The Scottish Parliament
Pàrlamaid na h-Alba

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By email

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4 October 2022

Dear Deputy First Minister

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

As you are aware, the Finance and Public Administration Committee is responsible for scrutinising Financial Memorandums (FMs) to Bills. To help inform how we approach our scrutiny of future FMs, we were keen to assess actual spend against original cost estimates in an FM where the policy proposals have been in place for a number of years. We therefore recently undertook an inquiry to establish the accuracy of the original cost estimates in the FM that accompanied the Children and Young People (Scotland) Bill (now the 2014 Act), and the cost of implementation, focusing specifically on the expansion of early learning and childcare (ELC) provisions. We hope our findings and recommendations set out in this letter help to inform the Scottish Government's development of future FMs.

During the inquiry, the Committee took oral evidence from COSLA, Scottish Borders Council, the National Day Nurseries Association, the Scottish Childminding Association and Early Years Scotland, followed by the Scottish Government Director for Early Learning and Childcare.

In addition, we received written evidence from Audit Scotland, the Scottish Childminding Association and the Scottish Private Nursery Association.

We selected this particular Bill for post-legislative scrutiny on the basis of significant concerns raised by the Session 4 Finance Committee over the original financial estimates. During the passage of the Bill, a supplementary FM was published, and the Committee recommended that expenditure relating to the policy roll-out be monitored during implementation.

Separately to our inquiry, the Education, Children and Young People Committee is also carrying out some work in this area. It recently held a one-off evidence session on the expansion of funded ELC, focusing specifically on the implementation of the policy[1], and it also plans to examine this area as part of its pre-budget scrutiny. While our scrutiny focuses on the financial aspects of the expansion of ELC, we have copied this letter to that Committee to inform its wider work in this area.

Managing uncertainty in Financial Memorandum costings

The Session 4 Finance Committee's report on the FM expresses concern in relation to the robustness of the estimates and assumptions upon which the FM was predicated, as well as disparity between the estimates provided in the FM and the views of local authorities. That Committee's report concludes that:

> "Government needs to develop a more robust methodology for forecasting potential savings from preventative policy initiatives. There is also a need to develop measures to ensure that the actual savings are effectively monitored and reported."[2]

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 particular model adopted by an individual council would have a bearing on the costs of implementation.

The first study of the costs of implementing the policy, "Financial review of early learning and childcare in Scotland"[3] was published by the Scottish Government in 2016. The study found that spending by local authorities on the expansion of ELC did not appear to be in line with the amounts allocated to local authorities by the Scottish Government, with actual spending reported to be considerably lower than the amounts allocated. The review showed a gap between the funding provided (£329 million) and reported expenditure (£189 million) which appeared to indicate that the policy was not costing as much as had been anticipated. Both the methodology of the report and its conclusions were criticised by COSLA, however, the review appeared to highlight an early indication of the inaccuracies in the initial estimates.

The Committee accepts that estimates in Financial Memorandum costings bring with them an inevitable level of uncertainty. However, we believe that FMs should clearly set out the nature of any uncertainties and risks, and that costings in such situations should reflect a range, rather than a specific cost.

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. The significant extension to the policy translated into increased estimated costs and allocations to local authorities. As the extension from 600 hours to 1,140 hours was implemented via secondary legislation, there was limited scope for scrutiny of the additional costs involved and the Committee has found there is very little robust data available on the actual costs of the policy at this early stage.

The importance of including realistic costs in Financial Memorandums accompanying parliamentary bills was emphasised by Audit Scotland in their written submission to the Committee, particularly in the context of the current National Care Service Bill.[4] In June 2017, an ELC Finance Working Group was established to lead the work on determining allocations in relation to the expansion to 1,140 hours. The Finance Working Group agreed the process for gathering data and prepared a finance template to be issued to local authorities. In April 2018, the Scottish Government and COSLA leaders reached agreement on a multiyear revenue and capital funding package for the expansion.

Evidence received by the Committee suggests that there was limited consultation with the private, independent and voluntary (PVI) sector prior to implementation and that the views of the PVI sector were not necessarily taken on board.

To enhance transparency and enable effective scrutiny, the Scottish Government should avoid implementing major policy expansions via secondary legislation, where costs are significantly higher than estimates in the original FM. This is noted as a particular concern in relation to the National Care Service Bill.

In its scrutiny of the Financial Memorandum, the Session 4 Finance Committee emphasised the need for ongoing monitoring of implementation costs. However, we have found that clarity and detail over costs only became a focus following the policy expansion to 1,140 hours.

In her evidence to the Committee, Alison Cumming, Director of Early Learning and Childcare at the Scottish Government admitted that:

> "it would be a fair reflection to say that we significantly refined and developed the cost estimates after the decision was taken to expand provision to 1,140 hours. We recognised that that expansion involved a significant investment of public money and that we needed to dedicate significant amounts of Scottish Government resource and local government resource to working together to ensure that we really understood the level of resource that was required and what was driving those costs."[5]

The Committee has identified several issues with the monitoring of costs, which the report explores in further detail below. Despite early acknowledgement by the Scottish Government of the need to monitor spending, no specific systems were put in place in order to do so and the existing financial returns proved inadequate for the task.

Monitoring of implementation costs

Throughout the inquiry, one of the Committee's principal aims has been to evaluate the accuracy of initial cost estimates and the policy's ability to deliver sustainability and value for money.

The need for monitoring of implementation costs was highlighted during scrutiny of the original FM, when the Scottish Government acknowledged the uncertainties around initial cost estimates and promised to fully fund any additional costs.
The Session 4 Finance Committee expressed concern in relation to some of the costings in the initial FM and the evidence provided to support these. In its report, the Committee emphasised the need to ensure costs and savings are effectively monitored and reported, and made specific recommendations regarding the collection and publication of data:

> "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."[2]

The Committee acknowledges the various attempts that have been made to collect data on implementation costs, including:

- The Scottish Government analysis, "Financial review of early learning and childcare in Scotland: the current landscape"[3], published in 2016, which indicated a significant gap between the funding provided (£329 million) and reported expenditure (£189 million), analysis which was disputed by COSLA;
- A template developed by the ELC Finance Working Group, the returns from which were received in 2019 but considered not to be robust enough to be published;
- A revised template and data collection exercise undertaken in 2020, which produced only 17 robust returns;
- The most recent data collection exercise undertaken in December 2021, which produced 31 returns and offered a more thorough assessment of expenditure. This analysis does not directly compare allocations with expenditure.

During oral evidence, we heard that monitoring of implementation costs has been hampered by the Covid-19 pandemic and differences in individual councils' set-up and reporting, including the lack of a specific ELC line in council accounts. In their evidence, COSLA noted that the available data has been impacted by the pandemic and does not reflect "business as usual" requirements and take-up. Their recommendation is that the sector is allowed to reach a "steady state" before further long-term funding decisions are made.

David Robertson, Chief Financial Officer at the Scottish Borders Council, acknowledged that there is "an element of variability in the allocation of central support overheads", however, noted that "the majority of direct costs are accounted for fully and consistently by councils through the LFR [local financial return], and they are fully auditable and transparent."[6]

Data gaps around eligibility for two-year-olds have also been identified and work is ongoing between the UK and Scottish Governments to create a data gateway to address this issue.

Despite initial acknowledgement from the Scottish Government that monitoring of expenditure would be critical as the policy is implemented, the Committee is yet to see a comprehensive comparison of allocations to local authorities relative to levels of expenditure. The lack of comprehensive data makes it difficult to assess whether allocations are at an appropriate level and whether the Scottish Government has fulfilled its commitment to fully fund the policy.

The Committee's concern over gaps in the availability and reliability of data was echoed in the written evidence submitted by Audit Scotland:

> "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."[4]

We believe that outcomes and monitoring information should be considered at an early stage in the development of policy. Evidence provided to the Committee shows that monitoring of expenditure continues to pose challenges to the Scottish Government and local authorities. Robust financial data is needed to provide a clear assessment of outcomes, sustainability and value for money.

While the Committee acknowledges the progress that has been made in this area, we recommend that the Scottish Government undertakes further, more detailed data collection exercises on a regular basis, including comparisons between allocations and expenditure at local authority level.

The Committee further recommends that future Financial Memorandums include comprehensive information on the Scottish Government's plans to monitor expenditure to ensure that new policy initiatives are being appropriately funded and ensure greater transparency around spending.

Distribution of funding

Initial funding allocations to local authorities for delivery of expanded ELC reflected the cost estimates from the revised FM, despite the concerns raised during the Committee's scrutiny of the original FM and the Scottish Government's own acknowledgement that the FM costs were only indicative at that stage. It remains 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.

One of the issues raised during evidence was the absence of a single standard funding formula. Both the Scottish Government[5] and COSLA[6] have highlighted that the decision of COSLA leaders in 2018 to distribute funding on the basis of estimates that individual local authorities had submitted to the Finance Working Group was, in fact, "a political decision". On 25 June 2021, COSLA leaders agreed that from 2022-23 a single standard formula should be used to distribute funding between local authorities. While noting that the multi-year funding agreement did provide stability to the sector, COSLA emphasised its preference for a smooth transition to a needs-based formula, which will allow Councils to respond to needs in their areas.

The Committee's view is that agreement on a distribution formula should have been reached at an earlier point so as to support transparency around allocations and allow for funding to be more responsive to service provision.

In their written evidence to the Finance Committee on the original FM, COSLA highlighted capital costs as "an area where close monitoring of the actual costs against the costs identified in the FM is recommended."[7]

During scrutiny of 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"[8]. The supplementary FM further stated that "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. A Scottish Futures Trust report from February 2021 noted that 620 projects were required for delivery of 1,140 hours ELC and that 581 were complete as at August 2021, however, there is currently no data available to assess actual spend compared to allocated amounts for capital projects.

One of the recommendations made by the Scottish Private Nursery Association in their written submission to the Finance and Public Administration Committee was that "the Scottish Government should make a capital works grant funding package available for private, voluntary, and independent nurseries."[9]

In their evidence, the National Day Nursery Association also emphasised the opportunity for cost-effective development in private and third sector partner provision and highlighted the difficulties partner providers faced in accessing capital funding. While some limited funding was available in certain local authorities, "there were a lot of hoops to jump through", while "people were seeing millions of pounds being spent on other projects"[6]. Graeme McAlister of the Scottish Childminding Association echoed that and noted some local authorities had commenced capital build projects irrespective of existing capacity in the private and voluntary sector:

> "If you take away only one statistic from today, please let it be this one: in our 2021 audit and in previous audits, we asked how many local authorities had undertaken impact assessments of their childminding expansion plans, and only four out of 32 had done so."[6]

The Committee invites the Scottish Government to reflect on the allocation of funding for capital projects and how this can be improved for future policy implementation, particularly in the context of the current National Care Service Bill. If provision through the private and voluntary sector is required to support policy expansion, then capital budgets must be designed in a way to support this.

Payment rates for partner providers

Rates of payment for independent, private and third sector partner providers had a significant bearing on the overall costs of the policy. While the intention of the initial funding model was to be 'provider neutral' and offer parents their choice of setting or childminding, the Committee has heard concerns around the neutrality and transparency of Councils in setting payment rates, as well as the considerable variation in the amount of expenditure that is accounted for by partner providers.

While scrutinising 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 at that time 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.

The Committee recognises that, since the Bill was passed, there has been further work on establishing sustainable rates for ELC partner providers, including guidance published in April 2019 and March 2021. The Scottish Government report "Overview of local authority funding and support for early learning and childcare providers"[10], published in August 2021, sets out the hourly rates paid by local authorities to providers delivering the funded ELC entitlement and 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." For 3 to 5-year-olds, rates paid range from £5 per hour (Orkney) to £6.40 per hour (West Lothian), with different rates applied for 2-year-olds and (for some local authorities) to childminders. Several local authorities did not increase their partner provider rates between 2020-21 and 2021-22.

The “Financial sustainability health check of the childcare sector in Scotland”[11], also published in August 2021, notes 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 stated that “being a funded ELC provider was highlighted by a number of respondents as a benefit in terms of their sustainability”.

During the evidence session with representatives of the private, voluntary and independent sector, the Committee heard that there is a lack of transparency in how local authorities are arriving at their rates. Jonathan Broadbery from the NDNA stated that their members lack the time or expertise to review and understand the process whereby rates are agreed. Jane Brumpton of Early Years Scotland further highlighted that:

> “It is very difficult for some members to speak to the right person or to have their voices heard and be able to jointly discuss what the local needs are and what their cost basis is. Some members are saying that they feel as if the process is done to them and that they do not necessarily have a voice in it.”[6]

There is, however, significant variation across local authorities, and:

> “In the authorities that are doing this well […] the key thing is active engagement with the sector to ensure that they are setting appropriate rates for the settings in their area, adhering to the agreed COSLA principles, valuing the input from the sector in their areas and realising the added impact that the local [private, voluntary and independent] PVI sector can bring.”

The Scottish Private Nursery Association stated in their written submission that “The manner in which Local Authorities have set their rate, no matter which method they used, are questionable.”[9]

Evidence received from COSLA and the Scottish Government suggests Councils are open and transparent about the rates they set each year. It is clear, however, that this view is not shared across the PVI sector and more should be done to improve accessibility and transparency around the methodology and decision-making process.

During the session on 21 June 2022, the Committee also explored the merits of setting a standard rate across Scotland. Partner providers represented on the panel expressed a preference for an advisory rate to be set, while appreciating that there would always need to be room for local variation. The NDNA proposed a “childcare passport” policy, whereby:

> “The funding rate would almost be passed to a parent—not in cash terms, but in an account that they can use with a registered provider, and they would be able to blend their places. They would take the passport, which would set out their budget based on where they live, what their child’s needs are and what

they are entitled to, to a local authority setting, a nursery, a childminder or wherever they want."[6]

In their written submission, the SPNA called on the Scottish Government to either:

1. Provide funding for the provision of the 1,140 hours direct to parents through either a voucher scheme or through an online portal which allows nurseries to be funded directly; or,
2. Directly set the rate which all children will receive for their 1,140 hours.

During the Committee's evidence session on 28 June, the Director of Early Learning and Childcare rejected the suggestion of a national standard rate and noted that future funding will be informed by the latest data collection exercise. While the Committee accepts that 2022-23 will be treated as an interim year for ELC allocations, it is essential that future payment rates for partner providers are realistic and sustainable and arrived at in partnership.

The Committee notes that the rates used in the original FM did not reflect the rates that were actually being paid by local authorities to partner providers and were below rates that would be consistent with sustainable service delivery.

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 relevant Financial Memorandum.

<u>**Impact on partner providers**</u>

During the evidence session on 21 June 2022, the Committee heard concerns that rates did not support sustainable services and that, as a consequence, staff turnover increased significantly as staff would often leave for better-paid jobs in the local authority sector.

The "Financial sustainability health check of the childcare sector in Scotland"[11], of August 2021, 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. Graeme McAlister of the SCMA explained that the main reason behind childminders leaving the workforce is the significant increase in bureaucracy and paperwork and the duplicative quality assurance at national and local levels, which has become unsustainable. Other areas of concern for the SCMA are the limited number of hours offered to childminders as part of blended placements and the lack of understanding and promotion of childminding as an option for funded ELC.

The SCMA calls for a "proportionate, joined up and light touch" quality assurance process. This is echoed by Early Years Scotland, who calls for overall simplification of the process, a single inspection body for ELC and more active engagement with the PVI sector during the early stages.

Despite assurances received from COSLA that there is no squeeze on partner provision at national level and changes are linked primarily to parent-demand, research commissioned by the Scottish Government confirmed that training, administrative demands and inspections are lead causes of the current decline in the childminding workforce.

The Director of Early Learning and Childcare advised the Committee that the Scottish Government will be consulting on a shared inspection framework for the early learning and childcare sector as a whole, however, this work is at very early stage.

Given the decline in private and voluntary settings, and the challenges facing the wider labour market, the Committee recommends that the Scottish Government prioritises their work on the ELC inspection framework as a matter of urgency in order to ensure the sustainability of the sector.

Setting and measuring outcomes

One of the areas highlighted by Audit Scotland in their submission is "the need to be clear from the outset about the outcomes that policy is expected to deliver, and to consider the different options for achieving those outcomes – the Scottish Government did not do this for the expansion to 600 hours of funded ELC."[4] Audit Scotland noted that, by the time their "Early learning and childcare follow up report"[12] was published in 2020, "it was not clear how the longer-term economic benefits will be assessed, or how family wellbeing will be measured".

The need for a greater focus on data and outcomes at an early stage has been echoed by David Robertson, Chief Financial Officer, Scottish Borders Council and by COSLA, who noted in their evidence that current data collection focuses primarily on output data from the Improvement Service. Measuring the less tangible benefits, such as family wellbeing, remains a challenge which COSLA hopes will be addressed via the Scottish Government's study of early learning and childcare.

Reflecting on the implementation of the policy, Sarah Watters (COSLA) stated that:

> "I think that it is possibly one of the best examples of our working constructively with our Scottish Government, private sector and third sector colleagues for the greater good and the greater policy goal. What I would perhaps do differently would be to not view the ultimate focus as being on the provision of childcare. I think that we need to look at it across the piece, and to consider how the policy relates to things such as employability, transport and the other areas that sit within the gift of councils."[6]

During the evidence session on 28 June 2022, Alison Cumming, Director of Early Learning and Childcare at the Scottish Government, stated that "We are examining other indicators to help us to monitor and understand quality, and, within the next few months, we will publish a refreshed monitoring and evaluation strategy that takes account of the impact of Covid."[5]

The Committee looks forward to the publication of the renewed strategy. We hope this will contribute to further clarity and transparency on outcomes, in line with expectations set by the National Performance Framework.

Yours sincerely

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Deputy Convener, Finance and Public Administration Committee

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[3] The Scottish Government. (2016, September 27). Financial review of early learning and childcare in Scotland: the current landscape. Retrieved from https://www.gov.scot/publications/financial-review-early-learning-childcare-scotland-current-landscape/ [accessed 27 September 2022]

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[6] The Scottish Parliament. (2022, June 21). Official Report of the Finance and Public Administration Committee. Retrieved from https://www.parliament.scot/api/sitecore/CustomMedia/OfficialReport?meetingId=13846 [accessed 27 September 2022]

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[8] The Scottish Parliament. (2013, September 18). Official Report of the Finance Committee. Retrieved from https://www.parliament.scot/chamber-and-committees/official-report/search-what-was-said-in-parliament/FI-18-09-2013?meeting=8505&iob=92746 [accessed 27 September 2022]

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[10] Scottish Government. (2021, August 31) Early learning and childcare providers - local authority funding and support: overview. Retrieved from https://www.gov.scot/publications/overview-local-

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[11] Scottish Government. (2021, August 31) Financial sustainability health check of the childcare sector in Scotland. Retrieved from https://www.gov.scot/publications/financial-sustainability-health-check-childcare-sector-scotland/ [accessed 27 September 2022]

[12] Audit Scotland. (2020, March 3). Early learning and childcare: follow-up. Retrieved from https://www.audit-scotland.gov.uk/publications/early-learning-and-childcare-follow-up [accessed 27 September 2022]