



Permanent Secretary

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Neil Carmichael MP
Chair of the Education Select Committee
Education Select Committee
House of Commons
London
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11 December

Dear Mr Carmichael

DEPARTMENT FOR EDUCATION – ACADEMIES CONSOLIDATION AND REPORTING FRAMEWORK

Following my earlier correspondence in September I am now writing to provide further details of the proposed reforms to the financial reporting framework for the Department for Education (DfE).

As pointed out in my earlier correspondence it has become clear that the current financial reporting framework is unsustainable. The DfE consolidated accounts for 2013-14 received an "adverse" opinion from the Comptroller and Auditor General (C&AG), and I expect a similar response when the audit concludes on the 2014-15 accounts.

The department has been working with the National Audit Office (NAO) and HM Treasury to develop a revised financial reporting framework for the DfE.

To ensure that Parliament has sufficient transparency and oversight of expenditure by academies we propose that:

- i) the DfE Supply Estimate and our annual accounts are amended to cover grant funding to academies, on a financial year basis; and
- ii) the DfE produces a new report to show how resources are deployed and consumed within the academy sector, on an academic year basis.

Once embedded, the new system will allow the DfE to lay its departmental report and accounts before the summer recess for the financial year ending in March, and additionally an audited sector report and accounts in the spring following the academic year end. The sector report will set out the financial performance of the sector aligned with academic outputs to better inform scrutiny and challenge by all stakeholders.

While this approach does not fully align with the requirements of CLoS – principally because we will report in the sector account on an academic year basis – it does in my view represent the best way to improve the transparency,

clarity and timeliness of reported information for Parliament. This approach has also now been considered by the Alignment Review Committee (ARC), which advises HM Treasury on Clear Line of Sight issues. ARC has endorsed this approach as the best way forward.

I am personally committed to these proposed reforms as I believe they will improve the accountability to Parliament of the sector, and the department – supported by more useable information. This approach is also aligned to our plans to improve financial management across the sector, and to help the sector deliver efficiency savings over the next few years.

HM Treasury will write to the House of Commons Liaison Committee in January to seek formal approval to proceed with the proposed reforms as these diverge from Clear Line of Sight. We understand the Liaison Committee will be particularly interested in the views of the Education Select Committee (ESC) and the Public Accounts Committee (PAC), which is why I am writing to you now.

Subject to approval by the Liaison Committee we are planning to implement the reforms for the 2016-17 financial year, with the first academy sector report and accounts for the 2015/16 academic year to be published in summer 2017. Given that this is a new approach, we plan to have a period of parallel running to test the new products, with governance and oversight being provided by the sub-committee of the ARC.

This proposal is designed to provide better accountability as the academy sector continues to grow. By avoiding the consolidation of bodies with different year ends (academies and the department) we will make a significant step towards improving the quality and transparency of information, as well as to addressing the underlying qualifications on the department's financial statements. My officials are continuing to work to resolve the other outstanding issues raised by the C&AG that have led to the qualification of the department's accounts in recent years.

Further details of the proposals are provided in the attached annexes, and my officials stand ready to provide further assistance to your Committee, or your specialist advisers.

I have copied this letter to Meg Hillier MP, Chair of the PAC.

Yours sincerely

Chris Wormald

CHRIS WORMALD
PERMANENT SECRETARY

ANNEX A

DEPARTMENT FOR EDUCATION – PROPOSED REFORMS TO THE REPORTING FRAMEWORK

Introduction

1. This note summarises:
 - a) how and why the existing arrangement for academies are failing to meet the principles and achieve the benefits of Clear Line of Sight (CLoS);
 - b) the options that have been considered to improve on the status quo;
 - c) how the proposed alternative approach may better meet the principles and intended benefits of CLoS;
 - d) review arrangements that would exist to monitor the implementation of the new approach to ensure it achieves the intended benefits.

Failure of the existing consolidation approach

2. CLoS reforms were implemented in 2011-12 in order to improve the transparency, clarity and consistency of reporting on public expenditure by aligning budgets, Supply Estimates and accounts across government. It aimed to do this by:
 - a) aligning Parliamentary controls (in Supply Estimates) with the government's budgetary controls and setting these on a net resource basis;
 - b) putting all non-voted expenditure and income within the boundary of Estimates; and
 - c) extending the Estimates and accounting boundaries to consolidate non departmental public bodies and other bodies classified to the central government sector.
3. DfE's existing reporting arrangements seek to meet the requirements and principles of CLoS. 'Net spending' by academies is included in the Supply Estimates and the departmental resource accounts seek to consolidate all academies. However it is clear that, in practice, the underlying aims and benefits of CLoS are not being achieved. There are four key issues that demonstrate failure to meet these aims and benefits.
 - a) In the absence of a better model to forecast academy trusts' (AT) expenditure the academies 'net spending' total approved by Parliament through the Estimates process is, in practice, the planned grant payments of General Annual Grant (GAG) rather than the net spending forecast.
 - b) There is very limited in-year financial data to enable academies' spending to be properly factored into the government's aggregate public spending controls and to inform wider financial decisions.
 - c) DfE's consolidated resource accounts for 2013-14 received an adverse opinion from the Comptroller and Auditor General (C&AG) as they were not considered to be true and fair. The problems with the current approach are primarily driven by:
 - i. non-coterminous year ends; and
 - ii. the rapid speed of growth and diversity in the sector with around 1,000 schools converting to academy status each year. There are now 3,026

charitable academy trusts consisting of 5,591 educational establishments¹.

- d) The laying of accounts and provision of underlying financial information are not timely. The DfE publishes its annual report and accounts up to ten months after the financial year end and is at risk of not meeting the statutory deadline of 31 January.

Criteria and issues considered in assessing the options

- 4. The options for reform were assessed by considering their impact on a number of issues and whether they meet certain criteria. We considered:
 - a) whether the transparency, clarity, accuracy and usefulness of DfE's reports would be improved, not only in terms of the information provided to Parliament but also information that is useful for the academy sector;
 - b) whether the proposals would allow the requirement for significant improvements to in-year data and financial year forecasting to be achieved;
 - c) the potential need for a new Parliamentary mechanism for net spending (see paragraph 15);
 - d) the possible improvements to DfE's approach to Whole of Government Accounts (see paragraph 18);
 - e) any legal barriers that would need to be overcome;
 - f) the impact on academies with a view to minimising burdens;
 - g) the timeliness of reporting, particularly whether reports can be laid before the summer recess;
 - h) the changes required to HMT systems (OSCAR);
 - i) how ongoing action by the department to improve the management of cash balances within the sector is supported;
 - j) the implications for the recognition of land and buildings (see paragraph 17); and
 - k) opportunities to support ongoing efforts to improve financial management capability across the sector.

Summary of options to improve the status quo

- 5. A wide number of options for improving on the status quo have been considered. The principal options considered are outlined below.
 - a) Align year ends to 31 March
This could be done by:
 - i. Forcing a change in academy trusts' own year end. However current DfE legal advice suggests there may be significant legal barriers to achieving alignment.
 - ii. Requiring academies to produce an audited return to 31 March in addition to their financial statements to 31 August. However, this is likely to lead to:
 - a significant administrative burden to the academy sector by creating misalignment between its operating cycle; and
 - a heavy cost implication for the sector in respect of additional audit fees, estimated by the DfE to be in the region of £30m.
 - b) Reclassification

¹ As at 1 October 2015

The government could remove further controls from the sector to enable academies to be classified by the ONS as outside of the public sector for the National Accounts (in accordance with the requirements of European System of Accounts 2010). However, AT assets are used by government to deliver statutory requirements and it was agreed that in order to satisfy the ONS criteria of reclassification to the private sector, a disproportionate degree of control would need to be discarded which would not be acceptable.

c) Continual improvements to existing arrangements

In order to improve the existing reporting outcomes under the current framework with no change to reporting year ends, a number of incremental improvements in timeliness, accuracy, financial management and fiscal reporting have been considered. However the limitations of these improvements would not enable the DfE to lay its accounts before the summer recess or address the fundamental issues around the accuracy of the financial information reported.

d) Alternative approach to Clear Line of Sight

An alternative option considered involves deviation from the normal Parliamentary and spending control framework underpinned by CLoS. In summary the DfE would:

- i. include the grant paid to academies for the financial year in their departmental Estimate and accounts;
- ii. cease to consolidate academies in their resource accounts; and
- iii. publish a separate, additional audited "sector report and accounts" which reports academies' financial performance on an academic year basis (ie. to a 31 August year end). The report would be prepared on a FReM compliant basis and include all designated academies for the academic year in accordance with an Accounts Direction issued by HM Treasury.

HM Treasury budget controls for the DfE would continue to apply to academies' net spending to support the management of the wider public finances.

Under this approach it is envisaged that Parliament would have more relevant, accurate and useful information needed to assess performance and governance, not only of the core department but also of the academy sector itself.

6. The balance of benefits and drawbacks of the above options has been considered by the DfE and HM Treasury, in consultation with the NAO, as well as by the Alignment Review Committee (ARC). Agreement has been reached that moving to the sector report approach is the most attractive and appropriate solution to address the significant weaknesses within DfE's current reporting approach. This is explored in more detail below.
7. The sector report will follow the structure agreed under the simplification and streamlining project for all those entities within the FReM boundary and will include a performance report, an accountability report and financial statements. A summary of the proposed contents of the sector report and accounts is provided in **Annex B**.
8. It is proposed that the new approach should be effective from the 2016-17 financial year with the first sector report and accounts for academic year 2015/16 published in 2017. The anticipated production timeline is set out in **Annex C**. The proposals for reform being put forward will be subject to a series of review points overseen by a governance committee reporting periodically to ARC.

Assessment of alternative approach against the principles and intended benefits of Clear Line of Sight

9. Meeting the principles of CLoS is at the heart of the reform proposals and any departure from it is seen as a unique circumstance with no intention of setting a precedent of misalignment. When CLoS was introduced it was recognised that it is not always possible to achieve full alignment in all areas and that a different treatment may, in certain cases, be legitimate. With this in mind, the proposals under the alternative approach seek, in practice, to align more fully with the overarching principles of CLoS by improving the transparency, clarity and timeliness of reported information, thereby making it easier for Parliament to scrutinise how voted funds are being spent.
10. The sector report would provide more comprehensible financial information on the academy sector by:
 - a) allowing Parliament to track more clearly the trends in academy spending over time;
 - b) drawing together more benchmarking information that the DfE collects across all schools;
 - c) improving clarity and coherence through separate and more accurate reporting linked to the operational performance of the sector;
 - d) removing significant uncertainties arising from the existing complex consolidation methodology to enable a clear reporting trail and line of accountability between the grant voted by Parliament (and received by academies) and the final total spending reported to Parliament for the sector; and
 - e) providing greater transparency on the income received by the sector from sources other than Parliament.
11. The boundary of public expenditure for which the DfE Accounting Officer is accountable to Parliament would remain the same as under the normal arrangements for CLoS. The difference is that the accountability would be provided through two publications (the departmental accounts and the sector report) instead of one. It is anticipated that these reports would be provided to Parliament on a more timely basis than is currently possible under the existing consolidation approach.

Alignment of Parliamentary and government control

12. As part of the reforms, Estimates and the associated Parliamentary control frameworks would switch to a grant basis. Given that the DfE currently sets its net spending total for academies at the level of grant funding to the sector (as a proxy for net spending), the new approach would, in practice, not represent a step change in terms of the voted provision in the Estimate. This does mean, however, that there would no longer be an excess vote if *academies* were to overspend – it would only occur if the DfE overspent against voted funds through paying out grant.
13. To help mitigate the loss of an excess vote in the current sense, DfE's Accounting Officer would remain accountable for academies' net spending and **HM Treasury's control framework would remain in place and apply to net spending**. In-year spending controls will be further strengthened by improvements to DfE's forecasts of academies expenditure. The DfE will be aiming to meet a 1% forecasting accuracy target and a review of the outcome against this target is factored into the reform package
14. Differences between the aggregate budgetary totals used by government to manage overall spending and the aggregate totals voted by Parliament would be created. However improvements to forecasting will, over time, allow more reliable data to become available to assist government's wider financial decision making and improve the management control of aggregate spending totals, a key principle of CLoS. As the size of the academy sector stabilises these improvements in modelling of spending may enable a return to a reporting approach that is fully aligned with CLoS.

15. HM Treasury, in conjunction with the Parliamentary Scrutiny Unit, NAO and DfE, considered the merits of introducing a separate Parliamentary mechanism for authorisation of academy net spend which aligns with the academic year. It was agreed that the benefits of doing this are limited. It would likely require new legislation and possibly a new Parliamentary process and would in part, replicate both Parliamentary control over grant through Estimates and Treasury control over spending through budgets.

Further issues to address

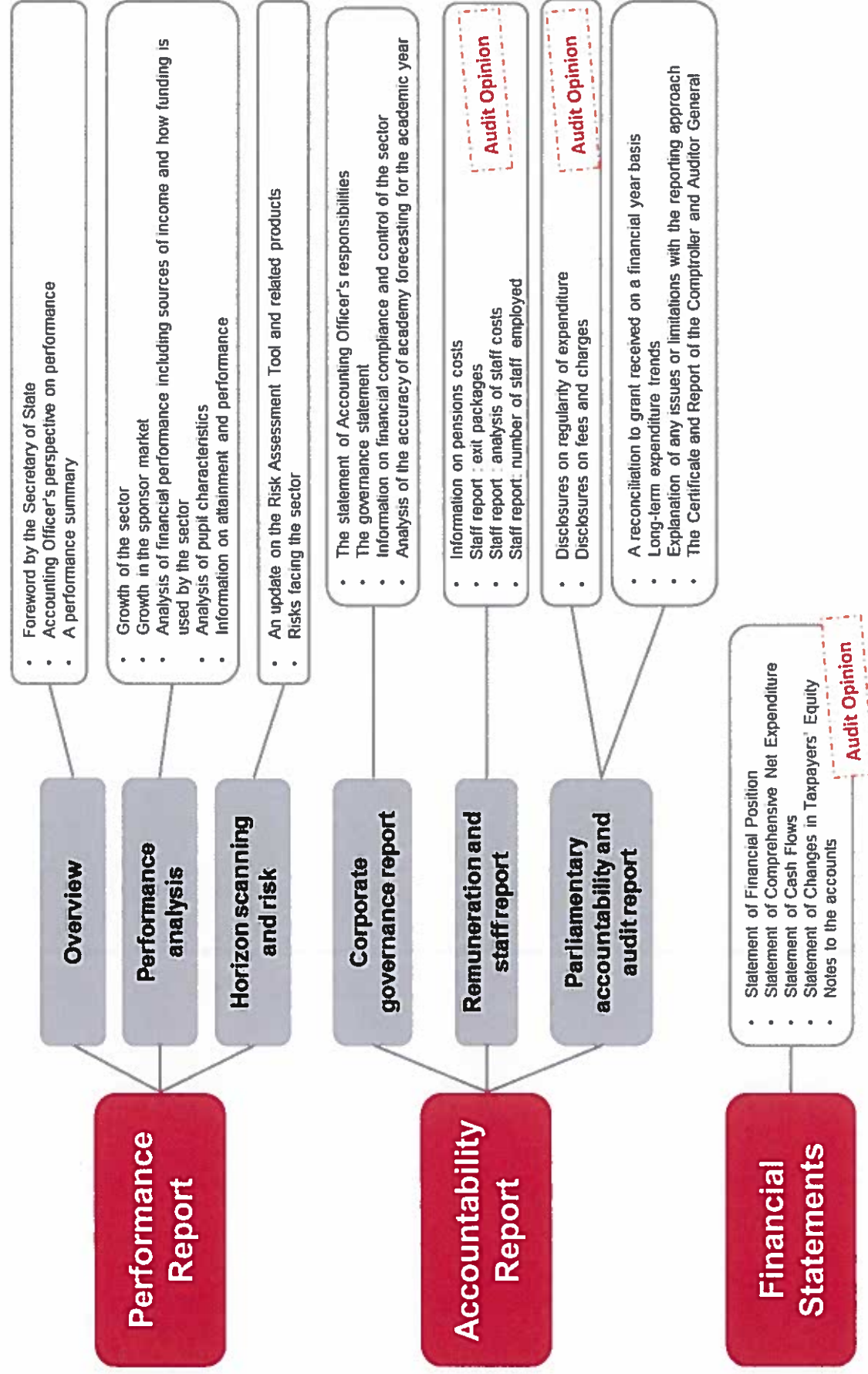
16. The introduction of the sector report does not resolve all reporting issues, in particular relating to Whole of Government Accounts (WGA), but these are being addressed by the DfE.
17. Limited assurance over the recognition of land and buildings has resulted in a qualification in DfE's consolidated accounts in recent years. This ongoing issue is likely to continue to result in a qualification in both the proposed sector report and WGA. The department is continuing to do work to resolve this issue but removing this qualification is unlikely to be immediately achievable under the new approach.
18. The requirement to capture the net expenditure and financial position of ATs for their consolidation within WGA remains. Additional information to support the balance sheet items will be obtained through existing returns from academies and local authorities. A mismatch in counterparty eliminations for the purposes of WGA will continue to be an issue due to the non-coterminous year ends. To ensure the methodology is robust it will be tested through a dry run in 2016 and be subject to review as part of the wider programme of review set out in paragraphs 19-22.

Review arrangements to monitor implementation

19. The new proposals offer improvements to the current arrangements but this will need to be kept under review. Once the size of the sector population stabilises, the accuracy of data and modelling assumptions used to determine academy net expenditure at that time may allow the department to return to arrangements more aligned to CLoS. This assessment will form part of the review considerations. The planned review timetable is set out in **Annex C**.
20. There will be ongoing review and monitoring at an operational level by HM Treasury officials in collaboration with the DfE. The NAO will be invited to provide regular feedback following audit assignments. The ongoing review will assess progress against the DfE project implementation plan and assess outcomes against the requirements stipulated by HM Treasury to improve forecasting, the accuracy of outturn data and WGA compliance.
21. Plans also include the establishment of a governance committee (as a sub-committee of ARC) which would have oversight of all aspects of the new reporting arrangements to ensure the intended benefits are being achieved and to assess whether the reforms continue to be the most appropriate solution. The committee would meet on a quarterly basis (reporting at least annually to ARC) and consist of representatives from the main ARC membership with a recommendation that the NAO attend as an observer
22. Gateway points will be secured within the review timetable linked to the Supply Estimates process from 2017-18 onwards. This will allow reversion to the existing framework if the new arrangements are failing to deliver the desired outcomes. The governance committee will, if it deems this to be the case, make a recommendation to ARC for wider discussion.

Annex B

The proposed contents of the sector report and accounts are summarised below:



Annex C

1. Planned reporting timetable

- a) DfE 2014-15 consolidated annual report and accounts published under existing framework – **January 2016**
- b) Academy sector report and accounts for academic year 1 September 2014 to 31 August 2015 – audited dry run report produced (but not published) by **summer 2016** (subject to timing of audit assignment)
- c) DfE 2015-16 consolidated annual report and accounts published under existing framework – **January 2017**
- d) DfE 2016-17 annual report and accounts published under new arrangements (excluding academies net spending) – **30 June 2017** [year 1 of new arrangements]
- e) Academies sector report and accounts for academic year 1 September 2015 to 31 August 2016 – audited report published by **30 June 2017** [year 1 of new arrangements]
- f) Academies sector report and accounts for academic year 1 September 2016 to 31 August 2017 – audited report published by **31 March 2018** [year 2 of new arrangements]

2. Review timetable

- a) DfE led Design Group and Steering Group meetings held monthly to monitor internal progress against implementation strategy. HM Treasury is a member of both groups and the NAO attends as an observer.
- b) Ongoing operational monitoring of outcomes against key deliverables and objectives by HM Treasury officials with input from the DfE and NAO feedback. Meetings on a monthly basis from January 2016.
- c) A governance committee to be set up with agreed terms of reference. Membership to consist of ARC members with at least one member from HM Treasury and the NAO to attend as an observer. The committee will meet quarterly from March 2016 and link to gateway review points of:
 - mid-April for Main Estimate; and
 - mid-January for Supplementary Estimate.
- d) ARC to meet annually from July 2016 and to consider:
 - in July 2016, the results of the dry run exercise;
 - in July 2016, the results of the year 1 sector report for academic year 2015/16 published in June 2016; and
 - in July 2017, the results of the year 2 sector report for academic year 2016/17 published in March 2017.
- e) The governance committee to call an extraordinary ARC meeting as necessary should a recommendation be made to revert to pre-existing arrangements.