



**OFFICIAL REPORT**  
AITHISG OIFIGEIL

# Local Government and Communities Committee

**Wednesday 12 December 2018**

**Session 5**



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**Wednesday 12 December 2018**

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**LOCAL GOVERNMENT AND COMMUNITIES COMMITTEE**

**35<sup>th</sup> Meeting 2018, Session 5**

**CONVENER**

\*James Dornan (Glasgow Cathcart) (SNP)

**DEPUTY CONVENER**

\*Alex Rowley (Mid Scotland and Fife) (Lab)

**COMMITTEE MEMBERS**

\*Annabelle Ewing (Cowdenbeath) (SNP)

\*Kenneth Gibson (Cunninghame North) (SNP)

\*Graham Simpson (Central Scotland) (Con)

\*Alexander Stewart (Mid Scotland and Fife) (Con)

\*Andy Wightman (Lothian) (Green)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Brian Howarth (Audit Scotland)

Ashleigh Madjitey (Audit Scotland)

Fraser McKinlay (Accounts Commission)

Dr Graham Sharp (Accounts Commission)

**CLERK TO THE COMMITTEE**

Peter McGrath

**LOCATION**

The James Clerk Maxwell Room (CR4)



## Scottish Parliament

### Local Government and Communities Committee

Wednesday 12 December 2018

*[The Convener opened the meeting at 09:45]*

#### Decision on Taking Business in Private

**The Convener (James Dornan):** Good morning, and welcome to the Local Government and Communities Committee's 35th meeting in 2018. I remind everyone to turn off their mobile phones. As meeting papers are provided in digital format, members may use tablets during the meeting.

The committee is invited to decide whether to take in private item 3, which is consideration of the evidence that will be heard today in relation to the committee's budget scrutiny for 2019-20, and item 4, which is the committee's work programme. Do members agree to do so?

**Members** *indicated agreement.*

## Budget Scrutiny 2019-20

09:45

**The Convener:** The committee will take evidence on the Accounts Commission's recently published report, "Local government in Scotland: Financial overview 2017/18", to aid our consideration of the Scottish Government's budget for 2019-20. I welcome from the Accounts Commission Graham Sharp, who is its chair, and Fraser McKinlay, who is controller of audit; and, from Audit Scotland, Brian Howarth, who is audit director, and Ashleigh Madjitey, who is a senior auditor. I invite Graham Sharp to make a brief opening statement.

**Dr Graham Sharp (Accounts Commission):** Thank you, convener. On behalf of the Accounts Commission, I welcome the opportunity to discuss our 2017-18 local government financial overview report. Our findings are similar to those of last year. Scotland's councils have continued to manage their budgets well while facing an increasingly complex range of challenges and continuing pressure on finances.

In 2017-18, revenue funding to councils reduced by 2.3 per cent in real terms and 0.6 per cent in cash terms. However, that reduction was largely offset by increases in council tax and in fees and charges. Councils used savings and reserves to manage budgeted funding gaps of £0.5 billion, or 4 per cent of net expenditure.

The impact across services has varied, and increased spending in education and social work has been balanced by reductions in other services. Councils are having to make hard choices about services. The position varies from council to council, but overall it is clear that there is a continuing need to make major changes to how services are provided.

Last year, we highlighted the risks for councils that were planning to use significant amounts of their reserves to manage funding gaps. I am pleased that this year, although overall reserves have continued to reduce, no council is planning to use its reserves at a level that risks its financial sustainability in the next two to three years.

Scottish Government revenue funding for 2018-19 has increased by 0.2 per cent in real terms, and councils expect to manage smaller funding gaps of £0.3 billion over that period. However, "Scotland's Fiscal Outlook: The Scottish Government's Five Year Financial Strategy", which was published in May 2018, identifies greater future uncertainty and indicates likely further reductions in funding.

Another significant challenge for councils concerns the financial issues that are associated with integration joint boards. Our report notes that, while funding to the IJBs increased by 3 per cent in 2017-18, which included additional funding from the national health service, the majority of IJBs have underlying financial sustainability issues. Without year-end support from both the NHS and council partners, 20 of the 30 IJBs would have reported deficits. Last month, we published a report entitled "Health and social care integration: Update on progress", which highlights areas for improvement that include financial management and financial planning.

My colleagues and I are happy to answer questions.

**The Convener:** Thank you. You mentioned the changing profile of local government revenue funding and the increased income from local taxation, fees and charges in the context of the decreasing settlement from the Scottish Government. We hear regularly that local government is under pressure. I accept that, as I accept that the Scottish Government and other areas are under pressure, too. However, in your report, you say that there is no difference and that the net result is basically a flat line. What does the changing profile mean? Does it mean that less money in total is going into local government, or that it is just less easy to see?

**Graham Sharp:** It is true to say that there is continuing and increasing pressure on finances as the funding from the main funder—the Scottish Government—reduces. That funding, which includes non-domestic rates and direct funding, currently stands at approximately 55 per cent. Any organisation that is faced with such a gap will, among other things, look at options to replace the funding. The options for councils include local taxation, fees and charges and commercial activities, which—as we have reported to the committee in the past—are less prevalent in Scotland than they are in some parts of England. In 2017-18, funding is a flat line, but the balance of how it is made up has altered.

**The Convener:** Given your comment about councils charging for services, is there more scope to close the gap further or even to ensure that more money is available to go into local authorities?

**Graham Sharp:** There is scope for councils to take advantage of the different options that are theoretically open to them. Those are policy decisions for local councils, depending on their particular circumstances. Looking ahead to 2018-19, we see that every council is going for the maximum council tax increase and looking at other ways to raise funds. It is clear that charging will continue to be an option, but we will have to wait

to see the extent to which that will provide additional funding. My colleagues may have a view on that.

**Fraser McKinlay (Accounts Commission):** There is real variation across councils in the services that they charge for and how much they charge, and we give some examples of those on page 15 of our report. Some of those decisions will have a direct impact on the people who need to use those services. Members will see that, throughout the report, in the right-hand column, we have put questions for councillors that are designed to ensure that they ask the right questions when it comes to budget time and when decisions on fees and charges are being made. We need to be sure, and councillors need to satisfy themselves, that they are making those decisions with a full understanding of what the impact on their communities will be.

**The Convener:** It seems that there is a recognition that the differential is down to local authorities—it is nothing to do with Government. The Government has given councils the right and the ability to make charges as they feel appropriate, and the councils have to get that information out to their residents.

**Fraser McKinlay:** Yes, and I would say that that area is still relatively small in the context of overall local government funding. Although some of the increases—for example, those that we highlight at paragraph 26—are significant, they add up to a very small amount in the grand scheme of things.

As members will know, there continues to be a lot of debate about how local government is financed and the extent to which it is financed locally through a range of local taxes or continues to rely on the central Government grant.

**Graham Sharp:** There is quite wide variation in the services that individual councils charge for and the level of fees that they charge. Over time, the picture may begin to flatten out, although that is just speculation.

**Graham Simpson (Central Scotland) (Con):** Fraser McKinlay referred to paragraph 26 of the report. It mentions an analysis of "16 types of charges", which councils are presumably putting up. I was struck by the first two: "purchase of grave (lair)" and "adult burial". Is there any evidence that councils are putting up charges for things that they might see as easy hits, which may be less likely to be controversial?

**Graham Sharp:** When councils consider what to do, they look at a number of different factors, one of which will—and ought to—be the impact on the public. They will also look at what other councils have charged for and how they compare.

As I mentioned in answer to the previous question, we do not start with a level playing field. Some councils could significantly increase charges in order to simply bring them up to the level that other councils have set, or they could introduce charges that other councils already have in place. As I said, there might be a flattening out as councils see what other services are being charged for and bring their own charges into line. That is one factor. Fraser McKinlay may want to add something.

**Fraser McKinlay:** Members will know better than we do, from their own communities, that some charges can be controversial. In East Lothian, where I live, car parking charges at beaches became a big local issue. As the chair said, those are exactly the types of judgments that local politicians need to make—and they are needing to make them more often, for sure.

**Alex Rowley (Mid Scotland and Fife) (Lab):** Is there evidence that the benchmarking tools, which were developed with the Convention of Scottish Local Authorities and others, are being used in looking at budgets and at what different local authorities are doing in order to achieve best practice?

**Graham Sharp:** The local government benchmarking framework is used by all councils, and their position is published as a matter of course—we require them to do that.

I was making a different point about charging for services. That is not necessarily picked up in individual benchmark tests, but individual councils will go through such an exercise in considering their own fees. They will look at what other councils are doing, so there will be a sort of bespoke benchmarking, if you like. Does Brian Howarth want to say something about that?

**Brian Howarth (Audit Scotland):** I could probably add something on both points. On fees and charges, if I cast my mind back to our evidence session with the committee last year, the point was made that the data in the Scottish Parliament information centre report, “Local Government Finance: Fees and Charges 2011-12 to 2015-16”, showed that fees and charges were

“a bit of a rollercoaster”.—[*Official Report, Local Government and Communities Committee*, 29 November 2017; c 33.]

In the report that we present to you this year, we have attempted to provide more insight into the data on fees and charges; indeed, we would like to increase the work that we do in that respect. We picked a selection of fees and charges across a range of services that show the most marked changes. As we go forward, it will be more useful for us to give you a more complete picture of the

range of areas that we ask about and the increases in charges.

On benchmarking, we will issue a report in March about performance that will be based significantly on Improvement Service data. It will build on the analysis that we are currently able to bring to you about benchmarking of performance and related costs.

**The Convener:** I would like to move on. Your report states:

“Overall increases in spending in education and social work were offset by reductions in other services.”

Have you seen evidence to suggest that that is significant? Have you given local authorities any advice or guidance on how they could look at that?

**Graham Sharp:** Education and social work together make up roughly between 70 and 75 per cent of expenditure. If there is no reduction in spending in those areas—or indeed, if there is an increase—it is clear that there will be a gearing effect on any global reduction for the remaining services. The figures that we quote in the report are taken from the Scottish Government’s five-year forward look and the analysis around that. The projected middle scenario is a 9 per cent reduction over five years in non-protected services, which would affect local government, so we would see that sort of gearing.

It is down to councils to set their own priorities. Clearly, there is a mix of services. There are front-line services that the public see, which relate to areas such as waste collection and the condition of roads. There are also services that the public do not necessarily see, such as those to do with planning, regulation and inspection, which nevertheless affect quality of life in the longer term. It is for councils to balance their priorities. If they have protected areas, they have to manage the balance according to local conditions.

**The Convener:** Once again, local authorities have to make such decisions on their own, which involves making a judgment call.

I believe that Andy Wightman has a couple of questions.

10:00

**Andy Wightman (Lothian) (Green):** I have more than a couple, convener.

Key message 3 in part 1 of the report refers to the need for more transparency

“to ensure clarity about how funding distribution”

works. I take it that that refers to exhibit 4 and paragraphs 18 to 20. The committee has previously discussed the transparency of budget figures; we will wait and see how transparent they

are in this year's budget. Perhaps you can clarify one point. Paragraph 18 states:

"The basis of the calculations ... are not publicly available".

I presume that, as the calculations exist in fact, they could be made available through freedom of information, but you note that they are not published as such.

Will you also comment on the significance of exhibit 4, which shows an interesting bit of analysis that you have done? Paragraph 15 states:

"the total amount of GAE has remained at £7.9 billion".

I thought that grant-aided expenditure changed all the time—perhaps you can clarify that point as well.

**Graham Sharp:** I will ask Ashleigh Madjitey to provide more detail on that, but I will deal with the second part of your question first. The basis of the calculations—the proportions that are used for each element—will be frozen; it is not looked at anew each year. The amount is not frozen; it continues to increase each year. The SPICe report, "Local Government finance: the Funding Formula and local taxation income" commented that

"the share of total revenue funding that is distributed on the basis of relative need has decreased over time",

precisely because the formula has not been renewed for 10 years.

Exhibit 4 illustrates that, although we can demonstrate a strong correlation between population and allocation of expenditure by councils, we are unable to show such a strong relationship in the case of deprivation, for which the correlation is medium to weak. That raises the question for the bodies that decide on the funding formula—COSLA and the Scottish Government—whether they are satisfied with the current arrangement. That is the question that we are raising. Ashley Madjitey might be able to provide a little more background about GAE.

**Ashleigh Madjitey (Audit Scotland):** GAE makes up part of what is called the "Updated Service Provision", which is column 1 in the local government finance circular. That amount has stayed exactly the same since it was put in place in 2008. It is made up of the 89 indicators that we mention in the report. Those are public—they are in the Treasury's "The Green Book: Central Government Guidance on Appraisal and Evaluation" so you can look at them and see how it all works.

The £3.7 billion that we mention at paragraph 18 is the bit that changes every year. It is made up of historically ring-fenced grants, new policy

commitments and additional funding. Those are the bits that we say are not transparent. Some are based on the weightings that are already in the GAE, and some are individual methodologies that are decided by the policy team and the settlement and distribution group that we mention at paragraph 20. We say that those bits are less transparent, as we have not had sight of them.

**Andy Wightman:** That is helpful. We should know all this stuff, but I find that I still have trouble with the funding formula. Paragraph 15 states:

"Since 2008/09, the total amount of GAE has remained at £7.9 billion".

That is an accurate statement, is it not?

**Ashleigh Madjitey:** Yes.

**Andy Wightman:** That marries up with Graham Sharp's comment that, because the £7.9 billion has been frozen, the amount that is subject to needs-based distribution has become less as a proportion of the total.

**Graham Sharp:** Yes—I think that that is the point.

**Andy Wightman:** Great. Thank you.

Exhibit 2 shows that, in 2017-18, revenue grant funding fell by 1 per cent and non-domestic rates funding, which is a smaller amount, fell by 5.3 per cent, which resulted in an overall fall of 2.3 per cent. Exhibit 1 shows the 55 per cent that you refer to as "total revenue funding". Have you always presented NDR as part of Government funding? It is local government's own tax, although the revenue is pooled and redistributed.

**Graham Sharp:** Colleagues will have to help me on the history. I believe that the reason why we do that is the offset. What is guaranteed in the budget is A plus B, not A or B, with A as the Government grant and B as the NDR.

**Fraser McKinlay:** The short answer is that we have always presented it like that, for exactly the reason that the chair has just described. If non-domestic rates income in a council area is less than anticipated, it is made up through the revenue grant, so we think that it must be looked at in the round. It is important to separate the two things out, but we think that it is reasonable to present them as a whole.

**Andy Wightman:** Just to be clear, is the non-domestic rate subject to the grant-aided expenditure calculations, or the part that is part of the £7.9 billion?

**Ashleigh Madjitey:** That is where it gets quite complicated.

**Andy Wightman:** Perhaps you can write me a letter about it, as we do not have the whole morning.



**The Convener:** Please do so.

**Fraser McKinlay:** We would be happy to do that—it might be easier.

**Andy Wightman:** Maybe we could have a seminar.

**Graham Sharp:** We tried to simplify what we presented on the formula this year, because otherwise that element can take over the report.

**Andy Wightman:** In the report, you comment that some councils complained that they set their budget and then two days later they got the final settlement. Has that changed substantially over the years of devolution? We have always been following the autumn statement and crashing into local government's budget process.

**Graham Sharp:** I think that it was mainly to do with the adjustment. Fraser McKinlay may want to comment on that.

**Fraser McKinlay:** As members will know better than we do, the timing is always such that the two processes are pretty close. We will get the high-level budget this afternoon, and there is then a process going through to early spring, when the final position is known. Councils are certainly used to making those kinds of adjustments at relatively late stages. The main difference this year—if this is the adjustment to which the chair referred—was the £35 million that we mention in exhibit 2, which came very late in the day. It was a relatively small amount of money, but it still made a difference for some individual councils.

The general budget cycle is unchanged. However, councils are now much better at medium-term and long-term financial planning, which means that, in a sense, the budget cycle does not really stop. Looking back five years, the budget process happened between now and February, and councils had to set a budget. Increasingly, the process is on-going. From that perspective, there is less of an issue: councils are much better prepared, and they engage in scenario planning and modelling to make changes when budget adjustments arrive in January or February. They are now better placed to deal with those changes than they would have been in the past.

**Brian Howarth:** In the two years that the report mentions—2017-18 and 2018-19—the lateness of the budget proposals was an issue that many councils raised with us. I cannot say whether that was the case in previous years, but the reduction in available resources probably makes the decision-making process a bit more tortuous for councils within a shorter timescale. That is perhaps what has felt different in the past couple of years.

**Andy Wightman:** At paragraph 36, you introduce us to Northamptonshire County Council. Why are you talking about an English council? It is an example of a council that is having to use almost all of its general funding and reserves. Is that the only reason why you mention it? Where does Scottish local government stand financially in comparison with English local government?

**Graham Sharp:** We used Northamptonshire as an example partly to illustrate some of the differences. For a number of reasons, it is not straightforward to compare Scottish local authorities with English local authorities. The structure is different, as there are three tiers of local government in England, whereas there are 32 unitary local authorities in Scotland; they do different things; and the funding is different. In Scotland, as we have just discussed, 55 per cent of funding comes from central Government, whereas for Northamptonshire, it is 17 per cent. Half of Northamptonshire's funding comes from fees and charges, whereas the equivalent proportion in Scotland is 25 per cent overall. The funding structure is quite different—if we compare an X per cent reduction in central Government funding in Scotland to a Y per cent reduction in England, we are not comparing apples to apples, because the significance of the various funding streams will be different.

**Kenneth Gibson (Cunninghame North) (SNP):** There are significant differences in funding streams, but it is clear, as was reported just last week, that there has been a 60 per cent reduction in United Kingdom Government funding to local authorities in England. Fifty per cent of local authorities in England now receive zero grant funding, which is why areas such as Northamptonshire and even Surrey are in crisis.

I want to examine the issue that Graham Sharp touched on in his opening statement. He said that there are

“major changes in the way in which services are provided.”

Paragraph 21 of the report says that only 13 per cent of income—£2.3 billion—was generated through council tax, while 25 per cent, or £4.3 billion, comes from fees, charges and grants credited. What kind of innovative and imaginative solutions are we seeing in Scotland or south of the border to help local authorities to improve their funding? As that paragraph shows, there was an increase of £320 million in income from those sources during that year. What are local authorities doing now that is more innovative and imaginative, and how can they learn from the situation south of the border?

**Graham Sharp:** There is a whole set of things in the service side that they can do; that is where we talk about transformation, choices and

priorities. We will look at that further in our spring report, which will focus on the challenges on the service side. The current report is more about the financing side.

As we have discussed, the structure of financing is rather different in England. One clear difference, to which we have referred previously at the committee, is the degree of commercial income in England. Some councils in England have significant commercial income, which tends not to be the case in Scotland, although it will be one of the options that councils look at. Whether there is scope to engage in that activity to the same degree as in some parts of England is an open question. I invite colleagues to give any specific examples.

**Brian Howarth:** It all depends on the risk appetite of individual councils. One of the possible issues with commercialisation is that it increases risk exposure, and we see that happening to an extent. One example that is not covered in the report concerns the Scottish pension funds that are moving into investment in infrastructure schemes. We are seeing commercialisation happening around the edges. As far as I am aware, the one council that is doing the most in that area is Aberdeen City Council, through its Marischal Square investments. As we say in the report, the council is taking on additional borrowing in the expectation that it will produce investment returns over time. In future, with the benefit of hindsight, we will see what success it has. If a council seeks commercial returns as a major part of its budget process, that increases its risk exposure.

**Kenneth Gibson:** The figures seem to show that Aberdeen City Council has the second-highest debt ratio of any local authority. I am the MSP for a constituency in North Ayrshire. Last year, the local authority voted by 17 votes to 16 to reject a commercial proposal that would have meant the purchase, at a cost of some £55 million, of a 47-year-old retail centre, with an additional cost of £17 million to refurbish it. We have seen what has happened to retail in the past year, so one wonders how sensible some such ideas are.

Have there been any particularly successful solutions—or ideas, at least—that could be implemented? Graham Sharp talked about choices and priorities, but surely a lot of local government is not about choices—councils must provide social work services, education and so on. I suggest that, over the years, the room for manoeuvre in local authorities has been diminishing, and statutory provision is using a higher proportion of spending. What kinds of ideas could local government examine to try to improve its funding situation.

**Graham Sharp:** You talk about choice being limited, which is illustrated by the fact that 75 per cent of expenditure goes on social care and education. However, there are choices to be made about how the remainder is spent, which will vary across councils according to local conditions. The remainder is still important in terms of balancing budgets and the quality of services that are provided.

**Fraser McKinlay:** The whole question of statutory provision is really interesting. For a lot of council services, statutory provisions are pretty broadly drawn. A council has to provide an education service, but there are loads of different ways in which it can do that—for example, it can amend the length of the school day. It is important to reflect on two different types of innovation. One is primarily, as Graham Sharp said, about improving service delivery, which may impact on efficiency.

10:15

Some of the school-building programmes in Ayrshire and elsewhere have been genuinely transformative for local communities: the new campuses that are being built in communities across Scotland are making a huge difference. That is not just about education—the campuses are important community facilities.

Scotland is a bit behind on commercialisation—although I say that with care, because I do not think that anyone would want to see here some of the stuff that we have seen in England, where some very small councils have bought out-of-area shopping centres for purely commercial purposes. The Chartered Institute of Public Finance and Accountancy is currently consulting across the UK on a new code that will say that we do not think that that is what borrowing public money is for. There is a philosophical question about whether such things are reasonable. The situation might be different if a council were to decide to invest in and transform a shopping centre in the middle of town as part of its wider regeneration activity.

As Brian Howarth said, it is about risk appetite; he mentioned Aberdeen City Council's investment in Marischal Square. Also, it is the one council in Scotland that has gone to the markets. It issued bonds to support infrastructure and investment, including a new Aberdeen conference centre, which was a new and innovative course of action.

As Graham Sharp said, as auditors we are not interested in whether that is a good or bad decision—that is for the council to decide. What is critical is that councillors who make such decisions fully understand the associated risks and opportunities. Such financial transactions are becoming increasingly complicated, so it is doubly

important that councils really understand what they are getting themselves into.

**Kenneth Gibson:** I will follow up on that. Is there best practice in Scottish local authorities in that respect, or is there advice or information that could be shared? I have been banging on about the issue for many years. People get upset when they see local authorities spending large amounts of money on external consultants to advise them on such matters. Can knowledge and understanding of the issues be strengthened? Can local authorities share what has gone well or what has gone wrong so that other councils can become more innovative and come up with new ideas to generate additional income while reducing their risks?

**Fraser McKinlay:** The short answer is yes. We would always like to see more of that. A key element in finance, which relates to issues that we have been talking about, is the CIPFA local government directors of finance group in Scotland, which is pretty active and operates quite a good network. The Association for Public Service Excellence is a very good UK-wide network for some of the same stuff, and it has done a lot of work around commercialisation. As it happens, the APSE commercialisation board was most recently chaired by a Dumfries and Galloway councillor, so Scotland is plugged in to that. The Improvement Service also plays an important role.

The challenge is in how councils learn: it is, indeed, a challenge because of the scale. People know that there are pockets of good practice; the trick is in how a council can make those ideas work to suit the circumstances in its area in a way that will make a difference at scale. Some of the stuff currently happens only at the margins.

Education and social work are relatively well protected in financial terms, but that does not mean that they should be free from change and transformation. There is a bit of a concern because there are ways of delivering those important services differently, so we need to be careful that we do not get sucked into a conversation in which people are saying that those services need to be left alone, and we can look only at the other stuff. Instinctively, I think that that approach cannot cut it.

**Brian Howarth:** That takes us back to fees and charges. A year ago, 24 councils engaged in a benchmarking exercise on fees and charges, which shows that such work goes on.

**Kenneth Gibson:** People do not want fees and charges to increase above the rate of inflation year on year—they want things to be done a wee bit differently.

I will touch on one more point. I mentioned that I represent a constituency in North Ayrshire. Paragraph 67 of the report states:

“The auditor for North Ayrshire IJB highlighted concerns that ‘in the medium term, the IJB is faced with an extremely challenging financial position’.”

That is well known locally. It goes on to say:

“In line with many other IJBs, it has not achieved short-term financial balance, but it has not been deficit funded by its partners.”

Exhibit 14 shows that North Ayrshire Council is the only local authority that has negative reserves, which amount to £5.8 million.

At paragraph 70, you mention three issues with the financial management of the IJBs that have been identified. Those include:

“late agreement of budgets ... poor financial monitoring due to delays and inaccuracies during the year”

and situations in which

“projected outturns forecasts during the last quarter of 2017/18 were very different from those actually achieved.”

What are the issues with the IJB in North Ayrshire Council that make it different from all the other local authorities? In a local authority with 135,000 people, £5.8 million is a significant amount.

**Graham Sharp:** I will ask colleagues to talk about the specifics in a moment.

The report reflects the fact that we looked at North Ayrshire from two perspectives. On one hand, the auditor has looked at the IJB as an individual stand-alone entity, and rightly said that there is a deficit position, which is concerning. On the other hand, if one looks at North Ayrshire as an operating IJB, is it that different from the other 19 IJBs that are in deficit but do not show a deficit in their accounts because they received additional funding from their partners? That is the difference between the two. I do not know whether we can say why it is that way.

**Brian Howarth:** I will not be able to say why, with regard to the detail. Kenneth Gibson made the link between exhibit 14 and the points that are made at paragraph 70, which is a good link for us to pick up.

As Graham Sharp said, in common with many other IJBs, the North Ayrshire IJB is overspending in-year. The main point of difference is that the other IJBs' positions are squared off in-year, whereas in North Ayrshire the hosts or partner bodies have taken the view that the IJB needs to redress that deficit position itself over the coming years. The only way it can make good the deficit is by reducing the funding that it gives its partner bodies in future years. There is simply a difference between host bodies' approaches to dealing with deficit.

**Kenneth Gibson:** Would it not be better for a standard approach to be taken, so that we could see much more clearly what is happening? In exhibit 14, it looks as if North Ayrshire stands out, when in actual fact, given your explanation, that is perhaps not so much the case.

**Graham Sharp:** That is the sense that we are trying to get across in saying that there are two ways to look at the matter. The fact remains that the IJB is a legal entity—it exists in fact and that is what the accounts show, so we have to record that. We are trying to give a bit of context around that.

**Kenneth Gibson:** A bit more explanation in the report would have been quite useful, because it would have enabled the committee to see that other local IJBs are also in real difficulties with regard to their funding and service delivery.

**The Convener:** We will move on. Alex Rowley has a question.

**Alex Rowley:** I will pick up from where we left off. When I saw the position of the North Ayrshire IJB a number of weeks ago, I thought that it represented a more transparent way of reporting. When I speak to local councillors, one issue that comes up time and again is that they think that there is not a great deal of transparency around funding of IJBs. Should you be looking at that? I agree with Kenneth Gibson that the North Ayrshire IJB's method of reporting is probably the most realistic and transparent option. Should you make recommendations in that regard?

**Fraser McKinlay:** I will start on that. Yes, we are doing that. One reason why we included in the report more information on IJBs than we included in previous reports was to respond to exactly that challenge. A lot of people—not only us, but Alex Rowley's colleagues on the Health and Sport Committee, among others—have said that there is a real lack of transparency around how IJB finances work. That is hugely significant, because—let us not forget—IJBs are responsible for more than £8 billion of public money.

At the top of page 29, we try to demonstrate, having done some analysis, that 20 of the 30 IJBs would have reported deficits had the partner bodies not done something about it in-year. We are putting that new information in the public domain for exactly the reason that Mr Rowley has outlined. As Graham Sharp said, North Ayrshire Council presents its information in a particular way, which one can argue is more transparent.

For us, as auditors, from a selfish point of view consistency would be great because it would make our lives an awful lot easier in terms of trying to pull together our report. However, the reality is that there are 30 individual IJBs with—critically—30 different agreements and integration schemes

that determine how they manage that stuff. We will absolutely continue to bang the drum for more transparency and will try to bring that into our reports, both locally in the work that Brian Howarth and his colleagues do on the IJBs, and when we report nationally on integration.

**Graham Sharp:** Fraser McKinlay made the point that the IJBs all have different agreements. Not only is what each IJB does subject to its own local arrangement, but the funding arrangements between the NHS and the council for each IJB are subject to particular local agreements, so they vary across the country.

**Alex Rowley:** I will touch briefly on a couple of other points. We have talked about the distribution mechanisms. Aberdeen City Council, which has been mentioned, claims that it gets a really raw deal from the distribution formula. When it comes to weighting for poverty and deprivation, one might say that Glasgow gets a fairly raw deal in comparison with some areas. Is the problem partly that local authorities cannot decide among themselves to change the current arrangements, given that there would be many winners and losers depending on the mechanism that was used? COSLA is not in a position to look again at the redistribution of finances, and the Scottish Government does not have the political will to do so. However, that does not mean that we should continue to operate under a distribution system that does not take account of modern Scotland. Where does that leave us?

On the same point, the report mentions the £3.5 billion that is now coming in through separate funding. On the distribution of that funding, the report states:

“methodologies are not publicly available and should be more transparent.”

Increasingly, more money is going into local authorities through different methods. That surely cannot be allowed to continue, as it is not transparent.

**Graham Sharp:** I am not entirely clear about your question. Funding is a zero-sum game: if the amount of money that goes to one local authority is increased, the amount for other local authorities will go down, which is a challenging environment in which to make adjustments. However, that does not mean that we should not pose to the Scottish Government and COSLA the question whether they are satisfied that the existing formula meets the objectives that they have set. It would be for them to look at the formula and the effect that it has, and to decide whether they were satisfied in the circumstances; we would not have a view on that.

**Fraser McKinlay:** We absolutely recognise the challenges with distribution, which we know is not

a straightforward issue. The Accounts Commission dipped its toe in the water on the topic last year, and we are dipping in slightly deeper this year. As I said last year, our point is fairly simple—fundamentally, as Alex Rowley said, the distribution system has not changed in the past 10 years, so it seems reasonable to ask whether it is still fit for purpose, given that the world has changed so much in that time.

As Alex Rowley highlighted, and as I said when I appeared before the committee last year, the increasing need to create different mechanisms to distribute a bigger proportion of the money raises questions for us about the core funding formula. Our job is to raise those questions, and—as the chair said—it is for the Government and COSLA to consider whether to take those concerns forward and, if so, in what way.

**Alex Rowley:** I suppose—

**The Convener:** Excuse me—I do not mean to interrupt you, Alex, but I have just noticed the time. We have a lot to get through, so I want to ensure that we do not spend too much time on one issue. Not everybody needs to answer.

**Alex Rowley:** I will tighten up my question. There was a clear policy direction from the late Campbell Christie, who headed a commission that talked about preventative spend. There are also clear policy directives from the Scottish Government on the need for joined-up government. If the funding system is not being targeted to fit with those policy objectives, it is no wonder that it is not successful.

The report states:

“Local government funding has reduced at a faster rate than other areas of the Scottish public sector”.

That is a very clear statement. The Scottish Government tends to disagree with that and would argue that local government has had its fair share, and the public might end up confused as to who is saying what. Has local government maintained a fair share of Scottish public funding, or has it not?

10:30

**Graham Sharp:** We are reporting on the numbers, which are quite clear, and our figures are consistent with the SPICe figures. We reported that, over the four-year period, local government funding reduced in real terms by 6.92 per cent in comparison with a reduction of 1.65 per cent in Scottish Government funding in general. With regard to making judgments about what is fair, that comes down to policy, which is not our area.

**Alex Rowley:** That is clear, convener.

**The Convener:** For clarity, does that figure include the money that councils raise from extra

sources, or does it represent simply the Government’s funding of local authorities?

**Graham Sharp:** Sorry?

**The Convener:** You say that funding for local authorities has reduced at a faster rate. Is that the funding from central Government?

**Graham Sharp:** Yes.

**The Convener:** So it does not include the money that local authorities can raise in ways that the health service, for example, cannot.

**Graham Sharp:** No, it does not—it is the funding from Government.

**The Convener:** Thank you—I just wanted clarity on that.

**Graham Simpson:** I will be very quick with my questions, as we have already covered some of the issues to do with IJBs that I was going to ask about. You mentioned transparency. As a committee, we have covered that issue previously. Every year when we look at the budget, the subject of IJBs comes up and it all gets a bit murky. It is hard to figure out how much money is actually going to local government when we also have IJBs in the mix. Every year, we say the same thing: we need more clarity. Essentially, you are saying that as well. What needs to be done?

**Graham Sharp:** That takes us back to the report on health and social care integration that we produced last month, in which we set out a range of things that need to be done. Critically, we need to address not just the money that goes to IJBs but the need for financial planning. That would enable IJBs to draw up medium-term financial plans to provide clarity and to support transformation programmes for which security of finance is required if they are to be carried out.

**Fraser McKinlay:** Medium-term and long-term financial planning for IJBs is one area that needs to be looked at. In the past couple of years, we have tried to bring some clarity to the process. In exhibit 2, we try to separate the different bits of funding. As has been said, a big point of contention over the years has concerned what we categorise in the report as “Health & social care funding via NHS”. The reason why we have not included that as core local government funding is that, in technical terms, it goes into the health budget and is then transferred to integration authorities.

In the past, the Government has said that that is, therefore, money that goes to local government. However, I am not sure that that is entirely clear, because what an IJB spends that money on may or may not be defined as local government services—for example, it could be spent on a community mental health nurse. That is

why we think that it is legitimate to recognise that £357 million, which is a significant amount, and to show it as a separate line. That is about as transparent as we can get on that front; it is for other people to decide whether or not that money is part of local government spend.

As I said earlier, we will continue to bang the drum for increasing transparency with regard to the settlement and how it is arrived at and—as the chair said—how the IJB funding is managed.

**Brian Howarth:** On the £357 million, the key thing is that it is not counted in two places—in the NHS and local government. That is why we treat it as counting in one place in our reports.

Exhibit 13 is our attempt—like it or not—to identify the flows in funding that go in and out of the IJBs. It is quite a hard position to present, but we have tried to make it as simple as possible. Nonetheless, we can try to do more, as we move forward, in presenting the flows of funds between the host bodies—the NHS and local government—and the IJBs, as well as the funding that is given back to the NHS and councils to provide services.

**Graham Simpson:** I will move on from IJBs to talk about reserves, which are covered in a section of the report. There is wide variation in what councils are doing and the amount of reserves that they have. Exhibit 7 is headed, “Usable reserves as a percentage of council annual revenue”. The island authorities—Orkney Islands Council and Shetland Islands Council—seem to do very well. On the mainland, Renfrewshire Council has a high level of reserves, and the chart runs all the way down to Aberdeenshire, which does not have as high a level. Is that wide variation an issue?

**Graham Sharp:** It is clear that there is variation. We look at each council in its own context, given that councils approach the provision of reserves on different bases. What matters to us is that the basis on which each council calculates its reserves is consistent with its financial planning. We want to know that that has been thought through rather than it being done by rule of thumb or using a number that just happened to drop out at the end of the calculation.

There is a logic behind the level of reserves that are held, and different councils approach the calculation in different ways. The financial sustainability of that is judged each year by an auditor who looks at reserves, debt and financial planning. As we produce our best-value reports on councils, we see in more detail the different approaches that they take. In general, it is an area—along with the medium-term financial planning approach that we have emphasised over the past couple of years—in which councils are improving significantly.

**Brian Howarth:** Exhibit 7 gives a flavour of that. It comes down to different treasury approaches within councils. At one end, mainland councils—for example, Renfrewshire Council—will put money away in capital funds to spend over a number of years in the future. In contrast, a council such as North Lanarkshire Council will take capital expenditure out of its in-year revenue reserves each year, or it may resort to borrowing if it has quite a bit of borrowing headroom. There are very different approaches, and exhibit 7 is intended to highlight the very different positions of councils when it comes to reserves.

Across the audits—this builds on the point that we make about Northamptonshire County Council—we take a consistent interest in the councils that are planning to use up their free general fund reserves over a period of time. In last year’s report, we highlighted a few cases in which it looked as though councils might run through their free general reserves within three years. In 2018-19, councils are not planning to use reserves to the same extent. We no longer have concerns about the three councils that we highlighted in our previous report, because it does not look as though their reserves will run out within three years. We will continue to monitor that key aspect, given the example of Northamptonshire that we used in the report. We are very keen on looking at the reserves position, but the picture is complicated because councils take very different approaches in how they build up and use reserves.

**Graham Simpson:** Reserves are very much linked to debt, for which the picture is similar. Net borrowing varies from 45 per cent of revenue in Shetland to 203 per cent in West Dunbartonshire Council, which is a huge difference. I do not know whether or not that is an issue. The report states:

“some councils would need to borrow further over the longer term to provide the cash to spend on commitments identified in their reserves”,

which

“would increase ... debt”.

It goes on to make the point, which you made earlier, that councillors need to be “aware” of what they are doing and the decisions that they are taking. Having been a councillor, I sometimes wonder whether councillors are informed in that way or have the level of understanding that they should have on such complicated issues.

**Graham Sharp:** I will answer the question about general debt and then ask Brian Howarth to talk about the point about internal borrowing that you raised.

As I said in my answer to the previous question, reserves, debt and financial planning are all part of the same issue. The whole thing has to make

sense as a whole. As you have highlighted, West Dunbartonshire Council has the highest level of debt. However, a best-value report on West Dunbartonshire that we brought out a few months ago was actually very good. When auditors looked at that particular council, its debt in the context of what it was doing with the borrowing made sense, and the overall judgment was good.

The position is even more varied than the numbers show, because councils have different types of debt, such as fixed-rate and floating-rate debt. We were talking earlier about Aberdeen City Council, which has index-linked debt—that has a very different risk profile from other, more conventional forms of debt. We need to look at each council on its own in that respect, and take a picture in the round of the asset and liability sides and see whether it all makes sense.

On the internal borrowing side—

**The Convener:** I must ask you to keep your answers brief, please.

**Brian Howarth:** Graham Simpson is right to mention reserves and debt. The missing bit in the middle is the cash and the investments that support those reserves. In exhibit 9 of the report, we attempt to show that many councils have used cash and investments and would therefore have to borrow further in order to support their reserves position. There is an issue in that respect with underlying debt, rather than the debt that currently sits on the balance sheet.

It is important for us to take a development approach. In this report, we are introducing some ideas for the first time. In future years, I would like to explore further the affordability and the extent of commitments such as debt and the servicing of that debt. I also want to explore issues such as the commitment to meet past decisions on early retirement, which is highlighted in exhibit 12. We want to develop that approach further in future reports.

On the point about council members' understanding, I do not underestimate the value of the overview report in informing members and practitioners; it is quite a powerful tool. I have been an auditor in local government for 25 years, and I know that the things that are said in the report have a real impact. A number of years ago, the commission talked about the need for councils to develop medium-term and long-term planning, and we can see from the current report that 30 councils now have medium-term financial plans in place. The reports have an impact, and the affordability of commitments is an area that we will take forward and develop further.

**The Convener:** Thank you—

**Graham Simpson:** I will just make one more point, convener. It is not a question—I know that other members have questions. When councillors have to make such important decisions, they are advised by officers. It might be a good idea if councillors had some kind of independent voice to advise them on what the impact of certain decisions might be.

**The Convener:** Okay—thank you. Alexander Stewart can go next.

**Alexander Stewart (Mid Scotland and Fife) (Con):** We have spent a lot of time this morning talking about medium-term financial planning, and you have identified that the majority of councils, if not all of them, now have such plans in place. However, your report notes that a significant number do not have in place the long-term planning that might be required to ensure that they capture what they are planning to do in the future. Why do those individuals choose not to engage in long-term planning? What risks are they putting on themselves and the council by not doing so?

**Graham Sharp:** As Fraser McKinlay mentioned a few questions ago, it was not that many years ago that many councils operated year by year. We started by emphasising the importance of medium-term financial planning, and now nearly every council is doing that. About half of councils do some sort of long-term planning, and around a third engage in long-term scenario planning. We are continuing to raise the bar by trying to ensure that long-term planning happens across the board. The direction of travel on medium-term planning has been very positive, and I hope that, in a year or two, we will succeed in getting more councils to produce long-term plans.

**Alexander Stewart:** You said that, last year, you identified three councils that were in a very difficult situation with planning and process, and you were concerned about what would happen to them if they continued in that way.

**Graham Sharp:** Yes.

10:45

**Alexander Stewart:** You also said that you now believe that the situation has changed. One of the three councils that were facing difficulties was Clackmannanshire Council, which falls within the region that I represent. What has Clackmannanshire, along with the other two councils, done that gives you confidence that things have changed?

**Graham Sharp:** The concerns that the previous report identified were based on the councils' plans. It was clear simply from doing the arithmetic that they would use up all their reserves in two or three years. That is no longer the case, as the councils

have addressed the issue. Obviously, we are still looking at their plans; as you will know, we have had specific concerns about Clackmannanshire, and we have asked Fraser McKinlay, as controller of audit, to come back to the commission in a few months with a report so that we can see how the council has been addressing those concerns. There were more issues involved than simply the arithmetic in relation to the reserves.

**Brian Howarth:** We cover the main element that has changed from 2017-18 to 2018-19 in paragraph 30. A number of councils felt unable to agree significant changes to budgets with the changes in administration around local government elections, so in 2017-18 we saw a blip in which councils resorted more to using reserves. We see early signs in the 2018-19 budget proposals that councils are dipping less into reserves. We will monitor that position to see what happens through to 2019-20.

**Alexander Stewart:** Many of the councils that were previously in a complex financial management situation are now experiencing some stability. It has become apparent that, by addressing the issues and engaging in transformation, and by looking at what other councils are doing, they have taken the opportunity to develop and progress.

**Graham Sharp:** Yes. They have taken on board the idea that they need to have plans other than using their reserves. Of course, half the risk lies in implementing the plans, so that remains an issue. However, we will monitor the situation as we go forward.

**Annabelle Ewing (Cowdenbeath) (SNP):** Good morning. I want to raise an issue that I assume you are aware of, which concerns equal pay and pensions. It was drawn to the committee's attention by our colleague Linda Fabiani, who is the MSP for East Kilbride. She wrote to the Equalities and Human Rights Committee, which has in turn corresponded with us and with the Public Audit and Post-legislative Scrutiny Committee on the matter. The issue concerns back pay that is due under equal pay claims. In some cases, it is being paid by way of a pay mechanism, whereas in others it is being paid by way of compensation.

For someone who is on a large salary, being paid by way of compensation might be more attractive because of the tax implications, but for someone who is not, it is not so attractive and would diminish their pension entitlement. Further to investigations that have been undertaken, it seems that no public body takes any responsibility for enforcement of the relevant legislation, which I understand to be the Local Government Pension Scheme (Scotland) Regulations 2014. I also understand that, on 12 October 2016, the Scottish

Public Pensions Agency issued a circular to address some of the issues that the 2014 regulations raised and to

“clarify the policy intent that a payment of arrears of pay, made in respect of an equal-pay claim, should be treated as pensionable”.

That is not happening in many of the local authorities that are involved in such claims. Can you clarify whether you are aware of that issue? Secondly, within the scope of your relevant remits, what can be done to ensure that the legislation is complied with?

**Graham Sharp:** I will make some general contextual comments and then Fraser McKinlay can comment in more detail. Last year, as you know, we produced a report entitled, “Equal pay in Scottish councils”. It was a challenging report to write, for a number of reasons. We noted, for example, that data was very difficult to obtain. In addition, because of the nature of the framework and the fact that it is subject to litigation, we were looking at a moving target, as there were cases in train that would affect the position. There was very little that we could say definitively at that time.

From an audit perspective, we are very interested in the progress of individual councils in implementing equal pay and the impact that that has on their financial position, and we need to ensure that agreements are properly accounted for. However, we are not involved in the negotiation between parties or in the regulations that is issued by the SPPA. We do not have any enforcement role in that regard. That is the general background; Fraser McKinlay can say more about the detail.

**Fraser McKinlay:** There was a very good article in *The Herald* that started it all—

**Annabelle Ewing:** It was in the *Sunday Herald*.

**Fraser McKinlay:** The *Sunday Herald*—I am sorry. The correspondence was sent to us via the Public Audit and Post-legislative Scrutiny Committee, as you mentioned. We are aware of the issue, and we have written back to Linda Fabiani—and copied in the conveners of this committee and the Public Audit and Post-legislative Scrutiny Committee—to say that we absolutely recognise the issue and that, with the benefit of hindsight, we should have mentioned it in our national report. I am not sure that we would have been able to say much more at that point, because it was right in the middle of genuine uncertainty around the application of the 2014 regulations. As you said, the SPPA sent out a circular—in fact, it sent out two—in order to clarify matters, and we were right in the middle of all that. That said, it would have been helpful if our report had reflected the issue.



There are two main things that we can now do as part of our role. The first concerns the guidance that we put out every year for all our auditors. Our past guidance mentioned the issue and referred to section 20—as it is technically known—of the 2014 regulations, but we will emphasise it more this year. In particular, we will seek to ensure that auditors fully understand and look at the difference between what is classed as arrears of payment and what is classed as compensation, because that is the key differential. Secondly, we routinely follow up all our national reports with an impact report, and we will build the issue into the next impact report, which will be published later in 2019.

Colleagues have raised an important point about whose job it is to enforce the legislation, because that is not clear. As the chair mentioned, part of the difficulty is that, even though the guidance is now clear that back pay and arrears will be pensionable and compensation will not, that is still subject to negotiation locally. The terms that are agreed locally will decide whether there is compensation or back pay. There is not a simple thing that says that one is wrong and one is right. There is still a negotiation process between staff members and their representatives and the councils concerned. We want a better understanding of the picture—that is a fair challenge for us. The *Sunday Herald* has started the job, and we will put out more guidance for our auditors next year.

**Annabelle Ewing:** Thank you for that. I am heartened to hear that you are taking the matter very seriously and that further information will be forthcoming. The individuals who are affected are losing out twice: they have lost out on their pay and they are losing out on their pensions. We cannot simply monitor the issue by way of footnotes to reports and so forth—it has to be looked into. Has Audit Scotland been doing anything on the issue?

**Fraser McKinlay:** I am sorry: I should have said that, in a sense, I am speaking for both organisations.

**Annabelle Ewing:** Okay. I just wondered whether Audit Scotland had anything to add.

**Fraser McKinlay:** Audit Scotland carries out the work on behalf of the Accounts Commission and the Auditor General for Scotland. We will be looking at the issue—our auditors audit all public bodies on behalf of the Accounts Commission and the Auditor General, and the guidance goes out to all of them. We will raise the issue across the piece.

**Annabelle Ewing:** So we would expect to see it come up in a future Audit Scotland report.

**Fraser McKinlay:** We will follow it up as part of the impact report that will follow our report on equal pay in councils. We will ask local auditors to have a look at that specific issue as part of next year's audit work.

**Annabelle Ewing:** Thank you very much.

**The Convener:** Unfortunately, we have run out of time. I know that Andy Wightman had a couple of questions—you can ask one very brief question, Andy.

**Andy Wightman:** Thank you, convener. I seek three brief clarifications. Paragraph 18 states:

“The basis of the calculations for the separate methodologies are not publicly available”.

I want to be clear on that. Have you seen that information?

**Ashleigh Madjitey:** No, we have not.

**Andy Wightman:** I turn to my second point. Exhibit 5 shows council tax increases. It shows that Dundee, on the right-hand side of the graph, has applied a 3 per cent increase in council tax, but there is no information under the “Banding or volume changes” heading. Is that because the information is not known? Some houses must have been built in Dundee. Perhaps you can come back to me on that, as we are tight for time.

**Graham Sharp:** Yes—we will do that.

**Andy Wightman:** My final point relates to exhibit 3. Would it be possible for you to disaggregate the revenue grant data and the NDR data, so that we can see the relative impact of both?

**Brian Howarth:** It is possible to do that, but it is not really relevant. The proportion of NDR and grant changes from council to council. For example, South Lanarkshire Council collects NDR on behalf of all utility businesses, so the relative proportion that it gets in NDR as part of the pot is bigger than it gets from the other element. We have to take the two as a whole; disaggregating the data would tell us very little.

**Andy Wightman:** Okay—you do not need to bother doing that, then. Thank you.

**The Convener:** I have one final question. The report talks about the implications of transformational change programmes in councils and whether those have had a destabilising effect. It also talks about whether workforce planning is being carried out efficiently and—most importantly—with effective leadership in place. What is your view on that? How important is effective leadership?

**Graham Sharp:** Leadership is extremely important, and we continue to emphasise that. By “leadership” we mean members and council

officers. That includes all members, because all members, whether they are in administration or opposition, have a responsibility for the corporate running of the council as an organisation. That is increasingly important for councils as they come under financial pressure. We will be looking at the service end in our second overview report in the spring, and we will have a better view on the issues of transformational change. As I said, the current report focuses more on the funding side of the balance sheet.

**The Convener:** So, we can expect to get something from you later on.

**Graham Sharp:** Yes.

**The Convener:** I thank you very much for your answers to our questions and for your attendance here today.

10:56

*Meeting continued in private until 11:50.*

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