## Report of the Comptroller and Auditor General to the Houses of Parliament

## Department for Education Accounts 2011-12

### Introduction

1. The Department for Education (the Department) Annual Report and Accounts for 2011-12 report a net operating cost of some £56.2 billion which includes some £55.0 billion of resource and capital grants paid to local authorities, academies and other bodies.
2. The Department is required to prepare its financial statements in accordance with the Government Financial Reporting Manual (FReM). Under the FReM, the Department is required to apply International Financial Reporting Standards (IFRS) adapted or interpreted for the public sector.
3. Under the Government Resources and Accounts Act 2000, I am required to examine, certify and report on the financial statements of the Department. This involves satisfying myself that, in all material respects, the expenditure and income shown in the financial statements have been applied to the purposes intended by Parliament and conform to the authorities which govern them (regularity).

### Purpose of Report

4. The net expenditure of government departments is authorised by Acts of Parliament. These Acts set a series of annual limits on the net expenditure which the Department may not exceed and on the total overall cash they can use. Where these limits are breached, I qualify my regularity opinion on the financial statements. HM Treasury then prepares a statement of all such excesses in the year and requests that the House of Commons authorise the expenditure by passing an additional Act of Parliament, which is part of the Supply and Appropriations (Anticipation and Adjustments) Act.
5. For the 2011-12 financial year, these authorised limits were aligned to those used by HM Treasury to control public expenditure. Further detail on the authorised limits can be found within the Main Supply Estimates[1] for 2011-12.
6. Parliament authorised an annually managed resource expenditure limit for the Department of £1,007,000. The Department's outturn against this limit was £63,634,000, meaning that the authorised limit was breached by £62,627,000 and so I have qualified my regularity opinion on the Department's financial statements in this regard. HM Treasury propose to ask Parliament to authorise a further £62,627,000 of annually managed resource expenditure.
7. On a separate issue, the Departmental group, through one of its executive non-departmental public bodies, the Young People's Learning Agency (YPLA), provided £6.1 billion in grant to 1660 academies in 2011-12. A funding agreement between the Secretary of State for Education and each academy trust controls how this grant funding can be used. These funding agreements impose compliance with the provisions set out in the Academies Financial Handbook. As central government bodies, academies are also required to comply with the requirements of HM Treasury's 'Managing Public Money', although this requirement is not explicitly built into the funding arrangements.
8. I have qualified my regularity opinion on the YPLA's 2011-12 financial statements because the control framework is not adequately designed to provide sufficient appropriate assurance that academies have complied with all aspects of HM Treasury's Managing Public Money. I have qualified my regularity opinion

[1] http://www.hm-treasury.gov.uk/d/intro_main_supply_estimates_april11.pdf

on the Department's 2011-12 group financial statements on the same basis. Under the Education Act 2011, on 1 April 2012, the YPLA was abolished with all of its functions, staff, assets and liabilities transferring to the Department for Education and the newly formed Education Funding Agency.

9. This report describes both:
   - the circumstances surrounding the Department's breach of the limit for annually managed resource expenditure which was voted by Parliament; and
   - the control framework operated by the YPLA over grants to academies, and the weaknesses in that framework that led to the qualification of my opinion on regularity in respect of the requirement to seek approval for specific transactions, as required by Managing Public Money.

**Explanation for Qualified Audit Opinion**

**Breach of Parliamentary voted total**

10. My audit identified that the Department made payments of over £12 million during 2011-12 in relation to the premature retirement compensation of teaching staff of ex-Grant Maintained Schools and Colleges and pension payments mostly relating to the staff of former non-departmental public bodies.
11. In previous years the Department has accounted for annual compensation and pension payments as expenditure at the point payments are made but it has not recognised a liability in the Statement of Financial Position equal to the future payments required as a result of retirements taking place. However the Department has a legal obligation to pay these amounts in the future. This means that a provision is required to be recognised under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.
12. The Department has created a provision in its Statement of Financial Position of £68 million in 2011-12 to recognise this liability in accordance with the requirements of IAS 37. The creation of provisions represents a charge to Annually Managed Resource Expenditure. When the Department requested resources from Parliament through the Estimates process, it had not forecast that these provisions would be required, and therefore did not request Annually Managed Expenditure to cover these costs. These amounts were not material to the financial statements in prior years.

**YPLA are accountable for the regularity of funds paid to academies**

13. YPLA is responsible for the funding and support of academies, including the payment of grant and oversight of the sector on behalf of the Department for Education. The YPLA Accounting Officer is responsible for the regularity of grant expenditure, and is accountable to Parliament for the proper use of those funds.

**The assurance framework covers compliance with the funding agreement**

14. YPLA has established a framework to gain assurance that academies are applying the grant for the purposes intended. The framework was designed specifically to evaluate compliance with the Academies Financial Handbook and individual funding agreements.
15. The framework can be summarised as:
    - Obtaining audited financial statements from academies, including an opinion on whether the grants from YPLA have been applied for the purposes intended. These accounts are the financial statements academies are required to prepare under Companies Act legislation, reflecting their constitution as charitable companies limited by guarantee;

- Assessment of academies' annual Financial Management and Governance Evaluation (FMGE) self-assessments. These are signed off by the Accounting Officer of the academy. YPLA perform a desk-based review of these returns, in the first instance, to consider whether the academies' self-assessment is supported by the explanations provided;

- Inspection visits to a sample of academies to validate FMGE returns and the data used for grant allocations; and

- The work of investigation teams and academy liaison offices which can include assessments of academies' financial health and investigation of whistleblowing or other similar reports on academies.

16. The YPLA concluded that this framework provided substantial assurance that academies were complying with their funding agreements and I was able to rely on this work in support of my regularity opinion.

17. This effectiveness of this assurance framework is highly dependent on academies delivering requested returns and audited accounts. A signification proportion of returns or accounts were submitted late:

    - Accounts: of the 435 academy trusts required to prepare their audited financial statements to 31 August 2011, 21 per cent had not been received by the YPLA's deadline of 31 December 2011. All were received by the end of June 2012.

    - FMGE: academies are given different deadlines for their FMGE returns depending on when they opened. In 2011-12, 54 per cent of all returns were submitted late. All but 13 returns were received prior to my certification of these accounts.

18. Whilst the auditors of academies are required to give an opinion on the use of grant funds, the YPLA has not set guidance for auditors to follow when reaching that opinion. Audits of this nature within the public sector are normally governed by the Auditing Practices Board's Practice Note 10, Audit of Financial Statements of Public Sector Bodies, but this covers wider parliamentary and HM Treasury authorities and it is not clear to what extent auditors have used this framework in reaching their opinion on academies. The audit opinions on regularity provide some assurance to YPLA, but this could be strengthened to ensure that auditors and the YPLA have a common understanding of the work required. YPLA have set out plans to strengthen the regularity assurance gained from academy accounts by working with auditors to develop the framework.

**The assurance framework does not cover the full requirements for regularity set out in Managing Public Money.**

19. Regularity in the central public sector is defined and governed by HM Treasury's Managing Public Money, which establishes the principles for propriety and regularity. HM Treasury have confirmed that Managing Public Money applies to academies because they consider academies to be central government entities.

20. In particular, Managing Public Money requires each body to have delegated authority before it can spend public funds. However, there are certain transactions and actions that HM Treasury do not delegate because they are potentially repercussive or of a novel or contentious type. These special payments include:

    - severance payments in excess of the employer's contractual commitment;

    - extra statutory payments in settlement of legal disputes out of court;

    - certain private expenses of employees made necessary because of their public duties;

- non-standard payments in kind; and
- unusual financing transactions, especially those with lasting commitments.

21. YPLA were aware of 14 instances at 9 academies where severance payments had been made by academies in excess of employers' contractual commitments, and submitted these cases, with an aggregate value of £227,832, to HM Treasury in June 2012 relating to the 2011-12 financial year. All were approved by HM Treasury.

22. Eleven of these cases were identified through the YPLA's external assurance inspection visits. The remainder were identified through discussions on funding with the academies.

23. YPLA has informed me that it interpreted the regularity requirements for the academy sector to stem from the funding agreements. Academies are charitable companies, and charities guidance sets different parameters for considering ex-gratia and other such payments. In particular, according to the Charity Commission2 the responsibility generally rests with trustees to consider whether they can justify the payment as being in the interests of the charity, whereas public sector entities require HM Treasury approval.

24. YPLA's external assurance team inspected 135 academies in support of YPLA's 2011-12 financial statements and governance statement, representing 8 per cent of the 1660 academies opened before the year end. It is unclear how many other special payments were made in the academy sector in this financial year, but the frequency of occurrence of payment requiring HM Treasury approval in this sample suggests that there were a number of other cases of severance payments over and above those submitted for approval. YPLA has not required academies to notify them of severance cases or any other payments which require Treasury approval and so I have concluded that the assurance framework YPLA had in place for the financial year was not capable of identifying and managing all cases.

25. Accordingly, I have been unable to confirm that, in all material respects, grants to academies conform with the authorities which govern them, and have been applied for the purposes intended by Parliament. For this reason I have qualified my opinion on regularity.

**Actions for the Department for Education and the Education Funding Agency**

26. The number of open academies has grown significantly during 2011-12 (from 440 academies in March 2011 to 1660 by 31 March 2012), and this growth is forecast to continue. There are a number of areas of the control framework over academies that the Department for Education through the Education Funding Agency (EFA) should consider improving in order to manage the future expansion of the sector more effectively:
    - *Compliance with Managing Public Money*: The EFA should discuss with HM Treasury how best to ensure compliance with the provisions of Managing Public Money set out above. Unless resolved, this issue is likely to result in a qualified audit opinion for the Department's and the Education Funding Agency's 2012-13 financial statements;
    - *Lateness of academy returns:* As noted above, a significant proportion of academies have been missing deadlines to submit returns to YPLA. The lateness of these returns has resulted in an assurance gap, although this gap did not require me to modify my opinion this year. However with the growing number of academies, there is potential that this assurance gap may become more significant in 2012-13. The EFA should consider how to ensure academies comply with submission deadlines; and

[2] Charity Commission guidance note 7 ex gratia payments by charities

- *Academy audited financial statements:* The Academies Financial Handbook requires academies to engage their auditors to provide an opinion on whether 'the grants made by the YPLA have been applied for the purposes intended'. This opinion, designed to cover the regularity of grant spent by an academy, is not in a format applied elsewhere in government. The opinion only covers whether the academies have complied with the funding agreement, without considering other regularity concerns, such as Managing Public Money. In addition, there is no framework as to what procedures the auditor should carry out to provide this opinion. The EFA should consider whether to require a standard regularity opinion, supported by a robust audit code, which would provide better assurance to the EFA Accounting Officer.

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