



**20 October 2009**

## **F40 Report on the progress of the formula review**

(This is an update of an interim report produced by Lindsey Wharmby, f40's financial consultant in August 2009 and discussed by the Group's Executive Committee at its meeting in September 2009).

### **1. Introduction**

PricewaterhouseCoopers (PWC) has finished its work and the final reports are available at:

<http://www.teachernet.gov.uk/management/schoolfunding/DSGformulareview/research>

The PWC reports detail their findings and outline the strengths and weaknesses in various possible courses of action, but they do not recommend any particular action.

In the autumn the DCSF will be considering the PWC findings and preparing proposals for ministers to consider around December. The plan is then for a consultation on the ministerial proposals early in 2010.

### **2. The Formula Review**

It is very important to remember that the formula review is about the formula distribution of the Dedicated Schools Grant to local authorities. Each local authority then has decisions to make on the amount and formula distribution to its schools – although the play between these is probably at the heart of all the decisions that will be made between now and 2010. The following is a brief summary of how we got to where we are and where the tensions and decisions are.

In 2003 the government introduced a new formula to calculate the amount a local authority should be spending on its schools budget. The formula was known as the Education Standard Spending Formula or ESSF. Remember that in 2003 this was simply the formula used to determine what the local authority should, in the government's view, be spending on education. Some of the money came from central government but local authorities had to contribute some from their own resources. That was one tension between central and local government – the centre was defining the curriculum in schools, inspecting the standards through OFSTED and setting the national targets but local authorities were deciding on their local priorities, on the organisation of their school system and on the funding allocated to the whole education budget and to the distribution formula for its schools.

The full 2003 formula had not been fully implemented in 2006 when the Dedicated Schools Grant (DSG) was introduced. The DSG was intended to remove some of the tension between central and local government. Central government would provide a 100% grant (the DSG) for the Schools Budget and local authorities had to spend that grant on their Schools Budget (although they could still add more from their resources if they wanted to). The DSG was based on actual spend in the authorities in the previous year with a percentage increase above this each year. This means that the current DSG is based on a partially implemented 2003 formula plus whatever the authority was adding in from its own resources in 2005 above the formula or a reduced formula if the authority was not funding the full ESSF. Most of the annual increases into the DSG since 2006 have been used for 'ministerial priorities', including a small movement to continue to implement the original ESSF formula. There are still a significant number of authorities that are being funded below true ESSF as the progress towards true ESSF was never going to be fast and the introduction of the DSG muddied the water.

There have also been other major developments affecting education funding since 2003. Two of the important ones are the increase in participation and entitlement for under-5s and the planned return of funding for 16-19 year olds to local authorities. In the under-5s, because the provision and take-up was so varied across the country, funding has been based on a combination of funding existing provision and enabling those authorities with poor provision to increase participation. The post-16 funding will initially continue to be a national formula at school and college level – the centre will decide on the formula and the money will be routed through the local authority without any control at local level.

Whilst it is easy to see that there is a crying need for a rational formula-based allocation, it will not be easy to start from here. It is also easier to implement changes in a time of generous year on year increases in funding; you can level up the under-funded without causing too much pain on those who, in the long-run, will come down in relative funding.

The final point to remember in the present funding system is that the DSG is a block grant to the local authority that has to cover all the Schools Budget, and there will always be some funds that have to be retained at the centre – for example for the assessment of special needs, for the education of pupils who are placed in schools outside of the authority (usually pupils with special needs that cannot be met within the authority) or pupils not in mainstream schools (excluded pupils).

There are also other costs that come from the 'central expenditure' in the Schools Budget, including capital expenditure from the revenue account (CERA) and joint projects with other arms of the children's services. It is another complication that, at the same time the independent DSG was being developed to extricate education funding from other local authority pots, local authorities were also being asked to ensure that their children's services were coherent.

### **3. Understanding the Issues**

The Formula Review is a review of the ESSF formula and it is unlikely that the basic structure will change. So we need to look at the formula in detail and understand the issues and problems for each part of the formula.

The original ESSF had 3 blocks:

- Primary
- Secondary
- High Cost pupils

Note that provision for the under-5s was through separate grants that were incorporated into the DSG when that was introduced.

### Original ESSF

Primary:  
(basic entitlement + AEN + sparsity) x Area Cost Adjustment

+

Secondary:  
(basic entitlement + AEN) x Area Cost Adjustment

+

High Cost Pupils:  
(amount) x Area Cost Adjustment

The Review is looking at the following issues:

**3a Under-5s: Should a block for a formula allocation for under-5s be included? If so how do we deal with the following issues?**

- Participation and entitlement are not the same as participation is “voluntary”
- It is extremely difficult to count them – they keep wriggling and changing their pattern of attendance
- There is a wide range of providers – maintained, private and voluntary
- It is difficult to plan over more than 2 years because the third year cohort will not have been born!

**3b Post-16: Should there be a block for post 16 included in the scheme? Post-16 is currently funded on a national formula. There are no plans to implement a 14-19 formula in 2011 and the present grant for 14-16 diplomas will continue at least until full implementation of the diploma entitlement.**

- Although the distribution will initially be based on the current LSC formula, some colleges will cross LA boundaries so there will need to be joint planning

- If there is to be a 14-19 formula it makes more sense to put Post 16 in as a block in the formula even though it is a separate formula for the time being.

### **3c Primary and Secondary:**

- The basic entitlement – this is where the Activity-Led formula comes into play and the key issue is the level of detail used in generating the formula
- Additional Educational Need – are the proxy indicators currently used the most appropriate?
- Sparsity – should this be in the secondary block as well?
- Area Cost Adjustment – how much and to whom?

### **3d High Cost Pupils:**

- How do you define high cost pupils?
- Are the current proxy indicators the most appropriate?
- How do we deal with the few very high cost pupils for whom there may not be suitable proxy indicators or the number of pupils so few that a formula allocation is inappropriate.

In addition should there be separate blocks to cover the following?

- Ministerial priorities and grants
- Central items other than high cost pupils

## **4. The PWC reports**

PWC looked at four strands:

- Activity Led formula for the basic entitlement
- Additional Educational Need
- Special Educational Need (High Cost Pupils)
- Area Cost Adjustments

In addition, the DCSF continued with work on the additional costs inherent in small schools.

### **4a Activity-Led Formula for the basic entitlement**

There seems to be general support for the concept of an activity-led basic entitlement but, as always, the devil is in the detail. The basic entitlement in the ESSF was calculated by taking the total pot, removing the funds already allocated for everything else and dividing the remainder by the number of pupils with a fairly arbitrary difference made between primary and secondary pupils based on average historic differentials. The simplest form of activity-led formula repeats this exercises and then defines the level of educational provision that could be bought for this basic entitlement. That at least would make the level of central funding to authorities open and transparent and ‘affordable’ (because the total pot has been defined at the beginning).

At the other end of the spectrum you start with a bottom-up model and calculate the cost of providing a basic level of educational provision at school level. You can do this a various stages – a simple primary and secondary split, by Key Stage, by

individual year groups and with varying degrees of complexity. This method determines the basic entitlement first and all additional/special needs provision has to be from the remaining pot after the basic entitlement is removed. If the most detailed version of the 'pure' method of reaching the basic entitlement is used, it will be very difficult for a local authority to fund its schools below this level. It would, in effect, be a national formula at school level as we already have at post-16.

It would become difficult to continue with the present system for the central expenditure from the schools budget. As we saw earlier, the local authority defines how much of its Schools Budget it requires for central expenditure and it does vary considerably across the country – not least in part because the range and level of central services varies across the country. At present, although there is a basic entitlement in the ESFF, it was notional because the local authority takes its central expenditure from across all the blocks. The more transparent you make a basic entitlement and the more you calculate it from the bottom up – that is based on how much it costs to provide the basic entitlement at school level, the bigger the problem of how to manage the central expenditure becomes. One possible solution is to have a separate central expenditure block in the ESSF – possibly calculated on an activity-led basis.

So, the stronger you make the basis for the activity led formula, the more difficult you make it for local authorities to vary this in their local formulae – that is you restrict their discretion. The original ESSF caused tension because there was no identification from the centre of the level of basic educational provision expected. If it is made transparent at the centre, it may also become effectively mandatory and that is a big political step away from our present system.

#### **4b and 4c Additional Educational Need and Special Educational Need (High Cost Pupils)**

To no-one's surprise, PWC have found that there is no common understanding of the various terms used to cover the range of additional and special needs. The old distinction between special and additional needs incorporating a "Statement" for those with 'special needs' is no longer appropriate and even using the concepts of School Action and School Action Plus are not relevant to-day when every child should have a programme of personalised learning.

What they did find was an interesting relationship between cost and incidence of need. At one end of the spectrum are the needs that are high incidence but low cost – for example, some individual or small group work at school to support literacy. At the other end of the spectrum are the few cases of pupils with severe and multiple problems that require very high cost support – low incidence but high cost.

There is a break in the continuum around the £6,000 per annum cost – above this the incidence of the need diminishes rapidly but the costs increase. Below this, the incidence is high but the cost lower. This is interesting because it mirrors the LSC findings for Post-16. The LSC funds the high incidence/low cost end through a formula allocation but for costs above approximately £6,000 there is a more individual approach. However much we dislike the term 'high cost pupils' for those with extreme need, it may in fact be the most sensible differentiation when it comes to allocating funding.

There is some interesting work on the possible proxy indicators to be used for the High Cost end of the spectrum. The ESSF used a mixture of measures based on social deprivation and incidence of low birth weight. It is very important to make the distinction between the proxy indicator used in a funding formula and the analysis and response to the needs of the individual. A good proxy indicator for distributing resources to local authorities will have a high correlation with the incidence of the need, be easily and independently measured and have good up-to-date data.

So self-reporting of need can be very up-to-date and helps with the analysis and response required but is not independent. Pupils eligible for Free School Meals (note – eligible not claiming) is reasonably easily measured, has not too much lag in the data and a very high correlation with low attainment. It is of no use whatsoever in identifying the particular support an individual (with or without FSM) requires.

Much of the work on the high incidence low cost end of the spectrum is about identifying the indicators that could be used and analysing the costs of providing the support needed. As with the work on the Activity Led formula, much of the data on costs comes at school level, but the formula review is about the formula distribution at authority level.

There is currently tension between local authorities and central government on the distribution of money for additional educational need. The government knows how much money is being allocated through the formula based on measures of social deprivation. It is concerned that local authorities appear to be distributing a small proportion to schools using measures of social deprivation. However, local formulae use varying proxy indices to identify AEN, and there is still a lack of clarity between social deprivation (the proxy indicator) and educational underachievement (the correlated educational issue).

The more prescriptive the centre becomes over the importance of replicating their proxy indicators in local formulae, the closer we move towards a national formula. A very tight definition of AEN based on proxy indicators with a requirement for the local authorities to use these coupled with a detailed Activity Led basic entitlement is very close to a national formula at school level.

#### **4d Area Cost Adjustment**

This is a very detailed analysis of a very complicated area.

The first problem is identifying the different costs of providing equitable educational provision across the country. London is the obvious example of the high cost area but the report looks in detail at various geographic splits in the country. It costs more to run a school in London because salaries are higher and about 90% of the school budget is either direct labour costs (about 80%) or indirect (services such as catering, cleaning, pay roll etc).

There is also what is known as the opportunity costs. Retention of staff, particularly teachers, is worse in London. There is a rapid turnover of young teachers and that costs the school in recruitment costs and, more importantly, management time in recruiting and inducting new and inexperienced staff. It is very difficult to put a figure against these opportunity costs.

Outside of London there is an argument that having a very stable staff is also costly, because more staff are at the top of the scale. The PWC report looks at this issue in detail. If the Teachers' Pay Scale was very accurate and reflected the different costs in different parts of the country (including the opportunity costs), then the ACA would be simple – based on the additional costs of employing teachers and support staff. However both the teacher pay scales and support staff pay scales are fairly crude in dealing with area differences (particularly within London and the immediate surrounds). So the Area Cost and the London Weighting are inextricably mixed and it is difficult to know which one to sort out first.

The second problem is how to sort out the differentials within London. The current differentiation between inner and outer boroughs does not even match the existing teacher pay bands but any smoothing mechanism introduces further complications into an already complex calculation.

The Area Cost Adjustment is always going to be a bone of contention. This very thorough piece of work by PWC should, at the very least, enable everyone to understand the complexity of the issues – but the outcome is never going to satisfy everyone.

## **5. Sparsity, small schools, rural deprivation**

PWC has looked at all these issues but are not much further forward. There is recognition that rural deprivation is different from urban deprivation and the costs of tackling it can be high – because there are fewer economies of scale. A few pupils with additional needs within a small school are a super-sparsity issue! The vexed question of the small school remains despite continued work by the DCSF. There are problems of definition of nearest neighbouring school; as the crow flies really does not work in the dales! An analysis of present curriculum choice in secondary schools was inconclusive – small secondary schools appear to offer a reasonable range. However, most rural authorities have some small school curriculum protection in their formulae even though there is no sparsity factor in the secondary block; the authorities are providing the support needed – at the expense of something else in the budget. The best that can be said is that the issues of rural deprivation are higher on the agenda but there are no magic solutions so far.

## **6. Conclusions and next steps**

The main information-gathering phase of the review is over – although it is likely that there will be further work on some of the detail. The next step is to consider the evidence and work up proposals for changes and then the political decisions will be made.

None of the issues are easy or clear cut. It will become increasingly important to be able to present clear and concise explanations of the issues to a wide range of politicians, who will, in the end, be making the key choices from a very complex basket – and finding the resources to implement any changes.