

The Report of the Comptroller and Auditor General on the Department for Education's 2014-15 financial statements

Introduction

1 The Department for Education (the Department) produces Resource Accounts in accordance with the Government Resources and Accounts Act 2000 and includes within these Resource Accounts the following:

- **The Department for Education financial statements** comprising the results of the Department, its three executive agencies (the Education Funding Agency (EFA), the National College for Teaching and Leadership, and the Standards and Testing Agency); and
- **The Departmental group financial statements** comprising the results of the bodies above, as well as the Office of the Children's Commissioner (a non-departmental public body) and the 2,824 academy trusts that operated 4,900 academies as at 31 March 2015.

2 In accordance with the requirements of the Government Resources and Accounts Act, I am required to examine and certify the above financial statements. I may also choose to issue a substantive report when I consider there are matters which may have a direct or indirect effect on public expenditure and warrant being drawn to the attention of Parliament.

Scope and purpose of this report

3 The purpose of this report is:

- To explain why the Department was unable to meet the original statutory reporting deadline for its 2014-15 accounts and had to request an extension (paragraphs 6-9);
- To explain the qualification of my audit opinion on the group financial statements and comment on developments from the prior year (paragraphs 10-35); and
- To draw attention to the work by the Department and HM Treasury to develop an alternative approach to accounting for academy trusts to improve the transparency to Parliament of academy trusts' spending (paragraphs 36-40).

4 With the exception of the EFA, the issues raised in this report do not relate to the audit opinions I have issued on the individual financial statements of the other bodies included in the group (the National College for Teaching and Leadership, the Standards and Testing Agency, and the Office of the Children's Commissioner). These bodies prepare their own individual financial statements and I have issued 'unqualified' true and fair and regularity opinions on each of these. Academy trusts also prepare individual financial statements and these are audited by separate auditors. I have not identified material inaccuracies in the financial statements of academy trusts which would have a material impact on the Department's group financial statements.

5 I have given an adverse opinion on the EFA group financial statements. This is due to the issues that are discussed in this Report with regard to the Department's financial statements. These relate to the methodology by which Academy trusts are consolidated into the EFA group financial statements, which is the same as that used by the Department in preparing its group financial statements. Further details of the impact of these issues on the EFA financial statements are set out in my Report on those accounts.

Extension to the statutory deadline

6 Under the Government Resources and Accounts Act 2000, the Accounting Officer of the Department is required to submit to me, as the Comptroller and Auditor General, the signed Department for Education group financial statements for 2014-15 by 30 November 2015. I am required by the Act to certify these by 15 January 2016 and to send them to HM Treasury. HM Treasury is required to lay the financial statements, along with my audit opinions and report, before the House of Commons by 31 January 2016.

7 The Department did not provide group financial statements supported by sufficient appropriate evidence to enable me to form an opinion within the statutory timetable. This was largely due to the scale and complexity of consolidating 2,824 academy trusts with year-ends that do not match that of the group (paragraphs 13-18), combined with issues relating to the significant expansion of the capital programme within the EFA (paragraphs 25-29). On 29 January 2016 the Accounting Officer wrote to the Chair of the Committee of Public Accounts, and the Chair of the Education Select Committee outlining his intention to delay the laying of the accounts. This was on the basis of the Department's assessment, which I supported, that a delay offered an opportunity to materially improve the quality of the supporting evidence and enable me to form an opinion on the group financial statements to be laid before Parliament.

8 Based on the Department's assurance of improvement, and following consultation with me, HM Treasury agreed to an extension of the statutory deadline. This was enacted by an Order under the Government Resources and Accounts Act 2000, amending the date for the laying of the 2014-15 accounts from 31 January to no later than 29 April 2016.

9 As a result of the extension, the Department was able to provide sufficient, appropriate evidence to enable me to conclude my audit and to form an adverse opinion on the truth and fairness of the group financial statements and an unqualified opinion on the financial statements of the Department (which consists of the core Department and agencies).

Adverse opinion on the Departmental group's financial statements

10 In 2013-14, I issued an adverse opinion on the truth and fairness of the Department's group financial statements as I had identified a level of misstatement and uncertainty, which I considered was material and pervasive to the group financial statements. I noted that I did not believe that the Department would be able to address the challenge of consolidating so many academy trusts with different year-ends from the group without a significant change in the current consolidation methodology.

11 For the 2014-15 group financial statements, I have continued to issue an adverse opinion due to a level of misstatement and uncertainty which I consider to be material and pervasive. The key areas of misstatement and uncertainty are:

- the financial statements are not materially compliant with International Financial Reporting Standard 10 *Consolidated Financial Statements*. I have identified increased levels of error and uncertainty arising from the consolidation of academy trust results with a reporting date seven months prior to the Department's reporting date, as well as the use of unaudited returns for those academies which had recently opened and had not yet produced financial statements;
- a continuing limitation of scope over the academy trust land and buildings recognised in the group financial statements; and
- material and pervasive misstatements in the prior year comparatives.

12 I discuss these matters further in paragraphs 13-24. In paragraph 36-40, I set out the progress that the Department has made towards agreeing an alternative approach for accounting for academy trusts that will, if implemented effectively, provide a solution to some, though not all, of the consolidation methodology issues it faces.

Findings from my audit

(a) Non-compliance with IFRS 10

13 In my previous Reports on the Department's financial statements for 2012-13 and 2013-14, I set out the significant challenges faced by the Department in preparing its consolidated financial statements and the approach it has taken to try to address these. Annex D: Consolidation approach and methodology, of the Department's Annual Report sets out the Department's approach.

14 The main challenges facing the Department arise from the consolidation of a large (and increasing) number of academy trusts and the different financial reporting periods for the Department and academy trusts. Whereas the Department is required to produce its financial statements to a 31 March year end, academy trusts have a year end of 31 August which aligns with the academic year. IFRS 10 *Consolidated Financial Statements* recognises that group financial statements may comprise bodies with different accounting periods but limits the allowable difference to three months. This gives rise to a significant challenge for the Department to prepare financial statements which provide a true and fair view of the financial activity for the period in question and the financial position at the end of that period.

15 The Department's approach to consolidating academies is based on three key sources of financial information:

- Audited academy trust financial statements to 31 August 2014 (my findings on this element are set out in paragraph 16) ;
- unaudited returns to March 2015 for those academies that had recently opened and had not produced financial statements (paragraphs 17-18); and
- centrally collated information on land and buildings, pension liabilities and assets under construction (paragraphs 19-29)

16 The Department has used audited academy trust financial statements to 31 August 2014 for 2,634 academy trusts. This approach is not in compliance with IFRS 10. As in previous years, it commissioned a "comparison study" which sought to prove that there was no material difference between the financial information included in the group accounts for these academy trusts and the information which would have been included had financial statements to March 2015 been used instead. I consider that the comparison study has not provided sufficient, appropriate evidence to support this assertion. The results of the study indicate that there is a material difference between academy trusts' financial information for the year ended 31 March 2015 and the information that has been included in the group accounts. I cannot quantify precisely the extent of the difference as limitations in the scope and design of the comparison study make it impracticable to draw valid extrapolations across all academy trusts. However, I consider the impact on the financial statements of this non-compliance with IFRS 10 to be material and pervasive, and as such, the financial statements as a whole do not present a true and fair view

17 Academy trusts that open during the 2014-15 financial year and new academies that join existing academy trusts between 1 September 2014 and 31 March 2015 and have yet to be included with audited academy trust financial statements, are required to submit an unaudited accounts return to the Department. The financial statements record £662 million expenditure, £622 million income, £364 million assets and £104 million liabilities for this population of 468 academy trusts (excluding land and buildings and pension valuations, which, as noted in paragraph 15 were subject to a central adjustment). There is insufficient evidence to support the accuracy and completeness of these balances.

18 The Department and the EFA undertook validation testing and assurance visits to a sample of academies to agree balances in the unaudited accounts returns to books and records. I reviewed the effectiveness of these controls and attended a sample of assurance visits, and concluded that they did not provide sufficient, appropriate evidence of the accuracy and completeness of the unaudited returns. The

Department took the decision not to carry out additional work to validate the unaudited data. Its view was that, in light of the results of the comparison study (discussed above), further work was unlikely to bridge the assurance gap, and so would not provide value for money, as well as placing an unwarranted burden on academies.

(b) Land and buildings

19 In 2012-13 and 2013-14 I limited the scope of my audit opinion in respect of the valuation of land and buildings held by academy trusts and I continue to do so for 2014-15. Academy trust land and buildings with a valuation of £33.3 billion have been recognised as at 31 March 2015.

20 As noted in paragraph 15, the Department has made a central adjustment for land and buildings rather than consolidating the balances included in the financial statements of academy trusts. This is because academy trusts prepare their accounts in accordance with *Accounting and Reporting by Charities: Statement on Recommended Practice* (the Charities SORP). The criteria for recognising and valuing assets in the Charities SORP are not fully aligned with those in International Accounting Standards and HM Treasury guidance (the basis under which the group accounts are prepared).

21 The Department has made an assumption that all land and buildings used by academy trusts should be capitalised within the group statement of financial position. This may not comply with the requirements of International Accounting Standards and HM Treasury guidance, for example where buildings are occupied on a short term lease or are owned by another entity.

22 The Department does not have robust data to demonstrate that its assumption is appropriate. As a result, I cannot determine the extent of land and buildings assets that may be erroneously capitalised in the consolidated statement of financial position.

23 The lack of central oversight and records of the academy sector estate has also led to further error and uncertainty in the accounts. This includes double counting of assets, classification errors between land and buildings and assets under construction and the inclusion of some assets on a valuation basis that is not compliant with HM Treasury guidance.

24 In my reports on the 2012-13 and 2013-14 financial statements, I noted that I did not believe that the Department would be able to resolve the issues around the recognition of Land and Buildings for a number of years. The Department stated last year that collecting the required information would be very costly (estimating that this could cost over £20 million to collate the information and between £5 million to £10 million a year to keep the data current) and therefore decided not to collect the information on value for money grounds.

(c) Capital projects

25 The Priority Schools Building Programme (PSBP) is a programme to address the needs of the schools most in need of urgent repair. The aim of the programme is for 260 schools to be rebuilt or have their condition needs met by the EFA over 4 years. In addition, the Government has pledged to open 500 free schools over the next 5 years. As a result, there has been a significant expansion of the EFA's capital programme during 2014-15 with over 900 active PSBP and free school capital projects at schools across England during 2014-15, an increase from less than 200 during 2013-14.

26 The expansion of the EFA's capital programme within a short timeframe has challenged the EFA's capacity and capability for central record keeping and financial management. My audit identified significant, but not material, uncertainties due to weaknesses in record management and sharing of information between the EFA capital group and the finance teams of the EFA and the Department. These included uncertainties on the timing of the acquisition of sites and completion of assets, as well as costs being incorrectly capitalised where the group did not hold the rights to the future economic benefits associated with the assets. Weaknesses in the EFA's method of formally assessing the progress of construction works as at 31 March 2015 led to uncertainty on the value of capital accruals. I also identified a number of clauses in capital

contracts which gave rise to provisions and contingent liabilities that had not been recognised in the financial statements.

27 Delays in providing capital project information for audit and the volume of issues noted on capital projects significantly delayed the accounts preparation and audit timetable. Because of inadequate information-sharing across the Department and the EFA, the finance teams were not fully prepared for the scale of expansion of the capital activity on free schools and PSBP and the potential financial accounting implications until March 2015. The review of the relevant records to derive the accounting treatment for the associated capital projects within the Department's financial statements was not completed until October 2015, nearly seven months after the financial year-end. Although the additional work on accounting for capital projects was completed by January 2016, the delay it caused to the accounts preparation process, combined with the complexities of the consolidation methodology, was a key factor in the Department seeking an extension to the statutory deadline.

28 The EFA had to seek retrospective approval from HM Treasury for some types of capital transactions, mainly public sector overage arrangements, which my audit identified as being prima facie novel and contentious (as defined by HM Treasury's *Managing Public Money*, which sets out the rules on how public money can be spent). The Department has provided details of the relevant classes of transaction in its Governance Statement on pages 46 to 48 of its *Consolidated annual report and accounts for the year ended 31 March 2015*. The EFA should have obtained HM Treasury's approval before signing the contracts to ensure that it only entered into projects where it had the authority to do so. HM Treasury provided retrospective approval in all of these cases.

29 The EFA is taking a number of actions to address the concerns I have raised on capital projects. A number of improvements are being made to the financial management of capital transactions including record keeping, enhanced training and guidance for staff; revision of internal processes; and strengthening of project monitoring. The EFA is also working with HM Treasury to agree a revised framework of delegations for its capital programmes, which will clarify which types of transaction require HM Treasury authorisation.

Qualification of my regularity audit opinion

30 A primary objective of preparing consolidated departmental financial statements is to provide accountability to Parliament for the financial activity it has approved for the year for the whole Departmental group, which includes the financial activity of academy trusts. The Statement of Parliamentary Supply is the parliamentary accountability statement and shows how the monies authorised by Acts of Parliament have been applied, including outturns against a series of annual limits on the net expenditure which each department may not exceed and on the total cash each department can use.

31 Any expenditure outside of these limits will result in an 'Excess Vote'. Such expenditure potentially undermines parliamentary control over public spending. Where these limits are breached, I qualify my regularity opinion on the financial statements.

32 In my 2013-14 report, I highlighted the weaknesses in the Department's ability to forecast spend accurately for the group, mainly due to the Department's lack of timely and accurate in-year information on the forecast spend of academy trusts. Academy trusts have some discretion in how they use the funds provided to them by the Department; they have freedom to determine their spending profiles and carry forward unspent grant. This represents a financial management and accountability challenge to the Department and HM Treasury's ability to manage in-year resources and make appropriate financial decisions including accurate forecasting and resource requests.

33 I qualified my regularity opinion on the Department's group financial statements for 2013-14 on the basis that the Department had breached its Annually Managed Expenditure Limit control total by £166 million due to higher than anticipated non-cash costs relating to pensions, depreciation and impairment charges.

34 I have again qualified my regularity opinion on the Department's group financial statements for 2014-15 as the Department has incurred three breaches of its Parliamentary control totals:

- Net expenditure of £4,787.4 million has been incurred against the Capital Departmental Expenditure Limit of £4,756.2 million. The breach of this limit by £31.2m has arisen from the difficulty that the Department faces in forecasting the number and value of donated assets transferring from local authority control to the academy sector.
- Net expenditure of £751.6 million has been incurred against the Resource Annually Managed Expenditure Limit of £650.2 million. The breach of this limit by £101.4 million is due to higher than anticipated impairment charges on land and buildings.
- Prior year adjustments with a net impact of £3,072.9 million on the Statement of Parliamentary Supply have been processed. The Department did not seek Non-Budget provision for these adjustments in its supply estimates approved by Parliament and thus has breached the Non-Budget limit by the full value of the prior year adjustments

35 The impact of the level of error and uncertainty within the income and expenditure which has led to my issue of an adverse opinion on the financial statements is not captured within the Statement of Parliamentary Supply. This limits the ability of Parliament to identify the actual spend by the academies sector for the year in question.

Alternative approach to accounting for academy trusts' financial results

36 In 2013-14, I recommended that the Department and HM Treasury work together to identify a solution to the causes of my qualification and that any alternative approach for accounting for academy trusts should provide more robust information for use in the HM Treasury's fiscal modelling and the Whole of Government accounts.

37 The Department's preferred option is to remove the academy trusts' financial results from the Department's group financial statements and to reflect only grants paid to academies. The Department would then prepare a separate aggregated account for academies as at 31 August (the Sector Report). As the Department notes in its Annual Report, it received an 'in principle' agreement from HM Treasury to develop the proposals for a Sector Report alongside a range of challenging conditions that would have to be met. These proposals have been reviewed and approved by the Alignment Review Committee, Scrutiny Unit, Education Select Committee and Liaison Committee and will therefore proceed, subject to meeting the conditions placed on this approval by these committees.

38 The problems with accounting for academies extend beyond the current consolidation methodology and the issues of non-coterminous year ends, into wider issues of Parliamentary accountability, financial accounting and financial management. The Sector Report option, if implemented effectively, will provide a solution to a number of the consolidation methodology issues faced by the Department. It will not, however, address all of the causes of error and uncertainty and limitations which I have detailed in this Report, such as the recognition of land and buildings. The Department has not yet fully developed its proposals to allow robust information on the results of academy trusts to be incorporated into the Whole of Government Accounts (WGA) on a more timely basis.

39 The Department's policy of autonomy for academies brings with it significant risks if the financial capability of the Department and academies are not strengthened; and the financial statements do not present a true and fair view and meet the accountability requirements of Parliament. This will become even more significant in the context of the planned expansion of the academy sector. The Chancellor announced in the Budget on 16 March 2016 that the government expects all schools to become academies by 2020 or to have an academy order in place to convert by 2022.

40 The Department has developed a programme of work to improve financial management in the sector and it is positive to see a coherent view of the work across the Department. I will continue to liaise with the

Department to ensure that progress is being made, particularly to ensure that appropriate measures are developed to assess how financial management in the academy sector is changing over time.

Recommendations

41 As discussed in paragraph 29, the EFA is taking steps to improve the financial management and record keeping in respect of the capital programme. I support these proposed actions, however I consider that the EFA will need to work rapidly to enable improvements to be in place for the 2015-16 financial statements and the proposed dry run Sector report. Senior management leadership and commitment within the EFA and the Department will be vital to their success. I intend to further explore EFA's capital expenditure as part of my Value for Money work programme.

42 In respect of the land and buildings recognition qualification, I previously recommended that the Department and EFA work with HM Treasury to seek a solution to identify the school estate and appropriate accounting at the Whole of Government Accounts level. I continue to recognise that a centrally coordinated review of all land and building ownership and leasing arrangements would be inefficient and costly. Instead, I recommend that the Department establish a longer term plan to investigate the sources of information on the school estate that may already exist within the Department, the EFA, the academy trusts and within local authorities and whether these data sources and processes such as the pre-conversion checks that occur before a school becomes an academy, could be used to begin to establish records of ownership.

43 As part of the process of preparing the dry run Sector Report and considering conditions set out by HM Treasury and Parliament, I further recommend that:

- In order to prevent any erosion of Parliamentary accountability, significant and immediate improvements are made to the Department's forecasts and management information to ensure in-year monitoring of spend is improved. As I have noted in my Report, there are weaknesses in the Department's ability to forecast spend accurately for the group.
- The Department's proposals to allow the results of academy trusts to be incorporated into the Whole of Government Accounts on a more timely basis should be developed fully and I will continue to monitor these proposals to ensure that the Department produces an acceptable methodology.
- The Department should satisfy itself that it has the capacity to deliver effectively a dry run Sector Report in summer 2016 alongside the existing group financial statements consolidating academy trusts' financial results.

Sir Amyas C E Morse

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Comptroller and Auditor General

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