National Audit Office

Report
by the Comptroller
and Auditor General

Department for Education

Financial sustainability of schools

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Key facts

8.0%
real-terms reduction in per-pupil funding for mainstream schools between 2014-15 and 2019-20 due to cost pressures

£3.0bn
savings mainstream schools need to make by 2019-20 to counteract cost pressures

60.6%
percentage of secondary academies that spent more than their income in 2014/15

20,179	state-funded primary and secondary schools in England as at January 2016
95.7%	of maintained schools' income came from government grants in 2014-15
£39.6 billion	total schools budget in 2015-16, comprising the Dedicated Schools Grant and pupil premium
£1.3 billion	savings in procurement spending that the Department for Education estimates mainstream schools can make by 2019-20 to address cost pressures
£1.7 billion	savings in workforce spending that the Department for Education assumes mainstream schools will need to make by 2019-20 to address cost pressures
11.6%	of maintained schools had surpluses worth 15% or more of their annual income in 2014-15

In this report, dates in the format '20xx–yy' refer to central or local government financial years (1 April to 31 March). Maintained schools report their finances in financial years. Dates in the format '20xx/yy' refer to academic years (1 September to 31 August). Academies report their finances in academic years.

Summary

1 The Department for Education (the Department) is accountable for securing value for money from spending on education services in England. It aims to "deliver educational excellence everywhere, so that every child and young person can access high-quality provision, achieving to the best of his or her ability regardless of location, attainment and background".[1] At January 2016, there were 20,179 state-funded primary and secondary schools across England, educating 6.4 million pupils aged between five and 15.

2 Securing the financial sustainability of schools involves a range of different bodies (**Figure 1** overleaf). In particular:

- As steward of the school system, the Department is responsible for ensuring that there is an adequate framework in place to provide assurance that all resources are managed in an effective and proper manner.
- The Department delegates responsibility for oversight to the Education Funding Agency (the Agency) and 152 local authorities. The Agency oversees financial management and governance in academies and local authorities, and local authorities oversee maintained schools.
- Schools are expected to achieve good outcomes for their pupils, put effective governance in place and manage their financial affairs efficiently and sustainably.

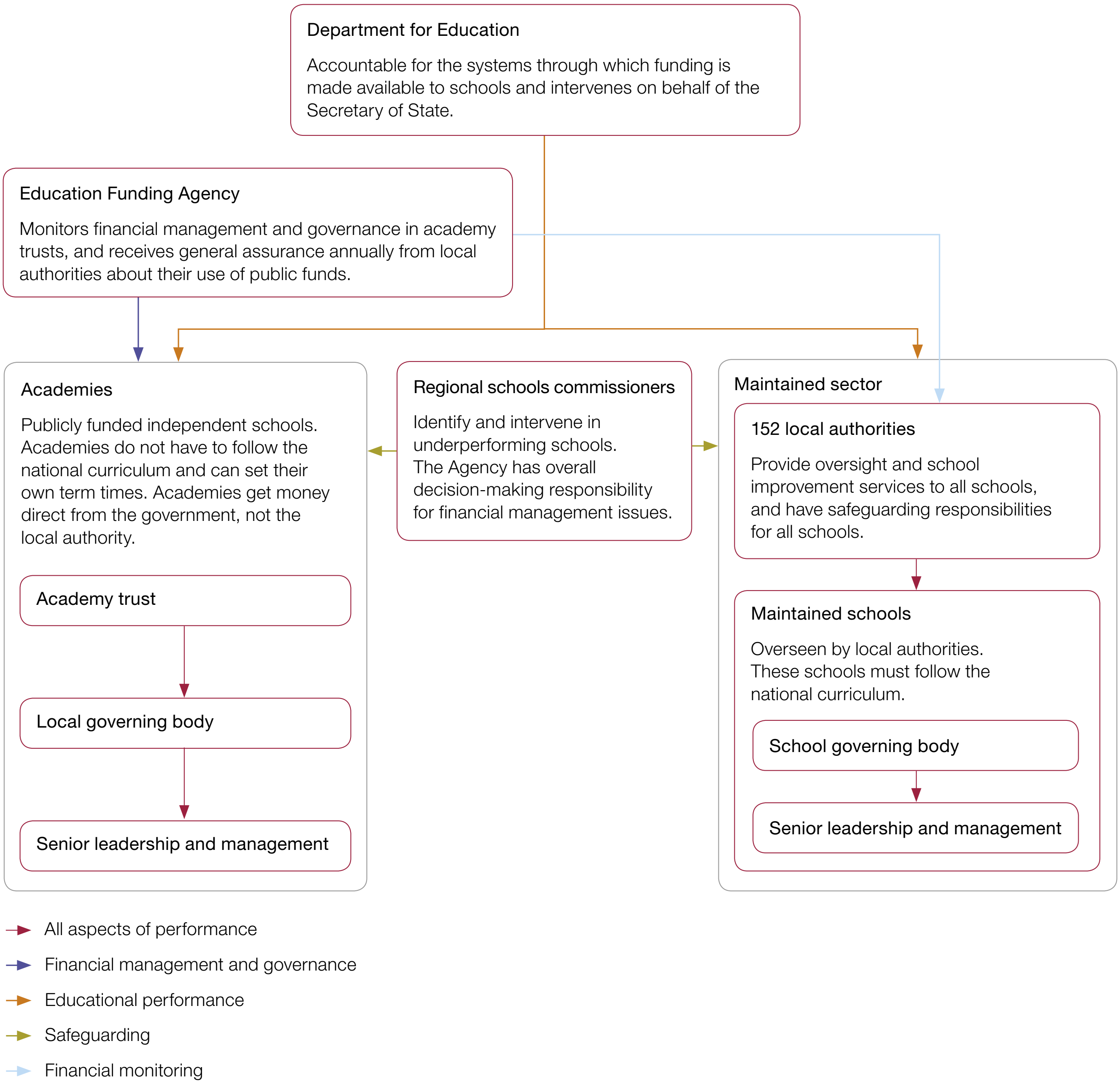
3 The main source of income for state-funded primary and secondary schools in England is funding from the Department. It funds academies directly and maintained schools via local authorities. Government funding accounted for:

- 95.7% of maintained schools' income (£24.1 billion) in 2014-15, with an additional 3.6% (£903.1 million) raised by schools themselves. The remaining funding came from non-government sources; and
- 94.1% of academies' income (£15.0 billion) in 2014/15, with an additional 4.3% (£680.3 million) raised by schools themselves. The remaining funding came from non-government sources.

1 Department for Education, *Educational Excellence Everywhere*, Cm 9230, March 2016.

Figure 1

Roles and responsibilities of the main organisations involved in schools' financial sustainability



Source: National Audit Office analysis of Department for Education and Education Funding Agency material

Focus of our report

4 Funding for schools has been relatively protected compared with most other areas of public spending. However, following the 2015 Spending Review, schools are entering a period of reducing real-terms funding per pupil. The Department is aiming to support schools to ensure that, by 2020, schools have the skills, capabilities and tools to manage pressures on their budgets without affecting their ability to deliver quality educational outcomes.

5 We consider that schools are financially sustainable when they can successfully manage activity, quality and financial pressures within the income they receive. This report examines whether the Department is well placed to support state-funded schools to manage the risks to financial sustainability. We assessed:

- challenges to schools' financial sustainability (Part One);
- the Department's understanding of, and support for, schools' financial sustainability (Part Two); and
- how the Department identifies and addresses the risk of financial failure in schools (Part Three).

6 We examined the overall budget and cost pressures for all schools but did not examine the financial sustainability of, support for or oversight of alternative provision and special schools. All figures reported are for primary and secondary schools only.

Key findings

Challenges to schools' financial sustainability

7 The Department's overall schools budget is protected in real terms but does not provide for funding per pupil to increase in line with inflation. In the 2015 Spending Review, the government increased the schools budget by 7.7% from £39.6 billion in 2015-16 to £42.6 billion in 2019-20. This is a real-terms increase that protects the overall budget from forecast inflation. The Department estimates that the number of pupils will rise over the same period: a 3.9% (174,000) increase in primary school pupils and a 10.3% (284,000) increase in secondary school pupils. Therefore, funding per pupil will, on average, rise only from £5,447 in 2015-16 to £5,519 in 2019-20, a real-terms reduction once inflation is taken into account (paragraph 1.4).

8 The Department estimates that mainstream schools will have to find savings of £3.0 billion to counteract cumulative cost pressures. Pay rises, the introduction of the national living wage, higher employer contributions to national insurance and the teachers' pension scheme, non-pay inflation and the apprenticeship levy will mean additional costs for schools. The Department estimates that, to counteract these pressures, schools will need to make economies or efficiency savings of £1.1 billion (equivalent to 3.1% of the total schools budget) in 2016-17, rising to £3.0 billion (8.0%) by 2019-20. This equates to an 8.0% real-terms reduction in per-pupil funding between 2014-15 and 2019-20 due to cost pressures (paragraphs 1.5 and 1.9 and Figure 4).

9 The Department's savings estimates do not take account of the cost implications for schools of its policy changes. The Department has not assessed the financial impact of policy changes, such as phasing out the Education Services Grant (saving £615 million by 2019-20), that is used by local authorities and academies to provide education services. As we were finalising this report, the Department was working to complete its assessment of the impact of withdrawing the Education Services Grant. The Department gives schools the freedom to decide how to spend their budgets and expects them to have capacity to cope with new policies. However, without evidence to support this assumption, the Department risks imposing higher cost pressures on schools than the £3.0 billion it currently projects (paragraphs 1.6 to 1.8).

10 The Department can demonstrate using benchmarking that schools should be able to make the required savings in spending on workforce and procurement without affecting educational outcomes, but cannot be assured that these savings will be achieved in practice. The Department's statistical benchmarking analysis compared schools with different levels of spending but similar pupil characteristics and levels of attainment. This analysis indicated that, with the support the Department plans to provide, schools could save £1.3 billion by 2019-20 through better procurement and the balance of £1.7 billion by using staff more efficiently. Schools have already found a number of ways in which to cut costs, including collaborating with other schools to benefit from economies of scale. However, they also told us that their ability to make savings is constrained to some extent. For example, the nature of classrooms and other facilities may make it difficult for schools to change size or layout. Furthermore, schools did not achieve the Department's aspiration to save £1 billion on back-office and procurement spending during the previous Parliament: this category of spending increased by £497 million between 2009-10 and 2014-15, a period when per-pupil funding increased slightly in real terms. The Department has not tested the minimum cost of running different types of school in practice to achieve the desired educational outcomes (paragraphs 1.9 to 1.12, 1.20 and 2.7 to 2.12).

11 The Department has not clearly communicated to schools the scale and pace of the savings that will be needed. The Department considers that schools are aware of the expected cost pressures as stakeholders, such as trade unions and sector organisations, have been warning of the likely scale of savings needed. The Department announced in the 2015 Spending Review its aspiration to save £1 billion a year through better procurement by the end of the Parliament but has not made clear the total savings that schools will need to make, or that it expects most of the total to come from workforce savings. Schools are also uncertain about how much funding they will receive each year. The Department is planning to introduce a national funding formula to give schools greater certainty and to distribute funding more equitably. However, it has delayed introduction of the new funding formula from 2017-18 to 2018-19 (paragraphs 1.13 to 1.16).

12 **Overall, the financial position of primary schools has been relatively stable, however, there are signs of financial challenges in secondary schools.**

- **Primary schools.** Between 2010-11 and 2014-15, the proportion of maintained primary schools spending more than their income dropped from 35.6% to 32.7% and the proportion in deficit fell from 5.7% to 4.2%. Between 2011/12 and 2014/15, thex proportion of primary single academy trusts in deficit decreased from 3.2% to 1.6% and, for those trusts, the average deficit fell in real terms from £58,000 to £48,000.
- **Secondary schools.** Between 2010-11 and 2014-15, the proportion of maintained secondary schools spending more than their income rose from 33.7% to 59.3%. The proportion in deficit was 15.0% in 2014-15 and the average size of deficit for those schools in deficit increased in real terms from £246,000 to £326,000. Between 2012/13 and 2014/15, the proportion of secondary academies spending more than their income rose from 38.8% to 60.6%.

In 2014-15, 11.6% of maintained schools had surpluses worth 15% or more of their annual income. The Department does not know with certainty why schools are overspending, or underspending to build up reserves, or for how long these patterns are sustainable (paragraphs 1.17 to 1.19).

Understanding and supporting financial sustainability

13 **In recent years schools have spent a smaller proportion of their budgets on teaching staff.** Around three-quarters of a typical school's expenditure is on staff costs, half on teaching staff. The Department's analysis found that from 2009-10 to 2013-14, 70% of a sample of maintained schools reduced the proportion of their spending that went on teaching staff, despite only 34% experiencing a reduction in funding. The Department has not done the same analysis for academies. The small sample of schools we spoke to told us that they planned to cut staff costs in a range of ways, including replacing more experienced teachers with younger recruits and relying more on unqualified staff (paragraphs 2.2 to 2.6).

14 **The Department continues to develop and publish advice and guidance to help schools improve their financial management and achieve efficiency savings, but has not yet completed work to help schools secure crucial procurement and workforce savings.** The Department published a review of school efficiency in 2013, followed by new benchmarking for academies and some guidance. Following the 2015 Spending Review, the Department launched its Schools Financial Health and Efficiency programme in January 2016 to help schools manage their budgets effectively and ensure their financial health, while maintaining or improving pupil outcomes. The Department has made progress in some areas, including publishing benchmarking and efficiency tools, guidance and access to framework contracts, such as for energy. If implemented, this support may be adequate for schools in stable circumstances, but it is not sufficient for schools in challenging positions. The Department has not yet completed important areas of work, including detailed advice and support to help schools make economies and efficiency savings in workforce and procurement. Without such support, there is a risk that schools may already be making poor decisions about how to cope with the financial pressures (paragraphs 2.13 to 2.20).

15 **The Department's support should be particularly useful for those schools where financial management is weakest, but it cannot be sure that those schools most in need of support will use it.** The Department's tools and guidance have focused on improving schools' financial management to help them make better decisions, with a view to improving educational outcomes. It has provided schools with information to help them undertake a financial health check if they wish, including a directory of potential suppliers. It has not vetted the suppliers listed on its website. The Department has a communications strategy to promote awareness of its guidance, including among 'hardest-to-reach' schools which are most likely to need support. It is taking action to identify this group of schools, but cannot yet identify all of them. The Department has delayed a planned 'invest to save' fund, intended to help schools make changes to enable them to become more efficient. It has a clear monitoring and evaluation plan for the Schools Financial Health and Efficiency programme, which it has started to implement (paragraphs 2.17 to 2.28).

Identifying and managing financial failure

16 **The Agency should intervene more often and earlier when it has financial concerns about maintained schools.** The Agency aims to intervene in a local authority when 2.5% or more of maintained schools in the area have excessive deficits or 5% or more of maintained schools have excessive surpluses, continuously over a four-year period. In calculating these percentages, the Agency has used as the population all schools open at any time during the four-year period, including those which have closed or converted to academies. The upshot of this is that the Agency has not intervened as often as it might have. In 2014-15, the Agency intervened in one local authority with regard to school deficits and 11 with regard to surpluses. Using a more comparable population (the number of maintained schools open in 2014-15), we calculated that the Agency would have contacted more local authorities – three with regard to school deficits and 27 with regard to surpluses. In light of our analysis, the Agency has decided to change its approach for 2015-16. The Agency did not intervene in the local authority with the highest proportion of schools in deficit in 2014-15 (13.0%), the Isle of Wight, because of how it applies its criteria (paragraphs 3.4 to 3.9).

17 **The Agency has a process for assessing financial risk in academies but its records make it difficult to gain assurance that all academies at potentially high risk have been dealt with consistently.** The Agency has a framework to help judge levels of financial risk, with the academy trusts most at risk having projected or actual deficits of 5% or more and no agreed recovery plan in place. Ultimately, the assessment of risk and decisions on whether to intervene are matters of judgement. This means that the Agency does not necessarily classify all trusts forecasting deficits of 5% or more as high risk. To provide assurance to senior management the Agency compiles a monthly 'national concerns report' listing academies most at risk, including due to financial issues, and the actions being taken in the highest risk cases. Our review of the 101 cases meeting the 5% deficit threshold in 2015/16 found that the Agency had included 64 in the

national concerns report. The Agency's central records did not indicate what it had done and why for the 37 other cases. It investigated each of these cases individually to provide us with evidence of the actions it had taken. The Agency told us that it is taking action to improve its record keeping and strengthening its oversight by developing a preventative approach to support trusts at financial risk (paragraphs 3.11 to 3.19 and 3.22 to 3.24).

18 The Agency does not systematically evaluate the impact of its financial interventions on schools' longer-term financial sustainability and educational outcomes. The Agency has not evaluated the impact on financial sustainability and educational outcomes of its different types of financial intervention and the speed at which it intervenes. Its main financial intervention with local authorities is a conversation about their plans for maintained schools in deficit or surplus. In overseeing academies, the Agency does not analyse how the financial risk has changed over time and it does not assess whether its interventions have helped to improve academies' longer-term financial sustainability or which interventions are most effective. Our analysis of the Agency's data suggest that its interventions may not always result in trusts successfully addressing the financial issues that led to them being included in the national concerns report (paragraphs 3.10 and 3.20 to 3.21).

Conclusion on value for money

19 The Department is seeking to deliver educational excellence everywhere, and to growing numbers of pupils, against a budget that provides little more than flat cash funding per pupil over the five years to 2019-20. This means that mainstream schools need to find significant savings, amounting to £3.0 billion by 2019-20, to counteract cost pressures. The Department believes that schools can finance high standards by making savings and operating more efficiently. However, it has not yet completed its work to develop tools and advice to help schools secure crucial procurement and workforce savings. It is clearly reasonable for the Department to look to schools to make efficiencies, but it is important to understand the implications of this method of doing so. The definite part of the Department's approach is that real-terms funding per pupil will drop over the coming years; the uncertain part is how schools are able to respond based on their particular circumstances. This could be by making the 'desirable' efficiencies that the Department judges feasible or it could be by making spending choices that put educational outcomes at risk. Based on our experience in other parts of government, this approach involves significant risks that need to be actively managed. To avoid things going the wrong way, the Department needs effective oversight arrangements that give early warning of problems, and it needs to be ready to intervene quickly where problems do arise. Until more progress is made, we cannot conclude that the Department's approach to managing the risks to schools' financial sustainability is effective and providing value for money.

Recommendations

a **The Department should publish, as soon as possible, its assessment of the financial challenges to be faced by schools between 2015-16 and 2019-20.** The Department should keep this information up-to-date as its assumptions change.

b **The Department should provide clear leadership to support schools and to ensure that all parties are open about the opportunities to make efficiency savings, are realistic about timetables and the implications of cost savings, and understand each other's concerns.** The Department must take responsibility for supporting schools to meet cost pressures in a financially sustainable manner, which takes educational outcomes into consideration.

c **The Department should move faster to set out how it envisages mainstream schools will achieve savings of £3.0 billion by 2019-20, together with the information and support schools will need in order to do so.** Experience shows that it takes time to secure savings in a way that does not damage services. Schools will need time to examine the Department's guidance on procurement and workforce in particular, and to develop and implement savings plans.

d **The Department should work with the schools sector to gather evidence to assure Parliament that school spending power can reduce at the same time as educational outcomes are improved.** This should be a core priority for the Department in evaluating its School Financial Health and Efficiency programme.

e **The Agency should develop further its approach to oversight and intervention with a renewed focus on preventing financial failure.** The Agency should continue to develop its preventative approach to identifying academy trusts at risk of getting into financial difficulty and consider with local authorities whether a similar approach is feasible for maintained schools. As with the maintained sector, the Agency should intervene when academy trusts are building up surpluses and develop its understanding of why trusts are doing so.

f **The Agency should improve its central records to provide assurance around its decisions whether or not to intervene and use its information to learn from what works.** The Agency should use its new records system to record better its decisions on whether to intervene. It should follow up and evaluate its interventions and share learning on what works best to address risks to schools' financial sustainability. The Agency could also develop the analysis we have undertaken about how trusts' financial risk has changed over time, coupled with its planned risk projections.