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Finance and Public Administration Committee

21st Meeting, 2022 (Session 6), Tuesday, 28 June

Post-legislative scrutiny of the Financial Memorandum for the Children and Young People (Scotland) Bill

At its meeting on 28 September 2021, the Committee agreed to undertake post-legislative scrutiny of the Financial Memorandum (FM) for the Children and Young People (Scotland) Bill, focusing specifically on the expansion of early learning and childcare (ELC) that was proposed by the Bill. The Bill was introduced on 17 April 2013 and received Royal Assent on 27 March 2014.

At this week's session, the Committee will hear from Alison Cumming from the Scottish Government's Early Learning and Childcare Directorate.

Members may also wish to note that the Education, Children and Young People Committee recently (25 May) held an evidence session on the expansion of ELC and also intends to consider the funding of ELC as part of its pre-budget scrutiny later this year.

Context

The Children and Young People (Scotland) Bill included a wide range of measures across a range of policy areas. In respect of ELC, the Bill proposed an expansion in the number of free hours of ELC from 475 hours to 600 hours per year and also broadened eligibility for free childcare to include some 2 year olds. The revenue costs of this policy, as estimated in the original FM were expected to be between £71 million - £96 million per year. In addition, capital costs of £30 million per year for three years were also estimated.

Shortly after the Act was passed, the Scottish Government announced plans to extend the policy to allow for 1,140 hours of ELC per year. This was originally intended to be implemented from August 2020, but the implementation date was delayed to August 2021 due to the pandemic. Reflecting the extension to the policy, estimated costs have also risen and the allocations to councils in respect of the policy have increased. However, as the extension from 600 hours to 1,140 hours was implemented through secondary legislation, there was far more limited scrutiny of the costs involved in this policy extension.

In undertaking this post-legislative scrutiny, the Committee will be able to consider whether the recommendations made by the predecessor Committee have been implemented (for example, in respect of monitoring of costs). Lessons may also be learned that might inform future scrutiny of FMs including, for example, the forthcoming National Care Service Bill.

To inform the evidence sessions, the Scottish Government provided a range of information to SPICe, which was included in the papers for last week's meeting.

Background

When the original FM was considered by the Session 4 Finance Committee, a range of concerns were raised in relation to the financial estimates and the assumptions underpinning them. Specifically, the Committee raised concerns around:

- The extent to which potential variation in delivery models for the expansion of ELC were reflected in the cost estimates
- The assumptions made in relation to rates paid to partner providers of ELC, who (at the time of the Bill) accounted for around 40% of all ELC provision which did not appear to reflect sustainable payment rates
- The lack of detail on the assumptions underpinning the estimated capital costs.

The initial cost estimates were later revised, primarily to reflect a decision during the passage of the Bill to further expand ELC provision for 2 year olds. This was reflected in a supplementary FM and further scrutiny by the Finance Committee.

The evidence session on 21 June explored a range of issues with COSLA, Scottish Borders Council and representatives from partner providers of ELC. The themes are further developed below, reflecting the evidence heard at that session. Detailed information is not repeated here, but can be accessed in the papers for the session on 21 June.

Delivery models

The original FM acknowledged that there were challenges in estimating the likely costs of the expansion to ELC with accuracy, as a range of different models of implementation were possible and the model adopted by an individual council would have a bearing on the costs of implementation. Reflecting this, the FM stated that:

> "These models are only examples and, therefore, costs are indicative. The final models developed by local authorities will vary according to locally identified need and cannot be anticipated in advance of consultation."

In its written evidence to the Finance Committee on the original FM, COSLA indicated that, while it was broadly content with the cost estimates presented in the FM, ultimately costs could vary depending on the degree of flexibility in provision. In evidence to this Committee on 21 June 2022, David Robertson of Scottish Borders noted that it was still early days in respect of the policy implementation and that models of delivery had taken time to develop. Sarah Watters of COSLA also stressed that delivery models could not be quickly adapted to reflect any changes in uptake, so that funding could not always be expected to exactly match costs. Furthermore, the pandemic had led to uncertainties in planning for uptake.

The initial allocations to local authorities for delivery of expanded ELC reflected the cost estimates from the revised FM. This was despite the fact that the Committee's scrutiny of the original FM had raised a number of issues with the initial costing exercise, and the Scottish Government had acknowledged that the FM costs were only indicative at that stage. It is unclear how any concerns around the accuracy of the FM estimates were reflected in the initial allocations for the expansion of ELC, or how later allocation methodologies have been developed to reflect variation in models of delivery.

This Committee's evidence session today provides an opportunity to explore the extent to which these initial allocations met the commitment to fully fund the policy and how the allocations to local authorities have been adjusted to reflect the subsequent extension to the policy and the development of a range of different delivery models across Scotland. In evidence to the Committee on 21 June, COSLA noted that, for revenue allocations, their preference was to move towards a needs-based formula, but that any transition would need to be managed so that local authorities could adapt to any new funding mechanism.

Partner provider rates of payment

The original FM noted that around 40% of ELC provision was secured through independent, private and third sector partners. This dependence on partner providers meant that the rates paid to these providers had a significant bearing on the overall costs of the policy. More recent data based on submissions from 17 local authorities shows considerable variation in the amount of ELC expenditure that is accounted for by partner providers.

The Committee also heard from partner providers on 21 June that, while rates paid to partner providers have improved, there are still concerns around the variation in the rates paid across Scotland and the lack of transparency in the methodologies used to determine these rates. There were concerns that rates did not support sustainable services and that, as a consequence, staff turnover was very high as staff would often leave for better-paid jobs in the local authority sector. Partner providers noted that there was often limited consultation with partner providers around the setting of rates, but that some local authorities were better than others in this regard.

Partner providers represented on the panel on 21 June expressed a preference for an advisory rate to be set, while appreciating that there would always need to be room for local variation.

At the time of the original FM, the (then) Committee expressed concerns that the ELC costings were based on an assumed payment rate of £4.09 per hour to partner providers that did not reflect the actual payments being made to partner providers. In written evidence to the Committee on the FM, the National Day Nursery

Association (NDNA) noted that average payment rates were only £3.28 per hour and varied widely across Scotland. At that time, NDNA advised that a payment rate of £4.51 per hour represented a sustainable payment rate that would fully cover actual costs.

Since the Bill was passed, there has been further work on establishing sustainable rates for ELC partner providers, as outlined below.

In April 2019, guidance was published to support local authorities to set sustainable rates for ELC partner providers from August 2020. The Scottish Government stated that:

> "This was produced based on feedback gathered from across the sector, and sets out the principles that should underpin any approach to setting sustainable rates; and options for taking forward the process."

Interim Guidance on the payment of sustainable rates was published in March 2021 to reflect the impact of the pandemic and ensure that any additional costs resulting from the pandemic were reflected in partner provider rates.

In August 2021, the Scottish Government published an Overview of local authority funding and support for early learning and childcare providers, which set out the hourly rates paid by local authorities to providers delivering the funded ELC entitlement. This report notes that "A key aspect of Funding Follows the Child is the payment of sustainable rates to providers in the private, third and childminding sectors for the delivery of funded ELC." Annex A of the report sets out the rates paid by local authorities to partner providers in 2020-21 and 2021-22. For 3-5 year olds, rates paid range from £5 per hour (Orkney) to £6.40 per hour (West Lothian). Different rates applied for 2 year olds and (for some local authorities), different rates were paid to childminders.

In giving oral evidence to the Committee on 21 June, Jonathan Broadbery of NDNA noted that nine local authorities had not increased their partner provider rates between 2020-21 and 2021-22.

Also in August 2021, the Scottish Government published a Financial sustainability health check of the childcare sector in Scotland. One of the findings of this report was that "some respondents felt that the hourly rate that they received from their local authority for delivering funded ELC did not cover their current costs of delivery", although it also noted that "being a funded ELC provider was highlighted by a number of respondents as a benefit in terms of their sustainability".

There is a commitment to repeating the sustainable rates data collection exercise every year, with updated information published by the end of August each year.

The report also highlights a decline in the number of private sector childcare service operators since 2017, while the number of local authority childcare services has increased. In their written submission to the Committee, the Scottish Childminding Association (SCMA) noted a 26% decline in the number of childminders over the last 5 years and added:

> "We agree that the issue of sustainable rates is important to providers' business sustainability and we have received feedback from a number of members to indicate that for some childminders the level of rates offered by local authorities in some parts of the country are too low to make their participation in ELC delivery financially viable."

In oral evidence on 21 June, David Robertson of Scottish Borders Council noted that in the Scottish Borders area there had been an increase in numbers of childminders, so there is likely to be variation across the country. The Care Inspectorate publish data annually on numbers of providers.

However, the SCMA submission and their oral evidence highlighted that sustainable rates should not be considered in isolation and that sustainable hours are also critical (with childminders unable to operate effectively with only a small number of hours). Factors such as increased administration and bureaucracy costs also needed to be taken into consideration in setting rates. Matthew Sweeney of COSLA also highlighted that factors such as discounted letting and training/CPD costs also needed to be taken into account.

In policy areas where delivery depends on provision through partners in the private and/or voluntary sectors, partner provider rates will have a significant bearing on both the sustainability of services and the appropriate level of funding. This needs to be taken into account at the earliest stage and reflected in the FM costings.

Capital costs

In its written evidence to the Finance Committee on the original FM, COSLA noted:

> "With regard to capital costs, the FM highlights the very limited basis of the assumptions, and costs to individual local authorities will depend on local circumstances and current pre-school estate. This is an area where close monitoring of the actual costs against the costs identified in the FM is recommended."

In giving evidence to the (then) Finance Committee on the original FM, the Scottish Government admitted that the assumptions underpinning its estimates of the capital costs associated with expanded ELC provision had not been based on "a thorough and detailed assessment", and acknowledged that "this is one area in which the estimate represents a best guess".

The supplementary FM which reflected increased provision for 2 year olds did not include any revised capital cost estimates, and noted that:

> "Capital costs have not been explicitly estimated. It is not possible to provide an accurate estimate of the level of infrastructure investment required at this stage. Further work will be required to explore the need for any additional capital funding."

With the expansion to 1,140 hours, a further £476.1 million in capital funding was provided to local authorities over the period 2017-18 to 2020-21. The allocations were based on local authority estimates of the funding required. However, Audit

Scotland reported that local authority plans indicated a requirement for £747 million of capital investment, so these plans were adjusted to take account of funding principles for new buildings (using standard area and cost reference rates and excluding any land purchase costs). According to Audit Scotland's 2020 report on Early Learning and Childcare, the adjustments resulted in some local authorities receiving less capital funding than they estimated the expansion would require and some receiving more than they had estimated.

The focus of data collection and publication has been on revenue costs, rather than capital costs. The Scottish Futures Trust (SFT) has been working with the Scottish Government and local authorities to support the development of local Early Learning and Childcare expansion plans and provided an update in February 2021 to the ELC Finance Working Group. However, this does not give a clear overview of how actual spend on capital projects compares with the allocated amounts. In terms of numbers of projects, the report notes that 620 projects were required for delivery of 1,140 hours ELC and that 581 were complete as at August 2021.

In written evidence to the Committee on the original FM, the National Day Nursery Association (NDNA) highlighted the need for partner providers to be able to access funding for capital investment:

> "In addition, to ensure that there is sufficient capacity to meet demand for increase numbers of places and increased hours, local authorities' capital funding should be available for investment, subject to appropriate terms and conditions, by partner providers. Historically this approach has been successful in some local authority areas. The assumption of the Bill and FM appears to be that capital will be used solely for maintained provision, but there is an opportunity for cost-effective development in private and third sector partner provision that can provide value for money, meet parents' needs for flexible childcare and avoid duplication of existing services."

In evidence to the Committee on 21 June, Jonathan Broadbery of the NDNA noted that partner providers had been able to access some limited capital funding, but that there had been a lot of hoops to jump through. Sarah Watters of COSLA noted that no further ring-fenced capital funding was available for ELC, so that any further requests for capital funding in this area would need to be considered as part of wider capital funding plans for local authorities.

The need for monitoring of implementation costs

During the evidence session on the original FM, the Scottish Government acknowledged that there were uncertainties around the costs set out in the FM:

> "The Government has promised to fully fund the additional costs. The financial memorandum represents our estimate of additional costs as at earlier this year. Of course, more information will come out, now and as we proceed towards implementation of the measures, and the Government is committed to ensuring that additional costs are properly assessed as they arise and are funded as appropriate."

Reflecting the commitment to fully fund the ELC policy, as well as concerns around the accuracy of the cost estimates, the (then) Finance Committee agreed that monitoring of expenditure would be critical as the policy was rolled out. The Committee made specific recommendations in its report regarding the collection and publication of data to enable costs to be monitored:

> "The Committee recommends that the Government requires local authorities to report annually on spending in relation to pre-school provision, in order that it can ensure that the anticipated levels of investment are being achieved. This should include details of expenditure on partner providers, including hourly rates paid. This information should be published."

In its written evidence to the Finance Committee on the original FM, COSLA also noted:

> "We also believe that it will be necessary for both COSLA and Scottish Government to jointly scrutinise and monitor the spending on this legislation, to ensure that local government is and continues to be sufficiently resourced to carry out the new duties that will be enacted."

The papers for the evidence session on 21 June set out in detail the attempts that have been made to gather data on the costs of implementation. Several data collection exercises have been undertaken, but – until now – these have not provided sufficiently robust data to allow for a comprehensive assessment of the extent to which the ELC policy expansion has been appropriately funded. In summary:

- Scottish Government analysis published in 2016 indicated a significant gap between the funding provided (£329 million) and reported expenditure (£189 million) on ELC, although COSLA questioned the methodology underpinning this analysis.

- A new template was developed by the ELC Finance Working Group, but the initial returns from this exercise (in June 2019) were not considered sufficiently robust to be published.

- A revised template was therefore drawn up and a further data collection exercise was undertaken in 2020. Only 17 returns were considered sufficiently accurate and robust to include in the analysis from this exercise and it was unclear the extent to which the pandemic had affected expenditure.

- A further data collection exercise was undertaken in December 2021 and 31 returns were received and a more complete assessment of expenditure was possible. The analysis does not directly compare allocations with expenditure.

The indications from the data are that, if anything, local authorities have been over-funded and have not spent as much on ELC as they have been allocated. However, weaknesses in the data make it difficult to reach a firm conclusion on this.

In oral evidence to the Committee on 21 June, COSLA noted that there was a need to reach a “steady state” and gather data on the basis of “business as usual” before reaching further decisions on funding for future years. The pandemic meant that this position had not yet been reached.

Funding for ELC currently involves a combination of money allocated as part of the General Revenue Grant (which is not ring-fenced) and a Specific Revenue Grant (which is ring-fenced). This combined funding has made it more complex to track how much is being spent on ELC and the existing systems were not suited to monitoring expenditure. David Robertson of Scottish Borders Council (who is also on the ELC Finance Working Group) noted that there was variability in approaches to recording some elements of expenditure, such as central support overheads, and this had affected data quality. The number of returns received from local authorities in the second data collection exercise had been affected by the pandemic.

David Robertson of Scottish Borders Council acknowledged that there should have been greater focus on collecting robust data from the outset.

In their written evidence to this Committee, Audit Scotland also noted concerns in relation to the data available on spend in this area:

> “Our 2018 report highlighted inconsistencies in how councils compiled local financial return information, making it difficult to conclude how much of the variation in council spend was genuine variation and how much was a result of these inconsistencies. Limitations in the available financial data made it difficult to examine the financial impact of different models of ELC and changes to flexibility. We recommended that the Scottish Government and councils collect better information on the cost of different models of ELC and their impact on children’s outcomes to allow them to better plan for the expansion to 1,140 hours. We have highlighted the importance of comprehensive financial information to support planning and decision making in previous audit work.”

It is clear from the information provided by the Scottish Government that monitoring of expenditure in relation to the expansion to ELC is still proving to be a challenge. This makes it difficult to assess whether the policy is being appropriately funded or whether the Scottish Government is providing more or less than is required to deliver the policy.

2022-23 allocations

The Scottish Government has recently confirmed 2022-23 ELC allocations, indicating that 2022-23 will be treated as an interim year and that future funding will be informed by the latest data collection exercise.

In its letter confirming 2022-23 allocations, the Scottish Government stated:

> “The Scottish Government is clear that the total ELC settlement provides sufficient funding to local authorities to continue to deliver high quality 1140 provision in line with the interim National Standard guidance.”

The Scottish Government letter goes on to state:

> "The 2022-23 allocation also begins to implement the new needs-based distribution methodology agreed by Scottish Ministers and CoSLA Leaders. This is designed to ensure the allocation of resources to local authorities more accurately reflects changes and local variation in the ELC population and measures of deprivation and rurality. The first phase of this methodology is applied from April 2022 and, as with any other change, we will continue to engage with CoSLA and Local Authority partners to ensure the subsequent phases can be implemented in a sustainable manner."

Learning from the FM and subsequent policy roll out

It is understandable that, when an FM is prepared, cost estimates may be out of line with actual expenditure when the policy is introduced. The level of uncertainty in the FM estimates was acknowledged in respect of the expansion of ELC and was why the Committee recommended that a priority should be given to data collection once the policy was rolled out. The evidence supplied by the Scottish Government suggests that there remain challenges in accurately assessing levels of expenditure on the ELC expansion.

There have also been several changes in the approach to determining local authority allocations in this area. Initially, allocations were based on local authority estimates of costs, however, for 2022-23 a formula approach has been implemented, and the approach to determining future allocations is still being developed.

In terms of other policy areas and future FMs, there are potentially lessons to be learned in respect of:

- how cost estimates are developed for FMs, including the data gathered to inform FMs and the extent to which different delivery models are considered and reflected in the estimates

- methodologies used to determine payments made to partner providers for delivery of services, and the extent to which these represent sustainable rates

- what arrangements are put in place at the outset to monitor expenditure to ensure that new policy initiatives are being appropriately funded

- what methodologies are used to determine allocations to local authorities (or other public bodies) and the usefulness of formula distribution methodologies as opposed to basing allocations of cost estimates from the bodies themselves.

These factors may be of relevance for future consideration of other policy areas or future FMs e.g. for the National Care Service Bill.

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June 2022