



National Audit Office

Report

by the Comptroller
and Auditor General

Department for Education

Entitlement to free early education and childcare

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Department for Education

Entitlement to free early education and childcare

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 1 March 2016

This report has been prepared under Section 6 of the
National Audit Act 1983 for presentation to the House of
Commons in accordance with Section 9 of the Act

Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

29 February 2016

This report evaluates whether the Department for Education is getting value for money from its expanding entitlement to free early education and childcare.

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Key facts

£2.7bn

allocated for free childcare
in 2015-16

1.5m

children receiving funded
childcare, January 2015

105,000

providers of childcare
in England, 2015

290,000

increase in the number of children receiving funded childcare since 2010

85%

the proportion of settings rated 'good' or 'outstanding' by Ofsted

£3,000

the average difference between what local authorities fund per 3- and 4-year-old over a year, from £4,000 in the authority that funds at the highest rate to £1,000 in the authority that funds at the lowest

390,000

the number of children the Department for Education estimates will be eligible for the new entitlement to an extra 15 hours per week

£5,000

the amount the Department for Education estimates 30 hours of childcare per child per year is potentially worth to parents

80%

of places already occupied in full day-care settings in 2013

70%

the proportion of parents not aware of their local authority's Family Information Service

Summary

1 In September 2010, the Department for Education (the Department) introduced an entitlement to 15 hours of free childcare per week for all 3- and 4-year-olds in England. In 2013, it extended this to include 2-year-olds from disadvantaged families. Free childcare can be taken in playgroups and pre-schools, nursery schools, nursery classes in primary schools, in children's centres or with childminders.

2 The Department oversees the delivery of early childcare, much of which contains an educational and developmental purpose. It gives funding to local authorities and sets the overall policy for free childcare which includes the Early Years Foundation Stage (a framework which sets standards for the learning, development and care of children from birth to age five). By providing free childcare, the Department aims to support children's development, ensure children are ready for school and help parents manage childcare costs and working patterns. It also aims to close the gap between the later educational achievement of disadvantaged children and their peers. Research shows that early education can help improve a child's development and educational attainment, and has the biggest impact on the development of disadvantaged children.

3 In 2015-16, the Department gave £2.7 billion to local authorities, with 1.5 million children taking up a free childcare place. Local authorities are responsible for ensuring sufficient places for the funded hours and allocating money to providers. They are legally required to provide information to help parents find an appropriate place for their child, and should also give support and training to providers to ensure childcare in their area is high quality.

4 There are approximately 105,000 childcare providers in England. Facilities run by local authorities are called maintained settings; others are called private, voluntary or independent (PVI). Parents choose which provider and how many hours to use. Providers can choose whether to offer free childcare, but must register with Ofsted (the independent inspector of schools and children's services). Ofsted inspects childcare settings to ensure they deliver good-quality education and care.

5 In 2015, the Department outlined plans to increase some families' entitlement to free childcare. It will double the number of hours' free childcare that working families with 3- and 4-year-olds are entitled to, from 15 to 30 hours per week. It estimates this will be worth up to £5,000 per child per year. The Department is planning to pilot the new entitlement from September 2016, and to implement it fully from September 2017.

Our report

6 In this report we evaluate how well the Department, working with others, has implemented its early years policies to date, including:

- whether it is meeting its objectives for take-up and the quality of childcare;
- how effectively local authorities are managing the childcare market;
- the relationship between available funding and providers' costs; and
- the challenges the Department will face in extending the entitlement to 30 hours.

We have not audited specific actions by individual local authorities or childcare providers. We set out our audit approach in Appendix One and our evidence base in Appendix Two.

Key findings

Current entitlements to free childcare

7 The Department has successfully implemented the entitlement to free childcare for 3- and 4-year-olds, with almost universal take-up of hours offered to parents. Since the entitlement was set at current levels in 2010, the number of children in early-years settings using some or all of it has increased from 1.19 million to 1.48 million. In 2015, 94% of 3-year-olds and 99% of 4-year-olds used at least some of their 15 hours, with 86% of 3-year-olds and 96% of 4-year-olds accessing at least 13 hours per week. There is some variation between areas, with only 90% of parents taking up the offer in more deprived areas, and the Department does not know whether this is caused by lack of provision or lower demand (paragraphs 1.10 to 1.12).

8 Take-up of free childcare for 2-year-olds is substantially lower and access for some groups remains difficult. Parents of disadvantaged 2-year-olds, of whom there are some 270,000, are less likely to use the free entitlement with only 58% doing so, against a Departmental aspiration for 73% to 77% take-up. The Department has monitored local authorities' progress with implementation, identifying areas where take-up is particularly low. It has commissioned research to identify barriers that prevent parents using free childcare, finding that awareness was an issue in Bangladeshi, Somali and Polish communities. It has launched an innovative communications strategy to address these issues, and some local authorities have also used various advertising strategies. They told us they expect numbers to increase further, but also that there can be good reasons why parents choose not to use free childcare; for example, some parents believe 2-year-olds are too young to go to nursery (paragraphs 1.12 to 1.14).

9 Based on Ofsted ratings, the quality of early years settings has been improving but deprived areas still have lower-quality provision. In 2015, 85% of settings were rated 'outstanding' or 'good' compared with 80% in 2013. Nonetheless, some 210,000 children are in settings rated less than 'good'. Deprived areas tend to have a lower percentage of settings rated 'good' or 'outstanding'. Some 18% of settings in the most deprived areas of the country were rated less than 'good' compared with 8% in the least deprived (paragraph 1.16).

10 The Department's measure of children's outcomes at age five has shown steady improvement but is of little use in determining the quality of different early years settings and will cease to be nationally comparable in 2017. The Early Years Foundation Stage (EYFS) profile assessment measures children's development across a number of areas and is assessed in the final term of reception year. In 2015, 66% of children reached a good level of development compared to 52% in 2013. The Department does not routinely link data with the early years settings children have attended, which could help to assess the types of provider that have most impact on children's development. The Department is making the EYFS profile assessment non-compulsory from September 2016. It is introducing new baseline assessments in the same year, but these will not be comparable with the EYFS profile data and the Department does not intend to publish the assessments as a national dataset (paragraphs 1.22 to 1.24).

11 The Department does not routinely measure the impact of free childcare on later educational outcomes. In 1997, the Department commissioned research to assess the impact of childcare on later educational outcomes. The research followed a sample of children and found that attending pre-school had a positive influence on educational attainment at age 16. Despite the great expansion in state-funded childcare since the late 1990s, such analysis has not been repeated, but the Department recently commissioned research to assess the impact of free childcare on disadvantaged 2-year-olds' later outcomes; this will report in 2020 (paragraph 1.25).

Funding

12 Nationally, the average flat rate of early years funding per child has been frozen since 2013-14, meaning many providers have faced cuts in real terms. In 2015-16, the Department has allocated £2.7 billion for early years childcare, of which some £2.2 billion is being spent on 3- and 4-year olds. The total amount of funding for 3- and 4-year-olds has increased since 2013, but funding per child has remained the same in cash terms, meaning a 4.5% cut in real terms. The current national average rates are £5.09 per hour for 2-year-olds and £4.51 for 3- and 4-year-olds, excluding Early Years Pupil Premium (paragraphs 2.2 to 2.5).

13 Early years funding is calculated using the schools funding formula, which is based on historic funding levels, meaning children in similar circumstances attract different levels of funding. Money for early years provision is allocated to local authorities as part of wider school funding. The government is aware of inequalities between local authorities based on historic funding practices and has committed to introducing a new early years formula from April 2017. At local authority level, schools forums advise on how much to pay each provider per child. The average rate local authorities funded providers in 2015-16 ranged from £2.28 to £7.15 for 3- and 4-year-olds, a difference of £3,000 per child per year. On average they currently choose to give £50 more per 3- or 4-year-old per year to school nursery classes than PVI settings. The interaction of these factors creates large unexplained variations in funding per child per hour (paragraphs 2.6 to 2.10).

14 Local authorities retain different amounts of early years funding centrally but the Department does not know whether they spend this money efficiently. The proportion of early years funds local authorities keep for central administration and support costs is significant. In 2015-16, 105 local authorities (out of 152) planned to spend up to 10% of the early years component of their Dedicated Schools Grant (DSG) on central services; 34 planned to spend between 10% and 20%; and the remainder planned to spend over 20%, up to a maximum of 34%. The Department has not assessed how much it costs to administer the funding or provide central services, or how the amount local authorities retain has changed over time (paragraph 2.12).

15 In many places, the affordability of the current free entitlement depends on goodwill and additional payments by parents. The Department has recently undertaken a costing review and found most providers relying to some extent on cross-subsidisation between ages (as childcare is more costly for younger children). Providers report that they also rely on funds received for extra hours parents purchase. Additionally, they told us they rely on the goodwill of volunteers and on lower-paid workers who have a sense of vocation about providing childcare (paragraphs 2.14 and 2.15).

16 The Department has announced a new average funding rate which is designed to encourage greater efficiency. The Department carried out an exercise to estimate the costs of childcare to inform the future funding rate for the free entitlement. This exercise produced a range of costs based on different assumptions and took account of different rates paid for 2-, 3- and 4-year-olds.

- Possible national hourly rates produced by the exercise varied between £4.54 and £10.83 (the higher costs in the range were associated with maintained and independent settings which together provide 4.5% of current places) for 2-year-olds and between £3.14 and £6.12 for 3- and 4-year-olds. Lower rates in both ranges are based on the Department's own assumption that large numbers of providers can become more efficient.
- Following the Spending Review 2015, the Department announced that funding rates for 2017-18 will be £5.39 for 2-year olds and £4.88 for 3- and 4-year olds, including Early Years Pupil Premium.

Nationally, local authorities kept 10% of early years funding centrally in 2014-15. Were local authorities to keep the same percentage in future, this would mean new average funding rates to providers of £4.85 for 2-year-olds and £4.39 for 3- and 4-year-olds. The rates are designed to encourage efficiency but the Department does not know how efficient providers currently are following the freeze in funding in recent years (paragraphs 2.16 to 2.19).

Managing the market

17 Local authorities have generally focused on improving the quality of existing early years providers rather than trying to encourage new providers into the market:

- **Local authorities typically have good oversight of the quality of childcare in their areas.** They are legally required to fund childcare places in settings that Ofsted rates 'good' or 'outstanding' and should intervene if settings are less than 'good'. Local authorities we visited all monitored and intervened in settings with low ratings (paragraph 2.23).
- **The composition of the early years market has not changed since 2011.** The total number of providers in the market has decreased only slightly, with the overall proportions of providers of different types staying the same, suggesting the market has been quite stable (paragraph 2.24).
- **Local authorities have limited powers to offer incentives for providers to enter the market or increase provision.** Local authorities are restricted in how they can use revenue funding and have limited capital funding to lower barriers to entry for new providers, for instance lack of premises. However, some have successfully used capital funding to offer incentives for providers to take disadvantaged 2-year-olds (paragraph 2.25).
- **Gaps exist in the information local authorities need to manage the market.** Local authorities must assess annually whether they have enough childcare places, but they no longer have to publish the resulting reports. Reports that have been published show gaps in some authorities' understanding of demand. For example, some authorities have made no attempt to analyse the kinds of issues parents raise when they contact local Family Information Services, a key potential source of intelligence. Local authorities are also adversely affected by the lack of information about the relative impact of different types of early years provider (paragraph 2.22).

18 Many parents experience initial confusion about the childcare market and how to access their free entitlement; better information would help many of them. Survey evidence has shown how parents are often unaware of formal information sources, relying instead on word of mouth. For instance, 70% of parents surveyed by the Department in 2012/2013 were unaware of their local authorities' Family Information Service (a large majority of those who used such services found them helpful). Overall, almost 4 out of 10 parents said they felt there was too little information about childcare in their local area, a proportion that had not changed since 2004 (paragraphs 2.21 and 2.22).

Delivering the new entitlement

19 Stakeholders are broadly positive about increasing the entitlement to 30 hours, but providers have concerns about the levels of funding they will receive. Parents welcome the offer of extra hours and demand is likely to be high. In autumn 2015, the Department ran a consultation with parents and some 90% of respondents said they would use an expanded entitlement if they were eligible. Providers have also been positive but are concerned about whether the change will be affordable with the new national average rates of £4.88 for 3- and 4-year-olds and £5.39 for 2-year-olds. While some providers may expand, creating greater economies of scale, others may face reduced opportunities to cross-subsidise as parents will be paying for fewer hours (paragraphs 3.6, 3.10 and 3.11).

20 The new entitlement for 3- and 4-year-olds could put further implementation of the entitlement for disadvantaged 2-year-olds at risk. In 30 local authorities, fewer than 50% of eligible 2-year-olds were accessing the free entitlement in January 2015, while the Department was still some way off its aspiration for 73% to 77% take-up nationally. Many providers have finite capacity and, in future, may choose to offer more hours to their existing 3- and 4-year-old children rather than take disadvantaged 2-year-olds, who require more staff per child. This would jeopardise the Department's objectives to improve outcomes for disadvantaged children and narrow the development gap at age five (paragraph 3.9).

21 Local authorities are likely to find it challenging to provide the necessary number of places in some areas if demand is as high as anticipated.

The Department estimates that up to 390,000 families will benefit from extending the entitlement (42% of those eligible for the existing entitlement). However, the Department's last survey of providers – carried out before it extended free childcare to 2-year-olds in 2013 – found that childminders were already, on average, 75% occupied, full day-care settings were 80% occupied and nursery schools 82% occupied. In November 2014, fewer local authorities than a year before reported having sufficient places for parents working full time or for parents with disabled children. The Department will provide an additional £50 million capital funding to help local authorities increase the number of places (paragraphs 3.7 and 3.8).

22 The success of the new entitlement will be difficult to measure. The new entitlement will give higher priority to enabling parents to work than to improving children's development, as evidence has shown that providing full-time early years education does not have additional impact on children's outcomes beyond what part-time early years education achieves. The new entitlement is likely to replace private funding for many parents who already pay for more than 15 hours' childcare. Beyond subsidising these parents' costs, the Department will need to set out what – if anything – it wants to achieve. The Department has not yet stated, for instance, to what extent it expects parents to work more hours as a result of the policy. Given the size of the investment, it will need to find measurable ways to track impact (paragraphs 3.3 to 3.5).

Conclusion on value for money

23 The Department has made significant progress in providing free entitlement to early years childcare, by:

- increasing take-up from parents of 3- and 4-year-olds;
- extending the entitlement to some disadvantaged 2-year-olds; and
- presiding over a system where the independent inspector sees quality rising.

Many parents and children are clearly benefiting from these entitlements.

24 However, the Department has not yet achieved full value for money because it does not understand enough about the outcomes delivered and how these vary between types of provider and at different levels of funding. As it expands free childcare from 2016, these gaps in its knowledge will become greater risks. Providers may decide not to offer the new entitlement unless the rate of funding is right, and many local authorities are untested in actively managing supply and demand. Without great care disadvantaged 2-year-olds could be the ones to lose out if providers choose to offer more hours to 3- and 4-year-olds within existing capacity constraints. To prove the value for money of its new entitlement the Department needs to address these issues and set out clearly what it expects to achieve from the extra hours and how it will measure progress towards these goals.

Recommendations

- a** To make sure that the Department achieves its objectives to close the attainment gap between disadvantaged children and their peers, it should set out publicly how it will intervene in local authorities with unexplained lower levels of take-up for the 2-year-old entitlement. It should also intervene in local authorities that have had lower-quality provision long term, particularly in areas of disadvantage.
- b** The Department has committed to reviewing the funding formula for early years. As it does so, it should make sure that it understands the demand for free childcare around the country and the true cost of providing it. It should use this information to set a long-term funding formula that distributes early years funding fairly.
- c** In implementing the new entitlement to free childcare, the Department should make full use of its pilots from September 2016 to:
 - Test assumptions about parental demand and estimate the number of new places needed.
 - Clarify what it wants to achieve from expanding the entitlement and develop measures to evaluate effectiveness, in particular, any expected future link to increased parental employment.
 - Evaluate the impact of the new entitlement on take-up of free childcare for disadvantaged 2-year-olds.
 - Understand how the most effective local authorities manage and develop their early years market and share this good practice.
 - Test ways of tracking the progress of individual children from childcare through to primary education.

Part One

Current entitlements to free childcare

1.1 In this part of the report we:

- describe the current entitlements to free childcare;
- examine how well the Department for Education (the Department) has met its objectives in offering free childcare; and
- assess how easy it is for parents to access hours they are entitled to.

Entitlement to childcare

1.2 Parents of 3- and 4-year-olds have been entitled to some free childcare since 2004. In 2010, the Department extended the number of hours they were entitled to from 12½ to 15 per week for 38 weeks per year. In September 2013, the Department also started offering 15 hours of free childcare to disadvantaged 2-year-olds, if their parents qualify for benefits such as Income Support or income-based Jobseekers Allowance (**Figure 1** overleaf). In January 2015, 1.3 million 3- and 4-year-olds were taking up free childcare, as were 157,000 2-year-olds (**Figure 2** on page 15).

1.3 Early years providers give care and education to children between birth and five, including those eligible for free entitlements. Any person or organisation providing formal childcare must register with Ofsted. This includes nurseries, pre-schools and childminders,¹ and early years provision in schools. There are currently 89,000 providers of childcare in England, plus 16,000 maintained schools with nursery and reception classes and 400 maintained nurseries, not all of which offer the entitlement to free childcare.

¹ Unless they register with a childminder agency which must register with Ofsted.

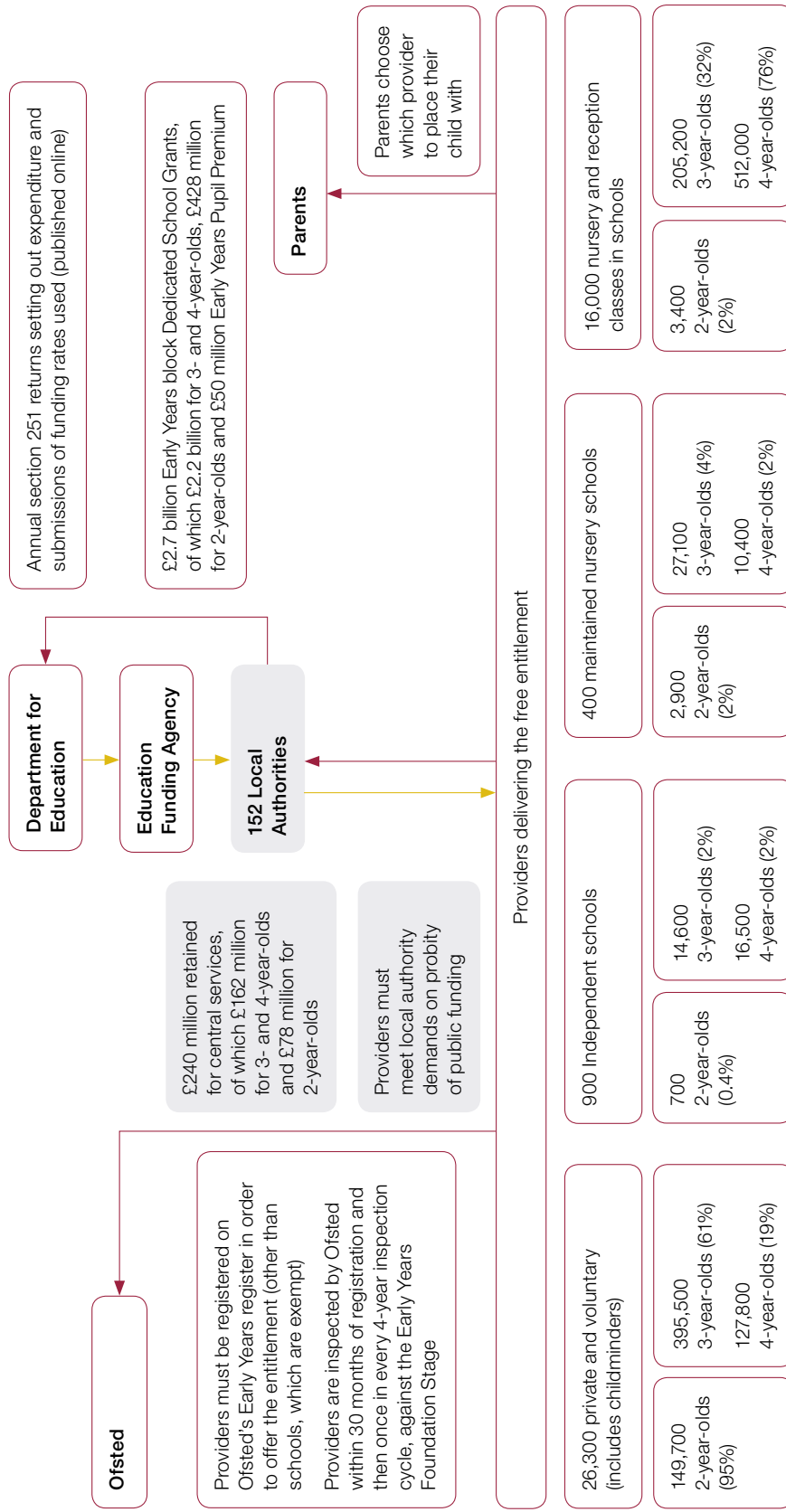
Figure 1
Eligibility for free childcare

Policy	Age	Aims	Point at which children become eligible	Criteria	Approximate population eligible (%)	Current national average funding rate per hour (£)
15 hours' free childcare	2-year-olds	<p>Improve the quality of education for disadvantaged children</p> <p>Encourage the best providers to expand into disadvantaged areas</p>	The term after their 2nd birthday	A parent must be receiving one of the following: Income Support, income-based Jobseeker's Allowance, income-related Employment and Support Allowance, support through part 6 of the Immigration and Asylum Act, tax credits (with an annual income of less than £16,190 before tax), the guaranteed element of State Pension Credit, Working Tax Credit 4-week run on, or Universal Credit. Children may also be entitled if they are looked after by a local authority, have a statement of special educational needs, or get Disability Living Allowance, or if they have left local authority care.	40	5.09
15 hours' free childcare	3- and 4-year-olds	<p>Support children's development and make sure they are ready for school</p> <p>Help parents manage childcare costs and working patterns</p>	The term after their 3rd birthday	Universal	100	4.51
Early Years Pupil Premium	3- and 4-year-olds	<p>Improve the quality of education for disadvantaged pupils and encourage the best providers to expand into disadvantaged areas</p> <p>Give additional funding to providers that take disadvantaged children</p>	The term after their 3rd birthday	A child must be receiving 15 hours of early education from an early years provider. Additionally, a parent must be receiving one of the allowances or benefits listed for the 2-year-old entitlement above or the child must have left care under a special guardianship order, child arrangement order or adoption.	19	0.53

Source: Department for Education

Figure 2
The early years childcare system

Early years free entitlement, funding and accountability 2015-16



→ Funding → Accountability

Notes

- 1 Percentages are an expression of total number of children of that age taking a free entitlement place.
- 2 A small number of children (not shown) are in state-funded special schools.
- 3 Providers in the figure only include those that offer the free entitlement, there are approximately 105,400 providers of childcare in total.
- 4 Children in reception classes in schools are not funded by the Early Years block of the Dedicated Schools Grant, but by schools' core funding.

Source: Department for Education

The Department's objectives

1.4 Strong evidence has existed for some time of the positive impact that early education and childcare can have on 3- and 4-year-olds' development and outcomes. Research shows good-quality early education helping children's speech and language development; literacy and numeracy; social development; and readiness for school.² Existing evidence also suggests that good-quality early education can have a disproportionately positive effect on children from disadvantaged backgrounds. As an incentive to encourage good-quality providers to work with such children, the Department introduced an Early Years Pupil Premium for disadvantaged 3- and 4-year-olds in September 2014.³ There is less evidence for the beneficial impact of early years education on 2-year-olds, but the Department is funding a study to evaluate its effectiveness.

1.5 The Department's specific objectives in funding free childcare for 3- and 4-year-olds are to:

- support their development;
- make sure they are ready for school; and
- help parents manage their childcare costs and working patterns.

1.6 The Department's objectives in funding free childcare for disadvantaged 2-year-olds are to:

- improve the quality of education for disadvantaged children; and
- encourage the best providers to expand into disadvantaged areas.

Further information on the eligibility criteria and objectives for various entitlements is in Figure 1 on page 14.

Roles and responsibilities

1.7 The Department sets the overall statutory framework for free childcare through its Early Years Foundation Stage and provides funding to local authorities through the Dedicated Schools Grant (on funding see Part Two). Under the current framework, local authorities have specific statutory duties relating to early years provision. They must:

- ensure there are sufficient places;
- give information, advice and assistance to parents on provision in the area; and
- give information, advice and training to providers judged less than 'good' by Ofsted.

² See for instance K Sylva et al, *The effective provision of pre-school education (EPPE) project: Findings from pre-school to end of key stage 1*, November 2004, www.ioe.ac.uk

³ We have not looked specifically at the Early Years Pupil Premium in this report, as it is still in its first year of operation.

1.8 Parents can choose where to use their free entitlement, but must select providers that are registered with Ofsted and signed up to deliver the Early Years Foundation Stage.⁴ Ofsted processes applications to the Early Years Register and inspects all providers at least once in a 4-year cycle, considering their compliance with the principles and requirements of the Early Years Foundation Stage.

Take-up of the entitlements

1.9 Before 2010, the Department offered parents of 3- and 4-year-olds 12½ hours per week of free childcare. Take-up was high: 95% of parents used some of the entitlement, although only 60% used it in full. The Department assessed that by offering 2½ more hours it would be likely to increase overall take-up. Evidence from recent years shows this has been the case.

1.10 Between 2010 and 2015, both the total population of 3- and 4-year-olds in England and the rate at which they took up free childcare increased. The total population had increased by 75,000 by January 2015, with 94% of 3-year-olds and 99% of 4-year-olds accessing free childcare (**Figure 3** overleaf). Most 4-year-olds (74%) were in primary schools in a reception or nursery class, and there was little variation by area. However, take-up was lower for disadvantaged 3-year-olds: 90% used the entitlement in more deprived areas compared to 98% in the least deprived (**Figure 4** on page 19). The Department does not know enough about local markets to know how much of the variation is caused by places available and how much by parental demand.

1.11 The Department has increased the proportion of parents using the previous maximum number of hours (12½). In 2015, 86% of 3-year-olds who were accessing some entitlement used 13 hours or more per week, and nearly all 4-year-olds used 13 hours or more (96%).

1.12 The Department implemented the entitlement for 2-year-olds in two phases. In September 2013, it offered 15 hours to the 20% of parents from the most disadvantaged backgrounds,⁵ increasing this to 40% of all parents in September 2014. In January 2014, some 87,000 2-year-olds accessed some hours. After eligibility criteria changed, this increased to 157,000 children in January 2015 (58% of the eligible population). The Department's aspiration is for 73% to 77% of eligible 2-year-olds to take-up some of the entitlement nationally.

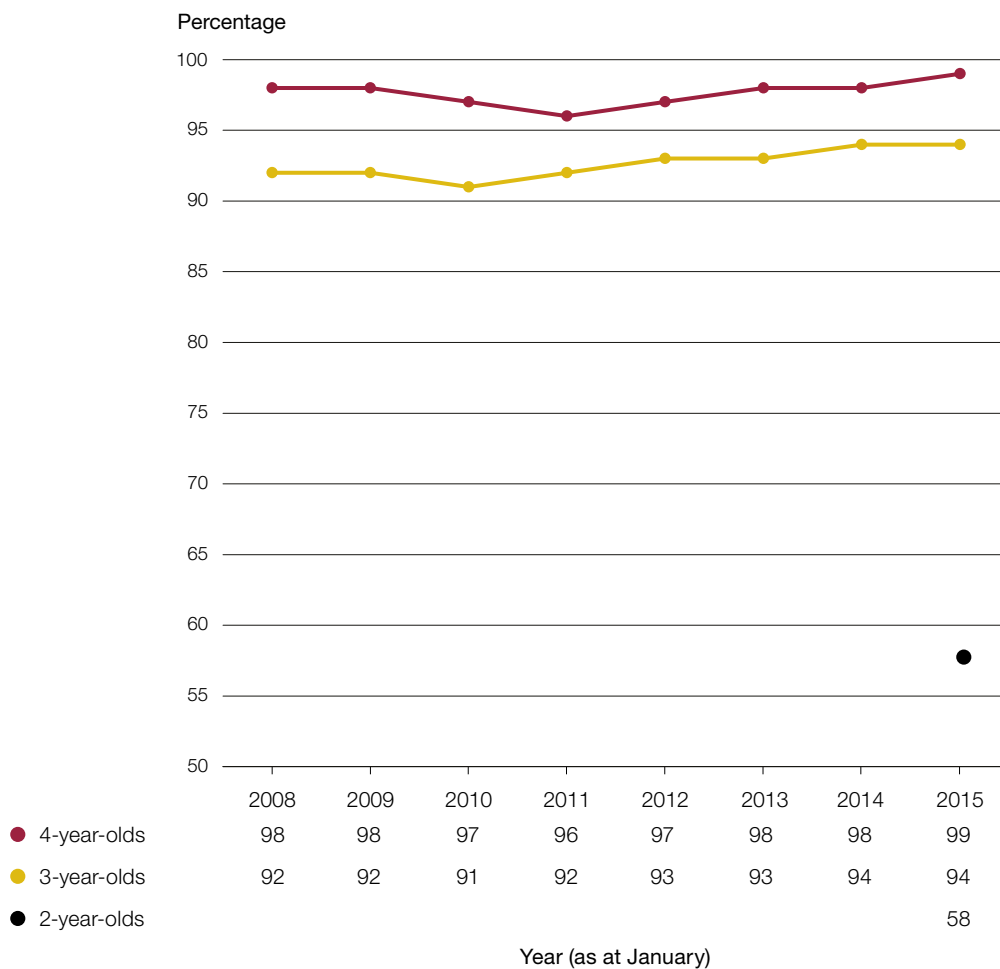
⁴ Unless an exemption from the learning and development requirements is in place.

⁵ Parents eligible for the benefits listed in Figure 1, but not those with low incomes.

Figure 3

Take-up of free childcare by 2-, 3- and 4-year-olds, 2008–2015

Take-up is high for 3- and 4-year-olds, but lower for disadvantaged 2-year-olds



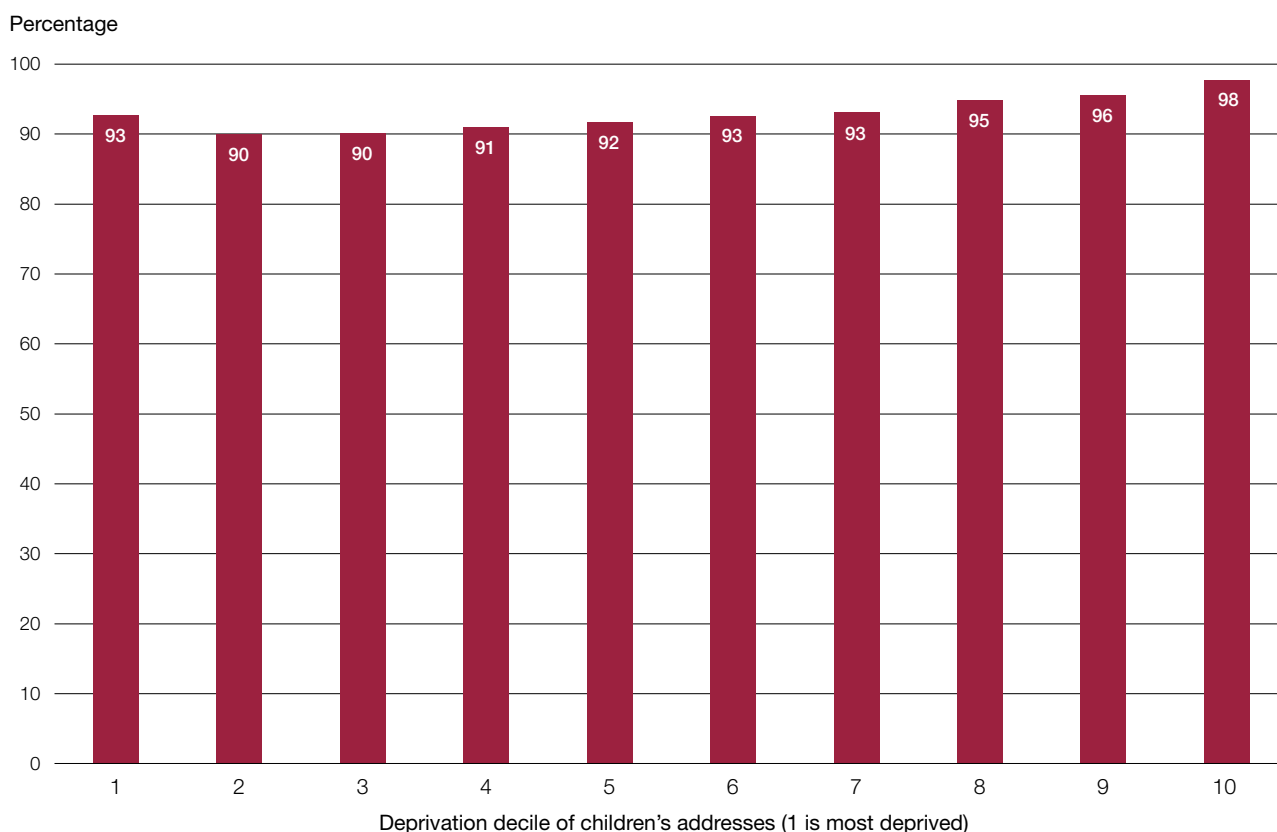
Note

1 Based on Office for National Statistics population estimates (ONS). Population data was revised by ONS in 2011. Figures prior to 2011 have not been adjusted.

Source: Department for Education

Figure 4

Take-up of free childcare by 3-year-olds by level of disadvantage, 2015

Take-up was lower for disadvantaged 3-year-olds

Source: Department for Education and Office for National Statistics

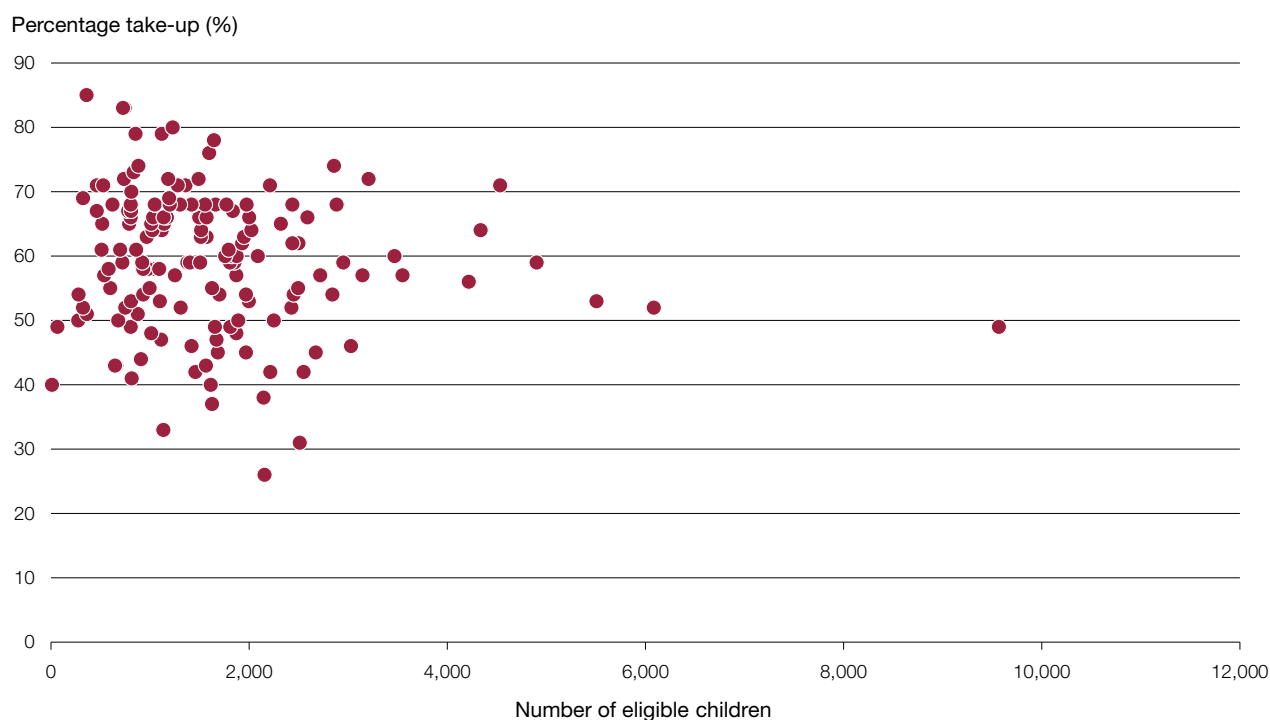
1.13 There is wide variation between local authorities in the proportion of 2-year-olds using free childcare (**Figure 5** overleaf). In 2015, 30 local authorities had take-up rates lower than the national level of 58%, with Tower Hamlets the lowest at 26%. Four local authorities had take-up rates of over 80%, with Richmond-upon-Thames the highest at 85%.

1.14 The Department monitors local authorities where take-up is low. It spent £7.4 million between 2012-13 and 2015-16 on activities intended to increase take-up, including £5.4 million on the national 'Achieving for 2-year-olds' programme, which provided support to local authorities to implement the new entitlement. Certain groups of parents are less likely to use their entitlement. The Department commissioned research into barriers that prevent them from doing so. Among the issues discovered was low awareness, particularly in Bangladeshi, Somali and Polish communities. The Department has subsequently directed national campaigns at these groups. It believes, however, that there are always likely to be some parents who choose not to place young children in childcare.

Figure 5

Take-up rates for free childcare for 2-year-olds by local authority, 2015

The percentage of children taking up free provision varies significantly, irrespective of the total number of children eligible



Source: Department for Education

Quality of early years childcare

1.15 The Department measures the quality of early years childcare using Ofsted ratings, the qualifications held by staff in early years settings, and data from the Early Years Foundation Stage profile about children's development at age five. These sources provide useful information about quality and all have shown improvements in recent years, but they have limitations that mean they require careful interpretation. The most important limitations are as follows:

- Ofsted conducts inspections independently but there may be substantial gaps, of up to 4 years, between inspections.
- The extent to which staff are qualified is monitored nationally and the Department has not conducted a survey since 2013.
- The Early Years Foundation Stage profile is usually assessed when children are in reception class, and there is no way of linking the data to any previous early years providers they attended.

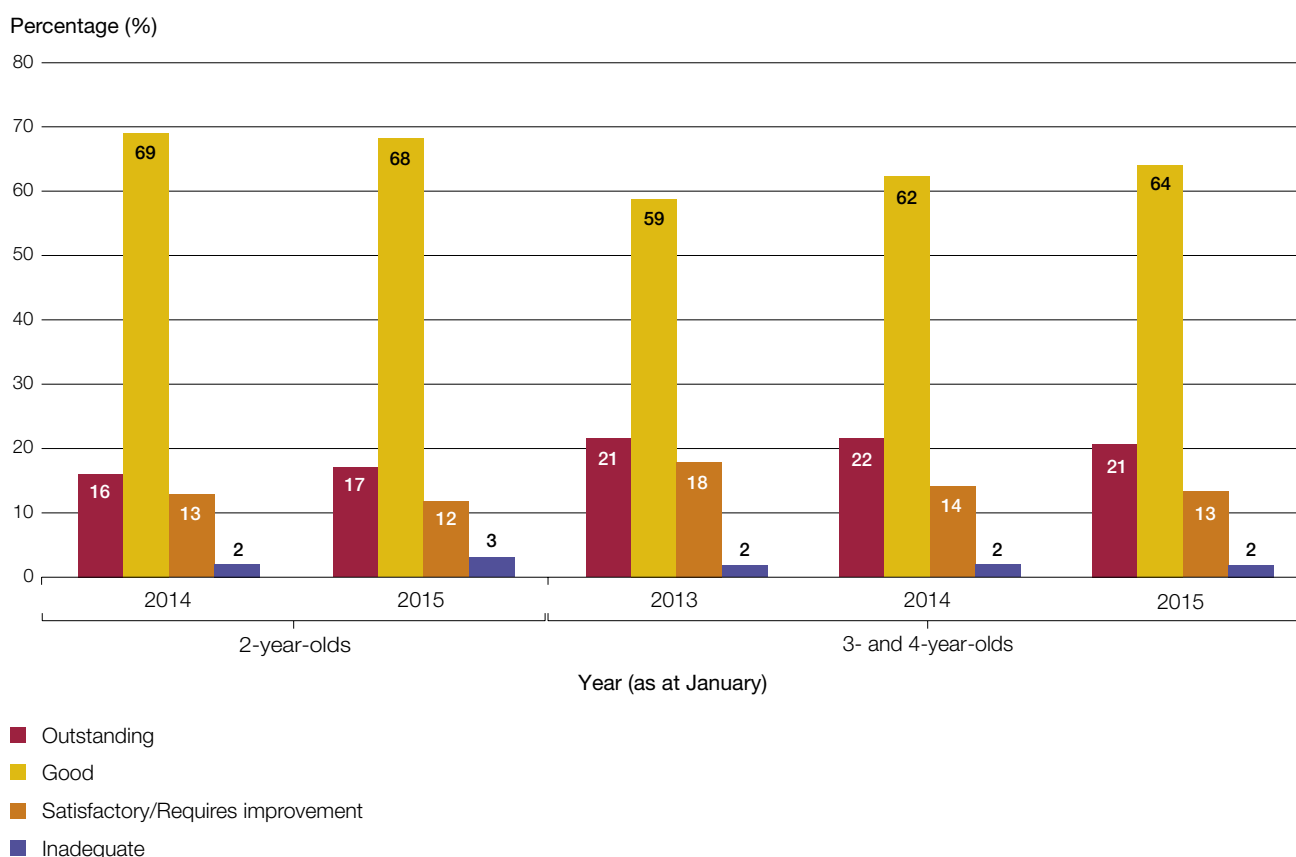
Ofsted inspections

1.16 The quality of providers, as measured by Ofsted, has improved in recent years. Of all children accessing free childcare in January 2015, 85% were in settings rated 'good' or 'outstanding', compared to 80% in 2013 (**Figure 6**). However, there was significant variation depending on levels of deprivation. In 2015, 18% of children in the most disadvantaged areas were in settings rated less than 'good' compared with 8% in the least disadvantaged areas. In total, we estimate that, in 2015, some 210,000 children were receiving free childcare from providers rated less than 'good'.

Figure 6

Ofsted ratings of early years providers by year and age

The percentage of children in 'good' and 'outstanding' providers has increased



Source: Ofsted and Department for Education

1.17 Using each provider's latest inspection rating masks the fact that some settings have not been inspected for a long time: on average, in August 2015, 'outstanding' providers had last been inspected 30 months earlier, and 'outstanding' childminders 40 months earlier. Considering the latest inspection ratings for all settings in August 2015, we found that 313 of the 690 rated 'inadequate' at their latest inspection had previously been rated 'good' or 'outstanding' (out of a total of 43,646 settings with inspection ratings).

1.18 Some local authorities also used to inspect early years providers, but in September 2014 the Department told them that Ofsted should be the "sole arbiter of quality". Most local authorities we spoke to felt Ofsted's framework was a good measure and said they used its judgements to inform their own work. However, some expressed concern that newly-registered settings or renamed settings could be open for up to two and a half years before being inspected.

Early years workforce

1.19 Research shows that a better educated workforce leads to higher-quality childcare and improved outcomes for children.⁶ A national review, published in 2012, reinforced the need for a professionalised workforce, recommending that there should be more specialist early-years teachers and also that all staff who count towards minimum staff: child ratios should be at least Level 3 qualified (equivalent to A-level standard) by 2022.⁷ The Department does not collect routine data on staff with level 3 qualifications but the last survey of providers published in 2013 suggested that numbers were rising in all setting types, with approximately 90% of paid staff qualified to Level 3 in both private, voluntary and independent (PVI) and maintained settings.

1.20 There are also more qualified teachers in the early years sector. Maintained schools and classes must be led by qualified teachers, while, the percentage of PVI settings and nursery schools with at least one teacher with qualified teacher status, early years teacher status or early years professional status has increased steadily, from 38% of those taking funded 3- and 4-year-olds in 2011 to 49% in 2015. Encouragingly, we assess that children from more deprived areas are just as likely to have contact with staff with relevant qualifications as more affluent children.

1.21 Important challenges remain. The number of applicants for courses that provide degree-level qualifications has fallen. Meanwhile, the Department has struggled to recruit to its new early years initial teacher training programme, introduced in September 2013. In the first year, the National College for Teaching and Leadership (NCTL) recruited 97% of its target of 2,400 trainees but this dropped to 41% in the second year, when it recruited only 879 applicants. Some local authorities told us that, in general, recruiting qualified staff was becoming more difficult as the economy improved.

⁶ S Mathers, et al, *Evaluation of the Graduate Leader Fund*, 2011.

⁷ K Nutbrown, *Foundations for quality: The independent review of early education and childcare qualifications*, June 2012.

Measuring outcomes

1.22 Outcomes for children measured at age five by the Early Years Foundation Stage (EYFS) profile have been improving nationally. The percentage of children achieving a good level of development increased from 52% in 2013 to 66% in 2015. This means almost two thirds of children are achieving at least the expected level of development in five areas of learning:

- communication and language;
- physical development;
- personal, social and emotional development;
- literacy; and
- mathematics.

There is, however, a large gap, of eighteen percentage points, between the proportion of disadvantaged children achieving these levels and their peers.

1.23 The profile is intended to support children's transition to Key Stage 1 by helping teachers plan a curriculum that meets their needs. Most children are assessed in their reception year of primary school. Attributing learning and development to the setting they attended previously is difficult, and not something the Department seeks to do. Moreover, the Department has not sought to track outcomes for cohorts of children who attended different types of early years provider, which would be one way to try to understand the relative effectiveness of different approaches.

1.24 The Department is making the EYFS profile assessment non-compulsory from September 2016, because in 2015 it introduced new baseline assessments in reception year. Baseline assessments will not be comparable to the EYFS profile data. The Department does not intend to publish the assessments as a national dataset. As currently planned, this change will reduce the comparable information available about the impact of early years childcare from 2016.

1.25 In terms of longer-term effects, the Department has invested £8.3 million in longitudinal research over the past two decades on the impact of early years on later outcomes. The children sampled were in childcare in 1997, and the research has tracked their development and attainment. It found that attending pre-school had a positive influence on educational attainment at age 16. There have been major changes to early years provision since the late 1990s but no further longitudinal research was commissioned in the intervening period. The Department has now decided to spend £5.6 million on long-term research into the impact of its funding for disadvantaged 2-year-olds; initial results will be available in 2020.

Part Two

Funding free childcare

2.1 In this part of the report we:

- explain how free childcare is funded;
- analyse the funding formulae;
- assess the sufficiency of funding and the potential for increasing efficiency; and
- examine how the early years market is managed.

Overall funding

2.2 In 2015-16, the Department allocated £2.7 billion for early years childcare (**Figure 7**), distributing the funding to local authorities as part of the Dedicated Schools Grant (DSG), which is ring-fenced for educational purposes. It set an indicative rate of funding per child but local authorities use their own formulae to decide how much early years providers actually receive. They do this in consultation with schools forums, which are groups of representatives from schools and early years providers.

2.3 Before April 2013, the Department decided how much to allocate each local authority for 3- and 4-year-olds based on historical allocations for school-age pupils. Since April 2013, the Department has based funding rates on local authorities' planned spend per eligible child in 2012-13. While there has been an increase in total funding for 3- and 4-year-olds there has also been an increase in the number of children using the free entitlement, so that the funding rate per child has effectively been frozen since 2013-14, equivalent to a real-terms cut of 4.5%. In 2015-16 the Department allocated £2.2 billion for 3- and 4-year-olds (Figure 7). The current national average rate for 3- and 4-year-olds is £4.51, excluding Early Years Pupil Premium (see paragraph 2.5).

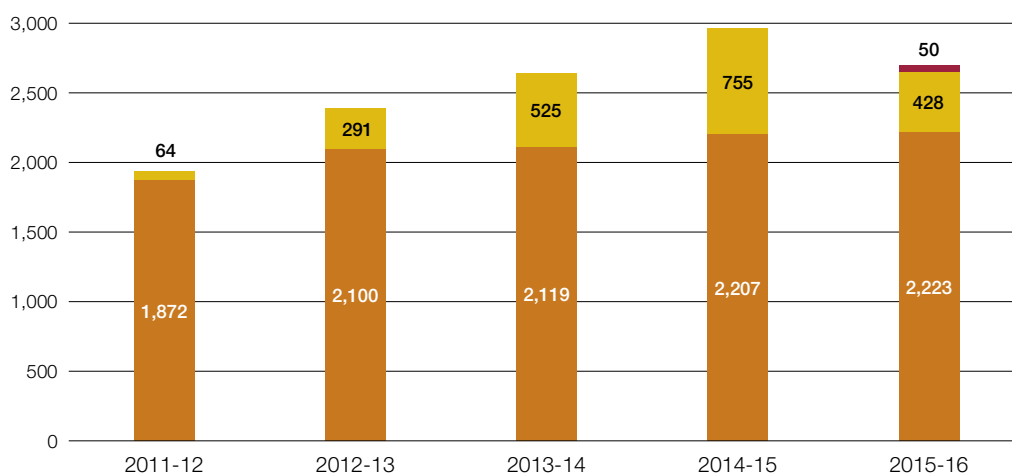
2.4 The free entitlement for 2-year-olds is also funded through the DSG, but the amount allocated is calculated on the basis of an hourly rate per child of £5.09, varied by up to £1.22 per hour to reflect differences in average wages across the country. In 2013-14 and 2014-15, the Department funded local authorities on the basis that all eligible disadvantaged 2-year-olds would use the entitlement, providing £525 million and £755 million respectively. The Department did not expect 100% take-up and intended local authorities to use surplus funds to secure new places and increase demand. From 2015-16, the Department is funding local authorities based on actual take-up and has initially allocated £428 million on this basis (Figure 7).

Figure 7

Departmental allocations for childcare, 2011-12 to 2015-16

Spending decreased in 2015-16 because of reduced funding for the 2-year-old entitlement

Amount allocated (£m)



- Early Years Pupil Premium (for disadvantaged 3- and 4-year-olds)
- Funding for 2-year-olds
- Funding for 3- and 4-year-olds

Note

- 1 Funding for 2-year-olds was allocated through the Early Intervention Grant until 2013-14, now through the Dedicated Schools Grant.

Source: Department for Education

2.5 In April 2015, the Department introduced the Early Years Pupil Premium for disadvantaged 3- and 4-year-olds. This funding is worth 53p per hour, up to a maximum of £302.10 annually for children who use all the hours for which they are eligible. The Department has allocated £50 million for 2015-16, but will not know how many claims providers have made until the summer.

Departmental funding choices

2.6 While the Department's funding of the free entitlement has delivered a large number of places of a quality that Ofsted judges to be 'good' or better, there is a worrying lack of evidence for the specific rates paid. In effect, under current arrangements it is likely that some parts of the country are overfunded while others receive too little. Until recently, there was a poor understanding of the necessary costs providers face.

2.7 The decision to base funding for 3- and 4-year-olds on the school funding formula means that there have been large unexplained variations in funding levels between local authorities, as described in our 2015 report, *Funding for disadvantaged pupils*.⁸ We have also been unable to find a strong evidence base for the Department's decision to set the funding rate for 2-year-olds at £5.09 in 2013-14. At the time, this was higher than the average national rate of £4.26 for a nursery place for children under 2, as reported by the National Family and Childcare Trust, remaining higher than the national rate reported in the same survey in 2015, at £4.62.

2.8 In 2015, the government announced that it would introduce a new funding formula for early years from 2017-18. This creates an opportunity to separate early years funding from school funding, and to link it more closely to the realities of working with this age group. For instance, it may be possible to take greater account of the different ratios of adults to children in early years, with one member of staff to eight children in some instances compared to a ratio of one teacher to around 30 children in primary schools.

Local authorities' funding choices

2.9 The average funding local authorities distribute to providers varies, even when the authorities are statistically similar. Partly this is due to different funding they receive from the Department but partly it is a result of choices they make. While local authorities must use a single funding formula for all providers of a particular type (rather than negotiate with individual providers), they can pay different base rates to different types of providers and make supplementary payments for quality, flexibility, deprivation and rurality. They may also choose how much early years funding to retain centrally to pay for administration and other activities. Typically, local authorities have chosen to give slightly higher funding to nursery classes in schools. On average, over a year, schools with nursery classes received £50 more per 3- or 4-year-old in 2015-16 than PVI settings.

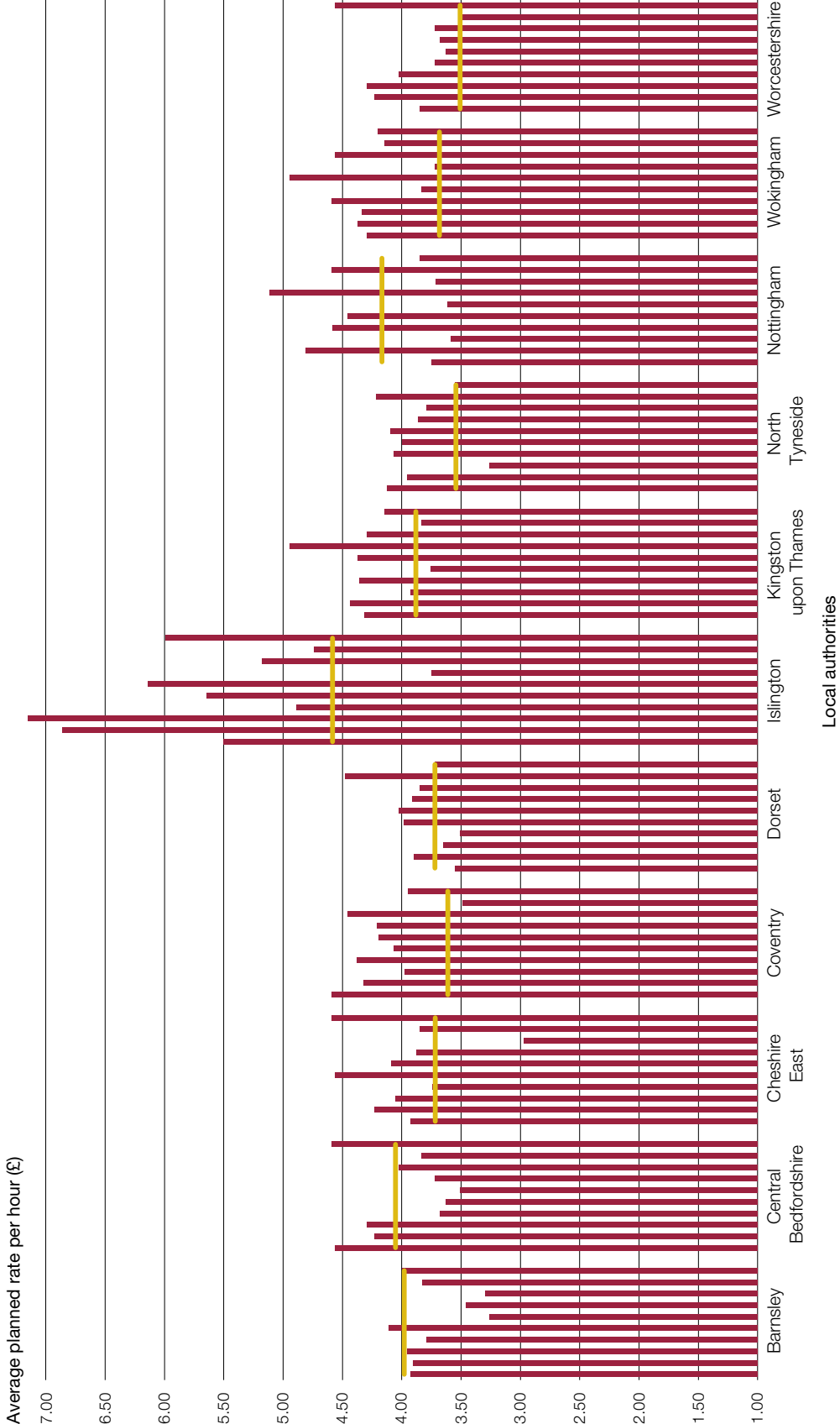
2.10 Some variation in funding rates is expected, due to demographic and geographical differences while others may be the result of choices by democratically elected local bodies. But our analysis of average hourly rates in a selection of local authorities showed large variations between them and their statistical neighbours (**Figure 8**). Across the country, the average funding rate per hour for 3- and 4-year-olds in 2015-16 ranged from £2.28 in Harrow to £7.15 in Westminster. For 2-year-olds, the rate varied from £2.75 in Torbay to £9.06 in Camden.

2.11 Some local authorities we spoke to said the composition of schools forums was a significant factor in these differences. Schools forums vary in their early years representation and their ability to influence funding rates. In some, early years representatives have a strong presence, but in others representatives of secondary schools dominate and, understandably, may be less focused on the costs of early years provision. In recent years, many local authorities have opted to pay a higher hourly rate for 2-year-olds' childcare in order to give incentives to providers to take more 2-year-olds, after the introduction of the new entitlement. In some cases, this has been achieved by paying less than the allocated hourly rate for 3- and 4-year-olds (**Figure 9** on page 28).

⁸ Comptroller and Auditor General, *Funding for disadvantaged pupils*, Session 2015-16, HC 90, National Audit Office, June 2015.

Figure 8
Local authorities' planned spend on 3- and 4-year-olds – average rate per hour, 2015-16

The average hourly rate varies considerably between local authorities and their closest statistical neighbours



■ Closest statistical neighbours
■ Case study local authority

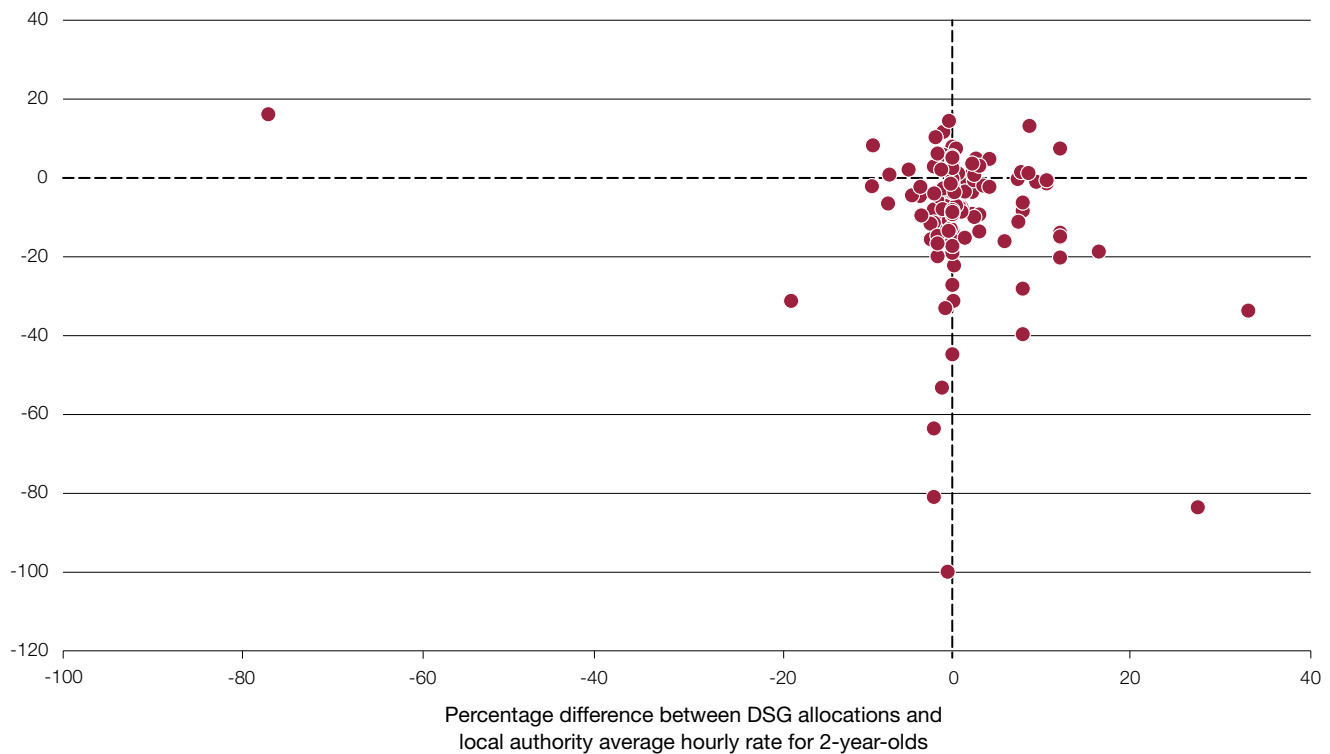
Source: Department for Education

Figure 9

Differences between per child allocations and local authorities' average planned funding per hour, 2015-16

Local authorities tend to fund the same or more than allocated by the Department for 2-year-olds and less for 3- and 4-year-olds

Percentage difference between DSG allocations and local authority average hourly rate for 3- and 4-year-olds (%)



Source: Department for Education

2.12 The amount of funding local authorities retain for central services varies greatly. In 2015-16, 105 local authorities (out of 152) planned to spend up to 10% of the early years component of their DSG on central services; 34 planned to spend between 10% and 20%; and the remainder (13) planned to spend over 20%, up to a maximum of 34% (unlike the DSG, local authorities must pass Early Years Pupil Premium funding to providers in full). The Department does not know how much it costs local authorities to administer early years funding or provide central support, and has not assessed how this amount has changed over time.

2.13 A final cause of variation is the fact that some local authorities choose to spend more on early years than they receive from the Department. The latest data on spending (for 2013-14) shows that, nationally, local authorities spent £233 million more on childcare than the Department funded.

Affordability of free childcare for providers

2.14 Providers of early years childcare told us that current funding rates for 3- and 4-year-olds did not allow them to cover their costs. Two ways that private providers make up shortfalls is by charging parents for additional hours, often at a higher rate, or by offering provision for children who are younger than 2 or not eligible for the 2-year-old entitlement. Providers also often rely on the goodwill of volunteers and fundraising.

2.15 Opportunities for cross-subsidisation and fundraising are likely to be higher in more affluent areas, as poorer parents are less able to pay. This may be one reason why fewer private and voluntary providers operate in deprived areas (**Figure 10** overleaf). Our analysis shows that when they do, they tend to offer more places, which is another way of keeping costs per child lower.

2.16 In advance of the spending review, the Department undertook an exercise to understand the current costs of providing early years childcare. This was done to help determine what rates to offer in future, including for the new entitlement. As part of the work, it also reviewed the operation of the childcare market and business practices of providers.

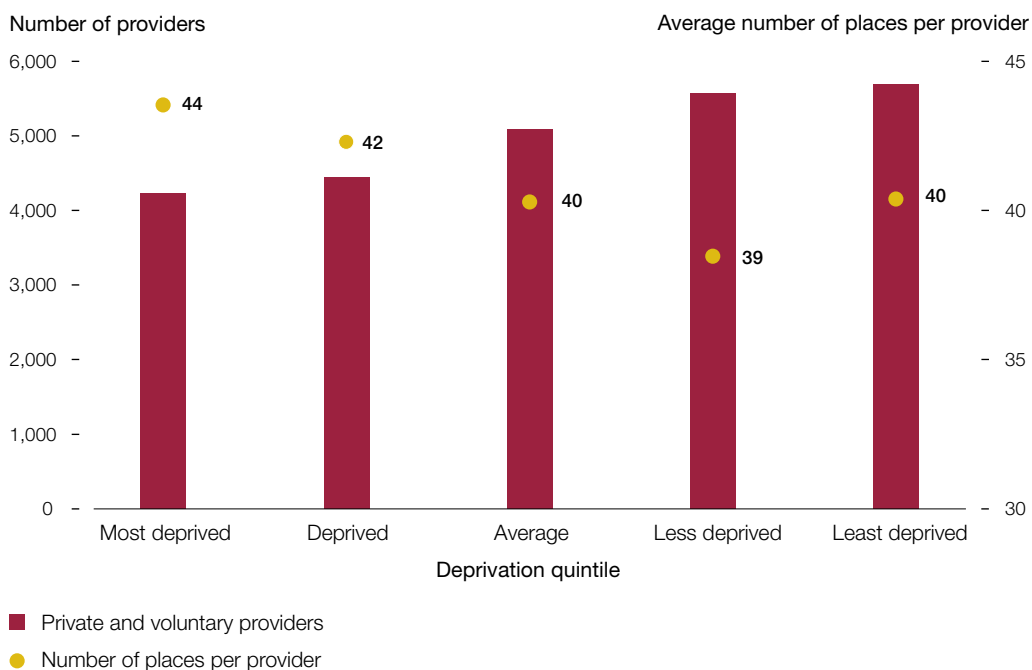
2.17 The Department's work was thorough and wide-ranging and used a variety of sources, including evidence from 2,000 providers and other stakeholders; survey data on providers' current operating models and subsequent focus groups and thematic discussions. The review confirmed that costs varied substantially between providers. It produced possible national hourly rates for 2-year-olds ranging from £4.54 for voluntary settings operating with statutory minimum ratios to £10.83 in maintained nursery schools operating at average ratios, and for 3- and 4-year-olds from £3.14 in voluntary settings operating with statutory minimum ratios to £6.12 in childminders operating at average ratios. The Department told us that it felt there was scope to make efficiencies, for example, by taking a more flexible approach to staffing and by operating at statutory minimum ratios of adults to children.

2.18 Following the spending review, the Department announced it would spend an extra £1 billion per year on early years by 2019-20. Its cost model was used to inform discussions about the new rates of funding, which will be the basis for both the current and new entitlements. The Department decided that funding rates for 2017-18 to 2019-20 would be £5.39 for 2-year-olds and £4.88 for 3- and 4-year-olds. The rate for 2-year-olds was partly based on the representative hourly cost for voluntary providers, without any additions being made for local authority central retention, the national living wage or inflation. The Department told us it had set the rate for 3- and 4-year-olds after adjusting for these factors, and that the rate also took account of the Early Years Pupil Premium. Nationally, local authorities kept back 10% of early years funding in 2014-15. If local authorities were to keep the same percentage in future, the average national rate delegated to providers would reduce by 49 pence per child per hour, to £4.39 for 3- and 4-year-olds, and by 54 pence for 2-year-olds, to £4.85. The Department plans to consult on the amount local authorities can retain.

Figure 10

Private and voluntary childcare places by band of deprivation, March 2015

There are fewer providers in more deprived areas, but these providers tend to have more places

**Note**

1 Excludes childminders.

Source: Ofsted

2.19 The funding rates broadly reflect the current unit costs of private and voluntary providers but are lower than the unit costs estimated for school-based settings, childminders and nursery schools for 2-year-olds, and independent schools, nursery schools and childminders for 3- and 4-year-olds. These settings currently provide 4.5% of places for 2-year-olds and 6% of places for 3- and 4-year-olds. The funding rates will be used as a basis to fund local authorities which in turn will use local formula to distribute the money to providers. It is important that this funding is set at the right level to ensure efficiency but there is a risk that some providers may be under-funded and may decide not to offer the free entitlement in future rather than reducing their costs. The Department does not know how efficient providers currently are following the freeze in funding in recent years.

Effective market management

2.20 Local authorities have a statutory duty to make sure there are sufficient childcare places to deliver the free entitlement in their area. The Department also expects them to intervene in the market where there is poor-quality provision. We have applied the principles of effective market management, as previously set out by the National Audit Office, to assess how effectively local authorities are meeting their duties.⁹ When applied to the childcare market, these principles cover:

- support for parental choice;
- having enough providers and places; and
- ensuring effective outcomes.

Supporting parental choice

2.21 In an effective market, consumers make informed decisions which influence and shape the market. Parents' choices in the market for childcare are complex, particularly for those wanting more than the hours funded by the Department or sending their child to more than one provider. The market is fragmented, with 105,000 providers in March 2015, and the characteristics in different local areas vary. In Sunderland, for example, most settings providing free childcare for 3- and 4-year-olds are maintained primary schools (74%), whereas in Bournemouth these represent only 33% of the market, while 65% is delivered by PVI settings. Providers sometimes restrict when parents can take free hours. Some participants in our focus groups found free hours had been offered only at inconvenient times, making it difficult to use the free entitlement without paying for additional care.

2.22 Local authorities are required to provide information, advice and assistance to parents about childcare in their area. When asked, however, many parents say they rely mainly on word of mouth. Some parents we spoke to in our focus groups felt they had had no choice but to do this. One said, "I just spoke to people and just asked. That was the only way. And I just googled and searched and found." While some parents may be able to carry out the necessary research well, others would undoubtedly benefit from further assistance. Many local authorities have a Family Information Service, but in a 2012/13 survey 70% of parents were not aware of this service, while 84% of surveyed parents who had used the service found it helpful.

⁹ Available at: www.nao.org.uk/wp-content/uploads/2012/06/Delivering_public_services_through_markets.pdf

Securing effective provision

2.23 Local authorities are responsible for ensuring there are enough places to deliver the free entitlement. Local authorities have focused on improving the quality of childcare but many have not focused on increasing choice and competition. They are required to assess whether they have enough places annually but no longer have to publish these assessments. We found that 133 local authorities out of 152 had a sufficiency report online, but seven of these were published before 2010, and a further 47 between 2010 and 2013. Local authorities had used a range of data in these reports, including surveys of providers and reviews of demographic changes and housing plans. But just one fifth of them used data from their Family Information Service (**Figure 11**), which could provide valuable intelligence about where surpluses or shortages exist.

2.24 The total number of providers has decreased slightly and the number of places has increased to accommodate additional children, but overall the marketplace has remained quite stable (**Figure 12** on page 34). For instance, the PVI sector has provided between 35% and 37% of free childcare for 3- and 4-year-olds since 2011. Providers we spoke to said their capacity to expand on existing sites was limited, and identified the following barriers to entering new markets or expanding in existing ones:

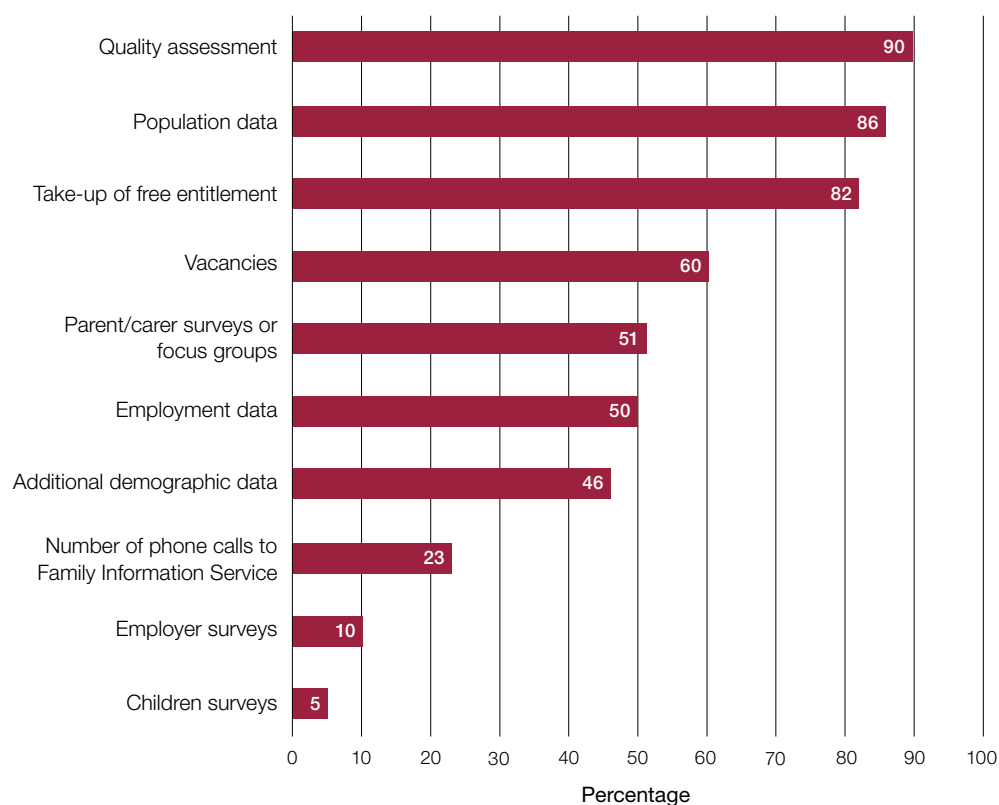
- funding rates that were set too low;
- difficulty accessing qualified staff;
- lack of capital funding for accommodation;
- regulatory burdens; and
- fluctuation in demand.

2.25 As providers of places themselves, via maintained schools and nurseries, local authorities can choose to expand their own capacity, but the Childcare Act of 2006 states they should only do this if no other provider is willing. In practice, therefore, local authorities have to try to stimulate the market in other ways. They have limited powers to offer incentives to providers to enter the market or expand provision. In 2012-13, the Department provided £100 million of capital funding to encourage take-up of the 2-year entitlement and many local authorities used this. However, they are more restricted in how they can use revenue funding. For instance, they are not allowed to pay a higher hourly rate to new-entrant providers. With free entitlement set to expand further, some local authorities may face challenges to increase capacity (see Part Three).

Figure 11

Percentage of sufficiency reports published by local authorities since 2013 that used each source of assessing demand

Only one in five local authorities used data from their Family Information Service as part of their assessment of free childcare places



Source: National Audit Office

Ensuring effective outcomes

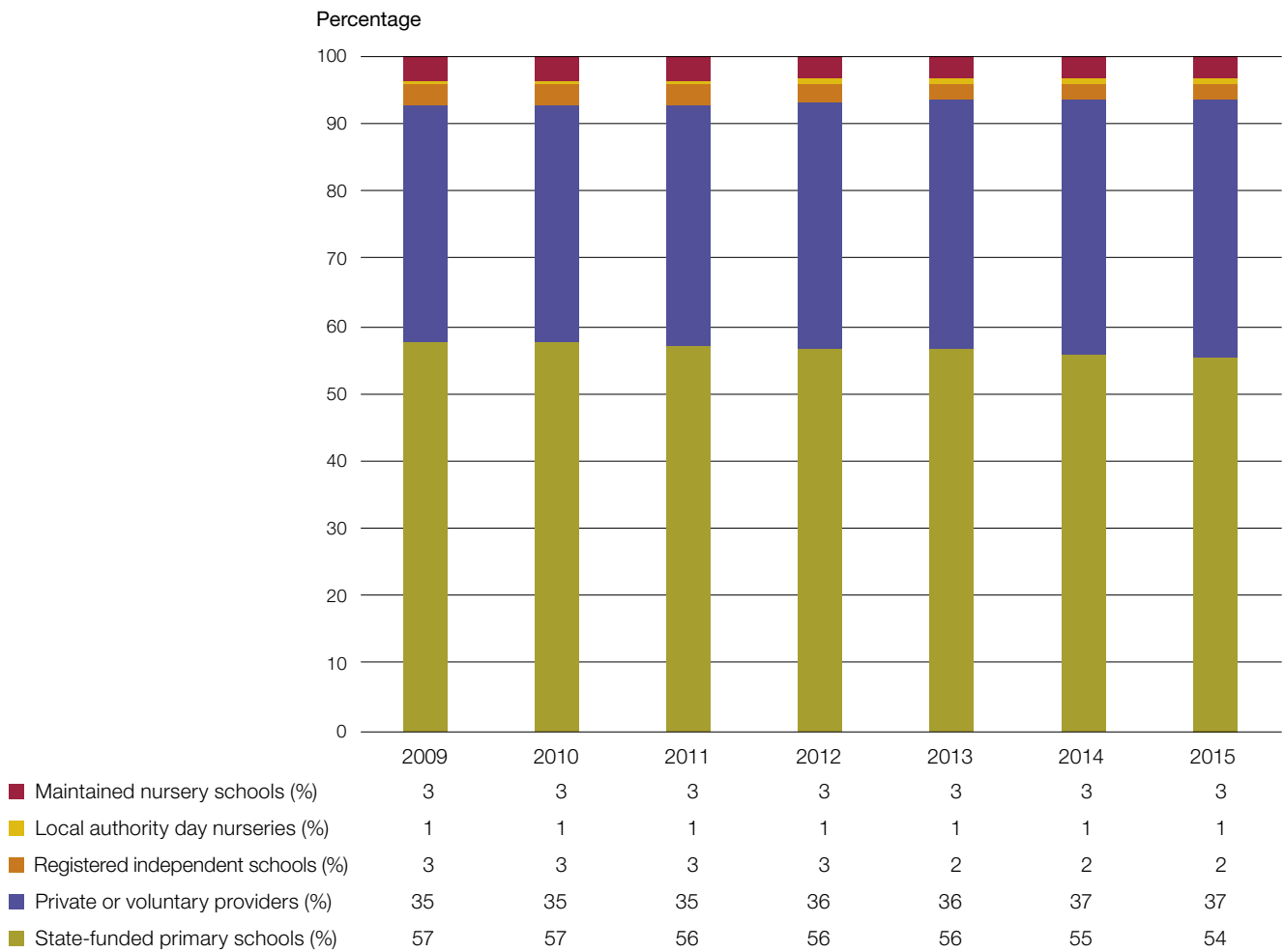
2.26 Data from Ofsted inspections are publicly available and providers often use this information in their marketing. In surveys, as in our focus groups, parents reported choosing settings based on reputation, which is likely to be influenced by quality, but also on convenience.¹⁰ For market mechanisms to bring about increased quality over time, low-quality providers need to face the threat of losing custom. This is less likely to happen where there is an overall shortage of capacity as parents may feel obliged to take places with a provider in a convenient location, even if the quality is not as they would wish. More information about the different outcomes that different types of provision lead to would also help the early years market to function more effectively.

¹⁰ Department for Education, *Childcare and early years survey of parents 2012/13*, January 2014.

Figure 12

Percentage of 3- and 4-year-olds by type of provider, 2009 to 2015

The childcare marketplace has remained stable since 2009



Source: Department for Education

Part Three

Delivering the new entitlement

3.1 In this part of the report we:

- explain the Department for Education's (the Department's) plans for the new entitlement; and
- assess the risks of implementing it.

The new entitlement

3.2 The Department plans to offer an extra 15 hours of free childcare to 3- and 4-year-olds from some working families in England from September 2017. Combined with the existing entitlement, the Department estimates that this will create state-funded childcare for eligible parents worth up to £5,000 per child per year. The details are still being agreed as part of the Childcare Bill 2015, which is making its way through Parliament. But the Department plans to pilot the new arrangements from September 2016, offering 5,000 places to children in selected areas.

Objectives

3.3 The objectives for the current entitlement are to improve outcomes for children and help parents manage childcare costs and work patterns (**Figure 13** overleaf).¹¹ Research supports this as there is little evidence that full-time early years education produces greater developmental benefits than part-time education.¹² But the Department says it will still aim for all childcare it funds to be of good quality.

3.4 In line with good practice for major programmes, the Department will need to define clearly its indicators of success. As the new entitlement is only aimed at working parents – the current plan is for parents to be entitled if they earn the equivalent of 16 hours per week of the National Minimum Wage (up to a maximum of £100,000 per annum) – most beneficiaries are likely to be people who already work and use more than 15 hours of childcare per week. The Department will be saving these parents money but will need to decide what if anything it wants to achieve beyond this. It may try to quantify, for instance, how many additional hours of work have occurred as a result of the new entitlement, although this could be challenging to measure.

¹¹ Department for Education, *Childcare Bill: policy statement*, December 2015, available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/465446/Childcare_Bill_Policy_statement.pdf

¹² K Sylva, et al, *The effective provision of pre-school education (EPPE) project: Findings from pre-school to end of key stage 1*, November 2004, www.ioe.ac.uk

Figure 13

Aims, funding and eligibility for the new entitlement to free childcare

Policy	Age	Aims	Point at which children become eligible	Criteria	Approximate population (%)	Planned national average funding rate (£)
Entitlement to a further 15 hours of free childcare	3- and 4-year-olds	Reduce the cost of childcare for parents Support parents into work, or to work more hours	The term after their 3rd birthday	Households where: both parents work (or one parent works in lone parent families), and each parent earns, on average, a weekly minimum equivalent to 16 hours at national minimum wage or national living wage, and less than £100,000 per year. Both parents are employed but one or both parents is temporarily away from the workplace on adoption leave, or away from work and receiving statutory sick pay, where one parent is employed but one has substantial caring responsibilities, where one parent is employed and one parent is disabled/incapacitated.	42	4.88

Source: Department for Education

3.5 The Department intends for there to be some beneficiaries who previously found the cost of childcare a barrier to working and now decide to enter the workforce. As yet, however, it has made no estimate of how many parents might be helped in this way. The new entitlement is part of a number of government policies encouraging people to work, which may make it challenging to attribute changes to additional free childcare.¹³

Meeting demand

3.6 Demand for the new entitlement is likely to be high. Parents, local authorities, providers and other stakeholders have all been broadly positive about increasing free childcare. The Department's consultation of parents had a good response, with over 2,000 parents completing it, and 90% of respondents saying they would use the 15 additional hours if they met criteria. A large number of respondents to the consultation (81%) also said having more free childcare would enable them to return to work or increase their hours.

¹³ Universal Credit, National Living Wage, increasing the income tax threshold.

3.7 The Department estimates that 390,000 children's parents will meet the criteria as currently defined, though this does not include any parents who are attracted back to work, or who work more hours, as a result of the policy. This is 42% of all children who are eligible for the existing entitlement and the Department estimates that a total of 45,000 new 15-hour places are likely to be needed to accommodate them. It does not know where these places will be required. Its estimate is partly based on survey data from 2012/13 which it used to generate assumptions about how many of the new free hours parents will use on average. Further work will be needed, therefore, including during the pilots, to test these assumptions and establish which local authorities will face the greatest pressure for places.

3.8 The Department will need to work with local authorities to deliver extra places, but, as described in Part Two, most local authorities have had limited experience of stimulating their early years markets in recent years. Even if providers wish to expand, many will not be able to do so within current settings. The Department's last survey of providers, conducted before free childcare was extended to 2-year-olds in 2013, found that childminders were already, on average, 75% occupied; full-day care settings were 80% occupied; and nursery schools 82% occupied. In November 2014, fewer local authorities than a year earlier reported having enough places for parents who work full time or for parents with disabled children. The Department is offering £50 million additional capital funding to help local authorities expand provision in their area.

Impact on disadvantaged 2-year-olds

3.9 There is a risk that the new entitlement will have a negative impact on the further success of the entitlement for disadvantaged 2-year-olds. Many eligible 2-year-olds are still not accessing this entitlement and providers told us they commonly had to cross-subsidise their work with 2-year-olds, which requires more staff per child, despite local authorities offering higher hourly rates. Expanding the number of hours which many 3- and 4-year-olds are entitled to may encourage providers to do more work with them and less with 2-year-olds.

Funding

3.10 As discussed in Part Two, many providers have reported that current funding rates do not cover their costs. Offering the right rate of funding is essential to ensure that providers feel confident to deliver the new entitlement. Future funding arrangements are uncertain as the Department is only starting to develop its new early years funding formula. However, the Department has already taken some decisions as part of the Spending Review 2015, setting out what the national funding rate will be from 2017 and stating that overall funding will increase by £1 billion by 2019-20.

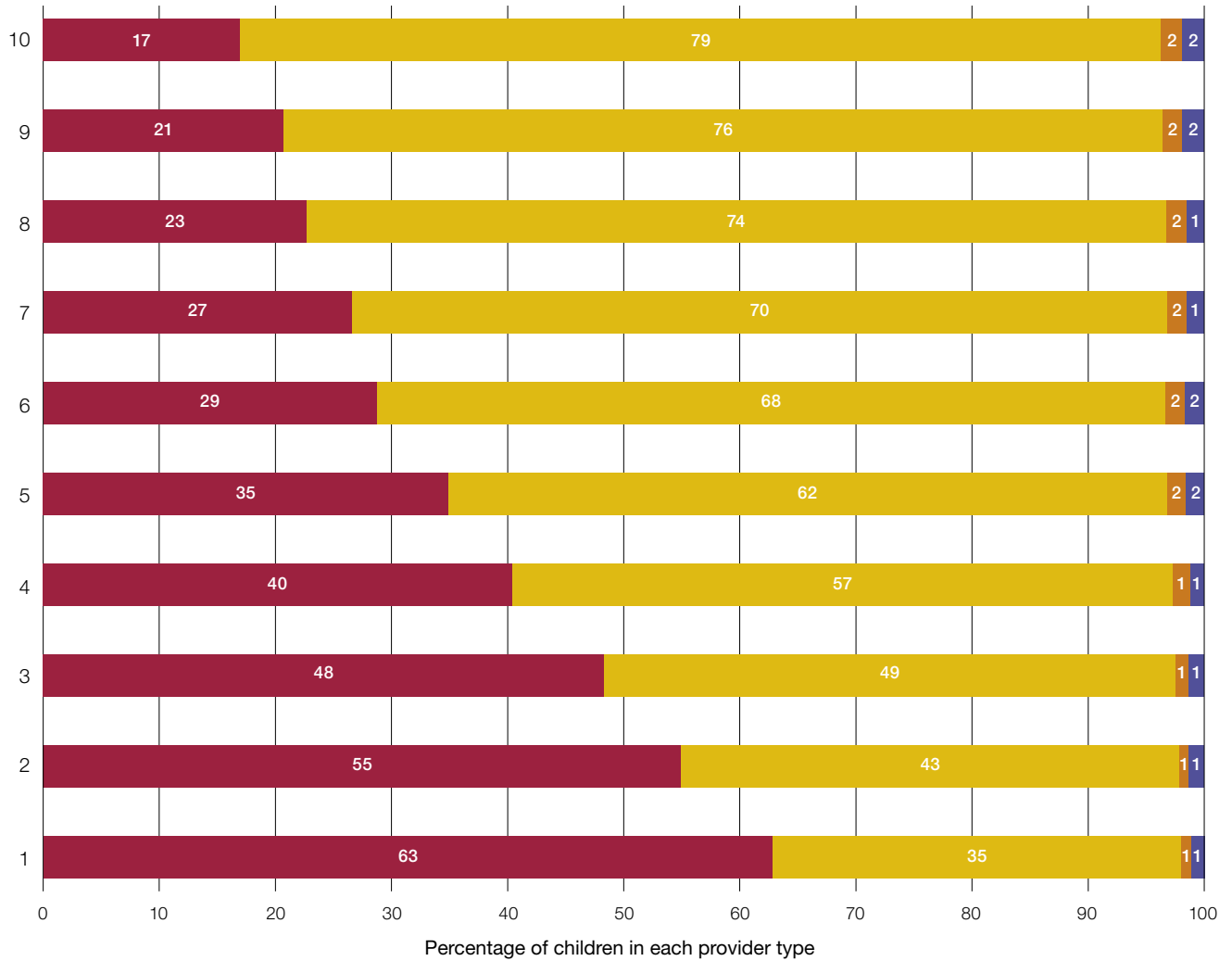
3.11 The new average funding rate will require providers to operate more efficiently in future as well as meaning that some will continue to rely on cross-subsidisation and volunteering. Potential economies of scale may create an incentive for some providers to expand, but others – particular those that cannot expand – may fear reductions in the opportunity to charge parents for additional hours. The Department will need to pay particular attention to the impact of new funding rates on take-up in deprived areas. Our analysis showed that deprived areas have more maintained settings, **(Figure 14)** which typically have less opportunity to cross-subsidise and higher costs. The Department has the opportunity to test the affordability of the new entitlement in the pilots it will run from September 2016.

Figure 14

Percentage of 3-year-olds in provider types by areas of disadvantage

Disadvantaged children are more likely to be in maintained settings than in private, voluntary and independent settings

Deprivation decile of children's addresses (1 is most deprived)



- Maintained
- Private, voluntary and independent
- Childminders
- Other

Note

1 Figures may not reconcile due to rounding.

Source: Department for Education and Office for National Statistics

Appendix One

Our audit approach

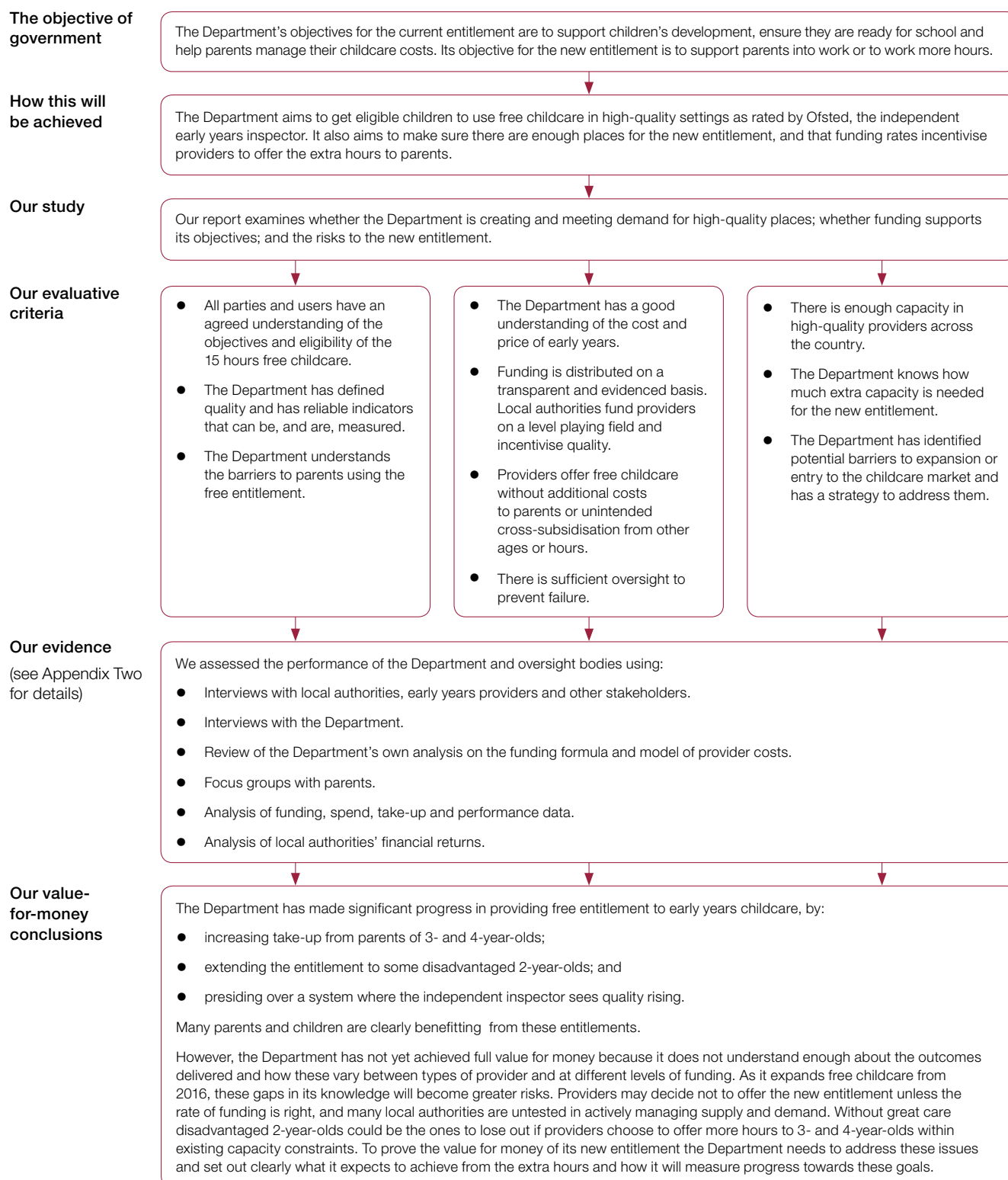
1 This report evaluated whether the Department for Education (the Department) is getting value for money from its expanding entitlement to free early education and childcare. We examined:

- whether the Department has made progress against its objectives to create and meet current demand for high-quality childcare for 2-, 3- and 4-year-olds;
- whether the Department's funding of the free entitlement supports its objectives effectively across the country and is sustainable; and
- what risks to the implementation of the new entitlement are.

2 We used an analytical framework with evaluative criteria to review the Department's current progress to create and meet demand for high-quality childcare places for 2-, 3- and 4-year-olds, and plans to extend the free entitlement. We also used a framework to assess how well local authorities are managing the early years market, and a model review framework to assess the Department's funding model.

3 Our audit approach is summarised in **Figure 15** and our evidence base is described in Appendix Two.

Figure 15
Our audit approach



Appendix Two

Our evidence base

1 We reached our conclusion on value for money after analysing evidence we collected between August and November 2015.

2 **We reviewed the Department's progress against its objectives to meet current demand for high-quality childcare for 2-, 3- and 4-year olds:**

- We **carried out a literature review** to understand research to date that assesses the success of the Department's current free entitlement to early education.
- We **interviewed 11 local authorities and eight stakeholders** to establish how the Department's objectives and eligibility for the free entitlement works in practice and what the Department is doing to stimulate demand.
- We **analysed data from the Department** on take-up and performance measures as defined by the Department.

3 **We assessed the Department's funding of the free entitlement to early years education and its sustainability:**

- We **interviewed Departmental officials and reviewed the Department's documentation** to understand how it oversees the programme and distributes funding for early years.
- We **reviewed the Department's funding formula and early years and childcare costing model.**
- We **interviewed 11 local authorities** to understand how much funding for early years education they receive and analysed local authority financial returns to assess how they distributed that funding.
- We **ran four focus groups with a mixture of parents** who did or did not use the free entitlement, in four different local authorities to understand the barriers parents faced to use childcare locally.
- We **consulted with providers and their representative groups.**

4 We examined the risks to the implementation of the new entitlement:

- We **reviewed the early years and childcare costing model** to understand how the Department decided on the funding rates as set out in the Childcare bill policy statement.
- We **ran four focus groups with parents in four different local authorities** to understand the barriers they faced in accessing the free entitlement and whether they would be likely to take-up the new entitlement.
- We **interviewed Departmental officials and reviewed the Department's documentation** to understand how it plans to implement and oversee the extension.
- We **consulted with providers and their representative groups.**
- We **spoke to six providers, chosen on a random stratified basis using an online platform**, to understand the barriers providers have to offering funded provisions and potential solutions.

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National Audit Office

Design and Production by NAO Communications
DP Ref: 11007-001

£10.00

ISBN 978-1-78604-035-0



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