Financial Management in the Department for Children, Schools and Families

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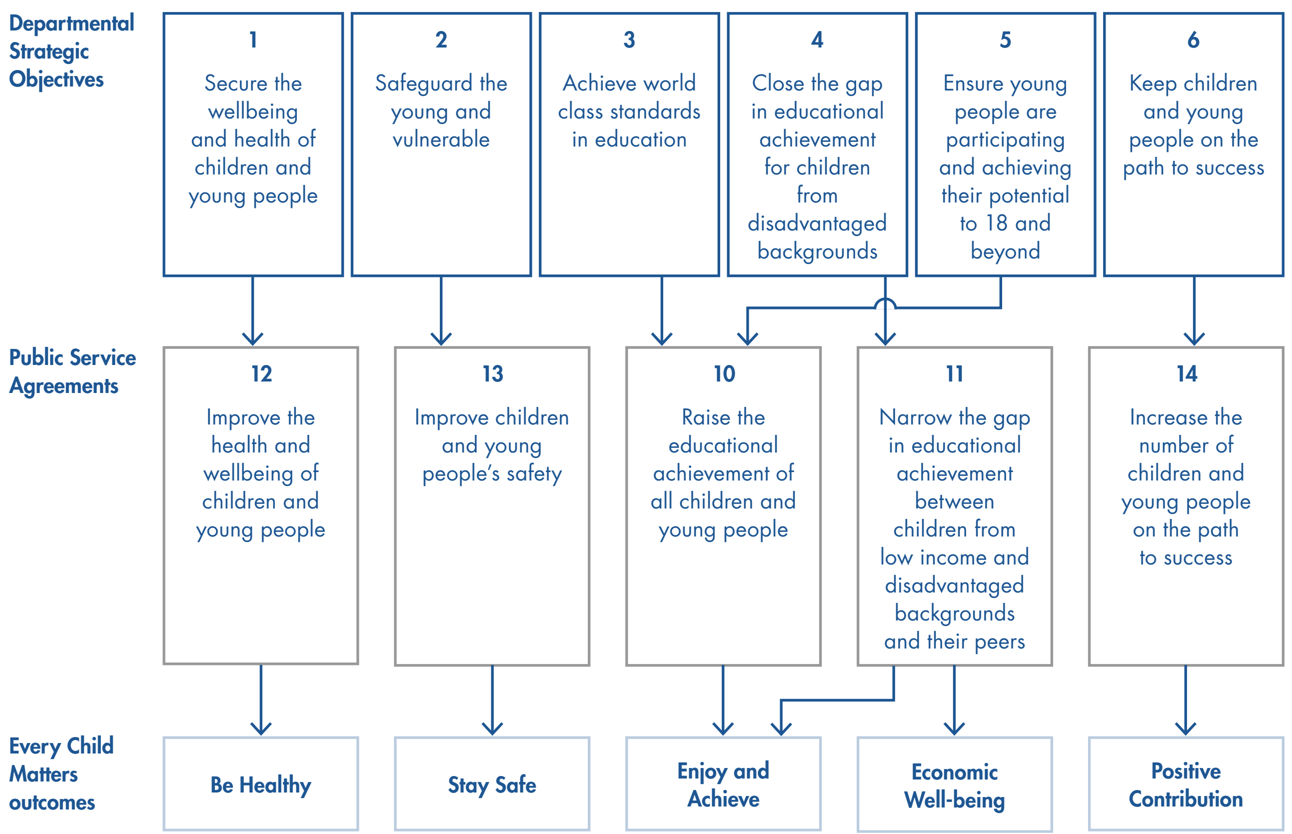
SUMMARY

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.