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Report
by the Comptroller
and Auditor General

Department for Education

Financial sustainability of schools

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Department for Education

Financial sustainability of schools

Report by the Comptroller and Auditor General

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Comptroller and Auditor General
National Audit Office

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This report examines the value for money of the Department for Education's approach to managing risks to schools' financial sustainability in light of increasing cost pressures.

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Contents

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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.

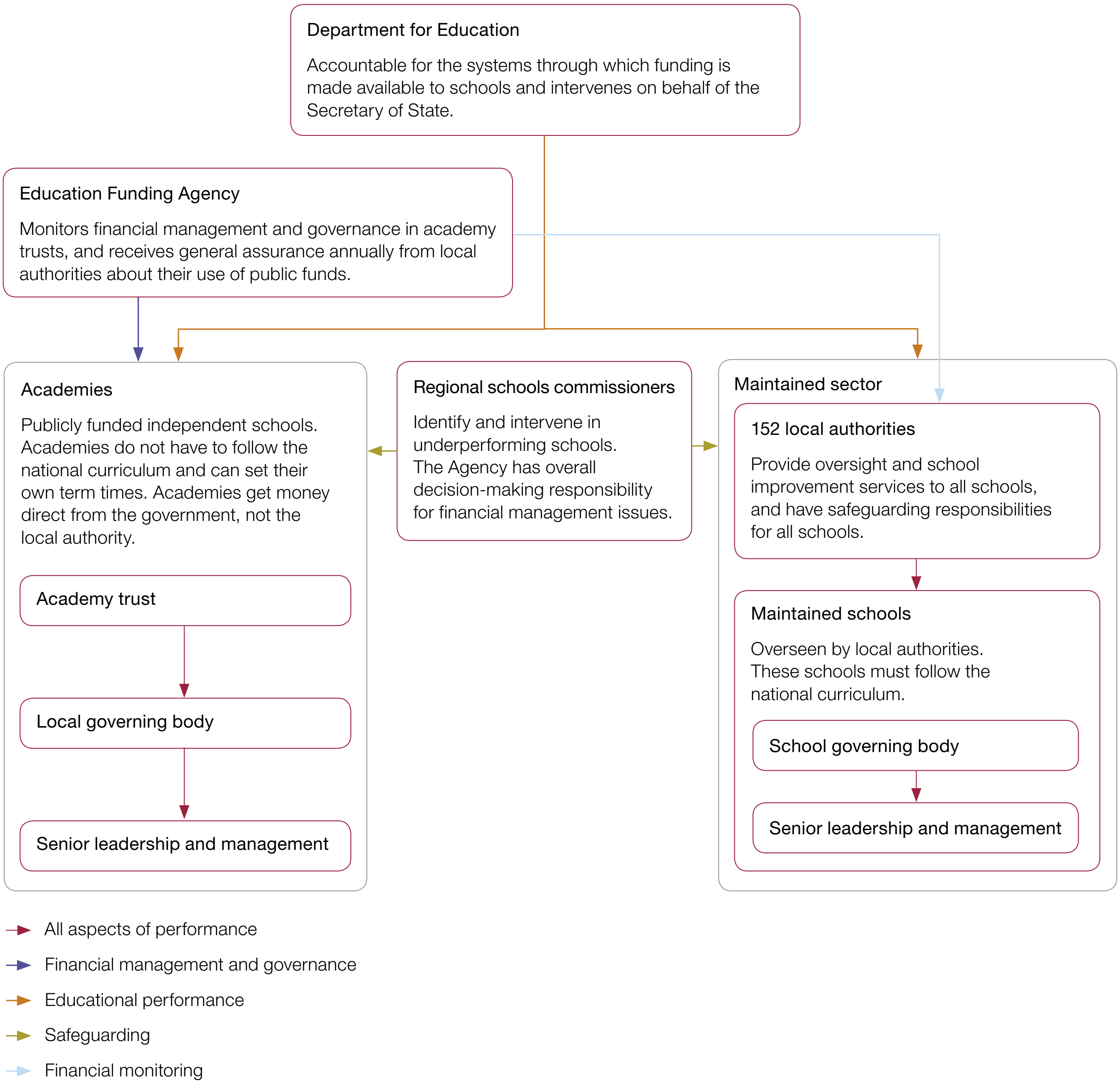
3 The main source of income for state-funded primary and secondary schools in England is funding from the Department. It funds academies directly and maintained schools via local authorities. Government funding accounted for:

- 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.

Part One

Challenges to schools' financial sustainability

1.1 We consider that schools are financially sustainable when they can manage activity, quality and financial pressures successfully within the income they receive. A financially sustainable school is able to help all its pupils reach their potential, deliver the curriculum, implement policy changes and manage its staff and facilities effectively while improving efficiency and financial management.

1.2 This part of the report outlines the financial context and the financial sustainability of schools to date.

Financial context

Funding

1.3 State-funded schools receive most of their funding from the Department for Education (the Department).[2] School funding in England has been relatively protected compared with most other areas of public spending. Between 2010–11 and 2014–15, the Department protected the main schools grant per pupil in cash terms and introduced the pupil premium for disadvantaged pupils. Analysis by the Institute for Fiscal Studies shows that, during this period, public spending per pupil on education rose by 0.6% in real terms across all state-funded schools.[3,4] The Department provides separate funding for pupils aged 16-19. This funding fell by 14% in real terms between 2010–11 and 2014–15, affecting those schools with sixth forms.[5]

1.4 The Department's settlement in the 2015 Spending Review does not provide for funding per pupil to increase in line with inflation. The government increased the schools budget, comprising the Dedicated Schools Grant (schools and high-needs blocks)[6] and the pupil premium, 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 inflation. The Department forecasts that the number of pupils will rise by January 2020: a 3.9% (174,000) increase in primary schools pupils to 4.7 million and a 10.3% (284,000) increase in secondary schools pupils to 3.0 million. As a result, funding per pupil will, on average, rise only by 1.3% from £5,447 in 2015-16 to £5,519 in 2019-20 (**Figure 2** overleaf).

2 For this report, schools comprise maintained schools, academies, free schools, university technical colleges, city technology colleges, studio schools and secondary schools with sixth forms.
3 L. Sibieta, *Schools Spending*, IFS Briefing Note BN168, Institute for Fiscal Studies, March 2015.
4 This real-terms increase per pupil includes pupils attending alternative provision and special schools.
5 See footnote 2.
6 The Dedicated Schools Grant comprises the schools block (the main component of schools funding), the high-needs block (funding for pupils with special educational needs and disabilities) and the early years block (funding for 3- and 4-year-olds and disadvantaged 2-year-olds).

Figure 2
The Department's settlement in the 2015 Spending Review

The overall schools budget is protected from forecast inflation but, as pupil numbers are rising, the amount per pupil schools receive, on average, will not rise in line with inflation

	2015-16	2016-17	2017-18	2018-19	2019-20
Total core schools budget[1] (£m)	**39,556**	**40,214**	**40,953**	**41,745**	**42,607**
Percentage change each year (%)		**1.7**	**1.8**	**1.9**	**2.1**
GDP deflator: forecast percentage change each year (%)[2]		1.5	1.8	2.1	1.9
Number of full-time equivalent pupils in state-funded schools January 2016 to January 2020 (thousands)[3]	7,262	7,394	7,516	7,628	7,720
Total schools budget per pupil (£)	**5,447**	**5,439**	**5,449**	**5,473**	**5,519**
Percentage change each year (%)		**-0.2**	**0.2**	**0.4**	**0.8**

Notes

1 'Total core schools budget' comprises the Dedicated Schools Grant (schools and high-needs blocks) and the pupil premium for all schools including alternative provision and special schools.

2 Gross domestic product (GDP) deflators at market prices, forecast change each year (HM Treasury, September 2016). Used as a measure of general inflation.

3 Pupil numbers from national pupil projections: July 2016.

Source: Department for Education

1.5 Schools have not experienced this level of reduction in spending power since the mid-1990s.[7] The Department estimates that schools face cumulative cost pressures of 3.4% in 2016-17, rising to 8.7% by 2019-20 (**Figure 3**). Alongside non-pay-related inflation, pay-related costs will increase through pay rises, the introduction of the national living wage, and higher employer contributions to national insurance and the teachers' pension scheme. Some schools and academy trusts will also have to pay the apprenticeship levy from April 2017.[8] The effect of these various cost pressures on individual schools will depend on their particular circumstances.

Cost of policy changes

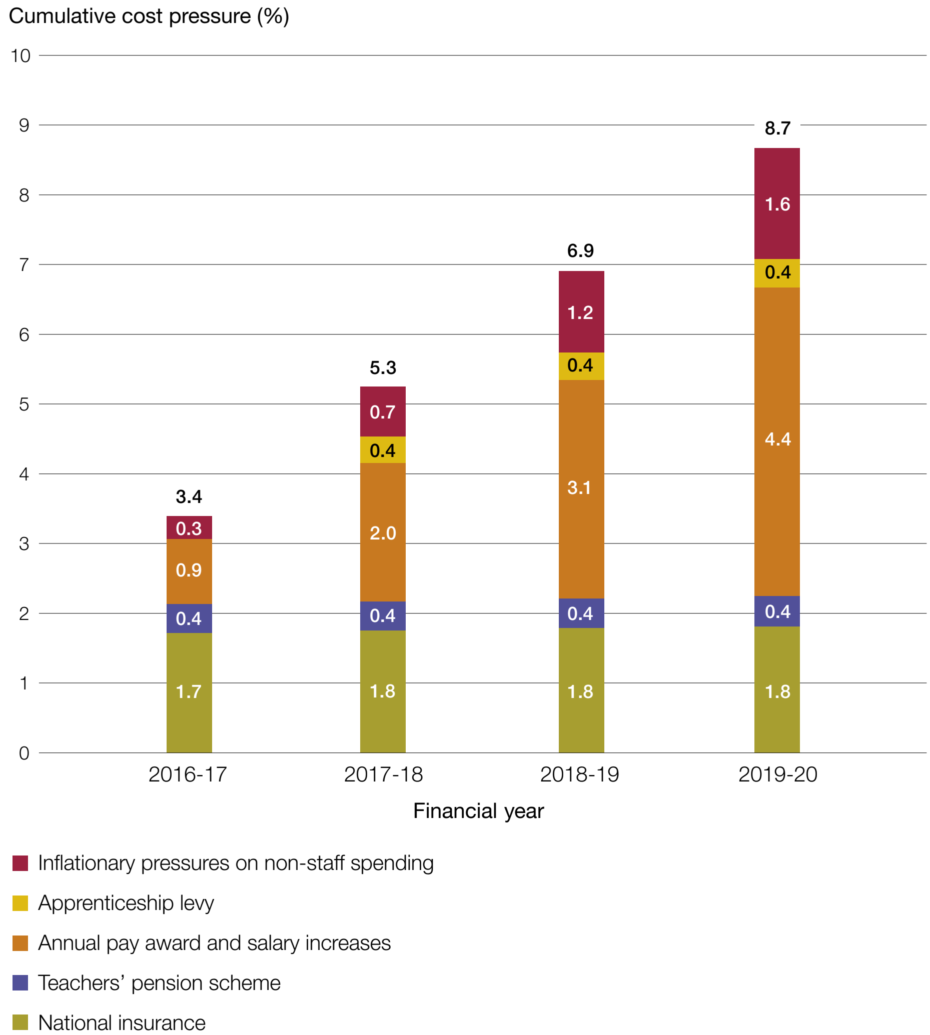
1.6 While the Department has estimated the pressures from inflation and increased pay-related costs, it has not assessed the financial impact for schools of its policy changes. The Department compiles a list of future policy changes that it expects will affect schools but has no plans to assess the financial implications for schools of these changes. It does not therefore have assurance that its policies are affordable within current spending plans without adversely affecting educational outcomes. It leaves schools and multi-academy trusts to manage the consequences individually.

7 C. Belfield and L. Sibieta, *English schools will feel the pinch over the next five years*, Institute for Fiscal Studies, October 2015.

8 From April 2017, all employers, with an annual pay bill exceeding £3 million, must pay an apprenticeship levy (0.5%of their annual pay bill) to fund apprenticeship training.

Figure 3
Cumulative cost pressures facing schools, 2016-17 to 2019-20

The Department estimates cumulative cost pressures on schools of 3.4% in 2016-17, rising to 8.7% by 2019-20



Note

1 Percentages may not sum due to rounding.

Source: Department for Education

1.7 For example, the Department is phasing out the 'general funding rate' from the Education Services Grant, which is used by local authorities and academies to provide education services. It will reduce the grant, worth £87 per pupil in 2015/16, and withdraw it completely in 2018/19, saving £615 million per year. The Department assumes that local authorities and academies will cope with the reduction in funding by becoming more efficient. It also expects the role of local authorities to reduce as schools convert to academies. However, in May 2016, the government changed its approach to focus the conversion to academies on struggling schools. As a result, more schools are likely to remain in local authority control, and require services from local authorities, for longer.[9] As we were finalising this report, the Department was working to complete its assessment of the impact of withdrawing the Education Services Grant.

1.8 While the Department must assess and fund extra costs for local authorities from introducing new powers, duties and other government-initiated changes, it does not have to do the same for schools. It highlights that some of its important policies have separate grants associated with them, such as the pupil premium to raise the attainment of disadvantaged pupils and the primary physical education and sports grant. Otherwise, the Department gives schools the freedom to decide how to spend their budgets and expects them to have capacity to cope with new policies: for example, where a curriculum change requires them to replace textbooks and learning materials. However, without evidence to support this assumption, the Department risks imposing additional cost pressures on schools.

Savings required to offset cost pressures

1.9 The Department expects schools to make significant savings in spending on workforce and procurement. In total, it estimates that mainstream schools will have to make economies or efficiency savings of £3.0 billion by 2019-20 to counteract cost pressures (excluding the impact of policy changes) (**Figure 4**). This equates to an 8.0% real-terms reduction in per-pupil funding between 2014-15 and 2019-20 due to cost pressures. However, it cannot be assured that these savings will be achieved in practice.

1.10 The Department has carried out statistical benchmarking analysis to assess the scope for savings in mainstream schools. It grouped schools by characteristics and attainment and then identified the level of savings that would be achievable were the relative high spenders to reduce their spending to the lower benchmarks achieved by similar schools. It has also examined procurement spending by other government departments through Crown Commercial Service frameworks, to estimate potential savings that schools could make through such frameworks.[10] Based on these analyses, and the support that it plans to put, in place the Department estimates that schools could save £1.3 billion by 2019-20.

9 Local authority services for maintained schools that are funded through the Education Services Grant include services for children with special educational needs, schools improvement activities and statutory duties including monitoring schools' financial management.

10 In 2015/16, schools spent £72 million through the Crown Commercial Service, an executive agency of the Cabinet Office.

Figure 4
Savings required to address cost pressures

Mainstream schools will need to save £3.0 billion by 2019-20 to address cost pressures

	2015-16	2016-17	2017-18	2018-19	2019-20
Total schools core budget for all schools as agreed in the 2015 Spending Review (£m)[1]	39,556	40,214	40,953	41,745	42,607
Estimate of total budget allocated for mainstream schools (£m)[2]	34,790	35,402	36,168	36,814	37,535
Estimate of net cumulative cost pressures for mainstream schools (%)[3]		3.1	4.6	6.3	8.0
Estimated savings required by mainstream schools to offset net cumulative cost pressures (£m)		**1,112**	**1,677**	**2,315**	**2,994**
Estimated savings from procurement required by mainstream schools to offset net cumulative cost pressures (£m)[4]		35	300	715	1,260
Estimated savings from workforce required by mainstream schools to offset net cumulative cost pressures (£m)[5]		1,077	1,377	1,600	1,734

Notes
1 Estimated funding is rounded to the nearest million (except for procurement savings: see note 4).
2 The budget for mainstream schools is the total schools budget less funding for non-mainstream schools such as alternative provision and special schools.
3 These percentages differ from those in Figure 3 because they reflect the increase in per pupil funding.
4 Estimated procurement savings are rounded to the nearest £5 million.
5 The Department assumes that 'savings from workforce' will be achieved by schools using their staff more efficiently.

Source: Department for Education

1.11 The Department assumes that schools will achieve the balance of savings, rising to £1.7 billion by 2019-20, by deploying and using staff more efficiently. The Department has compared per-pupil spending on workforce in groups of similar schools, defined in terms of pupil characteristics and attainment. It estimated that £2.9 billion could be saved if the highest spending schools reduced their spending to the median.

1.12 The Department is still finalising its procurement strategy, including a breakdown of how it expects procurement savings to be achieved in practice. It had a similar aspiration for schools to save £1 billion on back-office and procurement spending during the previous Parliament, but this was not met.[11] It has calculated that schools' spending on non-staff goods and services in fact increased by £1.8 billion (22%) in real terms between 2009-10 and 2014-15, from £8.1 billion to £10.0 billion. The Department considers that most of this increase (£1.3 billion) can be explained by: higher pupil numbers (£365.6 million); new responsibilities for schools to provide free school meals to every child in reception, year 1 and year 2 (£566.1 million of grants in 2014/15); and activities transferred from local authorities to academies, funded through the Education Services Grant and worth £384.1 million in 2014-15. Excluding these factors, schools increased their back-office and procurement spending by £497.1 million between 2009-10 and 2014-15, a period when per-pupil funding increased slightly in real terms.

11 HM Treasury, *Spending Review 2010*, October 2010.

1.13 We found during the course of our work that the Department has not clearly communicated to schools the scale and pace of the savings that will be needed to meet the expected cost pressures. The Department considers that schools are aware of the pressures as stakeholders 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. However, it has not announced that total savings of £3.0 billion will be required to counteract cost pressures by 2019-20, or that most of this amount will have to come from workforce savings and that these savings are expected to be achieved through greater efficiency.

Funding uncertainty

1.14 Schools are currently uncertain about how much funding they will receive each year, making it difficult to plan and budget effectively. The Education Funding Agency (the Agency) distributes funding directly to academies, and via local authorities to maintained schools. Funding is distributed through the Dedicated Schools Grant and other specific grants, using formulae set by local authorities. The main factor in determining a school's budget is number of pupils but other factors include prior attainment, deprivation and population sparsity.[12] Each local authority, in consultation with the local schools forum,[13] separately designs its own formula and adjusts funding allocations annually.

1.15 The Department plans to give schools more certainty about future funding through a national funding formula. Greater certainty is expected to come from a clear, transparent and predictable formula that links funding directly to school and pupil characteristics.[14] The Department also proposes to use the new formula to address the fact that schools in similar circumstances can receive very different levels of funding depending on where they are located. This proposal could result in the budgets for schools which currently have higher levels of funding being reduced, and more poorly funded schools having their budgets increased.

1.16 However, in July 2016, the Department announced that it would delay introducing the new national funding formula until 2018-19 to allow sufficient time for consultation and implementation. To give schools some certainty in the meantime, the Department has guaranteed that no school will have the funding it receives through the local authority formula reduced by more than 1.5% per pupil for 2017-18.

12 Schools receive 16–19 funding on the basis of the number of 16- to 19-year-old pupils who attended the school in the previous academic year.

13 A schools forum comprises representatives from schools and other organisations, such as nursery and 16–19 education providers. It acts as a consultative body (for example, on changes to the local funding formula) and a decision-making body (for example, on how much grant funding is retained by the local authority).

14 Department for Education, *Schools national funding formula – Government consultation – stage one*, March 2016.

Financial sustainability of schools to date

Surpluses and deficits

1.17 An indicator of the financial sustainability of schools is the extent to which they are able to manage within their budget without building up a significant deficit or surplus. We examined the financial positions of mainstream maintained schools and academy trusts separately because of their different financial reporting periods.[15]

Maintained schools

1.18 For maintained schools, our analysis suggests that, in general, the financial health of primary schools has remained relatively unchanged from 2010-11 to 2014-15 but an increasing proportion of secondary schools may be struggling financially. The main findings are that:

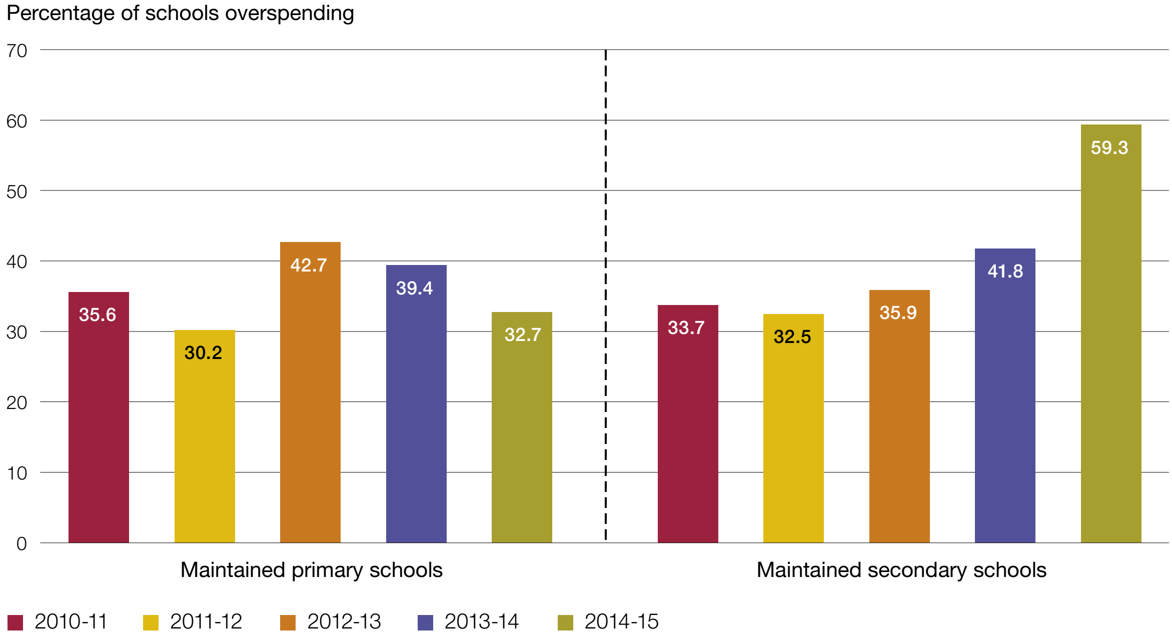
- the proportion of maintained primary schools spending more than their income decreased from 35.6% in 2010-11 to 32.7% in 2014-15, while the proportion of maintained secondary schools spending more than their income increased from 33.7% to 59.3%. (**Figure 5** overleaf);
- the proportion of maintained secondary schools in deficit stayed relatively constant at 14.6% in 2010-11 and 15.0% in 2014-15, but the average deficit increased in real terms from £246,000 to £326,000. For maintained primary schools, the proportion in deficit fell from 5.7% to 4.2% and the average deficit remained relatively constant throughout the period at £35,000 in 2014-15 (**Figure 6** on page 21);
- some maintained schools have built up significant surpluses since 2010 (**Figure 7** on page 22). The percentage of maintained schools with surpluses worth 15% or more of their annual income increased from 4.7% in 2010-11 to 11.6% in 2014-15. The Department does not know with certainty why schools are underspending to build up reserves. Stakeholders told us this may be due to uncertainty over future funding with schools seeking to build up a contingency in case of funding cuts; and
- there is variation between local authorities in the proportion of maintained secondary schools in deficit. A small number of local authorities account for a large proportion of schools in deficit: one-third of the maintained schools in deficit in 2014-15 were in just 13 local authorities. In 2014-15, 74 local authorities had no maintained secondary schools with a deficit exceeding 2.5%, but 14 local authorities had at least one-third of their maintained secondary schools with deficits exceeding 2.5% (**Figure 8** on page 23).

15 Analysis excludes alternative provision and special schools.

Figure 5

Percentage of maintained schools spending more than their income, 2010-11 to 2014-15

The proportion of maintained secondary schools spending more than their income increased significantly between 2010-11 and 2014-15



	Number of maintained primary schools overspending	Number of maintained secondary schools overspending
2010-11	6,052	1,054
2011-12	5,075	901
2012-13	6,960	707
2013-14	6,117	660
2014-15	4,823	832

Note

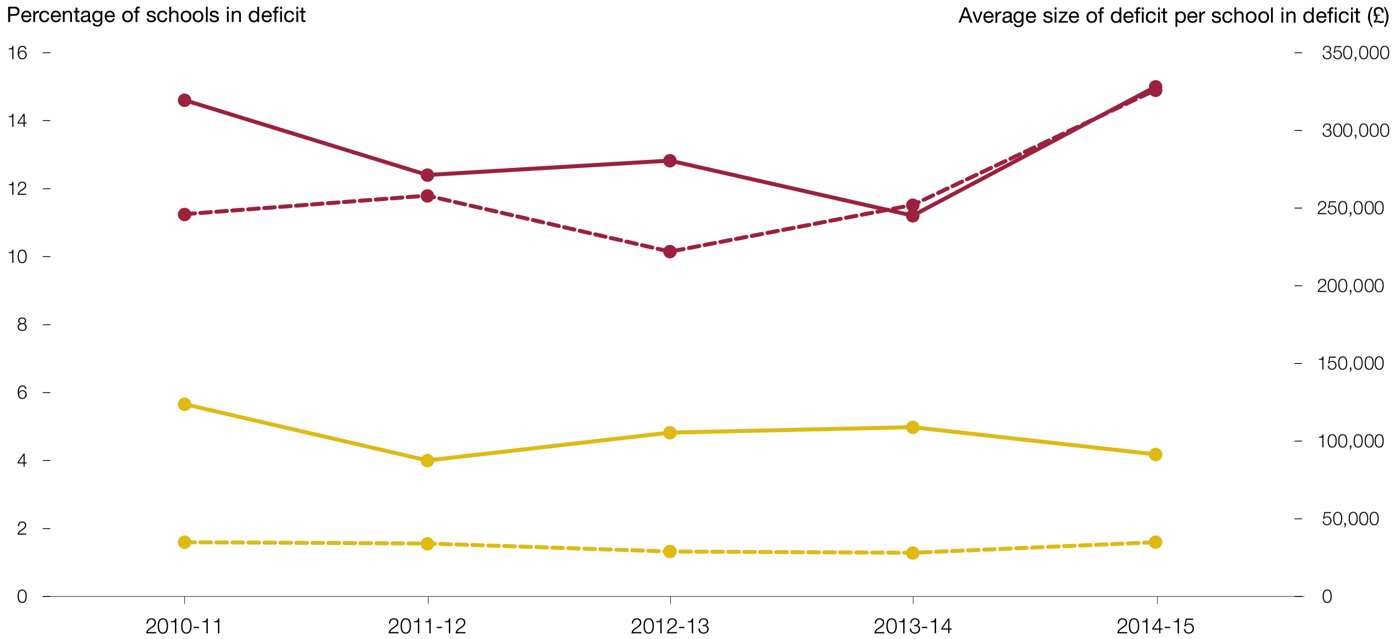
1 Despite the increase in the proportion of maintained schools overspending, the number of schools overspending is decreasing. This is because the total number of maintained schools is falling as more become academies.

Source: National Audit Office analysis of the Department for Education's maintained schools' income and expenditure data

Figure 6

Trend in percentage of maintained schools in deficit, 2010-11 to 2014-15

The percentage of maintained primary schools in deficit and the average size of their deficits fell from 2010-11 to 2014-15, but the average size of the deficit in maintained secondary schools increased by £80,000 in real terms during the same period



	2010-11	2011-12	2012-13	2013-14	2014-15
Secondary school (%)	14.6	12.4	12.8	11.2	15.0
Average size of secondary school deficit (£)	246,000	258,000	222,000	252,000	326,000
Primary school (%)	5.7	4.0	4.8	5.0	4.2
Average size of primary school deficit (£)	35,000	34,000	29,000	28,000	35,000

Notes

1 In 2010-11, 1,421 maintained schools were in deficit, of which 964 were primary schools and 457 were secondary schools. In 2014-15, 826 maintained schools were in deficit, of which 616 were primary schools and 210 were secondary schools.

2 All figures relating to the average size of deficit are rounded to the nearest thousand and reported in 2014-15 prices.

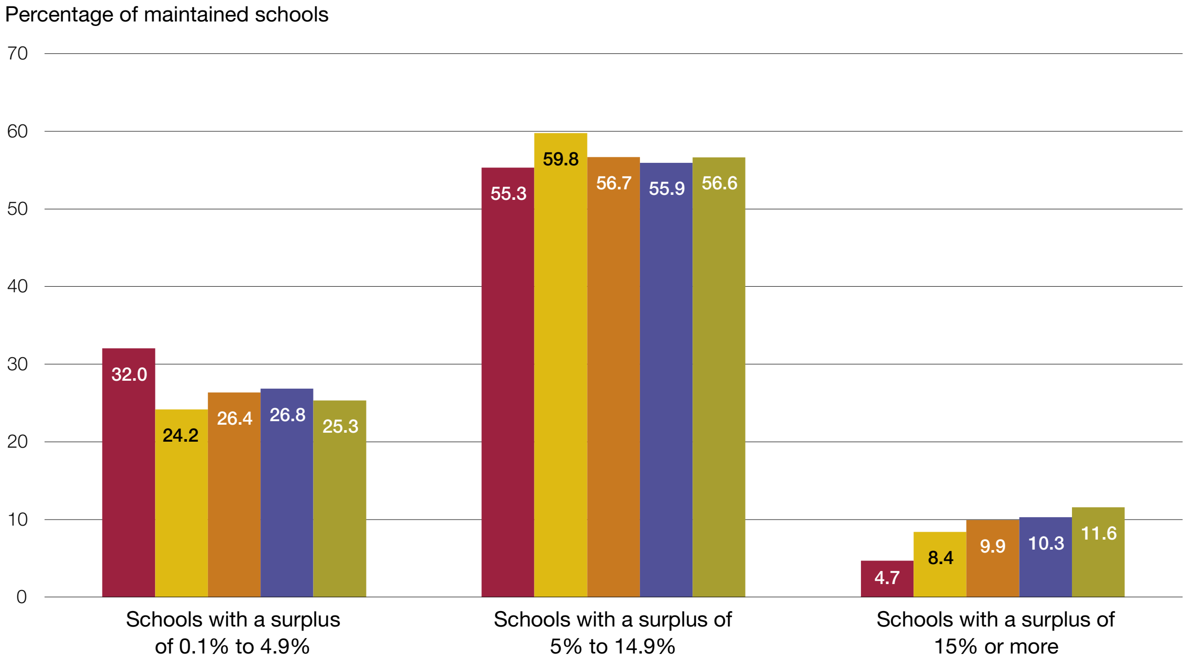
3 Secondary schools are generally bigger than primary schools in terms of pupil numbers and budgets, which could partly explain their larger deficits.

Source: National Audit Office analysis of the Department for Education's maintained schools' income and expenditure data

Figure 7

Percentage of maintained schools in surplus, 2010-11 to 2014-15

The percentage of maintained schools with surpluses worth 15% or more of their annual income increased from 4.7% in 2010-11 to 11.6% in 2014-15



Number of schools

	Schools with a surplus of 0.1% to 4.9%	Schools with a surplus of 5% to 14.9%	Schools with a surplus of 15% or more
2010-11	6,452	11,139	945
2011-12	4,789	11,848	1,662
2012-13	4,824	10,364	1,814
2013-14	4,591	9,572	1,760
2014-15	4,085	9,140	1,869

Source: National Audit Office analysis of the Department for Education's maintained schools' income and expenditure data

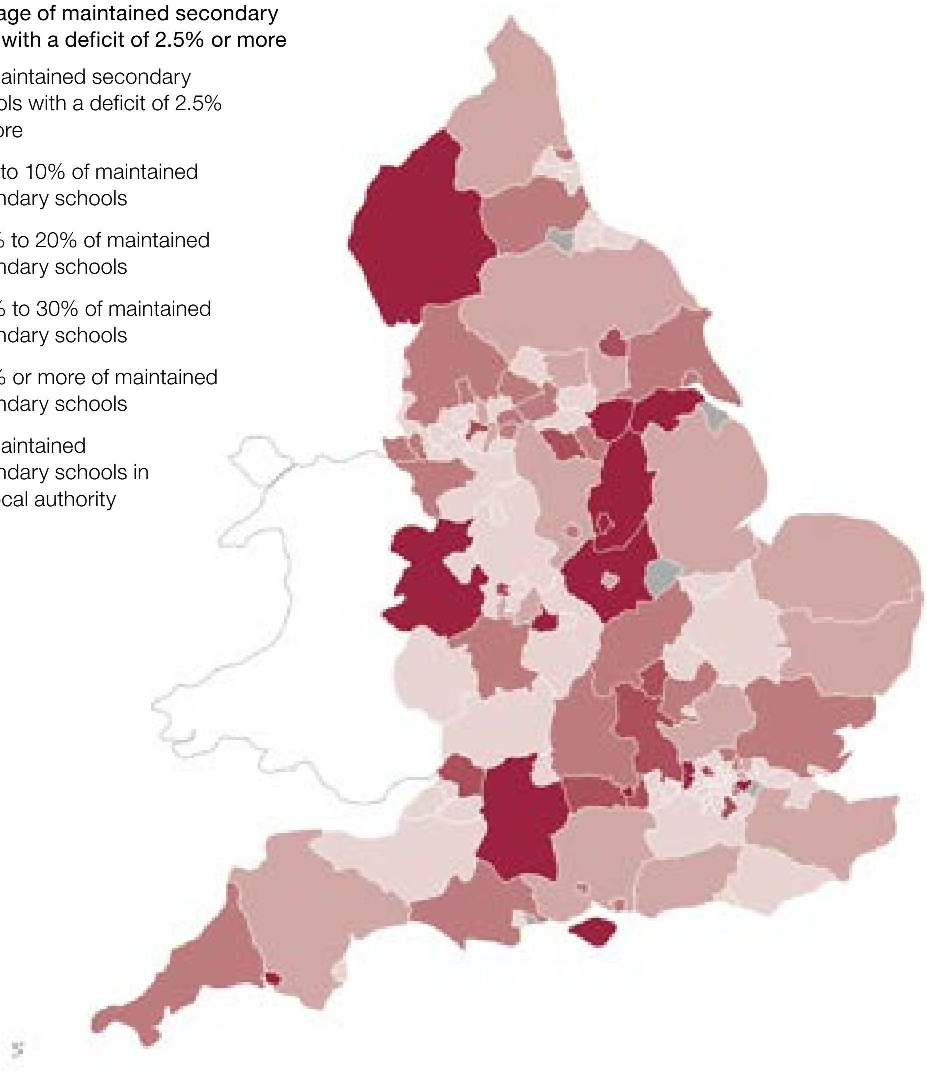
Figure 8

Percentage of maintained secondary schools with a deficit of 2.5% or more by local authority, 2014-15

There is variation between local authorities in the percentage of schools with a deficit of 2.5% or more but no regional pattern emerges

Percentage of maintained secondary schools with a deficit of 2.5% or more

- No maintained secondary schools with a deficit of 2.5% or more
- 0.1% to 10% of maintained secondary schools
- 10.1% to 20% of maintained secondary schools
- 20.1% to 30% of maintained secondary schools
- 30.1% or more of maintained secondary schools
- No maintained secondary schools in the local authority



Source: National Audit Office analysis of the Department for Education's maintained schools' income and expenditure data

Academies

1.19 For academies, our analysis suggests that some single academy trusts have been building up reserves. Also, an increasing proportion of academies, including multi-academy trusts, have been spending more than their income. The main findings are that:

- the proportion of single academy trusts with a surplus worth 15% or more of their annual income increased from 24.7% in 2011/12 to 38.5% in 2014/15 (**Figure 9**);
- the proportion of primary single academy trusts in deficit decreased from 3.2% (seven trusts) in 2011/12 to 1.6% (13 trusts) in 2014/15. In contrast, the proportion of secondary single academy trusts in deficit increased from 3.2% (25 trusts) to 6.1% (74 trusts) over the same period;
- for those single academy trusts in deficit, the average deficit fell in real terms from £58,000 to £48,000 for primary academy trusts, and from £350,000 to £238,000 for secondary academy trusts;
- the proportion of primary academies spending more than their income rose from 32.1% in 2012/13 to 44.1% in 2014/15; and of secondary academies spending more than their income from 38.8% to 60.6% (**Figure 10** on page 26);[16]
- the level of overspending has increased in real terms: in primary academies from £98,000 in 2012/13 to £104,000 in 2014/15, and in secondary academies from £324,000 to £363,000 over the same period; and
- those academies spending more than their income may be using their reserves, but the Department has not analysed income and expenditure alongside revenue balances. It cannot therefore be sure whether or not this pattern of spending is leading to increased deficits.

Educational outcomes

1.20 The Department considers good financial health as essential for achieving educational excellence. In a submission to the House of Commons Education Committee in 2014, the Department concluded that “establishing a robust causal link between resources and attainment is difficult because of the need to control for a wider range of other factors that influence attainment”.[17] It also concluded from research studies that the weight of evidence suggests that “additional school resources positively influence attainment, although the effects are relatively modest at all Key Stages”. The Department is undertaking statistical analysis to examine whether those maintained schools that experienced a real-terms reduction in per-pupil funding between 2009-10 and 2013-14 were able to maintain or improve their level of educational outcomes. It expects to complete this work in January 2017.

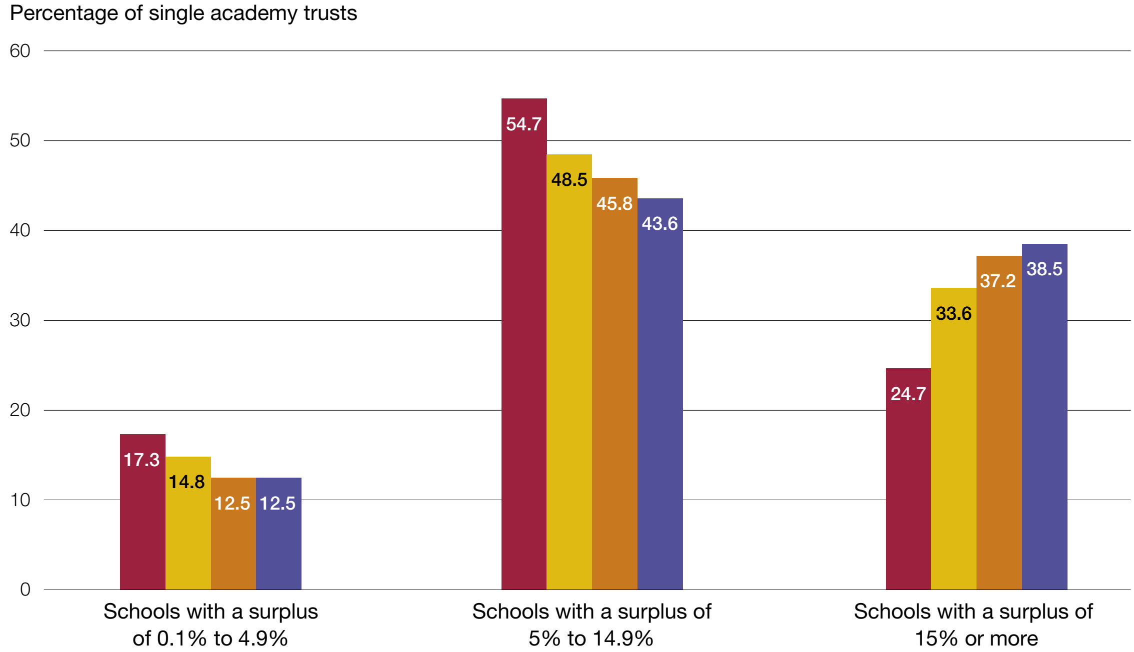
16 These percentages represent 393 primary academies and 636 secondary academies in 2012/13, and 1,163 primary and 1,277 secondary academies in 2014/15.

17 Department for Education, *What impact does school spending have on pupil attainment? A review of the recent literature*, July 2014.

Figure 9

Percentage of single academy trusts in surplus, 2011/12 to 2014/15

The percentage of single academy trusts with surpluses of 15% or more of their total income increased from 24.7% in 2011/12 to 38.5% in 2014/15



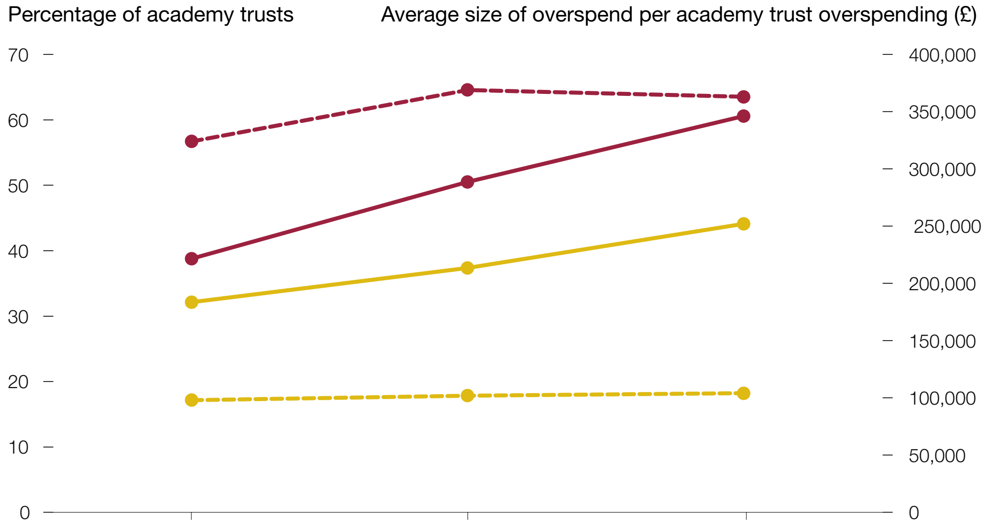
Number of schools

	Schools with a surplus of 0.1% to 4.9%	Schools with a surplus of 5% to 14.9%	Schools with a surplus of 15% or more
2011/12	174	550	248
2012/13	229	749	519
2013/14	232	854	693
2014/15	252	880	778

Source: National Audit Office analysis of the Department for Education's academies' income and expenditure data and revenue balances data

Figure 10
Academies spending more than their income, 2012/13 to 2014/15

In 2014/15, 44.1% of primary academies and 60.6% of secondary academies spent more than their income



	2012/13	2013/14	2014/15
Secondary academies (%)	38.8	50.5	60.6
Average size of secondary academies overspend (£)	324,000	369,000	363,000
Primary academies (%)	32.1	37.3	44.1
Average size of primary academies overspend (£)	98,000	102,000	104,000

Notes

1 All figures are rounded to the nearest thousand and reported in 2014-15 prices.

2 Secondary schools are generally bigger than primary schools in terms of pupil numbers and budgets, which could partly explain their larger overspends.

Source: National Audit Office analysis of the Department for Education's academies' income and expenditure data

Part Two

Understanding and supporting financial sustainability

2.1 This part of the report covers how schools have responded to past financial pressures and the support the Department for Education (the Department) is offering to schools to help them deal with future cost pressures.

How schools have responded to financial pressures

2.2 Most of schools' spending is on staff. In 2014/15, 75% of total academies' expenditure was on staff costs, and 25% on non-staff costs. Similarly, for maintained schools in 2014-15, the figures were 76% and 24% respectively. The largest component was the cost of teaching staff, which accounted for 52% of total expenditure in academies, and 51% in maintained schools.

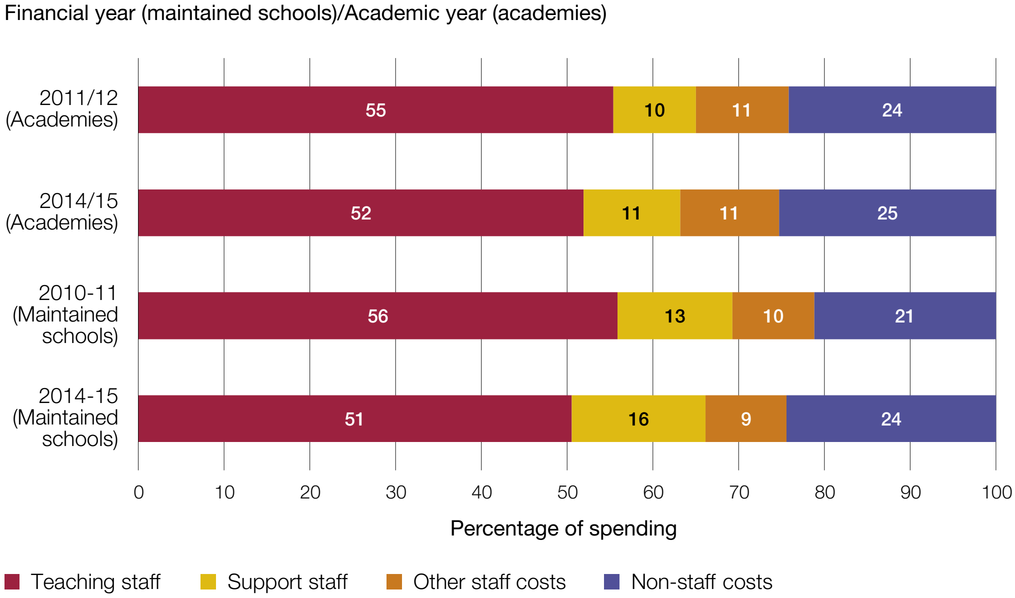
2.3 Despite a slight real-terms increase in funding per pupil in the previous Parliament (paragraph 1.3), schools reduced spending on staff. The Department is concerned about this response as it considers that the quality of teaching is more important to pupil outcomes than anything else a school can control.[18]

2.4 We found that across all maintained schools spending on teaching staff, as a percentage of total expenditure, fell from 56% to 51% from 2010-11 to 2014-15 (**Figure 11** overleaf). Similarly, academies' spending on teaching staff, as a percentage of the total, decreased from 55% to 52% between 2011/12 and 2014/15.

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

Figure 11
Changes in school spending patterns

Spending on teaching staff as a percentage of total expenditure has decreased over time



	Teaching staff	Support staff	Other staff costs	Non-staff costs
2011/12 (Academies)	£4.1bn	£716.9m	£805.5m	£1.8bn
2014/15 (Academies)	£8.4bn	£1.8bn	£1.9bn	£4.1bn
2010-11 (Maintained schools)	£18.5bn	£4.4bn	£3.2bn	£6.9bn
2014-15 (Maintained schools)	£12.6bn	£3.9bn	£2.4bn	£6.0bn

Notes

1 'Teaching staff' includes supply teachers.

2 'Other staff costs' includes premises staff, administrative and clerical staff, catering staff and other staff.

3 2011/12 academies data includes a small number of alternative provision and special schools within multi-academy trusts, which could not be separated out.

4 Spending figures are given in cash terms.

Source: National Audit Office analysis of maintained schools and academies' income and expenditure data

2.5 The Department analysed the spending of a sample of maintained schools' spending between 2009-10 and 2013-14 (selecting those that had full data for the relevant years). It identified that, in general, maintained schools decreased the proportion of their spending that went on teaching staff and increased the proportion on non-staff areas. Specific findings were as follows:

- Overall, real-terms funding per pupil rose by 3.5% for these schools. One-third of the schools saw their funding fall and, for the fifth of schools that experienced the largest reductions, per-pupil funding dropped by 9.5%.
- In 70% of the sampled schools, spending per pupil on teaching staff fell, despite only 34% of them experiencing a reduction in funding.
- The fifth of sampled schools that experienced the largest reductions in funding reduced spending per pupil on teaching staff by 12.8% on average.
- Average spending per pupil in these schools increased in real terms by £25 on back-office costs, £105 on running costs and £38 on learning resources.
- The sampled schools could not, or chose not to, use budget surpluses to compensate for reductions in funding.

For academies, the Department has analysed changes in spending patterns but has not examined the impact of funding changes on academies' spending behaviour.

2.6 The Department also conducted interviews with a sample of 24 head teachers to explore the challenges they face when deciding staffing, particularly where they have changed their approach due to budget pressures. Recognising the small sample size, it found that head teachers commonly: increase teachers' contact time, class sizes and the amount of teaching undertaken by senior staff; and reduce supply teacher costs and the size of leadership teams. Reducing numbers of teaching assistants was less common. The small sample of schools we visited also told us how they planned to cut staff costs. This included: replacing more experienced, higher-paid teachers with younger, less expensive recruits; recruiting staff on temporary contracts; encouraging staff to teach outside of their specialism; and relying more on unqualified staff.

Opportunities to reduce school spending

2.7 The Department is confident that schools can make efficiency savings. However, it has not tested the findings from its benchmarking analysis (paragraph 1.10) in practice and therefore cannot be assured that the savings will be achieved. The Department has not estimated the minimum cost of running different types of school to achieve desired educational outcomes. In 2009 the Department analysed school spending and concluded that it was very difficult to come up with meaningful minimum spending figures, given the variation in spending. It cannot judge how far individual schools can reduce spending before educational outcomes are affected.

2.8 As well as reducing staff costs, schools have found a number of other ways to make savings. The small sample of schools we spoke to have renegotiated contracts, switched suppliers, and reduced use of energy and consumables. They identified collaboration between schools as the main way to secure savings through economies of scale and combined buying power. Examples include sharing administrative support and joint contracts. Schools are also collaborating in providing education, particularly in sixth forms, to save money and broaden the options available to students. However, schools told us that collaboration could be constrained by the fact that they are competing with each other for students and staff.

2.9 Schools also told us that they are examining ways of raising income, for example by selling their catering and administrative services to other schools, and offering halls and sports facilities for hire. However, schools have been unable to generate enough income to offset financial pressures. Approximately 4% of schools' income is self-generated (£680.3 million for academies in 2014/15 and £903.1 million for maintained schools in 2014-15).

2.10 While all spending can be flexible in the long term, the small sample of schools we visited told us their ability to make savings is constrained in a number of ways:

- Land and buildings: facilities such as the size of classrooms, and whether funding is available to pay for alterations, can affect schools' ability to change their size and layout.
- Demographics: secondary schools we spoke to commonly reported that, while pupil numbers had previously fallen, they are forecast to rise given the number of pupils currently in primary schools. We highlighted this in our report *Training new teachers*.[19] In particular, schools did not want to reduce spending on staff, given the difficulty they have recruiting teachers.
- Committed expenditure: this includes contracts which schools have entered into and private finance initiative (PFI) charges. PFI contracts between schools and private investors can last for many years, with charges that schools may not be able to renegotiate. In 2014/15, 159 academies (3%) were subject to PFI charges. Local authorities can reflect the additional cost of PFI in their schools funding formula (paragraph 1.14).[20]

2.11 Small schools face particular financial challenges and are less likely to be able to benefit from economies of scale. For example, we found that smaller maintained schools are more likely to be in deficit: 21% of maintained secondary schools with fewer than 630 pupils were in deficit in 2014-15 compared with only 9% of schools with more than 1,178 pupils (**Figure 12**). There is less variation in maintained primary schools, with 5% of primary schools with fewer than 158 pupils in deficit in 2014-15 compared with 3% of schools with more than 348 pupils.

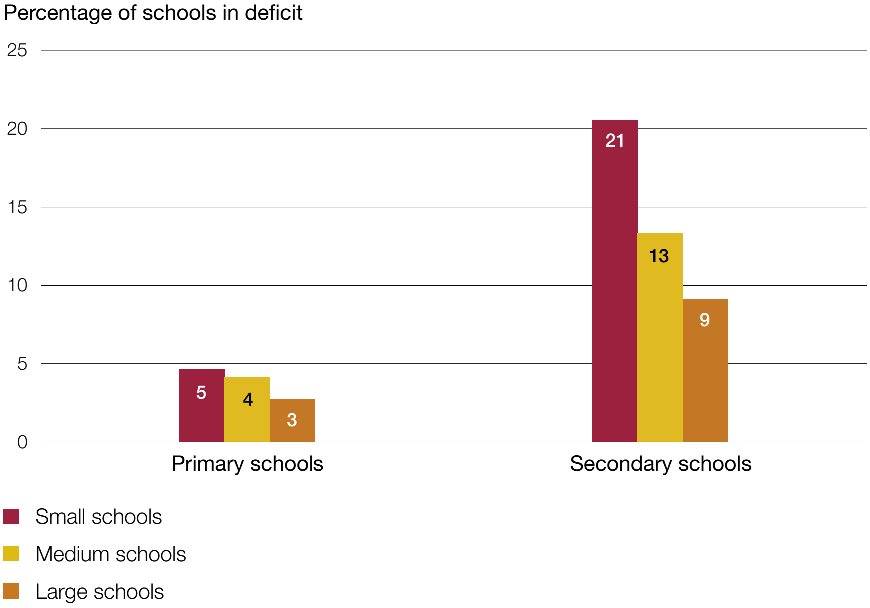
19 Comptroller and Auditor General, *Training new teachers*, Session 2015-16, HC 798, National Audit Office, February 2016.

20 Education Funding Agency, *Schools revenue funding 2017 to 2018: Operational guide*, July 2016.

Figure 12

Percentage of maintained schools in deficit by school size, 2014-15

Twenty-one per cent of secondary schools with fewer than 630 pupils were in deficit in 2014-15, compared with 9% of secondary schools with more than 1,178 pupils



Notes

1 Small schools are schools below the 25th percentile in terms of the number of full-time equivalent pupils enrolled (fewer than 158 pupils for primary schools, and fewer than 630 pupils for secondary schools).

2 Medium schools are schools between the 25th and 75th percentile in terms of the number of full-time equivalent pupils enrolled (between 159 and 348 pupils for primary schools, and between 630 and 1,178 pupils for secondary schools).

3 Large schools are schools above the 75th percentile in terms of the number of full-time equivalent pupils enrolled (more than 348 pupils for primary schools, and more than 1,178 pupils for secondary schools).

Source: National Audit Office analysis of the Department for Education's maintained schools' income and expenditure data

2.12 Schools may also face financial difficulties if their pupil intake is lower than predicted as this means their income will be lower than expected. For example, university technical colleges (UTCs) are a particular group of relatively small state-funded secondary academies that focus on teaching 14- to 19-year-olds in technical specialisms. There are currently 47 UTCs, with a further seven planned to open by September 2018. They have a typical capacity of 600 students and a broad catchment area. However, on average, in January 2016, UTCs had 236 pupils (ranging from 65 to 574).[21] Between February 2014 and October 2016, the Education Funding Agency assessed 22 UTCs as at risk due to financial concerns.

21 Department for Education, *Schools, pupils and their characteristics: January 2016*, Statistical First Release 20/2016, June 2016.

Supporting schools to achieve financial sustainability

2.13 There are a number of sources of support for schools including the Department, local authorities, the network of school business managers, professional bodies and consultants. Our report focuses on the support that the Department provides.

Schools Financial Health and Efficiency programme

2.14 In 2013 the Department completed a review of school efficiency and undertook to support schools through the following: effective workforce deployment; benchmarking; an indicator of school efficiency; improved procurement; support for clusters of primary schools to take on a school business manager; and more effective governance and accountability.[22]

2.15 The Department has made progress in some of these areas. In 2014 it made funding of £25,000 available to support clusters of primary schools to recruit school business managers, and approved 68 grants. In 2015 it published a new financial benchmarking website for academies and video presentations about better use of resources. Following the 2015 Spending Review, the Department launched its Schools Financial Health and Efficiency programme (the Programme) in January 2016. Key elements include: a webpage for the Department's guidance and tools; a financial health check service; strategies for workforce, procurement and communications; and access to framework contracts. Through the Programme, the Department aims "to support schools to manage their budgets effectively and ensure their financial health, whilst maintaining or improving pupil outcomes".[23]

2.16 However, important areas of the Programme have not yet been completed, notably the workforce and procurement strategies. The Department is developing additional guidance and deals to help schools reduce their workforce and procurement spending, but is yet to finalise the timetable for completing this work. It is unlikely that the support, some of which the Department plans to pilot first, will start to be available until 2017. It will then take time for schools to make decisions and take action based on that support. From our work across government we know that achieving sustainable cost reduction, beyond tactical efficiency savings, takes time to implement and for the savings to be achieved.[24] One of the Department's own good-practice examples suggests it takes three years to address a significant budget deficit.

2.17 We also know from our work that achieving sustainable cost reduction can require upfront investment.[25] Alongside the new national funding formula, the Department planned to launch an 'invest to save' fund. This is intended to help schools make changes that would enable them to become more efficient in the medium- to long-term. However, with the delay to the national funding formula until 2018-19, the Department has not yet decided when and how it will introduce the 'invest to save' fund.

22 Department for Education, *Review of efficiency in the schools system*, June 2013.
23 Department for Education, *School Efficiency and Financial Health strategy*, March 2016, unpublished.
24 National Audit Office, *A short guide to Structured cost reduction*, June 2010.
25 See footnote 24.

Schools Financial Health and Efficiency webpages

2.18 In January 2016 the Department launched dedicated webpages for the support it provides to help schools improve their financial management and efficiency. The support includes: an efficiency metric, which gives an indication of how efficient a school is compared with similar schools; benchmarking reports, which compare a summary of key spending data for one school with a selection of similar schools; links to benchmarking websites; guidance for head teachers, school business managers and governors, for example on strategic financial planning and collaborative procurement; access to framework deals, such as on energy; and case studies on how schools have achieved savings in practice.

2.19 Schools and stakeholders we spoke to had mixed views on the usefulness of the Department's support. The small sample of schools we spoke to told us that they seek guidance and support from a range of sources, most frequently from other school business managers in their area. They were also aware that the Department's support is available and had used some of it, such as the benchmarking tool, but generally found it too generic or not current.

2.20 To date, 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. The Department told us that its current priority is support for those schools with weaker financial management. From our work on financial management across government, we consider that, if implemented successfully, the available guidance and tools may be adequate for schools in stable circumstances, but not sufficient for those in more challenging positions.[26]

Financial health checks

2.21 In July 2016 the Department launched a financial health check service. This includes three checks, ranging from a basic review of systems and capacity to a more detailed review to support schools in financial difficulty. The Department has also published a directory of suppliers who are willing to undertake health checks for schools, and guidance on how to select a supplier. Suppliers include accountancy and consultancy firms, other schools and local authorities.

2.22 Concerns were raised with us, however, that the suppliers listed have not been vetted by the Department. The Department's guidance explains that organisations are asked to declare that their information is accurate, that it does not make any checks and that it is not endorsing suppliers by including them in the directory.[27] It is difficult to compare suppliers as they have provided different information about the service they provide. The cost of a financial health check will vary depending on complexity and the supplier that a school chooses. The Department has not provided additional funding for schools to undertake such a check.

26 National Audit Office, *Financial management maturity model*, February 2013.
27 Department for Education and Education Funding Agency, *Guidance: The schools financial health check: supplier directory*, July 2016.

Procurement strategy

2.23 The government stated in the 2015 Spending Review that "in 2016 the government will publish a set of specific actions to support school leaders target over £1 billion a year in procurement savings by the end of the Parliament".[28] The Department is developing a strategy to help schools achieve these savings. It has engaged external researchers to examine how schools currently buy goods and services, and sees its role as being to promote wider use of commercial practice. Its approach centres on improving the skills of schools' buyers and relationships between them, for example through the development of networks, where those responsible for school procurement can share expertise and good practice. It also wants schools to be better at identifying waste and unnecessary spending, for example by benchmarking their spending against others.

2.24 The Department also intends that buyers will be able to access more deals, for example through Crown Commercial Service. An example of a deal currently provided by the Department is the risk protection arrangement for academies, an optional alternative to commercial insurance. For an annual deduction of £20 per pupil from the funding of participating academies, the Department meets the cost of claims. This arrangement can offer significant savings for academies.

2.25 The Department expects much of the procurement strategy to be led by schools themselves, with some support from the Department. It is expanding its commercial team that supports schools. However, it cannot mandate schools to take these initiatives forward; it can only encourage them and advise on the benefits. From our work on shared services and procurement in other sectors, we know that such change requires strong leadership, clear plans for achieving savings, effective risk management and support from stakeholders.

Workforce strategy

2.26 The Department is developing a workforce strategy to help schools achieve the significant efficiency savings that will be needed in this area (estimated at £1.7 billion by 2019-20) without compromising educational outcomes. It aims to develop new products and guidance, such as case studies and training in curriculum-based planning, and a supply teacher procurement framework, but these are unlikely to be available until 2017. In addition, stakeholders suggested that schools will need practical guidance on how to achieve reductions in workforce spending. As analysis indicates that schools tend to reduce the proportion of their spending on teaching staff before other areas of spending, the delay in providing support in this area increases the risk that schools will make poorly informed decisions that could have detrimental effects on educational outcomes.

28 HM Treasury, *Spending Review and Autumn Statement 2015*, Cm 9162, November 2015.

Targeting and evaluating support

2.27 The Department has a communications strategy to promote awareness of the support it provides to schools. Its approach is to 'drip-feed' information through different channels – including working groups, email and professional networks – to build awareness and momentum and to 'nudge' schools to improve their financial health and efficiency. The Department told us that its priority is to communicate with the 'hardest-to-reach' schools. It is taking action to identify this group of schools and is developing its approach through a tool to predict academies at risk. However, it cannot yet identify all of the schools in this category. It is therefore not clear how the Department ensures that schools most in need of advice receive and use it.

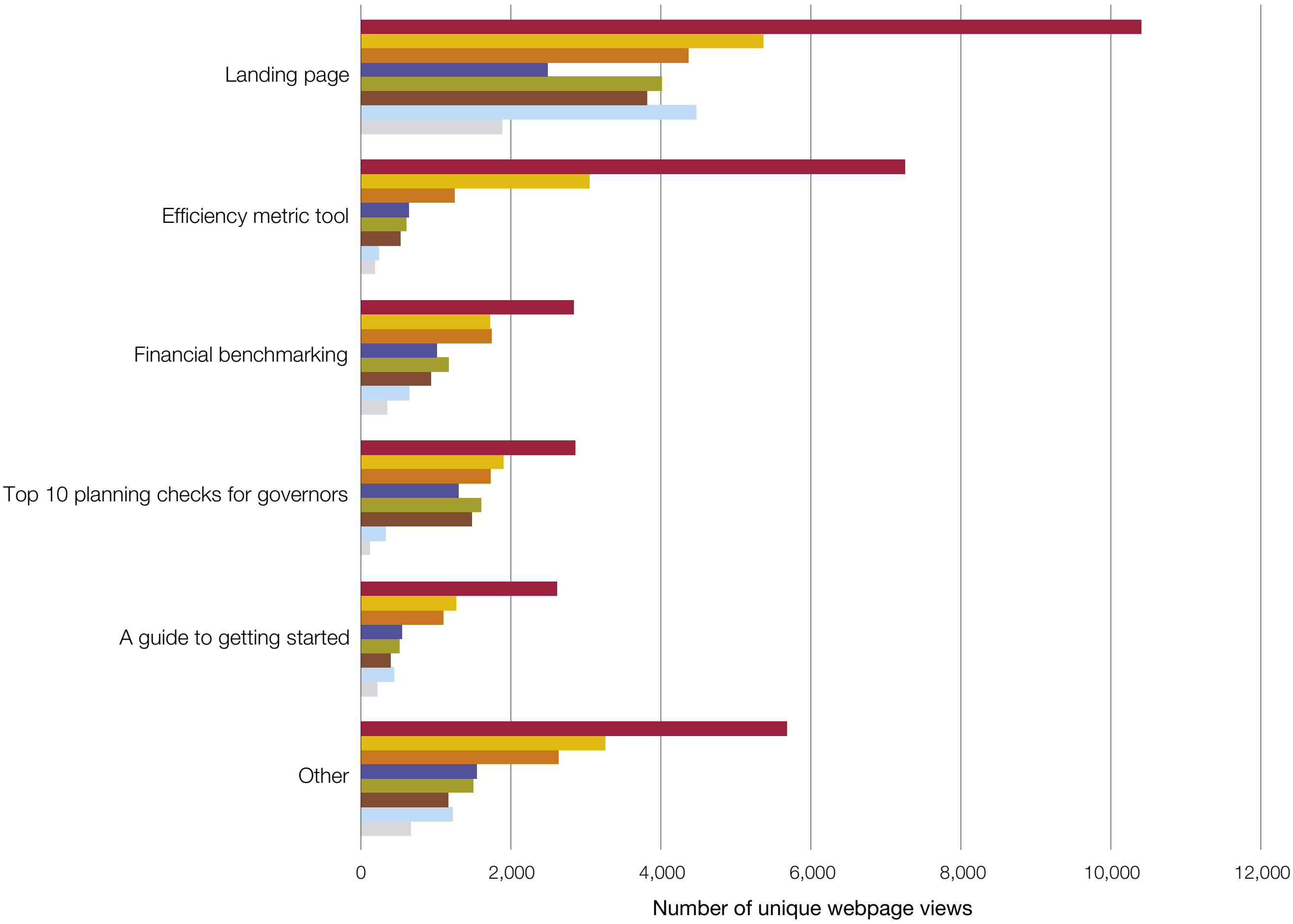
2.28 The Department has a clear monitoring and evaluation plan for the Programme that it has started to implement. Initially, it is measuring how often its tools and guides are viewed and downloaded. The data show that schools were accessing support more often in January 2016 when the Programme was launched. The website's landing page was visited more than 10,000 times, but interest has dropped in subsequent months (**Figure 13** overleaf). The Department also plans to visit schools, starting in late 2016, to assess whether they are aware of the support on offer and the impact the support is having.

Figure 13

Webpage hits for the Schools Financial Health and Efficiency programme

Unique views of the webpages and tools were highest when the dedicated webpages were first launched in January 2016

Support and tools available



	Landing page	Efficiency metric tool	Financial benchmarking	Top 10 planning checks for governors	A guide to getting started	Other
January	10,407	7,252	2,839	2,857	2,616	5,679
February	5,366	3,047	1,721	1,901	1,271	3,257
March	4,371	1,254	1,744	1,729	1,102	2,632
April	2,490	641	1,014	1,307	549	1,549
May	4,012	608	1,171	1,609	514	1,499
June	3,816	531	934	1,478	396	1,162
July	4,475	240	651	332	444	1,228
August	1,892	184	351	123	221	670

Note

1 The 'Other' category includes the following support and tools: the 'top tips for financial planning', 'the role of the school governor', 'sharing best practice', three to five year budget planning, 'effective procurement', 'the benefits of workforce planning' and 'collaborative procurement'.

Source: Department for Education

Part Three

Identifying and addressing the risk of financial failure

3.1 This part of the report covers the arrangements for identifying and addressing the risk of financial failure in schools.

Maintained schools

Approach to financial oversight

3.2 Local authorities are responsible for setting and monitoring a financial framework for the schools in their area, and for providing support to schools. Maintained schools must work within these local frameworks, maintain effective financial management and provide financial information as required by their local authority.[29]

3.3 The Department for Education (the Department) adopts a light-touch approach to its oversight of local authorities' management of schools' finances. It has delegated responsibility for oversight to the Education Funding Agency (the Agency). Local authorities must inform their regional schools commissioner when they plan to take certain actions, such as issuing a warning notice to a school.[30] Beyond this, the Agency does not routinely collect data on how local authorities are exercising their responsibilities. The Agency told us that the main incentive for a local authority to address financial problems in schools is the threat of funding being removed. This has not occurred to date.

29 Department for Education, *Accounting Officer – Accountability system statement for education and children's services*, January 2015.

30 The eight regional schools commissioners are responsible for intervening in underperforming academies. They also approve new free schools and the conversion of underperforming maintained schools into academies.

Approach to intervention

3.4 The Agency's approach is to intervene with local authorities where it has concerns, for example about schools with persistent excessive surpluses and deficits. It focuses particularly on schools with persistent deficits as it considers these are more likely to indicate an ongoing concern with financial management or viability. The Agency has set criteria to judge when to intervene. Specifically, it aims to contact local authorities when:

- a local authority overspends its Dedicated Schools Grant (paragraph 1.4) by 2% or more;
- a local authority underspends its Dedicated Schools Grant by 5% or more;
- a local authority has at least 2.5% of its schools with deficits of 2.5% or more for the previous four years, and their individual deficits have been at least £10,000 each year; and
- a local authority has at least 5% of its schools with surpluses of 15% or more for the previous five years, and their individual surpluses have been at least £10,000 each year.

3.5 The Agency has intervened in local authorities sparingly, in part because of how it applies its criteria. In 2014-15 the Agency contacted one local authority, Cumbria, with regard to school deficits and 11 with regard to surpluses.

3.6 How the Agency applies its criteria reduces the likelihood of intervention. In calculating the proportion of schools in deficit or surplus, the Agency uses as the population the total number of schools which were open at any point during the four-year period, including schools which have closed or converted to academies. In counting the number of schools which met its criteria for intervention, the Agency includes only schools which have had excessive deficits or surpluses for four continuous years. It excludes any maintained schools which have opened, closed or converted to an academy during the period.

3.7 We recalculated the proportion of schools with excessive deficits or surpluses using as the population the number of maintained schools open in 2014-15. This is more comparable with the number of schools in deficit for four continuous years. Had the Agency adopted this approach, it would have contacted three local authorities with regard to school deficits (rather than one) and 27 with regard to surpluses (rather than 11) in 2014-15. In light of our analysis, the Agency has decided to use this approach for 2015-16.

3.8 The Agency's current approach also means it is less likely to intervene in local authorities where the individual schools in deficit change during the period. Had the Agency counted all schools with deficits exceeding 2.5% in one or more of the four years to 2014-15 (regardless of whether the deficit had been continuous for four years), it would have contacted 21 local authorities with regard to deficits (rather than one) in 2014-15.

3.9 The Isle of Wight can be used to illustrate the implications of the Agency's approach. It had the highest proportion (13.0%) of schools with deficits of 2.5% or more in 2014-15. The proportion of schools with excessive deficits has been more than 2.5% each year from 2011-12 to 2014-15, but only one individual school had an excessive deficit throughout the four-year period. The Agency has therefore not intervened in the Isle of Wight because it does not meet the criteria (**Figure 14**).

3.10 In 2012 the Committee of Public Accounts recommended that the Department needed to undertake work to understand better the causes and consequences of persistent deficits and excessive surpluses.[31] In 2014 we reported that the Department did not know enough about the effectiveness of local authorities' oversight of schools.[32] The Agency's main financial intervention with local authorities is a conversation about their plans for schools in deficit or surplus. To date it has not intervened any further than this.

Figure 14
Calculating the proportion of maintained schools in deficit on the Isle of Wight

The Isle of Wight has had a growing proportion of schools with a deficit of 2.5% or more, but has not met the Agency's criteria for intervention

	2011-12	2012-13	2013-14	2014-15
Number of local authority maintained schools	65	46	47	46
Percentage of schools with a deficit of 2.5% or more (%)	4.6	8.7	8.5	13.0
Schools with a deficit of 2.5% or more				
School 1	✔	✔	✔	✔
School 2	✔	✔		
School 3	✔	✔		
School 4		✔	✔	✔
School 5			✔	✔
School 6			✔	
School 7				✔
School 8				✔
School 9				✔

Source: National Audit Office analysis of maintained schools' income and expenditure data from the Department, and data from Isle of Wight Council

31 HC Committee of Public Accounts, *Department for Education: accountability and oversight of education and children's services*, Eighty-second Report of Session 2010–2012, HC 1957, May 2012.
32 Comptroller and Auditor General, *Academies and maintained schools: Oversight and intervention*, Session 2014-15, HC 721, National Audit Office, October 2014.

Academies

Approach to financial oversight

3.11 In contrast to maintained schools, the Department has more responsibilities for academy trusts. The Agency directly funds academy trusts and the Agency's accounting officer must be satisfied, and assure the Department, that academy trusts have appropriate arrangements for financial management and governance.[33]

3.12 The Agency has a process for assessing financial risk in academy trusts. Ultimately the assessments are a matter of judgement. The monthly process involves an evaluation by the Agency's regional teams followed by central moderation and scrutiny. The Agency told us that it considers academy trusts on a case-by-case basis. It starts by reviewing the financial data that trusts must supply and follows up with trusts where there are indications of concern. It takes account of a range of data in its risk assessment tool and other sources of evidence, and adjusts the risk rating as new information becomes available.[34]

3.13 As with maintained schools, in assessing academy trusts' financial risk, the Agency relies mainly on data about past spending. It is therefore likely to pick up only trusts which are already in financial difficulty. The Agency told us that it has been working to strengthen its oversight and has developed a preventative approach to support trusts at risk of getting into difficulty. This includes a tool which it intends will provide projections of up to five years. The Agency plans to pilot the new approach in early 2017, with a view to implementing it in full from March 2017.

3.14 The Agency uses a framework to judge the level of financial risk and inform its decisions about whether and how to intervene. The levels of financial risk and the thresholds are as follows:

- **Red/black.** Actual or predicted cumulative deficit greater than 5% of current year income, with no agreed recovery plan, or evidence that the academy trust is not adhering to its payment plan.
- **Red/amber.** Actual or predicted cumulative deficit less than 5% of current year income, or evidence that the academy trust's recovery plan is on track, if the deficit is greater.
- **Green.** Actual or predicted cumulative deficit less than 5% of the current year income, or evidence over several months that the academy's recovery plan is on track.

Unlike the maintained sector, the Agency does not highlight academies with excessive surpluses as a concern.

33 See footnote 29.
34 The risk assessment tool includes a variety of data, including on financial performance, governance and educational outcomes.

3.15 Each month the Agency compiles a national concerns report to highlight academy trusts of most concern, including due to financial issues. For the highest-risk cases, the report sets out what interventions the Agency is taking. The national concerns reports are considered by senior officials in the Agency and one of the Department's non-executive directors provides external challenge.

3.16 Most of the 5,758 academies open in October 2016 have never appeared on the Agency's national concerns reports. Between November 2014 and October 2016, 472 academy trusts featured on the national concerns reports, some more than once.[35] Of these, 322 (68%) were highlighted due to financial issues. With regards to identifying academy trusts at risk, the Agency identified over one-third of these and one-quarter were added to the national concerns reports after trusts themselves identified issues, as they are required to do as a condition of their funding agreement. Whistleblowers identified 6% of recorded cases. However, the Agency did not record or could not match the means of referral for nearly 30% of cases. The more recent records were more complete and the Agency told us that its central records system, introduced in October 2015, will have improved its record keeping.

Approach to intervention

3.17 The Agency adopts a phased approach to intervention. This starts with discussions with the academy trusts concerned as part of the process of assessing risk.

3.18 After the assessment the Agency may, depending on the severity of issues identified, work with the trust to improve performance, direct the trust to make specific changes, or take more formal action such as a public warning, known as a 'financial notice to improve'. In the most severe cases, the Agency can take legal action and terminate a trust's funding agreement.

3.19 Since 2012 the Agency has issued financial notices to improve to 52 academy trusts due to financial sustainability issues, such as cumulative deficits of 5% or more. On issuing a notice, the Agency revokes certain delegated authorities, for example a trust may have to refer certain transactions to the Agency for approval. How quickly the Agency has issued financial notices to improve varies from 0 to 25 months from when the trust first featured on the national concerns report. The Agency decides case-by-case and tends to issue the notice relatively quickly to academy trusts in deficit, but gives trusts more time where the issues relate to viability, for example where a trust has a lower than expected pupil intake.

3.20 The Agency has not systematically evaluated the effectiveness of its different types of financial intervention. It told us that its lead officials can see records of previous interventions in individual academy trusts. However, the Agency does not undertake analysis of how the financial risk of trusts has changed over time. It told us that its system does not allow it to analyse individual trusts in this way.

35 Some academy trusts were listed more than once on the reports for differing reasons, thus 472 academy trusts were listed in total 497 times.

3.21 The Agency also does not assess whether its interventions have helped to improve trusts' longer-term financial sustainability or which interventions are most effective. Its ongoing risk assessment process means that academy trusts may move in and out of the national concerns reports. We found that the Agency had added 70 academy trusts (22% of the 322 highlighted for financial issues) back to the national concerns reports which it had previously removed. Of these, the Agency added 39 trusts back for the same reasons as they had originally been included, with 22 added due to new concerns, and it was missing part of the records for nine cases. This indicates that the Agency is actively monitoring risk, but also suggests that the Agency's interventions may not always result in trusts successfully addressing the financial issues that led to them being included in the national concerns reports in the first instance.

Record keeping

3.22 In 2015 the Committee of Public Accounts reported that both the Department and the Agency had acknowledged that their records were not good enough to explain why they had intervened in some academies and not others. The Committee recommended that the Department and the Agency should improve the recording of their decisions to identify and intervene in underperforming schools to ensure consistency in the approach to the schools.

3.23 During the work for this report, we found it difficult to gain assurance from the Agency's central records that all academy trusts at potentially high financial risk were being dealt with consistently. Of 101 cases with a deficit of more than 5% in 2015/16,[36] the Agency had rated 64 (63%) as red/black or red/amber and included them on the national concerns reports. The Agency did not include 37 (37%) cases in national concerns reports but the Agency's central records did not indicate why. The Agency had to investigate each of these cases individually to provide us with evidence of what it had done and why (although it could not explain its approach in three cases). The investigation showed that, for example, in some cases the Agency had contacted the academy trust and found that the data it was using were incorrect or that a recovery plan was in place.

3.24 In October 2015 the Agency introduced a new central system aimed at improving its record keeping. It told us that it will be continuing to work to improve its records in future.

36 We identified these cases using the 2015/16 budget forecast returns (67 cases from August 2015) and the 2015/16 academy accounts returns (34 from January 2016).

Appendix One

Our audit approach

1 This report focuses on the readiness of the Department for Education to manage the risks to schools’ financial sustainability, given changes to funding and cost pressures expected over the course of this Parliament. It assessed:

- the challenges to schools’ financial sustainability;
- the Department’s understanding of, and support for, schools’ financial sustainability; and
- how the Department’s identifies and manages the risk of financial failure.

2 We applied an analytical framework with evaluative criteria, which considered what arrangements would be optimal for achieving the Department’s aims. By ‘optimal’ we mean the most desirable possible, while acknowledging expressed or implied constraints.

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

Figure 15
Our audit approach

The objective of government

The Department aims “to ensure that, by 2020, that schools have the skills, capabilities and tools to manage pressures on their budgets without affecting their ability to deliver quality educational outcomes”.

How this will be achieved

The government has protected total funding for schools in real terms until 2019-20. The Department has launched a schools Financial Health and Efficiency programme to help schools manage their budgets effectively and ensure this financial health, while maintaining or improving pupil outcomes. It has delegated responsibility for oversight and intervention to the Education Funding Agency (the Agency).

Our study

We examined the value for money of the Department’s approach to managing risks to schools’ financial sustainability in light of increasing cost pressures.

Our evaluative criteria

What are the challenges to schools’ financial sustainability and what is the state of their current financial health?

Does the Department understand the risks to schools’ financial sustainability and their spending behaviour, and is it supporting schools adequately to manage such risks?

Does the Department have an effective oversight and intervention system in place to identify and manage the risk of financial failure in schools?

Our evidence

(see Appendix Two for details)

Interviews with the Department, including the Agency.

Review of analysis and literature produced by the Department, the Agency and stakeholders.

Analysis of schools’ income and expenditure data.

Interviews with a small sample of schools.

Interviews with stakeholders.

A call for evidence issued to teachers’ unions.

Analysis of the Agency’s records of oversight and intervention.

Our conclusions

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.

Appendix Two

Our evidence base

1 We reached our independent conclusions on the value for money of the Department for Education's (the Department's) approach to managing risks to the financial sustainability of schools by analysing evidence collected between April and December 2016. Our audit approach is outlined in Appendix One.

2 We assessed the challenges to schools' financial sustainability, and their current financial health by collecting evidence through:

- interviews with the Department and the Education Funding Agency (the Agency) about the scale of the future challenge to schools and the current financial health of schools;
- a review of analysis and literature produced by the Department, stakeholders and think tanks;
- analysis of maintained schools' income and expenditure data for the period 2010-11 to 2014-15;
- analysis of academies' income and expenditure data and end-of-year surplus and deficit data for the period 2011/12 to 2014/15;
- interviews with a sample of 10 maintained schools and academies. Schools were randomly selected from a list of all primary and secondary schools in England with an Office for Standards in Education, Children's Services and Skills (Ofsted) rating (as at 31 December 2015), excluding three city technical colleges. We selected a sample to include a mix of primary and secondary, academy and maintained schools from different regions with different Ofsted ratings and levels of deprivation were selected. The sample included two schools with financial notices to improve;
- interviews with stakeholders including: the Association of School and College Leaders; the Chartered Institute of Public Finance and Accountancy; Crown Commercial Service; the Education Endowment Foundation; the Government Digital Service; the Institute for Fiscal Studies; the Local Government Association; London Councils; the National Association of Head Teachers; the National Association of School Business Management; the National Union of Teachers; and members of the academies finance and assurance steering group; and

- a call for evidence issued to teachers' unions asking them to comment on: the Department's understanding of the potential impacts of funding changes on schools' financial sustainability and educational performance; the capacity and capability of schools to cope with financial pressures and to make difficult spending decisions; the suitability and utility of the support and guidance that the Department is offering to schools to help them achieve financial sustainability; and the Department's oversight of financial sustainability in schools and its strategy to intervene in the event of financial failure and related weak educational performance.

3 Ofsted inspects and regulates schools with regards to the quality of education provided. It does not comment on the financial management and performance of schools and its activity is therefore outside the scope of this report.

4 We examined the Department's understanding of how schools have responded to past funding pressures and its support for schools' financial sustainability by collecting evidence through:

- interviews with the Department about how schools have responded to previous funding pressures, including understanding of past behaviours on educational attainment, and the support it has made or plans to make available to schools to improve their financial health and sustainability;
- a review of analysis and literature produced by the Department and stakeholders;
- quantitative analysis of maintained schools' income and expenditure data for the period 2010-11 to 2014-15 using Stata and Microsoft Excel;
- quantitative analysis of academies' income and expenditure data for the period 2011/12 to 2014/15 using Stata and Microsoft Excel;
- interviews with a sample of 10 schools (as above);
- interviews with stakeholders (as above); and
- a call for evidence issued to teachers' unions (as above).

5 We assessed how the Department identifies and manages the risk of financial failure in schools by collecting evidence through:

- interviews with the Department and the Agency about the processes in place to oversee the financial management and performance of schools and to intervene in cases where financial issues arise;
- a review of analysis and literature produced by the Department and stakeholders;
- analysis of maintained schools' surplus and deficit data to identify those schools deemed to require intervention according to the Agency's criteria for intervention;
- a review of the Agency's intervention records for maintained schools and the Agency's national concerns reports of those academies it is monitoring closely or where it has intervened; and
- analysis of academies' end-of-year surplus and deficit data and budget forecast returns data for the period 2011/12 to 2014/15.

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