



**Independent
Schools** Victoria

Submission to the Senate Education and Employment Legislation Committee

March 2020

Response to the Inquiry into the
*Australian Education Amendment
(Direct Measure of Income) Bill 2020*

The Independent Schools Victoria Vision:

‘A strong Independent education sector demonstrating best practice, providing excellent outcomes for students and choice for families’.

To realise this, we:

- advocate for excellence in education
- champion Member Schools
- support quality education
- protect the right of parents to choose where and how their children are educated.

Independent Schools Victoria will assist our 215 diverse Member Schools to continue providing the best possible education outcomes for the citizens of tomorrow.

40 Rosslyn Street West Melbourne VIC 3000; PO Box 119 North Melbourne VIC 3051
T: (03) 9825 7200 F: (03) 9826 6066 E: enquiries@is.vic.edu.au W: www.is.vic.edu.au
ABN 44 711 074 857
A0009210H

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Executive Summary

Independent Schools Victoria (ISV) has serious concerns about the process undertaken by the Australian Government to introduce the Direct Measure of Income (DMI) approach for funding non-government schools. The initial process was rushed, with a focus on implementing the model to meet political timelines, rather than taking the necessary time to develop a stable model and communicate the consequences of the model to the schools that are directly affected.

As a consequence of this rush, a range of methodological issues remain unresolved in the model. In the short-term, the Government will need to make changes to the funding arrangements to address these issues. An unfortunate consequence has been to increase the uncertainty already being experienced by schools as a result of the new model.

In the medium-term, the transition arrangements proposed in the Bill assist schools to move more gradually from their old entitlement under the SES methodology to their new, DMI entitlement. The new model, however, results in significant funding changes for a large number of schools. In particular, it has a significant negative impact on a large number of schools in regional areas. Funding provided through the Choice and Affordability Fund will not be sufficient to cover this negative impact.

While the transition arrangements help to soften the blow for schools in the short and medium term, in the long term, the Government is yet to consider the impact on schools of changes in their DMI scores. Under the proposed arrangements, small changes in a school's DMI can have a large impact on its budget. At the same time, schools will have difficulty in predicting movements in their DMI. The introduction of the DMI approach will make it more difficult for schools to budget and plan effectively – particularly non-systemic Independent schools that cannot redistribute funding between members to cushion them against funding volatility.

Given these significant concerns, ISV cannot be certain that the DMI approach is fit for purpose. We cannot be confident that the Government has identified and resolved all of the unintended consequences. We therefore cannot recommend that the Bill be passed by the Senate.

Instead, ISV is calling on the Minister of Education to work collaboratively with stakeholders to ensure that the unintended consequences of the DMI approach are mitigated. In particular, we strongly urge the Minister to ensure that any future changes to funding arrangements are not rushed and, most importantly, are communicated to schools in a timely manner to enable them to adjust to any future changes in their funding entitlements. This includes lifting the current confidentiality provisions that apply to staff of the various Associations of Independent Schools.

Recommendations

- Recommendation One: That the Senate recognises that additional work needs to be performed to validate the Direct Measure of Income approach.
- Recommendation Two: That the Senate recognises that changes need to be made within the *Australian Education Regulation 2013* to ensure that the Direct Measure of Income funding approach is fit for purpose.
- Recommendation Three: That the Senate consider delaying the passage of the Bill until the work mentioned in the first two recommendations is completed.
- Recommendation Four: That the Minister for Education investigate the introduction of a direct measure of education and occupation into the Direct Measure of Income approach.
- Recommendation Five: That schools be informed of their funded Capacity to Contribute score at least 12 months in advance.
- Recommendation Six: That the Australian Government give consideration now to suitable transition arrangements for schools whose CtC score changes beyond 2022.
- Recommendation Seven: That the 'best of' funding arrangements that are proposed to apply in 2020 and 2021 be extended for an additional two years, to ensure that the DMI approach has been validated and finalised before being fully implemented.
- Recommendation Eight: That schools losing funding under the move to the DMI approach be given until 2031 to transition to their new funding entitlements.
- Recommendation Nine: Given the significant negative impact of the Direct Measure of Income approach as it currently stands on regional schools, that the Minister for Education consider alternative ways to support regional education and regional schools.
- Recommendation Ten: That the Australian Government lift the confidentiality provisions that currently apply to Associations of Independent Schools (AISs), so that the AISs can provide timely advice to schools about the implications of the new model for their operations.
- Recommendation Eleven: That the Australian Government provide schools with significantly greater detail about how their DMI scores have been calculated, and the specific data underlying these calculations.

Submission

Introduction

Independent Schools Victoria (ISV) welcomes the opportunity to make a submission to the Senate Education and Employment Legislation Committee's Inquiry into the *Australian Education Amendment (Direct Measure of Income) Bill 2020* [the Bill]. The submission should be read in conjunction with the Independent Schools Council of Australia's [ISCA] submission.

This submission is made on behalf of ISV's 215 Member Schools, over 90 per cent of whom will be directly affected by the introduction of the Direct Measure of Income (DMI) approach to calculating Capacity to Contribute [CtC]. These schools educated over 150,000 students in 2019.

As identified in the Explanatory Memorandum to the Bill, there are five key purposes to the Bill:

- amending terminology to replace references to a school's 'SES score' with references to a 'Capacity to Contribute score'.
- enabling the Regulations to prescribe a new methodology for calculating CtC scores by introducing a new direct measure of income.
- enabling the Regulations to alter the calculation of a non-government school's transition path.
- broadening the definition of a 'majority Aboriginal and Torres Strait Islander' [MATSI] school to address the situation where a school may move in and out of eligibility on an annual basis
- amending the Act to provide authority for GST inclusive payments.

The second purpose stated above is the fundamental purpose of the Bill.

The first and fourth purposes have been introduced because of the fundamental purpose of the legislation. Nonetheless, neither are directly dependent on the fundamental purpose of the Bill. The final purpose, while not specifically a consequence of the new DMI approach, is nonetheless a sensible clarification of the taxation consequences of Australian Government funding for schools. ISV supports these three purposes of the Bill as sensible legislative changes, regardless of whether or not the DMI funding approach is implemented.

The third purpose is a direct consequence of the second purpose, and makes little sense if the second purpose is not implemented. However, while ISV agrees with the principles underlying the transition arrangements, we believe that improvements can be made to the application of those arrangements.

This submission will focus predominantly on the second and third purposes stated above. Fundamentally, ISV has concerns about the rushed implementation of the DMI approach, and its implications for schools. Good practice would be to test and validate the DMI approach prior to implementation. For these reasons, ISV recommends:

- **Recommendation One:** That the Senate recognises that additional work needs to be performed to validate the Direct Measure of Income approach.
- **Recommendation Two:** That the Senate recognises that changes need to be made within the *Australian Education Regulation 2013* to ensure that the Direct Measure of Income funding approach is fit for purpose.
- **Recommendation Three:** That the Senate consider delaying the passage of the Bill until the work mentioned in the first two recommendations is completed.

Stability, Predictability and the Importance of Base Funding

In order for schools to ensure that they make the best educational resource decisions, they need as much stability and predictability in government funding as possible. This is particularly relevant where a more volatile element of funding accounts for a large proportion of a school's government funding.

Non-government schools receive the bulk of their government funding from the Australian Government. And within the Australian Government funding model, the bulk of funding is allocated through the base component, which is modified by a school's Capacity to Contribute (CtC) score.

In Independent schools, 79.5 per cent of total Australian Government funding is allocated through this component. Thus, after enrolment numbers, the single most important element of non-government schools' government funding is the basis on which the CtC score is calculated.

Any changes to the methodology for calculating CtC scores will therefore have a large impact on funding outcomes. To put this into context, for a school receiving 80 per cent of its notional entitlement under the Australian Government's funding model, without transition arrangements put in place, a one point change in a school's CtC score represents a change in funding of somewhere between \$80 and \$350 per CtC point per student in 2020, depending on the school's CtC score and its primary/secondary mix. By the time that schools reach the end of the Government's proposed transition period in 2029, this is estimated to increase to between \$100 and \$470 per student per CtC point.

It is reasonable to expect that schools' CtC scores will change over time. However, for schools to make the best decisions about resourcing, they need to have as accurate as possible picture of their future funding entitlements. This applies not just to the short-term. Not only are Victorian schools required to submit five-year business plans to the Victorian Regulation and Qualifications Authority (VRQA) as a condition of their registration, they also have to make long-term plans.

Where schools are uncertain about the level of funding they are likely to receive from government, they are required to budget conservatively. The consequences of this conservative budgeting are that:

- schools deliberately lower expected expenditure to ensure that they don't incur operational deficits. This reduces the level of educational provision for students, as well as resulting in inefficient spending decisions where schools do not learn their final funding allocations until late in the year in which they are legally required to expend or commit the funding received from government.
- in order to cover required expenditure, schools have to raise their fees, reducing access to the school for lower-income families.

Even where a school's government funding subsequently turns out to be higher than conservative estimates, schools have limited ability to change their fee structures and expenditure patterns in the short term.

There are several key elements that determine just how easy it is for schools to predict changes in its CtC score in advance, and thus to plan and budget with a greater degree of confidence. These are:

- the stability of the index over time
- the regularity with which the index is recalculated
- the extent to which transition arrangements are implemented when a school's CtC score changes
- the size of the school.

Index stability

When the Government introduced the SES methodology in 2001, an explicit decision was made to recognise the education and occupation levels of families, as well as their income levels. The key reasons for doing so were:

- to estimate the capacity of families to earn future income, as well as measuring current income levels
- to improve the stability of the index.

Individuals' income levels can change much more quickly than their education and occupation data. The proposal to move to DMI, which removes the weightings for income and occupation, will make the DMI methodology more volatile and unpredictable than the old SES methodology.

The implementation of the proposal to fund schools according to a rolling three-year average DMI score will help to reduce this volatility. However, the Government decided to implement the DMI model in 2020, before it had sufficient data to determine the extent of volatility in DMI data on an annual basis. The Department of Education, Skills and Employment currently only has two years of DMI data, and has not made any of this data publicly available, so it is impossible to tell the extent to which the rolling three-year average will increase the stability of the model.

In order to improve the stability of the DMI approach, and to recognise both current and potential future income levels of parents, ISV recommends:

- **Recommendation Four:** That the Minister for Education investigate the introduction of a direct measure of education and occupation into the Direct Measure of Income approach.

The Government already collects parental education and occupation data for two parents for each student, so this process would not add any administrative burden to schools or the Government.

Regularity of recalculation

As the SES methodology was linked to the Census of Population and Housing, SES scores were updated only every four or five years. By contrast, using the DMI methodology, a school's CtC score will be updated every year.

Even with the proposed rolling three-year average, mathematically, it would be reasonable to expect that a methodology that is calculated annually is likely to lead to more frequent changes in a school's CtC score, compared to a methodology that is calculated less frequently. Where a school's CtC score changed systematically as a result of a real change in its parents' relative income levels, a methodology that was calculated annually would be more responsive to those real changes, and would introduce the consequential funding changes more gradually.

However, since individuals' incomes levels can fluctuate rapidly over time, in a situation where a school's CtC score fluctuated randomly about a stable point over time, the probability that a

school would experience continual changes in its CtC score would increase. And since these fluctuations would be random, the ability of schools to predict the changes would be significantly reduced. Once again, the lack of data over time means that we cannot tell how much fluctuation in income levels would be reasonable to expect.

Funding Transition

Since the SES funding model was introduced in 2001, each time a school's SES score has been recalculated, or there has been another major shift in the funding arrangements, transition arrangements have been implemented.

The transition arrangements that the Government proposes to implement between 2020 and 2022 ensure that schools can move gradually from their old funding entitlement to their new funding entitlement. As such, although ISV would recommend that the current transition arrangements be extended (see later in this submission), we support the stated aim in the legislation to provide transition arrangements for schools.

However, ISV is concerned that the proposed transition arrangements only apply to a change in funding methodology for a school in 2020, 2021 or 2022. Where a school's CtC score changes at any time beyond 2022, there are no proposed transition provisions. Thus, the full effect of any DMI change beyond 2022 will be experienced by a school immediately, and in full. This is particularly problematic, since as things currently stand, schools are not able to predict their DMI score, and will only learn of their funded CtC score a short time before its directly impacts on their funding.

ISV is therefore recommending:

- **Recommendation Five:** That schools be informed of their funded CtC score at least 12 months in advance of it being used to determine funding.
- **Recommendation Six:** That the Government give consideration now to suitable transition arrangements for schools whose CtC score changes beyond 2022.

School Size

All of the above issues are particularly relevant for smaller schools. Small schools are likely to be more susceptible to changes in their funding entitlement under the current arrangements because it will be easier for their median family income level to change. Moreover, these schools are likely to be less able to absorb shocks in their funding or respond rapidly to those shocks. Finally, smaller schools are considerably less likely to have the staffing capacity to assess and predict changes in their funding entitlements over time.

DMI Implementation Process

ISV supports the arguments included in the ISCA submission, where ISCA outlines a range of sector concerns about the DMI approach, and the range of issues that remain unresolved. In particular, ISV supports the concerns expressed by ISCA about the lack of a comprehensive validation of the DMI methodology. We do not believe it is appropriate to introduce into legislation a methodology for which the Australian Bureau of Statistics is still yet to prepare a data quality and validation framework.

ISV is also concerned that the Direct Measure of Capacity to Contribute Technical Working Group, which was established by the Government with the specific purpose of providing recommendations on the technical aspects of the new approach, was not allowed to complete this task prior to the Government presenting the DMI approach as a fait accompli.

These issues should have been resolved prior to the Bill being presented to Parliament and prior to schools being informed of their notional CtC scores. However, until the issues are resolved, ISV cannot support the passage of the legislation through the Senate.

The implementation process for schools, by which schools are provided with the 'best of' approach in 2020 and 2021, before moving to the DMI approach in 2022, and the transition period with an end in 2029, are predicated on the legislation being passed in 2020. Given the considerable uncertainty that remains over the impact of the DMI, and particularly its volatility, we believe that the two-year 'best of' approach can only commence once the model has been validated and the unintended consequences addressed. Similarly, once the model is implemented, the agreed transition period length needs to be retained.

For these reasons, ISV recommends:

- **Recommendation Seven:** That the 'best of' funding arrangements that are proposed to apply in 2020 and 2021 be extended for an additional two years, to ensure that the DMI approach has been validated and finalised before being fully implemented.
- **Recommendation Eight:** That schools losing funding under the move to the DMI approach be given until 2031 to transition to their new funding entitlements.

Funding Impact on Schools

The final issue that the Government needs to address is the extent to which the proposed DMI funding approach results in significant changes in individual schools' funding entitlements. Large school systems are able to absorb changes in individual schools' funding entitlements from year to year, but stand-alone Independent schools can not.

ISV estimates that 37 per cent of Victorian Independent schools, representing 27 per cent of Victorian Independent school students, will gain funding as a result of the proposed move to DMI. However, 31 per cent of Victorian Independent schools, representing 56 per cent of enrolments in the sector, will receive less funding than they would otherwise have received.

We are concerned that the Government's communications to schools and to the general public do not enable a true comparison between the SES and DMI approaches. Where the Department of Education, Skills and Employment informs a school that it is 'better off' under the new approach, they appear to mean that the dollar amount the school is projected to receive in 2029 is higher than the amount of funding the school is projected to receive in 2020. This comparison includes funding indexation, which is not a function of the move to the new model. It does not enable schools to assess the true impact of the move to the DMI approach.

Notwithstanding this generous interpretation of schools being 'better off', modelling shows that eight Victorian Independent schools are still projected to receive less funding in nominal terms in 2029 than they receive in 2022, while five will receive less in 2029 than they received in 2020.

In addition to the schools whose funding actually goes backwards, ISV's modelling also suggests that the schools that will receive less funding as a result of moving to the DMI approach will receive total funding of approximately \$395 million less over the period from 2022 to 2029 under the DMI approach compared to the current approach. Eleven schools are predicted to experience a drop in their funding of more than \$10 million over that period, and a further 21 are projected to experience a drop of between \$5 million and \$10 million.

It is important to remember that the extent of these losses has been mitigated by the transition arrangements that the Government intends to implement between 2022 and 2029. To get a true idea of the impact of the DMI approach on schools, we need to look at the impact on schools once the transition period ends. In Victoria, 32 Independent schools are estimated to receive at least \$1 million less per annum in 2029 under the DMI approach, compared to what they would receive under the current SES methodology. For 15 of these 32 schools, this represents more than ten per cent of the school's annual funding from the Australian Government.

In expressing these concerns, ISV does not want to prevent schools whose funding increases as a result of the DMI to be deprived of their additional funding support. In Victoria, those Independent schools that gain funding under the DMI approach are estimated to receive an additional \$320 million over the next ten years. Nonetheless, the Australian Government needs to recognise the significant disruption that the proposed funding changes will have on individual schools that, unlike systems, are not able to redistribute funding between schools to protect them from changes in their government funding.

Regional Schools

While decreases in funding of this magnitude are difficult for any school to absorb, analysis of the DMI approach has shown that schools in regional Australia, particularly the larger regional schools and boarding schools, are particularly hard hit by the move to DMI. In Victoria, for instance, the ten regional schools most badly affected by the move to DMI suffer \$102 million of the \$395 million reduction in funding experienced by Victorian Independent schools between 2022 and 2029.

Since access to the data underlying schools' DMI calculations is not permitted, it is not possible to be certain why these schools' funding is so badly impacted by the move to DMI. Nonetheless, regional schools will face extreme difficulty in adjusting to their new funding entitlements. Some regional schools have already indicated that they would struggle to survive under their proposed DMI funding levels.

And even if this worst-case scenario does not transpire, it is highly likely that the regional schools will need to significantly increase their fees in order to continue to provide the services that they provide. These schools are concerned that a vicious spiral could ensue, under which:

- the school increases its fees to address the drop in government funding from the move to DMI,
- so lower income parents are priced out of the school as a consequence,
- thus leading to a higher median income level for parents remaining at the school,
- causing the school's CtC score to increase,
- leading to the school needing to increase its fees even further...

This would result in a significant drop in the availability of educational choices for families in regional Victoria – particularly for families that are required to choose boarding options because they do not live in proximity to a local school.

For this reason, ISV recommends:

- **Recommendation Nine:** Given the significant negative impact of the Direct Measure of Income approach as it currently stands on regional schools, that the Minister for Education consider alternative ways to support regional education and regional schools.

Data Sharing

ISV's final recommendation is to remove the current confidentiality provisions that the Government has imposed on Associations of Independent Schools. In order to participate in stakeholder discussions with the Department of Education, Skills and Employment, individual staff members at AISs were required to sign Confidentiality Agreements with the Department. These Agreements have prevented AISs from providing important information to schools about the implementation of the DMI model, and its implications for schools.

By contrast, the Department has held consultation meetings with several key school groups. This has enabled groups of schools to have access to significantly more information about the process than individual, stand-alone schools. This inconsistency of access to information has created confusion and uncertainty in the sector.

Regardless of the different level of information provided to different schools about the DMI process, all schools need additional information from the Government regarding the DMI calculation process. To date, schools have only received from the Government their 2011 SES score, their 2016 SES score, their indicative DMI score for 2020, based on a rolling two-year average, and static estimates of the predicted funding they will receive per student between 2020 and 2029.

This information is insufficient for schools to plan and budget. To assess the true impact of the DMI approach, schools need additional information on:

- the individual DMI scores for 2018 and 2019 that make up the school's rolling, two-year average DMI
- the matching rates between parental address data from schools and personal income tax records from the Australian Taxation Office for each of these two years
- the extent to which parental address data and tax data was matched in each of the various data passes for 2018 and 2019
- the extent to which other schools' DMI scores have changed, in both the Catholic and Independent sectors.

ISV recommends that:

- **Recommendation Ten:** That the Government lift the confidentiality provisions that currently apply to Associations of Independent Schools (AISs), so that the AISs can provide timely advice to schools about the implications of the new model for their operations.
- **Recommendation Eleven:** That the Australian Government provide schools with significantly greater detail about how their DMI scores have been calculated, and the specific data underlying these calculations.