

S.R. 2001/4
SCOTTISH BORDERS COUNCIL
EDUCATION DEPARTMENT
OVERSPEND

OCTOBER 2001

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**A REPORT BY THE CONTROLLER OF AUDIT TO THE ACCOUNTS COMMISSION
UNDER SECTION 102(2) OF THE LOCAL GOVERNMENT (SCOTLAND) ACT 1973**

**SCOTTISH BORDERS COUNCIL
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1. INTRODUCTION

- 1.1 The audited accounts of Scottish Borders Council for the 1999/2000 financial year were published in September 2000 and showed an overspend on education services of £1.6 million. In their report on that year's audit, the Council's appointed auditors (KPMG) referred to the Council's budget monitoring arrangements and questioned the accuracy and completeness of information presented to the Education Committee during the year.
- 1.2 The Council's 2000/01 accounts were prepared in June 2001 and show expenditure on education services of £62.9 million. The initial budget for that year was £59 million and, consequently, the cumulative overspend in 2000/01 was £3.9 million, or nearly 7% of that year's budget. An overspend of this magnitude, against the background of a significant overspend in the previous year, raises concerns regarding the management of a significant element of the Council's finances, with potential implications for the stewardship of public funds and levels of local taxation.
- 1.3 Having considered this matter and in view of the public interest, I have decided to make a report to the Accounts Commission, under section 102(2) of the Local Government (Scotland) Act 1973, in order that this can be considered by the Commission and by the Council. The primary purpose of my report is to provide an independent view on the situation which has emerged at Scottish Borders Council in terms of the financial management of its education services. This includes an assessment of how the overspend has arisen and the measures which are being taken to correct it. The performance of the service in educational terms and the impact on education services of action taken or proposed by the Council to address the overspend are outwith the scope of this report.

- 1.4 The audit of the Council's 2000/01 accounts is ongoing and, in due course, the appointed auditors will report to the Council and to me, in accordance with the established annual audit reporting process. I have compiled this report mainly from information received from the Council's appointed auditors who provided me with a report and supplementary information in August 2001, the factual accuracy of which has been agreed between the auditors and Council officers. A list of people whom the appointed auditors interviewed is contained in Appendix A. I have also undertaken further enquiries, examined documents relating to this matter and discussed my findings with the Council's Acting Chief Executive and other senior officers.
- 1.5 The remainder of my report is in five sections. Section 2 (page 2; findings page 4) provides background information about the Council's finances and provides the context for the overspend on education services. Section 3 (page 5; findings page 13) identifies the main reasons for the 2000/01 overspend. Section 4 (page 13; findings page 19) considers the respective responsibilities for financial management and highlights weaknesses which resulted in the breakdown in budgetary control and the failure to act when the possibility of overspending emerged. Section 5 (page 20; findings page 23) considers the steps taken by the Council in 2000/01 and 2001/02 in response to the overspending. In Section 6 (page 24) I draw on the findings from the earlier sections of the report to form my overall conclusions.
- 1.6 I wish to place on record my appreciation of the assistance I have received from the appointed auditors and the Council in the compilation of my report.

2. BACKGROUND

Overall financial position

- 2.1 The overspend on education services needs to be viewed in the context of the Council's general fund since expenditure on all services (other than council housing) is met from this source. Budgeted expenditure in 2000/01 was set initially at £59 million, representing 43% of the total general fund budget of £136 million.
- 2.2 In recent years, the Council has embarked on a planned utilisation of the balance on its general fund. The 1999/2000 accounts show a planned reduction of £5.1 million. In the event, the overall deficit for that year was £6.3 million leading to a reduction in the general fund balance

from £10.3 million at 31 March 1999 to £4 million at 31 March 2000, which represent 7.6% and 2.8% of the net cost of council services respectively. The position across all Scottish councils at 31 March 2000 was 2.7%.

- 2.3 The 2000/01 accounts (unaudited) show that the Council planned a further reduction in that year of £1.1 million and therefore anticipated a balance of £2.9 million at 31 March 2001 (assuming that expenditure during 2000/01 was in line with budget). In the event, however, service expenditure exceeded the after year-end adjusted budget for 2000/01 by £2.9 million (of which £2.7 million related to education services). The balance on the general fund would therefore have been eliminated in 2000/01 but for the effect of surpluses on trading activities, lower than expected interest charges and appropriations from other reserves. Once these are taken into account the overall deficit for the year was £1.8 million, leading to a general fund balance of £2.2 million at 31 March 2001 (unaudited), which represents 1.5% of the net cost of Council services in that year.

Spending on education services

- 2.4 The Council is the local education authority and provides pre-school, school and other education related services throughout the Scottish Borders area to over 16,500 children at nine secondary schools, 71 primary schools and 47 nursery classes. The service is provided by over 2,100 staff directly employed in the education service.
- 2.5 The Education Department is managed by the Director of Education (since 1 August 2001 the post has been retitled Director of Lifelong Learning), with four Assistant Director of Education posts, three of which have both strategic and area-based responsibilities for education services. The fourth post carries responsibility for finance and administration.
- 2.6 Expenditure on education is the largest single element of the Council's overall expenditure. Exhibit 1 shows expenditure on education services compared with the budget for each of the previous three years.

Exhibit 1: Budget and actual expenditure on education services 1998/99 – 2000/01

	Budget expenditure	Actual expenditure	Overspend	Overspend
	£'000	£'000	£'000	%
1998/99	56,693	56,669	-	-
1999/2000	58,577	60,207	1,630	2.8%
2000/01 (unaudited)	58,993 ¹	62,890	3,897	6.6%

¹ Under the Devolved School Management scheme, a post year end adjustment was applied to increase the 2000/01 budget to £60.179 million, producing an overspend of £2.711 million (see section 3).

Findings

2.7 The main findings from this section of my report are:

- Against a background of planned reductions in the balance on its general fund, the Council has reported significant overspending on education services in 2000/01. Without offsetting amounts and appropriations from reserves, the balance on the general fund would have been eliminated in 2000/01.
- The balance on the general fund at the end of 1998/99 represented 7.6% of the net cost of services. The equivalent figures for 1999/2000 and 2000/01 (unaudited) are 2.8% and 1.5% respectively. Unless action is taken to control the education budget the Council may face an overall deficit on its general fund, with potential implications for council tax levels.

3. EDUCATION DEPARTMENT: BUDGETARY PERFORMANCE

Introduction

- 3.1 The 1999/2000 education budget was overspent by £1.6 million. Under the flexibility allowed within the Devolved School Management (DSM) scheme operated by the Council, £1.2 million of this was deemed to be early utilisation of the 2000/01 budget. In accordance with the scheme rules this expenditure was to be deducted from the budget for 2000/01. (The DSM arrangements are considered more fully at paragraph 3.13).
- 3.2 During the year to 31 March 2000, the overspend was neither identified nor reported to the Education Committee; the February 2000 monitoring report projected an overspend of only £11,000. In reporting on the 1999/2000 financial year, the Council's appointed auditors questioned the accuracy and completeness of information being presented to the Education Committee during that year and recommended that steps be taken to review the position. The Council responded by stating that more rigorous checks had been put in place.
- 3.3 The deduction of £1.2 million from the 2000/01 budget was not addressed until November 2000, following consideration by the Policy and Resources Committee of the 1999/2000 accounts and appointed auditors' report. Consequently, the August and November 2000 revenue monitoring statements provided to the Education Committee both projected overspends of less than £300,000. The revenue monitoring statement presented to the Education Committee in January 2001, which was the first to incorporate the implications of the £1.2 million adjustment from the previous year, projected an overspend of £1.6 million. By March 2001, the reported projected overspend was £1.9 million.
- 3.4 Only on completion of the draft accounts for 2000/01 in May 2001 did it become apparent that the overspend was significantly in excess of that reported to the Education Committee in March 2001. At this point, the final outturn for 2000/01 was £62.9 million, an overspend of £3.9 million against the original £59 million budget for the year.

2000/01 overspend

- 3.5 As noted earlier, the Devolved School Management (DSM) scheme allows a degree of flexibility in spending between financial years. Under this arrangement, of the total expenditure

on education services in 2000/01 of £62.9 million, £1.1 million has been deemed by the Council to be early utilisation of the 2001/02 budget. The effect of this is to increase the original budget for 2000/01 from £59 million to £60.1 million and to reduce the budget for 2001/02 by a corresponding amount (effectively ‘repaying’ the general fund in 2001/02 for the overspend in 2000/01).

- 3.6 Exhibit 2 is a detailed analysis of net expenditure (£62.9 million) in 2000/01 compared with the revised budget for the year (£60.1 million).

Exhibit 2: Analysis of net expenditure 2000/01

	<u>Income</u>			<u>Expenditure</u>			<u>Net Expenditure</u>		
	<i>Budget</i> £'000	<i>Actual</i> £'000	<i>Variance</i> £'000	<i>Budget</i> £'000	<i>Actual</i> £'000	<i>Variance</i> £'000	<i>Budget</i> £'000	<i>Actual</i> £'000	<i>Variance</i> £'000
Nursery	2,895	2,400	(495)	3,085	2,979	106	190	579	(389)
Primary	2,240	2,299	59	20,008	20,364	(356)	17,768	18,065	(297)
Secondary	1,495	1,585	90	22,246	22,372	(126)	20,751	20,787	(36)
Special Needs	622	546	(76)	4,743	5,407	(664)	4,121	4,861	(740)
Curriculum Development	552	463	(89)	2,961	3,016	(55)	2,409	2,553	(144)
Transport	-	-	-	2,657	2,890	(233)	2,657	2,890	(233)
School Meals	1,135	1,056	(79)	1,689	1,907	(218)	554	851	(297)
Community Education	96	105	9	1,286	1,288	(2)	1,190	1,183	7
Administration	-	-	-	2,571	3,174	(603)	2,571	3,174	(603)
Capital Charges	36	-	(36)	6,928	6,872	56	6,892	6,872	20
Other ¹	437	389	(48)	1,513	1,464	49	1,076	1,075	1
	9,508	8,843	(665)	69,687	71,733	(2,046)	60,179	62,890	(2,711)

¹ Other includes libraries, bursaries, adult education, careers advice etc

- 3.7 Exhibit 2 indicates that the overspend of £2.7 million against the revised budget for the year of £60.1 million occurred across a number of budget heads. The remainder of this section considers the main variances and their reasons in detail as follows: nursery services

(paragraphs 3.8 – 3.11), primary and secondary education (paragraphs 3.12 – 3.21), special needs education (paragraphs 3.22 – 3.25), transport (paragraphs 3.26 – 3.27), school meals (paragraphs 3.28 – 3.32) and administration (paragraphs 3.33 – 3.34).

Reasons for overspend

Nursery services

- 3.8 Budgetary provision for Nursery services is based on estimates of the number of pupils expected to attend classes and other factors. The appointed auditors have been provided with different explanations for the budget variance in 2000/01. However, it appears that the Education Department overestimated the number of pupils and over-committed on nursery building projects. As a consequence, the budget was overspent by £389,000 in 2000/01.
- 3.9 In considering the reasons for this, the appointed auditors have indicated that the administration of nursery services was conducted throughout the Education Department, as opposed to the dedicated Nursery section and, as a result, responsibilities for enrolment, grant claims, income monitoring and administration were fragmented.
- 3.10 The first indication of an overspend in Nursery services was in March 2001 when the Assistant Director of Education (finance and administration) highlighted an under-recovery of income (shortfall in grant) of £381,000 offset by an underspend in expenditure of £285,000, resulting in a net overspend of £96,000.
- 3.11 Until that point the Assistant Director of Education (services to young people), who has overall responsibility for Nursery services, had no reason to believe that the Nursery budget was overspent. He advised the appointed auditors that he enquired regularly, but was assured by the Assistant Director of Education (finance and administration) that all was in order.

Primary and secondary education

- 3.12 The principal reasons for overspending on primary and secondary education relate to the budget for teaching staff costs under the Devolved School Management (DSM) arrangements (paragraphs 3.13 – 3.18) and to the National Grid for Learning computers programme (paragraphs 3.19 – 3.21).

Devolved School Management (DSM)

- 3.13 Under the Devolved School Management (DSM) scheme, head-teachers are responsible for their school budget. The DSM budget has two elements: ‘cash’ and ‘non-cash’.
- 3.14 The main components of the ‘cash’ element include the materials, books, supplies and services that each school can purchase. This expenditure is recorded in the Council’s financial ledger, and the difference at the end of the year between budgeted and actual expenditure is adjusted in the DSM (cash) budget for the following financial year.
- 3.15 The ‘non-cash’ element represents the staffing budget. Instead of allocating a cash amount for staff costs, each school is allocated ‘staff weeks’. The size of the school roll determines the number of staff each school requires, and this is then converted into a total number of staff weeks’ budget for the year. The aim of this approach, which is applied in councils across Scotland, is to ensure equity between schools with low staff costs and those with relatively high staff costs. Under these arrangements, if a school under-utilises allocated staff time, a conversion rate is applied to calculate a notional cash underspend which is carried forward to increase the school’s budget for the next financial year.
- 3.16 The process of converting unspent time into cash equivalents and its implications for the Education Department’s budget require careful consideration. To maintain control, conversion rates have to reflect closely the real cost of staff time and full reconciliation between the notional cost of staff time and the actual position in the financial ledger is required.
- 3.17 At Scottish Borders Council, the appointed auditors reported that the conversion rates applied by the Council have been adjusted on only two occasions in the seven years since the scheme’s inception and that, for 2000/01, the rates applied did not accurately reflect the true costs of staff salaries.
- 3.18 Because of the scope under DSM for flexibility between financial years, there has been a growing discrepancy between the actual costs and budgets for primary and secondary school staffing. For 2000/01, the Council’s financial ledger showed a £1.4 million overspend in the ‘non-cash’ element of the DSM budget offset by an underspend on the ‘cash’ element of the DSM budget of £725,000, leading to a net *overspend* in the financial ledger of £675,000.

However the DSM records for that year showed an underspend in 'cash' of £811,000 and an under-utilisation of staffing resources which, when the conversion rates were applied, produced a value of £251,000, which in turn led to a cumulative *underspend* in the DSM records of £1.062 million. As a result, there was an *increase* in the budget provision for staffing in 2001/02 of £251,000 (being the underspend produced by the DSM scheme conversion calculation) despite an overspend of £1.4 million in the 2000/01 accounts. As the adjustment was within the terms of the agreed DSM scheme, there was no requirement to obtain the approval of the Education Committee for the increase in the budget.

National Grid for Learning (NGfL)

- 3.19 Overspending on the National Grid for Learning (NGfL) computers programme is the other principal component of overspend on primary and secondary education budgets.
- 3.20 The NGfL programme is a national project to ensure that all children in schools have access to modern computers linked to the internet. It is financed by specific grants received from the Scottish Executive, along with additional funding provided by the Council. In 2000/01, the NGfL budget was overspent by £320,000. This remains under investigation by the Council.
- 3.21 The senior officer responsible for the NGfL programme has advised the appointed auditors of her concerns regarding the budget for the programme. As with other budget holders, she informed the appointed auditors that in raising her concerns with the Assistant Director of Education (finance and administration), she was advised that there would be no problems with the budget for the NGfL programme and that any specific issues arising would be addressed. At no time was the possibility of overspending in the NGfL programme reported to the Education Committee.

Special Needs education

- 3.22 There are currently over 1,500 pupils with special education needs in the Borders area. The net overspend of £740,000 in 2000/01 on Special Education was principally the result of additional costs, mainly staff and residential fees, as a consequence of higher than expected demand for the service.

- 3.23 Prior to November 2000 the Education Department estimated an overspend on Special Needs for 2000/01 in the region of £100,000. A report entitled 'Budget for Special Education' was presented to the Education Committee at its meeting in November 2000 which highlighted a 'significant' (although not quantified) overspend in the Special Needs budget. The revenue monitoring report, highlighting a projected overspend of £300,000 in Special Needs, was also presented at this meeting. The report on the Special Needs budget was 'noted' by elected members and there were no instructions to investigate the underlying reasons or to take corrective action.
- 3.24 The appointed auditors' enquiries have highlighted some confusion and misunderstanding in roles and responsibilities in relation to financial management and control between the author of the Special Needs report (the Assistant Director of Education (services to young people)) and the author of the revenue monitoring report (the Assistant Director of Education (finance and administration)). Although Special Needs services formed part of his line management responsibilities the Assistant Director (services to young people), despite his concerns about the position on the Special Needs budget, did not seek to challenge the views reported by the Assistant Director (finance and administration). As with Nursery services and the NGfL computers programme, it appears that officers within the Education Department placed full reliance on the Assistant Director of Education (finance and administration) on matters relating to the finances of the Department.
- 3.25 The appointed auditors also concluded that there has been a lack of basic understanding of the impact of spending on Special Needs by those responsible for the budget. They noted, for example, that in relation to a joint project with social work for secondary pupils with special education needs, a cost centre had been created outwith the Special Needs budget to which all costs were posted prior to a year end apportionment and recharge to the relevant budgets. The Education Department budget holders were apparently unaware of the arrangement, and sought to use the full budget allocation for other purposes. It was only after the end of the financial year, following the apportionment and recharge of its share of expenditure relating to the project, that the resulting overspend (£230,000) in the Special Needs budget was identified.

Transport costs

- 3.26 There was an overspend in the Education Department's transport budget in 2000/01. This was the result of increased demand for transport services, as well as increased fuel costs for which

insufficient budgetary provision had been made. An overspend of £256,000 was projected in the January 2001 revenue monitoring report, and this projection was increased to £395,000 in March 2001. The final reported overspend on the transport budget was £233,000.

- 3.27 The Transport Manager advised the auditors that at no time did the Education Department instruct him to curtail or otherwise revise any aspect of the transport service as a result of the projected overspends.

School meals

- 3.28 Catering services are provided by the Council's Direct Service Organisation (DSO). The Education Department budget for school meals was overspent by £297,000 in 2000/01.

- 3.29 The budget for 2000/01 included an assumption of an increase in income from school meals of £100,000, representing a 10% increase in the level of income generated in 1999/2000. This was to be achieved by increasing the price of a school meal by 10p. However, as the DSO serve only 350,000 meals each year, the assumed increase in income was unrealistic.

- 3.30 The Education Committee was first informed of an under-recovery in school meals income of £80,000 in August 2000. This projection was repeated in November. In January 2001, the under-recovery of income was reduced to £40,000 but additional costs of £385,000 were highlighted as a result of increased employee costs in the DSO arising from the European Union Working Time Directive and changes in bonus arrangements. This resulted in a total adverse forecast of £425,000. By the end of March, the projected total overspend for school meals had been reduced to £300,000.

- 3.31 The position on catering was first drawn to the attention of the Catering and Cleaning Manager in mid March 2001 when the Assistant Director of Education (finance and administration) informed him of a projected overspend on the school meals budget of £180,000. Previously, DSO management had submitted estimates and variation orders (for permanent amendments to contracts) to the Education Department, but had received no response from the Assistant Director of Education (finance and administration).

- 3.32 The Education Department and the Catering and Cleaning Manager have expressed conflicting views regarding responsibility for monitoring Education Department spending on school meals.

While the Catering and Cleaning Manager acts as both the client agent (for the Education Department) and the contractor (for Catering DSO), he does not regard himself as having any monitoring responsibilities for the Education Department. On the other hand, there appears to have been an expectation on the part of the Education Department that the Manager did in fact have responsibilities in this regard. Overall there appears to have been a lack of clarity regarding the respective roles of the Education Department and the DSO, together with poor communication from the Assistant Director of Education (finance and administration). These factors undoubtedly contributed to the overspend in this area.

Administration

- 3.33 The 2000/01 budget contained an item entitled 'staff turnover adjustment' (STA) of £545,000 which was included under the administration heading. This is a budget adjustment designed to save costs whenever a member of staff leaves the Council's employment. It is assumed that most employees who leave the Council are employed on higher scales within their salary grades, and savings can be made by employing a replacement at the lower end of the salary grade.
- 3.34 The majority of staff employed within education services and therefore the majority of turnover is in schools. However, a savings target for STA was only allocated to school budgets late in the financial year. Moreover, no action was taken by the Department to monitor the overall STA savings target, despite the fact that the 1999/2000 target of £438,000 had not been achieved. Against this background, the auditors concluded that there was no realistic prospect of the planned savings of £545,000 being achieved in 2000/01. This was the major reason for the overspend of £603,000 on administration in 2000/01.

Findings

3.35 The main findings from this section of my report are:

- Overspending in 2000/01 occurred across a number of budget heads.
- The budget setting process was flawed in a number of respects, including errors in costing and poor management co-ordination.
- There was a lack of monitoring and control of the Devolved School Management system and a failure to appreciate fully its impact on the Council's financial position.
- There has been a lack of proper budgetary control in relation to a number of service areas within the Education Department.
- Responsibility for operational management and budgetary control was not sufficiently well aligned within the Education Department. Complete responsibility for maintaining budgetary control was delegated by the Director of Education to the former Assistant Director of Education (finance and administration). As a result too much control rested with that one individual.

4. BUDGETARY RESPONSIBILITIES

Respective responsibilities

4.1 In terms of the Council's financial regulations, heads of service departments are required to:

- prepare capital and revenue budgets for their department, in consultation with the Chief Executive and the Director of Financial Services
- ensure that the financial performance of their services are properly monitored, in consultation with the Director of Financial Services
- ensure that all staff under their control comply with the Council's financial regulations.

- 4.2 The Director of Financial Services is, for the purposes of section 95 of the Local Government (Scotland) Act 1973, responsible for the proper administration of the Council's financial affairs.
- 4.3 At elected member level, the financial regulations require each service committee to monitor and regulate its financial performance and to achieve such financial targets as may be imposed by the Council.
- 4.4 Against this general background this section of my report considers budget setting, control and reporting in 2000/01 and the respective roles of the Finance and Education department officers and elected members in the monitoring of income and expenditure.

Budget setting 2000/01

- 4.5 In line with the Council's financial regulations the responsibility for preparing the draft education budget rests with the Education Department and, in particular, the Director of Education. The role of the Finance Department is to co-ordinate the process between the individual service departments, and to ensure that the overall Council budget is properly funded.
- 4.6 Most of the principal areas which contributed to the overspend in the Education Department's budget for 2000/01 arose either because incorrect assumptions were applied in establishing the budget or because insufficient provision was included in the budget for the level of services planned. Some examples are set out in Exhibit 3.

Exhibit 3: Deficiencies in budget setting 2000/01

Incorrect assumptions

- The level of income for nursery services.
- DSM scheme carry forwards were based on out of date conversion factors for staff time which resulted in school budgets not being reduced for 'real' overspending in previous years.
- A 10% increase in the school meals income budget in 2000/01 was deemed to translate to an additional £100,000 in income when, based on the number of meals served, the increase could only have realised maximum additional income of £35,000.
- The 'staff turnover adjustment' (STA) was intended to produce savings of £545,000 in 2000/01. The experience in the previous year indicates that this was not a realistic expectation.

Insufficient provision

- Insufficient provision to meet the costs associated with the National Grid for Learning computers programme.
- The level of demand for Special Needs education services was under-estimated.
- Transport budgets were not revised to take account of significant increases in the cost of fuel.

Budget monitoring

Reporting to committee

4.7 The Council's financial regulations state that the head of each service department is responsible for monitoring financial performance, in consultation with the Director of Financial Services. Procedural notes were produced by the Finance Department in 1999 which set out the Council's scheme for budget monitoring and reporting.

4.8 The monitoring reports to the Education Committee are joint reports by the Director of Education and the Director of Financial Services, both of whom must agree to their content prior to their submission to the elected members of the Education Committee.

4.9 As noted in paragraph 3.3, the deduction of £1.2 million from the 2000/01 budget (being expenditure in 1999/2000 charged against the 2000/01 budget) was not addressed in terms of its impact on 2000/01 until the latter part of that year. Consequently, the August and November 2000 revenue monitoring statements projected overspends in education of less than £300,000.

4.10 The revenue monitoring statement presented to the Education Committee in January 2001, the first monitoring statement to reflect the impact of the £1.2 million adjustment from the previous year, projected an overspend of £1.6 million. By March 2001, the projected overspend had risen to £1.9 million. A summary of the information reported to the Education Committee is shown in Exhibit 4.

Exhibit 4: Financial monitoring reports

	Budget	Outturn	Variance
	£'000	£'000	£'000
Per Budget Book	59,428	59,428	-
August 2000	59,842	60,074	(232)
November 2000	59,091	59,386	(295)
January 2001	58,682	60,824	(2,142) ¹
March 2001	58,886	60,808	(1,922)
Outturn	58,993	62,890 ²	(3,897)
Final accounts	60,179 ³	62,890	(2,711)

¹ Reported as £1.578 million (due to arithmetical error)

² The movement from the March 2001 figure represents after year-end accounting adjustments which were not reflected in the in-year monitoring statements

³ This figure reflects the £1.1 million adjustment under the DSM scheme

4.11 In interviews with senior officers, the appointed auditors established that once agreements had been reached between Finance and Education as to the content of the monitoring reports, they were amended by the Assistant Director of Education (finance and administration) and returned to Finance for comment. However, the appointed auditors were advised that the amended monitoring statements were consistently late in resubmission to Finance with little time available for inspection by Finance officers before the reports were sent to members of the Education Committee.

4.12 The appointed auditors' enquiries have also revealed that agreed changes to the monitoring statements were not always implemented with figures in the reports being changed by the Education Department without the prior agreement of finance staff. The Finance Department claims that it had insufficient time to check the amended reports prior to their distribution to the Committee. However the reports were presented to the Education Committee in the name of both the Education and Finance Directors and there is no evidence to suggest that elected members were informed of any differences in opinion which may have existed.

Finance Department

4.13 Staff in finance have informed the appointed auditors that they were concerned about the position on the Education Department finances, specifically because there was:

- very little in the way of projected overspends in the August and November 2000 monitoring reports
- a lack of explanation from the Education Department as to the reasons for the overspend in 1999/2000
- a lack of action taken by the Education Department with regard to addressing that overspend in its 2000/01 budget.

4.14 These concerns were reported to the Chief Accountant in financial services and, in November 2000, he submitted his analysis to the directorate of the Finance Department and the Assistant Director of Education (finance and administration). After a meeting attended by senior staff from both the Education and Finance Departments, including both directors, it was decided that the Chief Accountant should produce a set of projections for education. By mid December 2000, the Chief Accountant reported a minimum projected overspend of £2.7 million for 2000/01.

4.15 However, as noted at paragraph 4.10, the January monitoring report indicated an overspend of £1.6 million. As the position became clearer, the Chief Accountant prepared a further report to the directorate of the Finance Department and to the Assistant Director of Education (finance and administration) in February projecting a revised overspend of £3.3 million.

4.16 Having reviewed the workings produced by the Chief Accountant to support these projections the appointed auditors are of the opinion that these are detailed and specific. The projections were based on actual spend to date and realistic estimates of the level of spending in the period

to the year end. The Chief Accountant and the Senior Accounting Technician in financial services dealing with education both prepared further independent analysis later in February 2001, and determined projected overspends of £3.4 million and £3.3 million respectively. While the accuracy of these projections may be open to question and detailed analysis, as a minimum, they provided a clear indication that the Education Department's budgetary position required urgent and careful consideration. Despite this, the Education Committee was advised in March 2001 that the projected overspend was £1.9 million, as shown in the monitoring report. The Finance Department advised the appointed auditors that the Education Department, particularly the Assistant Director of Education (finance and administration), provided assurances about the budget position and it was on this basis that the information was presented to the Education Committee.

Role of elected members

- 4.17 As noted earlier, the August and November 2000 monitoring reports presented to the Education Committee projected relatively small overspends in the education budget and both of these reports were noted by the committee. The November report on the Special Needs budget which referred to 'significant' overspends was again noted by the members. No questions were raised and no instructions were given to explore or to address the overspend.
- 4.18 The Director of Financial Services reported to the Policy and Resources Committee in November 2000 that the projected revenue expenditure for the Council as a whole was £404,000 above the approved budget (at this stage education accounted for £295,000 of this overspend). The Policy and Resources Committee advised all committees that they should take steps to ensure that their expenditure was maintained within the budgeted provision. Both the chairman and vice chairman of the Education Committee were present at that meeting.
- 4.19 When the projected overspends were reported to the Education Committee as being £1.5 million and £1.9 million in January and March 2001 respectively, the members again 'noted' the reports. No questions were raised and no instructions were given to address the overspend.

Findings

4.20 The main findings from this section of my report are:

- A number of the deficiencies in the budgetary estimates were basic in nature and suggest that the budget setting process was not sufficiently rigorous.
- Budget monitoring within the Council is based upon a documented set of procedures involving officers from the Finance and service departments. In the case of monitoring and reporting on the Education budget, however, these procedures were not sufficiently followed in practice. In particular, excessive reliance was placed on assurances given by the Assistant Director of Education (finance and administration) despite projections from Finance officers that were inconsistent with these assurances.
- Budget monitoring reports in the joint names of the Director of Education and the Director of Financial Services were provided to the Education Committee in some cases without the full agreement of the Finance Department.
- The Director of Education did not ensure that the financial performance of the education service was properly monitored and therefore did not discharge fully his financial management responsibilities in terms of the Council's financial regulations.
- The joint monitoring reports presented to members by the Directors of Education and Financial Services significantly underestimated the eventual overspend and were based upon financial information which was not sufficiently robust and reliable to form the basis of sound administration of the Council's financial affairs.
- Reports presented to elected members were inadequate and inaccurate. Nevertheless, when presented with reports highlighting potential financial problems, the Education Committee failed to investigate the position or to consider appropriate courses of action to address these matters.
- Overall, there was a breakdown in the arrangements established by the Council to ensure the effective financial management of the Education Department's budget.

5. ACTION TAKEN BY THE COUNCIL

Action taken in 2000/01

- 5.1 As noted earlier, under the flexibility within the Devolved School Management scheme, expenditure of £1.2 million incurred in 1999/2000 was deemed to be early utilisation of the 2000/01 budget. This was decided in preparing the 1999/2000 accounts, in June 2000. In accordance with the scheme rules the DSM budget for 2000/01 was to be reduced by an equivalent amount. However, the Education Department did not address the impact of this significant adjustment until early 2001, by which time it was too late to implement savings in the 2000/01 budget. Consequently, the £1.2 million DSM adjustment was not recovered in 2000/01. Had this been included in the November report (the first meeting of the Education Committee following certification of the financial statements for 1999/2000), or earlier, elected members would have been made aware that the projected cumulative overspend for 2000/01 was in the region of £1.5 million. At that stage some preventative measures might have been possible to eliminate or at least minimise the level of overspend in 2000/01.
- 5.2 In addition to this, the deficiencies in budget monitoring and late identification of the full extent of the overspend meant that, in practice, it was not possible to implement any significant course of action to reduce expenditure in 2000/01.
- 5.3 A series of meetings chaired by the Chief Executive and attended by the Directors of Financial Services and Education were held between November 2000 and March 2001. These were convened to deal with the large number of issues which were emerging. The appointed auditors have indicated that there are no minutes for these meetings. However, the Acting Chief Executive has advised that, in his capacity as Director of Financial Services, he expressed concern at these meetings about the budget position and the potential difficulties associated with placing too much reliance on the Assistant Director of Education (finance and administration).
- 5.4 In response to the projected outturn position, a decision was taken at the Council meeting on 8 March 2001 to establish a working group to review the levels of service provided and the Education Department budget. The composition of this group and its remit are contained in Appendix B.

Action taken for 2001/02

- 5.5 The budget for the current financial year (2001/02) was set before the full extent of the overspend in 2000/01 was known, and does not take into account any recovery of the cumulative overspend.
- 5.6 The original budget for 2001/02 was £62.1 million which includes approximately £2 million for additional staff costs in recognition of the McCrone Committee recommendations on teachers' salaries. This was increased to £64.5 million as a result of a specific central government grant of £1.3 million for McCrone and an uplift in the Devolved School Management budget of £1.1 million to reflect the underspend in terms of the DSM scheme at the end of 2000/01 (see paragraph 3.18). This was applied despite the reported cumulative overspend on the financial ledger.
- 5.7 The appointed auditors have indicated that action is being taken by the Council to reduce school budgets with the intention of eliminating the effect of the carry forward from 2000/01 under the DSM scheme. The Council has also commissioned an independent consultant to review the DSM arrangements at the Council.
- 5.8 At a Council meeting on 5 July 2001, a series of measures was proposed to save around £1.6 million from the 2001/02 revenue budget. A decision was postponed until 1 August 2001 to allow full consideration of the proposals. The savings programme recommended by the Director of Education was subsequently approved by the Council on 1 August 2001. The specific savings identified are summarised in Exhibit 5.

Exhibit 5: Savings identified for 2001/02

Proposed action	Saving £'000
Reduction in childcare budget	32
Cancel centrally funded teaching staff development programme	95
Virement in excellence fund to NGfL	525
Reduction in repair and maintenance	150
Capitalisation of eligible expenditure	73
Non-filling of vacancies	138
Non-appointment of foreign language assistants	49
Reductions in grants/bursaries	66
Reduction in clothes/footwear budget	60
Nursery budget reduction	18
Salary budget reduction	100
DSM – conversion factor	240
Software support	8
Miscellaneous savings	<u>25</u>
	<u>£1,579</u>

- 5.9 According to the Director of Education's report in August 2001, these savings will not prevent overspends in 2001/02 on catering, transport, special needs and National Grid for Learning computers programme. The auditors have been advised that spending within education has been curtailed, with all discretionary spending by schools having been stopped, and vacancies being left unfilled where possible. In addition, the Acting Chief Executive has advised that a range of measures have been taken or are proposed to control the education budget for 2001/02 and future years. However, it is not yet clear how these will impact on the 2001/02 budget and to date no report summarising the projected outturn for 2001/02 has been presented to the Council .

5.10 The appointed auditors have reported that the education budget will, during 2001/02, be under severe pressure if a further significant overspend is to be avoided.

Findings

5.11 The main findings from this section of my report are:

- The impact of the significant adjustment required to the 2000/01 budget brought about under the DSM arrangements was not addressed until early in 2001, by which time it was too late to implement savings in the 2000/01 budget.
- The budget for 2001/02 was set before the full impact of the overspend in 2000/01 was known. The Council has since approved a series of measures which are intended to reduce expenditure on education services and minimise the potential overspend in 2001/02. It is, however, too early to assess the effectiveness of the measures approved and no projected outturn for the current year has yet been presented to the Council.
- The Council does not yet have a clear strategy to eliminate the overspending, either in the current year or over the longer term. Nor has it yet determined whether the general fund will be compensated for the overspending incurred against the Education budget in earlier years. Decisions on these matters will have implications for the Council's general fund balance and, potentially, for council tax levels in future years.

6. CONCLUSIONS

- 6.1 There have been serious weaknesses in the financial management of education services within Scottish Borders Council, resulting in significant overspends in the Education Department budget in 1999/2000 and, to a greater extent, in 2000/01.
- 6.2 Budgetary control has been deficient in a number of areas, including weak management coordination, poorly constructed estimates and lack of a clear understanding regarding roles and responsibilities between Council officers. Of specific concern is the administration of the Devolved School Management system and the failure to reconcile and integrate this system fully with the management of the Council's overall finances.
- 6.3 Operational and financial management responsibilities within the Education Department were not well aligned. As a consequence, too much control was allowed to be exercised by one member of staff (the former Assistant Director of Education (finance and administration)). This created an environment in which some budget holders, including senior staff in the Education Department, placed too much reliance on that individual and did not pursue their legitimate concerns regarding expenditure and income levels and the implications for the Department's budget.
- 6.4 In terms of the Council's financial regulations, the Director of Education, in consultation with the Director of Financial Services, has responsibility for ensuring that the financial performance of the service is properly monitored. In effect, this responsibility was delegated entirely to the Assistant Director (finance and administration) without adequate controls being in place to ensure that financial management was properly integrated with other aspects of the management of the education service and consistent with the overall arrangements for the Council's financial administration. In practice, therefore, the Director of Education did not fully discharge his financial management responsibilities in terms of the Council's financial regulations.
- 6.5 The statutory responsibility for financial administration rests with the Director of Financial Services. This includes the effective application of the Council's financial regulations and review of expenditure against budgets for all services, with corrective action where appropriate. It is clear that these requirements were not fully met in the management of the finances of the Education Department. Documented procedures for budget monitoring were not sufficiently adhered to and reliance was placed upon assurances provided by the Assistant Director of

Education (finance and administration) regarding the budget position. This resulted in reports being presented to members which significantly underestimated the eventual overspend on the Education budget.

- 6.6 Elected members are entitled to rely upon officers presenting reports which accurately reflect financial performance, adequately explain significant variances and bring matters of concern to their attention. In relation to the Education budget for 2000/01, elected members were poorly served by officers in this regard. Nevertheless when presented with reports which did highlight potential financial problems, the Education Committee did not investigate the position or consider appropriate courses of action to address these matters.
- 6.7 The quality of monitoring reports and the roles of elected members and officers in relation to these reports were highlighted in the Accounts Commission's report '*Understanding our business – management information for DLOs and DSOs and other operational services*'. Although this report focused on the management of DLOs/DSOs, its general messages are also relevant to the management of other local authority services. In the case of Scottish Borders Council, deficiencies in financial monitoring reports had been highlighted by the auditors in September 2000. This points to the need to ensure that key recommendations by councils' appointed auditors are acted upon and followed up effectively. Appropriate arrangements for this purpose are an important element of the sound governance of public services.
- 6.8 The Council has taken steps to reduce expenditure within the current financial year and has identified potential savings of £1.6 million. In addition, the Acting Chief Executive has indicated that a range of measures are being taken or are being put in place to control the education budget for 2001/02 and future years. It is not possible to comment at this stage, however, on how effective these measures will be or whether they will prove sufficient to avoid a further overspend in 2001/02. Overall, it is essential that the Council takes appropriate action in 2001/02 to improve financial control and follows a clear strategy for financial recovery in future years. These will be subject to review by the Council's appointed auditors in due course.



R HINDS
CONTROLLER OF AUDIT
4 OCTOBER 2001

**ELECTED MEMBERS AND OFFICERS OF SCOTTISH BORDERS COUNCIL
INTERVIEWED BY THE APPOINTED AUDITORS**

Name	Designation
Councillor Tulley	Leader, Scottish Borders Council
Councillor Suckling	Chairman, Education Committee
Councillor Evans	Vice Chairman, Education Committee
John Campbell	Acting Chief Executive (Director of Corporate Services)
John Christie	Director of Lifelong Learning
Alan Bowman	Head of Financial Administration, Corporate Services Department
Kenneth Paterson	Assistant Director of Education (services to young people)
David Mallen	Assistant Director of Education (educational development)
Graeme Donald	Assistant Director of Education (continuing education)

NOTES

1. The Council's Chief Executive, Alistair Croall, has been on ill-health leave since 12 March 2001 and his employment was terminated by the Council on 18 September 2001 on the grounds that he is permanently incapacitated to carry out the duties of the post. John Campbell (Director of Corporate Services) has been acting in the capacity of Chief Executive since March 2001.
2. John Taylor (Assistant Director of Education (finance and administration) ceased to be employed by the Council, in June 2001 in a matter not directly concerned with the Education overspend.
3. Councillors Suckling and Evans have since resigned as Chair and Vice Chair of the Education Committee.

EDUCATION WORKING GROUP

Membership

Councillor A L Tulley (Chairman)	Independent
Councillor D C Lindores	Liberal Democrat
Councillor W Hardie	Independent
Councillor A Nicol	Liberal Democrat
Councillor H Wight	Conservative

Establishment and remit

The Working Group was established on 8 March 2001 to “To review the levels of service provided and the relevant budget provision in respect of the variances in the Education Committee budget.”

