

Implementation of a single funding formula for early years

Interim guidance for local
authorities July 2008



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GLOSSARY OF TERMS

Term	Stands for	Description
ACORN		ACORN is a leading geo-demographic tool used to identify and understand the UK population (competitor to MOSAIC – see below).
Aspirational Costs		Costs which reflect a desired cost level rather than the actual current cost level.
AWPU	Age Weighted Pupil Unit	A factor used in local authority funding formulae to distribute different amounts of funding for pupils of different ages.
CEL	Central Expenditure Limit	The maximum amount of expenditure that can be retained by the local authority from the Schools Budget for central items without the gaining the approval of the Schools Forum.
Cliff Edge		Any situation where a formula creates a significant change in the level of funding as a result of a minimal difference in the characteristics of the provider.
Cost Apportionment		The apportionment of the costs relating to a single resource or activity to the multiple users of the resource or activity on an agreed basis.
Deprivation		Funding to support children from socially deprived backgrounds so as to promote their opportunity to achieve at equivalent levels to other children.
Dividend		A distribution of the profits of a business to its owner(s) in proportion to their share in the ownership of the business.

Term	Stands for	Description
DSG	Dedicated Schools Grant	The ring-fenced grant from DCSF to local authorities covering funding delegated to schools, and other provision for pupils such as Pupil Referral Units and early years education in Private, Voluntary and Independent settings.
EYC	Early Years Census	The annual collection of information from each local authority on pupils accessing the free entitlement in private, voluntary and independent settings.
Flexibility		The free entitlement is being extended to 15 hours, offered flexibly from September 2010. Guidance on the extension of the free entitlement and the definition of flexibility is available at www.everychildmatters.gov.uk/earlyyears/lapractice/entitlement/
FTE	Full Time Equivalent	DSG funding is based on the number of full-time equivalent pupils. Where a pupil is not in full time education the purpose is to reflect the amount of provision they are taking up for funding purposes.
Impact Assessment		An assessment of a change, for example the financial impact, or pupil number impact on the settings within a local authority.
ISB	Individual Schools Budget	The sum of the delegated budgets of all schools in a local authority.

Term	Stands for	Description
Management Fee		A fee levied by an owner of a business in payment for services provided to the business, or by a head office of a business on a subordinate part of the business in payment for services provided by the head office function.
MFG	Minimum Funding Guarantee	A guaranteed increase for a school in year on year funding per pupil where pupil numbers are constant. For the current funding period (2008-2011) this is 2.1% per annum per pupil.
MOSAIC		A market-leading consumer segmentation product which classifies all 24 million UK households into 11 groups, 61 types and 243 segments (competitor to ACORN – see above).
Outlier		A value at the outer ends of a range of values and which may not be consistent with the other values in the range.
Participation		The level of attendance at a setting on which funding under the free entitlement is to be based.
Perverse Incentive		A feature of the formula that provides a reward for taking a future action that is at variance with or even the opposite of that intended, and/or that promotes inefficiency.
PVI	Private, Voluntary, Independent	The different categories of childcare providers other than those in the maintained sector.

Term	Stands for	Description
Schools Budget		The sum of funding from the DSG plus Learning and Skills Council for post 16 education plus any other funding the LA choose to add which must be used for purposes prescribed in regulation for education. The early years funding for the free entitlement is part of the Schools Budget.
School Budget Share		The funding provided to a school under the terms of the local authority's school funding arrangements.
Sufficiency		A local authority's obligation to ensure that sufficient places exist to offer parents provision under the terms of the free entitlement.
Supplement		An additional payment to a setting which reflects a particular characteristic .
Sustainability		The ability of a setting to remain financially viable.
Windfall Gain		An unexpected and significant gain from a change in the funding arrangements which cannot be justified.
Transitional Arrangements		Arrangement put in place to ensure that the transition from the current funding regime to the single formula is manageable for all or the large majority of settings.

1 Introduction

1.1 Background

To support the extension and increased flexibility of the free entitlement for 3 and 4 year-olds and to address inconsistencies in how the offer is currently funded across the maintained and PVI sectors, the government announced in June 2007 that local authorities (LAs) will be required to use a single local formula for funding early years provision in the maintained and PVI sectors from 2010-11 and encouraged LAs to introduce the formula from April 2009 wherever possible.

Since November 2007, DCSF has been working with six pilot LAs who agreed to implement the single formula a year early (in April 2009) to test the issues and provide good practice guidance for other LAs. The six LAs involved in this Formula Development Project (FDP) are Hertfordshire, Somerset, Leeds, Rochdale, Croydon and Southampton. This interim guidance is based on learning from those pilots and is intended to support LAs in developing their own single formula, setting out key requirements and good practice examples. Although this guidance is 'interim', we do not anticipate that the core content will change and it is important that LAs start thinking about their formula now. Final guidance will be issued next year to reflect any changes to regulations (see paragraph 1.4).

1.2 Timetable

There are three stages on the way to a single formula:

2008-09: Establishing a robust understanding of costs, across all providers (see Section 5) and starting to consider the shape of the new formula. Those LAs with non-schools members on the Schools Forum will be required to have PVI representation by September 2008.

2009-10: Counting on the basis of participation, rather than places. LAs are not required to fund on that basis until 2010, although they can move to participation-led funding in 2009, if they wish to do so. To reflect this shift, the Early Years Census (from 2008) and the School Census (from 2009) will also count the hours taken up by children.

Also during 2009-10, working on the development of a single formula in partnership with providers from the PVI and maintained sector, undertaking formal consultation with the Schools Forum, and securing buy-in from all stakeholder groups.

Those LAs who currently do not have non-schools members on the Schools Forum will be required to have PVI representation (subject to the passing of the current Education and Skills Bill).

2010-11: Introducing a new single formula, based on a clear impact assessment and underpinned by appropriate transitional arrangements.

1.3 Policy Context

2010 will see substantial change in the delivery of the free entitlement with the introduction of a new formula, and the requirement on LAs to offer 15 hours flexibly to all 3 and 4 year olds. It is vital that LAs consider these changes together and work in close partnership with all providers on their design and implementation. Interim guidance on delivery of the extended entitlement is being published in parallel to this document and is available at: www.everychildmatters.gov.uk/earlyyears/lapractice/entitlement/

Funding to support the extension to the free entitlement is available through the Standards Fund until 2010-11. After that, this funding will become part of DSG. LAs will need to consider when it is best to incorporate this funding into the formula. They can do so immediately, but will need to be assured that this doesn't compromise the policy to target additional funding to the 25% disadvantaged in 2009.

1.4 Regulatory Change

The FDP LAs say consider that they would find difficulty in delivering the single formula in the way that DCSF would like, without change to regulations for the maintained sector. We are currently exploring ways to proceed and will provide further information as part of a broader consultation on the School Finance Regulations in the Autumn of 2008. Further guidance will become available after more work has been undertaken in this area.

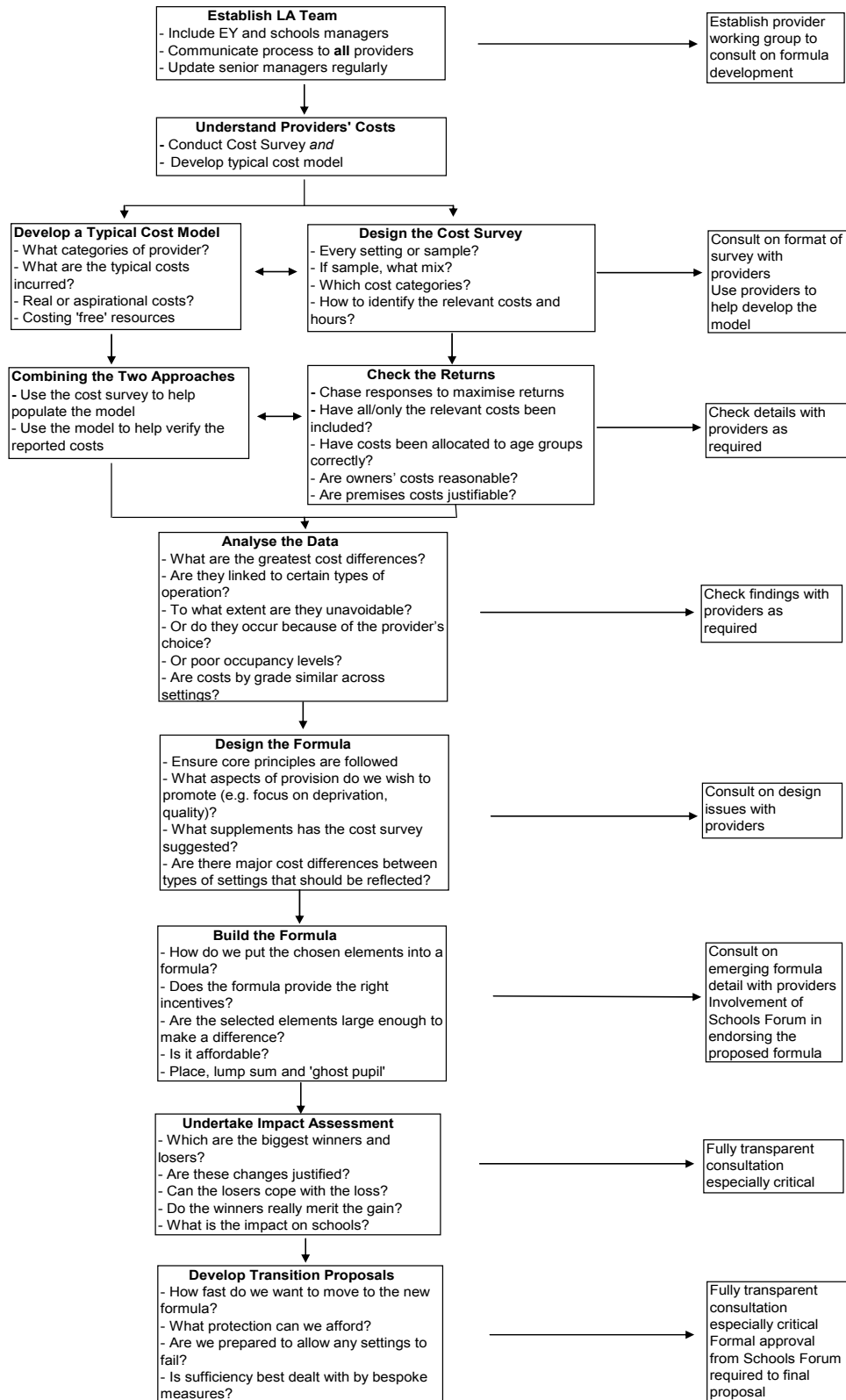
1.5 Maintained Provision

There are a number of issues that affect only maintained provision. These have been addressed throughout the document, but brought together in one place as Appendix 10.

Finally, there are no shortcuts in this process, the work needs to be transparent and thorough; it is unlikely to involve simply taking part of an existing formula and assuming it can be applied across the board. This may be possible, but LAs will need to go back to first principles, work with representatives of all providers, and ensure that their formulae meet the whole spectrum of provision. The strongest message coming out of the pilot LAs is that developing a single formula is challenging and takes time. Given that DCSF is expecting real change in 2010, it is critical that every LA starts work towards the formula now. This guidance provides practical help for LAs, setting out how to get a clear understanding of costs, the steps needed to design a single formula, and to assess its impact and suggestions for developing transitional arrangements.

2 Overall Process

Developing the Formula - Key Building Blocks



3 Core Principles

LAs must have regard to the core principles when developing their formula

3.1 Definition

At an early stage in working with the FDP LAs it became clear that the work should be founded on clear principles. These are that:

- The development of a single formula should:
 - Support effective and efficient distribution of resources at a local level
 - Facilitate greater flexibility of provision so that parents have greater choice in how they use the free entitlement;
 - Preserve diversity and choice in the market;
 - Incentivise improvements in the quality of provision.

With regards to the operation of the formula:

- The same factors should be taken into account when deciding the level of funding for each sector;
- Decisions must be transparent and any differences between the sectors should be justifiable and demonstrable;
- The level of funding should be broadly cost-reflective and all the main cost elements should have been considered explicitly;
- There should be no perverse incentives and any change in the formula must not endanger sufficiency of provision;
- The formula must be based on common cost information from both the PVI and maintained sectors and all costs and public sources of incomes should be considered;
- Settings should be funded on the basis of participation, not places or similar factors. Any exceptional use of place-led funding should be based on clearly defined local imperatives such as sufficiency and sustainability;
- The formula must take into account the sustainability of all settings, giving sufficient stability to all sectors to plan for the future and improve quality;
- Transition from the current funding mechanism to the future funding mechanism must be planned and managed carefully, and based on a clear impact assessment;
- The application of formulae in different settings should be based on common operating principles wherever possible.

4 Working in Partnership

LAs must:

- *Manage the expectations of their providers effectively*
- *Ensure that all providers from PVI and maintained sectors are engaged as early as possible in the process of developing the early years formula*

LAs should:

- *Engage with providers at two levels: with all settings to keep them aware of the nature of the changes that will happen, and broadly up to date with progress; through a smaller working group, which is representative of all providers to discuss the details*
- *Make every effort to use the knowledge and understanding of representative groups such as the National Day Nurseries Association (NDNA) and the Pre-School Learning Alliance (PSLA)*

A key finding of the work with the FDP LAs is the crucial importance of effective partnership working. The policy announcements to date have generated both expectation and concern amongst providers in all sectors, and LAs must therefore manage the expectations of their providers effectively. Partnership working with providers is also critical to getting the formula right.

Furthermore, FDP LAs also identified the importance of establishing a local team from the outset that includes early years policy leads and schools finance personnel. Without this, there is a real risk that a process that is perceived as either 'finance-led' or 'early years-led' may stall at a critical time late in the project, because it hasn't taken full account of the wider implications of the proposed formula. It is also critical that senior managers and elected members understand these changes and can provide strategic leadership for this work.

LAs must therefore ensure that all partners are engaged as early as possible in the process of developing the early years formula, in order to help shape thinking from the outset, and to avoid any group of providers from feeling that they have no influence over the process. Early engagement can be particularly useful in developing a full understanding of provider costs either from the cost survey where provider engagement can ensure that the key costs and cost drivers are covered comprehensively, and that the survey is designed in a way that enables all settings respond, or in developing a more conceptual model of provider costs to inform the subsequent development of the formula.

Engagement should be at two levels:

- All settings need to be aware of the nature of the changes that will happen, and be kept broadly up to date with progress;
- A smaller working group, which is broadly representative of all providers, should be established to discuss the details.

The composition of the working group is a matter for LAs to decide. Two models have been used in the FDP LAs and both have worked well:

- Separate consultative groups for each sub-sector as a starting point (each of private/independent, voluntary and maintained);
- A single group with representation from all sectors which may encourage greater collaboration in the long-term.

There is no prescribed format to the structure and composition of the group – the key issue is that it should be as representative as possible of all providers on a broadly proportionate basis. In particular, LAs must ensure that their maintained sector providers are fully engaged, as there is some evidence that schools have not realised that the changes will affect them. In this respect, one FDP LA has used head teacher ‘champions’ to help communicate the changes to their colleagues, and this has proved to be very effective.

Clearly, any group of partners will need to be small enough to discuss detailed issues, but large enough to cover a representative range of providers. This suggests up to a dozen external representatives covering, at least:

- Nursery schools and nursery classes separately;
- Day nurseries;
- Playgroups;
- Larger and smaller operators;
- Settings in deprived and less-deprived areas;
- Different geographical areas (for larger LAs).

LAs should also make every effort to use the knowledge and understanding of representative groups such as the NDNA and the PSLA.

5 Understanding Providers' Costs

LAs must:

- *Be able to explain any differences in the funding allocated to different categories of provider under the new formula*

LAs should:

- *Complete the cost survey and make every effort to get providers involved fully in the design of the survey*
- *Extend the cost survey to the maintained sector if they have not already done so*
- *Develop a typical cost model and make every effort to involve providers in this process*
- *Update the cost survey and cost model on a regular basis*

5.1 Introduction

It is important that all LAs develop a clear and comprehensive understanding of their providers' costs in order to ensure that, as far as possible, the key principles set out in Section 2 of this Guidance are observed. In particular, LAs must be able to explain any differences in the funding allocated to different categories of provider under the new formula. LAs must as a minimum be in a position to justify and explain in wholly transparent manner:

- The core level of funding and any differences between providers of different characteristics, including any differences in funding levels between providers in different sectors;
- All supplementary payments over and above the core funding level;
- All funding that is based on anything other than actual levels of participation.

Developing a level of understanding which enables LAs to justify their formulae in these ways is challenging. Two approaches have therefore been used by FDP LAs to develop their understanding of providers' costs – the cost survey, which LAs will already have undertaken, and what we have termed the 'typical cost model'.

These two approaches, the cost survey and the typical cost model, are supportive of one another, and it is recommended that LAs use both to support their further work on understanding provider costs.

5.2 The Cost Survey

DCSF required all LAs to complete a survey of the costs of the PVI sector to inform budget setting for 2008-11. The purpose of the cost survey is to inform LAs as to the costs of provision across their full range of providers, but particularly in the PVI settings. FDP LAs all found that it was necessary to include maintained settings in the cost survey, and it is therefore recommended that any LA which has not incorporated its maintained sector providers in the original cost survey should also extend the survey to do so.

The cost survey should be designed to help LAs to identify:

- The overall costs of provision and the hourly costs of provision for the entire setting (it is likely that LAs will wish to undertake their own allocation of costs to 3 and 4 year olds – see Appendix 1 ‘Identifying the costs applicable to the free entitlement’)
- The range of costs across their provider group;
- Differences in costs between different types of providers;
- The level of basic funding that is applicable to all providers;
- The extent to which supplementary levels of funding may be required to meet local priorities such as securing sufficiency, tackling under achievement in deprived areas and promoting quality.

LAs should make every effort to get providers involved fully in the design of the survey. They should also recognise that many providers may find the cost survey daunting, and that assistance with regard to completion may be necessary. Such assistance could be provided by the LA itself or, potentially, the local business link.

Full details on the process of conducting a cost survey are set out in Appendix 1.

5.3 Developing a Typical Cost Model

LAs should also develop their understanding of provider costs through a typical cost model. This approach seeks to work up a typical cost of different types and sizes of setting using known information from a variety of sources. Examples are provided at Appendix 2. In addition the NDNA have developed costing model which can be found at www.ndna.org.uk (under advice and information) which authorities may find useful in gaining an understanding of nursery provider costs.

The typical cost model should consider all the activities it takes to provide the free entitlement and attempt to cost these. Clearly, not all providers have the same costs, and LAs should therefore try to attempt to categorise providers in a way that reflects similarities between them to arrive at a relatively small number of categories. Categorisation into similar groups in cost terms may be based upon type of provider (although not all providers of a given type have the same cost structure, and there may be close similarities in cost

terms between providers of different types), or it may be based upon size of provider, or both. This will depend in part upon each LA's mix of current providers.

Thereafter each activity should be costed for each category of setting. Some costs may be common to all categories of setting, whereas some may apply to only one category. LAs should be able to justify and explain why a given cost is used in all cases, whether it applies to all provider types or a single provider type.

The core elements of developing such a model are as follows:

- Identify the full range of possible settings. In the examples developed so far, the range has included maintained nursery schools, maintained nursery classes, PVI day nurseries, pre-schools, childminders and independent schools;
- Identify the costs that each of the settings typically attract for a given size of operation. It may be appropriate to use only one 'typical' size of setting for each type (e.g. a maintained nursery school of 120 places, a maintained nursery class of 26 places, a day nursery of 48 places etc), if costs increase in a broadly linear manner with size of setting, or to use different sizes of setting within each type if costs are considered to move in distinct 'steps' at different sizes of setting;
- Thus for a maintained nursery class of 26 the costs would typically be an average teacher cost, premises related costs based on typical space allocations and typical property-related costs for that amount of space, typical learning resources costs, typical services costs, and apportioned costs for resources such as the head teacher and administration. (The full list of cost headings used in the example developed by the FDP LA is shown in Appendix 2);
- For maintained nursery schools the process is the same, but not all costs would need to be apportioned, as the nursery school is bearing the full cost.
- For other types of setting, again the process is the same, but the costs relate to typical costs incurred by the setting. Thus the costs might involve a setting manager rather than a head teacher, a room leader rather than a teacher etc. However, LAs should ensure that settings of different types which incur essentially similar costs – for example a teacher and a graduate leader – receive similar funding.

It should be evident that the working group of provider representatives discussed in Section 3 will have a key role to play in developing a model of this kind, and LAs should make every effort to involve them in this process.

Two specific issues that LAs will face in developing a typical cost model are:

- Use of 'real' costs or 'aspirational' costs. For example, should the model include the actual costs that PVI providers typically pay their staff, or the rate that the LA may desire them to pay to attract and maintain staff of the appropriate level of qualification and quality? It is recommended that LAs should operate within known affordability constraints, which is likely to limit the level of aspirational cost that should be included.
- Should the model attribute a cost to the 'free' resource that many voluntary providers enjoy, for example volunteer staff? It is recommended that LAs should cost 'free' resource of this kind at the appropriate market rate as otherwise the level of funding delivered through the formula will be insufficient in the event that the free resource ever becomes unavailable.

5.4 Combining the Two Approaches

In practice the typical cost model and the cost survey should both be used. The cost survey provides a substantial volume of real data on providers' current costs, and reveals important differences between, for example, providers of different types and providers in different parts of the LA. The typical cost model enables LAs to build on the costs survey, using the data gleaned from the survey, supported by other data sources (including the substantial body of cost knowledge held by representative bodies such as the NDNA and PSLA), thereby ensuring that it is robust, comprehensive and consistent. It also enables LAs to model important differences between settings of different types, sizes or localities, and to understand the impact of emerging cost pressures in subsequent years, without having to repeat the cost survey annually.

5.5 Updating the Analysis

LAs should also – as a matter of good practice – consider costs as part of the ongoing conversations with providers so as to ensure that their understanding of providers' costs remains relevant and up to date. For example, LAs may wish to update the main cost categories within the cost analysis on an annual basis using publicly available data such as relevant pay scales or salary cost indices for staff costs. In the event that other costs are subject to significant cost pressures – for example energy costs – LAs should also reflect such pressures in their cost analysis. LAs may also wish to use the cost analysis and cost modelling work to help providers develop a more robust and complete understanding of their own costs, especially in cases where the cost survey demonstrates that their understanding is not well developed.

6 Designing the Formula

LAs must:

- *Distribute funding for the free entitlement on participation other than in exceptional circumstances once the formula is introduced*

LAs should:

- *Consider a range of issues when deciding how the principles set out in Section 2 are applied including local policy objectives; existing knowledge of the financial position of providers; the issues faced by their schools; the hourly rates charged by providers; results of the cost survey and the typical cost model, and the requirement to support sustainability and flexibility*
- *Not use the results from the cost analysis simply to reinforce existing cost and funding differentials between different categories of settings*
- *Strike a balance between recognising existing cost differences; identifying what factors might lead to increased levels of need; and how best to distribute funding to help achieve policy objectives*
- *Determine a basic hourly rate for providers*
- *Decide which supplements are required in the formula to support local policy objectives*
- *Consider specific technical issues such as perverse incentives and 'cliff edges'*
- *Address the affordability issues at an early stage*

6.1 Applying the Principles

LAs should consider the following issues when deciding how the principles set out in Section 2 should be applied to the development of their early years formula:

- The policy objectives for early years provision and in particular how the formula should encourage any key policy objectives. For example, driving quality improvement through the appointment of more highly qualified early years staff would be supported by a supplementary payment linked to staff qualifications.
- Existing knowledge of the financial position of providers in the area. For example, is there a pattern to the types of providers that the LA deals with most often on issues of sustainability?

- The issues faced by their schools. LAs should consider using similar funding approaches to those in the local schools' formula. An obvious example here is support for small schools in rural settings.
- Results of the cost analysis survey and the typical cost model.
- Their obligation to ensure sufficiency of provision;
- The introduction of greater flexibility of provision.

Decisions about the structure of the formula should not be influenced too strongly by any single issue. In particular, care should be taken not to use the results from the cost analysis simply to reinforce existing cost and funding differentials between different categories of settings. A balance should be struck between:

- Recognising existing real cost differences between providers facing different circumstances.
- Deciding how best to distribute funding to help achieve policy objectives.
- Considering the impact that a new formula may have so that behaviours are not changed in an unforeseen way as a result of changes in funding. The possibilities for the single formula to have unintended consequences are particularly strong with regard to either schools' or parents' behaviour around admission to school or to the nursery.

6.2 Broad Structure

The distribution of funding for the early years free entitlement must be based on children's participation other than in exceptional circumstances. The basic structure of the formula is therefore likely to be:

Basic hourly rate	Hourly supplements	Number of hours participation	Other supplements
(This rate may vary depending on the "type" of provider.	+ Additional amounts per hour for extra "need" or to recognise policy objectives such as improving quality) x The method of counting the level of participation must be the same for all providers	+ In some circumstances, (e.g sufficiency) it may be appropriate to provide lump sum amounts

6.3 The Basic Rate

Each formula should incorporate a basic rate per child – usually expressed as a rate per child per hour. The basic rate should be sufficient for a provider to deliver care which meets acceptable quality levels to a child which does not have exceptional needs. While this could conceivably be the same basic

amount for all providers within an LA, two broad alternative variants of formula emerged among the FDP LAs:

- Variant One: differential hourly rates by type of setting with relatively few supplements;
- Variant Two: a common core rate across all settings supported by relatively high supplements for those types of settings where the core rate did not reflect the underlying costs of certain types of setting.

Both of these approaches are acceptable. In the case of Variant One, the LA concluded that different types of providers had genuinely different levels of cost which were determined by the characteristics of the settings (not just different levels of efficiency) and that it was therefore appropriate that the formula should recognise these differences and allocate the funding accordingly.

In the case of Variant Two, the LA concluded that the underlying costs of its providers were broadly similar, and that a common level of core funding was therefore more appropriate. However, it also recognised that certain categories of providers incurred exceptional costs which should be met by specific increments to either the per pupil element of the formula, or as a lump sum. These included rent, rates, a ‘London fringe’ uplift, an administration element, and a payment of head teacher costs for nursery schools.

These two variants are illustrated in the following table:

	Variant One			Variant Two	
	Playgroup	Day Nursery	Nursery Class		
Base Rate	Rate 1	Rate 2	Rate 3	Same rate all settings	
Supplements					
Flexibility	Relatively low values overall. Variable values and variable applicability according to the characteristics of the setting.			Rates/Rents	Relatively high values overall. Single values, but variable applicability according to the characteristics of the setting
Deprivation				London Fringe	
Quality				Deprivation	
Training				SEN	
Mentoring				Administration	
	Sustainability				
	Head teacher				

LAs should, of course, be careful that they do not ‘double fund’ any aspect of provision. For example, if they regard flexibility as a core part of the offer to be funded through the base rate, they clearly should not have a flexibility supplement.

These two alternatives do not represent the full range of options and are presented to make the point that the structure and composition of an LA's formula will reflect its own particular circumstances. Another FDP LA chose to implement a differential core rate of funding according to the opening hours of the setting, on the grounds that settings with longer opening hours unavoidably incurred higher core costs. The threshold at which the hourly rate changes is five hours, which differentiates between those open on a sessional basis (either for half a day, or for a morning and afternoon session) and those open throughout the day. A threshold of five hours reflects the flexibility requirement that implies that parents can exercise their 15 hours of free entitlement over a minimum of three days.

Results from the cost survey and/or from the development of the typical cost model may provide other evidence of systematic cost pressures among different types of provider. We therefore recommend that local knowledge is used to supplement the cost survey to determine whether there is a case for differential rates for different types of provider. An example of the type of analysis to apply to the cost survey to support this approach is provided at Appendix 3.

6.4 Supplements

Supplements to the basic rate allow LAs to reflect the needs of individual children, for example children from disadvantaged backgrounds, or to drive local policy objectives, for example the need to enhance the overall level of quality of provision. A range of supplements has been considered by the FDP LAs. This list should not be considered to be exhaustive as LAs more widely may identify other issues for which it is appropriate to provide additional funding according to local circumstances. However, meeting the needs of deprived children is a key part of the Government's objective of closing the attainment gap between children from different backgrounds and there is therefore an expectation that LAs will consider using the early years formula to target funding towards the most deprived children.

In assessing how much funding to distribute through supplements, LAs should consider:

- How different will the levels of funding be between the providers receiving the highest and lowest levels of funding? A supplement may not be appropriate if the level of need across all providers is very similar.
- How much funding will be distributed in aggregate using the supplement?
 - If the amount is very high, will it be affordable? Is it reasonable to distribute a high proportion of funding on one supplement?
 - If the amount is very low, is it worth the additional complication of incorporating the supplement?

A full list of the supplements considered, and in some cases rejected, by the FDP LAs is set out at Appendix 4.

6.5 Participation

LAs are required from 2009 to count children on the basis of participation, not places, across all settings. The Early Years Census and the School Census will be brought into line with each other in 2009, and DCSF will collect individual child level information about the number of hours of free entitlement a child receives in a given week of the term.

LAs that wish to do so can move to participation-led funding in 2009-10 but are not required to do so until 2010-11. DCSF is exploring changes to regulations to enable a better reflect of participation. Any changes will form part of a wider consultation in the Autumn of 2008.

6.6 Other Funding

Funding for the free early years entitlement must be based primarily on participation levels. However, there may be some circumstances, for example in rural areas where the sustainability of particular settings would suffer if all funding was participation based, in which an alternative approach is appropriate. It is expected that these alternative supplements will only be permissible in exceptional circumstances, and restricted to a given proportion of the overall funding.

6.7 Affordability

All LAs will have to consider the affordability of their preferred formula, together with any transitional protection for settings affected adversely. In general it is not good practice to design a formula which implies funding levels that are unaffordable, and which have to be 'scaled back' to the available funding level. It is therefore recommended that LAs take an early view on the proportion of DSG which they intend to allocate to the free entitlement, and designs its formula accordingly. In many cases this is likely to be the current early years budget, and LAs may therefore wish to model all impact and transition issues (see Sections 7 and 8) on the assumption of no increase in funding.

Arriving at a formula which meets an LA's early years funding objectives, but which also operates within an existing affordability constraint, is likely to be an iterative process involving both 'top-down' and 'bottom-up' processes:

- From a top-down perspective an LA will have to consider what level of funding is available, and what can be done within that funding level;
- From a bottom-up perspective an LA will have to build a formula to meet its early years obligations and objectives, determine the likely total cost implied by the formula, and compare with the top-down funding constraint.

Options for restricting the costs of the new formula to the available funding are set out in Appendix 5.

6.8 Other Issues

In developing their formulae, LAs should also consider the following issues:

- Perverse incentives: something that provides a reward for taking a future action that is at variance with or even the opposite of that intended and/or that promotes inefficiency;
- 'Cliff edges': any situation where a formula creates a significant change in the level of funding as a result of a minimal difference in the characteristics of the provider.

These are defined more fully, and the issues associated with them set out, in Appendices 6 and 7.

7 Impact

LAs must:

- *Undertake an impact assessment of the effect of the new formula for every setting*

LAs should:

- *Assess the impact of possible unknown effects of the new formula for every setting such as changes of provider behaviour in response to the new funding regime*

7.1 Introduction

Before implementing a new early years formula, LAs must conduct an assessment of the impact the formula and any associated changes (such as increased parental choice) may have on each of its early years providers, and further consider what transitional arrangements, if any, may be required.

7.2 Impact Assessment

This assessment could take different forms, depending on the degree of turbulence expected in each sector, and could extend beyond the immediate early years arena if there are changes to other DSG-funded activities at the same time (such as a change to the formula for allocating school budget shares caused by the new arrangements). LAs should model the impact of each specific change that they make, distinguishing for example between the impact of the formula change, the impact of the introduction of 15 hours of free entitlement, and the impact of any other change that may be considered. The overall aims of the assessment should include:

- Giving assurance to the LA (including the Schools Forum) that the overwhelming majority of settings will be able to cope with changes caused by the new arrangements;
- Identification of which settings may be affected adversely by the changes, and to consider whether or not this is reasonable and whether or not additional support may need to be provided;
- Consideration of whether any settings will benefit to an unreasonable extent from the changes, and to consider whether such benefit should be limited;
- Consideration of the effect on capacity and parental choice.

7.3 Sources of Change

The impact of the new arrangements will vary between LAs, depending on the degree of departure from existing practices. The principal changes are likely to be as follows.

For schools:

- A move from various forms of place-led funding (where such forms of funding currently exist) to an actual count of child-hours;
- The complete or partial replacement of early years funding for nursery classes and nursery schools through the schools funding formula, with an early years formula for the 3 and 4 year old component of schools' funding;
- In cases where there are fixed points of admission, the possibility that schools will seek changes to admission arrangements to allow children to be recruited throughout the year as a response to funding on a participation basis. If LAs make such a change to admissions policy, it is likely to affect the pattern of demand for school places though the year and, consequently, the predictability and size of schools' income;
- Knock-on effects of removing nursery children from the main School Budget Share formula (with its inbuilt stability) and funding them through this separate route. The importance of this will depend on how LAs' formulae are constructed and might conceivably extend to schools without nursery children;

For PVIs:

- The replacement of their present flat hourly rate payment with a different hourly rate. In many cases this will involve the replacement of a single value with a new basic amount and one or more supplements;
- Knock-on effects of changes to schools' admission arrangements as described above (should these be introduced). This could change the pattern currently seen in many LAs of a build-up of children in the PVI sector through the year, punctuated by sudden falls at fixed school admission dates;

For all providers:

- Changes flowing from the increased parental choice on patterns of care and the increase to 15 hours' free care in most LAs.

7.4 Modelling Known Changes

The fundamental objective of the impact assessment is to demonstrate the impact of the change in the funding methodology, independently of any other change that may be taking place in early years provision.

LAs should therefore present providers with data which shows, for their own setting:

- The funding received under the existing funding method for the year prior to the introduction of the new formula;

- The funding they would have received for the same year under the new formula, assuming that the same number of hours of provision had been delivered;
- The difference in funding between the two approaches, either positive or negative;
- In the event that supplements are being introduced, for example for deprivation or quality, LAs should explicitly demonstrate how much funding would have been payable through such supplements and how they have been calculated;
- In the event that a transition mechanism is being introduced (see Section 8), the way in which the mechanism will operate and the specific impact it will have on the provider's funding.

7.5 Modelling Potential Changes

In deciding what level of early years funding is affordable, LAs will need to consider how their local market might respond in reaction to the changes in the funding regime. For example, will the maintained sector seek to fill empty places in response to a change to participation based funding? If so, what would be the impact on neighbouring PVI providers?

It would be over-ambitious for LAs to try to illustrate all the potential effects for each individual setting. Instead, it will probably be more helpful to providers to illustrate a small number of different scenarios. This would allow individual setting managers to make an assessment of their potential income over the coming year.

Such an illustration might include:

- The effect of a 5% or 10% increase in child-hours;
- The effect of a 5% or 10% decrease in child-hours;
- The maximum funding a setting could receive;
- The minimum funding a setting could receive;
- The effect of one or more possible transition schemes.

An example is provided at Appendix 8.

If, however, an LA can predict clearly that a given setting is likely to be subject to a series of changes which would have a 'compound' effect, it should make every effort to model these changes and address what that is likely to mean for the sustainability of the setting.

8 Transitional Arrangements

LAs should:

- *Decide whether and how to offer protection to providers from the impact of the changes*

As noted above, the introduction of a new early years formula may create some turbulence in providers' funding levels. Depending on the levels at which basic rates and supplements are set, LAs may see large numbers of providers facing the prospect of changed levels of funding.

In implementing a single formula, LAs should therefore consider whether transitional arrangements should be included to ensure that individual settings do not suffer unduly from a sudden or substantial reduction in funding, or that settings receive unforeseen 'windfall' gains.

Settings may see changes in levels of funding driven by four potential sources:

- A change in the way participation is measured. This is likely to affect schools particularly, but in making the counting methodology consistent between sectors, LAs may also introduce changes to PVI settings;
- A change in the basic rate paid to providers – a direct consequence of introducing the single formula;
- An increase in the number of hours per child as more parents become eligible (or opt for) the full 15 hours of free entitlement;
- Natural movement in the numbers of children.

LAs should consider whether and how to protect providers from the impact of some or all of these changes, particularly if several impinge on the same providers at the same time. A number of possible mechanisms, including an assessment of their respective merits are set out at Appendix 9.

In addition, LAs should consider whether other forms of non-financial support are required, such as helping providers to re-shape their services to limit the impact of the changes, or providing support in business or financial planning.

Appendix 1 – The Cost Survey

Which Providers to Include?

The new formula will apply to all early years settings which provide the free entitlement. In order to ensure that decisions are based on robust data, the cost analysis must therefore consider data from all types of providers. In general LAs should include all providers in the survey. For large LAs with very large numbers of providers this may not be practical, but every effort should be made to ensure that the survey information is gathered from a representative sample of providers. This should include:

- Setting representation – data should be gathered from a suitable number of providers covering each of the different types of setting. This should not just focus on the standard maintained, private, voluntary and independent definitions, but should consider different provider characteristics, such as size of setting, and the range of care provided, for example, full day care, extended days, and sessional;
- Geographical representation – data should be gathered from providers from across the whole LA. For county councils, this should therefore include examples of providers from both urban and rural settings. For urban LAs (metropolitan districts, unitary LAs and London boroughs), data should be gathered from providers across the LA, including city or town centre and suburban locations.

Any LA which has not incorporated its maintained sector providers in the original cost survey should also extend the survey to do so.

Maximising the Response Rate

In all cases, LAs should make every reasonable effort to obtain data from as many providers as possible. Response rates and data quality can be improved by:

- Using proven forms of communication between the LA and its providers, and using existing knowledge of provider costs;
- Taking advantage of planned meetings or visits, for example, where LAs are undertaking financial health checks with providers;
- Pre-populating surveys with any known data;
- Providing comprehensive explanations of the types of data required and how this information will be used (the greater the providers' understanding of the purpose for the data, the more likely that the data will be complete and consistent);
- Arranging face to face contact to help providers to complete the surveys will not only help improve response rates but can help ensure that data obtained is more consistent.

Designing the Survey

It is likely that a long and complicated survey will deter providers, and lead to a low response rate. This will be especially the case where data is requested that may not be readily to hand. However, this has to be balanced with the need to obtain sufficiently accurate and reliable data to help inform decisions about budget setting, and the design of the formula. The first step in designing the survey is therefore to determine what information is required. The data required includes:

- All costs relating to the delivery of the free entitlement;
- A breakdown of costs across main cost categories. Sufficient detail is required to support decisions relating to both the level of any basic hourly rate, and the payment of any supplements that are to be justified on cost grounds;
- Data on the number of hours of provision that the costs relate to:
 - In general the most reliable data on expenditure will relate to providers' most recent full financial year;
 - The most easily available hours of provision may relate to current occupancy levels. In such cases it is therefore important that LAs make appropriate adjustments for any significant changes in levels of provision.

Identifying the Costs Applicable to the Free Entitlement

While LAs may be interested in providers' overall costs and income (from a sustainability point of view, for example), the development of the formula requires identification of the costs specifically relevant to 3 and 4 year olds. There are two levels of complexity here:

- What proportion of costs is applicable to 3 and 4 year olds (as opposed to other age groups)?
- What proportion of the 3 and 4 year old costs is applicable to the free entitlement (given that many children benefitting from the free entitlement also receive additional hours paid for by parents)?

Taking each of these in turn – what proportion of costs is applicable to 3 and 4 year olds?

With regard to allocating total setting costs to 3 and 4 year olds, it would be possible to ask providers to allocate their own setting's costs, using their own knowledge of how their costs break down across the different age groups. However, the FDP LAs found that it was better to allocate the costs on a standardised basis, as it provided assurance on the consistency of approach across all settings. In general this was based on the applicable staff ratios for the different age groups.

Thus (using a simplified example) if a setting's participation was divided as set out in the following table (one third of children in the 2-3 years age band

and two thirds of children in the 3-4 years age band, the staff cost would be allocated on the basis that the 2-3 year old element required twice as many staff as an equivalent number of 3 and 4 year olds (because of the relative staff ratios of 1:4 and 1:8 respectively). Other costs tended to be allocated on an unweighted basis i.e. divided according to the simple proportion of children in the two age groups.

Age Range	0-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs
No. children	0	8	16	0
Staff/child ratio	1:3	1:4	1:8	1:8
Minimum staff required	0	2	2	0
% of total staff cost		50*	50*	
Other costs %		33**	67**	

* Weighted according to the number of staff required to support the two applicable age groups

** Unweighted i.e. reflecting the proportion of children in each of the applicable age groups

It may also be necessary to discount any costs which are not applicable to the free entitlement, for example catering (recognising that catering may be applicable for children entitled to free school meals).

With regard to the proportion of the 3 and 4 year old costs applicable to the free entitlement, in general it will be more practical to assume that the average hourly costs are the same for both free entitlement hours and for any additional paid-for hours, given that it will often be impossible to identify exactly which hours of provision are free for any particular child.

Validating the Data

However the data is obtained, the first step in the analysis should be to ensure that the responses are valid. This is a key issue as FDP LAs found the quality of return to be highly variable. Obvious errors to look out for include:

- Confusion around whether the cost return is complete, or whether providers have attempted their own allocation to 3 and 4 year olds;
- Allocation of expenses to incorrect headings.

The simplest approach to validating data is to identify any 'outliers' (i.e. providers whose costs fall well outside the normal range, either in aggregate or for a particular category of expenditure). LAs should use their local market knowledge, and their knowledge of the particular providers concerned, to

determine whether the reported expenditure levels are reasonable. LAs must, in particular, satisfy themselves that providers have not inflated the costs reported in the cost return in the belief that this may lead higher levels of funding. Where necessary, this should involve contacting providers to confirm the data, and/or to provide more information.

The most likely causes of inconsistent data for the main cost types are considered below.

Staff Costs

The key considerations are likely to be:

- Have the full costs of employment been included i.e. salary plus on-costs? Pension contribution rates, in particular, can vary significantly between providers;
- Have related costs such as agency costs, the costs of sickness absence, maternity leave and training been included?

Management Costs and Profit

Management costs can be treated differently by different types of provider, for example:

- Owner-managed businesses may include their time in general staff costs, as a management staff cost, or may pay themselves a dividend or other non-salary forms of payment;
- Settings which form part of a chain of providers may have a management fee (or similar) that is charged to the setting's account. These may not be readily identifiable unless a specific request for this type of information was included in the survey.

There may be a temptation for private sector providers not to declare profit, or for LAs to 'disallow' it for the purpose of calculating an appropriate level of payment. In the context of a mixed market with significant provision from the private sector it is entirely legitimate for the providers of all kinds to generate surpluses, either to provide a return on their own investment, or for future investment. LAs should therefore encourage providers to include profit in their cost return, and to incorporate a level of profit that is acceptable to them in their calculation of funding levels. FDP LAs have found that active engagement with their providers on this point has been particularly beneficial in discussing how to address profit, and arriving at a level which is acceptable to both sides.

Premises Costs

Premises costs will include a range of individual cost headings, according to the specific circumstances of the setting, including:

- Rent;
- Business rates;

- Maintenance costs;
- Mortgage interest or other financing charges;
- Other premises running costs such as utilities.

There are many reasons why premises costs might vary. This is particularly the case for mortgage payments, where the amount paid (and the division between interest and principal) will depend on the size of the loan compared to the purchase price and the term remaining. It may also be the case that the business premises and the private residence of a provider are shared and funded through a single mortgage.

LAs should therefore consider whether to exclude some values from particular providers, or use their local knowledge to determine an appropriate cost. For example, providers that operate (through choice) from premises with a particularly high cost could be excluded from the calculation of an average hourly cost. Alternatively, their premises costs could be scaled back to a more reasonable level when calculating an average hourly cost. With regard to shared business/residential premises, LAs should ensure that only the element of the mortgage that is applicable to the business premises is allocated to the setting's costs.

Conversely, if a setting operates from freehold premises with no mortgage or other finance cost, LAs should consider 'adding back' an appropriate level of cost, based on a market rent for such premises.

Identifying premises costs, and, in particular, identifying why premises costs might vary between different providers, is an important element of the cost analysis and will help to inform decisions about whether the funding formula should reflect the causes of these differences.

A differential premises related element in the formula might be applicable if:

- The different applicability of business rates is sufficient to warrant a different level of payment to providers in different sectors;
- Providers in different parts of the LA experience very different levels of overall cost, solely because of the higher property costs in their specific locality.

Calculating an Hourly Cost

LAs will need to ensure that the calculation of hourly costs is based on consistent data. Generally, this will mean:

- Hours and costs should relate only to 3 and 4 year old provision;
- If costs that relate solely to the free entitlement have been identified, then only the hours of free entitlement should be used.
- The same time periods should be used i.e. if the costs are based on a provider's financial year, so too should the hours of care.

The current hourly cost will be an important part of the evidence base that LAs use to determine the funding level in their early years formula. It is therefore important that any average is calculated in an appropriate way. There are three possible approaches:

- Approach A: the 'mean' average in which total cost divided by the total number of hours across the LA (or for a particular type of provider). LAs may choose to calculate different means for different types of setting if they intend to move to differential rates by provider type;
- Approach B: the mean of the hourly costs of each setting (i.e. the sum of the hourly cost for each setting divided by the number of settings). This gives all settings an equal weight in the calculation irrespective of their size, and is therefore generally not preferred;
- Approach C: the median hourly cost per setting i.e. the hourly rate at which half of the settings receive more funding and half receive less.

Approach A is generally preferred. The other approaches should only be used in exceptional circumstances, where there is concern that the sample is unduly influenced by a small number of providers. For example, approach B may be applicable if a small number of large providers (not necessarily outliers) have an excessive impact on the overall average. C can be appropriate where the impact that a small number of outliers (i.e. those with unusually high or low costs) have on the outcome of the calculations is excessive.

Maintained Settings

Maintained settings consist of nursery schools and nursery classes in primary schools. For nursery schools, the full cost of the school is applicable to the free entitlement. For nursery classes, there are two broad categories of cost:

- Direct costs: the costs of the nursery teacher(s) and the nursery nurse(s) that teach the class, plus any consumables that are clearly identifiable to the nursery class;
- Indirect costs: the shared costs that the nursery class benefits from by being part of a wider school – management, administration, premises etc.

The direct costs should be easily identifiable, for example from the LA's payroll for staff costs. Indirect costs will generally require apportionment. LAs may choose their own apportionment methods based on the data available to them, but should attempt to identify the full costs of the setting. This will involve apportionment of management costs (for example on the basis of the proportion of FTE children in the school), premises costs (for example on the basis of the space occupied by the nursery class), and other overhead costs (either on the basis of known consumption or pro rata to FTE child numbers).

Where private or voluntary providers operate from maintained sector premises, they should be allocated an appropriate share of the costs they incur. Where children's centres with nursery provision operate from maintained schools, an appropriate share of the school's costs (for example management and premises) should be apportioned to the children's centre. It is very difficult to be precise about the methods to be employed in these cases, as practice varies widely across the country, but LAs should seek to ensure that the cost apportionment is representative of the costs incurred, and that there are no hidden subsidies between one service and another. (These arrangements are likely to be set out in current leases or contracts.)

Appendix 2 – The Typical Cost Model

Example 1: FDP Provider Approach

Early Years Theoretical Cost Model

	Maintained Nursery Class 2FE Primary	Maintained Nursery School	PVI Day Nursery	Pre School	Independent School
Pupils receiving free entitlement					
Operating					
Staff Ratios					
Teaching Staff					
Teacher					
Teacher PPA time					
Education Support Staff					
Nursery Nurse					
NNS PPA time					
LSA					
Premises Staff					
Caretaker					
Admin & Clerical Staff					
Secretarial					
Catering Staff					
Other Staff					
MSAs					
Indirect Employee Expenses					
Adult Meals					
Recruitment Costs					
Travel & Subsistence					
Development and Training					
General					
Governor Training					
Supply Teacher Insurance					
Staff Related Insurance					
Supply Insurance-Nursery Nurse					
Supply Insurance-LSA					
Liability Insurance					
Building Maintenance					
Outdoor Environment					
Grounds Maintenance					
Cleaning					
Contract Cleaning					
Cleaning Mats					
Window Cleaning					
Water and Sewerage					
Energy					
Rates					
Other Occupation Costs					
Rent					
Hygienic Disposal					
Refuse Collection					
Security Services					
Alarm Call Outs					
Paper Towels/Toilet Rolls					
Water Dispensers					
Fire Extinguishers					
Electrical Testing					
Paper Towels/Hand Dryers					

Example 1: FDP Provider Approach (Cont)

	Maintained Nursery Class 2FE Primary	Maintained Nursery School	PVI Day Nursery	Pre School	Independent School
Learning Resources					
ICT Learning Resources					
Computer Hardware					
Compute Leases					
Computer Maintenance					
ICT Resources					
Exam Fees					
Admin Supplies					
Admin ICT					
Admin Reprographics					
Postage					
Telephones					
Bank Charges					
Admin Stationery/Supplies					
Admin Furniture/Equipment					
First Aid					
Other Insurance Premiums					
Balance of Risks					
Fire Insurance					
Travel Insurance					
On Site Accident Cover					
Special Facilities					
Catering Supplies					
Agency supply teaching staff					
Bought in Professional Services-Curriculum					
Herts Media					
Music					
SIAS					
SITSS					
SLS					
Carewell					
Bought in Professional Services-Others					
Building Service					
Financial Services					
Legal Services					
Governor Clerking					
Payroll Services					
Personnel Services					
CRB Checks					
NDNA/PSLA Membership					
Ofsted Registration					
Overheads					
Headteacher (share)					
Deputy (share)					
Head of Foundation (share)					
Induction (home visits, parental meetings etc)					
Total					
Per Pupil at full capacity					
Per Pupil at 90% capacity					

Example 2: DCSF Approach

This model should be viewed as an aide memoire rather than a prescribed model to be used. It gives ideas of costs that may be applicable, but it is for each authority to consider the costs and methods it wishes to employ in its own single formula and this should be done in partnership with its providers.

Some of the figures to be input into this model will be based upon actuals. They may not be averages, they may be based upon a "mode" rather than an average. The figures should provide sufficient funding for providers to provide the free entitlement, without raising incentive for providers to change behaviours or rewarding expensive choice by providers.

There will be some costs that are inescapable for some types of provider and these should be included (nursery school headteacher for example). There will be some costs that are politically sensitive (eg profit), but where private providers are supplying the free entitlement this will be legitimate cost of the free entitlement.

This model assumes a size of provision for each sector. It may be that LAs want more than one size model for a particular sector depending upon local circumstance and what their cost analysis appears to be saying. If so add it in.

No of Hours/week

Adult : Child Ratio

1:

30/07/2008 10:34

Childminder	Voluntary	Private	Independent	Nursery Class	Nursery School
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A DELIVERY OF FREE ENTITLEMENT

CLASS SIZE

No of Adults required

Teacher/Leader	Leader	Leader	Grad Leader	Teacher	Teacher	Teacher
Set up & Put away						
SENCO						
Preparation Planning/ Pupil Assessment						
Team Meetings						
Admin						
Team Management eg appraisals						
Other - meetings with parents, training, network etc						
Delivering free entitlement						
Total Teacher/Leader Hours	0.00	0.00	0.00	0.00	0.00	0.00
Teacher/Leader Pay Costs (inc on costs)						
Wks per year						
Total for Teacher/Leader for 38 week contract	£ -	£ -	£ -	£ -	£ -	£ -
Per Pupil/per hour for 38 weeks						
Assistants / Nursery Nurses	number					
Set up & Put away						
SENCO						
Planning/ Pupil Assessment						
Team Meetings						
Admin						
Appraisals						
Other - meetings with parents, training, network etc						
Delivering free entitlement						
Total Assistant Hours	0.00	0.00	0.00	0.00	0.00	0.00
Assistants Pay (inc on costs)						
Wks per year						
Total for Teacher/Leader	£ -	£ -	£ -	£ -	£ -	£ -
Per Pupil/per hour for 38 weeks						
TOTAL DELIVERY OF FREE ENTITLEMENT						

Number of hours per week undertaken by leaders on task. Look at each row, if a figure is completed consider it for each heading on that row. There may still be blank cells on that row - that's fine but know why that is the case and be able to justify it. Similarly if there is a difference in number of hours attributed.

Annual Pay costs including on costs

No of weeks per year in staff contract (inc hol pay etc)

Annual Pay divide by 52.143 multiply by weeks per year

Divide line above by 38 weeks / Class Size / hours of FE per week

Number of hours per week undertaken on average by assistants on task, following same principles as for leaders

Annual Pay costs including on costs

No of weeks per year in staff contract (inc hols)

Annual Pay divide by 52.143 multiply by weeks per year

Divide line above by 38 / Class Size / hours of FE

B MANAGEMENT						
Incremental Costs						
Apportionment of Headteacher / Manager						
	£	-	£	-	£	-
Per Pupil/per hour for 38 weeks						
SENCO						
	£	-	£	-	£	-
Per Pupil/per hour for 38 weeks						
Finance Admin Secretarial						
	£	-	£	-	£	-
Per Pupil/per hour for 38 weeks						
Absence						
	£	-	£	-	£	-
Per Pupil/per hour for 38 weeks						
Other						
	£	-	£	-	£	-
Per Pupil/per hour for 38 weeks						
TOTAL MANAGEMENT per pupil						
C EQUIPMENT ADMIN COSTS ETC						
Learning Materials						
Postage						
Telephone						
Professional Support						
Advertising & Marketing						
Subscriptions/ofsted						
TOTAL EQUIPMENT per pupil per hour	0.00	0.00	0.00	0.00	0.00	0.00
D PREMISES COSTS						
Rent						
Rates						
Training costs						
Cleaning Materials						
Insurance						
Area Cost Adjustment						
TOTAL PREMISES per pupil per hour	0.00	0.00	0.00	0.00	0.00	0.00
E UNAVOIDABLE COSTS						
Maintained Teacher for 52 week contract (additional hours)						
FT Headteacher in Nursery School						
Profit						
TOTAL UNAVOIDABLE COSTS per pupil per hour	0.00	0.00	0.00	0.00	0.00	0.00
F TOTAL PER PUPIL						

Costs or Incremental costs of Manager

Incremental Costs of SENCO for nursery pupils

Additional hours for nursery data collection,

Allowance for staff absence

Example costs apportioned for FE

Example costs apportioned for FE

Costs that particular providers must incur - for example nursery schools must have a full time HT that it may not be possible to "sell" in additional hours

These supplements may be per pupil or as a lump sum (although lump sums and ghost pupils should be avoided). Supplements will probably not be paid to every pupil but to some based upon specific criteria. The criteria must be transparent, published, understood by all providers and applicable to any provider that meets the criteria equally.

S1 SUPPLEMENTS DEPRIVATION

TOTAL DEPRIVATION per pupil per hour	0.00	0.00	0.00	0.00	0.00	0.00

Criteria?

S2 SUPPLEMENTS SEN

TOTAL SEN per pupil per hour	0.00	0.00	0.00	0.00	0.00	0.00

Criteria?

S3 SUPPLEMENTS SUFFICIENCY

TOTAL SUFFICIENCY per pupil per hour	0.00	0.00	0.00	0.00	0.00	0.00

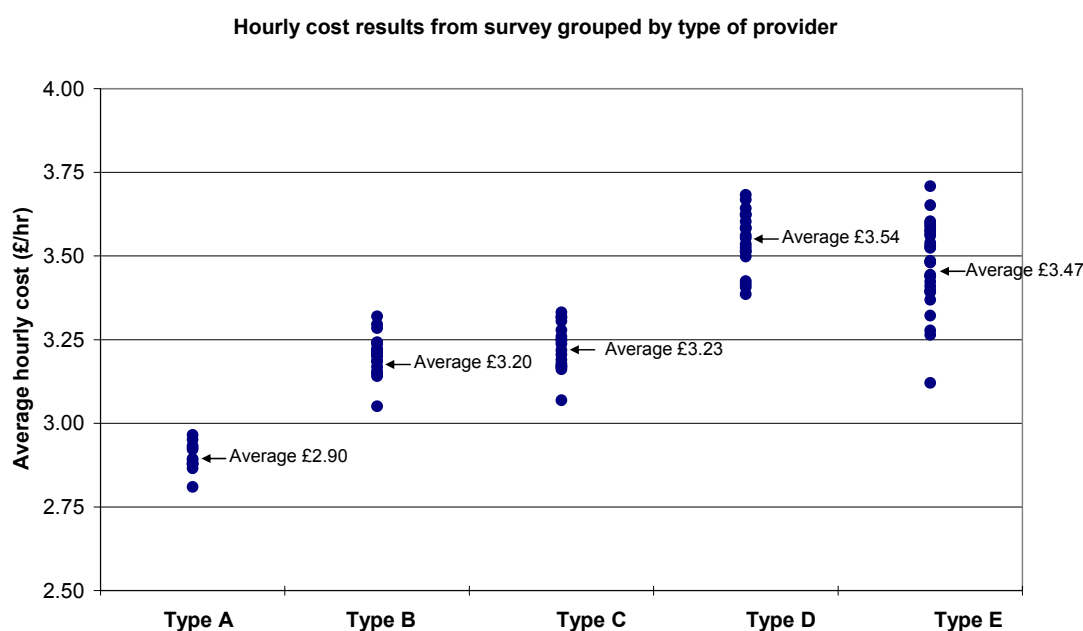
Criteria?



Appendix 3 – How Many Basic Hourly Rates?

Chart 1: Evidence of varying cost pressures by type of provider

The following example is based on illustrative but realistic data. It represents possible ranges of provider costs in a notional LA. It is a form of analysis and presentation that LAs may find useful in assessing whether there are significant and systematic differences in costs between different types of providers.



The chart provides clear evidence that:

- Type A has consistently lower average hourly costs than all other types;
- Although the overall average hourly cost for providers of type C is a little higher than that for type B, the overall distribution of costs shows that there is no obvious differential;
- Providers of type D have an average hourly cost consistently higher than that for types A, B or C;
- There is considerable overlap in the average hourly cost for providers of type E and those for type D, but there is also some overlap with the higher costs of types B and C.

What reasonable conclusions can be drawn?

Before drawing any conclusions at all, it is important that LAs consider the results in context. There will be many factors affecting the hourly costs, and LAs should consider to what extent these factors affect any, or all, types of provider. For example, it could be that the sample is biased towards the more expensive providers of type D. Or it may be that many of the higher cost

providers have staff with higher qualifications. If the formula is to include a separate qualification supplement it may be appropriate to set a lower basic rate than the average suggested by the cost survey, but also pay a qualification supplement. Similarly, the more expensive providers may all be small providers in rural settings. In this situation the most appropriate method of targeting a higher level of funding to those providers may be through a supplement which recognises the cost pressures on small, rural settings.

It could also be the case that the more expensive providers are simply those that are relatively inefficient, and it would clearly be inappropriate to use the formula to provide greater levels of funding to inefficient providers.

Assuming that the sample illustrated in the above chart does not include any of these types of issues, it would be reasonable to conclude that different hourly rates may be applicable as follows:

- Providers of type A should have the lowest rate;
- Providers of type B and C should have another rate at a level approximately 10% higher than A;
- Provider type D should have a third rate at a level around 10% higher than that for types B and C;

These results alone do not suggest any single particular solution for type E. Decisions about the basic hourly rate to apply to type E providers should take into account any factors that might be influencing their costs.

Appendix 4 – Supplements

Introduction

The FDP LAs considered a range of supplements to the basic hourly funding level. These are described below.

LAs should note that supplements of this kind should be reviewed periodically to ensure that they still remain relevant. For example, a supplement to encourage flexibility may have a transitional application, and cease to be relevant once flexibility is established as a part of the core offer.

Deprivation

Meeting the needs of deprived children is a key part of the Government's objective of closing the attainment gap between children from different backgrounds. As such, there is an expectation that LAs will use the early years formula to target funding towards the most deprived children.

There are a number of data sources which could be used to measure deprivation including ACORN and MOSAIC, and this guidance makes no recommendation on the most appropriate – LAs should decide this for themselves.

Amongst the FDP LAs the Income Deprivation Affecting Children (IDAC) Index was the most commonly used. This is a subset of the Income Deprivation domain of the English Indices of Deprivation 2007 published by the Department for Communities and Local Government. Data is provided for each "lower super output area" (LSOA) in England¹.

The work of the FDP LAs considered how to use the index to measure deprivation of providers. It was clear that simply using the IDAC index measure based on the postcode of the provider's address was not appropriate. Their work concluded that there were two potential approaches to measuring deprivation for the early years formula:

- The proportion of children living in LSOAs that exceed a given level of deprivation. This has the potential to create a 'cliff edge' (i.e. a distinct difference in the level of funding caused by a marginal change in the mix of children in a giving setting). This issue is discussed further in Appendix 7;
- The average IDAC index deprivation measure based on the home addresses of children attending the provider. This is the preferred approach, as it links the deprivation supplement most closely to the children attending the setting.

¹ Officially defined geographic areas, generally covering a similar level of population of around 1,500 people.

Quality

Quality is a key driver for improving children’s outcomes and narrowing attainment gaps. Therefore, there is a presumption that the formula will be used to promote and incentivise a culture of continuous improvement in the quality of the provision. To help LAs establish quality-based supplements, some key indicators of high quality which LAs should consider taking into account within their formula are set out below.

The most obvious proxy is the level of qualification of a setting’s staff. The Government’s ambitions for graduate-level leadership of practice within settings, and for all other staff to have Level 3 qualifications as a minimum, present key criteria for attracting additional funding. This is being considered by one FDP LA whose plan involves categorising providers into those with staff with a basic, medium or high level of qualification. The criteria currently being considered are as follows:

Level of “Quality” funding element of formula	Workforce Qualifications which represent quality at this level
High	<ul style="list-style-type: none"> • Graduate (level 6/EYP) <u>leading EYFS Practice</u> and, in settings employing over 10 fte staff • Manager/deputies with level 4 or above and 75% of staff at level 3 or above
Medium	<ul style="list-style-type: none"> • Graduate (level 6/EYP) or Foundation degree practitioner <u>leading EYFS</u> and/or a • Manager/deputy with level 4 or above <u>leading EYFS</u> and 50-74% of staff with level 3
Basic	<ul style="list-style-type: none"> • Level 3/4 practitioner/manager <u>leading EYFS</u> and 50% of staff at level 2 or above

Other indicators include:

- The Ofsted inspection rating. One example under consideration involves a payment to any setting achieving an OFSTED rating of ‘good’, with twice the payment for a rating of ‘outstanding’. In this case, the supplement is designed to be a recognition of good performance and the amounts are modest;
- Membership of, or participation in, a recognised quality improvement or assurance scheme. While this in itself does not signify that the provision is of high quality, participation in such a scheme demonstrates the setting’s commitment to high quality, and will contribute to other factors such as their inspection rating and, ultimately to outcomes;

- Well developed plans for staff development, and a commitment to continuous professional development (CPD). Providers that have an effective policy for staff training, and which invest time and resource in staff development, are likely to value high quality and should be incentivised accordingly;
- An effective strategy for engaging parents in their children's learning. Providers which demonstrate that they have a strong ethos of working in partnership with parents to share knowledge and understanding of the child should be recognised because of the positive impact they will have beyond the setting itself;
- A strong, inclusive approach, involving personalised support for children, especially those with additional needs. Providing an additional supplement for settings which demonstrate effective use of data and observation to tailor learning and development activities to particular children's needs, and which ensure an inclusive ethos will send a strong signal about the importance attached to these approaches, and will have a positive impact on outcomes – especially on closing the attainment gap between the lowest achieving children and the rest.

Flexibility

The Government is committed to offering parents flexible access to the free entitlement, and all LAs will be required to offer 15 hours flexibly by 2010. This will be a huge change for many providers, and LAs may therefore wish to consider incorporating a supplement that rewards providers for offering extended opening hours, or other flexible arrangements.

In making a decision about whether to incorporate a supplement for flexibility, LAs will need to consider the definition of flexibility that DCSF published at the end of July, which is available at www.everychildmatters.gov.uk/earlyyears/lapractice/entitlement/

and to decide what behaviour they wish to incentivise. One of the FDP LAs has included this type of supplement in its draft formula, giving providers a percentage of their base rate per hour, depending on whether they are open for at least 3, 4.5, 6 or 8 hours per day.

High Cost Areas

It is widely acknowledged that costs vary across the country (London and the South East in particular have above average costs). Some LAs may find that similar issues apply within their area (i.e. that costs in one part of the LA are consistently higher than the average). This may be solely a function of property costs, as discussed above, or may also apply to other costs such as staff costs. If this is the case, then evidence should be found in the cost survey.

Where this occurs the LA may consider incorporating a supplement within their early years formula. This supplement could for example be a:

- Fixed amount per hour paid according to the location of the provider; or
- A percentage uplift based on the location of the provider.

Special Educational Needs (SEN)

As has previously been stated, the early years formula must apply consistently to every sector: maintained, private, voluntary and independent. One area where the FDP LAs found that consistency may not apply is in SEN. SEN funding for children with relatively low-level needs is typically delegated to schools, whereas support to non-maintained providers for SEN is often provided through access to specialised staff (in other words, is not financial).

FDP LAs have also made the case that an SEN supplement would probably involve very small payments which the provider could not use to offer a meaningful enhancement in provision, and that it would therefore be more effective to retain any SEN monies centrally, to fund specialist staff who can then be deployed as required to meet specific needs.

Sustainability

An LA may find that its duty to provide access to the free entitlement for all parents and three and four year-olds can only be discharged by providing financial support – or sustainability funding – to a setting(s) that, without such support, would be economically unviable. Sustainability funding can be channelled in two broad ways:

- By including mechanisms in the formula to protect potentially unsustainable settings, using similar approaches to schools funding formulae in offering protection to small schools. So, for example it would theoretically be possible to include a sparsity factor to recognise the fact that settings in rural areas may have or only be able to recruit from a limited number of children; or
- Using the formula to calculate the funding that a setting would receive, irrespective of sustainability issues, and subsequently addressing sustainability outside the formula.

In general it is recommended that the latter approach is used. The former implies use of place funding or equivalent approaches.. Moreover, as the statutory guidance on Securing Sufficient Childcare makes clear, sustainability support should be a judgement based on the need the LA has to provide support to secure a particular form of childcare in a specific area i.e. to meet a defined need at a particular time [Cf 'Securing Sufficient Childcare: Guidance to Local Authorities'].

LAs should ensure that, in considering allocations of funding on the grounds of sustainability, they follow the guidance on transparency and fairness as set out in paragraphs 4.15 – 4.21. They should also have regard to paragraphs 4.27 – 4.29 in considering the length of time for which sufficiency funding is provided.

Premises

Initially, a number of FDP LAs considered a supplement for higher premises costs. There are two broad justifications for doing so:

- That there are providers or groups of providers who incur higher premises costs, simply because of the underlying property prices of the locality in which they are situated. LAs which border London often have groups of providers in such circumstances, but this can also occur in LAs with providers in expensive city centre locations;
- That higher quality and higher cost accommodation is one element in delivering higher quality outcomes.

In practice, none of the FDP LAs decided to adopt a premises supplement. This was because premises costs are not a particularly large proportion of the total cost, the difference in premises costs between high and low cost providers was not extreme, and the level of supplement would therefore have been very low.

Appendix 5 – Affordability

In the event that the cost of a formula which attempts to meet all of an LA's policy objectives appears to exceed the funding available, LAs will have to consider how to arrive at an agreed affordability level. The following table sets out the main approaches to restricting the cost of the formula to the level of available funding:

Method	Pros	Cons
Maximum funding levels per child-hour (i.e. constrain the core funding level to a fixed limit consistent with the overall affordability level)	Simple; does not need a base position for schools; only the highest funded lose out	Those with highest increases may be best-placed to contribute instead
Maximum funding increases per child-hour (i.e. constrain any increases in funding levels to a level consistent with the overall affordability level)	Simple; only the highest increases lose out	Needs a base position for schools; may take many years to implement fully; transparent and therefore easy to criticise; high increases may be readily justified and hence wrong to target these settings
Scaling back increases (i.e. reduce all funding levels determined by the formula on a pro-rata basis to the overall funding level)	Spreads cost over many settings	More complex; many settings would probably lose out
Reducing some or all elements of the formula (i.e. reduce selected elements – either the core rate and/or supplements – to a level consistent with the overall affordability level)	Need not be transparent so less easy to criticise; effectively spreads cost over many settings	More complex; many settings would probably lose out

Appendix 6 – Perverse Incentives

A perverse incentive is something that provides a reward for taking a future action that is at variance with or even the opposite of that intended and/or that promotes inefficiency. Avoiding perverse incentives is an essential part of any sound formula.

In the early years context there are several clear perverse incentives that LAs should avoid:

- Paying actual salaries. This could encourage settings to pay higher wages for no return to the setting or children. This is different to paying average salaries in a sector or for a specific role, where an individual setting would not gain directly by paying a higher salary;
- Paying actual energy bills. This could encourage energy inefficiency;
- Paying actual property costs to all providers. This could encourage settings to take up more expensive premises. LAs may choose to fund actual rents in some circumstances, for example where provision is needed in a given location and where premises are scarce or particularly expensive. Even in these circumstances, it may be better to base the payment on a notional market rent for the area in question (unless the LA had some form of control over the costs, for example if it was directly involved in selecting the premises).
- Funding through lump sum payments or other proxies for places, rather than pupil numbers. This could discourage settings from recruiting more children. Place funding might be appropriate where there is a need to provide stability to providers in exceptional circumstances, for example where there is a sufficiency issue. Even in such cases some increased funding should ideally accompany any increase in pupil numbers so as to encourage higher participation.

There are also potential perverse incentives that are less clear. For example, an LA might choose to award a deprivation supplement to all settings with more than 50% of children from households in receipt of Income Support (IS). In a setting with 15 IS children of a total of 30 there would therefore be an incentive not to recruit a non-IS child as this would cause the setting's deprivation level to fall below 50%; worse, it could even encourage a setting with 15 IS children out of 31 to remove a non-IS child. Both of these scenarios are contrary to the intent of the deprivation supplement.

A key point to note is that the comments above relate to potential future responses of a setting to a feature of the funding methodology. It may be completely legitimate in the short term for an LA to, for example, fund items of expenditure like actual salaries or actual rents directly, in circumstances where the setting did not know at the time that its actual costs would be met (and has therefore taken the decision to incur that expenditure for its own reasons).

Appendix 7 – Managing ‘Cliff-edges’

Definition

The term ‘cliff-edge’ describes any situation where a formula creates a significant change in the level of funding as a result of a minimal difference in the characteristics of the provider. Ideally, the structure of the formula, as well as the design of any individual supplements, should avoid cliff-edges wherever possible. Where cliff-edges are unavoidable, LAs should ensure that they are confident that the difference in funding between providers is reasonable and justifiable.

Acceptable Cliff Edges

One obvious example of a cliff-edge is where different basic hourly rates are set for different types of provider. This could be appropriate if the evidence from the cost survey justifies the cost difference, or if an LA wished to encourage a particular type of provider, for example for reasons of quality, sufficiency or sustainability.

The design of the hourly supplements may also include cliff-edges. For example, some of the FDP LAs have considered a supplement related to quality, usually determined by the qualification levels of early years staff. Such a supplement almost inevitably involves a cliff edge. That is, those providers that satisfy the quality criterion receive a supplement, while those that do not meet the criterion do not.

The FDP LAs have also considered deprivation supplements that involve cliff-edges. For example, one option involved categorising providers as operating in high, medium or basic deprivation area as follows:

High deprivation	65% or more of the funded children attending the setting have home addresses located within an output area considered to be within the 30% most deprived areas (using IDAC index data)
Medium deprivation	More than 30% but less than 65% of the funded children attending the setting have home addresses located within an output area considered to be within the 30% most deprived areas (using IDAC index data)
Basic deprivation	All other settings i.e. those where less than 30% of the funded children attending the setting have home addresses located within an output area considered to be within the 30% most deprived areas (using IDAC index data)

Any LA using criteria similar to this will need to consider at which point in time and what levels of deprivation (i.e. the 30% cut-off for deprived areas and the

30% and 60% cut-offs for the numbers of children) should be used to determine the classification of providers. If selecting different points in time (over the course of a year or even over the past couple of years) results in providers shifting between the different levels of deprivation (and therefore funding), careful consideration should be given to the approach. A good way to test the reasonableness of the approach would be to compare the difference in funding between the highest 'medium deprivation' setting and the lowest 'high deprivation' setting, and to ensure that this is justifiable, given the circumstances of these providers.

Unacceptable Cliff Edges

The following example, using the same proposed deprivation structure as described above, highlights a situation where a step change in deprivation funding is not appropriate.

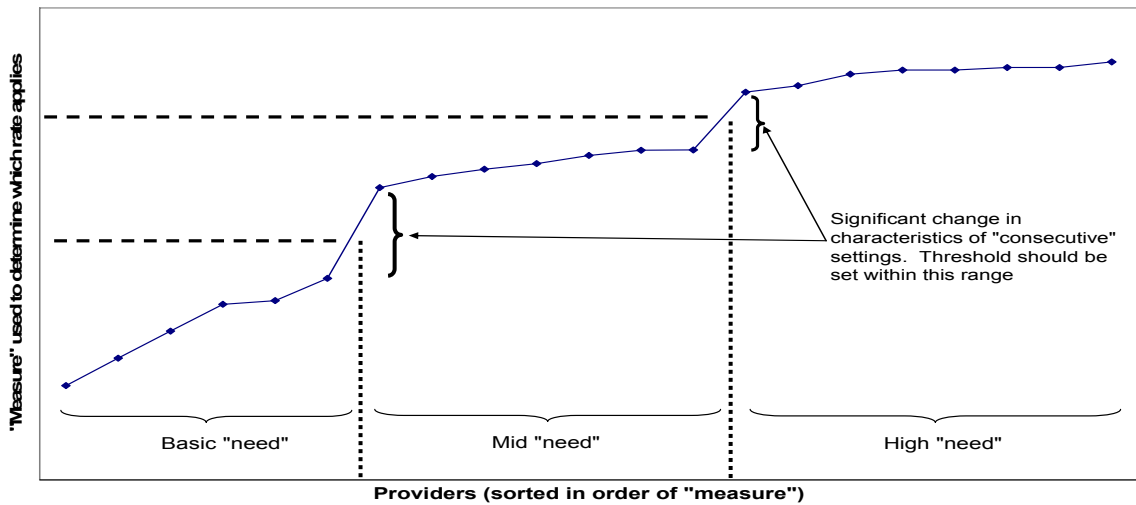
Setting A	A total of 50 children take their free entitlement at Setting A. Of these 33 live in output areas that are in the most 30% deprived areas of the country. This passes the 65% threshold and so Setting A is considered to be 'high deprivation'.
Setting B	A total of 50 children take their free entitlement at Setting B. Of these 32 live in output areas that are in the most 30% deprived areas of the country. This is below the 65% threshold, but above the 30% threshold and so Setting B is considered to be 'medium deprivation'.

The difference between Setting A and Setting B in this example is very small. In fact, a switch of one 'deprived child' from Setting A to Setting B would lead to Setting B meeting the 'high deprivation' criterion, but receiving less deprivation funding than Setting A.

Good Practice

This example illustrates the point that, if supplements are to incorporate thresholds in this way, it is vitally important to choose appropriate criteria. This is illustrated in Chart 2 which shows a situation where it is reasonable to use thresholds when setting supplementary amounts. This approach could apply to any appropriate measure of deprivation or other "need".

Chart 2: Reasonable Thresholds



In this example all of the providers classed as mid need will receive the same level of supplement, as they each have a very similar level of need. High need providers will receive a higher level of funding than mid need, but at the same level as one another. This structure of supplement would be acceptable because there is a significant change in need in moving from basic to mid, and mid to high, but within each category of mid and high, the level of need is similar between providers.

Appendix 8 – Impact Assessment

In this appendix we set out a possible form of presentation of the impact assessment. The example presented below assumes:

- A change from a flat hourly rate for all PVI settings to hourly funding with supplements leading to different rates for each setting;
- No change in levels of participation, so that the change in funding level that is applicable solely to the formula is clearly identifiable.

It is presented on a setting by setting basis.

As can be seen:

- Setting A moves to a lower basic rate under the new formula;
- Setting B benefits from the additional supplements and therefore receives a higher rate overall;
- Setting A does not benefit from additional supplements and therefore loses funding.

Setting	Previous Year			New Formula			
	Pupil-hours	Rate	Funding	Pupil-hours	Rate	Funding	Change
A	1,000	3.00	3,000	1,000	2.90	2,900	-100
B	5,000	3.00	15,000	5,000	3.50	17,500	2,500
etc							

With regard to illustrating the impact of potential changes that may not be known at the time the new formula is implemented, LAs may simply wish to present the impact changes in participation levels, either up or down, together with the impact of any transition arrangements they may choose to introduce – see Appendix 9.

Setting	New Year - 10% more pupil-hours				New Year - 10% fewer pupil-hours			
	Pupil-hours	Rate	Funding	Change	Pupil-hours	Rate	Funding	Change
A	1,100	2.90	3,190	190	900	2.90	2,610	-390
B	5,500	3.50	19,250	4,250	4,500	3.50	15,750	750
etc								

Clearly, many other options are possible for presenting the impact of change. This example simply illustrates the form of presentation an LA may use to illustrate the potential impact of the change.

Appendix 9 – Transition Mechanisms and Funding

Transition Mechanisms

There are various types of transition mechanism including:

- A guaranteed minimum level of funding per child per hour (i.e. no child in any setting will receive less than £x per hour even if the formula suggest a lower figure);
- A guaranteed minimum basic level of funding per child per hour, but with potential supplements (as above for the basic element of the funding, but recognising that supplements could add to the core funding);
- A guaranteed minimum increase in funding per child per hour (every setting will receive an increase of at least £x per hour);
- A guaranteed minimum increase in the basic level of funding per child per hour, but with potential supplements (as above for the basic element of the funding, but recognising that supplements could add to the core funding);
- A guaranteed minimum increase in funding to each setting (a mechanism that operates at setting level, such that a setting receives a minimum total payment which may be greater than the sum of the individual child payments);
- Transition based on inputs to the single formula rather than cash outcomes (for example guaranteeing to fund at least the same number of children as the previous year rather than actual current your participation);
- Transition over a fixed number of years (for example giving a setting in the first year half of what it would be due under the new formula and half of what it would be due under the previous formula).

Strengths and Weaknesses

The seven basic transition methods described above have differing pros and cons:

Method	Strengths	Weaknesses
Minimum level of funding per child-hour	Simple; does not need a base position for schools (i.e. a funding level from the previous year to allow a like-for-like comparison with the new scheme)	May still leave some settings worse off (if set low) or give substantial increases (if set high)

Minimum increase per child-hour	Simple	Needs a base position for schools; may take many years to implement fully
Minimum basic funding plus supplements	Ensures supplements are received by the setting to drive policy change	May still leave some settings worse off (if set low) or give substantial increases (if set high)
Minimum basic increase plus supplements	Ensures supplements are received by the setting to drive policy change	Not easy to calculate for schools; may take many years to implement fully; likely to leave little spare resource for supplements
Minimum increase in funding to each setting	Reduces sustainability risk if child numbers fall	Risks removing incentive to recruit children
Transition based on inputs	Avoids a setting losing from reduced inputs and reducing funding for those inputs simultaneously	More complex; may still leave some settings worse off or give substantial increases
Transition over a fixed number of years	Clear timescale	Needs two formulae to be run; may leave some settings substantially worse off

Funding

Any additional funding provided to a setting under a transition scheme could be from one or more of several sources:

- Additional monies found by an LA (although it would be more prudent to assume that the total level of funding remains unchanged);
- Monies from previous years' Dedicated Schools Grant underspends (if available);
- Diverting resources from other recipients of the Dedicated Schools Grant;
- Limiting amounts paid to providers to a maximum funding level per child (different maxima could be used for different types of setting);
- Limiting amounts paid to providers to a maximum increase in per child funding;

- Scaling back increases that would otherwise be due to some settings;
- Reducing some or all elements of the early years formula from what they would otherwise have been.

An LA could readily justify using more than one method from each list, so we can only offer general advice on the advantages and disadvantages. Indeed, in most LAs early years children in schools are funded using a complex formula which includes school-related as well as child-related amounts, while PVI settings are funded on a flat rate per child per hour, so different approaches to the two sectors might be appropriate.

Considerations

In drawing up a transition scheme, LAs will need to balance:

- The potential need to avoid a sudden loss of funding to any setting. It is possible that the formula will be introduced with relatively little advance notice in some LAs, and they may therefore wish to protect settings in the short term, at least until providers have had time to prepare for any differences in funding levels;
- The potential need to avoid a substantial loss of funding to any setting. It is possible that the preferred new formula may lead to substantial losses for some providers. There may be a need for more medium-term protection;
- The desirability of implementing the new formula quickly to help those that would gain (and the risks of not doing so);
- The affordability of the transition mechanism;
- The potential for excessive levels of transitional protection to hinder policy changes (for example, if the transition scheme deterred a setting for opening over longer hours because it would see no increase in funds for doing so);
- The rate at which any sudden or substantial increases in funding would translate into improved outcomes (some settings may not be able to spend any increased resources appropriately in the short term);
- The need to fund increases from 12.5 to 15 hours per week per child in many or all cases;
- The difficulty in establishing a baseline position for schools because of the complexity of their funding regime;
- The need to avoid excessive complexity.

Illustration

This example uses the same exemplary data as the example in Appendix 8, but also assumes a transitional ‘damping’ mechanism in which settings which lose from the change are compensated in full for the loss of funds in the first year. Thus the loss in funding of £100 that Setting A would have experienced

if the formula had been implemented without the transitional arrangements, is off-set by the damping mechanism. In this example, no 'cap' has been imposed on settings receiving an increase in funding, and Setting B therefore receives the full increase.

Setting	Previous Year			New Year - Unchanged Pupil-hours					
	Pupil-hours	Rate	Funding	Pupil-hours	Rate	Funding	Change	Damping	Overall Change
A	1,000	3.00	3,000	1,000	2.90	2,900	-100	100	0
B	5,000	3.00	15,000	5,000	3.50	17,500	2,500	0	2,500
etc									

As set out above, a range of transitional mechanisms are possible, and there is no obligation to compensate settings for losses in the way illustrated, although transitional arrangements of this kind are not unusual when funding regimes change. LAs may also wish to consider transitional mechanisms in which increases such as those flowing to Setting B in this example are capped, and in which the funding in excess of the level of the cap is used to fund the damping payments to settings which lose from the new formula.

The second example presents the possible funding levels should participation change either up or down. As pupil hours increase, both settings receive higher levels of funding than the previous year, and therefore receive no damping payment. As pupil numbers fall, again assuming full compensation for loss of funding, Setting A receives a damping payment to offset its loss. Setting B does not, because its funding level is still higher than it would have been under the old funding method.

Setting	New Year - 10% more pupil-hours						New Year - 10% fewer pupil-hours					
	Pupil-hours	Rate	Funding	Change	Damping	Overall Change	Pupil-hours	Rate	Funding	Change	Damping	Overall Change
A	1,100	2.90	3,190	190	0	190	900	2.90	2,610	-390	390	0
B	5,500	3.50	19,250	4,250	0	4,250	4,500	3.50	15,750	750	0	750
etc												

Appendix 10 – Maintained Provision

Minimum Funding Guarantee (MFG)

The School Finance Regulations require the calculation of the MFG for all maintained schools (including nursery schools and other schools with nursery classes). The MFG will apply to all schools' budgets until the end of the current funding period ending in March 2011. Thereafter, the review of the Dedicated Schools Grant (DSG) funding system that is currently in progress is expected to have come into effect.

This review will address the future of the MFG and other regulations and guidance concerning the delivery of the DSG to local authorities, and subsequent flow of funding to schools and early years providers. As yet, no decisions on the future of the MFG have been made. LAs should therefore neither rely on the long term retention of the MFG to protect schools' budgets, nor should they assume that it can be disapplied for maintained provision for the current funding period.

LAs are free to apply a similar mechanism to the MFG to PVI providers if they so choose, but should understand that this may raise expectations about funding protection that are not sustainable in the future, should the MFG disappear or change its form.

Nursery Schools

The DCSF is clear that the change to a single formula is not intended to threaten the viability of maintained nursery schools. It is understood by DCSF that these schools tend to be more expensive than other types of provision because of a range of unavoidable costs that they incur, for example the costs of a Headteacher, of dedicated premises, and of other overhead costs that, because of the relatively small size of most nursery schools, make them appear to be expensive on a per pupil basis.

The single formula does not mean that all provision must be funded at the same cash value; rather it means that the same principles must be applied to all settings within the formula. Therefore, where there are obvious unavoidable additional costs in a particular type of provision, it is perfectly legitimate for that cost to be recognised in the single formula.

Maintained Nursery Provision Budgets

Currently, the maintained sector receives a single budget at the beginning of each financial year, based largely on either pupil numbers as at the previous January, or the number of places held for nursery pupils, or a combination of the two. Once received, that budget is not reduced and rarely increased.

DCSF is currently exploring with Ministers possible changes to regulations which may mean that funding for all settings becomes more flexible. LAs are likely to be required to provide tools to settings so that they can estimate their

own future funding levels, and to be able to update such estimates as regularly as they choose with reasonable accuracy and certainty.

The implication of this is that maintained providers that are not at capacity are likely to have more volatile early years budgets than at present, although schools will continue to be able to charge for hours taken over and above the free entitlement (and therefore outside compulsory education).

Full Time Places

Some LAs have expressed concern that they currently provide free provision for pupils on a full time basis (that is for up to 25 hours per week, in line with the school day). The free entitlement is currently for either 12.5 or 15 hours depending upon where the LA is in the roll out of the free entitlement programme. An LA can choose to fund additional hours, although we advise that these decisions should be made on clear and justifiable reasons e.g. support for children with additional needs.

Deprivation Review

LAs were asked in 2007 to provide details of how the DSG was being targeted to assist deprived pupils in their area. Initially this included asking LAs to complete a template showing the amount of DSG they received, how much of that the DCSF deemed to have been provided for deprived pupils, and how this was being targeted through the local formula. Early Years Funding is part of the DSG and therefore, where LAs are targeting funding to deprived pupils through the single early years formula, that funding may be counted in the future versions of the template, whether it goes to pupils in maintained provision or pupils in PVI provision.

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