduction

3.1 Financial management is important in managing the use of resources cost-effectively to deliver services that meet the needs of young people and families. Good financial management helps an organisation manage its budgets, manage the financial risks to the organisation, allocate resources and make decisions supported by an understanding of the relationship between costs and performance, and deliver its services cost effectively. Good financial management supports the Department in meeting its responsibilities to the public, while also delivering value for money for taxpayers.

3.2 Financial management by the Department is complicated by the need to rely on a range of organisations removed from it through complex chains of accountability. The degree of direct influence that the Department can exercise once it has allocated funds is variable. The principles of sound financial management still apply, however, in that the Department has to forecast and budget for future expenditure requirements, monitor how funds are used, and be confident that appropriate standards of financial stewardship are followed throughout the sector for which it has responsibility. This part of the report assesses the financial management capacity of the Department and the sector against five criteria: financial governance and leadership; financial planning; financial decision making; financial monitoring and forecasting; and financial and operational reporting.

Financial governance and leadership

3.3 The quality of financial governance and leadership within an organisation, the tone from the top, is fundamental if financial management is to be taken seriously. Sound financial governance also depends on well developed internal control and risk management, and staff having appropriate financial management skills and expertise.

3.4 We found that the Department is committed to good financial governance and has taken steps to identify and remedy weaknesses. The Department's governance structure could be strengthened to fully address the financial management challenges it faces. In particular the Board needs to develop the means by which it gains assurance on financial management and risks at its delivery partners, financial skills need to be improved across the Department, and the Board needs to monitor compliance with policies and procedures. The Department has recently strengthened its governance processes to specifically address these issues and is taking action to improve the effectiveness of its Finance functions. The Department's monitoring of school finance is focused on cumulative revenue surpluses and deficits built up by schools over time, but the cumulative net revenue surplus continues to increase year-on-year, and the Department needs to work with local authorities to address this issue.

3.5 **Leadership.** The Department's Management Board regularly reviews financial performance by considering a finance report at most Board meetings. The Board also regularly discusses operational performance assessments against Departmental Strategic Objectives. Minutes of Board meetings indicate that financial matters directly relating to spending by the Department are given consideration.

3.6 The post of Director of Corporate Services is a Board position that has been filled by a qualified accountant since May 2006. Two non-executive directors provide external challenge and constitute a quarter of the Board. There have been two non-executive directors on the Board since 1997, but the number has not increased. Since 2001 one of the two non-executives has been from a local authority background. Of the 16 other Government departments, 11 in 2007-08 had three or more non-executive directors, and only four had a lower proportion of non-executive directors than the Department for Children, Schools and Families on their boards. In completing its review of the corporate governance structure, the Department should have sufficient independent non-executive member representation to constructively challenge and scrutinise financial management decisions. Some existing sub-committees have other non-executive representation, for example, the Audit and Risk Assurance Committee, and the Department has introduced a number of new sub-committees to replace the Executive Management Board from 1 April 2009, including a Finance Strategy Board with one member being a non-executive.

3.7 Budgetary control. The Permanent Secretary formally delegates budgets, for example, for the Sure Start and Academies programmes, to senior departmental managers. They are responsible for managing the allocation of funds to organisations directly responsible for delivery, and for monitoring both expenditure and performance in achieving programme objectives. Accountability is achieved through annual assurance statements that designated budget holders provide to the Permanent Secretary. A review by the Department's internal audit in 2007-08 assessed budgetary control to be sound overall, but found that most managers did not receive confirmation of their budgets until between June and August, several months after the start of the financial year.

3.8 Internal control and risk management. The Permanent Secretary, as Departmental Accounting Officer, has responsibility for maintaining an effective system of internal control to safeguard public funds and the Department's assets. Signed declarations by Director Generals, Directors, Deputy Directors and Chief Executives of the Department's non-departmental public bodies provide assurance to the Permanent Secretary to inform the Department's overall Statement on Internal Control.

3.9 The Department has an established internal risk management process. Policy groups within the Department's directorates are responsible for managing and reporting risks in their programme areas. Director Generals and Directors are designated risk owners within their directorates. The Programme & Project Management, Risk & Assurance Unit in the Corporate Services Directorate provides risk management support to those responsible for business planning and delivery. The focus on key departmental risks is delegated to the Risk Committee, chaired by the Director General of Corporate Services. The Audit and Risk Assurance Committee, chaired by a non-executive member of the Board and comprising independent members, scrutinises the risk management system, reviews the risk register, and provides assurance to the Departmental Accounting Officer.

3.10 While the Department's risk management systems are well established, relevant strategic risks are not always escalated to the Department by organisations within its delivery chain. For example, the Department had not been alerted to the following risks sufficiently early for remedial action to be taken to minimise disruption to service delivery.

- In February 2007 the Qualifications and Curriculum Authority awarded a £156 million contract to Educational Testing Service (ETS) for the marking of national curriculum tests for the five years 2008-2012. In summer 2008, ETS encountered serious problems in processing the marking and recording of test papers, causing delays in the release of the test results to schools and pupils. The Authority decided, based on an options appraisal, to terminate the ETS contract and received £25 million as settlement from ETS. The Authority then paid £7.7 million to a new provider to complete the marking and processing of national curriculum test papers in 2008. An independent inquiry[9] found that while the Department had good risk management processes, ETS failed to report risks of delay to results to the Authority, the Authority had insufficient oversight of the risks associated with the ETS contract, and Departmental officials may not have sufficiently challenged the Authority on its management of risk.
- In July 2007 the Learning and Skills Council awarded an £80 million contract to Liberata to manage the delivery of learner support schemes, including Education Maintenance Allowances, for six years[10]. Three weeks into the autumn 2008 academic term, 200,000 or one in three students were still waiting for their allowance of up to £30 a week to help them keep studying beyond the age of 16. As a result of the contractor encountering technical difficulties with their proposed information technology system for processing the allowance applications, learners suffered serious delays in receiving the allowance payments. The contract with Liberata was terminated in November 2008 and Capita was appointed to process the relevant allowances. Additional costs, directly related to the disengagement of the Liberata contract, of about £12.5 million have been incurred by the Council to complete the payments of allowances for the 2008/09 academic year. A further payment of £4 million was made for the transfer of the interim payment service and the transfer of physical information technology assets and applications software to ensure a smooth and orderly transition to

9 The Sutherland Review, published 17 December 2008.

10 The Learning and Skills Council is a statutory non-departmental public body sponsored by the Department for Innovation, Universities and Skills. Learner support schemes, including Education Maintenance Allowances, are funded by the Department for Children, Schools and Families.

the new service. The Council also waived potential penalty payments totalling £3 million, which would be due from Liberata for delivery failure.

3.11 Financial management skills. In 2007–08 the proportion of professionally qualified finance staff within the Department as a percentage of total finance staff has been significantly lower than the average across public sector organisations. Eighteen out of 71 staff in the central finance function were fully qualified. A further 25 out of 210 staff working across the Department supporting policy development and programme management were professionally qualified accountants. In addition, 26 staff were part qualified or members of the Association of Accounting Technicians, and 25 were working towards membership of the Association of Accounting Technicians or a full professional accountancy qualification.

3.12 To improve financial management skills the Department: (i) is undertaking a recruitment exercise to increase the number of qualified accounting staff in the central finance function; (ii) is recruiting a qualified finance professional for each policy directorate at deputy director level, and all three posts will be filled by May 2009; (iii) has introduced mandatory financial management training for all principal budget managers; and (iv) has established a bursary scheme to enable staff to study for a finance qualification. More generally, relevant staff have financial management competency incorporated in their annual objectives. Achieving better financial management and compliance with internal controls are, however, not explicitly reflected in performance appraisals.

3.13 Review of financial management. In May 2007 the Department commissioned the Institute of Public Finance to carry out a review to identify scope for further improvements in financial management. Overall, the review found that the fundamentals of financial management (governance, internal control, probity and propriety) were firmly in place, but that the Department needed to establish core financial competencies and achieve consistency of financial management skills throughout the organisation. Thirty six required actions were set out in the report issued in August 2007, and the Department has made some progress in addressing the issues identified. Many of the actions are linked to the implementation of the new finance and information systems under the shared service arrangement with the Department for Work and Pensions, due for Autumn 2009. A further number are linked to finalising the Department's Finance Strategy, due during Spring 2009. Only two of the thirty six required actions have been fully addressed to date, although a further 27 have been partially addressed.

3.14 Financial management in schools. The Department is seeking to promote better financial management in schools. It defined the Standard of financial management which schools should achieve as part of the new arrangements for school funding introduced from 2006-07 **(Box 3)**. The Standard covers the principles expected of a school that is well managed financially: Leadership and Governance; People Management; Policy and Strategy; Partnership and Resources; and Processes.

BOX 3

Financial Management Standard in Schools

The Financial Management Standard in Schools was introduced as part of the new arrangements for school funding from 2006-07. The Standard is a statement of the principles to be achieved, rather than the precise way they should be achieved. This is expected of a school that is well managed financially, covering: Leadership and Governance; People Management; Policy and Strategy; Partnership and Resources; and Processes. The Standard recognises that schools have different levels of financial management resource and are organised in different ways.

Compliance with the Standard is measured firstly by a school self-assessment, and secondly by an external assessment. The Standard is supported by a comprehensive toolkit designed by the Department and Institute of Public Finance. It provides best practice guidance on financial management against which governors and senior school managers self-assess the school's performance, enabling them to monitor compliance and identify improvements. The external assessment must be carried out by either the local authority, for example, its internal audit function, by an approved third party accredited by the local authority, or external providers approved by the Department.

All secondary schools were expected to have met the Standard by 31 March 2007. All primary, middle and special schools are expected to comply by 31 March 2010. Local Authority Chief Finance Officers are responsible for confirming that their schools are complying, or taking steps to comply with the Standard, and to sign a declaration at the end of each financial year advising on what arrangements are in place to ensure that all its schools meet the Standard and to remedy any shortfalls.

Source: Department for Children, Schools and Families

3.15 Local authorities are required to report to the Department annually in their end-of-year returns on the extent to which schools meet the Standard. All secondary schools were expected to have met the Standard by 31 March 2007. By March 2008, local authorities reported that some 74 per cent of secondary schools had been externally assessed to have met the Standard, and a further 11 per cent through self-assessment alone. There were, however, five local authorities where less than half of secondary schools had done so. All primary, middle and special schools are expected to be compliant by 31 March 2010. An independent review commissioned by the Department found that local authorities had generally offered a high level of support to schools on the implementation of the Standard. The Department's School Funding Implementation Group is considering how best to secure improvements where the Standard continues not to be met.

3.16 School surpluses and deficits. The Department's monitoring of school finances is focused on cumulative revenue surpluses and deficits built up by schools over time. Revenue funding is to pay for teachers and support staff, and to meet schools' day-to-day running costs for the financial year. Schools build up surpluses when they do not spend their full budgets and carry over the balances to future years. Schools should not be aiming for a zero balance but to retain a small surplus from year to year as a part of sound financial management. Excessive surpluses year on year, however, suggest the possibility that local authorities could re-distribute funds to other local schools in line with priorities and needs. Some local authorities encourage schools to maintain a certain level of cumulative surplus to fund future unforeseen eventualities. Some schools incorrectly build up revenue surpluses to fund a capital improvement project when separate capital funding is usually available.

3.17 Schools build up deficits when they overspend their budgets and carry forward the overspend to future years. In some cases the deficit may be because a school is faced with unforeseen unavoidable expenditure, such as the need to employ supply teachers to cover staff vacancies. Where a school is in deficit, it agrees a recovery plan with the local authority to eliminate the deficit, normally over three years.

3.18 At the end of the 2007-08 financial year, around 20,500 of England's 22,300 maintained primary, secondary, special and nursery schools (92 per cent) had balances that were in surplus. The total cumulative surplus was £2.04 billion and the average cumulative surplus per school was £100,000, ranging between an average cumulative surplus of £71,000 in the South West and £166,000 in London **(Figure 13)**. 38 per cent of the total number of schools had excessive cumulative surpluses totalling £592 million and 22 per cent held an excessive cumulative surplus for at least the last three years.[11] 1,700 schools (8 per cent) had balances that were in deficit. The total cumulative deficit was £120 million and the average cumulative deficit per school was £71,000, ranging between an average cumulative deficit of £43,000 in the North East and £106,000 in London **(Figure 14)**. There was no significant variation in the proportions of schools with cumulative surpluses and deficits across the regions.

3.19 From examination of 2007-08 audited local authority accounts that became available within six months of the financial year-end, we estimated the cumulative net surplus for 2007-08 to have increased by around 15 per cent or £250 million. In February 2009 the Department released data to confirm the national total of school revenue balances stood at a net surplus of £1.9 billion by the end of the 2007-08 financial year. Only one in five local authorities managed to reduce their cumulative net revenue surplus. The cumulative net revenue surplus in schools has almost tripled in the last nine years when data for school balances was first collected. The cumulative net revenue surplus is almost six per cent of total revenue funding for schools in 2007-08 and is deemed too high by the Department.

3.20 In autumn 2007 the Department consulted on a proposal to redistribute locally five per cent of all surplus balances that schools have accumulated, which are considered to be unacceptably high. The Department postponed taking further action on balances after schools expressed a number of concerns about the implementation. Schools and local authorities were encouraged to bring down the level of balances over the next three years, including making use of the existing power for local authorities to claw back excessive, uncommitted cumulative surpluses. The Department has in addition introduced an annual one per cent efficiency saving into the Dedicated Schools Grant over the period 2008-09 to 2010-11, which it expects will lead some schools to apply their cumulative surpluses. The cumulative reduction equates to around £1 billion over the three-year period.

11 The Department defines an excessive cumulative surplus as over five per cent of annual revenue budget for a secondary school and over eight per cent of budget for a nursery, primary or special school, after taking into account money committed to specific projects.

13 Regional variation in average cumulative school surpluses

Region	Number of schools with cumulative surpluses	Proportion of schools with cumulative surpluses (%)	Total cumulative surplus (£m)	Average cumulative surplus per school (£000)	Total cumulative revenue surplus as a proportion of total revenue income (%)	Total number of schools with excessive[1] cumulative surpluses	Proportion of schools with excessive cumulative surpluses (%)	Value of cumulative surpluses over excess cut-off point (£m)
England	**20,462**	**91.7**	**2,039**	**100**	**6.8**	**8,552**	**38.3**	**592**
North East	1,145	93.5	104	91	6.6	485	39.6	28
North West and Merseyside	2,974	90.7	296	99	7.2	1,353	41.3	88
Yorkshire and Humberside	2,132	91.7	173	81	5.8	703	30.2	36
East Midlands	1,949	91.9	182	94	7.4	936	44.1	60
West Midlands	2,232	90.5	264	118	7.8	1,160	47.0	87
Eastern	2,487	93.9	206	83	6.2	947	35.7	49
South East	3,101	91.2	286	92	6.5	1,181	34.7	84
London	2,238	91.2	371	166	7.5	977	39.8	126
South West	2,204	92.6	157	71	5.9	810	34.0	35

Source: Department for Children, Schools and Families

NOTE

1 Where the cumulative surplus exceeds that recommended by the Department as a proportion of the schools annual budget, eight per cent for primary, nursery and special schools, and five per cent for secondary schools, after taking into account money committed to specific projects.

14 Regional variation in average cumulative school deficits

Region	Number of schools with cumulative deficits	Proportion of schools with cumulative deficits (%)	Total cumulative deficit (£m)	Average cumulative deficit per school (£000)	Total cumulative revenue deficit as a proportion of total revenue income (%)
England	**1,695**	**7.6**	**120**	**71**	**3.5**
North East	76	6.2	3	43	2.5
North West and Merseyside	299	9.1	21	69	4.4
Yorkshire and Humberside	184	7.9	14	79	3.3
East Midlands	168	7.9	9	54	2.6
West Midlands	175	7.1	13	72	3.8
Eastern	150	5.7	9	63	3.3
South East	267	7.8	18	67	3.3
London	207	8.4	22	106	4.1
South West	169	7.1	11	64	3.5

Source: Department for Children, Schools and Families

3.21 From our examination of the relationship between grades awarded by Ofsted and 2007-08 school balances for all secondary schools inspected during the 2007/08 academic year (Appendix 2), we found there was only a small variation between the performance of secondary schools with cumulative surpluses below five per cent and those with cumulative surpluses above five per cent. For schools with cumulative deficits, however, a significantly smaller proportion obtained 'outstanding' and 'good' grades. A significantly greater proportion of schools with cumulative deficits obtained 'satisfactory' and 'inadequate' grades. **Figure 15** presents the distribution of schools against Ofsted judgement 'Overall effectiveness of the school', showing that schools with cumulative deficits perform generally worse than schools with cumulative surpluses.

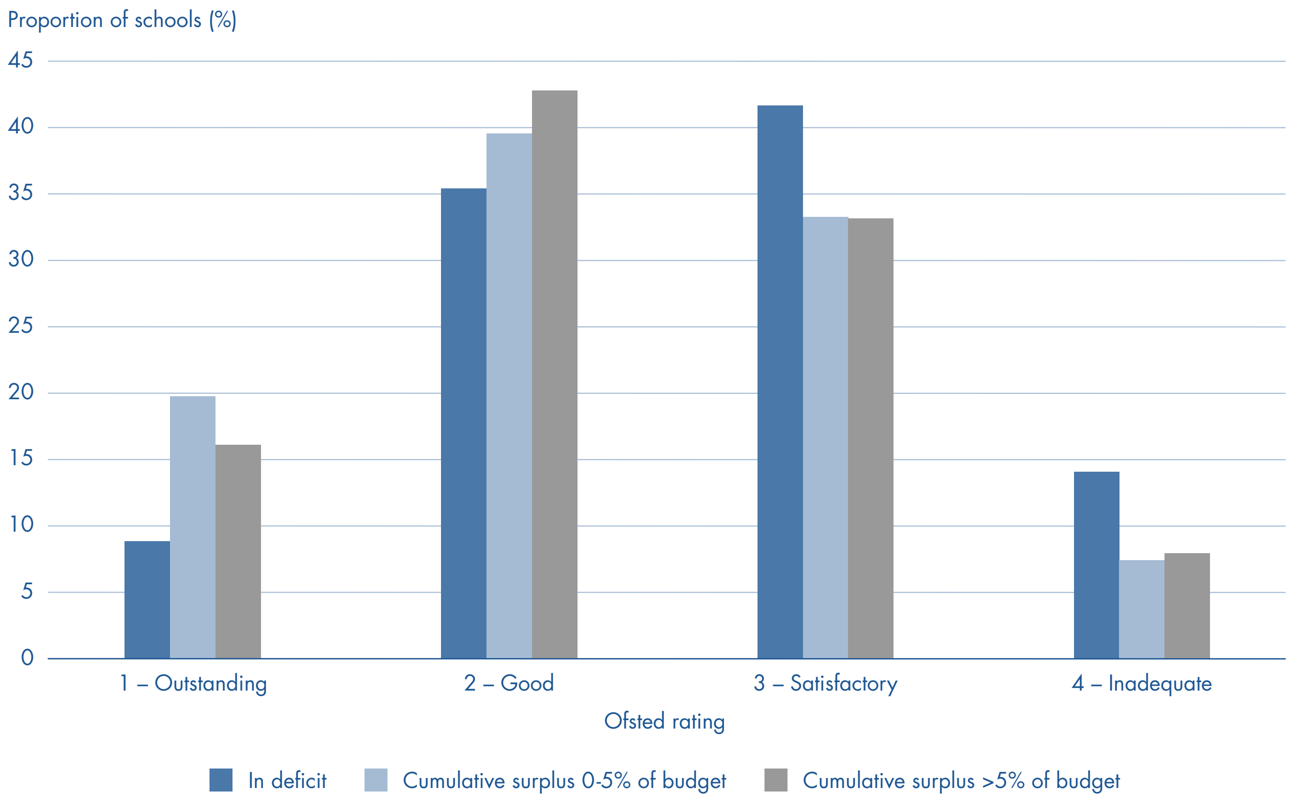
Financial Planning

3.22 The Department allocates many tens of billions of pounds annually, mainly to delivery partners, and plans capital expenditure over periods in excess of ten years. The Department must therefore plan its future expenditure accurately, whilst maintaining some flexibility to respond to changing priorities.

3.23 The Department has medium term financial plans for revenue spending. Longer term financial planning is restricted to capital plans, but capital planning requires improvement. The Department has taken steps to improve and integrate financial and strategic planning through the introduction of a business plan split by departmental strategic objective. Financial planning has not yet reached a position of maturity where budgets are fully prioritised to allow the Department to make quick responses to changes in the operating environment. The Department has used the 2009-10 business planning process to identify the scope for prioritisation of budgets.

3.24 Constraints and the scope for flexibility. The Department was responsible for expenditure of £48.9 billion in 2007-08 (excluding £10.7 billion for the funding of teachers' pensions). Some 85 per cent of the Department's annual expenditure is fixed for three years and most of the remainder supports ministerial commitments. The Department has varying degrees of flexibility over funding streams, and even the Dedicated Schools Grant is flexible over longer timescales. Once funding has been devolved to delivery partners the Department has little opportunity to influence how this money is spent should priorities change.

15 Distribution of schools against Ofsted judgement 'Overall effectiveness of the school' for 2007-08



Source: Department for Children, Schools and Families, and Ofsted

3.25 Expenditure requirements are largely influenced by the current and future numbers of children and young people at different stages in their development, and the way in which education and children's services are delivered. The Department must also take longer-term decisions about the level of new capital spending required to maintain and enhance the infrastructure needed to support learning and children's services. These requirements emphasise the importance of both medium and longer-term financial planning, combined with some flexibility to respond to changing priorities.

3.26 The Department's medium-term financial allocation for three years is set through the Comprehensive Spending Review. Accordingly, the Department does not agree budgets beyond three years. It does, however, set longer-term plans for major capital programmes such as Building Schools for the Future. In February 2008, following the publication of the Children's Plan, the Department produced a business plan that linked budgets to its strategic objectives for the first time.

3.27 Schools funding formula. Following consultation the Department announced in June 2007 that it would continue to use the current methodology (based on 2005-06 schools' budgets as explained in paragraph 2.7) for distributing the Dedicated Schools Grant to local authorities for the period 2008-11. The Department recognises that long-term continuation of this method will make it increasingly difficult to explain variations in the level of Dedicated Schools Grant between local authorities, because it is based on the 2005-06 schools budget per pupil uplifted annually by a minimum amount. It does not adjust for changes in the numbers of different types of pupils year-on-year, or take into account the cumulative net surplus position of school revenue balances in each local authority. The Department has stated its intention to introduce a single more transparent formula from 2011-12, and has a consultation under way. The aim is to determine the best way of reallocating funds to reflect local changes in the pupil population.

3.28 Academies. Academies are state-funded schools independent of local authorities that either replace poorly performing secondary schools or are established where there is a need to increase provision. The Department has a target of opening 400 Academies (230 by 2010). While the Department encourages local authorities to include plans for Academies in their strategies for secondary education provision, the funding for Academies is provided centrally, and therefore the Department is responsible for planning the financing of the Academies programme. Academies are not required to participate in local authority strategic planning of services for children and young people, although they are increasingly doing so.[12]

3.29 Other priorities. Planning of funding for other priorities is based on a mix of assessment of need at national and local levels, bids for funds from delivery partners (based on their own assessment of local need), and distribution of available total funding. For example, local authorities receive funding to implement their Local Area Agreements. The amount of funding each receives is based on the priorities they have identified, funding for some priorities in proportion to local need (for example, number of young people from deprived backgrounds), and set amounts for other priorities. For example, in 2007-08 all local authorities received £25,000 anti-social behaviour grant pooled and paid through the Local Area Agreement. By contrast, local areas bid annually to the Department for funding to implement the reforms to 14-19 education, the Department assesses each bid, and allocates funding to those it deems of acceptable quality.

3.30 Capital planning. The Department's capital planning of the Building Schools for the Future programme extends to 2018, and to earlier dates for other programmes. Programme plans are drawn up on the basis of assessed need and delivery capability. For example, in the case of the Building Schools for the Future programme, the aim is to refurbish the entire secondary school estate, and a major component of the delivery capability is the capacity of local authorities and contractors to manage and deliver their share of the programme.

3.31 Underspending of capital. The Department has underspent against its capital programme budget in recent years, primarily because of over optimistic assumptions on the rate of progress to be achieved in the early stages of the Building Schools for the Future programme (Figure 7). A recent National Audit Office study found that local authorities initially lacked the necessary skills and expertise to negotiate and manage complex Private Finance Initiative arrangements and required support from Partnerships for Schools. The time taken to set up Partnerships for Schools was longer than anticipated and contributed to delays in starting projects.[13]

12 Academies evaluation fifth annual report, November 2008, PricewaterhouseCoopers.
13 NAO Report. *The Building Schools for the Future programme: Renewing the secondary school estate* (HC 135, 2008-09).

3.32 Under end-year flexibility arrangements set by the Treasury, the Department can carry forward unspent capital balances. At 31 March 2008 the Department's unspent balance was £1.9 billion and rose to around £2.4 billion by 31 March 2009. Current spending estimates indicate that balances will not be fully spent by 31 March 2011, the end of the current Comprehensive Spending settlement. The Department has, however, a longer-term capital plan through to 2018 that covers how unspent capital will be utilised. The plan only covers school capital funding, and currently the Academies programme and Children's Centres also have capital underspends of £210 million and £391 million, respectively.

3.33 The Department announced in March 2009 that £924 million of capital expenditure would be brought forward from 2010-11 to 2009-10 to support the Government's fiscal stimulus. Given the history of capital underspends, this acceleration could be a significant challenge to the Department. The Department will need to ensure that these plans remain realistic given the difficulties private sector partners may find in securing funding in the current economic climate. To address some of these difficulties, the Treasury announced in March 2009 that the Government would lend funding to Private Finance Initiative projects where this funding cannot be raised from the private sector, funded from unallocated funds and Departmental underspends.

Finance for decision making

3.34 The Departmental Board needs to consider the value for money achieved by allocating resources to different activities in the sector. It also needs to have a thorough understanding of the financial implications of policies, programmes and activities.

3.35 We found that the Department cannot make a clear link between expenditure and outputs, compounded by the devolved delivery framework within which it operates. The Department has procedures to ensure that financial implications are considered in decision making, but the analysis of financial implications is not always sufficiently robust.

3.36 Linking funding to outcomes. At present the Department reports expenditure, other than the Dedicated Schools Grant, against its Departmental Strategic Objectives as a year-end exercise for the Department's Resource Accounts, but it does not form part of the Department's ongoing financial management during the year. Delivering mainly through partners makes it difficult for the Department to report and manage expenditure during the year against its strategic objectives or other outcome indicators. Requiring front-line providers such as schools to provide meaningful information would be burdensome and would not be practical as most costs relate to the salaries of teachers and support staff that cut across objectives. The Department therefore needs a straightforward system to gain a better understanding of costs against its Strategic Objectives during the year. A pragmatic solution would require certain entities such as other Government departments and non-departmental public bodies that directly receive funding from the Department to provide in-year information on expenditure against its Strategic Objectives. The situation is more challenging and complicated with respect to local authorities where the Department will need to consult further to find a workable solution. Without such a system the Department is unable to identify the impact on outcomes of changes in the allocation of resources, which would inform decision making and allow it to practise better financial management. Any solution needs to be devised collaboratively to ensure that it provides the appropriate level of information without imposing undue burdens on the delivery partners. The House of Commons Children, Schools and Families Committee has also asked the Department to include information on expenditure against objectives in the Departmental Report from 2009.[14]

3.37 Financial implications in policy submissions. The Department's financial guidance stipulates that an assessment of financial implications should be carried out for all policy proposals. Policy submissions should include challenge by directorate Financial Advice and Challenge Teams, and approval by central finance above £10 million for one-off projects or £5 million per annum for ongoing commitments. Our analysis of all policy submissions that the Department could locate made in the six months between November 2007 and April 2008 found that around 10 per cent either did not have an assessment of financial implications, or had an assessment that was insufficiently detailed. There is no comprehensive system for recording the clearance and submission of these proposals to ensure that a satisfactory assessment is always included.

3.38 Findings from two recent National Audit Office Value for Money studies[15] also found that assumptions made by the Department on which financial modelling and forecasting are based are not always robust, necessitating changes to funding after the start of the programmes:

14 House of Commons Children, Schools and Families Committee, Public Expenditure, First Report of Session 2008-09.

15 NAO Reports. *The Building Schools for the Future programme: Renewing the secondary school estate* (HC 135, 2008-09) and *Partnering for success: Preparing to deliver the 14-19 education reforms in England* (HC 99, 2007-08).

- The Department and Partnerships for Schools made unrealistic expectations for how quickly they would set up the Building Schools for the Future programme and build the first schools. The programme is two years behind initial forecasts and there has been a nine per cent real increase in costs from earlier estimates.
- The Department's work to understand the costs of delivering the new 14-19 Diplomas has lagged behind their implementation. The Department did not undertake thorough financial assessment of the costs of delivery when the policy was being developed and has had to allocate additional money to the programme since its start. The Department did not require schools and their partners to include estimated costs in their applications to deliver Diplomas, missing an opportunity to collect useful data which could have been used to better forecast the overall cost of the 14-19 programme.

Financial monitoring and forecasting

3.39 The Department needs to have good quality financial monitoring systems in place to verify that its resources are being spent as intended and so that it understands its financial position at any time. It should monitor and review the costs of its key activities and assure itself that financial performance to date and forecast financial outturn for the year are in line with plans. Variances should be identified so that management can take corrective action. Financial information needs to be integrated with non-financial performance and activity information, to provide a basis for financial forecasts and enable value for money to be monitored. The financial information used both for setting the budget and internal accountability, monitoring and forecasting throughout the year should be derived from the same systems that are used to generate the results reported externally in the Department's statutory financial statements.

3.40 We found that the current cash-based systems make it difficult for the Department to accurately monitor and forecast expenditure. The planned move to monthly accruals accounting will address this issue if used as intended. Much of the Department's expenditure is fixed over the period of the Comprehensive Spending Review, and therefore relatively easy to forecast, but more work needs to be done to identify volatile budgets so that forecasting can be improved. The Department needs to improve the timeliness and consistency of information from its delivery partners, and the integration of financial information with performance information. The introduction of the shared service arrangement with the Department for Work and Pensions in 2009 will provide an integrated financial and performance information system.

3.41 Cash-based financial management systems. The Department's financial management systems have historically been cash-based, with accruals identified only at year-end, and in 2007 the Department was one of three which had not implemented monthly accruals based accounting and budgeting systems.[16] Accruals have not been material to the Department's monthly financial position because most of its expenditure is in the form of grants but accruals accounting allows departments to better understand how they are using their financial resources and should help improve the accuracy of forecasting. The Department implemented a new system to identify accruals over £100,000 on a monthly basis during 2008-09 and the system was fully implemented for the start of the 2009-10 financial year. The Department's focus has predominantly been on ensuring that budget allocations are not breached. It is currently identifying volatile budget areas so that budget monitoring and management can be focused on those areas.

3.42 Timely financial information. The Department relies substantially on financial information that has to be obtained from partner organisations. The Board monitors the financial position of non-departmental public bodies through quarterly assessments in the Corporate Performance Report, but the information provided and its timing is not consistent across all bodies. Typically the information from non-departmental public bodies is a month behind the Department's. The Department aims to address this lag from 2009-10 by altering the non-departmental public bodies' remit letters to request provisional financial information for inclusion in Board reports.

3.43 Within the Department, reports for individual budget managers on a cash basis can at present be produced on the first day following the month end. To prepare finance reports for the Board, however, forecast information must be collected manually from budget managers. Finance reports to the Board are produced within 13 days of the month end, comfortably ahead of the monthly Board meetings and close to the Treasury's target of ten days. However, the timetable for producing the Board reports means that returns are submitted before Directorate Senior Management Teams have met to review the figures. This timing increases the risk that the information presented to the Board will not be of sufficient quality or accuracy. The introduction of the shared service arrangement with the Department for Work and Pensions in 2009 aims to improve the position and ensure the timely provision of quality assured information for Board meetings.

16 NAO Report. *Managing financial resources to deliver better public services* (HC 240, 2007-08).

3.44 In 2007-08, six months into the financial year, the Department forecast an outturn position of 1.7 per cent overspend. The eventual outturn position was a 1.6 per cent underspend. The variance of 3.3 percentage points compared with an average across public sector organisations of 2.2 percentage points,[17] despite the relative predictability of the Department's grant payments.

3.45 In February 2008 the Department drew down £122 million of its £973 million unused budget brought forward from the previous year, mainly to fund schools spending. It had originally planned to draw down £443 million in the year, but had reduced this amount owing to slippages in programme spending being rolled forward into 2008-09. This funding, however, was not in the end required, because the Department had an overall underspend of £777 million in 2007-08, and the Department lost the ability to use this funding in the future because of Treasury rules.

3.46 Monitoring of the schools sector. Financial information from schools is provided by local authorities in annual outturn statements that they are required to submit to the Department within five months of the end of the financial year. However, the Department's collation and analysis of these statements is not completed until almost a year after the end of the financial year, meaning the information is of limited value for financial monitoring and forecasting. In practice, the Department has few options for directly influencing the spending of school budgets, and expects local authorities to take the lead on monitoring and responding to financial activity at the school level.

3.47 Through a review reported in July 2008, the Department's Internal Audit Unit provided assurance that the 2006-07 Dedicated Schools Grant funds had been used for the purposes intended, and that 2007-08 allocations had been distributed by local authorities in line with regulations. However, it reported that the Department's School Funding Unit does not have effective systems in place to ensure that timely and robust assurance is available for Dedicated Schools Grant. The review identified several areas that the School Funding Unit needs to address, but acknowledged that the Unit was planning a 'lessons learned' review from the first year of reporting on the use of the Dedicated Schools Grant.

3.48 The Department monitors the operational performance of schools and local authorities against 18 mandatory education and early years' delivery targets, as well as up to 35 performance targets from the National Indicator Set of around 200 performance indicators across all departments. These are selected by the local authority, agreed with the relevant department, and set out in the local authority's Local Area Agreement. It is difficult for the Department to link expenditure to outcomes because of the broad nature of Local Area Agreements and Area Based Grants.

3.49 Monitoring of the Academies programme. Direct spending by the Department on Academies continues to increase, and the means of monitoring is the Funding Agreement between each Academy and the Department. Agreements set out the conditions for receiving funds from the Department and the required reporting arrangements. Academies have to make quarterly financial returns to the Department. In order to gain assurance on the adequacy of financial governance, the Department conducts financial review visits which look at whether the Academy's systems and controls meet the requirements of the Funding Agreement. Each Academy is visited in the first year of opening; visits thereafter are scheduled on a risk-assessment basis.

3.50 Integrating financial and non-financial performance information. The quarterly Corporate Performance Report presents both financial and non-financial performance information. The Board regularly discusses performance assessments against Departmental Strategic Objectives. These discussions include financial performance, but not against Strategic Objectives because the activities funded (for example, teachers' salaries) apply across a range of objectives and costs cannot easily be apportioned. The monthly finance reports to the Board cover key financial information, for example, resource and capital spending by programme, administrative spending by directorate, and achievement of efficiency savings.

Financial and operational reporting

3.51 The Department needs to demonstrate to its stakeholders how it is spending its resources and what it is achieving. Internally it is important that reports support management to make timely and sound decisions on the allocation of resources, and they should therefore integrate financial and operational performance information.

3.52 We found that although the Department presents financial and operational performance information together in a single quarterly internal report to the Board and some external reports, these do not generally integrate financial reporting with strategic objectives or outcomes. The Department has made improvements to the Corporate Performance Report to better meet the needs of users, and presents the Departmental Report to provide

17 Institute of Public Finance report, *Public Sector Corporate Services VfM Indicators Finance 2006-07 – Department for Children, Schools and Families.* The public sector average is based on 56 public sector organisations reviewed by the Institute of Public Finance at the time of its report.

comprehensive operational and financial performance information to stakeholders in an informative way. The Departmental Report 2008 was published before the audited Resource Accounts. The Department, however, has, within the time available, been unable to fully reconcile the financial information in the Departmental Report to its audited Resource Accounts. For example, total expenditure reported in the 2008 Departmental Report for 2007-08 was more than £1 billion higher than that reported in the 2007-08 Resource Accounts. The Resource Accounts and the data in the Departmental Report are produced from different data sources and with differing timescales, an anomaly the Government's Alignment Project, rationalising reporting mechanisms, is attempting to address[18].

3.53 External reporting. The Department needs to provide timely, accurate and balanced information about its stewardship and use of resources and its non-financial performance to the Department's different stakeholders. The Departmental Report is the prime document for communicating with stakeholders. The report highlights the Department's key achievements and progress against each of the Departmental Strategic Objectives, and reports progress against its Public Service Agreement targets. The report includes a considerable volume of financial information. Although the information is not integrated with operational performance, expenditure is reported both by function and sector, and trend data is also reported, including planned expenditure for the subsequent three years.

3.54 The Department's Resource Accounts meet parliamentary reporting requirements and are primarily for external financial reporting. The 2007-08 Resource Accounts were presented for audit within 35 days of the year-end and certified before the Parliamentary recess. The Statement of Operating Costs by Departmental Aim and Objectives reports expenditure against objective, but is a year-end exercise and does not form part of the Department's ongoing financial management. The Department's non-departmental public bodies report directly to Parliament through their own annual reports and accounts.

3.55 Reporting of schools' income and expenditure. Local authorities report on schools within their areas through returns which they are required to submit to the Department within five months of the end of the financial year. For individual schools, the Consistent Financial Reporting framework introduced in April 2003 has standardised the reporting of school finances in all maintained schools in England. A website holding the schools' data enables them to compare results with those of similar schools. An aim of Consistent Financial Reporting is to increase the accountability of school managers and encourage schools to become more self-managing. Less efficient schools are expected to look to more successful schools for advice on best practice.

3.56 Reporting of income and expenditure of Academies. The Department has direct responsibility for Academies. Academy charitable trusts prepare and publish their accounts in accordance with company and charity law. Because the accounts are of the trusts' income and expenditure, individual Academies do not have their own published accounts where a trust covers more than one Academy (55 out of 132 opened Academies as at January 2009). The Department does not currently consolidate or provide a specific report to Parliament on the performance of this major programme. The Department is planning to transfer responsibility for funding and accountability of Academies to the new Young Person's Learning Agency.

3.57 Internal reporting. To run the Department effectively, the Board needs up-to-date financial and non-financial performance information on a timely basis. The Board receives monthly Finance Reports that provide key financial performance information but do not cover operational performance, which is reported quarterly to the Board through the Corporate Performance Report. This Report also contains financial data, but it is not integrated with performance information.

18 The Governance of Britain, Green Paper (July 2007), announced that the Government would simplify its financial reporting to Parliament, ensuring that it reports in a more consistent fashion. The Alignment (Clear Line of Sight) Project has been set up to meet this objective.

APPENDIX ONE

Methodology

1 We employed three principal methodologies in our examination.

- **Interviews with officials of the Department** – this included members of the Board, senior managers, managers with specific financial roles, representatives of financial support teams and budget managers. Similar themes were discussed in these meetings, but varied depending on the roles and responsibilities of the individuals being interviewed. These interviews took place between May and September 2008.
- **Review of documentation** – we examined a sample of Departmental documentation including Board papers and minutes, departmental reports, internal audit reports and internet resources including teachernet. We also examined guidance and reviews by external bodies including the Civil Service Capability Review, Children, Schools and Families Select Committee reports, the Review of Financial Management by the Institute of Public Finance, and previous National Audit Office research.
- **Analysis of secondary data** – we have undertaken an analysis of secondary data including the Department's accounts and departmental report, information on Departmental programmes, and school and local authority financial data including 2007-08 local authority accounts. Our detailed analysis of the relationship between school balances and Ofsted performance data is at Appendix 2.

2 The National Audit Office developed its own toolkit for reviewing financial management from published methodologies, and this was used when undertaking the review. The approach followed the principles set out in the Audit Commission Discussion Paper World Class Financial Management published in 2005 and broadly accepted by the Treasury and other commentators. The toolkit identified a series of key statements on good financial management under the five main criteria: financial governance and leadership; financial planning; finance for decision making; financial monitoring and forecasting; and financial and operational reporting. As evidence from all sources was gathered, it was logged against the relevant good practice statements. This was then used to assess the situation in the Department and the sector, what the strengths and weaknesses of this situation were, and what the Department is doing to change this situation for the future. The toolkit enabled us to ensure comprehensive coverage of all aspects of financial management over the course of the review, compare evidence from different sources, identify gaps in financial management practice, and maintain an audit trail of evidence.

APPENDIX TWO

Comparison of school revenue balances with performance

1 We examined the relationship between grades awarded by Ofsted and 2007-08 school balances for all secondary schools inspected during the academic year 2007/08, 1,149 schools in total (around 40 per cent of all secondary schools). We selected for comparison five judgements from the full range that Ofsted determine for each school: the overall effectiveness of the school; three intermediate judgements that contribute to the overall effectiveness judgement which themselves are derived from a number of lower-level judgements; and one lower-level judgement that contributes to the Leadership and Management intermediate judgement:

- **Overall effectiveness of the school**: How effective, efficient and inclusive is the provision of education, integrated care and any extended services in meeting the needs of learners?
- **Achievement and standards**: How well do learners achieve?
- **Quality of provision**: How effective are teaching and learning in meeting the full range of learners' needs?
- **Leadership and management**: How effective are leadership and management in raising achievement and supporting all learners?
- **Use of resources**: How effectively and efficiently are resources, including staff, deployed to achieve value for money? (This grade contributes to the Leadership and Management grade)

2 We divided the 1,149 schools into three categories: those with cumulative deficits, those with a cumulative surplus between 0 and five per cent of annual school budget (taken to represent an acceptable level of cumulative surplus), and those with a cumulative surplus in excess of five per cent (taken to represent a higher than acceptable level of cumulative surplus). We determined how many schools within each category obtained Ofsted grades 1 to 4, where the grades represent differing levels of performance against each judgement:

1 – Outstanding

2 – Good

3 – Satisfactory

4 – Inadequate

Figure 16 overleaf gives the proportions of schools within each category, judgement and grade.

3 The results of the analysis are presented in **Figures 17-21 on pages 39-41**, each showing the distribution of schools across the five selected judgement areas.

16 Number and proportion of secondary schools obtaining Ofsted grades 1 to 4 across five judgement areas, split by level of cumulative surplus or deficit, for 2007-08

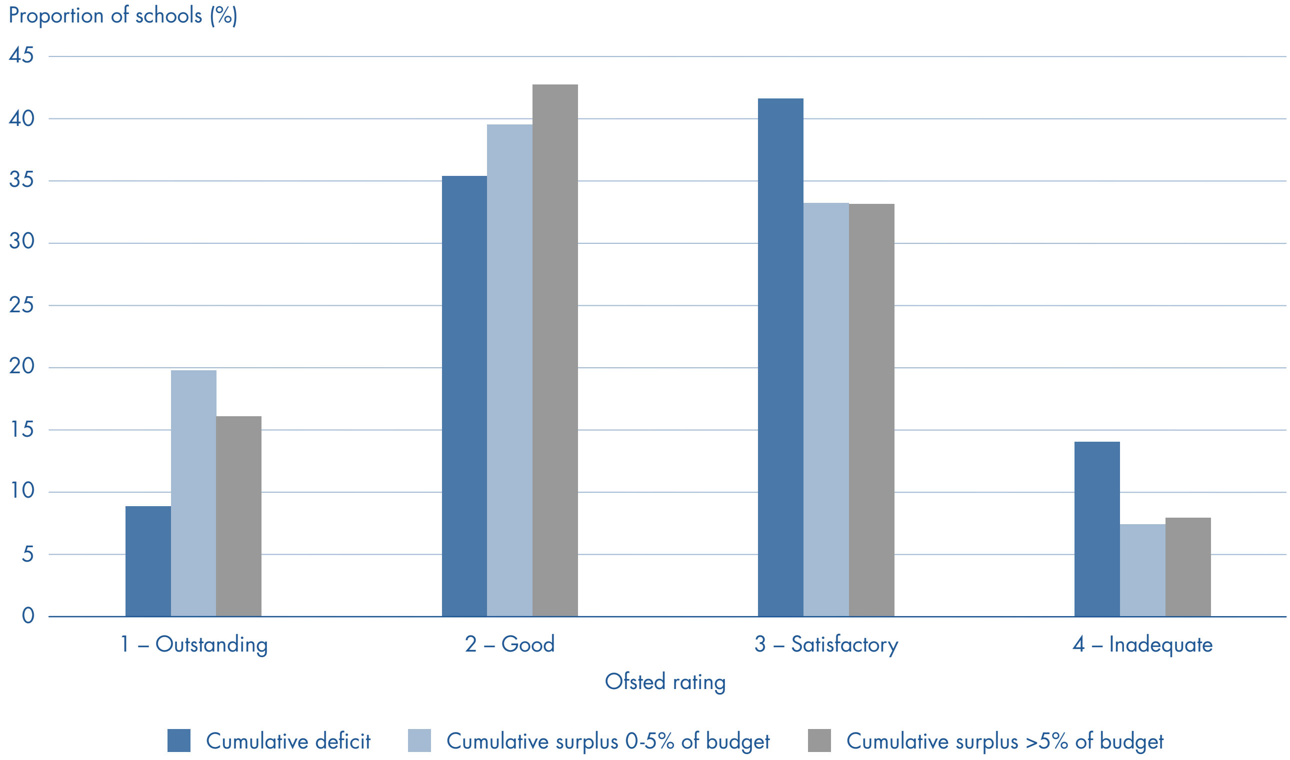
	Schools with cumulative deficits		Cumulative surplus 0-5% of annual budget		Cumulative surplus >5% of annual budget	
	Number	%	Number	%	Number	%
Overall effectiveness of the school						
1 – Outstanding	17	9	107	20	67	16
2 – Good	68	35	214	40	178	43
3 – Satisfctory	80	42	180	33	138	33
4 – Inadequate	27	14	40	7	33	8
Total	192		541		416	
Achievement and standards						
1 – Outstanding	19	10	96	18	60	14
2 – Good	67	35	222	41	185	44
3 – Satisfctory	81	42	184	34	140	34
4 – Inadequate	25	13	39	7	31	7
Total	192		541		416	
Quality of provision						
1 – Outstanding	9	5	65	12	38	9
2 – Good	80	42	264	49	209	50
3 – Satisfctory	90	47	188	35	153	37
4 – Inadequate	13	7	24	4	16	4
Total	192		541		416	
Leadership and Management						
1 – Outstanding	24	13	124	23	83	20
2 – Good	87	45	244	45	198	48
3 – Satisfctory	69	36	154	28	122	29
4 – Inadequate	12	6	19	4	13	3
Total	192		541		416	
Use of resources						
1 – Outstanding	21	11	122	23	82	20
2 – Good	67	35	223	41	183	44
3 – Satisfctory	75	39	161	30	120	29
4 – Inadequate	29	15	35	6	29	7
Total	192		541		414[1]	

Source: Department for Children, Schools and Families, and Ofsted

NOTE

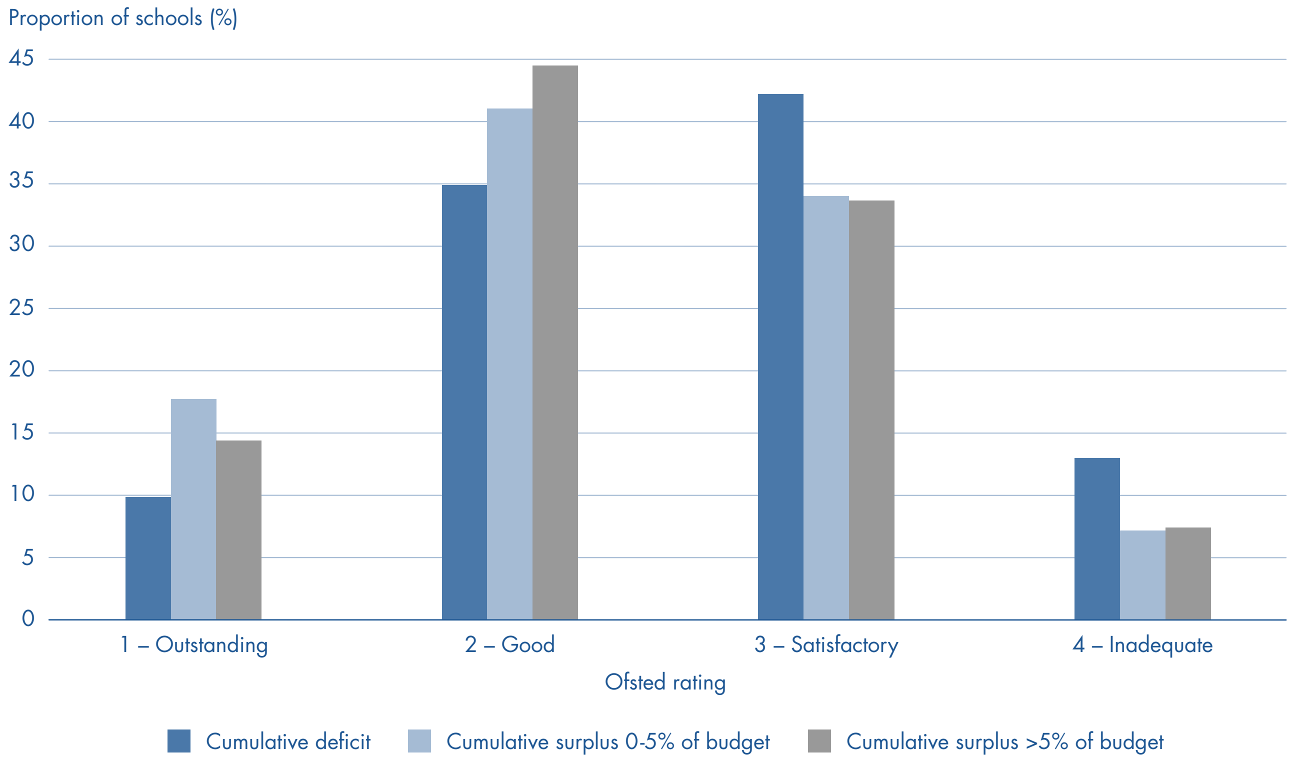
1 The 'use of resources' grade was not available for two schools.

17 Distribution of schools against Ofsted judgement on overall effectiveness of the school



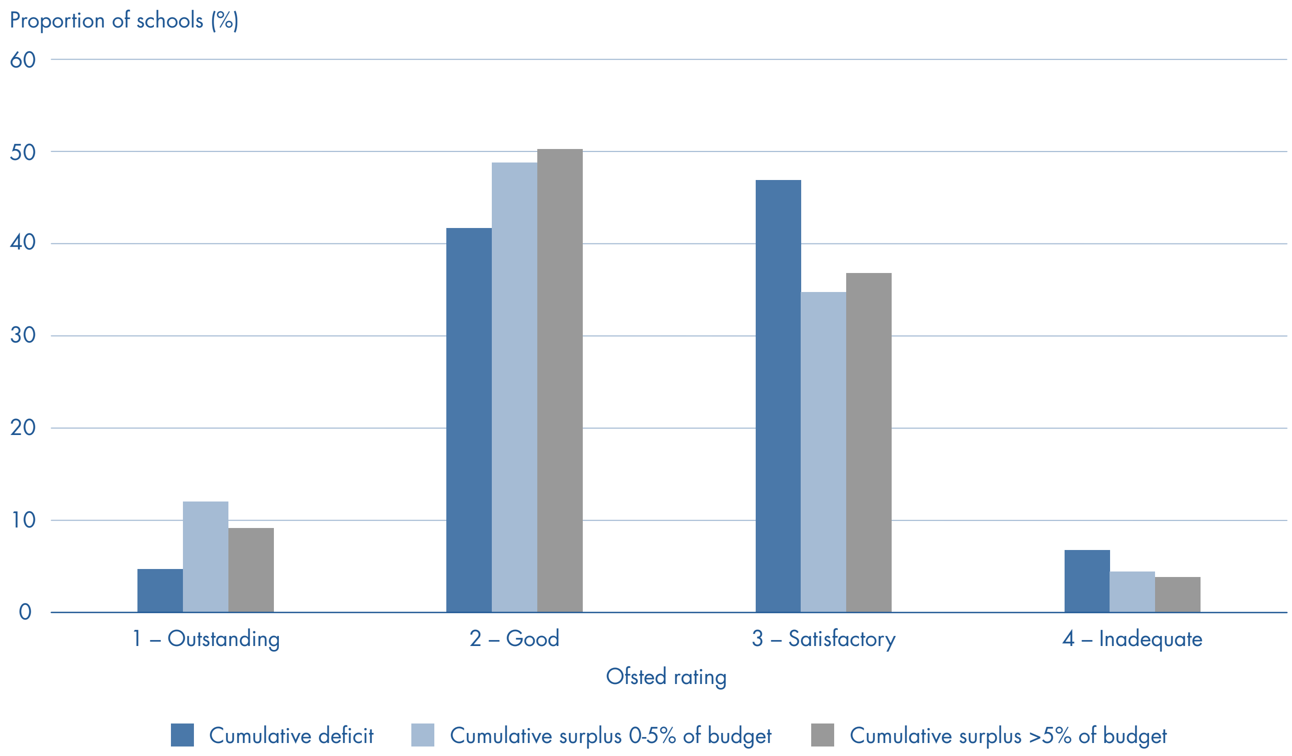
Source: Department for Children, Schools and Families, and Ofsted

18 Distribution of schools against Ofsted judgement 'Achievement and standards'



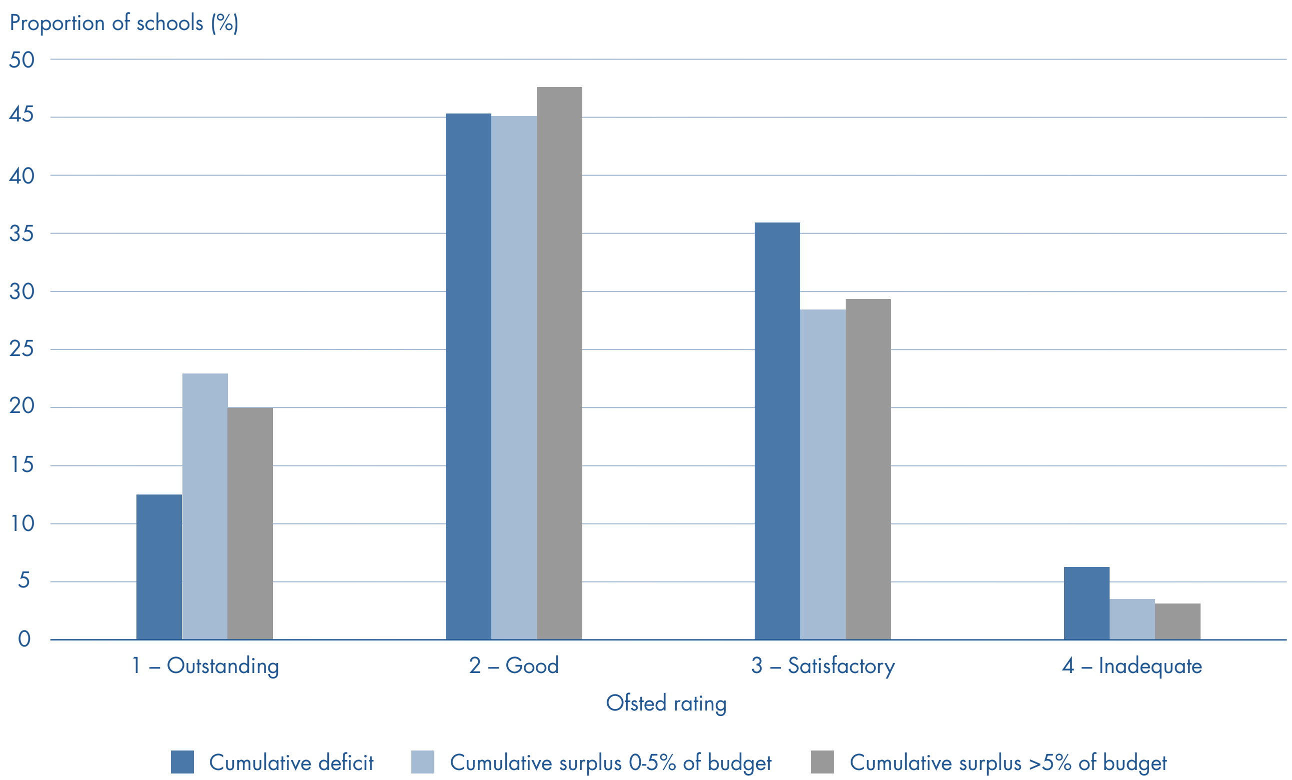
Source: Department for Children, Schools and Families, and Ofsted

19 Distribution of schools against Ofsted judgement 'Quality of provision'



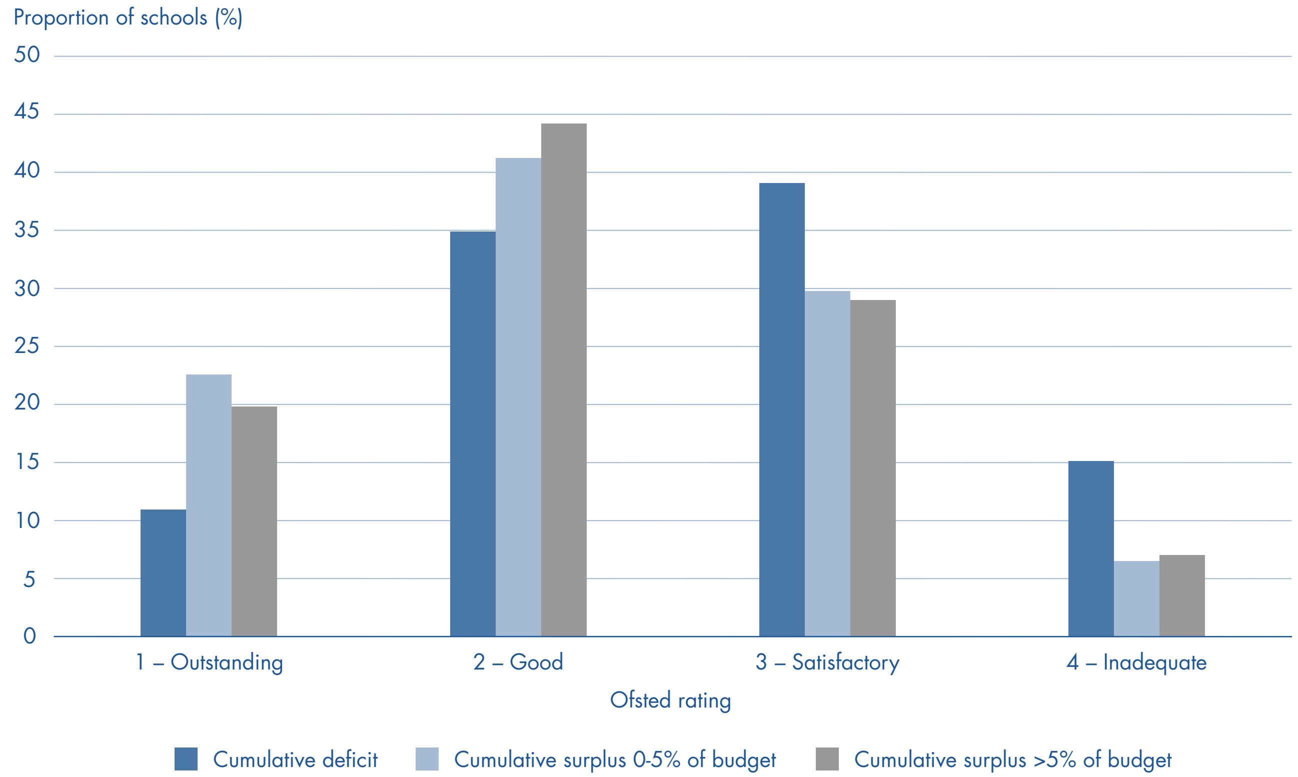
Source: Department for Children, Schools and Families, and Ofsted

20 Distribution of schools against Ofsted judgement 'Leadership and management'



Source: Department for Children, Schools and Families, and Ofsted

21 Distribution of schools against Ofsted judgement 'How effectively and efficiently resources are deployed'



Source: Department for Children, Schools and Families, and Ofsted

4 We found only a very small correlation between schools with large cumulative surpluses and performance, but a more significant correlation between schools with cumulative deficits and lower performance. Across all five judgement areas, a slightly higher proportion of schools with cumulative surpluses below five per cent received 'outstanding' grades compared to schools with cumulative surpluses above five per cent, and similar proportions received 'satisfactory' and 'inadequate' grades. For schools with cumulative deficits, however, a significantly smaller proportion obtained 'outstanding' grades across all five judgement areas, and a significantly smaller proportion obtained 'good' grades across four of the five judgement areas ('Leadership and management' being the exception). A significantly greater proportion of schools in deficit obtained 'satisfactory' and 'inadequate' grades across all five judgement areas.

GLOSSARY

Academy	An all-ability, state-funded school established and managed by a sponsor or sponsors. They generally either replace existing poorly performing schools, or are established in areas lacking sufficient provision. They are not maintained by the local authority, but they collaborate closely with it, and with other schools in the area.
Accrual	An accrual is a cost that has been incurred but not yet paid for, or income that is due but has not yet been received.
Building Schools for the Future	Announced in 2003, the Building Schools for the Future Programme (BSF) aims to renew all English secondary schools over the period to 2020. It plans to entirely rebuild half the school estate, structurally remodel 35 per cent, and refurbish the rest.
Children's centre	Children's centres provide integrated services and information for children under five years old and their families. Set up under the Sure Start programme, it is the Government's aim that by 2010 every community will be served by a children's centre, ensuring that every child gets the best start in life. Services provided can include: integrated early education and childcare; support for parents; child and family health services; and help for parents into work.
The Children's Plan	The Children's Plan, published in December 2007, sets out Government's plans over the following 10 years under each of the Department for Children, Schools and Families' strategic objectives. It includes targets up to 2020.
Comprehensive Spending Review	The Government's mechanism for periodically reviewing and determining its spending priorities, resulting in a settlement covering all Government spending over a three year period. The current Comprehensive Spending Review settlement covers the period April 2008 to March 2011.
Dedicated Schools Grant	Introduced in 2006-07, the Dedicated Schools Grant provides ring-fenced funding for schools from the Department for Children, Schools and Families to local authorities. Local authorities have responsibility for distributing the funding to schools according to local needs and priorities.
Delivery Partners	Schools, colleges, children's centres, local authorities, non-departmental public bodies and other bodies delivering services on behalf of the Department.
Education Maintenance Allowance	A weekly allowance of £10, £20 or £30 paid to 16-18 year olds who stay in education. It is paid directly to pupils and is assessed against household income.

End Year Flexibility	This is a financial mechanism that allows unspent resources to be carried forward from one year to the next. It is used in a planned way to carry money forward for specific purposes, to handle slippage in capital projects, and to avoid pressure to spend current budgets at year-end.
Every Child Matters	The green paper published by the Government in response to the Climbié review. Following the consultation, the Government passed the Children Act 2004, providing the legislative background for developing more effective and accessible services focused around the needs of children, young people and families. The five Every Child Matters outcomes were identified in the green paper as those that are most important to children and young people.
Learning and Skills Council	A non-departmental public body sponsored by the Department for Innovation, Universities and Skills. Its role includes: funding of providers of further education, work-based learning, adult education, and schools' sixth forms; strategic planning of provision to meet government priorities; audit and review against targets and quality standards; and funding of programmes. The Learning and Skills Council is planned to close by 2010, handing over its functions to 150 local authorities, a new Skills Funding Agency and a new Young People's Learning Agency.
Non-departmental public body	A public body that works for, but at arms-length from, a central government department. There are four types of non-departmental public body: Advisory – advise ministers on particular policy areas; Executive – deliver a particular public service; Tribunal – have jurisdiction in an area of the law; and Independent monitoring boards – monitor prisons and the treatment of prisoners.
Office for Government Commerce	An independent office of the Treasury, it works with central Government departments and other public sector organisations to improve procurement, project and programme management, and estates management. Office for Government Commerce Gateway Reviews are independent examinations of programmes and projects to review progress and the likelihood of successful delivery of the programme or project.
Office for Standards in Education, Children's Services and Skills (Ofsted)	A non-ministerial government department accountable to Parliament that is formally independent of Government. The 'new Ofsted' was created in April 2007 from a merger of the schools inspectorate with the Adult Learning Inspectorate, parts of the Commission for Social Care Inspection, and inspectors of the family courts service. It inspects and regulates care for children and young people, and inspects education and training for learners of all ages.
Public Finance Initiative (PFI)	Under a Public Finance Initiative scheme, a capital project such as a school, hospital or housing estate, is designed, built, financed and managed by a private sector consortium, under a contract that typically lasts for 30 years.
Public Service Agreement	Public Service Agreements (PSA) detail the aims and objectives of each central government department for a three-year period. They describe how targets will be achieved and how performance against these targets will be measured.
Young People's Learning Agency	The Young People's Learning Agency is planned to be a non-departmental public body taking over the Learning and Skills Council's responsibilities for 16-19 education provision from 2010. It will work closely with local authorities, which from 2010 will have a statutory duty to provide learning places for pre-19 year olds.

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