The Scottish Parliament

FINANCE COMMITTEE

AGENDA

2nd Meeting, 2001 (Session 1)

Tuesday 30 January 2001

The Committee will meet at 10.00 am in Committee Room 2 to consider the following agenda items:

1. **Committee Business:** The Committee will consider whether to take agenda items 2 and 3 in private.

2. **Budget (Scotland) (No. 2) Bill:** The Committee will consider how it wishes to handle agenda items 7 and 8.

3. **Inquiry Into Resource Accounting and Budgeting:** The Committee will consider how it wishes to handle agenda item 4.

4. **Inquiry Into Resource Accounting and Budgeting:** The Committee will take evidence from Steve Renwick, Management Consultant, Forensic Accounting Services (Edinburgh) Ltd.

5. **Future Inquiries:** The Committee will consider topics for future inquiries.

6. **Budget (Scotland) (No. 2) Bill:** The Convener will move—

   That the Finance Committee considers the Budget (Scotland) (No. 2) Bill at Stage 2 in the following order: each section and schedule in order; and that each schedule is considered immediately after the section that introduces it.

Not before 11.30 am

7. **Scotland's Budget Documents 2001/02:** The Committee will take evidence from the Minister for Finance and Local Government.

8. **Budget (Scotland) (No. 2) Bill:** The Committee will consider the Budget (Scotland) (No. 2) Bill at Stage 2.

Callum Thomson
Clerk to the Committee
Room G.6, Committee Chambers
Tel. 0131 348 5215
Email: callum.thomson@scottish.parliament.uk

The papers for this meeting are:

Agenda Item 3

Paper from Professor Irvine Lapsley	*Private Paper to follow*

Agenda Items 3 and 4

Paper from Steve Renwick	FI/01/2/1

Agenda Items 7 and 8

Budget (Scotland) (No.2) Bill	FI/01/2/2
Letter from Minister for Finance and Local Government	FI/01/2/3
Scotland's Budget Documents	FI/01/2/4

SCOTTISH PARLIAMENT – FINANCE COMMITTEE
30 JANUARY 2001

PREAMBLE:

It is a considerable pleasure and honour to be able to address your Committee today on this most important of subjects.

I am aware that Vernon Sore of CIPFA opened his evidence to you with a quote from JK Rawlings; as a practising Christian I thought that I'd find something suitable from the Bible for our consideration today – so here goes:

Luke 14 vv 28 – 29

Suppose one of you wants to build a tower. Will he not first sit down and estimate **all** the costs to see if he has enough money to complete it ? For if he lays a foundation and is not able to finish it, everyone who sees it will ridicule him.

So we see that even in biblical times the debate around capital budgeting and accounting was prevalent.

STRUCTURE OF PRESENTATION:

1. Introduction of presenter and company
2. Introducing the theme of the discussion
3. Historical experience
4. Thoughts about Resource Accounting
5. A view (apocalyptic) of the future – The Empty Balance Sheet (apologies to Charles Handy)

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1 Introduction

PRESENTER: Stephen G Renwick

- Business Studies Graduate;
- Chartered Accountant (1991);
- Chartered Public Finance Accountant (1995).
- 5 years in Local Government Finance
- 5 years with Touche Ross Chartered Accountants
- 1 year with the Scottish Office – NHS Management Executive
- 3 years as Director of Finance; Falkirk Royal Infirmary
- 3 years Managing Director of Forensic Accounting Services (Edinburgh) Limited.

Forensic Accounting Services (Edinburgh) Limited:

- Founded 1997;
- Incorporated 2000;
- Provides Consultancy, Investigative Accountancy, Company Doctor, expert witness and Training Services to a wide range of Public and Private Sector clients.

2 Theme of the Discussion:

<u>Letter of Invitation</u>

"The Committee would welcome the opportunity to hear your view on how capital accounting can help or otherwise the management of major public services."

3 Historical Experience

- Resource Accounting and Budgeting was the norm in my private sector experience based firmly upon SSAP 2 principles of accruals, consistency, prudence and going concern;
- Accruals accounting was also practised in the NHS for all management accounting and formal returns to "the Centre".
- So enshrined was this approach in the formal accounting training that it was quite a culture shock to encounter cash and "vote" accounting in Central Government;
- As a member of the team establishing NHS Trusts here in Scotland, it was evident that stringent capital accounting was necessary for the NHS. This was for two primary reasons, firstly to engender discipline with NHS Trusts in their use of assets and secondly to avoid any appearance or perceptions that these newly formed "quangos" were just being handed vast sums of capital assets on a plate.
- Having identified a need however, the chosen mechanism was somewhat a blunt instrument – "capital charges"
- Capital Charges = Interest plus depreciation
- Impact was that NHS pricing rules became Price = Cost plus a 6% on asset base addition
- Issues then arose as to functional suitability, estimates of useful economic life, charges on non-revenue generating assets such as car parks and a myriad of other anomalies including a major revaluation exercise which took effect from 1 April 1996 though wasn't completed until 1997.
- A further malady was the addition of commentary on Trust Audit Reports to comment that the Trusts didn't actually own the assets for which they were paying capital charges since the legal transfer was held up;
- In summary, capital charges became "funny money" which did little to instil a financial discipline on the NHS;

- Indeed, as Dr Collings said to this very Committee in November last year "if one keeps presenting two sets of figures separately, the capital charges do not get taken seriously".
- The outcome of this exercise was to add to the massive sense of artificiality of the Trust Finance regime both in the practitioner's eyes and those private sector colleagues looking on.

Issues that should have been addressed:

- Ownership not imposition – practitioners were faced with a myriad of significant issues at the inception of trusts without having this cumbersome issue launched upon them;
- Personality power – very few individuals actually understood the system and thus the few that did were very popular indeed.
- Establish a very clear link between the assets actually owned by the public services and the ability of those assets to pay for themselves by service delivery. A system should also have been derived whereby any surplus assets could be disposed of quickly and efficiently;
- A simple system should have been instigated whereby Trusts became responsible for the replacement of their own assets.

4 Resource Accounting

As has been stated earlier, Resource accounting as opposed to cash accounting is the model which most closely aligns with Generally Accepted Accounting Practice and private sector principles.

I wholeheartedly support and advocate the introduction of RAB into the public services and acclaim it as an advance in the demonstration of good stewardship and good corporate governance.

It is not an understatement to identify that Resource Accounting can herald a truly strategic phase to public sector financing. Cash accounting is intrinsically myopic – annualised financial reporting hence the world ends at midnight on 31 March each year. Miraculously however, the world then starts again and another annual cycle starts and miraculously also the liabilities and assets from one year are carried forward with a relentless momentum.

Resource Accounting has PRUDENCE writ large as a major theme; the public services represent major and complex businesses which have the vast array of financial transactions that characterise any other large venture and thus a prudent approach to financial risk and accounting is clearly to be espoused.

5 A View (apocalyptic) of the Future – The Empty Balance Sheet (apologies to Charles Handy)

It is my contention that the public services should move even closer towards a commercial model. To ask Richard Branson or Bill Gates what his capital funding stream is during any given year would be to invite derision (as the Managing Director of Reg Vardy Plc said to me recently, "we don't want any public sector accountants, who round to the nearest million, here!"). Their ability to invest in infrastructure is strictly determined by their sales success and their willingness to be risk-takers.

The dramatic rise of revenue funded Private Finance Initiatives and Public Private Partnerships with the consequent lack of assets on the public sector balance sheets will, in my opinion force a radically new way of looking at accounting for infrastructure.

I am convicted that we should move the public services to a single funding stream by removing the artificial delineation between Revenue and Capital. The public sector should, in the same way as Marks and Spencer or Wal-Mart fund all of its activities through a revenue income stream.

Such a change as this would be a potential to drop the Balance Sheet from public sector accounts and replace it with a Working Capital Statement which showed the skill and expertise of the organisation's management.

Coupled with these moves should be the introduction of real three-year budgeting. This is in contrast to the lip service currently being paid to this subject in which annual break-even targets are still the norm despite being badged three-year budgets.

I believe firmly that this package of measures will instil a discipline in managing a capital infrastructure never before seen in the Scottish Public Services.

Many thanks for the opportunity to address your Committee.

Stephen G Renwick
January 2001

Minister for Finance & Local Government
Angus MacKay MSP

Victoria Quay
Edinburgh EH6 6QQ

Telephone: 0131-556 8400
scottish.ministers@scotland.gsi.gov.uk
http://www.scotland.gov.uk

Mike Watson MSP
Convener
Scottish Parliament Finance Committee
Scottish Parliament
EDINBURGH
EH99 1SP

22 January 2001

PRE BUDGET BILL REPORT

I introduced the Budget Bill for 2001-02 into Parliament on 19 January and as you know the Stage 1 debate on the Bill is scheduled for 25 January. I will make the documentation supporting the Budget Bill and this letter available to MSPs to scrutinise on Tuesday 23 January.

The written agreements between the Scottish Parliament and the Scottish Executive indicate that I should provide a report on any suggestions for change that the Scottish Parliament has made during the wider budget process, and identify where there has been any financial changes brought about by Whitehall.

In response to suggestions from your Committee, the budget documents now contain a full set of real terms numbers for each vote. I have also arranged for the capital charges associated with particular expenditure to be shown within each Schedule 3. Finally, I have introduced a table showing PFI payments made by the Scottish Executive. These are of course over and above the Parliament's suggestions on health and justice spending we took accounts of after Stage 1.

The major financial change that has occurred after I presented the draft budget is the transfer of responsibility for grants for the provision of rail services in Scotland to the Scottish Executive. As a result Department of the Environment, Transport and the Regions transferred £111m to the Scottish Executive for 2001-02, £108m in 2002-03 and £107m for 2003-04. This covers the fixed franchise payment. I have set up a new schedule – schedule 3.5 on page 54 of the documentation supporting the budget – to set out this information. This schedule will be an ongoing feature of the budget documentation. Offsetting this increase in our total managed expenditure in 2001-02 is a reduction in European expenditure of some £32m. This reflects money which the Executive will pull forward into 2000-01 to meet a larger than anticipated demand for payments in 2000-01. The 2001-02 budget reflects these changes and the effects on 2000-01 will be shown in the spring budget revision.

As last year the budget reflects the voted element of public expenditure. It excludes non-voted items in the total budget, such as judges' salaries and election expenses, local authority capital consents which appear on the face of the bill and takes account of the difference between the cash and RAB treatment of public corporations.

I hope this is helpful.

ANGUS MacKAY