House of Commons
Committee of Public Accounts

Education Funding
Agency and
Department for
Education financial
statements


Report, together with formal minutes, oral and written evidence

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Committee of Public Accounts

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Contents

Report

Summary 3
Conclusions and recommendations 5
1 Improving the collection and use of information 8
2 Improving financial management and governance 12

Formal Minutes 15
Witnesses 16
List of printed written evidence 16
List of Reports from the Committee during the current Parliament 17
Summary

Since it was set up in April 2012, the Education Funding Agency (the Agency) has succeeded in getting money to schools, local authorities, colleges and other education providers on time. It needs to improve efficiency, transparency and accountability in the education sector, especially in respect of the growing number of academies. The Agency needs complete, accurate and timely data, such as on academies’ finances, and needs to be more robust in relation to academies that fail to comply with financial reporting requirements. As the Department for Education (the Department) itself acknowledged, where the Agency does have the data, it needs to be quicker and smarter at spotting risks and intervening quickly in cases of poor financial management and governance in academies, including free schools.

We recognise the scale of the task that the Agency faces as it deals with an expanding workload whilst reducing its costs by 15%. But it is essential that the Agency now gets to grips with effective oversight to improve public confidence in the system. Our recommendations are designed to help it in that task. We also recognise that, by consolidating academies into its accounts, the Department is now providing a more complete picture of spending in the education sector. But the Department is still struggling to solve the problems of reconciling different financial year ends, of clarifying who exactly owns academies’ land and buildings, and of improving the data it receives from academies. Finally, the Agency must be prompt to act in response to any evidence suggesting conflicts of interests, where academy trusts buy goods and services from individuals and organisations connected to their schools.
Conclusions and recommendations

1. The Department for Education created the Education Funding Agency in April 2012 to ensure efficiency, accountability and transparency in the education sector. In 2012-13, the Agency distributed £51 billion of capital and revenue funding for 10 million learners to local authorities, academies, academy trusts, further education institutions, sixth-form colleges and other types of education providers. Since it was established, both the scope and the scale of the Agency’s activities have changed and expanded rapidly: for example, during its first year the number of academies almost doubled to nearly 3,000 and it took on new responsibilities including managing the Youth Contract for 16- to 17-year-olds. Between 2012-13 and 2015-16, the Agency expects that the number of all education providers it funds will increase by around 50% to almost 12,000, of which nearly 7,000 will be academies. At the same time, the Agency plans to reduce its administration costs by 15%. Ensuring proper accountability for public spending with less resources will be a huge challenge and the Department has yet to demonstrate that it can meet its responsibilities for proper accountability.

2. The Agency is accountable to the Department for the funding it distributes and, in turn, the Department is accountable to Parliament for ensuring regularity, propriety and value for money in the work that it and the Agency undertake. In 2012-13, the Department and the Agency consolidated academies into their financial statements for the first time, and laid their annual reports and accounts just prior to the statutory deadline of 31 January 2014. However the Comptroller and Auditor General qualified his opinion on these financial statements on a number of grounds relating to both poor data and inadequate methodology.

3. The Agency lacks the systems and data it needs to provide transparency and accountability, and demonstrate efficiency, in the education sector. We recognise the Agency’s success in moving quickly to distribute funding on time. At the same time, the Agency has had to manage a huge expansion in the number of academies. But the Agency now needs to get to grips with improving the information that is vital to its critical oversight role. The Agency relies on information provided by academies, local authorities and other government bodies on, for example, learner numbers, the size and condition of schools and in some cases their finances. But the Agency has found it difficult to gather complete, consistent and high-quality data. It does not have a clear policy or understanding of what data it needs to collect, and how it will use these to provide Parliament and the public with sufficient transparency over education spending and, in turn, to support proper accountability. It has contributed further to the problem by holding data across a range of different systems and spreadsheets, from which it is challenging to establish a ‘single version of the truth’ and impossible to make sensible comparisons.

Recommendation: The Agency needs a clear information strategy, which specifies the data it needs to collect and use to provide transparency and accountability and improve efficiency in the education sector. It also needs to get systems in place as
quickly as possible to capture data at low cost and without overburdening the sector.

4. The Agency has not yet achieved an acceptable level of compliance with its reporting requirements. The Agency requires some education providers, such as academies, to submit various financial returns and other information in line with funding agreements (a contract between them and the Secretary of State). But a number of providers still do not comply with the conditions of their funding agreements. Between April 2012 and April 2013, there were 411 breaches of funding agreements, of which 339 (82%) related to academy trusts’ failure to submit financial returns on time, including submitting annual accounts. For 2011-12, 13% of academy trusts failed to submit annual reports and accounts by the deadline of 31 December 2012 and for 2012-13 this figure still stood at a worrying 9%. Where academies do not comply with the Agency’s requirements it can issue them with a financial notice to improve, so they lose some financial freedoms and flexibilities or ultimately the Agency can terminate a funding agreement. By March 2014 the Agency had only issued eight financial notices to improve to academies. But the Agency has yet to demonstrate an effective approach to ensuring proper compliance and has yet to show that restricting financial freedoms works as an effective deterrent for non-compliance.

Recommendation: The Department and Agency need to implement an effective joined up strategy for enforcing compliance with funding agreements and consider appropriate incentives and sanctions.

5. The Agency is too reactive and does not spot risks or intervene in schools quickly enough. The Agency’s knowledge of poor financial management or governance in schools does not come from a systematic or forensic analysis of the data it holds in order to identify risks; instead, it relies on broad desk-based reviews that are not sufficiently risk focused. The Agency also relies on whistleblowers, and the work of external auditors of academies. As a result, Agency interventions in at-risk institutions can come too late, as in the case of E-Act Academy Trust. Even when the Agency is presented with data that should trigger concerns and lead to further investigation, the Agency has not always taken action quickly enough, as in the case of Kings Science Academy in Bradford. The Agency accepts that it needs to improve its data analytics and horizon scanning.

Recommendation: The Department and Agency should set out how and when they will develop an analytical capability to spot risks and target their interventions early.

6. The Agency does not know enough about conflicts of interest in academies and the risk they pose to the proper use of public money. We were concerned that individuals with connections to both academy trusts and private companies may have benefited personally or their companies may have benefited from their position when providing trusts with goods and services. The Agency has reviewed 12 cases of related-party transactions, when a conflict of interest could arise; but it is likely that many more exist and have gone unchallenged by the Agency. In line with accounting standards, academy trusts are required to disclose related-party transactions in
audited accounts, but the Agency does not keep a log of such transactions, and is unaware of how many disclosures have been made. The Agency now insists that goods or services provided by individuals or organisations connected to academy trusts, such as trustees, or relatives of trustees, are provided at no more than cost, but it only introduced this rule in November 2013. The Department takes the view that related-party transactions are acceptable. We feel that related-party transactions are always open to accusations of conflicts of interests, even when supposedly on a no profit basis.

Recommendation: The Agency should reconsider its policy which permits related-party transactions. At the very least it must be able to extract and analyse complete information on related party transactions and must then use that analysis to determine risk-based interventions.

7. The Agency has no way of knowing whether academy chief executives and trustees are 'fit-and-proper persons'. In a very devolved system, as in the case of academies, a lot of trust is invested in the organisation, chief executive, principal and trustees for managing public money. It is therefore reasonable to expect that these people are properly vetted. The Department has a process to vet those planning to open free schools; however, it told us that it does not have a fit-and-proper persons test for vetting those appointed as academy trustees or chief executives. At Kings Science Academy, the Agency did not even know who the chair of trustees was.

Recommendation: The Department should introduce, at individual academy and academy trust level, a fit-and-proper persons test.

8. There are flaws in the methodology used to consolidate the accounts of academies, as well as data quality issues, which undermine accountability. In 2012-13 the Department and the Agency consolidated academies into their financial statements for the first time, and the C&AG qualified his opinion on a number of grounds, relating to methodology and poor data. Of four qualifications, the Department accepts that two will be difficult to rectify. First, the Department has to consolidate academies’ September-to-August accounts into its own April-to-March account, which involves making adjustments that carry risks. The Department intends to discuss what to do about this with HM Treasury and the National Audit Office. Second, the Department knew what land and buildings were used by academies, but did not always know who owned them. The Department predicts that it would cost £30 million to collate the necessary data on land and buildings and a further £8 million a year to keep these data up to date.

Recommendation: The Department should set out how and when they will address the causes of each of the qualifications of the C&AG’s opinion, particularly those relating to issues of methodology or poor data quality.
1 Improving the collection and use of information

1. On the basis of Reports by the Comptroller and Auditor General, we took evidence from the Department for Education (the Department) and the Education Funding Agency (the Agency) on the performance and capability of the Agency and on the Department’s 2012-13 financial statements.¹

2. The Agency provides funding for educating over 10 million learners aged between 3 and 19, or from birth to 25 for those with learning difficulties and disabilities. In 2012-13, the Agency distributed £51 billion of capital and revenue funding to local authorities, academies, further education institutions, sixth-form colleges and other types of education providers. It also managed capital building and maintenance programmes for local authority maintained schools, academies and sixth-form colleges. The Agency is responsible for ensuring that funds are used properly, through financial assurance undertaken by itself, or by others.²

3. The Department set up the Agency on 1 April 2012 and, since it was established, the scale and scope of the Agency’s activities have both grown. During its first year, the number of academies almost doubled to nearly 3,000 and it took on new responsibilities including managing the Youth Contract for 16- to 17-year-olds. Between 2012-13 and 2015-16, the Agency expects that the number of all education providers it funds will increase by a further 50% to almost 12,000, of which nearly 7,000 will be academies. At the same time, the Agency plans to reduce its administration costs by 15%.³

4. In 2012-13, the Department and Agency consolidated academies into their group financial statements for the first time, and laid their accounts just prior to the statutory deadline of 31 January 2014. The C&AG qualified his opinion of these accounts on a number of grounds, which related to the methodology used for consolidating the accounts and issues around the quality and timeliness of data.⁴

5. We recognised that the Agency has successfully distributed funding on time and accurately.⁵ The Agency has also reported that changes to specifications and more standardisation of school designs has meant that the cost of new school buildings has fallen, on average, by 40% and that the procurement process for building schools is now quicker than it used to be.⁶ Given the Agency’s responsibility for distributing £51 billion of public money, however, we were concerned as to whether this money was being spent properly, especially as the number of academies continues to increase.⁷

² C&AG’s Report paragraphs 1, 2 and 6
³ C&AG’s Report paragraphs 2, 1.5, 2.4 and 2.8
⁴ C&AG’s Report paragraphs 1.26 and 1.28; Department for Education, Consolidated Annual Report and Accounts
⁵ Qq 7, 9; C&AG’s Report Figure 5
⁶ Qq 6, 7; C&AG’s Report paragraph 1.17
⁷ Qq 7, 125, 177
set up the Agency to provide better accountability and transparency, and improve efficiency, in the education sector. We repeatedly asked the Agency whether it had achieved this in practice. Although the Agency explained to us how it had improved its own administrative efficiency and how it had reformed the funding system to make it clearer, it was not able to provide us with a clear picture of how it had improved accountability and transparency over the £51 billion distributed. We challenged the Agency and Department on whether this was due to a lack of good quality information and systems.

6. The Agency’s data, such as on learners, the size and condition of schools and in some cases on providers’ finances and governance comes from many different sources including academies and other education providers, local authorities and other government bodies. The Agency holds the data across various systems and spreadsheets, so it has found it challenging to establish a 'single version of the truth'. We were also concerned that the Agency did not have the capacity to collect and analyse data, especially as it has faced challenges in recruiting people with the right skills in the past.

7. We recognised that the Department and Agency were “on a journey” to improve the quality and timeliness of their data. But the Department agreed with us that their information was not as it should be, and said that it was aiming to improve it. So far, the Agency had produced a draft data plan, but this had not been published. The Department also told us that it was publishing more financial information about academies than in the past.

8. Every academy has a funding agreement, which is a contract between the academy trust and the Secretary of State for Education. This agreement sets out funding arrangements, the obligations of both parties, including the requirement for academies to submit various financial returns and other information on time and the conditions under which the agreement could be terminated. In 2012-13 there were 411 breaches of funding agreements, of which 339 (82%) related to a failure to submit financial returns on time, including annual accounts. Academies are required to submit audited annual accounts to the Agency by 31 December each year, yet 13% of academy trusts did not submit their accounts on time for 2011-12, and this figure improved but still stood at a worrying 9% in 2012-13. The Agency told us that it was not happy with this performance, but that it was improving.

9. We were concerned about how the Agency dealt with academies that did not have a good track record of complying with data requests. The Agency told us that its main penalty for non-compliance was to issue a financial notice to improve, when some financial
freedoms and flexibilities were taken away from an academy. The Agency also told us that it was planning to write to 22 academies that had been late in submitting their accounts to the Agency, to warn them that they may receive such a notice.\textsuperscript{16} By the end of March 2014 the Agency had issued eight financial notices to improve to academies.\textsuperscript{17} When we asked the Agency what other sanctions it has, it told us that it seeks to recover funds from academies when they have been spent for purposes other than that for which they were intended. Ultimately, the Agency can appoint additional governors, or terminate a funding agreement as it had done with the Discovery New School, a free school in West Sussex.\textsuperscript{18}

10. The Agency also told us about its role in enforcing charity law in respect of academies, although it cannot itself take regulatory action against individuals. The Agency told us that if it considered that an academy trustee should be disqualified, it would need to liaise with the Charity Commission, but it has not yet done so.\textsuperscript{19} The Agency can also make a referral to the conduct council at the National College of Teaching and Leadership, which it told us it has done on at least one occasion. In five serious cases in the last two years, it has referred a matter to the Police.\textsuperscript{20}

11. We were concerned that the Agency relied on desk-based reviews to identify risks in local education providers in a timely fashion and whether, without additional local intelligence, that this was sufficient to identify all issues.\textsuperscript{21} The Agency told us that it collected information on pupil numbers and academies’ budget forecasts, which meant that it was aware of academies that were in, or at risk of being in, financial deficit.\textsuperscript{22} The information it collects on academies also helps the Agency to identify other issues of concern, and it compiles a list of academies of national concern each month which it shares with the Department and Ministers. The Department told us that there were currently 37 academies or academy trusts on the list, as concerns can be at a school or trust level, and wrote to us after the hearing to say that 98 institutions had appeared on the list at some point since October 2012.\textsuperscript{23}

12. Although the Agency had started to develop its data analytics, it had made slow progress updating its information and systems. We therefore questioned the value and effectiveness of the Agency’s current analysis if the data it is interrogating is of poor quality.\textsuperscript{24} Due to a lack of ‘horizon scanning’, the Agency had been vulnerable to missing risks during the first 18 months of its operations and not just those related to its oversight of academies. For example, it had missed the risk of receiving inconsistent data from local authorities as part of the Property Data Survey Programme, through which it planned to collect data on the condition of around 23,000 schools by October 2013, to support future

\textsuperscript{16} Q 27, 42, 88, 92-93, 158; C&AG’s Report paragraph 1.25
\textsuperscript{17} Note from Department to Committee dated 8 April 2014
\textsuperscript{18} Q 27, 87, 90, 177-178
\textsuperscript{19} Q 13, 15, 94-96, 100-104, 107
\textsuperscript{20} Q 52-54, 97-99, 177
\textsuperscript{21} Q 16, 65, 81-82
\textsuperscript{22} Q 16, 27, 73
\textsuperscript{23} Q 38; C&AG’s Report paragraph 1.25; Note from Department to Committee dated 8 April 2014
\textsuperscript{24} Q 84; C&AG’s Report paragraph 2.31
capital spending decisions. The Department accepted that its ability to horizon scan was something that it was looking to improve in future years.\textsuperscript{25}

13. The Agency has relied on whistleblowers to raise concerns and we asked the Agency about its systems for protecting and encouraging them. The Agency told us that it provided staff training, and publicises whistleblowing arrangements on its website.\textsuperscript{26} The Agency said that it also insists that all academies have whistleblowing arrangements in place; however, the \textit{Academies Financial Handbook} suggests that this is recommended best practice rather than a mandatory requirement.\textsuperscript{27} The Agency assured us that it takes whistleblowing seriously and that information from whistleblowers has led to investigations, although these may also have been triggered by information reported in academies’ financial statements. The Agency has published the results of six investigations to date.\textsuperscript{28}

14. The Agency also placed considerable assurance on the work of over 200 external auditors of academy trusts. It told us that it does not have a role in choosing these auditors, but assured us that these auditors must be licensed practitioners and were responsible to the Agency for providing an opinion on the regularity of expenditure.\textsuperscript{29} The Agency told us that auditors should not be connected to academy trusts through personal or professional relationships. It later confirmed to us in a note that auditors were bound by the ethical standards produced by the Financial Reporting Council, covering any financial, business, employment and personal relationships with academy trusts.\textsuperscript{30} Relying heavily on audited accounts makes it more difficult to intervene early on issues of concern developing in a particular school or a particular trust. Even when the Agency receives information, such as from whistleblowers, that should trigger action it does not always investigate or publish the results of investigations quickly enough, such as in the case of Kings Science Academy. The Agency told us that it was aiming to speed up its investigation processes, and highlighted that it had concluded its recent investigation of Barnfield College more quickly than in the past. However, it also stressed that publishing reports on investigations can be delayed at the request of the police. After the hearing the Agency told us that it had published five investigation reports, of which the police had requested a delay in publication in two instances.\textsuperscript{31}

\ \textsuperscript{25} Q 37; C&AG’s Report paragraph 1.18, 2.17
\textsuperscript{26} Qq 65, 69; C&AG’s Report paragraph 1.25
\textsuperscript{28} Q 27, 69
\textsuperscript{29} Qq 28, 81-82, 124-126; C&AG’s Report paragraph 1.24
\textsuperscript{30} Qq 127-129; Note from Department to Committee dated 8 April 2014
\textsuperscript{31} Qq 51, 52, 107, 180; Note from Department to Committee dated 8 April 2014
2 Improving financial management and governance

15. We were very concerned about trustees and others connected to academies potentially benefiting personally from contracts with schools to supply goods and services.\(^{32}\) The Agency told us that it had improved its guidance on this over the last two or three years, which is in the *Academies Financial Handbook*. The Agency requires academies to declare related-party transactions, and to ensure that goods or services are provided by individuals or organisations connected to the trust at cost but it does not prohibit related-party transactions.\(^{33}\) The Agency told us that it introduced the no-profit requirement on such transactions in November 2013. We will be seeking reassurance that this will not merely lead to suppliers increasing costs artificially to compensate for any loss of profit.\(^{34}\)

16. The Agency considered that there can be good reasons for connected parties wanting to get involved with providing goods and services to local schools. To guard against conflicts the Agency requires that a school uses a competitive process for procuring goods and services, and excludes individuals with potential conflicts of interest from decisions relating to procurement.\(^{35}\)

17. We asked the Department how it collects information on any related party-transactions, which could lead to a conflict of interest, and what it does with this information. In line with accounting standards, academy trusts are required to disclose related-party transactions in audited accounts and the Agency told us that it reviews the accounts for such transactions.\(^{36}\) It had identified 12 academy trusts with significant related-party transactions that it wanted to explore further. The Agency told us that it does not keep a log of related-party transactions, and it could not tell us the number of such transactions disclosed in the 1,400 sets of accounts that it received in 2011-12.\(^{37}\)

18. We questioned the Agency’s capacity to spot related-party transactions given that it is dealing with so many education institutions. We were concerned that the Agency might not know the true extent of related-party transactions in all education providers—even if it implements sophisticated monitoring arrangements—in the same way that the accountability system in local authority settings might identify these transactions.\(^{38}\) The Department told us that much of the responsibility for spotting related-party transactions falls on academies’ auditors. It also told us that it was working with academy auditors to ensure that they meet the standards required by the Department.\(^{39}\) In response to our

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\(^{32}\) Qq 33, 39, 44, 58-59, 63, 65, 133

\(^{33}\) Q 16, 33; C&AG’s Report paragraph 1.23

\(^{34}\) Q 61, 63, 113

\(^{35}\) Q 63, 115; Note from Department to Committee dated 8 April 2014

\(^{36}\) Qq 33, 63, 107, 114, 118

\(^{37}\) Qq 33-34, 107, 109-112, 120, 167, 169, 172, 174, 177

\(^{38}\) Q 44

\(^{39}\) Q 55
concerns, the Department agreed that it needs to reflect on the issue of related party transactions and consider stronger action.\textsuperscript{40}

19. The highly devolved academy system invests a lot of trust and public funding in academy trusts and their trustees and chief executives and we asked the Agency whether it carries out fit and proper persons tests.\textsuperscript{41} The Agency told us that it had a process to vet individuals in groups seeking to establish free schools, but that it did not have an equivalent test for individuals appointed as academy trustees, or as academy chief executives. At Kings Science Academy, for example, the Agency was not aware who the chair of the trustees was, despite the Academies Financial Handbook requiring academy trusts to notify the Agency of key staff and changes to staff, including the chair of trustees, principal finance officer, and chief executive or principal.\textsuperscript{42} We asked that the Department report back to us on whether it planned to carry out fit-and-proper persons tests.\textsuperscript{43}

20. In 2012-13 the Department and the Agency consolidated academies into their financial statements for the first time, and the C&AG qualified his opinion on the Department’s financial statement on a number of grounds.\textsuperscript{44} The consolidation had been a complex exercise that had presented the Agency with a number of problems. Academy trusts have different year-ends and different accounting frameworks to the Agency, which meant the Agency had to make adjustments on consolidation. The Agency had also received poor quality data from academies, which had resulted in a significant level of corrections and missing or late returns.\textsuperscript{45} We pressed the Department on how soon it could remove the C&AG’s qualifications on his opinion. Of the four qualifications, the Department told us that it expects to have rectified two of these by next year. However, it considers that the qualifications relating to different year-ends and ownership of academies’ land and buildings will be more difficult to remove.\textsuperscript{46}

21. On the C&AG’s qualification relating to different year-ends, the Department told us that it made perfect sense for a school to produce its own accounts on an academic-year basis to 31 August, as a school sets it budgets, recruits its staff and receives funding based on the academic year. The Department explained that this had caused it problems when consolidating academies’ accounts into its own financial year account ending on 31 March. However, the Department considered that, for academy accounts to be of most use at local level, they should continue to be produced on an academic year basis.\textsuperscript{47} The Department told us that it was in discussion with both HM Treasury and the National Audit Office about what it could do to resolve the problems of making adjustments that carry a risk of

\textsuperscript{40} Qq 67-68, 174 \\
\textsuperscript{41} Q 121-123 \\
\textsuperscript{42} Q 167-168, 172 \\
\textsuperscript{43} Qq 123-124, 134 \\
\textsuperscript{44} Department for Education, Consolidated Annual Report and Accounts \\
\textsuperscript{45} Q 17; C&AG’s Report paragraph 1.26 \\
\textsuperscript{46} Qq 140-141 \\
\textsuperscript{47} Qq 84-86, 141
qualification. The Department questioned whether the current approach was the most helpful way of presenting information to Parliament and others.48

22. The Department acknowledged that the qualification on land and building recognition would also be very difficult to address. It had a clear idea of the land and buildings used by academies, but it did not have a clear picture of who owned the land and buildings, particularly for ex-voluntary aided schools, many of which were historical buildings.49 As a result, the Department could not demonstrate which land and buildings used by academies should be included on its balance sheet. The Department estimated that it would cost £30 million to collate data on land and buildings and a further £8 million a year to keep the data up to date and it was not convinced that this would represent value for money.50
Draft Report (Education Funding Agency and Department for Education 2012-13 financial statements), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 22 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Sixty-first Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Thursday 5 June at 9.45 am]
Witnesses

Wednesday 5 March 2014

The following witnesses gave evidence. Transcripts can be viewed on the Committee’s inquiry page at http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/inquiries/parliament-2010/education-funding-agency-department-for-education-accounts/?type=Oral#pnlPublicationFilter.

Chris Wormald, Permanent Secretary, Department for Education, Peter Lauener, Chief Executive Officer, Education Funding Agency, and Simon Parkes, Chief Financial Officer, Education Funding Agency

List of printed written evidence

The following written evidence was received and can be viewed on the Committee’s inquiry web page at http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/inquiries/parliament-2010/education-funding-agency-department-for-education-accounts/?type=Oral#pnlPublicationFilter. INQ numbers are generated by the evidence processing system and so may not be complete.

1. Department for Education
2. Department for Education and Education Funding Agency
# List of Reports from the Committee during the current Parliament

The reference number of the Government’s response to each Report is printed in brackets after the HC printing number.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Second Report</td>
<td>Early Action: landscape review</td>
<td>HC 133</td>
<td></td>
</tr>
<tr>
<td>Third Report</td>
<td>Department for Communities and Local Government: Financial sustainability of local authorities</td>
<td>HC 134</td>
<td></td>
</tr>
<tr>
<td>Fourth Report</td>
<td>HM Revenue &amp; Customs: tax credits error and fraud</td>
<td>HC 135</td>
<td></td>
</tr>
<tr>
<td>Fifth Report</td>
<td>Department for Work and Pensions: Responding to change in jobcentres</td>
<td>HC 136</td>
<td></td>
</tr>
<tr>
<td>Sixth Report</td>
<td>Cabinet Office: Improving government procurement and the impact of government’s ICT savings initiative</td>
<td>HC 137</td>
<td></td>
</tr>
<tr>
<td>Seventh Report</td>
<td>Charity Commission: the Cup Trust and tax avoidance</td>
<td>HC 138</td>
<td></td>
</tr>
<tr>
<td>Eighth Report</td>
<td>Regulating Consumer Credit</td>
<td>HC 165</td>
<td></td>
</tr>
<tr>
<td>Ninth Report</td>
<td>Tax Avoidance—Google</td>
<td>HC 112</td>
<td></td>
</tr>
<tr>
<td>Tenth Report</td>
<td>Serious Fraud Office—redundancy and severance arrangements</td>
<td>HC 360</td>
<td></td>
</tr>
<tr>
<td>Eleventh Report</td>
<td>Department of Health: managing hospital consultants</td>
<td>HC 358</td>
<td></td>
</tr>
<tr>
<td>Twelfth Report</td>
<td>Department for Education: Capital funding for new school places</td>
<td>HC 359</td>
<td></td>
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<td>Thirteenth Report</td>
<td>Civil Service Reform</td>
<td>HC 473</td>
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<td>Fourteenth Report</td>
<td>Integration across government and Whole-Place Community Budgets</td>
<td>HC 472</td>
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<td>Fifteenth Report</td>
<td>The provision of the out-of-hours GP service in Cornwall</td>
<td>HC 471</td>
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<td>Sixteenth Report</td>
<td>FiRe Control</td>
<td>HC 110</td>
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<td>Seventeenth Report</td>
<td>Administering the Equitable Life Payment Scheme</td>
<td>HC 111</td>
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<td>Eighteenth Report</td>
<td>Carrier Strike: the 2012 reversion decision</td>
<td>HC 113</td>
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<td>Nineteenth Report</td>
<td>The dismantled National Programme for IT in the NHS</td>
<td>HC 294</td>
<td></td>
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<td>Twentieth Report</td>
<td>The BBC’s move to Salford</td>
<td>HC 293</td>
<td></td>
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<tr>
<td>Twenty-first Report</td>
<td>Police Procurement</td>
<td>HC 115</td>
<td></td>
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<td>Twenty-second Report</td>
<td>High Speed 2: a review of early programme preparation</td>
<td>HC 478</td>
<td></td>
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<td>Twenty-third Report</td>
<td>HM Revenue &amp; Customs: Progress in tackling tobacco smuggling</td>
<td>HC 297</td>
<td></td>
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<td>Twenty-fourth Report</td>
<td>The rural broadband programme</td>
<td>HC 474</td>
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<td>Twenty-fifth Report</td>
<td>The Duchy of Cornwall</td>
<td>HC 475</td>
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<td>Twenty-sixth Report</td>
<td>Progress in delivering the Thameslink programme</td>
<td>HC 296</td>
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<td>Twenty-seventh Report</td>
<td>Charges for customer telephone lines</td>
<td>HC 617</td>
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<td>Twenty-eighth Report</td>
<td>The fight against Malaria</td>
<td>HC 618</td>
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<td>The New Homes Bonus</td>
<td>HC 114</td>
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<td>Thirtieth</td>
<td>Universal Credit: early progress</td>
<td>HC 619</td>
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<td>Thirty-first</td>
<td>The Border Force: securing the border</td>
<td>HC 663</td>
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<td>Thirty-second</td>
<td>Whole of Government Accounts 2011–12</td>
<td>HC 667</td>
<td></td>
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<td>Thirty-third</td>
<td>BBC severance payments</td>
<td>HC 476</td>
<td></td>
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<td>Thirty-fifth</td>
<td>Access to clinical trial information and the Stockpiling of Tamiflu</td>
<td>HC 295</td>
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<td>Thirty-six</td>
<td>Confidentiality clauses and special severance payments</td>
<td>HC 477</td>
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<td>Thirty-seventh</td>
<td>Supporting UK exporters overseas</td>
<td>HC 709</td>
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<td>Thirty-eighth</td>
<td>Improving access to finance from small and medium-sized enterprises</td>
<td>HC 775</td>
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<td>Thirty-ninth</td>
<td>The Sovereign Grant</td>
<td>HC 665</td>
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<td>Forty-first</td>
<td>Maternity Services in England</td>
<td>HC 776</td>
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<td>Gift Aid and other reliefs on charitable donations</td>
<td>HC 835</td>
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<td>The Charity Commission</td>
<td>HC 792</td>
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<td>Forty-fourth</td>
<td>Progress at Sellafield</td>
<td>HC 708</td>
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<td>Forty-fifth</td>
<td>Student loan repayments</td>
<td>HC 886</td>
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<td>Forty-sixth</td>
<td>Excess votes 2012–13</td>
<td>HC 1068</td>
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<td>Forty-seventh</td>
<td>Emergency admissions to hospital</td>
<td>HC 885</td>
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<td>Contracting out public services to the private sector</td>
<td>HC 777</td>
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<td>Forty-ninth</td>
<td>Department for Communities and Local Government: Council Tax support</td>
<td>HC 943</td>
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<td>Fifty-first</td>
<td>The rural broadband programme</td>
<td>HC 834</td>
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<td>Programmes to help families facing multiple challenges</td>
<td>HC 668</td>
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<td>Fifty-third</td>
<td>BBC Digital Media Initiative</td>
<td>HC 985</td>
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<td>Ministry of Justice and National Offender Management Service: Managing the</td>
<td>HC 1001</td>
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<td>COMPASS: Provision of asylum accommodation</td>
<td>HC 1000</td>
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<td>Fifty-sixth</td>
<td>NHS waiting times for elective care in England</td>
<td>HC 1002</td>
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<td>Fifty-seventh</td>
<td>Establishing Free Schools</td>
<td>HC 941</td>
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<td>The Ministry of Defence Equipment Plan 2013-23 and Major Projects Report 2013</td>
<td>HC 1060</td>
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<td>Fifty-eighth</td>
<td>Probation: landscape review</td>
<td>HC 1114</td>
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<td>The Criminal Justice System</td>
<td>HC 1115</td>
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<td>Promoting economic growth locally</td>
<td>HC 1110</td>
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