FINANCE COMMITTEE

AGENDA

24th Meeting, 2001 (Session 1)

Tuesday 20 November 2001

The Committee will meet at 10.00 am in the Debating Chamber to consider the following agenda items:

1. **PFI/PPP Inquiry (In private):** The Committee will consider its lines of questioning for agenda item 2.

2. **PFI/PPP Inquiry:** The Committee will take evidence from—

   Stuart Riddell, Head of Association of Chartered Certified Accountants (ACCA) Scotland;

   Andy Wynne, Head of Public Sector Technical Issues (ACCA);

   Philip Grant, Head of Infrastructure Finance, Bank of Scotland;

   Vernon Sore, Policy and Technical Director, Chartered Institute of Public Finance and Accountancy (CIPFA);

   David Dorward, Vice Chair, CIPFA Scottish Branch;

   Lynn Brown, Head of Corporate Finance, City of Edinburgh Council (Member of CIPFA Scottish Branch);

   Bill Davidson, Northlink Orkney and Shetland Ferries Ltd.

3. **Resource Accounting and Budgeting Inquiry:** The Committee will consider the Executive's response to its report.

4. **Witness Expenses:** The Committee will consider witness expenses for its PFI/PPP Inquiry.

David McGill
Acting Clerk to the Committee
Room G.6, Committee Chambers
Tel. 0131 348 5215
Email: david.mcgill@scottish.parliament.uk

The papers for this meeting are:

Agenda item 1

Paper by Professor Peter Jackson, Adviser to the Committee on PFI/PPP inquiry	PRIVATE PAPER

Agenda item 2

Paper by ACCA	FI/01/24/1
Additional paper by ACCA	FI/01/24/1(a)
Paper by Bank of Scotland	FI/01/24/2
Paper by CIPFA	FI/01/24/3
Paper by Bill Davidson	FI/01/24/4

Agenda item 3

Executive response to RAB Report	FI/01/24/5

Callum Thompson
Clerk to the Finance Committee
Committee Chambers
Scottish Parliament
Edinburgh
EH99 1SP

31 May 2001

Dear Mr. Thompson

Technical accountancy matters and other issues which arise through PFI/PPP

The Association of Chartered Certified Accountants (ACCA) is pleased to have been invited to participate in the inquiry into the technical implications and other issues arising from Private Finance Initiatives (PFI) and Public Private Partnerships (PPP). We welcome the inquiry as a forerunner to the Scottish Parliament taking oral evidence on this subject in the summer.

The paper has been considered by ACCA's Public Sector Technical Issues Committee. The Committee's members are professional Chartered Certified Accountants with considerable experience of public sector practice.

We respond to the specific matters raised for comment as follows.

Specific Matters for Comment

(1) In preparing this submission, ACCA did not presume that public services generally can be provided better by either the public or the private sector. We believe that governments (local and central) and their agencies need to make the best use of resources available, whether in the public, voluntary or private sectors, when aiming to deliver new and improved public services and when promoting economic growth and regeneration. It is our view that there is no one best service provision model which will meet all public service needs

and objectives.

It is our view that many leisure and cultural services provided by public sector entities could arguably be classed as commercial activities and the distinction between what constitutes a "true" public service and what does not is becoming blurred. ACCA shares the Government's view that both sectors and hence the economy as a whole should be able to benefit from well structured arrangements which combine private sector investment and entrepreneurial skills with the experience and resources of the public sector when delivering many services.

The main advantage to be gained from funding capital schemes through PFI/PPPs is that such arrangements can open up additional sources of financial sponsorship and capital investment for the provision of many public services. Entities, for example, which have the ability to invest in or have invested in new technology and which have access to specialist skills and knowledge, in areas such as procurement or facilities management for instance, can often enjoy economies of scale giving them a natural market advantage over competitors and hence the means to deliver high quality and cost-effective services.

Such schemes offer government bodies the opportunity to procure services rather than assets and hence they are able to avoid having to manage the risks associated with providing asset intensive services leaving public sector managers to concentrate on delivering core services. The main disadvantages associated with procuring services through PFI/PPPs appear to stem from accountability issues, getting the contract right in the first instance and then monitoring the contractors performance over time. The following bullet points outline potential problem areas:

- the complexities of EC procurement regulations and tendering procedures (for example hindsight has shown that negotiated procedures give better results than EC restricted procedures);
- designing outcome service specifications and measuring performance of arrangements which typically span considerably

long time frames (15-30 years);

- drawing up transparent measured contingency plans; and
- ensuring that public sector managers have excellent negotiating skills and trusting elected members to have long term vision which should take precedence over short term political aspirations.

ACCA is not aware of any reason why it is necessary to obtain private capital in order to obtain efficiency savings in public service delivery.

(2) PPP projects should be structured to provide incentives for the private sector supplier to perform efficiently and effectively in order to ensure that services are delivered at best value to citizens. ACCA believes that the best value determinants of a PPP are as follows:

- contract specifications should be output based, as opposed to stipulating how the service is to be delivered; no unnecessary constraints should be placed on the private sector for the delivery of these outputs;
- contracts should ideally require the contractors to take responsibility and assume risk for the performance of assets over a significant part of their useful life, if efficiencies arising from long term asset management are to be realised;
- payments made to the contractor should be related to performance;
- projects should involve extensive consultation with the community and be subject to a rigorous value for money options appraisal; options considered should include "do nothing" or "do minimum". Where appropriate, the appraisal should include a public sector comparator.

(3) The assumptions used in assessing projects (for example, discount rate, risk transfer and repayment period) are critical for effective decision making. Business plans and project investment appraisals should be subject to a rigorous sensitivity analysis with risks sufficiently quantified (contingency plans, insurance costs to mitigate or eliminate risk) within business plans and investment appraisals.

(4) Public sector bodies are encouraged to procure asset intensive services (such as schools, police stations, magistrates courts and

other accommodation) from the private sector so that the private sector operator carries the risks associated with ownership of the assets. As payment passes to the operator from current revenues based on performance, such schemes are classed as revenue projects as opposed to capital projects. This type of scheme eliminates the need to account for the associated assets and project costs (except, perhaps the decommissioning costs of old assets) in the capital programme.

Without a sufficient level of risk transfer, the substance of transactions are likely to viewed as financing arrangements (in effect giving the public body access to borrowed funds through a finance lease or deferred payment). The DETR's explanatory note on PFI and public/private partnerships in local government points out that given sufficient risk transfer, the capital investment undertaken by the private sector will not score against public sector capital spending limits: "changes to the Capital Finance Regulations mean that projects meeting specified criteria will require reduced or no credit cover, depending on the precise circumstances, and can therefore be undertaken outside an authority's capital budget".

It may be possible to separate out capital costs or charges from operational costs in order to make comparisons between like projects carried out by public and private sector entities and to establish benchmarks or cost indicators for determining efficiency savings.

(5) The introduction of Resource Accounting and Budgeting (RAB) does not provide a mechanism for tracking this form of public sector capital investment but it does go a long way towards ensuring that public sector accounts are prepared on a comparable basis with the private sector which in turn should provide better information for decision making purposes.

The RAB implications of a transfer from capital charges to revenue funding are that a one line entry for the provision of a service would appear in the current/revenue account of the public sector entity (in addition there would appear the client costs of managing the contract) and there would not be any fixed assets associated with delivery of the service in the balance sheet (unless a contractual arrangement allowed for the transfer back of assets over a certain

time frame).

Some PPPs take the form of joint venture company (JVC) with the public and private sectors working together to increase capital investment to assist service delivery, or to encourage economic development and urban regeneration. The public sector entity would have to account for its share of activities including the extent to which it owned the assets and liabilities of such schemes.

(6) PFIs which involve complete privatisation do not appear in public sector accounts, nevertheless associated regularity costs need to be built into the budget. With housing privatisation, for example, housing benefit costs may rise as a direct result of rising costs in the social housing sector, over which the public sector has no control.

Most PFI/PPPs (other than privatisation) typically span 15-30 years and therefore, providing that contracts have been structured in such a way so as to allow service costs to rise in line with specific inflation indices, then a degree of certainty is provided over the term of the contract for budgeting purposes. Risk management strategies should allow for measured contingency costs to be included in the budget in the event of contract failure.

Some projects will earn additional revenue support from central government. It is important to ascertain which projects qualify for such support and to identify how it is to be incorporated within the Barnet formula.

(7) Although some aspects of a PFI/PPP contract might be commercially sensitive, authorities are encouraged to make as much of the contract detail available to the public as is considered possible. Much operational detail, should be made public and private sector operators should not be allowed to work to standards lower than those prevailing in the public sector. For example, if authorities operate equal opportunities practices, have ethical investment policies and operate environmentally friendly waste management

systems then contractors should be required to operate like policies.

(8) When employees transfer to the private sector under TUPE agreements, it is essential that staff are transferred for the right reasons. Similarly if redundancy payments are built into the agreement they should be calculated on a fair and transparent basis. Employees should be kept informed and be consulted throughout the process. If the transfer is seen to be used as a means of getting rid of surplus staff through the private sector then an air of distrust will be formed around the initiative.

We hope that our comments prove helpful to you in your inquiry. If you have any queries please do not hesitate to contact Georgina Ayling, Secretary to the Public Sector Technical Issues Committee, 29 Lincoln's Inn Fields, London WC2A 3EE or e-mail: g.ayling@accaglobal.com or telephone: 020 7396 5794.

Yours sincerely

Stuart Riddell (Head of ACCA Scotland)

The Private Finance Initiative and Public Private Partnerships

- An Enquiry by the Scottish Parliament

Evidence from the Association of Chartered Certified Accountants

November 2001

ACCA is the largest and fastest growing global professional accountancy body, with nearly 300,000 members and students in 160 countries. ACCA headquarters are in London and it has 32 staffed offices around the world. ACCA's mission is to provide quality professional opportunities to people of ability and application, to be a leader in the development of the global accountancy profession, to promote the highest ethical and governance standards and to work in the public interest.

Further information on ACCA is available on ACCA's website, www.accaglobal.com

Executive Summary

The Association of Chartered Certified Accountants (ACCA) is pleased to have been asked to provide evidence to the Finance Committee as part of the Scottish Parliament's enquiry into the Private Finance Initiative and Public Private Partnerships.

The Private Finance Initiative (PFI) and Public Private Partnerships (PPP) have been shrouded in controversy. For example, the Skye Bridge, one of the first PFI projects, has been subject to sustained local opposition. Opinion is at best divided on the value of using PPP to improve the quality of public services. In a recent survey, by the magazine *Public Finance*, only one in ten senior public sector finance managers expressed strong support for the statement that:

'PFI and other forms of Public-Private Partnerships are having a beneficial effect on public services'.

James Stuart, Chief Executive of Partnerships UK, admitted last month that the Government faces an uphill task in convincing the public of the need for PFI deals.

Whether using PPP will ensure value for money is still largely a political rather than professional opinion as there is so little evidence of the outcome of such agreements. In a recent report, the Audit Commission stated that it was 'too early to say whether PFI contracts generally offer the public sector long-term value for money'. The often-quoted Arthur Andersen/London School of Economics study (2000) is flawed as it is based on exercises to compare the costs of PFI and direct provision where it was believed that only if the PFI option were shown to be cheaper would

approval be gained for the projects. Thus the aim of each exercise was to show that the PFI option would provide value for money.
The UK government is, however, convinced that 'the private and voluntary sectors can play a role…[and] where use of them can improve public services, nothing should stand in the way of their use' (Tony Blair 16 October 2001). As a result, in the short-term at least, PPPs are often the 'only show in town', in that it is only by these approaches that the necessary approval for capital investment will be gained.

There may be alternatives which would allow publicly funded capital investment and these may be worth exploring. One possibility would be to use public funds for one aspect of a development and to use PFI/PPP for other aspects. We are not aware of any work which has been undertaken in this area.

The Scottish Parliament may consider that it is worth making the case for it to be given greater freedom to fund direct public sector capital investment. The Commission on Public Private Partnerships (July 2001) commented that there should be 'an evidenced based approach to policy. A commitment is necessary to pilot, monitor, and systematically evaluate a spectrum of partnership arrangements. Depending on the evidence that emerges PPP could be rolled out or rolled back'.

As a result of the current usage of PFI and PPP, they will remain a significant feature of public finance for some years to come regardless of whatever future changes of policy which may occur. In this situation it is important that they are managed efficiently. The remainder of this paper considers certain aspects of the management of private provision of public services which we believe are particularly significant.

Management of the Private Finance Initiative and Public Private Partnerships

The Private Finance Initiative and Public Private Partnerships

1. Organisations should develop clear criteria on whether PFI/PPP is the correct approach for each project. These criteria should include the social and environment aspects of the project. The criteria should then be monitored throughout the procurement process and the life of the project to ensure that agreed objectives and success criteria are actually achieved. The results of this exercise should then be used to inform future decisions on the most suitable approach for investment in public services.

Length of time taken to sign contracts

2. The time taken to sign PFI/PPP contracts can be considerable. The procurement process is long and complex and requires a great deal of senior management time. The Audit Commission found that the average time to complete a PFI deal was over two years. Public sector organisations will have to wait three to four years (at a minimum) before PFI/PPP schemes are operational.

3. Purchasers should ensure that more than one contractor remains in the procurement process for as long as possible. The Audit Commission recommends that purchasers should avoid being in exclusive negotiation with only one contractor for more than nine months.

4. If purchasers are to reduce the length of time taken to close PFI deals they should:

- demonstrate a clear purpose and a strong vision of the desired outcomes of the scheme

- translate that vision into a simple output specification and resist the temptation to make regular changes to the specification

- get early commitment to the scheme from key stakeholders

- set up a project management structure which allows for an appropriate level of delegation to key officers and is integrated with existing decision making processes

- agree a clear project plan, establish project milestones and monitor progress against the plan on a regular basis

- agree the key contractual terms, including payment mechanisms and risk transfers, prior to issuing the invitation to negotiate in order to force bidders to indicate their position early on in the negotiation process

  and

- be clear about how they are going to evaluate bids.

(Source: Audit Commission)

Sensitivity and Flexibility

5. All PFI/PPP proposals should be subjected to sensitivity analysis to see whether different assumptions, for example about different forms of risk allocation, would significantly alter the value for money assessment. These projects are particularly sensitive to the discount rate used. None of the first 11 PFI schemes in the NHS would have been considered to provide value for money if a discount rate of 4%, rather than 6%, had been used in their evaluation.

6. PFI/PPP contracts are often long term deals and even the shorter contracts for services such as IT and communications commit substantial future funds. It is essential that contracts provide the public sector with enough flexibility to take advantage of changes in circumstances, technology or other improvements to service delivery which may become available during the contract period. All PFI/PPP contracts should, for example, have explicit provisions for sharing super-profits arising from re-financing deals. A number of PFI/PPP have not been successful, for example the provision of IT systems at the Passport Office and in magistrate offices. It is necessary to ensure that suitably detailed contingency plans are developed to avoid the public sector bearing the costs of potential private sector failure.

Developing and maintaining public sector expertise

7. There are relatively few private sector firms which are actively involved in PFI/PPP projects compared with the number of public sector organisations using this approach. As a result, it is important that the experience of managing PFI/PPP projects is identified and made available to other public sector organisations. Without this the

private sector may have a significant advantage during the lengthy and complex procurement process.

8. The National Audit Office has stated that:

'There is no substitute for the knowledge that is acquired while developing and negotiating a PFI deal. The public sector needs to retain staff with experience of PFI deals and to use there experience on future deals'.

9. Teams of management advisors should be established centrally and be made available to work with organisations managing PFI/PPP projects. Across the public sector the status and career structure of procurement officers should be significantly enhanced.

Making partnerships accountable

10. Accountability has always been a key aspect of public services. The involvement of private and voluntary providers in public service delivery should not lead to a dilution of public accountability. A number of steps should be taken to ensure that this goal is achieved. These will include:

- private and voluntary sector providers accepting that higher standards of disclosure and transparency apply in the public sector than in the rest of the economy

- performance data on services provided thorough partnerships always being made publicly available

- the mandatory framework for disclosing information currently existing in the NHS being extended to all PFI/PPP projects

- the Auditor General for Scotland being given statutory powers to access information on private providers relating to public contracts above a certain size

- all PFI/PPP contracts clearly setting out the grievance procedures through which individual citizens have redress

and

- all PFI/PPP contracts to contain mandatory social and environmental reporting requirements.

3rd Floor,
New Uberior House,
11 Earl Grey Street,
EDINBURGH. EH3 9BN.

Telephone: Direct Line: 0131-659-0539
Switchboard: 0131-442-7777
Fax: 0131-659-0591
(Auto CCITT Groups 2 & 3)

Our Ref : PG/SM

Your Ref:

Mr Mike Watson MSP
Room 4.6 PHQ
Scottish Parliament
Edinburgh
EH99 1SP

11th June 2001

Dear Mr Watson

SCOTTISH PARLIAMENT
FINANCE COMMITTEE INQUIRY INTO PFI/PPP

INTRODUCTION

We refer to your letter requesting responses to specific questions in anticipation of the forthcoming enquiry. Our responses are brief in anticipation of a more expansive exploration of the issues before the Committee.

Bank of Scotland ("the Bank") is a top 50 FTSE Company. Founded in 1695 and headquartered in Edinburgh, it has a market capitalisation of £9.5 billion and its annual pre-tax profits in the year to 28th February 2001 were £981 million. The Bank currently employs some 19,000 people and has a strong commitment to the communities of Scotland. We see the lending and investments that we make in UK Infrastructure as an integral part of this. We believe our activities in Infrastructure Finance make a positive contribution the economy of Scotland and the quality of life the people of Scotland. We also export our skills to projects across the UK and overseas.

The Bank is a leading funder and sponsor of Private Finance Initiative ("PFI") and Public Private Partnership ("PPP") projects and has been so since the inception of the process in the mid 1990's. A total of 56 Bank of Scotland projects have reached financial close. The Infrastructure Finance team comprises 30 professionals based in Edinburgh and London. This team has, to date, completed the funding of 11 Scottish PFI projects with a total capital value of circa. £400 million. Furthermore the Bank is supporting bidding

consortia for a further 7 Scottish projects with an aggregate capital value of over £200 million.

Our experience to date is that the PFI/PPP model delivers major capital projects on time and cost within a stable contractual and financial framework. It is now central to the development of essential Infrastructure and the provision of high quality public services in Scotland, the UK and beyond.

RESPONSES TO QUESTIONS

1.What are the advantages and disadvantages to the Public Sector funding capital expenditure in this way?

The main advantages which we see to the process are:

1. The contractual concentration on delivering to, or beyond, a service standard defined by the Public Sector.
2. The transfer of risks to the private sector. These risks include construction cost and time over runs, operating costs, asset replacement, lifecycle costs and availability of services.
3. Cost predictability and stability to the Public Sector.
4. Generation of innovative "whole" solutions focussed on delivering services outputs defined by the Public Sector.
5. A focus on a whole life cycle cost maintenance regime avoiding the deterioration over time of the asset base and associated services.
6. Accelerated and improved project management of the Capital Programme.

The main disadvantages are:

1. Time delays associated with the tendering and contractual process.
2. There can be complex contractual arrangements which are expensive to formalise and may inhibit innovative flexibility during the operating phase.
3. There is a possibility that an elaborate tendering process may reduce competition, particularly for smaller projects.

What is the basis for the argument that private capital is required to obtain efficiency savings and service delivery?

Our view is that private capital and the action of the market contributes to achieving efficiency savings in service delivery. To service the return requirements of private capital, the Private Sector is incentivised to create value through meeting and exceeding the service output specifications of the Public Sector within its definition of Affordability.

This is delivered through a project framework which incentives and penalises the Private Sector against predetermined standards.

The nature of the competitive process relating to the overall project, and the funding thereof, delivers improvements in solutions and processes as well as reductions in costs. Private capital has sponsored and funded the PFI process since its inception contributing to the development of the current model.

As the model evolves the provision of private capital will continue to be integral to the provision of public services.

What are the best value determinants for PPP?

The best value determinant for PPP is a comparison (value measure) of the Private Sector solution to that of the Public Sector i.e. a comparison of a traditionally procured asset and service through the Public Sector route against the PPP/ PFI alternative. This measure requires to accommodate design solutions, service outputs, construction and asset costs, time to delivery, lifecycle costs, operating costs / efficiencies, service standards and cost of capital.

We believe that the process can deliver innovative design and service provision together with cost stability over the life of a project. The Public Sector derives value by benefiting from a consistently high standard of service and facilities over the whole life of the concession, irrespective of external economic considerations and other influences.

How relevant are the assumptions used in assessing projects (eg discount rate, repayment period, risk transfer)?

We believe that the key issue is an assessment of any project's affordability. This is typically expressed as its **net present value**. Further criteria that are useful when assessing projects are:

1. The public sector comparator.
2. The output specification and ability of the project to meet this.
3. The cost of capital and its relationship to the capital structure.
4. The quality and experience of consortium members.
5. The requirements of the Public Sector client; to ensure it is getting an optimised capital structure.
6. The long term expectations of consortium members should be aligned with long term requirements of the Public Sector.

What are the costs of the capital programme? Is it possible to separate out capital charges from efficiency savings

Typically the cost of the capital programme is a blended project IRR of c. 7.0% (real, ie excluding inflation). We doubt that it is possible to separate out capital charges from efficiency savings.

To what extent is open consultation possible given "commercial confidentiality" requirements?

As a financial participant in the PPP/PFI process we are comfortable with open consultation. Any financing package and its costs are transparent to the Public Sector and its advisers. Whilst we would not wish this information shared widely during the competitive tendering process, following financial close of the transaction we would be supportive of open consultation subject to the important caveat of meeting our obligations to customer confidentiality.

What has been the experience of this form of investment on Public Sector employees?

From our involvement in the bidding process of PFI/PPP transaction we are aware increasingly of the importance of this issue to the Public Sector in assessing PFI bids. In our experience, our Construction and Facility Management partners are required to satisfy the Public Sector on their credentials, policies and practices as employers.

The Bank is committed to taking an active role in the development of PPP/PFI in Scotland and beyond. I would be pleased to expand upon any of the forgoing comments if it would assist the Committee in its deliberations.

Yours sincerely

Philip Grant
Head of Infrastructure Finance

SUBMISSION TO THE SCOTTISH PARLIAMENT FINANCE COMMITTEE: INQUIRY INTO PFI/PPPs

MAY 2001

CIPFA is one of the leading professional accountancy bodies in the UK and the only one that specialises in the public services. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards.

CIPFA's members work (often at the most senior level) in public service bodies, in the national audit agencies and major accountancy firms. They are respected throughout for their high technical and ethical standards, and professional integrity. CIPFA also provides a range of high quality advisory, information and training and consultancy services to public service organisations. As such, CIPFA is the leading independent commentator on managing and accounting for public money.

CIPFA
8 North West Circus Place
Edinburgh
EH3 6ST

Contact: Angela Scott
Senior Manager – Policy & Technical Services
0131 220 4316

1.0 INTRODUCTION

1.1 CIPFA is pleased to submit this memorandum of comments to the Scottish Parliament's Finance Committee's inquiry into PFI/PPP.

1.2 Earlier this year, through the work of its Treasury Management Panel, CIPFA published guidance for finance directors in the public services on public private partnerships and this memorandum of comments draws on the work undertaken by CIPFA for that guidance. In addition, CIPFA has undertaken extensive work in the area of accounting for best value and this memorandum in particular draws on the work currently being undertaken in the area of accounting for partnerships.

1.3 The Institute's views were sought specifically on any "technical accountancy matters" which arise through PFI/PPPs and also on a number of specific issues. Section 2 of this response therefore deals with the accountancy matters and Section 3 with the specific issues raised. Accounting for PFI was previously an issue of huge debate amongst the accountancy profession. However, following the issue of guidance from the Accounting Standards Board, the matter now attracts little substantive debate and local authorities are fully complying with the accounting requirements.

2.0 TECHNICAL ACCOUNTANCY MATTERS

Accounting Requirements for PFI Transactions

2.1 On 10 September 1998, the Accounting Standards Board published an amendment to FRS 5 Reporting the Substance of Transactions by way of a new Application Note F 'Private Finance Initiative & Similar Contracts'. The Application Note provided guidance on the accounting transactions required in relation to a PFI contract and also provided guidance on the question of which contract partner should recognise the asset and liability associated with the contract in their balance sheet. The requirements of Application Note F were included in Technical Note No. 1 (Revised) issued by the Treasury Private Finance Taskforce in 1999. This note sets out the mandatory accounting treatments for bodies included in Resource Accounting and Budgeting.

2.2 For local authorities, the Code of Practice on Local Authority Accounting (the SORP) defines 'proper practice' as regards producing an authority's statement of accounts and the SORP adopts FRS 5 and the concept of substance over form and the disclosure requirements of Application Note F.

Current technical accountancy matters being addressed by the Institute

2.3 When CIPFA issued its Best Value Accounting Code of Practice on 25 February 2000, it acknowledged that it would need to develop its initial guidance on how to account for partnerships because the modernising agenda for government promotes partnership approaches and local authorities are increasingly engaging in partnership approaches to service delivery.

2.4 CIPFA is of the view that authorities participate in partnerships for a wide variety of reasons. Examination of these reasons showed that to evaluate the cost effectiveness of partnerships properly local authorities need access to information normally beyond the scope of their traditional financial and management information systems. For example they need to know:

- The value of external funds levered in by each partnership
- The value of economies achieved through individual partnerships
- The extra costs (direct, indirect and opportunity) of different partnerships
- The outputs or outcomes achieved by individual partnerships

2.5 Authorities are therefore looking for advice from CIPFA that helps them to review the cost effectiveness of their partnership activities.

2.6 In December 2000 CIPFA issued its consultation paper "Accounting for Partnerships in the context of Best Value". It presented the following four possible options. These are summarised below: :

Option 1: where an authority records only the transactions that it as an entity in its own right is responsible for. This was referred to as the stewardship option.

Option 2: extends option 1 to include grant funds received and then passed on to other separate entities if a local authority is the Accountable Body and is therefore liable to repay any grant spent by another body that was not spent in accordance with the conditions of the grant. This was called the accountability option.

Option 3: is the use of group accounts. The consultation paper noted that any move to Group Accounts must be preceded by changes to the SORP.

Option 4: where the contents of local authority financial records and performance reports are extended to include the gross expenditure of partnerships that the authority works with, facilitates or partly funds and contributions made by other organisations towards the funding of the partnerships would be shown as income. This was labelled the Enabling Council Option.

2.7 CIPFA must ensure that any proposals for partnership accounting are technically correct and comply with Generally Accepted Accounting Practice (GAAP). The correct treatment of a public-private partnership under GAAP will depend on the exact structure of the arrangement. Contracts might result in a structure which involved the public authority in a joint venture with the private sector, or in the purchaser having an interest in a specific vehicle which would class as an associate under GAAP. However, many arrangements will be treated as simply a contract for services, raising no 'partnership accounting' issues.

2.8 The consultation paper recognised that neither Option 1 or 2 fully comply with UK GAAP. Neither takes any account of the group accounting requirements required by FRS 2 (Accounting for Subsidiary Undertakings) nor FRS 9 (Associates and Joint Ventures). Both options ignored the element of FRS 5 (Reporting the Substance of Transactions) that refers to the treatment of quasi-subsidiary organisations ie a company, trust, partnership or other arrangement that is controlled by an authority even though it is not a subsidiary.

2.9 The consultation paper recognised that Option 1 further failed to take account of the main provisions of FRS 5. It does not reflect the substance of the transactions that a local authority, acting as accountable body, is responsible for.

2.10 Under UK GAAP Group Accounts reporting requirements are governed by FRS 2, FRS5 and FRS 9. Group Accounts show the transactions that an authority

controls/influences through subsidiaries, associates and other joint arrangements. The consultation paper noted that there was an argument that, in Best Value terms, any accounts, financial statements or performance reports that do not include these transactions do not fully represent the activities of a local authority and are not a reliable basis for:

- Consultation with stakeholders as a full picture is not provided to consultees
- Comparison between authorities as significant activity relating to a councils role in its local community is excluded
- Challenging what a local authority does and how it does it as its full range of activity is not reported.

2.11 The consultation paper recognised that option 3 can only be implemented if group accounts become the prime accounting statements for a local authority under the SORP. The 2001/2002 SORP does not require Group accounts to be primary statements. They remain as supplementary summary statements only. The application of group accounts is not, however, a simple case if changing the status of the current supplementary group accounts to make them primary accounts with equal status to the current local authority Consolidated Revenue account and Balance Sheet. Moving to the use of group accounts as the primary statements many have legislative implications, and would certainly require changes in the way authorities were regulated and judged.

2.12 This is because currently the SORP only requires the profit/loss after tax of a subsidiary to be incorporated into an authority's Group Revenue accounts and the investment to be included in the Group Balance Sheet. This does not comply with FRS2. It requires that the trading, assets and liabilities of a parent and its subsidiaries should be presented as if the group was a single entity. Hence, to follow UK GAAP CIPFA guidance would need to require that subsidiaries are consolidated on a line by line basis.

2.13 Option 4 would involve the inclusion of transactions by other organisations not necessarily controlled or influenced by a local authority, in a local authority's accounts. As such it would significantly exceed the requirements of UK GAAP.

2.14 The option appraisal concluded that option 3 (Group Accounts) cannot be recommended without the SORP being amended first. The CIPFA/LASAAC Joint Committee will be considering the development of group accounting for the 2002/2003 SORP.

2.15 The consultation paper concluded that currently option 1 (stewardship) and option 2 (accountability) are the only viable options. They are not considered perfect solutions as they fail to give the wider picture about a local authority's partnership activity.

2.16 The consultation period has concluded. Consultation largely supported the conclusions of the paper but recognised that further guidance was needed. CIPFA is soon to issue guidance on the issue of Accounting for Partnerships in the context of best value. This guidance will be issued in the context of current accounting treatment and before any potential amendments to the SORP which would introduce group accounts as

primary financial statements. (Any subsequent amendments to the SORP are likely to require further consultation, and amendment to the requirements of the Best Value Accounting Code of Practice.)

2.17 The new guidance will cover both options 1 and 2 and will reflect the impact of FRS 5 *Reporting the Substance of Transactions*. There are situations where an authority is genuinely a*ccountable e.g.* it has been given *Accountable Body* status with *in substance* wider responsibilities/accountabilities etc. The guidance will help authorities decide when they need to include full (total) cost of a partnership for which they are the *accountable* in their accounts, as required by the Best Value Accounting Code of Practice.

2.18 The new guidance will also include:

- advice on the application of *FRS12 Provisions Contingent Liabilities and Contingent Assets* regarding *Contingent Liabilities* and *Provisions* in relation to partnerships,
- the calculation and reporting of the value of material *in kind* contributions to partnerships.

2.19 This guidance on partnerships will also cover the issue of presenting the wider picture of local authority partnership activities. The guidance will recommend additional Best Value Performance Plan notes about significant partnerships which includes information on:

- Partnership objectives,
- The authority's contributions (including in kind) to the partnership,
- The approximate spending by the partnership towards the shared objective,
- The outcomes achieved to date by the partnership and time related target outcomes

3.0 SPECIFIC ISSUES RAISED IN INVITATION LETTER

3.1 ***What are the advantages and disadvantages to the public sector in funding capital expenditure in this way? What is the basis for the argument that private capital is required to obtain efficiency savings in service delivery***? Good PFI/PPP should deliver additional services, higher quality services or more efficient services than the public sector alternative. The public sector can generally provide finance for investment more cheaply than the private sector. Consequently, any scheme that is only about financing capital investment is unlikely to deliver good value for money. The private sector must bring more to the party than just money.

3.2 Schemes with a wider scope will generally offer the private sector more potential for efficiency and quality improvements. For example:

- Rather than just looking for a private sector partner to deliver and run an IT system, greater value for money might be achieved by looking at the whole service that the IT system is helping to deliver, which would allow the partner to look radically at the whole service chain
- Rather than just looking for a private sector partner to design, construct and maintain a new building, think about the service being delivered from the building and the link between this and the design and operation of the building

3.3 It is the scope of the project ie where inter-dependent services are packaged together that offer the scope for efficiency saving through integrated management of these services.

3.4 ***What are the best value determinants of PPP?*** The application of the 4C's (challenge, consult, compare and compete) provides a means of rigorously examining potential PFI/PPP schemes and has the particular virtue of advancing a comprehensive scrutiny of all aspects of the proposal in terms not only of its suitability for PFI/PPP but also its context within public service priorities and resourcing.

3.5 The thrust of the challenge process is to ensure the purpose of the scheme has been thoroughly tested and all options for service delivery have been fully explored. If PFI/PPP is a genuine option then the structure, financing, operation and maintenance of the scheme should be developed.

3.6 If PFI/PPP is the preferred solution for the scheme then this should be the product of meaningful consultation with all relevant stakeholders. At the least such consultees should have a say in the strategic options that have been examined and the service needs/aspirations of the public sector body. The consultation might extend to the nature and packaging of services proposed. Only in this way can the PFI/PPP process be considered transparent.

3.7 Fundamental to the PFI/PPP process is the need to compare the different ways in which the service might be delivered both in terms of investment and service provision. Although the public sector comparator offers a basic discipline for comparing the in-

house/traditional and PFI/PPP options there is a further consideration in taking into account the comparisons with other similar (and dissimilar) public service organisations. Benchmarking is a key feature of Best Value and provides, potentially, a substantial amount of information about whether alternative methods of service provision have succeeded elsewhere.

3.8 Competition is a key element of PFI/PPP as is the rigour of the procurement process generally. The Best Value regime endorses this in ensuring genuine competition.

3.9 To achieve best value for money, a good scheme will be based on what is to be delivered rather than how. The public sector should determine the outputs required allowing the private sector to be innovative in determining how these can be delivered.

3.10 The outputs must, however, include clear and measurable performance standards understood by all parties and wherever possible, set out a programme of continuous improvement over the life of the contract.

3.11 ***How relevant are the assumptions used in assessing projects eg discount rate, repayment period, risk transfer?*** If good value for money is to be secured risks must be allocated to the party best placed to manage them. Without risk transfer, the private sector partner will be guaranteed an income but may set charges to give an inappropriately high return. But if the public sector tries to transfer risks that the private sector cannot manage then the private sector will charge a premium compromising VFM.

- It is likely to be inappropriate for the public sector to retain the risk of ensuring IT systems are euro-compliant if the private sector partner is responsible for the design and implementation of systems that are fit for the purpose.

3.12 The finance director has a key role in first identifying the risks to service delivery, then quantifying them and finally assessing whether they are best managed by the private sector, by the public sector or shared.

3.13 CIPFA does not recommend that accounting conventions such as depreciation be used in option appraisal. As is standard procedure, option appraisal should be based on cash flows. All aspects of alternative schemes must be considered in option appraisal, not just any capital elements.

3.14 ***What implication does the introduction of Resource Accounting and Budgeting have for tracking this form of public sector capital investment, particularly what are the implications in this connection of a transfer from capital charges to revenue funding?***

It is CIPFA's view that the introduction of Resource Accounting and Budgeting (RAB) throughout the public services, will assist appropriate decision making. In essence, resource accounting means that money spent will be recorded in the year it is used, not in the year it is spent (unless the two are the same). So instead of a new asset that is

purchased through public procurement appearing in the service revenue account when it is built, the cost will be spread over its lifetime. This will mean that the cost of capital investment will be spread over the life of the project, whether procurement is via the PFI/PPP or through traditional procurement.

3.15 For PFI/PPP schemes, the service will pay a service charge. For publicly funded procurement, the service will be charged with (notional) interest on the capital value and will have to make an allowance for depreciation.

3.16 This has of course been the case for some years in local authority and in NHS Trust accounts – but its implications have not to date fed through into the control mechanisms for capital borrowing in local authorities and for capital expenditure in health, which are operated by central government. Nor has it yet fed through into the control mechanisms operated by central government for its own spending.

3.17 It would be consistent with resource accounting, and also with the fiscal framework, to treat expenditure on the acquisition of fixed assets through traditional procurement differently from current spending, by controlling the former through prudential, sustainable investment limits. It should be noted (see also above paragraph 3.13) that it is not recommended that accounting conventions such as depreciation are used in option appraisal. As is standard procedure, option appraisal should be based on cash flows. Rather, resource accounting is pertinent to the issue of affordability - where one scheme may be better value for money over time than another, but not affordable under traditional cash accounting and budgetary control because of high up-front cash flows.

3.18 CIPFA recommends that public private partnerships should be seen as one in a range of financing and procurement methods available to public service managers, to meet identified and planned investment needed to maintain and develop public services. It is CIPFA's view that best value will be obtained overall when public policy frameworks assist the consideration of options on an equal footing. The introduction of RAB throughout the public services will facilitate this.

3.19 ***What extent is open consultation possible, given "commercial confidentiality" requirements?*** It is CIPFA's view that the development of asset management plans and strategies will improve local consultation and understanding of both the direct impact for services and long term implications of capital investment.

3.20 ***What has been the experience of this form of investment on public sector employees? Is the perceived effectiveness of PFI/PPP projects obtained at the expense of individuals who are providing the service.*** Two thirds of public sector finance managers in Scotland believe that private money is needed to drive the modernisation of public services in Scotland, according to a survey, conducted jointly by CIPFA and Zurich Municipal, which was published at the CIPFA Scottish Conference in April of this year. However, despite the appetite for working more closely in partnership with other bodies/sectors to deliver better public services, two thirds of respondents felt that partnership working with the private sector presented significant risks.

3.21 27% of respondents said that decision making and management arrangements within their organisation has not been adapted to reflect the increase in partnership working and outsourcing.

3.22 Of particular concern was the finding that only 58% of organisations are sure that they have processes in place to identify and manage these risks.

3.23 On a more positive note, 62% were confident that modernisation, growth in partnership working was improving the public's perception of public service delivery in Scotland.

Mike Watson MSP
Finance Committee Convenor
The Scottish Parliament
Edinburgh
EH99 1SP

Our ref wsmd/516

Contact W S M Davidson
0131 527 6652

31 May 2001

Dear Mr Watson

Finance committee inquiry into PFI/PPPs

Thank you for your letter of 4 May 2001 asking for my views on the questions which form the remit for the above. This I am pleased to provide and if you wish I will be happy to discuss my responses with you and, if appropriate, provide oral evidence to the committee at a later date.

My views and experience are based on a career encompassing 12 years in the NHS, 10+ years as a management consultant and, the last 4 years as full time in corporate finance with the majority of my work involving the financial aspects of PFI/PPP projects. Since its invention in 1992 I have worked (to a greater or lesser extent) on over 30 PFI/PPP projects covering health, education, MoD housing and transport including road, rail, tunnels and lastly passenger shipping. The latter being in the form of a Wider Markets Initiative response to a commercial opportunity, which in my view is a true public/private partnership.

The views expressed below are principally my own but in part I have drawn on the experience of colleagues. As a firm we have the collective experience of well over 200 PFI/PPP projects across all sectors and now increasingly in other countries which have adopted the PFI/PPP principles from the UK.

Turning to your specific questions I have used the same numbering as in your letter and for completeness have repeated your questions.

1 *What are the advantages and disadvantages to the public sector in funding capital expenditure in this way?*

In my experience those working in the public sector usually see the achievement of progress on wish-list capital projects as the main benefit of PPP. From a tax-payers perspective I see the rigour of the PPP process as being of great value as so much detail has to be discussed, agreed and documented before the first brick is laid. This adds to the timescale in comparison to a conventionally funded project but I believe it is time and effort well spent. Secondly, from a tax-payers perspective I believe that the PPP focus on whole life costs (as opposed to the more conventional lowest capital cost tender approach) has resulted in a change in the thinking and proposals of bidders which will pay handsome dividends for the service funder (the tax payer) over the life of the contract. Lastly, I believe that those within the public sector see as a disadvantage the transfer from them of the responsibility for the design, building and operation of assets such as buildings. However, I believe these transfers are a positive move which allows the funds and efforts of public sector managers and staff to be more properly directed into their

core business, the delivery of a public services (such as health services or education), using properly designed and maintained assets.

What is the basis for the argument that private capital is required to obtain efficiency savings in service delivery?

The demand for efficiency that accompanies private sector borrowing plus the rigour of the extensive due diligence reviews demanded by financiers' credit approval processes introduces a pressure not present in a conventional public sector funded project.

It is frequently said that because government is a better credit risk it can borrow more cheaply than the private sector. However, in a recent simulation we compared the whole project life NPV of a PPP deal with the NPV of the same scheme assuming it had been able to borrow at the government's rate. The difference was less than 3%.

2 What are the best value determinants of PPP?

'Best value' is a term with a specific meaning within the Local Government setting. In the wider public sector a similar term frequently used is 'Value for Money'. This I interpret as being the comparison of the NPVs of a the 'Risk adjusted Public Sector Comparator' and the PPP option. For a scheme to be better value for money the NPV of the PPP option must be less than the NPV for the public sector comparator and hence it will cost the taxpayer less over the life of the scheme. While essentially an arithmetic exercise the comparison of a risk adjusted public sector comparator and the PPP option is the closest that one can get to ensure that the comparison is a true 'apples with apples' comparison.

Some suggest that in such comparisons the parameters are adjusted to provide the required result. In my experience this is not the case and there have been many potential PPP projects where the NPV difference was so small that the schemes did not proceed as a PPP project.

3 How relevant are the assumptions used in assessing projects (eg discount rate, repayment period, risk transfer)?

Each of these parameters are actuals for any project rather than just assumptions. In the early stages of a PPP project the public sector (or more properly their advisers) have to make assumptions regarding these parameters when preparing the Outline Business Case and in similar work. In my view the assumptions that are used should be those that the adviser believes are 'at the market' and would be as used if the PPP project were reaching financial close that day.

The repayment period is a function of the length of committed public sector requirement for the serviced asset and is usually as long as can reasonably be financed, typically 25 years. It is not many years ago that 15 years was the maximum financing available for a project financed scheme but now deals are regularly being signed for periods of 27 years, 2 years construction

and 25 years services. As a generality the longer the period of the PPP concession offered then the longer the period of the debt that can be written which results in a lower unitary charge for the public sector. Refinancing projects after a few years, once they are passed the construction phase and there is a track record of performance, is an option for reducing costs further through a rate reduction and a debt period extension. However, the desire of the public sector to gain the financial benefits of refinancing make it less likely that projects will be refinanced as the financial benefits to the concessionaire for doing so are significantly reduced.

The discount rate used in PPP projects is set by HM Treasury and is common to all projects.

The assumptions on risk transfer are critical to the funding of the project and the pricing of the debt. To ensure off-balance sheet treatment (for the public sector) there has to be significant risk transfer to the concessionaire. However, conflicting with this is the public sector desire to have the lowest possible PPP unitary charge. The pricing of debt, debt/equity ratios, etc are directly related to the level of risks being taken by the parties and, their assessment of the chances of the risk arising and its financial consequence.

4 What are the costs of the capital programme?

I am unclear as to what you mean by this question.

Is it possible to separate out capital charges from efficiency savings?

I would have thought so as capital charges are a nominal charge for which public sector bodies are given a nominal allocation. Capital charges are therefore circular virtual money. Efficiency savings are cash savings realised through increased efficiency.

5 What implications does the introduction of Resource Accounting and Budgeting have for tracking this form of public sector capital investment, particularly what are the implications in the connection of a transfer from capital charges to revenue funding?

I am aware that you have also invited the Institute of Chartered Accounts in Scotland to respond to your questions and I know they are planning to address this point in some detail in their response.

6 What are the long-term implications of PFI/PPP projects on revenue funding in the Scottish budget?

Not significant. Excluding the water PPP projects (because they have been undertaken to comply with EC requirements and are being funded by the water users through increased charges) I believe that the annual revenue cost of signed PPP deals in Scotland is probably at most a few £100m per annum out of a total revenue budget of what, some £20billion?

However, by entering into 25 year deals for the provision of serviced assets the Scottish public sector is committing itself to 25 years of recurrent funding of the PPP unitary charges – regardless of whether the serviced asset is still required or not. While there is always the option of an early termination of a PPP contract there is an associated cost and hence this is probably not a very realistic option. As a consequence the policy options of future administrations in theory will be more limited than at present.

7 *To what extent is open consultation possible, given "commercial confidentiality" requirements?*

Open consultation is possible and desirable during the early stages of a PPP project where the scope is being defined. Once the PPP bidders are in competition it is contrary to the public interest if the bidders' commercially confidential ideas and proposals are put into the public domain. To do so will inhibit the innovations and creativity of ideas proposed. When a preferred bidder has been chosen and their scheme finalised it is desirable to publish this but by that time the detail will have been frozen and hence the results of any consultation cannot easily be accommodated within the scheme other than at additional cost.

Once PPP schemes have reached financial close the fine detail of the transaction can be placed in the public domain but without appropriate interpretation the information will be of little value other than to the successful bidder's competitors or those inclined to make mischief with selective data.

8 *What has been the experience of this form of investment on public sector employees? Is the perceived effectiveness of PFI/PPP projects obtained at the expense of individuals who are providing the service?*

My impression is that public sector employees approach a PFI/PPP project with fear, uncertainty and doubt. However, once the new facilities have been built and they have transferred to become employees of the new services company, usually on a TUPE transfer, they find that their new employer is more willing and able to invest in equipment and training to allow them to perform their duties more efficiently.

Hospital cleaners are a classic example where, through under investment, the routine cleaning of corridors has taken a large amount of effort with very basic equipment to produce only a barely adequate result. By comparison under a new employer the corridor will be cleaned by fewer staff, taking less time but using relatively expensive specialist equipment which takes less physical effort but produces a better final result.

It may be true to say that the efficiency improvement has been achieved through investment in equipment and training and, a corresponding reduction in staff numbers, but I believe it is not the role of the tax-payer funded public sector to create and fund more jobs than are necessary.

I trust the foregoing is of value to the committee and I will be happy to expand on any of the above points if you should wish.

Yours sincerely

W S M Davidson
Director National Financing Group
KPMG Corporate Finance

SCOTTISH EXECUTIVE

Minister for Finance & Local Government
Angus MacKay MSP

Victoria Quay
Edinburgh EH6 6QQ

Mike Watson, MSP
Convenor
Finance Committee
Room 4.6 PHQ
Scottish Parliament
Edinburgh
EH99 1SP

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

November 2001

I refer to your letter of 23 October on the subject of your Committee's report on resource accounting and budgeting.

I am grateful for the Committee's report on this important and complex area.

Resource accounting and budgeting will play an important part in increasing the transparency and public understanding of the finances of departments and measuring their success in meeting their targets. I see this as essential to improving public confidence in the effective management of public finance.

I attach a memorandum responding to the specific recommendations in the report.

A copy of my letter and the memorandum has been sent to the Clerk.

Angus MacKay

INVESTOR IN PEOPLE

POSITIVE ABOUT DISABLED PEOPLE

Finance Committee
7th Report 2001
Resource Accounting and Budgeting

Response by the Scottish Executive

1. This memorandum responds to the main recommendations in the report in the order they appear in the report. The Scottish Executive has taken note of the other matters highlighted in the report and will ensure that these are given due weight going forward.

2. Resource accounting and budgeting (RAB) is undoubtedly a major change in the way central government conducts its business. In carrying out its study and presenting its report at what can arguably be called stage 1 of the change the Committee has made a valuable contribution to the ongoing development of RAB.

Recommendation 1

> **It would be useful for a separate Scottish Assets Register to be kept and we therefore recommend that the Executive publish a list of the assets in Scotland which will attract capital charges. (paragraph 13)**

3. The Government published the first National Asset Register (NAR) in 1997. The register has been updated (to include entries up to 31 March 2000) and was published in July 2001. Included within that publication is a separate section dealing with Scotland. The NAR covers all central government departments together with their executive agencies, executive non-departmental public bodies, NHS bodies, other public corporations and nationalised industries. The 2001 version of the NAR shows the value of every asset (or group of assets) and provides a comprehensive description of all significant changes in the last 3 years.

Recommendation 2

> **It is imperative that all levels of management with responsibility for resources and all staff responsible for budget considerations are fully conversant with the implications of RAB. We support the Deputy Minister's intention to review what is currently being done in this regard and to ensure that any missed needs are met. We recommend that he report the results of this review to the Committee. (paragraph 26)**

4. The Scottish Executive commissioned the Civil Service College to run a series of seminars for Finance staff to explain the context of RAB and explore its impact on the Scottish Executive and its relationships with its sponsored bodies; a majority of staff attended these seminars. The course content was supplemented by providing written and published material (e.g. "Resource Accounting" published by the Civil Service College) for personal study.

5. For the wider office seminars have been held for those in the Senior Civil Service and RAB training has been embedded within the office wide programme, particularly through

INVESTOR IN PEOPLE
POSITIVE ABOUT DISABLED PEOPLE

making available the inter-active course "Business Manager's Guide to Management under RAB" developed specifically for the Scottish Executive by PricewaterhouseCoopers. This course provides an insight into the responsibilities of finance and non-finance managers in planning and managing resources in a RAB environment.

6. Training needs are kept under constant review and will be adjusted in the light of experience as resource accounting and budgeting evolves. The Scottish Executive's new Learning Strategy was launched in June 2001 and addresses the needs and options for upgrading skills and adapting to the demands and challenges of change; change in the global environment, change in expectations of the public, and change in the way Scotland is governed. The strategy sets out how the Executive plans to support people through learning to respond to the challenge of change over the next 3 years.

Recommendation 3

> **We understand that there is a requirement at UK government department level to sign a certificate confirming the extent of RAB training provided. This approach seems sensible to us and we recommend that the Scottish Executive adopt it. (paragraph 27)**

7. Implementation of RAB at the UK level was controlled via a Treasury led Trigger Point strategy that identified a series of critical milestones to successful delivery. While the Scottish Executive is no longer subject to the Treasury's control in this respect it was decided to follow the programme as an aid to delivering the various aspects of RAB on time.

8. Trigger point 3's purpose was to allow an overall view as to departments' ability to implement RAB successfully. It required the Principal Accounting Officer to deliver a number of assurances to Treasury. In consultation with Audit Scotland it was agreed that for the Scottish Executive the Principal Finance Officer (PFO) should be required to deliver these assurances to the Permanent Secretary in satisfaction of the Trigger point 3 requirements. On the basis of the progress made, and the views expressed by Audit Scotland in their letter dated 26 May 2000, the PFO wrote to the Permanent Secretary on 30 May 2000 confirming, *inter alia*, that robust resource budgeting data had been provided for use in the 2000 review and in the shadow based resource estimates for 2000/1; and that in respect of RAB training a core competencies framework has been prepared which will form the basis of the training framework for staff.

Recommendation 4

> **We recommend that the continued effectiveness of the IT capability is monitored closely and that an evaluation of the requirement for IT related training and support is included the Deputy Minister's review of training needs and evaluation of delivery. (paragraph 31)**

9. Following a review of the existing system's capabilities, a contract has been awarded to deliver Oracle Financials which will enable the Scottish Executive to process RAB accounting requirements. A further IT project has been initiated to develop an extended core business system that will be integrated with the main accounting system and provide a reporting tool (for use internally and for reports to be published and laid before the Parliament) and links to the budgeting and planning process. As RAB changes and evolves,

the Scottish Executive will monitor the IT system effectiveness. IT training will be offered to all users of the replacement system depending on their specific needs.

Recommendation 5

> **It will be important to understand how capital charges are affected by the application of the Barnett formula when capital charges move from the annual managed expenditure (AME) element of the budget to the departmental expenditure limit (DEL) element of the budget. Accordingly, we recommend that the Scottish Executive publish an analysis of the capital charges figures for English and Welsh departments, compared with the equivalent departments in the Scottish Executive within 2 months of the publication of this report. (paragraph 44)**

10. An exercise has been undertaken to provide a comparison of Depreciation and Cost of capital charges between Scottish and England departments. The output of the exercise was not particularly informative due to differences in the make up of departments. It is expected that the recently issued guidance for the baseline conversion for SR2002 will reduce variations and make comparison more meaningful. The comparison will be pursued once the baseline conversion has been completed.

The Scottish Executive
Finance and Central Services Department - Finance

5 November 2001

INVESTOR IN PEOPLE
POSITIVE ABOUT DISABLED PEOPLE