

# A BLUEPRINT FOR 2020: THE EXPANSION OF EARLY LEARNING AND CHILDCARE IN SCOTLAND

FUNDING FOLLOWS THE CHILD AND THE NATIONAL  
STANDARD FOR EARLY LEARNING AND CHILDCARE  
PROVIDERS: GUIDANCE FOR SETTING SUSTAINABLE RATES  
FROM AUGUST 2020



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## **NOTE TO THE READER**

**This guidance note is not intended as a substitute for legal advice and any party seeking to rely upon it should seek their own legal and / or related specialist advice before doing so.**

*Scotland Excel is the Centre of Procurement Expertise for the local government sector. Established in 2008, Scotland Excel are a leading non-profit shared service funded by Scotland's 32 local authorities.*

*Scotland Excel has been commissioned by the Scottish Government, on behalf of the Service Models Working Group, to develop a suite of supporting operational guidance and information that helps local authorities and providers in the private and third sectors, including childminders, implement Funding Follows the Child, and the underpinning National Standard, from August 2020. This included guidance on setting sustainable rates for delivery of the funded entitlement.*

*This Guidance has been produced based on feedback gathered from local authorities, providers, provider bodies and other stakeholders (for example, Care Inspectorate). This has been through various focus groups and meetings, and a survey which was issued to all Care Inspectorate registered providers and to local authorities. Comments were also received from a smaller group of providers and local authorities, as well as provider bodies, on drafts of the guidance notes.*

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## **INTRODUCTION**

1. The Scottish Government and local authorities have committed to the near doubling of the funded Early Learning and Childcare (ELC) entitlement from 600 to 1140 hours per year from August 2020 for all 3 and 4 year olds, and eligible 2 year olds.
2. In order to ensure that the funded entitlement is delivered in high quality ELC settings, Funding Follows the Child will be introduced in August 2020 alongside the statutory roll-out of the expanded entitlement.
3. This approach is ‘provider neutral’ and is underpinned by a National Standard that all settings who wish to deliver the funded entitlement will have to meet.
4. The Scottish Government and COSLA published national guidance on [Funding Follows the Child](#) in December 2018. This included supporting [Operating Guidance](#) and a [Frequently Asked Questions](#) document.
5. Funding Follows the Child was developed through the Scottish Government, COSLA and local authorities working in partnership, through the Service Models Working Group and through wider engagement with the ELC sector, including with providers. This included a consultation on Funding Follows the Child and the underpinning National Standard, which was supported by a programme of engagement events<sup>1</sup>.
6. Scotland Excel has been commissioned by the Scottish Government, on behalf of the Service Models Working Group, to develop a suite of supporting technical guidance and information that supports local authorities and providers to implement Funding Follows the Child. The technical guidance documents cover:
  - establishing sustainable rates for funded providers;
  - meeting the business sustainability criteria in the National Standard; and,
  - transition options on contracting.

### **Sustainable Rates**

7. Under Funding Follows the Child, local authorities will set a rate locally that is paid to funded providers in the private and third sectors, including childminders, to deliver the funded entitlement. This rate should be sustainable and reflect national policy priorities, including funding to enable payment of the real Living Wage to all childcare workers delivering the funded entitlement.

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<sup>1</sup> More information on the Consultation, including the responses and an analysis of the responses is available at: <https://consult.gov.scot/children-and-families/service-model-for-2020/>.

8. The Operating Guidance published in December 2018 states that:

*“under a ‘provider neutral’ approach, it is essential that provision is financially sustainable in order to ensure that providers across all sectors are willing and able to deliver the funded entitlement.”*

9. A sustainable rate is imperative to ensure a high-quality ELC experience for children and their families.

### **Aim of this Guidance Note**

10. This document provides guidance to enable the setting of a sustainable local rate for funded hours from the full national roll-out of 1140 hours of funded ELC entitlement from August 2020. It is the responsibility of the local authority to set a sustainable rate for the delivery of the funded hours in their area. It is for private and third sector providers, including childminders, to determine whether the rate set is suitable for their business and whether they wish to enter into a contract on this basis.

11. A small number of local authorities have already confirmed their rates for August 2020. Where this is the case, it is expected that local authorities will be able to clearly and transparently set out the methodology that they have used to determine these rates, which should align with the approaches and principles set out in this guidance.

12. It is vital that the process for establishing sustainable rates in a local authority area is transparent and reflective of evidence on the costs of delivery.

13. This guidance reflects both current underlying cost factors and the delivery of national policy priorities from 2020. The principles and processes also provide a framework to monitor the costs of ELC for future contract management.

### **Background**

14. In 2016, the Scottish Government commissioned Ipsos MORI to produce [Costs of Early Learning and Childcare Provision in Partner Provider Settings](#). This outlined the key cost drivers for providers in the private and third sectors based on responses to an online survey of funded providers to which there were 191 respondents who covered 222 providers in total.

15. The detailed cost information collected from providers by Ipsos MORI included: staffing; rent / mortgage; utilities; tax; consumables; buildings and maintenance; equipment; catering; ICT; and staff training.

16. Feedback from provider bodies and local authorities gathered at Scotland Excel focus groups (held in September, October and December 2018) suggested that the methodology used for the Ipsos MORI report was appropriate and that the research provided an accurate reflection of the costs of ELC provision, at the time of the survey.
17. ***Based on the feedback, this guidance builds on the research conducted by Ipsos MORI, by providing information on how local authorities and private and third sector providers can ensure sustainable funding rates, based on cost, for and beyond 2020.***

## **SECTION 1: CHARACTERISTICS OF A SUSTAINABLE RATE**

18. Responses to the [ELC Service Model for 2020: Consultation Paper](#) demonstrated that sustainability was of key importance to funded providers. This section defines a sustainable rate in the context of ELC services and its' stakeholders.
19. For clarification, 'rate' is the sum of money paid to a funded provider for a set period, usually either hourly or sessional, for the provision of funded ELC services to one child.
20. The Funding Follows the Child [Operating Guidance](#) sets out that the sustainable hourly rate set by local authorities to be paid to funded providers in the private and third sectors, including childminders, to deliver the funded entitlement should meet the following:
- The rate will support delivery of a high quality ELC experience for all children;
  - It will be a rate that reflects the cost of delivery, including the delivery of national policy objectives;
  - The rate will allow for investment in the setting – staff, resources and physical environment; and,
  - It will enable payment of the real Living Wage for those childcare workers delivering the funded entitlement.
21. In particular, feedback gathered from local authorities and provider bodies indicated that a sustainable funding rate should cover the cost of running the service and allow for future investment and development. This differs from a rate which only reflects short-term operational costs.
22. Local authorities also indicated that the rate must be sustainable for them in terms of the budgets available. The following points are also important to consider when setting a sustainable rate:
- The rate does not have a detrimental effect on the local authority's ability to continue to pay for the service in the long-term;
  - The wider package of 'in-kind benefits', which are separate to the sustainable rates and are available to the funded provider as part of the contract with the local authority; and
  - The rate does not need to be cross-subsidised by parents and carers through charges for non-funded hours.

## **SECTION 2: PRINCIPLES OF SETTING SUSTAINABLE RATES**

23. Engagement with stakeholders, in particular local authorities, private and third sector providers, has included discussion on the principles of establishing sustainable rates.

24. The following principles should be applied when establishing sustainable rates and illustrate key agreed themes that emerged throughout these discussions:

- Local authorities and providers should approach the sustainable rate setting process with a focus on a high-quality ELC experience for children and their families;
- The rate should be evidence-based, taking account of the cost of providing ELC in a local area based on parameters which are clear and transparent;
- Local authorities and funded providers should work together to be as transparent and open as commercially reasonable when discussing rates and costs;
- The definition of a 'sustainable rate', as set out in paragraph 20 should be read and understood by all parties before rate setting exercises are undertaken;
- Local authorities should clearly set out what is included (and not included) in the support package in addition to the hourly rate, at the point of application;
- Inflationary and real Living Wage increases should be reviewed on a regular basis, to understand any changes to these and their impact on costs;
- A sustainable rate (or rates) for the funded hours will be set at local authority level; and,
- The sustainable rate setting process should consider return on investment or surplus whilst recognising that funded hours will generally not represent all the hours a private or third sector provider, including childminders, delivers.

## **SECTION 3: COST STRUCTURE OF THE MARKET**

### **3.1: Previous Research**

25. The [Funding Follows the Child and the National Standard for Early Learning and Childcare Providers: Operating Guidance](#) states that:

*“The ELC sector in Scotland operates as a mixed economy model with a mixture of public, private and third sector providers. Most of these providers offer the funded entitlement.*

*However, for providers in the private and third sectors the Financial Review of Early Learning and Childcare in Scotland highlighted that the majority of their income comes from the fees that they charge to parents and carers for non-funded hours.”*

26. The [Financial Review of Early Learning and Childcare in Scotland: The Current Landscape](#), published in September 2016, set out more context on the structure of the childcare market in Scotland and the sources of income for private and third sector providers. As part of the Financial Review of ELC, the Scottish Government commissioned Ipsos MORI to produce [Costs of Early Learning and Childcare Provision in Partner Provider Settings](#).

27. The analysis highlighted that, in 2016, around 23% of the income that funded providers received was from funded hours. The report found that this share was considerably higher for funded providers located in remote areas.
28. The majority of funded provider income (around 77%), in 2016, was from fees paid directly by parents and carers. This could cover fees for non-eligible children (for example, those aged 0-2) or for additional hours that parents of eligible children required (for example, non-funded hours or ‘wrap-around’ hours).
29. The share of income accounted for by the funded entitlement in funded providers is expected to increase with the roll-out of 1140 hours as settings allocate more of their capacity towards delivering the funded hours.
30. The report highlighted that the average (mean) reported rate paid to providers in 2016 by local authorities for delivery of the funded hours (for 3-5 year-olds) was £3.59 per hour. This compared to an overall estimated average (mean) cost to providers of providing one hour of ELC to 0-5 year-olds of £3.70. However, the report also highlighted that:

*“the cost estimates are an average across 0-5 year-olds. Because of the higher costs associated with younger children (for example, due to higher adult-child ratios), the average unit cost of providing ELC to 0-2 year-olds will be higher than £3.70, and for 3-5 year-olds will be lower.”*

31. Analysis produced using data from the Financial Review highlighted that, in 2016, the funding rate paid by local authorities to around 40% of funded providers in the private and third sectors did not cover their costs for delivering the funded hours.
32. To determine sustainable rates, it is important to have a shared understanding of the cost of delivering the funded entitlement. This will support local authorities to establish an affordable and sustainable rate for delivery of funded hours across private and third sector providers, including childminders. While actual costs need to be explored locally, previous research on private and third sector providers has demonstrated that the cost of provision is similar across these settings.
33. Table 1 shows the breakdown that the Ipsos MORI report found in the 'average' provider cost structure.

**Table 1: Cost breakdown from Ipsos MORI report<sup>2</sup>**

<b>Cost (across 0-5 year olds)</b>	<b>Percentage<sup>3</sup></b>
<b>Staff</b>	71%
<b>Rent / Mortgage</b>	7%
<b>Utilities</b>	4%
<b>Consumables</b>	4%
<b>Catering</b>	0%
<b>Play and learning equipment</b>	3%
<b>Services</b>	1%
<b>Training</b>	1%
<b>Equipment</b>	1%
<b>Transport</b>	1%
<b>Maintenance</b>	2%
<b>Building service</b>	1%
<b>Business rates</b>	1%
<b>Other taxes</b>	2%
<b>Other costs</b>	4%

34. Whilst the Ipsos MORI report captured a range of detailed cost information, it did not include information regarding the return on investment (profit) within settings.
35. A key feature of a sustainable rate is that it needs to allow for investment in the setting - staff, resources and physical environment - to ensure continuity of service. This occurs through profit in a private sector setting or surplus in a third sector organisation.

<sup>2</sup> Based on Figure 1 on page 28 of [Costs of Early Learning and Childcare Provision in Partner Provider Settings Technical Report \(2016\)](#)

<sup>3</sup> Figure adds to more than 100% due to rounding

36. Data produced by Ibis World, which covers the Pre-Primary Education sector at the UK level, is shown in Table 2.

**Table 2: Costs breakdown from IbisWorld Industry Report<sup>4</sup>**

<b>Industry Costs (2017-2018)</b>	<b>Percentage</b>
<b>Staff Wages</b>	73.1%
<b>Rent</b>	1.1%
<b>Utilities</b>	1.6%
<b>Purchases</b>	14.1%
<b>Depreciation</b>	3.3%
<b>Other</b>	2.4%
<b>Profit</b>	4.4%

37. The research confirmed the primary cost of service provision is related to staff (at between 70-73% of cost) despite the two pieces of research focusing on different time periods (Ipsos MORI in 2016 and IbisWorld in 2017-18) and geographical markets (Ipsos MORI Scotland only and IbisWorld is UK-wide).

### **3.2: Specific Considerations**

38. There are other considerations in setting a sustainable rate which have not been covered in previous research or have changed since this research was carried out. It is important that these are recognised when setting sustainable rates in local areas (See Table 3).

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<sup>4</sup> "P85.100: Pre-Primary Education in the UK", February 2018 – available from [www.ibisworld.co.uk](http://www.ibisworld.co.uk)

**Table 3: Considerations specific to the Scottish ELC marketplace or policy**

<b>Consideration</b>	<b>Information</b>
Inflation	Annual inflationary uplifts were included in the multi-year funding agreement between the Scottish Government and COSLA to support delivery of the expansion. Local authorities should consider how to account for the effects of inflation while reviewing and setting rates. This includes being transparent about the time period in which inflationary uplifts will be reflected in any changes to the rate.
Real Living Wage Increase	<p>Settings delivering the funded entitlement will, in accordance with the supporting guidance on Transition Options for Contracting<sup>5</sup>, pay the real Living Wage to all childcare workers delivering the funded entitlement from August 2020.</p> <p><b>Note:</b> For childminders, this is only relevant where workers are regularly employed to provide direct care to children.</p> <p>Where possible, the process for determining the sustainable rate should identify the estimated element of the rate which reflects payment of the real Living Wage commitment.</p>
Business Rates	Since the publication of the Ipsos MORI analysis, 100% business rate relief for premises wholly or mainly used as day nurseries was introduced from April 2018 (for a minimum of three years).
Food	<p>As set out in the <a href="#">Operating Guidance</a>, funding to deliver the free meal commitment from 2020 will be additional to the sustainable rate for funded providers.</p> <p>Local authorities must ensure that they are transparent as to the funding being provided to private and third sector providers for the delivery of the free meal commitment.</p> <p>Providers will also receive additional payments (i.e. additional to the sustainable rate) for delivery of a healthy snack and milk. In order to minimise the administrative burden on funded providers, local authorities may wish to include all these elements in one payment, however, there should be transparency for providers regarding the separate elements of funding being provided.</p>
Local Market Structure	The makeup of the local market may require additional consideration in the sustainable rate setting process. This is especially important in areas where the market is fragile, such as rural or remote areas. Ensuring adequate representation of

<sup>5</sup> In previous documents, this document is named as the ‘Transition Options’ guidance, specifically under *Criteria 8: Fair Work Practices, including Payment of the real Living Wage* of the National Standard for ELC Providers.

	different types and sizes of providers will lead to a rate being set that is more reflective of the local market as a whole.
Transport and Clothing Costs	Transport and clothing are not statutory requirements and, therefore, have not been included as cost elements. However, dependent on local delivery plans and circumstances, local authorities may take a different approach to these costs.

39. In addition to these specific considerations, a full breakdown of standard costs and cost elements can be found in Annex A of this paper. This information should be used to inform local sustainable rate setting.

## **SECTION 4: DEVELOPING A LOCAL RATE**

40. Setting a sustainable rate locally will require sharing of knowledge and information between funded providers and local authorities in a spirit of meaningful and genuine partnership working.

### **4.1: Research**

41. To set medium- to long-term sustainable rates, local authorities will need to undertake a process to understand actual costs incurred by funded providers when providing funded ELC in their local area, unless this is already available. By working together with private and third sector providers, including childminders, to understand costs, the rate should take account of the cost of providing funded ELC in the local area.

### **4.2: Consultation and Procurement**

42. Where active consultation is undertaken, and a public tender is under consideration, public procurement regulations should be observed. This includes Regulations 41 (Preliminary market consultation), 42 (Prior involvement of candidates or tenderers) and 53 (Publication at national level) of the Public Contracts (Scotland) Regulations 2015. Local authority procurement and legal advisers will provide specific advice on the extent to which this should be reflected in the rate setting process.

### **4.3: Sharing Information**

43. Setting a rate requires considerable sharing of cost information between local authorities and funded providers. For this to take place, relationships and trust between parties need to be developed. The options open to local authorities, and their success, is dependent on the structure of the market and the willingness of both parties to co-operate.

### **4.4: Cost Verification**

44. Private and third sector providers and local authorities need to jointly acknowledge that the local authority has an overarching responsibility to ensure best value. It must also be clear that, in order to ensure robustness of cost information, independent verification of benchmark information may be required.

#### **4.5: Transparency**

45. Local authorities must act transparently, regardless of the process chosen, and make available details of the process, including any relevant non-commercially sensitive information. The local authority should record and justify the costs that have been taken into consideration during the process including where information or details have been removed. Where mechanisms or formulas are used, these should be clearly explained by local authority representatives.

#### **4.6: Rates across Provision**

46. Some local authorities may consider a tiered rate approach for different types of funded provider and for other considerations. It should be noted that any of the processes outlined in Section 5 could be used to gather information to inform a tiered rate approach.

47. A local authority may consider having a different rate based on a child's age and this should be taken into account when developing their sustainable rate process.

48. This does not mean that different processes need to be undertaken, however, variations to costs should be reflected in the rate, for example considering different staff ratios for different ages of children.

#### **4.7: Affordability and Efficiency**

49. Funded providers and local authorities must recognise that local authorities are tasked with managing the sustainable rate within their budgets, meaning that a fair, sustainable rate should consider affordability and efficiency for the local authority. This includes making the most effective use of public funds, within the Best Value requirement of the Local Government in Scotland Act 2003. The local authority should clearly set out where this has been a consideration in the sustainable rate setting process.

## 4.8: Occupancy

### **BOX 1: Understanding Occupancy**

Occupancy and the efficient allocation of available hours of ELC is an important consideration in rate setting as these directly relate to the cost per hour.

The number of available hours in a funded provider setting will be determined by the number of Care Inspectorate registered places and the setting's business model.

This could be established by considering the total number of on-ratio staff hours during the day divided by the appropriate staffing ratios for each age group (to reflect that staffing levels in settings can vary throughout the day).

This total reflects the total number of available hours, based on the business model of the setting, and it operating at full occupancy.

50. Where the process permits, local authorities should request occupancy figures and the number of hours delivered, to understand the cost per hour.
51. It should be noted that, due to the degree of flexibility required in ELC settings, local authorities may include settings that are operating significantly below full occupancy in the sustainable rate setting process, due to local market conditions (for example, in rural areas) and local delivery plan requirements. However, local authorities should ensure best value when contracting services, and this may include considering the appropriateness of including funded providers operating with very low levels of occupancy in the sustainable rate setting process.
52. Where occupancy and actual hours of care delivered are not available or required in the process, the local authority may set the occupancy level to inform the cost estimates, for example, where the local authority is undertaking the process outlined in *Section 5.4: Cost Modelling*. Where the local authority sets the occupancy level, this should be clearly communicated, including the methodology which has been used.

## 4.9: Nature of the Contract

53. The processes set out within this document apply to the most widely used type of contract with funded providers which is currently a contract where the rate paid to a provider reflects the service provided per hour.
54. There may be instances, for example, where increased flexibility, continuity of service and available provision means that a local authority may agree a different payment arrangement (for example, a block grant) or a different contracting

method (for example, a block contract). These arrangements would be the exception rather than the norm and may be subject to alternative processes.

#### **4.10: Meal and Snack Costs**

55. Every child receiving a funded ELC session will receive a free meal. They will also receive a healthy snack and milk. These funded elements should be separate from the sustainable rate.

56. To ease the administrative burden on providers, a local authority may decide to include these elements in the same payment as the sustainable rate or a local authority may account for it separately. The local authority must make sure, particularly where all elements are reflected in one payment, that there is transparency for providers regarding the separate elements of funding being received.

## **SECTION 5: OPTIONS FOR LOCAL RATE SETTING**

57. There are a number of processes that can be used to gather information to establish a sustainable rate. The processes outlined in this section will support local authorities to establish an average rate for the cost of ELC in their area.

- **5.1: Survey (Costs)** – Review detailed cost information provided by private and third sector providers;
- **5.2: Working Group** - Agree, for each cost, a percentage (%) figure and indicative cost through a working group;
- **5.3: Survey (Prices)** - Review current rates charged by private and third sector providers in the local area; and,
- **5.4: Cost Modelling** – Develop costs based on modelling of an ‘average’ local ELC setting.

58. It should be noted that a local authority may choose to use a process, aligned with their available resources, that uses the principles and the points explained in Section 4 (Developing a Local Rate) of this document but which differs from the processes outlined in this section.

## 5.1: Survey (Costs)

59. In this option, the local authority would survey funded providers to establish an average cost based on actual evidenced expenditure. This would yield an average hourly rate that can then be used as the benchmark for a sustainable rate. Figure 1 shows the steps involved.

**Figure 1: Overview of process – Survey (Costs)**



60. As part of this process, funded providers need to evidence actual incurred costs, for example, through balance sheets, profit and loss accounts and any other evidence of actual expenditure to show the different costs incurred. It is likely that the local authority would require significant support from finance colleagues or an external source, to review this information in a timely way. Finance officers should be involved in this process.

61. A local authority would use this information to understand the cost structure of their local private and third sector providers, including childminders, and identify a sustainable rate which reflects the average cost of delivering the service in their area.

62. This can be a resource-intensive and time-consuming process dependent on the number of providers. However, it is based on actual costs (as long as evidence is provided) and, therefore, can be used to understand the impact on the average rate of changes in factors such as the real Living Wage or inflation.

### **Worked Example**

63. The local authority would meet with funded providers to design the survey that will be used to collect cost information. The survey should consider the main cost elements and any sub-headings within these (see Annex A) and the number of hours delivered. It is essential to include provision for profit / surplus or earnings in terms of ensuring continued investment and continuing services in the sector

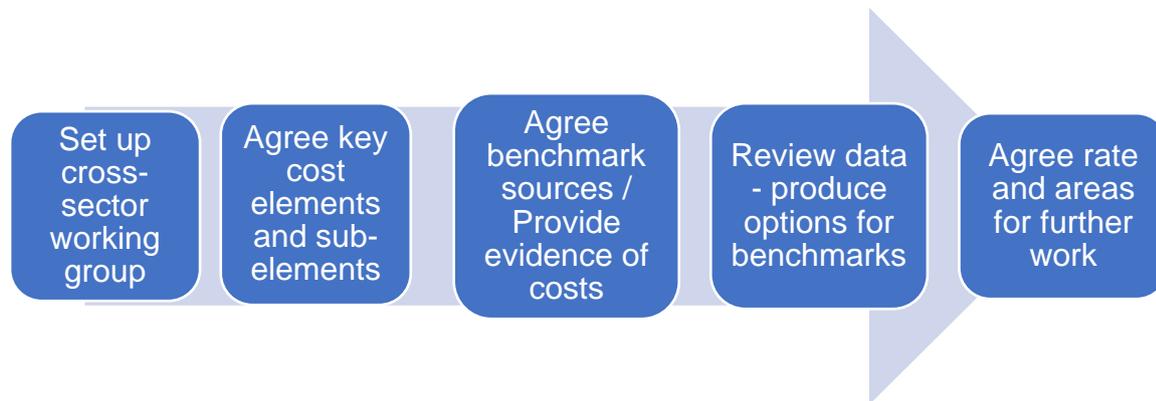
(as per Annex A). The local authority would then devise a form based on this to be completed by each provider, for example, in the form of a spreadsheet.

64. This will allow the local authority to consider the same information, in the same format, from every provider. The local authority may request evidence for incurred costs. Evidence may include information found in balance sheets, profit and loss accounts, management accounts or similar. A local authority may choose to verify information provided to ensure its accuracy. This could be done using a benchmark or external source.
65. **Note:** If the local authority is considering setting a tiered rate, the form may change depending on the information required, for example, childminders may fill in a form that reflects the nature of their setting compared to private nursery settings.
66. Funded providers would be given a fixed time period to submit their return and the local authority would keep a record of those private and third sector providers that submit evidence or any other correspondence received regarding the process.
67. Local authority staff (including finance officers) would then review the survey returns and evidence, requesting clarification, if required. The local authority should confirm that no commercial information submitted is shared with other funded providers.
68. Where the local authority wants to review costs based on the different types of provider, they would separate providers into categories, for example, private providers, third sector providers and childminders. The local authority could then establish different average costs per type of provider.
69. The total average cost incurred divided by the total number of hours delivered by private and third sector providers would then produce the average hourly cost. This can be used as the benchmark for a sustainable rate. If the local authority is considering setting a tiered rate for different settings, this should be repeated by provider type.
70. This process could be undertaken on a regular basis (i.e. annually) in order to ensure the rate reflects the cost of providing the service. An alternative option would be to review changes to key cost drivers, such as changes in the real Living Wage and inflation, to ensure the rate remains sustainable.

## 5.2: Working Group

71. The local authority would set up a working group (or use an existing group) to establish a range of benchmarks for costs. Funded providers and local authorities would work together to agree, for example, working group participation, the cost structure and make-up of the local market, agreeing on the formula used for local costs. Figure 2 shows the steps involved.

**Figure 2:** Overview of process – Working Group



### **Worked Example**

72. The local authority may initially set up an internal meeting with procurement, legal and finance representatives to agree structure, scope and time limits for the process. The local authority would consider the data protection implications of such exercises (for example, childminder data) with their own internal specialist advisers and take necessary steps to comply with data protection requirements.

73. The local authority would then set up a meeting with funded providers to agree the costs that inform the rate. The meeting should include representatives from finance, procurement and potentially a neutral or third party and providers which were representative of the mix of private and third sector providers, including childminders, in a local area. This approach works well when there is an existing representative group of providers and good communication with providers across the local area.

74. The working group would then agree the costs associated with each type of provision. A detailed overview is shown in Annex A, however, a basic summary showing the considerations between childminders and private and third sector settings is shown in Table 5. It is essential to include provision for profit, surplus or earnings in terms of ensuring continued investment and continuing services in the sector (see Annex A).

75. After key cost elements and sub-headings are agreed, benchmark sources would also be agreed. For example, wages could be based on average salaries advertised in the area with additional cost estimates (on-costs) to cover National Insurance, pension and holiday / sickness cover. Annex B illustrates a number of key questions which need to be answered in respect of each benchmark for staffing, before moving to agree the cost value.

**Table 5: Summary of cost considerations**

<b>Childminder</b>	<b>Private / Third Sector</b>
Earnings	Staff
Utilities	Mortgage / rent
Consumables	Utilities
Play and learning equipment	Consumables
Building maintenance and repairs	Play and learning equipment
Transport	Building maintenance and repairs
Catering costs	Transport
Overheads (accountancy fees, bank charges, ICT systems, insurance costs etc.)	Catering costs
Staff training	Overheads (accountancy fees, bank charges, ICT systems, insurance costs etc.)
	Staff training
	Profit / surplus

76. The working group would develop the benchmarks for each of the cost elements and agree on the source of data for each one. When the benchmarks are agreed, values can be calculated for each cost element and totalled to create an hourly rate.

77. Where public benchmark sources are not available, the local authority may request evidence from private and third sector providers to verify actual costs incurred.

78. By agreeing benchmarks, this process can be used over a predetermined number of years and does not need to be conducted on a regular basis. For example, if wage costs are set at the real Living Wage, then any change in this is reflected annually in the rate. Therefore, the rate reflects any relevant changes in staffing costs and inflation. Generally, the benchmarks and values would be reviewed between 3 to 5 years to ensure that they are still relevant to the cost of delivering these services.

### 5.3: Survey (Prices)

79. The local authority would survey local funded providers to establish their current price for a standard day (for example, 8 am to 6 pm) or, for example, an average rate charged over the different sessions run throughout the day. Some settings may charge a different hourly rate depending on the length of the session being purchased, with a full-day session often having a lower average hourly charge relative to a half-day session and this would be taken into account when setting a sustainable rate. Figure 3 shows the steps involved.

**Figure 3:** Overview of process – Survey (Prices)



80. To evidence this, the local authority may request a sample of pricing schedules or invoices. By focusing only on the price charged rather than costs, this process does not yield information on the impact of the real Living Wage on staff costs, or the impact of inflationary increases. However, it is assumed that providers set their prices with reference to their underlying costs of delivery plus an adjustment for profit / surplus.

81. By gathering price information from funded providers, this can be used to confirm an average rate based on local market conditions, on the assumption that the averages prices being charged by private and third sector providers reflect the costs of delivery plus a mark-up for return on investment / profit. This can then be used as the benchmark to inform a sustainable rate.

#### **Worked Example**

82. The local authority would design a survey to collect pricing information from private and third sector providers. The survey may be designed in partnership with these providers and could include different price categories.

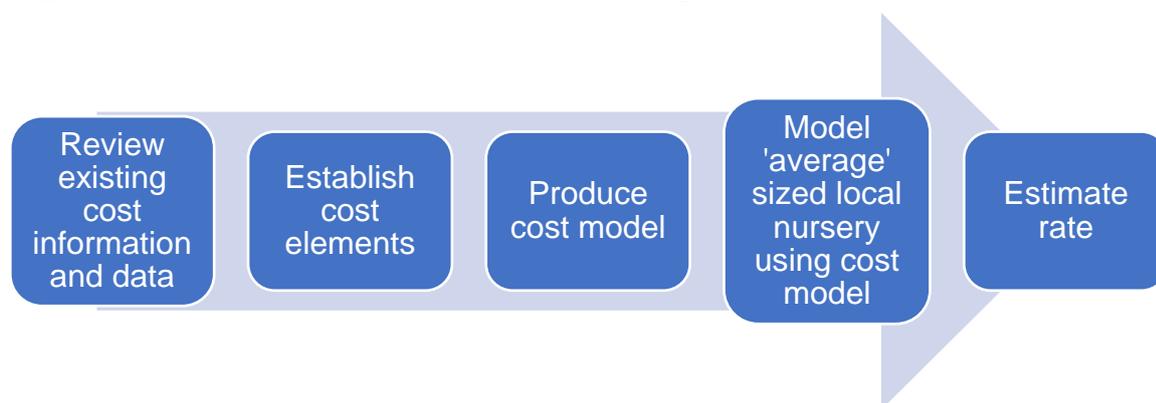
83. The local authority would then request evidence of the pricing fee structure and prices charged.

84. Funded providers, as per National Standard *Criteria 9: Payment Processes*, must clearly and transparently set out the fee structure for any hours purchased in addition to the funded hours, therefore evidence requested from private and third sector providers, in addition to the survey return, may include charging statements or invoices to parents, branded marketing leaflets or similar.
85. Funded providers would be given a designated time period to submit these to the local authority.
86. Local authority staff, including procurement, would then review the evidence submitted and maintain commercial confidentiality. No commercial information sent to the local authority can be shared with other funded providers. A rate could then be generated based on an average hourly rate across private and third sector providers that responded.
87. It should be noted that this process does not account for the difference between the price charged and the cost to provide the service. It also does not clarify the impact that any changes to the real Living Wage and inflation would have on the rate.
88. This process could be conducted on a regular basis to review if the rate offered is in line with the rates charged by the market.

## 5.4: Cost Modelling

89. In the event that no cost data is available, or provided, by private and third sector providers then a local authority could undertake research to establish a 'model' cost based on the average size and scale of provision in their local area. This would reduce the need for funded providers to share information, however, it would potentially give less accurate results. Figure 4 shows the steps involved.

**Figure 4:** Overview of process – Cost Modelling



90. In this case, it is imperative that where mechanisms or formulas are used, these are clearly set out and explained. Additionally, the local authority should record and be transparent with regards to what has been taken into consideration during the process and what has been omitted, including the reasons for this. The cost considerations could be broadly based on those outlined in Annex A.

### **Worked Example**

91. The local authority would base the modelling on information available, for example, through its finance or education department or public data sources. The local authority would agree the main cost elements and any sub-headings internally and supplement cost information from its own settings with estimates for costs it would not incur.

92. The local authority would complete a template (for example based on the table presented in Annex A) to show the main cost elements and any sub-headings with populated figures and the estimated average hourly rate that this would yield.

93. Where estimates are used in the figures, these should be highlighted within the published information.

94. The local authority can consider the real Living Wage commitment within the cost structure and use the populated template to consider / apply any real Living Wage and inflationary changes to the figures.

95. Although this process is not based on actual cost data supplied by private and third sector providers, it provides a transparent and consistent process to setting a sustainable rate, and the local authority could provide detailed information on the data sources for the cost data.
96. This process would need to be updated on a regular basis to ensure that the rate consistently reflects the costs incurred.

## 5.5: Process Summary

97. The table below outlines the processes discussed in this section and highlights further considerations that may assist a local authority when it is deciding which particular process to use when establishing a sustainable rate.

98. For example, if time and cost are important considerations then a Cost Modelling or Survey (Prices) process may be the best method to determine a sustainable rate. However, this may need to be conducted annually to reflect changes in relevant cost drivers and inflation.

99. If the key driver is transparency and building on existing relationships with providers, then the working group approach may provide a longer-term solution and prevent the need for undertaking an annual process.

100. If the local authority wants to understand the impact of changes in cost factors on the rate, then the Survey (Costs) method would provide this transparency.

101. Regardless of the process chosen, it is important that the process is transparent, based on evidence and shared with private and third sector providers (including childminders) locally.

**Table 6:** Summary of processes to set sustainable rates from 2020

<b>Process</b>	<b>Key Requirements</b>	<b>Key Considerations</b>	<b>Further Considerations</b>
<b>Survey (Costs)</b>	<p>A form for providers to submit cost information.</p> <p>Guidance for completing forms / information requests.</p> <p>Willingness of local authorities and providers to engage: High</p>	<ul style="list-style-type: none"> <li>✓ Based on costs submitted by providers</li> <li>✓ Should be undertaken regularly</li> <li>✓ Information sharing: high – all private and third sector providers surveyed</li> <li>✓ Costs of conducting a survey</li> </ul>	<ul style="list-style-type: none"> <li>➤ Needs to be reviewed regularly</li> <li>➤ Expected to be a 3 – 6 month process</li> <li>➤ Transparent – requirement to validate costs (evidence from private and third sector providers)</li> <li>➤ Time- and resource-intensive</li> </ul>

<b>Process</b>	<b>Key Requirements</b>	<b>Key Considerations</b>	<b>Further Considerations</b>
<b>Working Group</b>	<p>Clear roles and responsibilities for providers and local authorities.</p> <p>Clear guidance on completing templates.</p> <p>Willingness of local authorities and providers to engage: High</p>	<ul style="list-style-type: none"> <li>✓ Based on cost benchmarks</li> <li>✓ Potential to use for 3 to 5 year period</li> <li>✓ Can be used for real Living Wage / Inflation adjustments</li> <li>✓ Information sharing: low – from representative private and third sector providers only</li> </ul>	<ul style="list-style-type: none"> <li>➤ Establishing the group, benchmarks and rate can take up to one year</li> <li>➤ Can be used for up to 3 – 5 years (provided agreement to uplift benchmarks)</li> <li>➤ Ensure working group is representative of local funded provider market</li> <li>➤ Transparent</li> <li>➤ Time- and resource-intensive</li> </ul>
<b>Survey (Prices)</b>	<p>Information from providers on current pricing structure.</p> <p>Willingness of local authorities and providers to engage: Medium</p>	<ul style="list-style-type: none"> <li>✓ Based on current market prices</li> <li>✓ Information sharing: medium – pricing information only sought from all providers</li> <li>✓ Costs of conducting a survey</li> </ul>	<ul style="list-style-type: none"> <li>➤ Based on price not cost although assumes that providers set prices with reference to their underlying costs of delivery, plus a mark-up for return on investment / profit</li> <li>➤ Less transparent around actual costs incurred</li> <li>➤ Quick method – Less time- and resource-intensive</li> </ul>
<b>Cost Modelling</b>	<p>An understanding of the costs associated with ELC settings, including profit and re-investment requirements.</p> <p>Willingness of local authorities and providers to engage: Low</p>	<ul style="list-style-type: none"> <li>✓ Based on the local authority's understanding of costs</li> <li>✓ No information sharing</li> <li>✓ No development / survey costs</li> </ul>	<ul style="list-style-type: none"> <li>➤ Based on modelled costs, not actual costs incurred</li> <li>➤ Quickest method in the short term</li> <li>➤ Least time- and resource-intensive</li> </ul>

## **SECTION 6: LOCAL AUTHORITY FUNDED PROVIDER SUPPORT PACKAGE**

99. Along with the sustainable rate, local authorities provide a range of benefits to funded providers. Additional benefits, over and above the funded rate, should be clearly outlined at the time of application to become a funded provider.

100. As set out in the [Operating Guidance](#) (pages 49-50), the type of support provided by local authorities to funded providers could include (but is not limited to):

- training programme resources;
- support for workforce planning;
- marketing and recruitment support;
- funding for staff to undertake relevant qualifications;
- grant funding for specific resources;
- buildings support; and
- regular contact through local authority ELC meetings.

101. The range of benefits that a funded provider receives will be different depending on the type of provision, location of the provider and needs of the children attending. The [Operating Guidance](#) states that:

*“it is for local authorities to decide the best package to ensure high quality ELC provision is offered to children and families, based on their own local circumstances. However, local authorities should ensure that settings have a clear and consistent understanding of the level of support they can expect.”*

102. A local authority should outline the support package available, and its monetary value (where available), to funded providers at the time of application and, where this support package has been considered in the sustainable rate setting process, this should also be clearly outlined to funded providers. This support package is in addition to the sustainable rate set by the local authority. The local authority should clarify what elements of the support package are guaranteed and which are optional or dependent on need. Mandatory, statutory requirements and costs should not be included in this.

103. This will ensure transparency around both the sustainable rate and support package to funded providers, providing them with the information they need to make the decision on whether or not to participate in a local authority’s exercise to become a funded provider.

104. A funded provider is always responsible for their own provision and the quality of ELC provision. However, where a provider fails to meet these, the approach will be to support them to improve within a service improvement period.

## **SECTION 7: SUMMARY**

101. This guidance sets out a number of processes to consider when setting a sustainable rate. This includes guidance on how funded provider support packages, which are in addition to the sustainable rate, may be taken into consideration by both local authorities and funded providers. Such provider support packages are a direct benefit of being a funded provider.
102. This guidance is not designed to provide an exhaustive set of principles and processes and local authorities may decide that there are additional factors or processes that need to be considered within their local context.
103. It should also be noted that the rate set by the local authority is for the delivery of the funded hours only.
104. Ensuring a sustainable rate in the current economic climate is challenging. For private and third sector providers, this means an adequate return on investment and being able to recruit and retain staff. For local authorities, it means that the service reflects high quality ELC provision and affordability.
105. Local authorities may wish to consider the following points to ensure an effective process is developed and undertaken:
- Engage with providers to create and maintain dialogue, including any concerns or queries about the process;
  - Be transparent and share information on numbers and costs without compromising commercial sensitivity;
  - Maintain an audit trail for all stakeholders to document how decisions about sustainable rates have been made (including where cost inclusions and omissions have been made);
  - Where possible, reflect actual, up to date costs;
  - Use a common way of calculating costs; and,
  - Review the process with other groups, or local authorities, to understand best practice in services that have similar considerations<sup>6</sup>.

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<sup>6</sup> For example, best practice in other areas such as [CIPFA Working with care providers to understand costs: A guide for adult social care commissioners](#).

## **ANNEX A: DESCRIPTION OF COSTS RELATING TO THE COST OF ELC**

<b>Employee Costs</b>
Employee Costs: Salaries & Wages (including National Insurance & pension costs and holiday / sickness cover)
Employee Costs: travel
Employee Costs: training
Employee Costs: staff advertising and recruitment
Employee Costs: miscellaneous staff costs
<b>Total Employee Costs</b>
<b>Property Costs</b>
Capital Repayment / Loans
Capital Refurbishment
Insurance
Ordinary Repairs / Maintenance
Upkeep of Grounds
Furniture & Fittings
Heating & Lighting
Cleaning
Other Property Costs (please specify)
<b>Total Property Costs</b>
<b>Supplies &amp; Services</b>
Provisions
Other Supplies for Children
Equipment and supplies for education / activities / sport
Catering supplies
Other Supplies / Services Maintenance Contracts
<b>Total Supplies &amp; Services</b>
<b>Administration Costs</b>
Printing and Stationery
Telephones / Mobiles / ICT
Audit / Legal Fees
Other Admin Costs - Bank Charges / Publicity / Marketing
<b>Total Administration Costs</b>
<b>External Service Costs</b>
Registration Fee for Care Inspectorate
Other Supports (please specify)
<b>Total Direct Service Costs</b>
<b>Operational Cost of Service</b>
<b>Profit / Surplus (£)</b>

106. Local authorities may want to request a detailed breakdown of staffing costs (an example is shown in Appendix 2), as this is generally the biggest cost driver and determines affordability of the real Living Wage and other policy impacts.

**ANNEX B: EXEMPLAR QUESTIONS REGARDING STAFFING COSTS –  
WORKING GROUP CONTRACTING OPTION**

<b>Cost</b>	<b>Description</b>	<b>Question</b>	<b>Supplementary Information</b>
STAFFING	ELC practitioner	What is the average basic hourly rate?	Is it linked to the real Living Wage or National Minimum / Living Wage?
	ELC Support Worker	What is the average basic hourly rate?	What is the differential between a team leader and a practitioner?
	ELC Lead Practitioner / Manager	What is the average basic hourly rate?	An average benchmark of advertised vacancies could be used
	Domestic Staff	What is the average basic hourly rate?	Is it linked to National Minimum / real Living Wage?
STAFFING ON COSTS	All grades	What are the statutory minimum provisions?	National Insurance, Sick Pay etc. Similar to other sectors e.g. care
	All grades	Is there a training backfill provision?	
STAFFING HOURS	All grades	For a 40 place nursery, what is the minimum staffing?	What skill mix is in place e.g. 1 team leader to 5 practitioners?

## **ANNEX C: GLOSSARY**

<b>Term</b>	<b>Description</b>
Accounts	A term used to refer to financial statements, that is, the income statement and balance sheet, and often the cash flow statement.
Business Rates	Business rates (also called non-domestic rates) are a tax on non-domestic properties to help pay for local council services.
COSLA	COSLA, the Confederation Of Scottish Local Authorities, is the voice of Local Government in Scotland. They provide political leadership on national issues, and work with local authorities to improve local services and strengthen local democracy.
Early learning and childcare / ELC	The relevant legislation defines early learning and childcare as: <i>“a service consisting of education and care, of a kind which is suitable in the ordinary case for children who are under school age, regard being had to the importance of interactions and other experiences which support learning and development in a caring and nurturing setting.”</i>
Funded hours	The hours of funded ELC provision for children which are funded through the local authority up to the statutory entitlement of 600 hours per year or (from August 2020) 1140 hours of funded ELC per year for all 3 and 4 year olds and eligible 2 year olds.
Funded Provider	An ELC setting who meets the National Standard and offers the ELC funded entitlement to children.

Healthy snack and milk	It is proposed that, under Scottish Government’s newly devolved powers to deliver the Welfare Foods commitment, children will receive a healthy snack and milk as part of their ELC experience. This will equate to 1/3 of a pint of whole or semi-skimmed cow’s milk and a piece of fruit or vegetable for every ELC session. This will be available to all ELC settings across Scotland, whether they are funded or non-funded.
Meal	Every child attending a funded ELC session – which is any session that includes funded hours, regardless of whether they are mixed with ‘paid for’ hours – from 2020, will be provided with a free meal. This meal should be in line with <a href="#">Setting the Table</a> and the <a href="#">Eatwell Guide</a> and should ensure that individual cultural and dietary needs are met.
National Standard	The Standard that all funded providers in Scotland will need to meet to offer the funded entitlement to children from August 2020. This is regardless of whether the funded hours are provided by a setting in the public, private or third sectors, including provision offered by childminders. It is aligned to the guiding principles for the expansion to 1140 hours: quality; flexibility; accessibility and affordability. It is also underpinned by the regulations in the <a href="#">Public Services Reform (Scotland) Act 2010</a> which applies to all care services across Scotland, including daycare of children and childminding settings.
Provider	Any organisation offering ELC provision registered with the Care Inspectorate under daycare of children or childminding registrations.

Public Contract	Subject to regulation 98(6) of the The Public Contracts (Scotland) Regulations 2015, means a contract for pecuniary interest concluded in writing between one or more economic operators and one or more contracting authorities and having as its object the execution of works, the supply of products or the provision of services.
Real Living Wage	The rate of pay for staff that is calculated based on the cost of living. Employers who pay the Living Wage to their staff can apply for Living Wage Accreditation. The real Living Wage rate at December 2018 was £9.00 an hour. The rate is updated in the first week of November each year. The real Living Wage should not be confused with the National Minimum Wage (including the “national living wage” for those aged 25 and over) which is the legal minimum an employer must pay an employee and is set by the UK Government.
SCMA	A charity and membership organisation that provides support, training and information to childminders in Scotland.
Scotland Excel	The Centre of Procurement Expertise for the local government sector. Their services are designed to help local authorities meet the twin challenges of reducing budgets at a time of growing demand. Collaborative procurement increases efficiency and ensures money is saved to protect front line services. By working together through Scotland Excel, local authorities work to realise a host of social, economic and environmental benefits from their spend.
Service Model Working Group	A group established in 2017 to bring together Scottish Government, COSLA and local authorities to work in partnership to develop Funding Follows the Child and the underpinning National Standard for ELC providers.
Setting	Any service offering ELC provision registered with the Care Inspectorate under daycare of children or childminding registrations.
Sustainable rate	The hourly rate that is paid to funded providers in the private and third sectors, and childminders, to deliver the funded entitlement.

	<p>The rate will support delivery of a high quality ELC experience for all children; reflect the cost of delivery, including the delivery of national policy objectives; allow for investment in the setting – staff, resources and physical environment; and enable payment of the real Living Wage for those childcare workers delivering the funded entitlement.</p>
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