



**OFFICIAL REPORT**  
AITHISG OIFIGEIL

# Local Government and Communities Committee

**Wednesday 29 November 2017**

**Session 5**



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**LOCAL GOVERNMENT AND COMMUNITIES COMMITTEE**

**29<sup>th</sup> Meeting 2017, Session 5**

**CONVENER**

\*Bob Doris (Glasgow Maryhill and Springburn) (SNP)

**DEPUTY CONVENER**

\*Elaine Smith (Central Scotland) (Lab)

**COMMITTEE MEMBERS**

\*Kenneth Gibson (Cunninghame North) (SNP)

\*Jenny Gilruth (Mid Fife and Glenrothes) (SNP)

\*Graham Simpson (Central Scotland) (Con)

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

\*Andy Wightman (Lothian) (Green)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

David Bookbinder (Glasgow and West of Scotland Forum of Housing Associations)

Tim Bridle (Audit Scotland)

Michael Cameron (Scottish Housing Regulator)

Daren Fitzhenry (Scottish Information Commissioner)

Ronnie Hinds (Accounts Commission)

John Marr (UK Finance)

Fraser McKinlay (Accounts Commission)

Sally Thomas (Scottish Federation of Housing Associations)

George Walker (Scottish Housing Regulator)

**CLERK TO THE COMMITTEE**

Jane Williams

**LOCATION**

The David Livingstone Room (CR6)



# Scottish Parliament

## Local Government and Communities Committee

Wednesday 29 November 2017

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

### Housing (Amendment) (Scotland) Bill: Stage 1

**The Convener (Bob Doris):** Good morning. I welcome everyone to the 29th meeting in 2017 of the Local Government and Communities Committee. I remind everyone present to turn off their mobile phones. As meeting papers are provided in a digital format, tablets may be used by members during the meeting. We have received no apologies; we have a full house this morning.

We move to agenda item 1. The committee will take evidence on the Housing (Amendment) (Scotland) Bill at stage 1. I will introduce all our witnesses together. I welcome George Walker, chair, and Michael Cameron, chief executive, from the Scottish Housing Regulator; Sally Thomas, chief executive of the Scottish Federation of Housing Associations; David Bookbinder, director of the Glasgow and West of Scotland Forum of Housing Associations; Daren Fitzhenry, the Scottish Information Commissioner; and John Marr, senior policy adviser from UK Finance. Thank you all for coming.

We move straight to questions. We will ask questions in a structured way, because the bill is quite technical. That said, we always start with a very general question. Do the witnesses agree with the Scottish Government's policy intention to ensure that the Office for National Statistics can reclassify registered social landlords as private bodies? In particular, what would the implications be if RSLs were not reclassified as private bodies? Everything else works around the premise that the policy intent is correct, so we should get something on the record about that.

**David Bookbinder (Glasgow and West of Scotland Forum of Housing Associations):** There is widespread recognition—certainly within the housing association sector but I think well beyond it too—that the bill is necessary. Thankfully, the reclassification has not had an impact on the way in which housing associations run their business day to day.

As the committee will be aware, ultimately the bill is about how housing association debt is treated. It will be treated as Scottish Government

debt if the decision to reclassify RSLs is not reversed. Treating that debt as such would be bad at any time, but it is really bad at a time when there is a welcome, hugely ramped-up development programme. A number of us have whimsically wondered how and why all the bodies represented today and the Scottish Government have spent so much time dealing with the matter, when, in the past few weeks, the decision to reclassify has been reversed south of the border. You wonder about all that time and effort, but we know that the bill is absolutely necessary, purely in terms of the debt. There are issues that a number of us will want to discuss—in particular, with the regulator—about looking at a slightly different kind of regulatory regime, but there is not much doubt within the sector that the bill is necessary.

**The Convener:** What would the implications be if the bodies were not reclassified?

**David Bookbinder:** The obvious one is the impact on the development programme. We could not build 50,000 homes because so much money would have to be set aside against our associations' borrowing.

As a representative of community-based housing associations, I think that there is a real feeling among associations—certainly in our sector, but I suspect that it is shared in the sector across Scotland—that housing associations are not truly public bodies. Yes, they benefit from public money and perform a number of public functions, but they are managed by voluntary committees and boards. Although it is only a statistical reclassification, it still means something in a symbolic sense. It will feel better to be reclassified as a private body, even though being a private body does not necessarily do us justice.

**Sally Thomas (Scottish Federation of Housing Associations):** I reiterate the point that David Bookbinder has made. The SFHA is absolutely of the view that the reversal of the reclassification is necessary.

I want to make two points about that. First, it will protect the Scottish Government's interests and ambitions in the housing programme, which has, as far as I understand, cross-party support. The housing that the people of Scotland need and deserve will be protected if we reverse the reclassification.

Secondly, it will provide assurance to lenders. The lending industry is critical to the housing programme and the ability of housing associations and co-operatives to build at scale and within a timeframe that is appropriate to the needs of the population.

We also think that reversal of the reclassification will achieve a level playing field across the United Kingdom, which is important for the lending

industry and the financial profile. That will give the sector the headroom that we need alongside the lending industry to be able to fund the programme that we require to provide in the coming period.

**George Walker (Scottish Housing Regulator):** We absolutely agree that the response is appropriate, right and proper. The SHR will, of course, operate within any legislation that Parliament passes, but it seems to us that the bill is proportionate and will deal with the issues at hand.

I make it clear that the bill will not impede or change our statutory objectives and functions as a regulator. Certain elements mean that we will have to operate in different ways, but we are broadly comfortable that we can do that. Indeed, the coincidence of our doing a regulatory framework review, which we flagged up the last time that we visited the committee, is fortunate, as it means that we can take into account in that review the issues that the legislation raises. We are very comfortable with the approach that is being taken.

**John Marr (UK Finance):** I will pick up on points that Sally Thomas and George Walker have made.

As the trade body that represents commercial funders and investors in the RSL sector in Scotland, we certainly agree that it is appropriate to take the bill through the Parliament. Having looked at the proposals in detail, we see that they are broadly consistent with measures that have been taken elsewhere, and they are proportionate to the challenges that the ONS decision has set. We recognise the strength of regulation in protecting and safeguarding existing and future investment in the sector. Although the bill will make changes to regulation and how it works in Scotland, we are confident that those changes will still enable the regulator to deliver an effective regulatory function.

**Daren Fitzhenry (Scottish Information Commissioner):** I note the policy intention behind the bill, but our concern is that the committee should be mindful of potential unintended second-order effects from it, particularly in relation to freedom of information and the possibility that bodies that are currently subject to the environmental information regulations would potentially cease to be subject to them. The issue is how that is managed and how the bill addresses it. The bill would potentially create uncertainty where there is a current certain arrangement in which RSLs are subject to the environmental information regulations. Our concern is that, if that is not recognised and addressed, current rights to information would potentially be lost and, at the very least, uncertainty would be caused about whether organisations were subject to the environmental information regulations.

**The Convener:** That is helpful. A colleague wants to pursue that issue a little further, but I have a question before we move on.

The witnesses seem to accept the general policy intent of the bill. There is an obvious question to ask before we go into a bit more detail. Is there any other way in which the policy intention could have been secured? Could anything have been done other than by using the mechanism of legislative change to ensure that we conform appropriately to ONS requirements? There might not be anything, but we want to ensure that the bill is the only mechanism in town.

**Sally Thomas:** Absolutely—you have just said it. The bill is the only way to do what we need to do to get the protection, reassurance and benefits that the sector, the Government and the country need.

**The Convener:** Rather than everyone saying the same thing, are there any divergent views? I see that there are none. That is very helpful scene setting for the committee. We will move to more detailed questions.

**Andy Wightman (Lothian) (Green):** I have a question specifically for Mr Fitzhenry. You laid out in your evidence what you see as the risks to the applicability to RSLs of the Environmental Information (Scotland) Regulations 2004. It was your predecessor who made the specific ruling on the Dunbritton Housing Association, but your office made the ruling in the context of the legislation. Helpfully, you append to your submission the environmental information regulations.

It is now clear that the ONS intends to reclassify RSLs unless the bill goes through. Assuming that the bill goes through and the extent to which the regulator regulates the sector is relaxed, so that the ONS is satisfied that RSLs are no longer public bodies, are you free to interpret the environmental information regulations relating to public bodies in a different way to how the ONS interprets things, or do you feel that you cannot really deviate for two different statutory purposes?

**Daren Fitzhenry:** We certainly would not be bound by the ONS view in relation to that. However, we would be bound by the terms of our legislation and we would have to take a reasonable and rational interpretation of the regulations.

One of the key definitions that we look at is whether the body is under the control of a public body. The bill specifically addresses reducing that level of control. At the very least, the argument that there would be control will be reduced. I cannot bind myself to a decision at this stage because that decision will depend on the facts and the legislation presented to me at the time, including any subordinate legislation dealing with

local authorities. We can safely say that the current clear position will be left, at the very least, less clear, and potentially the right could be lost.

There may be other issues. There may be an argument, under a different subparagraph of the regulations, that the body would be treated as another Scottish authority, but again there is no precedent. We are creating a lack of clarity for at least a period of time. I mentioned in my written evidence that the situation could be resolved through the potential extension of a section 5 order under the Freedom of Information (Scotland) Act 2002. That would fill the gap and make RSLs subject to freedom of information legislation, including the EIRs. However, the potential issue is one of timing. Even if the extension were made, there could still be a lacuna—the time between the implementation of the bill, if enacted, and the commencement of a section 5 order.

**Andy Wightman:** That is helpful. The environmental information regulations refer to a public body under the control of a person or body, so clearly the regulations still exercise a degree of control. Presumably in practical terms, if the bill passes, you would await an application or an appeal to you relating to a failure to provide information under the EIRs, and you would take a fresh view on whether RSLs are bound by the regulations.

**Daren Fitzhenry:** That is exactly right.

**Andy Wightman:** That decision would be appealable as a matter of law, in terms of your interpretation of the EIRs, to the Court of Session. Ultimately, the Court of Session would rule on your powers to determine that question.

**Daren Fitzhenry:** Should my decision be appealed, yes. My understanding is that the Dunbritton case was never appealed further.

**Andy Wightman:** I apologise if this is in your evidence, but do you have any sense of how many freedom of information requests are made to RSLs under the EIRs, but not appealed to you?

**Daren Fitzhenry:** Unfortunately, we do not currently gather that information. It is a matter that I have looked at and discussed with my team, with a view to seeing how we can start gathering that as a particular data source.

If there is uncertainty, people may not be able to access information—for example, relating to the types and specifications of materials used in buildings, the repairs that are commissioned or health and safety and fire safety assessments. There could be an impact—and where there is uncertainty there almost certainly will be at least some impact—with some housing associations taking a different view from others.

10:00

There certainly will be some impact: the number of EIR requests across the board was in the region of 7,500 in the past year. There is also an important perceptual impact. If it was seen that the provision of information could be discarded or put at risk to provide a quick fix when things get a bit difficult and we are looking to make changes, the legislation and the message being put forward would have a very clear perceptual impact.

**David Bookbinder:** I offer the committee some reassurance on the concerns that Daren Fitzhenry has raised. I can only speculate while we await the decision on what will in effect be the extension of FOI to housing associations, but if the decision was to extend FOI on some as yet unknown date, and there was a gap between the bill coming into force and the FOI extension coming into force, we would have great faith in our members carrying on responding to requests as if RSLs were still subject to the EIRs, even if they were not under the letter of the law. Given that they are subject to the EIRs at the moment, the extension of FOI will cement and extend that thinking. If there is a small time gap, I do not think that our members will suddenly think, “Oh wow, we don’t have to answer any questions on our repair service any more.”

**Sally Thomas:** I absolutely go along with that; the SFHA takes exactly the same position. It is interesting to reflect on the fact that in the transitional or standstill period between the ONS reclassification and its reversal, which has been a year or two, there has been an agreement among all interested parties that, for our purposes, we carry on as we did before. In other words, we do not suddenly depart from our normal relationships, processes, strategies, agreements, expectations and requirements. We carry on, as previously, in a constructive and positive way until there is clarification.

**The Convener:** That is helpful.

**Daren Fitzhenry:** I very much appreciate the intent from David Bookbinder and Sally Thomas on that point. However, although they may wish to comply with the spirit of the law, ultimately if an appeal comes to me and I feel that I am bound not to hold RSLs subject to the EIRs, under the law I would be unable to grant any redress relating to a decision that the applicant had disagreed with. There is still a practical risk.

I do not know whether a possible remedy to that issue would be welcomed by the committee. An additional provision could be considered, whereby the legislation makes it clear that the EIRs apply to RSLs. That could be a new provision in the bill, stating that RSLs are to be treated as Scottish public authorities for the purposes of the EIRs, or a consequential amendment to the EIRs,

specifically adding RSLs either to the definition of Scottish public authorities or by reference to a schedule. I simply mention that as a potential solution, subject of course to advice from parliamentary counsel.

**The Convener:** The Cabinet Secretary for Communities, Social Security and Equalities will be in front of the committee in a few weeks' time. Those are the kinds of things that we can discuss in that evidence session, so that is very helpful. Do you want to progress with your questioning, Mr Wightman?

**Andy Wightman:** That response was very helpful. I am sure that we will reflect further on that important point.

You have all submitted evidence on sections 1 and 2, particularly with regard to the appointment of managers. The regulator thinks that it will still be able to do what it has done in the very few cases where it has used such powers, so the bill will, in practice, make no difference. Are you content with the proposed changes to the regulator's powers to appoint a manager and to remove, suspend and appoint officers of an RSL, as a matter of principle?

**The Convener:** The SHR has a variety of powers at the moment, but, looking at the issue in its broadest sense, they are going to be narrowed under the bill. Are you content with that narrowing?

**David Bookbinder:** In some ways, it has been interesting to remind ourselves of the original powers. The forum was certainly surprised at their breadth, but it is confident that, where statutory managers have been appointed in recent years under the current framework, those appointments have been made for much narrower purposes and to deal with very serious issues that have arisen in a small minority of associations. We think that, instead of making the regulator turn to those original and rather broad criteria, the bill, by narrowing those criteria, reflects actual practice.

**John Marr:** When the provisions were first drafted and we engaged with the Government on their development, we were initially concerned about the threshold of intervention being that an organisation "has failed" rather than is failing, because we felt that that might be too late, with the problem transitioning to actual failure before intervention could occur. However, as a result of our engagement and with the relatively wide definition of failure that is now in the bill, those concerns have largely been addressed.

That said, we suggest in our evidence that consideration be given to specifying in the definition in the bill that failure would include a failure to meet some of the requirements under the regulatory framework. Although lenders and

investors who are familiar with the sector and with how regulation works would be able to see the link in the bill to the definition encompassing a failure to meet a regulatory requirement, investors who might be contemplating coming into the market in Scotland and who would be more distant from and less familiar with the system might not be able to make that link so easily, and that might lead to their being reticent in deciding whether to step into the market.

**Sally Thomas:** For us, this is about minimising risk—I think that we all agree on that. We certainly want to work closely with the regulator—as we already do—and other colleagues to ensure that the change, if it happens, does not increase risk but rather minimises it and provides the assurance and confidence that we need to give not only our individual constituencies but as a whole. We must ensure that all the changes have a positive effect and do not lead to any great increase in concerns, problems or exposure to risk.

**George Walker:** As the regulator's new chair, I think that what has been very visible is the seriousness with which the word "proportionate" has been taken in the SHR's approach to regulation. It really intervenes only where it has judged an issue to be so serious that such intervention is warranted.

Thus far, from my perspective as chair, there is no evidence that the changes would have hampered us in stepping in to intervene in any previous cases in an appropriate manner and in the proportionate way that we have done. Michael Cameron may have a comment on past interventions and how he feels about that, but I feel that, thus far, the word "proportionate" is key, because SHR has acted and will continue to act in a proportionate way, and the changes will not stop us doing that.

**Michael Cameron (Scottish Housing Regulator):** We certainly set a high bar for the use of the powers, recognising their significance. The word "proportionate" is absolutely to the fore when we are considering whether we need to use such powers.

It is probably worth picking up on the point about regulatory standards and whether it would be worth having them in the legislation. Although that would certainly aid clarity, we are pretty confident, having read the bill, that regulatory standards are referenced and that the way in which the bill is constructed means that it points to statutory provisions, and regulatory standards are set through statutory provisions. Therefore, although including them would be clearer, we are still pretty relaxed about regulatory standards being the touch point for us in interpreting whether we need to intervene in an organisation.



**Andy Wightman:** The representatives of the regulator are saying that, in practical terms, they do not consider that the change would have made any difference to the way in which the powers have been exercised hitherto. Is that correct, in essence?

**George Walker:** Yes.

**Andy Wightman:** Forgive me for asking this, but are regulatory standards a thing in law? If you were to put them in the bill, would that demand more articulation about what was really meant?

**Michael Cameron:** The Housing (Scotland) Act 2010, as it stands, includes a requirement for us to put in place standards for governance and financial management for registered social landlords, so they are empowered under statute.

**Andy Wightman:** So if we were minded to recommend that, would it be relatively straightforward?

**Michael Cameron:** You could certainly refer back to those statutory provisions.

**The Convener:** Mr Marr, you have already answered questions about the need for clear definitions around the failure of RSLs, including the failure to meet regulatory standards—you have put some comments on the record in that regard. I was going to ask for more detail on how, in your view, that might impact on investor confidence. You have put a lot on the record already. Is there anything that you would like to add before we move on?

**John Marr:** I accept what the SHR said about being quite comfortable with regulatory standards as the touch point. In considering how, or whether, to address the point, it may be that the explanatory notes to the bill could be elaborated to include that reference more specifically, if it is felt that the bill is not the place for it. We can add that into the mix as well.

**The Convener:** That has been a useful exchange. Thank you.

**Alexander Stewart (Mid Scotland and Fife) (Con):** Following on from some of the questions for the regulator, I want to look at the removal of consent powers and how that will result in a loss of regulatory intelligence. Some clarity on that would be useful.

**Michael Cameron:** At the moment, all registered social landlords are required to come to us for our consent in relation to certain disposals and constitutional changes. When they do that, they present a business case that includes a series of documents, depending on what the consent request relates to. That enables us to engage with the organisation. As well as ensuring that we are able to proceed with consent, it gives

us a better understanding of how the organisation conducts its business and governs itself. It gives us a level of assurance that means that we do not need to engage with the organisation in any other way to be content that it is well governed and appropriately managed.

10:15

**Alexander Stewart:** You have touched on the level of risk that exists in the process. How would you address the increased level of risk for the sector as a result of the changes that the bill would implement?

**Michael Cameron:** George Walker touched on the fact that we have initiated a review of the regulatory framework. We will give consideration to exactly how we will be able to use our remaining powers to obtain the same level of assurance from landlords and to act where we need to act to ensure that the interests of tenants and other service users are protected.

An important point is that although certain powers are being removed or changed, we are picking up that there is no expectation that there should be a reduction in the protections that are offered to tenants and other service users. We will look at the full range of powers that the Parliament gives us to ensure that we are able to use them to maintain the level of protection.

**Alexander Stewart:** So you perceive that the safeguards will still be in place.

**Michael Cameron:** Those safeguards that are provided through the consents process will be removed, and the removal of any safeguards from a system inevitably means that there might be more risk in that system. We will look to see what we can do through our other powers and our approach to regulation to ensure that we can mitigate, where possible, any increased level of risk.

**Alexander Stewart:** The financial memorandum talks about your potential need for perhaps an additional three members of staff to fill the gap. That would have a cost implication for the organisation, which you have estimated as being up to £176,000. Will you explain a bit more about how that will be managed?

**Michael Cameron:** We identified the need for three members of staff, together with that figure, in an attempt to quantify what the impact on our resources might be. That might not necessarily translate into the employment of three members of staff, but we felt that that quantified the additional resource requirement on us if we are to obtain the type of assurance that is currently provided through the consents framework. We might need to do more than we currently do through the

consents framework, because it not only provides us with regulatory assurance, but enables us to stop things that would not be in the interests of tenants and other service users. The framework also ensures that any disposal or change that happens without our consent is void. Following the proposed changes, that will no longer be the case, so there might be a bigger requirement on us to engage with organisations in which something happens that should not have happened.

**The Convener:** Before we move on, I want to check something. Alexander Stewart talked about the intelligence that the housing regulator gets through the system of consents, which means that you know what is going on across the sector regarding the relocation of offices, the disposal of land and so on. You get a lot of information about things that, in theory, housing associations and RSLs do not have to tell you about. Do you anticipate that, because of good practice, you would still be informed about all those things and that you would still take a view about them, even if consent was not required in statute?

**Michael Cameron:** Certainly, one of the discussions that we need to have through the framework review is about how we might be able to ensure that any loss of the safeguards that are in place through the consents process is addressed in other ways by using our other powers. We are very clear that we are not looking to put in place a consents process by proxy.

If Parliament decides to remove the consents framework, that is how we will operate—without our consent being required. We will look at the need for us to run more closely to more organisations if we cannot rely on receiving the type of assurance that we would have previously received through the consents framework.

**David Bookbinder:** We and the SFHA stress in our submissions a point about consent for something significant, such as the disposal of more than one property or a pattern of disposal. In theory, an association could seek consent—although, as the case may be, it might no longer have to do so—to convert social rented housing into mid-market rented housing or private rented housing or simply to sell it off. Housing associations do a range of due diligence. No housing association in Scotland gets rid of social housing lightly. It happens sporadically, in particular tenements and closes. It might make good asset management sense for an association that has only one remaining flat in a close to divest itself of that property. Equally, it might be sensible to acquire property.

Although it is not at all likely that there will be scale disposals to worry about, theoretically, if a housing association appeared to be making disposals that threatened the balance of its own

social housing and had implications for the area—or, indeed, national implications—that would become an issue not just for the regulator but for the Scottish Government. However, I do not envisage that happening because of the care with which associations consider those important decisions.

**Sally Thomas:** I will add a couple of points to what Michael Cameron and David Bookbinder have said. There will still be a requirement to notify the regulator on completion of any disposal of properties or restructuring, and there will still be a requirement to hold a tenant ballot. That is a very helpful protection with which we all agree. There will still be notification, but the timeline will move, so that it will be provided during or after the disposal, not in advance.

**The Convener:** That is helpful and takes us seamlessly to our next line of questioning.

**Jenny Gilruth (Mid Fife and Glenrothes) (SNP):** My question is for David Bookbinder. In your submission to the committee, you say:

“Again our main interest has been in seeing tenant consultation and ballots protected where a change of landlord or a group structure move to a parent body is being proposed.”

Does the proposed tenant consultation do enough to protect tenants?

**David Bookbinder:** Yes. We recognised that the current provisions had to go because they were so inextricably linked to the regulator’s consents regime, so we have been particularly keen to deal with the issue. The forum had a key role in extending the ballot provisions in the Housing (Scotland) Act 2014 to apply equally to group structure changes, where one association joins another’s group structure. We are happy with the provisions as they stand. The bill does not include the word “ballot”, but, as the forum sees it, the only way of complying with the bill’s requirements is to hold a ballot and to abide by it, so we are happy that those important provisions are indeed protected, as Sally Thomas has just said.

**Jenny Gilruth:** We have discussed the bill’s proposals to remove the need for the regulator to have consent powers. Does the panel think that RSLs have robust enough governance arrangements in place to compensate for that?

**Sally Thomas:** That is a pertinent question. Governance of housing associations is absolutely fundamental to their success and to providing assurance to tenants that they are being run in the most efficient and effective way and that the best use is being made of taxpayers’ money. We work very closely with the regulator and other colleagues to make sure that the governance arrangements that are in place are the best that

they can be. We appreciate and understand, as I think others do, that we will have to work even harder at that.

That is not to say that we expect to see governance failures or weaker governance, but as a result of the change we know that we will have to ensure that we are on the ball in terms of governance being the absolute best that it can be, in the interests of tenants, taxpayers and the development programme.

**George Walker:** I think that Jenny Gilruth gets to the heart of the matter—it is a very important question. We have touched on our framework review, and it is interesting that one of the key issues emerging from the review—it is an issue on which we will consult in the new year—is the idea of boards assuring themselves.

I agree with Sally Thomas, in that I do not think that anyone expects an overnight failure of governance because of the change. However, we will encourage boards to ensure that they are self-assuring in the areas where consent has been required. In the past, an association might have found comfort by asking the regulator whether something was appropriate and reasonable. As that will no longer be available, self-assurance and encouraging self-assurance will be important parts of the consultation that we will bring forward in the new year.

**John Marr:** I will pick up on points made by Sally Thomas and George Walker. Due diligence was mentioned in the context of disposal by an RSL. It is quite right that an RSL board should ensure that it has gone through the required due diligence before it disposes of any assets. Equally, lenders go through due diligence. Clearly, that can help offset any concerns about the loss of regulatory and business intelligence.

Self-assessment has been mentioned, I think. That will certainly have a role in ensuring a degree of comfort across the piece that where disposals are made, they are made appropriately.

We look forward to engaging with the regulator further as part of the framework review when there is more concrete detail about some of the proposals.

**Elaine Smith (Central Scotland) (Lab):** I want to follow up on some of what John Marr just said, but first I would like to ask David Bookbinder specifically to comment on something that was in his submission, which says:

“The provisions may ... make it more straightforward for sensible changes to be made, where these, for example, will help associations prevent potentially disruptive individuals or groups having undue influence or control over an association’s affairs.”

Could you comment further on that statement?

**David Bookbinder:** Yes. I hope that that is not something that many housing associations would ever encounter. There are two points to make. Most housing associations want as many people as possible in their share membership and they want as many of those people as possible to be willing, from time to time, to stand for board or committee membership. The background to this issue is that a lot of associations are perhaps not crying out for, but are certainly very welcoming of people’s willingness to stand. We are very keen to make standing attractive to potential committee and board members.

Every now and again an association might want to make a sensible change to its rules, its constitution or its code of conduct for board members, when it encounters one or more individuals about whom the association has absolutely sound evidence that they are not there to act in the association’s best interests. At the moment, the code of conduct would enable an association to take action against a board member who, it is felt, is not acting in the association’s best interests, but not against somebody who is applying to be a board member. We know that some of our members have been looking at changing their rules to address such potential situations.

10:30

I am not suggesting—far from it—that the regulator would not engage if there was such an instance today of one of our members going to the regulator to ask whether it would be okay to take such action. That is an example of the kind of sensible rule change that an association might want to make. That would probably be quite a traumatic time for the association, so cutting out one stage in the process—its having to go through the consent mechanism—would certainly help, where that would evidently act in the interests of the association.

I do not want to suggest that there is a big issue about our movement being under threat from lots of people trying to inveigle themselves on to boards. That is just an example of where a little less red tape would be welcome.

**Elaine Smith:** I am concerned about who judges what is disruptive behaviour. Who makes that decision? What constitutes that kind of behaviour? Could it just be someone taking a different position from the board and making legitimate points that the board might not be listening to? I see that Sally Thomas is nodding: perhaps there is something that she wishes to say.

How do you ensure that when a board is made up, gender and diversity are recognised?

**David Bookbinder:** Make-up of boards is a big issue for the movement. The biggest imbalance at the moment, I would hazard, is in respect of age. Many associations throughout our area and, I am sure, throughout Scotland are attempting to balance their boards and to get younger people on to them.

On how we know whether a board is making the right decision about something, I would say—and, I think, the regulator would say—that it is up to the association to get that right: the regulator will not decide for it. An association has to get such decisions right through the experience of its board, which must have a real sense of what is right for the association.

**Sally Thomas:** That is another absolutely pertinent question, but there is no clear and exact answer to it. Board membership—how to attract people to boards, get a balance and get diversity—is an on-going and major issue for the sector, as it is for many others.

The point about whether behaviour constitutes disruption or challenge is well made. A case will always have to be taken on its merits at the time, and there will always be a judgment of sorts.

That said, the issues of self-assurance and of doing more work to ensure that organisations' governance is the best it can be are front and centre of what we need to do. If we do that in the right way, get all our ducks in a row and have our priorities right, we can address the issues that Elaine Smith raised. It is an on-going process, however: it is not one that we can safely say is done and dusted. We cannot say that we have done it, that we are successful and that it is all great.

To the SFHA, the Glasgow and West of Scotland Forum of Housing Associations and others, tenant representation on boards is absolutely critical. I have come from England, where tenant representation on boards has been run down for a variety of reasons, so it is an absolute pleasure to be in a place where tenant representation is treated as important, and increasingly so. We want to do everything that we can to ensure that representation is retained. Given David Bookbinder's concerns, which are credible and realistic, and given Elaine Smith's question, which is absolutely pertinent, we need to do the best that we can to ensure that there is tenant representation in the best way possible, and that tenants are supported to contribute in the best way possible to governance arrangements. We also need to do the best that we can to take on board and to continually review and reassess, as Elaine Smith asked, whether we are achieving good governance and diversity, and whether behaviour is a challenge rather than a disruption.

**Elaine Smith:** Unless anybody else wants to follow up, I have a question for John Marr—

**The Convener:** If you will indulge me, there is something that I want to follow up. There is a general theme that housing associations need a little bit of disruption because the same handful of tenants will have been on the board for a long time, so well-paid officials put through rent increases, rent restructuring and investment programmes that get rubber-stamped. At what point does the board become part of the co-production and corporate governance of the organisation? At what point do they just put things through on the nod? That is a challenge in the housing association movement.

Incidentally, some housing associations are superbly run—there can also be a challenge there. Challenge does not necessarily mean that the housing association is poorly run. I did not pick out that point about challenge from Mr Bookbinder's evidence, but it grated with me a little when I heard about it because we need well-qualified disruptive individuals to challenge the housing association movement's senior officers to make sure that an association really is a tenant-led organisation. Any observations on that would be welcome. We will then, of course, move on to Mr Marr.

**David Bookbinder:** That is an absolutely fair comment. The forum takes seriously the notion of committee and board members having the ability to challenge. For example, with our colleagues at Scottish Housing Associations Resources for Education—SHARE—the forum is about to produce in the next week or so a small booklet, aimed at committee members, on knowing the basics of sound financial management and knowing when to challenge. They need to do that when it is important—when they do not understand something or when they are uncertain about something. The booklet is about giving them the confidence to do that. We could never claim that a housing association is well run if there is a lack of challenge.

We have also done work this year on succession planning, which is about making sure that committees and boards are fit for the future, and having people with the right experience. That includes the critical local input that can come only from local people. We take succession planning and good governance very seriously and have produced a lot of work on them.

**The Convener:** Thank you for indulging me, deputy convener. You can move on with your line of questioning now.

**Elaine Smith:** Thank you. Mr Marr, with specific regard to sections 3 to 7, can you expand a bit more on the kind of risks that removal of the

regulator's powers of consent could pose for funders? We touched on that previously.

**John Marr:** We are talking about a transfer from a system of consents to a system of notifications, not only in relation to disposals but to organisational changes—which could, for instance, be proposals for RSLs to merge or form different business structures.

We mentioned in the earlier discussion that notification might mean that there could be a degree of loss of regulatory and business intelligence. However, we are comforted by and take reassurance from the fact that associations, through their own due diligence, and lenders, through their due diligence, and the possibility of an increased role for self-assessment, could help to fill some of the gaps that might arise through the change. Clearly, there will be provisions within existing loan agreements requiring the borrower to seek lender consent for specific events, which would definitely include constitutional changes. Lenders will still go through that process of engagement with their borrowers to provide consent or otherwise to those changes upon merger.

Even though we are moving to a new approach under the proposed legislation, lenders can still take comfort that existing practices—in terms of their own processes, through their loan agreements—as well as changes down the line from changes to the regulatory framework, will provide sufficient reassurance.

**Elaine Smith:** In your written evidence you say that you expected that funders would have to

“ramp-up their own due diligence”,

but you also suggest that funders would expect boards to strengthen their self-assessment regimes. Would that result in increased costs for RSLs?

**John Marr:** There may be costs associated with some changes, but it is difficult to forecast what they might be from this distance. In our submission I touch on the point that lenders might “ramp-up their ... due diligence” and the possibility of there being costs associated with that. I emphasise that that would not be changes in costs to funds per se, but rather to transactional and process costs associated with striking a deal. I would not expect those costs to be significant in the grand scheme of things—they would continue to be proportionate to the deals.

**Elaine Smith:** Do the representatives of the RSL sector have any comments on that?

**Sally Thomas:** The question is about a possible cost to boards of increased self-assessment. With David Bookbinder and John Marr, as part of the regulatory review, the SFHA would hope to find

ways to minimise that as much as possible. The SFHA would do that by trying to provide as much information and support to advise and, where necessary, to strengthen board activity—particularly self-assessment—at minimal cost to the organisation.

There is a huge diversity of organisations in the sector—they range from very small to very big. The bigger ones can probably do what they need to do using their own means and without taking a big hit to their resources. Other organisations will find it much more difficult, time consuming and resource intensive in proportion to their size and activity. We will focus our resources as a support organisation to ensure that they are targeted in the right way in order to minimise the costs and effort that would be involved for individual organisations.

**The Convener:** Does anyone want to add to that?

**David Bookbinder:** Our lenders are our key partners and I welcome John Marr's assurance that any further due diligence would be proportionate.

**The Convener:** That is now on the record—although it is not binding.

**Graham Simpson (Central Scotland) (Con):** Mr Marr's written submission suggests that there should be a sunset clause in section 8 of the bill. Can you expand on that?

**John Marr:** Yes. We understand the rationale for inclusion of section 8. When the bill was drafted there was still a fair degree of uncertainty about how the ONS might view the provisions and whether they would be sufficient to achieve the outcome of restoring the “private sector body” classification. Now that we have seen the ONS move relatively swiftly south of the border in restoring the classification to English housing associations, after the Westminster Government implemented the final pieces of the puzzle in the deregulatory measures of the Housing and Planning Act 2016, and given that those measures are broadly consistent with the measures that have been proposed for Scotland, we can perhaps take comfort that implementation of the legislation in Scotland will enable the ONS to move as quickly as it did down south and reverse its decision. That being the case, one could ask whether the open-ended provision of section 8 is really necessary.

Our concern is that inclusion of the provision—as I said, we understand why it is there—but leaving it entirely open ended would prolong the uncertainty for investors considering coming into the market. It would be helpful if the period within which the power could be exercised were to be limited in some way. We have suggested that the period could last until the end of the current

session of Parliament, although, given how quickly the ONS has acted down south, it may be that the power is not even necessary. However, that is clearly an issue for consideration.

10:45

**David Bookbinder:** Section 8 really feels like a just-in-case section. I agree with John Marr: we have good reason to be confident that the ONS will be satisfied with the bill's measures. We are certainly relaxed about that provision being there. The Scottish Government has acted in a very consultative manner on the provision. I think that it would carry on doing that in the unlikely event that it had to use a sunset clause, as you refer to it. However, we do not see it as a threat.

**Graham Simpson:** The Delegated Powers and Law Reform Committee made some recommendations in its stage 1 report, one of which relates to section 8. It says:

"The scope of those powers extends to permitting any modification of the functions of the Regulator which relate to social landlords. The power is therefore drawn more broadly than is required to achieve the policy objective. The Committee considers that, in principle, the power could be framed more narrowly in accordance with the policy objective. It recommends that the Scottish Government consider this further".

Do you have any thoughts on that?

**The Convener:** This might be the first opportunity that the witnesses have had to hear that recommendation in the report. We could be catching you cold a little bit, Mr Marr.

**John Marr:** That is a welcome progression towards narrowing the scope within which the power could be used. It still leaves the timeframe element open, which was one of our more significant concerns.

**The Convener:** Are there any other reflections on that? The report came out yesterday, so it is hot off the press. The witnesses seem to be generally content with the power if it is required but think that it would be good to narrow its scope a bit. Mr Marr has spoken about a possible sunset clause.

**David Bookbinder:** It is a theoretical argument; on the face of it, the power looks very broad. I do not think that anyone in the housing association sector believes that such a power would be misused. If it is prudent to look at narrowing it, so be it, but it is important that the power is retained as a just-in-case clause, as I referred to it earlier.

**Graham Simpson:** Section 9 would restrict the local authority power of nomination to an RSL board to a maximum of 24 per cent of board members. Inverclyde Council is concerned that the plans are "unduly prescriptive" and will

"not allow for the exercise of local discretion for local circumstances."

In other words, the council is saying that 24 per cent is too restrictive. Does anyone agree or disagree with that?

**David Bookbinder:** As the committee knows, that generally applies to stock transfer and, probably, to the largest stock transfer associations, where having a proportion of local authority elected members was part of the transfer arrangements. It may be for others to comment. It is not as if a reduction from 51 per cent is required. We are talking about nuances of between a third and a quarter. I would have thought that, under the proposed arrangement, local authority board members would still have an influence, as they do under the current 33 per cent arrangement. It is clutching at straws to say that the proposal will make a big difference, especially if, as we believe, the ONS needs that change to happen.

**Sally Thomas:** While in some senses it might appear to be a loss, I would hope—certainly, we would hope as an organisation—that the relationship between local authorities and housing associations is sufficiently good that they will be able to work that out between them in discussion. If it is felt helpful by both parties to have local authority representation on boards, so be it. It is up to the individual housing association and local authority to work that out. That is just as it should be.

**Graham Simpson:** Does any of the witnesses think that it is appropriate that ministers should have the power to set the limit in the first place?

**The Convener:** No one is grabbing at that one. Maybe you could provide a bit of clarity. Do you mean that it should be open ended?

**Graham Simpson:** Should ministers be able to set a limit, whether it is 24 per cent or whatever? I am sorry for all these tough questions.

**The Convener:** May I clarify that, so that we get an answer that fits with the policy intent of the bill? My understanding—as the committee's convener it is always dangerous to try to understand something—is that the reason for the restriction was to better conform with the ONS requirement that RSLs be seen as private bodies and to reduce the influence of other public bodies on RSLs. Does that mean that there has to be a cap somewhere down the line? Mr Simpson asked why such a cap should be specified by the Government. There might still be no takers for your question, Mr Simpson.

**David Bookbinder:** Ideally, we would not want ministers to dictate how our boards are structured. In this case, we think that, as the convener said, it

is probably a proportionate response to the requirement for ONS to see a perceived reduction in public influence or control.

**Graham Simpson:** I should have sent my questions in advance, convener.

**Elaine Smith:** Having served in the Parliament since 1999, I was in the Parliament when the stock transfer legislation went through. At the time, my former colleague John McAllion and I raised concerns about the fact that stock transfer could just be seen as privatising an asset, council housing, that had previously been owned, in the public sector, by all of us. We are now taking that a step further. At the time, discussion about local authorities' influence on boards was to try to bat off the accusation of privatisation of a public asset.

My concern now would be the implications, in areas of wholesale stock transfer, of a reduction in local authority influence on local authorities' duty towards homeless persons. The question is specifically for David Bookbinder and Sally Thomas, but if the regulator wishes to comment I would be happy to hear from him.

**David Bookbinder:** The sector regarded it as really important, especially in the light of stock transfer, and of the six local authorities in Scotland that do not have any stock, that there were robust statutory measures for housing associations to support local authorities in housing homeless households.

Section 5 of the Housing (Scotland) Act 2001 has been really important. In practice, a lot of local authorities do not resort to using that provision because the more informal nominations and referral arrangements in most parts of Scotland appear to work very well. However, the duty remains critical in ensuring that all associations, particularly those in areas with no council housing, can make a proper contribution to housing homeless households.

**Elaine Smith:** Will it continue to work well if the local authority nominations to boards are reduced?

**David Bookbinder:** The forum does not associate the success of housing homeless people locally with the constitution of the board—I do not see a correlation there at all.

**Sally Thomas:** This is an important issue. The extent to which housing associations have influence, which represents democratic processes, the taxpayer and the public good, is important.

There is a difference between local authority influence possibly being reduced in statute in policy terms, as we have here, and reality. Who can second-guess this? I hope and anticipate that, while there might be a provision that looks ostensibly as though the impact could be to reduce local authority control and influence, the

reality of it might not be that at all. The situation might well stay as it is, or their control and influence might even increase.

The joint intentions and collaborative aspects of how local authorities and housing associations work together, and the relationships that they have built up since stock transfer, are mostly good—I would not want to say that they are wholly good; that would be too much to profess—which means that that level of influence would be retained, and increased where necessary, for the provisions that you have been talking about with regard to achieving reductions in homelessness and housing people who need it.

**The Convener:** Given that percentages are being specified, and there is a direction of travel, does anyone really think that there will be any difference in the good governance of RSL boards, or in the partnership relationship that such boards do or do not have with the local authority, based on whether a local authority can appoint 33 or 24 per cent of board members? Is that completely missing the concept of engagement and partnership?

**Sally Thomas:** Yes. To follow on from my previous point, I would not want to discount that completely—it would be naive and ridiculous to do so. However, knowing what I know about how the sector behaves and what the sector, collectively, intends to do, I think that the relationships that are in place now and the historical development of those relationships over time since stock transfer will mean that we are in a much better place than we ever were then. The partnerships will reflect that; so, too, will the impact of those partnerships and relationships on the housing needs and demands that we know are out there.

**Andy Wightman:** I want to pick up on Graham Simpson's points about the Delegated Powers and Law Reform Committee, of which he is the convener. That committee's report, which came out yesterday, reveals a disagreement between the committee and the Government on the section 8 and section 9 order-making powers. The committee considers that the powers are too broadly cast; the Government says that it is content. We may need to mop up on anticipated feedback from the ONS. I am not looking for a response now, but we would find it most useful should anyone want to come back and comment on the nature of that disagreement and where the balance might be most appropriately set.

**The Convener:** The Scottish Government has still to respond to the report that was published yesterday—it has yet to look at the evidence in it. That is the context in which we should view that disagreement. Does anyone want to take up the cudgels on that one? There appears to be no great thirst to do so.

**Sally Thomas:** The member mentioned taking time to reflect and come back on the issue. That is probably the most sensible way forward for the SFHA.

**Graham Simpson:** The Delegated Powers and Law Reform Committee report is quite technical, but I suggest that you read it first and then come back to us.

**The Convener:** That is very helpful. Our committee will have to take a view on the matter, so we want to be informed not just by the Delegated Powers and Law Reform Committee's report but by your views and those of the minister when he comes before us.

As there are no more questions, I thank everyone for coming along this morning. It was a very useful and structured evidence session, which will inform our stage 1 deliberations. Please contact the committee with any additional information that you want to give us, not just on the specific matter that Andy Wightman raised but on anything at all. I thank all the witnesses for their time.

11:00

*Meeting suspended.*

11:05

*On resuming—*

## **Draft Budget Scrutiny 2018-19**

**The Convener:** The committee will take evidence on the Scottish Government's draft budget for 2018-19. I welcome Ronnie Hinds and Fraser McKinlay from the Accounts Commission; and Tim Bridle from Audit Scotland.

I invite Ronnie Hinds to make an opening statement before we move to questions.

**Ronnie Hinds (Accounts Commission):** I will not take up much time, convener. I hope that the report is self-explanatory. There is a summary at the beginning and there are key points in each of the sections. The only point that I wanted to make by way of introduction is that this is the second time that we have separated out the financial from the other aspects of local government resources and performance into two reports at different times of the year. The reason for doing that is that we think that it is most helpful to have this information in the public domain at this point in time when the budget cycle is in full flow. The report is intended to be informative and helpful and it is in that spirit that we are here today to answer questions about it.

Because of the complex nature of some of the matters to do with local government finance, if there is anything that we are unable to answer satisfactorily today, we will come back with further information after the meeting.

That is as much as I wanted to say by way of introduction, convener.

**The Convener:** We will move to questions.

**Andy Wightman:** I thank the witnesses for coming today and for another excellent report. Their clarity in presentation and language helps us to make sense of a complex landscape. Earlier, some of us were discussing exhibit 4, which is an attempt to put in a diagrammatic and simple-to-understand form the funding formula, which some of us are still struggling to get a grip of.

You issue some stark warnings about the financial state of local government, notwithstanding the fact that you have issued no qualified audits on local authorities. How do you view the financial state of local government now in the historical context? Obviously, you can go only as far back as you have been working in this area but, looking at the past five, 10 or 17 years of devolution, where do you think we are now?

**Ronnie Hinds:** The point that you made about the absence of qualifications of any accounts is not something to gloss over. It is quite a significant achievement. It happens every year, but we



should not take it for granted. It is an indication of the good stewardship of public funds that we continue to see in local government. I just wanted to say that because it is important.

Notwithstanding that fact, and the fact that, by and large, councils can live within their means taking one year with another, this year we can see an enhancement of the pattern that we have seen in the past few years, which is increasing challenges and difficulties facing councils. It is not uniform across the country—each of the 32 councils has its own story to tell—but there is a general trend of increasing difficulty.

The way that we have highlighted that in this report was picked up in some of yesterday's media coverage. For the first time, we see a majority of councils dipping into their reserves to balance their in-year budget. There is nothing untoward about that. They are perfectly entitled to do it. However, we thought that it might be significant that a majority did that in budgetary and actual terms in the course of the year of this audit.

That does not necessarily mean that we are at some kind of tipping point. We do not believe that to be the case. It is far too early to make that kind of judgment. However, it might indicate that, faced with the choice between using their reserves and looking further into the service budgets to make the necessary reductions, they have chosen to use their reserves. As I say, a majority of councils have taken that view for the year that we are looking at, and that seems to us to be quite significant.

**Andy Wightman:** I have a question that I have asked before. Part of the issue is about the quantum of the resources that are granted by the Parliament through the vote on the budget for local government, which is a matter that will be before us imminently. Given the challenges for local government finance, what role could be played by structural change in the way in which local government is financed? I am thinking about things such as more fiscal autonomy, multiyear budgeting and fiscal frameworks. Those are the kinds of processes that could be put in place—there are others—to create more financial resilience in local government. As I understand what you are saying, part of the issue is caused by the fact that local government has very little means at its disposal to raise revenue and is dependent on another sphere of government, which creates tensions.

**Ronnie Hinds:** A lot of your question goes beyond the scope of the report and indeed the work of the commission, because it involves policy issues, so I will limit myself to the aspects that I can safely comment on.

We repeatedly make recommendations on multiyear budgeting and forward planning. As you see in the report, it remains the case that roughly half of councils do not routinely roll forward a three-year planning horizon every year for their revenue budgets, and they do not do it for capital, either. We recognise the difficulties with doing that, particularly when there is a one-year financial settlement for the largest part of their funding, which comes from the Scottish Government, but it is not impossible, because otherwise none of them would be able to do it. We continue to press for all of them to do that and to put their planning on as secure a basis as possible. That is one thing that could be done even within the current arrangements.

On the broader picture, we have just seen in the current financial year the removal of the council tax freeze, and the report touches on that and the way in which councils responded to it. That restores a degree of local flexibility that has largely been missing for a decade. It is not for us to say whether that is a good or bad thing, but we comment on the use that is made of it. One point that we make, which touches on Andy Wightman's question, is that the council tax freedom, on which a 3 per cent ceiling is currently imposed, does not make much of a difference to the overall amount of money that local government spends. In the report, we compare it to the cost of a 1 per cent pay award for staff. It would therefore be wrong to get hung up on the idea that, by itself, council tax is necessarily the magic solution, even if the 3 per cent ceiling were removed.

It is for others to conclude whether there should be some continuation of the status quo or whether something else needs to be brought into play in the wider funding of local government. All that we can do is comment on the situation that exists.

**Andy Wightman:** I have one final question, which picks up on that point about council tax. I am interested in paragraph 68 and exhibit 19, which look at council tax in 2017-18 and the impact of the banding reform, the increase in rates and the removal of the discount on second homes. Paragraph 68 says:

“Additional income arising from council tax reforms to banding multipliers are also shown—

those are the statutory reforms for the top three or four bands—

“but councils do not benefit from these increases as the Scottish Government funding mechanism has been adjusted accordingly.”

Let us assume for the sake of argument that the general revenue grant is £100 and the increase arising as a consequence of the banding is £10. Are you therefore saying that, were the banding not to have changed, the general revenue grant

would be £110 and that, in other words, there is no net impact on the receipts to local government of the banding change? I want clarity on that, because the issue is obviously partly related to the bigger question about transparency of figures and numbers, which we talked about last year.

**Ronnie Hinds:** We are not saying that, but Tim Bridle can explain better than I can what we are saying.

**Tim Bridle (Audit Scotland):** We are talking about individual council level, where there is an equalisation. What we try to say in relation to exhibit 19 is that the councils that have a high incidence of higher banded properties do not benefit from that, and the income is equalised through the mechanism. We are not saying that the overall level of settlement has been reduced equally, if that makes sense. We are talking more about individual council level.

**Andy Wightman:** So, basically, when you say that

“councils do not benefit from these increases as the Scottish Government funding mechanism has been adjusted accordingly”,

you mean that individual councils do not necessarily benefit by all of the increase. If, for the sake of argument—this is probably correct—the City of Edinburgh Council has the highest yield from the top bands, it does not get all the additional revenue. The equalisation means that some of that flows to other councils.

**Tim Bridle:** Exactly.

11:15

**Fraser McKinlay (Accounts Commission):** That was a very helpful question, Mr Wightman. As it happens, we talked about paragraph 68 just before we came into the meeting. It might be helpful to write to the committee to clarify that. We recognise that the wording of that paragraph could be a bit clearer on that specific point. We will be happy to clarify that in writing, but Mr Wightman’s description of the situation is correct.

**Andy Wightman:** That is grand. If it would be possible to create a beautiful graph like the one in exhibit 19 to illustrate that redistribution, that would be helpful, but it does not matter if you cannot.

**The Convener:** There is an issue that I want to clarify, which I thought that I understood, until Mr Wightman started asking his questions; now I am not sure whether I do. Exhibit 19 says:

“Additional income from council tax banding reform £110 million”.

Is it the case that that is real money?

**Ronnie Hinds:** Yes.

**The Convener:** The discussion that we are having is about how that is distributed among councils and how much each council gets, but councils are getting £110 million.

**Fraser McKinlay:** There is an added complexity, in that we do not know exactly what the figure will be, because that will depend on collection and everything else at the end of the year. If we work with the figure of £110 million, which is the anticipated figure, that is new money in the system at the top line. We have been discussing how that works through into individual councils.

**The Convener:** It is new money—everything else muddies the waters. It will be interesting to see the details.

Is it correct to say that councils increasing the council tax by up to 3 per cent will generate £53 million of new money?

**Fraser McKinlay:** Yes. The light blue bar in exhibit 19 represents the decisions that the relevant councils have made on their council tax, and it equates to about £53 million.

**The Convener:** We can look at the proportion of overall spend but, in theory, local government is receiving £163 million of new money because of council tax reform. I just wanted clarity on that, following Mr Wightman’s questions.

I have another short question. Were the councils that decided to raise the council tax in any more financial distress than the ones that decided not to do so? Were they any less likely to manage their finances well than the ones that did not raise their council tax? In looking at the policy decision that councils took on whether to raise council tax, I am trying to ascertain whether the reason for that was to do with their financial management, whether that was good, bad or indifferent. Was there a correlation there? Did you look to see whether there was a correlation there?

**Ronnie Hinds:** No, we did not, because it is difficult to exercise a judgment on councils’ financial management. As I said earlier, in auditing individual councils, we make judgments about their financial stewardship and so on, but there is a slightly more qualitative element to the judgment about how well or badly they manage their finances. It is a very complex judgment to make, so I do not think that we would be able to make such a correlation or to demonstrate that it does not exist.

The reasons for choosing to raise or not to raise council tax are many and wonderful. Some of them have to do with service pressures, but they have to do with other factors as well, including some political considerations. *Prima facie*, I would not expect to see a correlation between how well a

council was managed and its decision about whether to raise council tax.

We would tend to look at the issue the other way round and make the starting assumption that, if a council did not have to raise its council tax, all other things being equal, the pressure on its budget ought to have been less acute, because otherwise it would have taken the option of raising the council tax. I would not expect the councils that were in most difficulty to have been the ones that chose not to raise their council tax, but we have not tried to make that correlation to find out whether it was the case.

**The Convener:** That was helpful. I wanted to know whether there was a consistency in the reasoning of councils on whether to increase the council tax and whether that decision related to financial distress. It is clear that it is hard to take the political choices out of that.

In key message 4, you say:

“Councils’ expenditure and use of reserves often differed noticeably from that originally planned, indicating the need for budget-setting to become more robust and reliable.”

Does that mean that, where there is a big differential, they have just got the numbers wrong, or have local authorities made in-year policy changes and choices that were not factored into the budgets that were set initially? If a council had decided on a suite of closures of facilities or the restructuring of an organisation, and the political climate locally was such that it decided not to do that and it did not accrue the savings, that would show a differential from the budget that was originally set. I am trying to tease out whether what we are seeing is the result of councils changing their policy intentions halfway through a financial year, or whether it is just that their planning was poor to begin with.

**Fraser McKinlay:** That is an excellent question and I do not think that we have the exact answer for it, because it varies enormously, but you are right to highlight the detail of exhibit 9 on page 22. It is striking that the vast majority of councils do not use their reserves as planned. Some use more and some use less, and we think that that is an issue. In some cases, we think that it is about the budgets that are set at the start of the year. We had one report at the commission recently of a council that has routinely underspent its budget for the past five years or so, and has therefore increased its reserves in an unplanned way year on year. That council might argue that that is prudent, but our view is that it would have been prudent if that is what its plans had said. There will be occasions when something that has happened in-year affects a budget, but it is equally likely that either the budget setting is not robust enough or the financial monitoring through the year is not robust enough. That is a long way of saying that it

is difficult to tell, but all the things that you have described will be in the mix.

**The Convener:** I had looked at exhibit 9, but I got a bit of brain freeze when looking at it, to be honest. That was one of my reasons for asking the question. It seems to be all those things and none of the above at the same time. It is a mixed picture and it is difficult to tease things out. Would you never do a breakdown for each local authority to say that the variation from original plans was mainly because of policy changes or mainly because of weakness in the initial numbers?

**Fraser McKinlay:** I have been asked to report to the Accounts Commission on all councils in respect of their duty to achieve best value over the next five-year period, so when we get into the more in-depth best-value reviews of each individual council, we can get a more qualitative assessment of exactly what is going on. It is a big piece of work to get under the skin of why the situation is as it is, and those best-value reviews will allow us to do that.

**Ronnie Hinds:** The question was a good one, and I will add to what Fraser McKinlay has said by saying that we comment in our report on the deficiency, in some cases, of the management commentaries that councils are obliged to make under their public reporting duties. That is where, in the first instance, I would expect to see the kind of detail that you are asking about. The primary responsibility to give a clear and coherent account of why things have panned out as they have rather than in the way that was planned lies with councils, and they have a duty to do that. We criticise councils in the report for not paying sufficient attention to that, so we will continue to exercise sinew over that and to get councils to report that better in the first instance. As Fraser McKinlay says, we may have an interest in looking at the best-value aspect of council budgets to see what that tells us and how we can interpret and explain it, but the information has to come from the councils. They are the ones that will be taking the decisions as the year pans out.

**Kenneth Gibson (Cunninghame North) (SNP):** Thank you for an excellent and fascinating report, as always. Exhibit 21 shows budgeted use and remaining levels of general fund reserves. We touched last year on the huge variance in reserve levels across local authorities; we see, for example, Inverclyde Council with about 26 per cent of its income and Dundee City Council with about 3 per cent.

You say in exhibit 21:

“Councils using more General Fund reserves relative to the amount remaining face greater challenges”.

You also point specifically to three local authorities—Moray Council, Clackmannanshire Council and North Ayrshire Council—and say:

“using General Fund reserves at the current rate is not an option for some councils—Clackmannanshire, Moray and North Ayrshire councils would run out of General Fund reserves within two to three years if they continued to use them at the level planned for 2017/18.”

I am the MSP for a constituency in North Ayrshire. Assuming that the Scottish Government distributes resources to local government according to the current formula, what will such constraints mean for the local authorities’ ability to deliver services?

**Ronnie Hinds:** Do you mean the ones that are closest to running out of reserves?

**Kenneth Gibson:** Yes, those three. They will not be able to dip in any more.

**Ronnie Hinds:** Given the situation that those councils face, I would be expecting them to set budgets for next year and the years ahead that reflect the fact that they have less buffer room in their reserves. For all I know, they might well budget to replenish those reserves—that is one possibility. Therefore, what I am saying is that the situation is not static. When we talk about what might happen if they continue to run down their reserves at the same rate, it is not because we expect that to happen; we recognise that other circumstances will come into play.

Secondly—and this has already been touched on in our discussion—what actually happens in the course of a financial year will not, in every instance, be what was planned for. The councils in question might plan to restore their balances. They might find their financial situation to be somewhat better than expected and that they are able to make savings faster and to restore those balances further than they had anticipated. We simply do not know. The only point that we can safely make is that, if nothing else changes, they might hit difficulties sooner than other councils, but it is difficult to say more than that.

I do not take the view that, because their reserves are getting close to some kind of deemed minimum, those councils are necessarily going to run out of reserves in two or three years. There are choices that they can make in that respect.

**Kenneth Gibson:** Yes, but my other question was about the impact on services if those councils seek to continue to have reserves and therefore have to do more rebalancing. Will they have to make deeper reductions in service provision than other local authorities?

**Ronnie Hinds:** That is one thing that might happen. We have not looked in any detail at the circumstances of each of the councils that you

referred to, so I will make a general point by extrapolating from the specifics. All other things being equal, if a council is taking longer to make some of the harder decisions that other councils might already have made, some harder decisions will still lie ahead of it, unless its overall financial situation changes for the better. We have seen no indication of that happening. It might well be that some councils still have to make difficult decisions about services, and the situation might be compounded by their feeling that they have to increase reserves to give them greater longer-term security. However, those are all hypothetical comments; I would not know until we looked at the individual circumstances.

The level of reserves held by a council is a function of a number of factors. For example, some councils that we would regard as being relatively well run do not have high levels of reserves, but they are comfortable with that because they have confidence in their ability to manage their budgets. That is another factor.

**Kenneth Gibson:** They do not use their reserves.

In paragraph 28 of your report, you say:

“Councils delegated £2.4 billion of social care expenditure to”

integration joint board

“budgets for 2016/17 and NHS boards contributed £5.6 billion.”

However, you then say:

“The establishment and development of IJBs has been a complex exercise and will take time to mature. Their operation will be the focus of further performance audit work we have planned in 2018.”

Given the huge amounts of money that we are talking about, how can the work of the IJBs be made transparent?

**Fraser McKinlay:** As the report points out, on behalf of the commission and the Auditor General we are doing our second report on integration, which will probably be published around this time next year. We did a report at the outset of IJBs, and the second one will monitor their progress.

There is no doubt that it has taken the boards the past couple of years to get the basic governance arrangements in place. By that, I mean the operation of the board as well as budgeting, which continues to be challenging and difficult because of the different timings of budget cycles in the NHS and councils. We are very clear that the IJBs need to make progress with the nuts and bolts of how they operate so that they can begin to focus on integrating services on the ground. After all, the integration exercise is all about improving outcomes for local communities.

We will be doing an update report on that over the next 12 months or so, and we will be in a position then to say more about progress and the kinds of things that need to happen in future. However, my sense at the moment is that the IJBs are still struggling to get beyond some of the issues about how new organisations work; and that not enough time, energy and focus are going into integrating services on the ground.

11:30

**Kenneth Gibson:** At the end of paragraph 22, a highlighted sentence says:

“Councils have been seeking to maximise the income available to them from charging for services”.

However, that does not seem to be the case. The Scottish Parliament information centre report, “Local Government Finance: Fees and Charges 2011-12 to 2015-16”, says that there has been a 4.5 per cent reduction in charges, from £569.7 million to £544.2 million.

The report shows that, for some councils, charges are on a bit of a rollercoaster—they seem to go up and down and round and about from year to year. For example, in the past year, West Lothian Council has increased charges from more than £4 million to about £11 million; Falkirk Council has increased charges every year for 11 years, from £17 million to £20 million, in real terms; and Perth and Kinross Council has steadily reduced charges from £14 million to less than £7 million over the same time period. What is actually going on here?

**Tim Bridle:** First, as I understand it, that report is an analysis of information that has been submitted to the Scottish Government, which has not been subject to audit. We do not have a full picture, because that information is submitted through councils and, quite often, councils provide services through arm’s-length external organisations such as leisure services trusts and care trusts. Some of those ups and downs could be because there is a new ALEO and so the income is no longer shown on the council’s return to the Scottish Government.

There is also a bit of a data quality issue around the fact that, in some cases, transfers between councils feature as income, which is clearly not what we want to analyse in terms of charges to service users. I know that the Scottish Government is looking to address that issue and clean up the data for 2016-17. That information will be available in the new year, and it will be interesting to see what movement there has been.

The comment that we make is really off the back of what we see in budget-setting reports, which shows that councils are looking to maximise their income. That is not to say that they would

necessarily increase their fees and charges by more than inflation but, ordinarily, they would increase their fees and charges to some degree.

Towards the back of the report, there is an exhibit in which we consider some of the budget initiatives for 2017-18. It contains some examples of the sort of things that are being done to increase charges and, in some cases, introduce new charges.

**Kenneth Gibson:** The SPICe report says:

“Income from fees and charges for Culture and Leisure services decreased ... from £42.6m in 2011-12 to £30.5m in 2015-16”.

It also says:

“10 councils did not consistently report income in every year suggesting that they will either be recording this income within different categories or, where income has not been recorded in 2015-16, new arrangements may have been introduced.”

I note that it includes an element about ALEOs.

In North Ayrshire Council, Aberdeen City Council and Angus Council, more than 80 per cent of the arts and culture budget is received in charges. However, in other councils, such as East Renfrewshire, 0 per cent of that budget is received in charges.

Even taking into account things such as ALEOs, the report suggests that there are significant inconsistencies, and I do not see any great evidence that local authorities are maximising the income available by charging for services, which they should be at this challenging time.

Will you respond to some of that?

**Fraser McKinlay:** The reason why we have worked with SPICe to produce the report, which I think is enormously helpful, is that we recognise the need to answer the question that you ask, which is: what is going on here? The subject came up when we spoke to you last year, which is why we progressed that piece of work. The SPICe briefing asks lots more questions about consistency and about how individual councils work in that regard. The point that our report makes about seeking to maximise income, which Tim Bridle talked about, is a more recent development, which we saw in the last budget setting. You are absolutely right to say that there has been a downward trend since 2011-12. What we are beginning to see, given budget pressures in other areas, is councils looking to reverse that downward trend, and we will want to track that carefully as we head into the future.

The basic point is that we need to understand what is going on here. A couple of years ago, we produced a report that set out some principles around how to go about setting fees and charges and the kind of things that we would expect to see

in the interests of ensuring that the setting of fees and charges is not a kind of finger-in-the-air exercise and is instead planned so that it is in line with priorities and so on. We want to keep a close eye on that area, and the SPICe briefing is a really good starting point for that.

**The Convener:** Mr Wightman has a question—but only if it is on the same issue.

**Andy Wightman:** It is a brief follow-up question on fees and charges. SPICe notes that the level of income from those is falling. Is that because councils are charging less or because a lot of people are choosing not to use the services because they cannot afford them any more?

**Fraser McKinlay:** I do not think that we are in a position to say that, although we might want to get into that kind of analysis in the future. At the moment, at least we have a better picture of the current situation.

**Alexander Stewart:** Good morning. Many councils see themselves as being in financial crisis, and your report highlights those councils that find themselves in a more difficult situation. Each council has a short, medium and long-term financial plan, which Audit Scotland looks at in the round before telling it whether it has strong financial planning, strong financial management and that kind of stuff. Many councils have a borrowing strategy to manage the situation. At the moment, we have quite low interest rates and many councils use that to give them a buffer when they are borrowing. Going forward, the situation might change and that buffer might be removed, along with others—as you have indicated—if the reserve is not being managed effectively. What is your view on that? If the reserve strategy and the borrowing strategy are not going to progress, where does local government find itself in the process?

**Ronnie Hinds:** I would dispute the assertion that, across the board, we are looking at reserves and borrowing strategies not progressing or not working. A significant amount of money continues to be held in reserves—not by all 32 councils, but across the piece—which continues to represent some kind of buffer, as you put it, against the vagaries of what funding and other matters might hold for councils.

The situation with borrowing is comparable, although interest rates have recently gone up and it is anybody's guess—mine is no better than anyone else's—what that might mean in the longer term. It might turn out to be a step on a journey, or it might be a one-off that could be reversed—we do not know. What we do know is that councils have, by and large, pretty good treasury management strategies that include the amount that they borrow. In the report, you can see the

extent to which they make use of the various devices that they have at their disposal to ensure that they are not exposed unduly to things such as fluctuations in interest rates. Therefore, although for you and I, if we have a mortgage, an increase of 0.5 per cent might have a real impact on our pocket the day after tomorrow, that will not necessarily be the case for well-managed councils, because they will have negotiated fixed interest rates.

Councils also have other strings to their bow; they can decide when to borrow, for example. If their crystal ball is a little clearer than mine—they will get good advice on what might happen to interest rates in, say, 12 months' time—they could decide to borrow now to avoid a possible rate rise, which would give them a further cushion. Our view is always a holistic one: we look at how well councils manage their finances in context, across the piece, rather than at how exposed they might be to one-off changes in interest rates and so on. Therefore, we do not have overwhelming concerns about that.

In the report, we do say that, for the year that we have just audited, there has been a significant shift in the overall amount of debt that local government has, and the key question is what that means for affordability. We say that, broadly speaking, something like 10 per cent of general fund expenditure is committed to repaying debt and the interest that goes with it. However—Tim Bridle will keep me right on this—although that 10 per cent is not an insubstantial figure, it is actually a reduction on the figure for the year before. These things move around a bit, and the fact that there has been an increase in interest rates over the past few months does not mean that local government budgets will commit 13 or 14 per cent to debt repayment next year.

We will have to keep an eye on the issue in the long term, and we work with councils to ensure that they have good strategies behind what they do, but I would not be concerned that the borrowing trend that we have reported for the past year and the movements in reserves mean that councils are more perilously exposed than they were.

**Alexander Stewart:** In reality, they might find themselves to be less exposed, because they have a strong financial management process that they can tap into, which gives them an advantage over other organisations in the field. We can see that how that is interpreted and how each local council plans to manage its finances over the next three to five years is an important process for them. In the report, you identify councils that perhaps do not have as strong a view on that or as strong a process to ensure that they do not find themselves in a more perilous situation. The idea

of trying to coordinate and manage the finances is important.

Councils are looking at the long term, with new demographic difficulties and IJBs and so on coming into the mix. The way in which they spend their money is changing, depending on what they are trying to manage within the process. They do not have flexibility on some of those, because some things are statutory and are left to them to do, so they must spend money on those before they can deal with other services, which they might have to reduce or might have to increase charges for.

What is your view on that situation, which exists for many councils?

**Ronnie Hinds:** If what you are referring to is the comment in the report about the differential impact of the savings that have had to be made across the range of services that councils provide, we feel that that is an increasingly important point, which is why we made it again in this report. In the early part of the new year, we will make it again in a different fashion when we look at the services themselves in the overview report.

Clearly, and not just because of statutory protection, degrees of preference or priority are attached to some services compared with others, and for perfectly understandable and justifiable reasons. Our view is that, although that is justifiable and it is up to councils to set their own priorities, sometimes in conjunction with the Scottish Government, setting priorities has to be done with your eyes wide open, and you have to be very conscious of the impact on other services.

We tried to set that out in the report in financial terms. We are not saying that the 12 per cent reduction over a three-year period in culture and leisure services is unsustainable; that is not our view. Our view is that that is quite clearly different from the level of savings that have had to be made in, say, the education service. Although councils are entitled to say that they want to protect education, and the Scottish Government is entitled to come to understandings with them on that, the consequences of that for other services have to be noted, and we think that it is part of councils' best-value duty to make sure that they do that. We are pushing very hard to ensure that the impact of savings on other services is understood by councils, and we will say more on that in the report that we publish in the new year.

**Kenneth Gibson:** I have a very brief question on the issue of debt. You talked about local authorities being able to manage debt by borrowing and interest rates being low but, at the bottom of paragraph 53 of the report, you also said:

"PPP/PFI and indexed linked bonds include charges that increase with inflation."

Surely that means that local authorities that have high payments for private finance initiatives, such as North Ayrshire, are more exposed.

**Ronnie Hinds:** All other things being equal, I agree with that. In the new year, we are going to do a bespoke piece of work on the various forms of funding for capital projects, including PFI and public-private partnerships. I will ask Fraser McKinlay to say more about that in a moment.

The work is not just driven by this issue, but you are right to say that, to a degree, there is a lack of flexibility with some forms of funding that might not apply to other aspects of capital funding. We have to make sure that that is considered in the context of the bigger picture that we are trying to paint, which is about how much of a council's budget is given over, one way or another, to maintain the costs of capital investment decisions that were made in the past. That is not because we think that those decisions were badly made, but because the overall financial context in which some of those earlier decisions might have been made was very different from the context now. There is room for manoeuvre one way or another but, if it is decreased, the impact is greater on the council budgets.

Fraser McKinlay might want to say a wee bit more about the piece of work that we intend to do in that particular area.

**Fraser McKinlay:** There is not much to say other than that we have a plan to look at not just PFI/PPP, but all the alternative means of financing and funding capital projects, and we will get into some of those issues.

It comes back to the same central point about the importance of good medium and long-term financial planning. Councils should be aware of their exposure and we would expect them to carry out good sensitivity analysis that lets them understand what would happen if an interest rate were to rise or not, and to look to, as many councils do, actively manage and reprofile their debt accordingly. All of those factors are the reason for our banging the drum for better medium and longer-term financial planning.

11:45

**Jenny Gilruth:** Good morning, panel. I have a question on paragraph 20, which is about universal credit. As you say, it has been rolled out across five council areas in Scotland. You say:

"Rent arrears across these councils increased in 2016/17 by an average of 14 per cent, compared with an average of 4 per cent across the remaining councils",

and your housing benefit performance audit report highlighted that councils are finding that the roll-out of universal credit is having

“a detrimental effect on their collection of housing rental income.”

Is universal credit increasing financial pressure on local councils?

**Tim Bridle:** For housing authorities, it is fair to say that. There are pressures on rents in housing revenue accounts. We normally differentiate between general services, which are funded via general revenue grant and taxation, and housing revenue accounts, which are funded by rents. It is fair to say that, so far, the pressures for councils have been housing revenue account pressures caused by rent collection issues. There is a sense that some general fund pressures may be associated with universal credit, but it is a bit early for me to be able to comment on that.

**Ronnie Hinds:** In any report we touch on a number of issues that we cannot really develop, of which that is one. It would be remiss of us not to make any mention of universal credit just because the primary focus of the work happens to be the council's general fund. However, we are planning a specific piece of work on housing. We did a report on housing around three years ago, and we feel that it is time to look at a number of situations, including universal credit. I expect that that would be the opportunity to get into the depths of the issue. When we do that, we will know more. At the moment, we know only what we can report to you, which is not much.

By the time that we produce that report, I presume that we will be beyond the pilot stage with a number of councils and we will be able to look in greater depth at what impact, if any, universal credit is having on rent arrears. At the moment, we can see a pattern of correlation emerging, but we need to get under the skin of it and find out what is actually happening and whether it is something that is sustainable or is perhaps just a blip because of the difficulty of introducing a new system of benefits. We do not know at this stage.

**Jenny Gilruth:** You may not know the answer to this question either, but I will ask it anyway. The report talks about risk and uncertainty. A number of groups in my constituency in Fife are being supported directly by European Union structural funds. Such budgets are often administered via councils, and I know that Fife Council works closely with those groups. Do you have a view on how Brexit will impact local government finance? *[Laughter.]*

**The Convener:** A nice easy question.

**Jenny Gilruth:** Yes, just an easy one.

**Ronnie Hinds:** I am very tempted just to pull up the drawbridge and say that we do not cover that in the report.

**The Convener:** I thought that that was Brexit.

**Ronnie Hinds:** I cannot comment on that. What I can say with some security is that the picture will become clearer. The committee would be surprised if I were to say anything other than this: we have already identified Brexit as being one of the bigger landscape risks within which we have to operate. Our view is clearly focused on local government. Brexit pervades the economy as a whole, and other factors too. As we do our risk planning and come to decisions about which pieces of work we might most usefully do—a couple of which I have referred to already—Brexit is one of the risks that we are considering, and it is getting bigger.

The best thing that I can say is that when Brexit's impact on EU funding for local communities, particularly via councils, becomes a little clearer, our thinking will be sharper about whether a piece of work on that might be useful. At the moment, anything that we did would be too speculative to add value.

**Fraser McKinlay:** This year, as we begin planning for the coming audit year, which kicks off about now, we have asked auditors to look specifically at how the bodies that we audit across the public sector—on behalf of the Accounts Commission and the Auditor General—are preparing for Brexit. We are doing work to check the extent to which individual public bodies understand its impact.

My feeling is that councils are really quite alert to that. They understand the money that comes via Europe and are doing what they can to prepare for Brexit. As we know, the challenge is that there is so much uncertainty on the topic that it is very difficult to plan in any detail.

**Graham Simpson:** Last year, when we were considering the matter, it was not very clear whether council funding was going down or staying the same. It was all very confused, as we suggested in our report. One of the factors in that confusion was the funding for integration joint boards. Are we any clearer now?

In paragraph 11 of your report you seem to include money from integration joint boards and state that there was a revenue cut in 2016-17 of 5.2 per cent in real terms. Last year, we struggled to reach a definitive figure. Are you any clearer on that this year?

**Ronnie Hinds:** I am looking for the reference in the report—there is a table that demonstrates the movements in funding. Are you asking about the movements over time in the funding for local



government or have I misunderstood your question?

**Graham Simpson:** No. Last year, when we considered the budget, we struggled to ascertain a figure that showed whether money to councils was going down or not. One of the confusing bits was the contribution of IJBs and other factors. I am asking whether we are any closer to getting some clarity on that.

**Ronnie Hinds:** I hope so. Part of that greater clarity might be the result of the decisions that the committee came to on considering our report as well as evidence from other sources. I have seen the correspondence on that and some of the undertakings that the Government has made. We await with interest the budget figures that will be produced in a few weeks' time to see what that will mean.

On the specific point about IJBs, at exhibit 11 we have tried to separate out the effect of the additional resource given to IJBs in 2016-17 and later we do that for 2017-18. I hope that that is helpful. We stand by what we said at the time about whether it is right to include IJB funding in an account of Scottish Government funding as a whole to local government: the money to the IJBs goes into the accounts of health boards, and as a consequence, we do not think that it should be included in the local government total. However, we recognise that some people take a different view, so we have tried to separate it out so that you can see for yourself. It is a matter of choice which line in that analysis you consider to be the right one.

That is as clear as we can be. The money for IJBs clearly goes into the accounts of health boards. What happens to it after that is part of the bigger picture of IJBs that we touched on earlier. Among other things, we will be interested in clarity about whether all that money finds its way into the budgets of the IJBs. However, at the moment, all that we can say is that that money does not go to local government and so, in our view, is not part of local government funding from the Scottish Government.

**Graham Simpson:** When we look at it, should we discount the IJB money that goes to health boards and just look at the money that goes directly to councils?

**Ronnie Hinds:** It depends what point you are trying to make. We are trying to make a comparison over a period of years to say what the position for local government funding from the Scottish Government is compared to the Scottish Government's own funding. To make that comparison, you would use the statistics in one way. If you are trying to make another point, you

would use the statistics in another way. It depends on what point you want to make, Mr Simpson.

**Graham Simpson:** I am not trying to make a point. Last year, we just needed to know the position. You have illustrated the problem.

**Fraser McKinlay:** It will always be difficult to get everyone to sign up to one figure that will answer the question of whether the funding is going up or down. That is why we have tried to separate things out in this year's report. As the deputy chair, Mr Hinds, said earlier, this is the second time that we have produced the report and I am sure that we will be able to do more next year to bring further clarity and transparency.

I refer to our experience of reporting on similar issues, such as reserves. When the commission started reporting on reserves some years ago, that shone a spotlight on an opaque area of local government finance. The fact that we are now able to have a conversation about what is happening with reserves in individual councils is a sign of how the debate can be moved on a little. I anticipate this area being similar. As the deputy chair said, we will watch with interest in a few weeks how the cabinet secretary presents things. Rather than come up with a single figure, we are trying to be as clear as we can about the elements of that figure, after which, as Mr Simpson says, people will make their own judgments.

**The Convener:** I might just follow up on that, because I have been pursuing that line of questioning for some time as well. If we focus on what has happened specifically to the revenue grant from the Scottish Government to local authorities over the years, that gives one set of statistics, but, given that we are doing budget scrutiny as part of this evidence session as well, could you outline what additional revenues from the Scottish Government, direct or indirect, go to local authorities to support the delivery of services? Exhibit 2 shows the significant difference in the numbers if IJB funds are included, which is helpful. With regard to the spending power or the liabilities of local authorities, do you not recognise that IJB funds have to be included, given that £125 million of those funds were used in the past year for living wage and wage pressures in the social care sector? Had those moneys not come through the NHS, they would have had to be found elsewhere.

**Ronnie Hinds:** I will rephrase my comment. It depends on your interest in the subject. The way that you have put it is helpful. If your interest is in seeing how much purchasing power there is to provide a range of local services, your eye would be drawn in exhibit 2, for example, to the bottom line, which says that the £250 million in 2016-17 that went into IJBs was clearly meant to buy local health and care services. That is the conclusion

you would draw. If your interest is in which bits of the local government funding formula are properly attributable to councils as entities, you would look at something different. It is not the point that you are trying to make, but the interest that you have in the matter.

**The Convener:** Does the general revenue grant include the £110 million generated by the change in the council tax bands and the multipliers on that?

**Tim Bridle:** No; that is very much local income that councils collect.

**The Convener:** I will explain why I asked. Mr Wightman set the scene well at the opening of the evidence session. We are scrutinising local authorities' spending power and their flexibility to raise revenue. Over the years, there has been a belief that local authorities have become too reliant on the revenue grant from the Scottish Government and, as other streams of revenue have become available to them, it would be helpful for those to be outlined in the same tables. I would have found it helpful if exhibit 2 had also included the moneys generated by the council tax multipliers, because there was a Scottish Government decision to give that money to local authorities. I would also have found it helpful to have the projected 3 per cent council tax increase included to get the actual revenue position of local government.

My frustration, which I experienced when the Convention of Scottish Local Authorities appeared before us recently, is that while I accept that the Scottish Government tries each year to make the financial position of councils look as good as it can and that COSLA tries to make it look as weak as it can, the truth lies in between. We await with interest the information that will be provided by Mr Mackay when the budget is produced. We have been clear about what the committee expects from him, but we will have to wait to see whether that transpires.

Would the commission consider in future revisions of its report the inclusion of those other moneys in exhibit 2 to give us a better feel for the actual position of local government?

12:00

**Ronnie Hinds:** In the report, we show the figure that you referred to—the £110 million—in a different context. We are not disputing for a second that that is additional resource that local government has at its disposal. The question being posed now is whether that sits properly in the analysis on the page that we are looking at, underneath exhibits 1 and 2. We can take that point on board.

As I said, we are happy to provide further information to the committee as a result of this morning's discussion, if you think that that would be helpful. We would be more than happy to put together the pieces of the jigsaw, if you like, in a response to you and set out as best we can where we think the relative sums of money sit.

In advance of doing that, I would say that the answer depends on what interest you have in the matter. That part of the report is looking at Scottish Government revenue funding to councils. It would be a significant misinterpretation of that to say that council tax—even a part of it—was Scottish Government revenue funding to councils. It might be funding that councils have at their disposal, but it would not sit happily under that heading. We would need to think about how best to present the information in a way that was clear and helpful.

**The Convener:** That point is very well made and I fully accept it. I also accept that it is not your responsibility to do that; it is the Scottish Government's responsibility to set out its figures clearly so that they can be scrutinised by you, us and others. Although we would find that helpful, the onus does not sit with your organisation.

I will ask a couple of questions about exhibit 23, then the deputy convener will ask some other questions. I am looking at exhibit 23 now—I thought that I understood it, but then I went off on a tangent, so let me look at it again.

We will find out shortly what the funding settlement is for the coming financial year. Does the potential funding shortage of £343 million refer to the overall money going to local authorities or just the revenue grant?

**Tim Bridle:** That is based on local authorities' overall income from the general revenue grant and taxation, including council tax.

**The Convener:** Does it include integration joint board funds?

**Tim Bridle:** That is a good question.

**The Convener:** It is one that COSLA could not answer.

**Tim Bridle:** I do not think that it does. Those funds do not feature at that level. They come into the accounts at the higher level. Exhibit 23 deals with what we call net revenue expenditure, which is funded from the general revenue grant and taxation. The IJB money would come in at the higher level.

**The Convener:** Your report says:

"In the absence of further savings, councils would use around £343 million in 2018/19 if expenditure were to increase by 0.5 per cent and income decrease by 1.5 per cent."

It would be helpful to know whether that funding gap assumes that £250 million had already been given to local authorities via IJBs. Is the funding gap £343 million minus £250 million, or whatever the current figure is?

**Ronnie Hinds:** We will clarify that in the letter that I referred to. It will be another part of what I call the jigsaw that it would be useful to set out for you.

**The Convener:** That would be very good.

So the £343 million is predicated on a revenue cut of 1.5 per cent from the Scottish Government. Is that right?

**Ronnie Hinds:** It is an overall reduction in councils' income, so it is a mix: a reduction in their income from council tax, the general revenue grant and non-domestic rates.

**The Convener:** So it is predicated on a reduction in council tax funds.

**Ronnie Hinds:** Yes.

**The Convener:** I do not have any further questions on the table at exhibit 23. I just wanted to better understand it for when we do our budget scrutiny.

**Ronnie Hinds:** I should say—I am sure that you would have figured this out anyway—that we are not saying that that £343 million figure has any specific significance. We are setting out a range of possibilities. You will have heard from other parties where they think it sits in all this, and you will need to form your own judgment. However, in our supplementary letter to you we will set out more clearly the assumptions that underlie the reductions in income and the increases in expenditure.

**The Convener:** Your evidence was very helpful. When COSLA gave evidence, it talked about a funding gap of about £580 million, but that was predicated on every worker being given a 3 per cent pay increase. We are getting clarity on whether integration joint board money was included in that mix. We are in contact with COSLA to confirm whether it was.

**Kenneth Gibson:** The COSLA figure included a 3 per cent pay rise and a 2.8 per cent increase, I think, in demand pressure, but it is not obvious whether that increase is due to an ageing population or whatever it happens to be.

**Ronnie Hinds:** Yes. The figures across the top of exhibit 23 are just changes in expenditure—we do not differentiate between rises in inflation and the increase in demand or anything. It is just a matter of picking a number that looks sensible and asking what that would mean in terms of the funding gap.

**The Convener:** I think that exhibit 23 helps the committee in so far as it gives us a table of baselines to which we can add pressures or revenues to see how those all interact with each other. Now that I think I understand exhibit 23, I can see that it is of value.

Elaine Smith has been very patient.

**Elaine Smith:** First, I ask for some clarification on the same exhibit. You have picked out the figure of minus £343 million as an example. Is that just to show how the table works?

**Ronnie Hinds:** Yes.

**Elaine Smith:** It is not a real figure.

**Ronnie Hinds:** No.

**Elaine Smith:** Paragraph 17 of your report states:

“The Scottish Government and COSLA should assure themselves that the funding formula remains fit for purpose in a changing landscape for local government.”

Do you have an opinion on whether it remains fit for purpose? Who should look at it to see whether it remains fit for purpose?

**Ronnie Hinds:** This is the first time that we have ventured into this territory, but we have done so because we think that transparency and clarity around a very complex arrangement would be beneficial. The committee has also expressed that view in the past. We are not doing this because we think that we are experts in the difficulties of local government funding, let alone the complexities of the distribution process that this is just a high-level representation of. We are not sitting in front of you as experts; therefore, even if we had an opinion, it would probably not be of any great value to you. Nevertheless, having looked at the issue and having reported as we have, we think that it has been some time since there was a fundamental review of the funding formula.

At the top of exhibit 4, we point out the number of distinct elements that feed into the top part of the process in somebody's spreadsheet, which eventually distils a set of figures that represent real funding for the 32 councils. Those elements are all quite different from each other, and the question is how coherent such a mixture of things can be. We are not saying that it is not coherent; we just think that the question is worth posing. We also think that the changes that have taken place over the 10 years or so since the formula was last looked at in a fundamental way have been not just changes in the financial context for local government but changes in policy and in other contexts—not only in local government, but in the Scottish Government as well.

Against that background, given the aspiration to deliver better outcomes for the people of Scotland,

whether any funding arrangement—let alone one as significant as this—is absolutely fit for purpose seems to be a valid question to pose. We are not saying that we think that it is not; we are just saying that, after 10 years, you should look at it. A lot has changed in 10 years, some of which is spelled out in exhibit 4. We do not have an opinion on the matter, because we are not experts, but we advocate at least having a look at the formula for the sake of the transparency that the committee and other interested stakeholders need to see how it all pans out in local government budgets.

**Elaine Smith:** At the start of paragraph 17, you say that

“funding to expand early years’ childcare ... has come as ‘additional funding’”

but that it is

“specifically directed at delivering particular national policies.”

We used to call that ring fencing. Do you think that funding that is specifically for national policies should be looked at differently? Is that what you are suggesting?

**Ronnie Hinds:** No. We are asking whether the foundation of the process remains what it has always been—a needs-based formula to distribute resources equitably between 32 councils. If that remains the objective of the funding distribution, it is worth looking at the formula again to see whether the things that have been added to it over the past 10 years or so are genuinely needs based and whether it still produces the best outcome if the Government is trying to deliver resources to councils so that they can play their part in servicing their local communities and in delivering high-level policy priorities that both councils and the Scottish Government have an interest in delivering. The answer might turn out to be yes, but we think that the question is worth posing.

**Fraser McKinlay:** Our core question is a simple one. If there is a growing sense that we should be allocating money for particular purposes in different ways—for example, through the pupil equity fund or support for the early years—that raises the question of the core funding formula. If the core funding formula was designed to reduce inequality and improve outcomes, as the policy framework is now designed to do, it could be argued that we do not need separate revenue streams for additional funding and non-specific changes. The more that is added on to those bits, the more reasonable it seems to ask the question about the core funding formula. That is our core point.

**The Convener:** Time is almost upon us. I apologise to Mr Wightman, but he will have to be brief. I hope that we can finish the evidence session by a quarter past 12.

**Andy Wightman:** I have a brief follow-up question. Your answers are helpful. I have been engaging with the process because of the proposed cuts to the funds for the City of Edinburgh music school, which were ring fenced in 2008. The concordat says that the funds are now wrapped up in the settlement, but where they are in the settlement is a little bit unclear. It would be useful to explore that in the future.

Exhibit 5 talks about “budgetary pressures” including the single state pension, the living wage for social care workers, annual increases in staff costs and so on. Is it your impression that those pressures are now significantly greater than they have been over the past decade or so? I would like to get an impression of the relative scale of the pressures that are now being faced.

**Ronnie Hinds:** Others might have a more coherent view than I have, but I would not say that. Financial pressures—cost pressures, to be more accurate—of one sort or another are an everyday and every-year fact of local government life, so we have not looked to see whether those pressures were more or less severe in 2016-17 than they were in previous years. However, I can safely say that they were not out of line—they were not extraordinary pressures. Therefore, even if they were consistent with the pressures in previous years, against a backdrop of reducing resources they were harder to deal with. That is the core point that we are making.

**Andy Wightman:** That is all. Thank you.

**The Convener:** That was very brief, Mr Wightman. I appreciate that.

Members have no further questions. As always, the report is really helpful and challenging. It will enable us, as MSPs, to better scrutinise the budget when the numbers come out, so we very much appreciate that. We look forward to working in partnership with you in the months and years ahead. Thank you very much.

We move to agenda item 3, which the committee has agreed to take in private.

12:12

*Meeting continued in private until 12:28.*

This is the final edition of the *Official Report* of this meeting. It is part of the Scottish Parliament *Official Report* archive and has been sent for legal deposit.

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