

8. We therefore do not recommend using a financial penalty to fulfil the at-risk aspect of the policy.

Option 2: a payment for meeting or exceeding targets

9. In some outcomes-based contracts, the amount of funding that is to be at risk has been set by determining the amount of funding needed to run an efficient operation and setting this as, say, 95 percent of the total funding available. This leaves 5 percent of funding available for good performance.
10. Cabinet has approved a resourcing formula for Partnership Schools that is based on state schools with similar characteristics. On the above model, one option would be to determine that the schools would get, for example, 99 percent of the formula funding if they meet their targets and 100 percent if they exceed targets.
11. We do not have research or modelling that identifies whether a reduced amount relative to state schools would enable partnership schools to run a well-managed school, especially given the amounts that all schools rely on from parent donations and fund-raising that are not present in other outcomes-based contracts (e.g. private prisons). There is therefore no ability to determine where to set the percentage before tipping a school into real difficulties. There could be perverse incentives, with partnership schools increasing "donations" to make up any perceived shortfall in funding.
12. If we withhold a proportion of the funding formula, it is likely that schools will develop operating models that work within the reduced amount, which would effectively mean that less money is available to support the educational achievement of students. In other words, partnership schools would be likely to develop an operating model based on 99 percent of the total funding they are entitled to receive, rather than assuming that they will receive the extra one percent performance payment.

Option 3: a performance payment above the resourcing formula

13. A third option would be to provide a 1 percent performance payment above the amount generated by the resourcing formula to schools that exceed their national standards or NCEA student achievement targets and that meet or exceed all their other targets.
14. This variation on option 2 would be slightly more expensive for the Crown. It would mean that performance that exceeds the targets would be financially rewarded, and poor performance would result in other consequences, including instructions to do things differently, and, in extreme cases, termination of the contract.
15. The first payment would not be until 2015 (i.e after the first year of operation). If the amount at risk were to be one percent and all schools were eligible, the amount required as a charge against the Budget 2013 allocation would be \$43,682.
16. Given that the at-risk payment would be against the whole contract amount, there would also need to be a small increase for the per student amount which cannot be offset against funding taken from the state school system as students move into Partnership Schools. Based on the final rolls of five schools proposed to proceed and assuming that all qualified, this would amount to \$43,901.
17. The total funding required on these assumptions would be \$87,583. This amount could be included when the annual cost increases are calculated in future Budgets.
18. Risks with this approach are:

- if the number of Partnership Schools increase, the amount of funding that would need to be found for the performance payment would increase
- there is a risk that state schools will react negatively to a performance payment for partnership schools that is over and above the resourcing received for comparable state schools. They may claim that they are performing just as well as the Partnership Schools (especially since the targets are based on well-performing state schools), but are not entitled to a performance payment. This can be partly mitigated by providing the at-risk component for exceeding targets
- there will also be adverse comment if future Partnership Schools are for-profit entities.

Preferred option

19. On balance, we believe that adding a small at risk amount above 100% of the funding formula (option 3) is the best way to give effect to Cabinet's intention. It does not jeopardise the successful operation of Partnership Schools and tests a possible incentive model.
20. In light of the Cabinet paper text regarding a one or two percent at risk payment, we recommend that the performance payment be one percent.
21. However, if a future decision is made by Cabinet to increase the at-risk funding component, we recommend that the policy settings associated with how that payment is made should be reviewed at that time. We will ensure that the contract for the schools provides the flexibility for the Crown to review the performance payment during the term of the contract.