

SCHOOLS IN FINANCIAL DIFFICULTY- USE OF DE-DELEGATED CONTINGENCY

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1. Purpose

- 1.1 To provide a report to Forum on the anticipated overspend of the 2016/17 general contingency budget to support closing/amalgamating schools and schools facing financial difficulty.

2. Summary

- 2.1 Schools Forum agreed a de-delegated general contingency budget to support closing/amalgamating schools and schools facing financial difficulty when the School Funding Regulations were revised in 2013. To date, this fund has been sufficient to ensure that maintained schools are safeguarded against costs could not be planned for or avoided and would have otherwise tipped them into deficit. However, there was a marked deterioration in the financial health of many schools in 2015/16; with ten or so maintained secondary schools exhausting their reserves and a rapid reduction in the total balances held by primary schools. In the context of real terms reductions expected to at least the end of the Parliament, recovering from a deficit position is particularly challenging. For some schools, significant restructures have taken place and despite this, deficits appear to be unresolvable, leaving a negative legacy for present and future pupils as schools look to MAT arrangements to deliver economies of scale.
- 2.3 Given significant savings that will be realised to the DSG budget in 2016/17 in National Non Domestic Rates, a series of one-off payments to schools that are in severe financial difficulty that are ineligible for Falling Rolls Funding will be made to minimise the impact on pupils of unresolvable debt and enable the schools to move forward with future planning to secure economy of scale. The deficit balance of a maintained school converting to Academy has also been charged to the general contingency budget. Together, these payments will lead to a significant overspend of the general contingency budget on 2016/17.

3. Background

2015/16 Position

- 3.1 Schools Forum approved the introduction of de-delegated funding in January 2013. Within the de-delegated suite of budgets is a general contingency fund to provide support to closing/amalgamating schools and schools facing financial difficulty. This budget is de-delegated at £2 per pupil and totals £208k.
- 3.2 As previously reported to Forum, given real terms reductions in budget shares resulting from cost pressures, 2015/16 saw a significant change in the financial health for many schools in Hertfordshire with school balances falling rapidly across the County. The modest overspend of the general contingency in 2015/16 reflects this deterioration- a number of schools had exhausted balances and were unable to absorb unexpected costs that hadn't been planned for and were unavoidable.
- 3.3 In 2015/16 general contingency payments totalling £217k were made to seven schools, four primary schools and three secondary schools. The impact of the payments was significant. In the primary phase the payments ensures that all four primary schools avoided an absolute deficit owing to unforeseen and unavoidable costs and the absolute deficit of the three secondary schools owing to unforeseen and unavoidable costs was lessened, easing cash-flow difficulties in these schools.

Table 1: Contingency Payments 2015/16

School	Rationale	Amount Awarded
Primary Phase		
School A	Contribution towards legal fees and supply costs from an industrial tribunal that left the school in absolute deficit	£ 50,000.00
School B	Support to a deficit budget of a school resulting from a challenging PAN	£ 27,500.00
School C	Contribution towards the settlement of an industrial tribunal that left the school in absolute deficit	£ 16,500.00
School D	Cost of repairs for a sink hole not covered by insurance	£ 4,000.00
	SUB – TOTAL	£ 98,000.00
Secondary Phase		
School A	Additional costs incurred following the sudden death of a teacher and termination and recruitment costs following mental illness of a teacher	£ 54,800.00
School B	Staff sickness not covered by insurance	£ 34,451.00
School C	Additional costs following suspension of staff member	£ 21,168.00
School D	Support with temporary heating costs following sudden failure of boiler	£9,000
	SUB-TOTAL	£119,419
	GRAND TOTAL	£217,419

2016/17 Position

- 3.3 In 2016/17 with reserves considerably reduced in both phases, the Council and HfL are carefully monitoring around 30 primary schools with balances of less than 2% together and 15 secondary schools forecasting to be in absolute deficit in the next three years. At this stage it is expected that 12 schools will be in absolute deficit at the close of 2016/17- eight secondary and four primary. The projected deficits at primary schools are relatively small (typically 20k per annum), foreseen and are largely the result of excess staffing that schools have not addressed. In all but one case, plans are in place to reduce staffing through either natural wastage or small-scale redundancies and return to the schools to balance with loans repaid within the next three years. Given that in these cases costs could have been foreseen and planned, general contingency payments will not be made. Given the proven ability of light touch interventions to return primary schools to balance, it proposed to continue to monitor the balances of primary schools and intervene as necessary. Only in cases where costs that top schools into deficit could neither be foreseen nor avoided will payments from the general contingency fund be made.

- 3.4 The deficits projected at the secondary schools are of significant concern. They are larger (typically £500k-£1m per annum) and complex to resolve given specialist teaching staff, cuts to sixth form funding and surplus capacity within the secondary phase. In all cases, tackling the deficits and returning schools to balance require a wholesale school restructure involving staff and curriculum. Recognising the negative legacy that unresolvable debts will leave for both current and future pupils, addressing the projected deficits at secondary schools has necessitated some very difficult and unpalatable decisions to be made.
- 3.5 It is clear given the state of secondary school balances that the call on the fund will increase from the secondary phase in 2016/17. With some schools facing chronic deficit and cut staff and resources to the point that further cuts will precipitate a collapse in standards, payments from the general contingency fund have been made to support three secondary schools in unique circumstances. These are set out in 3.9 and 3.10. Given the planned total overspend the primary and secondary contingency budgets have been separated to ring-fence primary contributions given they are the largest contributor.

General contingency payments to schools in severe financial difficulty which are ineligible for Falling Rolls Funding

- 3.6 Forum is aware that Financial Action Groups are supporting schools causing financial concern. There are currently 11 FAGs in process- nine in secondary schools and two primary schools. The impact of the process has been positive, reducing forecast deficits across the schools concerned by £4.5m.
- 3.7 As detailed above, with significant resource investment in a wholesale school restructure and a number of challenging decisions, the finances of most secondary schools projecting significant deficit can be bought back into balance. However, for schools smaller than 550 pupils in size the challenge is particularly acute. Hertfordshire's smallest secondary schools operate with a diseconomy of scale given a number of fixed costs comparative to much larger schools. To ensure budgets balance, the smallest schools are now running single teacher departments and a narrower curriculum than neighbouring schools. Falling Rolls Funding is a lifeline to these schools, enabling their budgets to just balance whilst maintaining a structure and curriculum that just about enable them to remain 'Good' schools.
- 3.8 Recognising that there is a significant primary school pupil bulge transitioning to secondary school in the next three years, Schools Forum has approved a Falling Rolls Fund in Hertfordshire to enable schools in areas of future demographic growth to be sustained in the short to medium term. Whilst the decision to operate a Falling Rolls Fund is a local decision, the DfE sets mandatory criteria that in order to qualify schools must be graded 'Good' or 'Outstanding' by Ofsted. Real terms reductions in budgets have compounded the costs pressures of schools operating at a diseconomy of scale such that those eligible for Falling Rolls Funding can just balance and those that are

ineligible are in a deficit position despite running exceptionally lean staff teams and narrow curriculums.

- 3.9 The School Funding Regulations are such that in order for a deficit to be licensed a school has to demonstrate financial recovery within three years. Whilst the primary bulges are typically three years away, schools not eligible for Falling Rolls Funding will need at least two or three significantly larger intakes before their budgets can be brought into balance. Given this will take five or six years licences cannot be granted and schools are in financial free-fall, relying on cash from the Council to pay their staff and adding to an unresolvable debt.
- 3.10 In 2016/17 there are nine schools in Hertfordshire with 550 pupils or fewer on roll. Two of these schools, one Academy and one maintained school receives very large amounts of Minimum Funding Guarantee protection. Of the remaining seven schools, four are maintained and three are Academies. Of the four maintained schools, one is eligible for Falling Rolls Funding and is financially stable, one is newly eligible and has a historical deficit in part due to criteria that have now been changed that led to a lag in funding; and two are ineligible. Visibility on Academy budgets is limited; all three of the remaining Academies are now 'Good' and eligible for Falling Rolls Funding.
- 3.11 It is clear to the LA having worked with both small secondary phase Academies and maintained schools that finances simply cannot be sustained by budget share alone. Recognising this, and its duty to all Hertfordshire children, the LA is seeking to be equitable in its approach by ensuring that all small secondary schools receive a level of support in the interim to ensure that standards do not collapse in these schools whilst wider structural change is brokered to ensure sustainability. The proposed payments below will mean that all schools under 550 pupils have received financial support this year either through Minimum Funding Guarantee, Falling Rolls Funding or a Contingency Allocation.
- 3.12 The LA recognised through the initial work of Financial Action Groups that the level of Falling Rolls Funding and the timing by which it could be accessed following a 'Good' Ofsted judgement needed adjusting to provide sufficient funding to meet its purpose. Forum agreed revised criteria in January 2016 to be effective from April 2016 (the earliest point by which the changes could apply). As indicated in 3.9 above, for School A that achieved a 'Good' grading in June 2015 there was a significant funding lag between the judgement and being able to access the funding contributing to a historical deficit which has caused an ongoing cash-flow crisis in the school in 2016/17. Whilst Falling Rolls Funding enables the budget to just balance; there is no prospect of the deficit being repaid in the short or medium term. A Financial Action Group has reduced staffing and resources to a level where further cuts would precipitate a collapse in standards. School A is in an acute cash crisis unable to pay its staff each month given the impact of the historical deficit. Recognising that the fund criteria has been changed to avoid this circumstance in the future and the negative legacy this unresolvable historical debt for School A, a contingency payment has been made to address the historical deficit in lieu of Falling Rolls Funding.

- 3.13 In the discussion in January 2016 on the Falling Rolls Fund Criteria, Forum recognised the need for all small secondary schools to access the fund. Had the DfE criteria permitted us to do so at that point, we would have extended eligibility to all schools regardless of Ofsted rating. The consequence of not being able to do so is a whole series of problems at these schools which, so as not to precipitate the collapse of these schools and a wider set of problems, we are supporting them to overcome through a contingency payment in the short-term while structural change is brokered in the medium-term.
- 3.14 Schools B and C are both under 550 in size and both recently graded as 'Requires Improvement' by Ofsted and therefore ineligible for Falling Rolls Funding. School B is in significant historical financial deficit – a Financial Action Group has reduced the forecast deficit by £2.1m over the next three years and the 2016/17 forecast deficit by £700k. However, the budget cannot be bought back into balance through further cuts without precipitating a collapse in standards. If School B was eligible for Falling Rolls Funding it could be bought back into in-year balance.
- 3.15 School C is in a similar position, graded as 'Requires Improvement' it closed 2015/16 in surplus through exhausting reserves and will enter absolute deficit in 2016/17. A Financial Action Group is currently working on a staff restructure which will generate savings but these will not be sufficient to keep the school in balance. If the school was eligible for Falling Rolls funding then the budget could be balanced.
- 3.16 Together, schools A, B and C would have been eligible for £867k under the Falling Rolls Fund (with the 2015/16 criteria applying for School A). Through virtue of not qualifying for the Falling Rolls Fund in the periods specified, £681k of absolute deficit will be generated by the end of 2016/17. Contingency payments in lieu of Falling Rolls of £681k will ease considerably the financial pressures at schools A and C and enable Governing Bodies to transition their schools towards Academy Status without a scale of debts that will prevent the right solutions for the schools being brokered. School B will still have a significant historical deficit but the Contingency payment will at least ease the immediate cash crisis in the school.
- 3.17 It is assumed that once a National Funding Formula is introduced, the criteria for Falling Rolls Funding will either change substantially, or will be discontinued. The contingency fund will also cease to exist at this point as it is proposed that de-delegation will end. It will therefore be a priority to ensure that these schools are able to transition smoothly to MAT status to ensure educational outcomes are not compromised by growing unresolvable debt post introduction of the hard formula.
- 3.18 There can be no doubt that for small schools in areas of demographic growth that are not eligible for Falling Rolls Funding, budgets can no longer balance. Whilst sustained growth in pupil numbers is projected for these schools in the medium term; the only option for these schools in the short-term is structural

change. Clearly such change cannot be achieved overnight if the right solutions are to be found, however, it is being brokered as a priority.

Treatment of Deficit Budget on Conversion to Academy Status

- 3.19 School D was judged to be Inadequate by Ofsted in October 2014. School D converted to a Sponsored in September 2016. School D had a licenced deficit in place, agreed prior to the Financial Action Group Process. Given that School D was forecasting to exceed the licenced deficit in 2015/16 and the financial sustainability of the school could jeopardise Academisation, a Financial Action Group was put in place to reduce the projected overspend. A number of savings were realised in the short-term and a staff restructure implemented for the new Academic Year (the earliest it could be achieved given statutory notice periods) resulting in the school recording a very modest absolute deficit in 2015/16 and forecasting to break-even in 2016/17. However, given the costs of the previous structure were borne in the 5/12s budget along with some significant additional other costs including exam fees, School D converted to Academy Status with a projected deficit £150,000¹. In line with the DfE's guidance note to schools and local authorities on the treatment of balances when maintained schools become academies, this balance has been charged to the de-delegated contingency fund.

Totality of demand to date

- 3.20 For the reasons stated above, payments of £681k have been made from the general de-delegated fund for secondary schools in 2016/17 with a further £150,000 estimated to be paid in October.

Schools A, B and C	Payments in lieu of Falling Rolls Funding	£681,000
School D	Deficit on conversion	£150,000
	GRAND TOTAL	£831,000

This represents a significant overspend of a modest budget. At this stage it is not anticipated that there will be any further payments to schools in such exceptional cases. In all four exceptional cases reported in this paper, budgets have been reduce to the extent that further reductions would precipitate a collapse in standards. It is proposed to continue to work with schools under 550 in size and those projecting to Academise with deficit to minimise financial pressures in these schools.

- 3.21 It should be noted that the LA is not intending to routinely provide contingency funding to schools just because they are in deficit but will consider the case where exceptional circumstances are evident as in the cases described in this paper.

¹ The exact figure will be confirmed once the final accounts are received in October 2016

- 3.22 Whilst the costs of the overspend will be met from DSG, it should be noted that a project has been underway to convert the highest rate paying schools to Foundation Status in order to deliver savings in National Non Domestic Rates (NNDR). Whilst the exact savings will be reported at the close of the Financial Year, it is estimated that £666k of savings will be made in 2016/17 and upwards of £1.0m per annum from 2017/18 onwards. The general contingency payments will therefore be negated by savings in NNDR.