This memorandum relates to the Public Finance and Accountability (Scotland) Bill (SP Bill 2) as introduced in the Scottish Parliament on 7 September 1999.

PUBLIC FINANCE AND ACCOUNTABILITY (SCOTLAND) BILL

POLICY MEMORANDUM

INTRODUCTION

1. This document relates to the Public Finance and Accountability (Scotland) Bill introduced in the Scottish Parliament on 7 September 1999. It has been prepared by the Scottish Administration to satisfy Rule 9.3.3(c) of the Parliament’s Standing Orders. The contents are entirely the responsibility of the Scottish Administration and have not been endorsed by the Parliament. Explanatory Notes and other accompanying documents are published separately as SP Bill 2–EN.

POLICY OBJECTIVES OF THE BILL

2. This Bill has two principal purposes. Part 1 is broadly about the procedures for authorising the use of Scottish public resources and finances. Part 2 is broadly about holding to account those whose funding comes (directly or indirectly) from the Scottish Consolidated Fund. Most of the provisions in the Bill have been prepared in response to the need for the Scottish Parliament, by virtue of provisions in the Scotland Act 1998, to make provision by or under an Act for rules to cover certain aspects of these matters. In particular, many of the provisions of the Bill are necessary -

(a) to set out the rules contemplated by section 65(1)(c) of the Scotland Act 1998 concerning the payment of sums out of the Scottish Consolidated Fund and to make the kind of provisions about application of receipts contemplated by sections 21(7) and 64(4) of the 1998 Act; and

(b) to make the provision relating to financial control, accounts and audit matters required by section 70 of the 1998 Act, namely to provide for –

(i) proper accounts to be prepared by the Scottish Ministers, by the Lord Advocate and by other persons to whom sums are paid out of the Scottish Consolidated Fund, of their expenditure and receipts,

(ii) for the Scottish Ministers to prepare an account of payments into and out of the Fund,
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(iii) for the Auditor General for Scotland to exercise, or ensure the exercise by other persons of, the functions of –

(a) issuing credits for the payment of sums out of the Fund,

(b) examining Parliamentary accounts (which includes determining whether sums paid out of the Fund have been paid out and applied in accordance with section 65), and certifying and reporting on them,

(c) carrying out examinations into the economy, efficiency and effectiveness with which the Scottish Ministers and the Lord Advocate have used their resources in discharging their functions, and

(d) carrying out examination into the economy, efficiency and effectiveness with which other persons to whom sums are paid out of the Fund have used those sums in discharging their functions;

(iv) for access by persons exercising those functions to such documents as they may reasonably require,

(v) for members of the staff of the Scottish Administration designated for the purpose to be answerable to the Parliament in respect of the expenditure and receipts of each part of the Scottish Administration; and

(vi) for the publication of Parliamentary accounts and of reports on such accounts and for the laying of such accounts and reports before the Parliament.

3. The provisions of the Bill generally about accountability for the use of Scottish public resources and finances are contemplated by section 70(4) of the 1998 Act. This includes provisions in the Bill-

(a) standardising arrangements for the audit, under the control of the Auditor General for Scotland, of the accounts of certain Scottish public authorities;

(b) transferring responsibility for the audit of Health Service bodies in Scotland from the Accounts Commission for Scotland to the Auditor General for Scotland;

(c) introducing mechanisms to enable the Parliament to control the borrowing of certain Scottish public authorities; and

(d) making arrangements to enable the operations of the Keeper of the Registers of Scotland to continue to be financed and accounted for on a basis similar to the existing trading fund arrangements.
4. The provisions of the Bill are based on the recommendations of the Financial Issues Advisory Group (FIAG), a body consisting of leading figures from the financial world, together with individuals representing a cross-section of wider public and private sector interests. The Group was established in February 1998 and reported a year later. Its report has been considered and endorsed by the Consultative Steering Group. Copies of the report have been placed in the Scottish Parliament Information Centre. The report can be found on the Internet at www.scottish-devolution.org.uk, or copies may be purchased from the Stationery Office Bookshop, 71 Lothian Road, Edinburgh, EH3 9AZ, telephone: 0131 228 4181, FAX 0131 622 7017.

5. FIAG developed 5 overarching policy objectives to inform the arrangements (statutory and non-statutory) to be put in place concerning the procedures for approving expenditure, the use of resources, the management of audit and the scrutiny of the outputs obtained from expenditure. They were:

   (a) to ensure probity in the handling of the public funds under the Scottish Parliament’s control;

   (b) to help maximise the cost effectiveness of the expenditure under the Scottish Parliament’s control;

   (c) to provide the information which the Parliament needs to make properly informed and timely decisions and to judge the probity and wider value of the actions of the Executive;

   (d) to provide the Scottish people with understandable, consistent, relevant and timely information; and

   (e) to contain the overhead and compliance costs associated with the procedures.

6. FIAG developed 82 recommendations intended to meet the requirements and objectives set out above. Not all of FIAG's recommendations require to be given effect in legislation; some have already been incorporated into the Parliament's Standing Orders and others will be implemented administratively. The latter will require the agreement of written understandings between the Parliament and the Executive over such matters as the procedures for Parliamentary scrutiny of the earlier stages of the annual budgeting exercise and the information the Executive will supply to the Parliament. The Executive intends to start work on drafting such agreements for the Parliament's consideration in the near future. In addition to the non-statutory action that is required, a number of FIAG's key recommendations require the Scottish Parliament to legislate and this Bill is intended to give effect to them.
ALTERNATIVE APPROACHES

7. As stated above the Scotland Act 1998 requires that the Scottish Parliament legislates to a certain extent to set up a financial framework. To that extent, dealing with the issues associated with the Bill by non-statutory means is not therefore an option.

8. The Bill covers a wide range of issues. During the consultation process etc, a number of policy alternatives were considered. The most notable ones were as follows.

Budget Approvals

(a) FIAG considered the possibility of setting budgets for more than one year at a time. The Group concluded that there was a requirement for annual statutory procedures as these would aid Parliamentary control and scrutiny without undermining the flexibility of longer-term administrative arrangements for financial planning. It was also concluded that annual arrangements would help dovetail with UK requirements for financial monitoring and control, accounting and auditing.

(b) FIAG considered whether Parliamentary approval for expenditure should be by primary or secondary legislation. The Group took the view that there should be an annual Budget Act, using primary legislation that would set the main authorisations for the financial year ahead. Though secondary legislative procedures might enable a more rapid decision making process, the importance of this task, the Group concluded, merited primary procedures. In its consultation paper “a Financial Framework for the Scottish Parliament” (see below), the Scottish Executive sought views on this point. The response from consultees was almost universally in favour of using primary legislation for the main expenditure approvals. The Bill provides that expenditure must be authorised by Budget Act.

(c) FIAG also concluded that Budget Revisions should be made through primary legislation. The Executive has considered this issue at length. If primary legislation is used for revisions the Executive would have to bring to the Parliament, in addition to the main Budget Bill, two, three or exceptionally more, Budget Revision Bills during the course of a year. These would be necessary to seek Parliamentary approval for changes to funding allocations necessary in the light of unfolding events, and for Parliament to approve the additions to the budgets of departments of the Scottish Executive and other spending bodies arising from previous year’s underspends.

(d) A simpler procedure would be possible if the Bill conferred on the Scottish Ministers a power to approve Budget Revisions by secondary legislation. Under such a system, Budget Proposals would be approved through the use of Orders. These would require approval by the Parliament and Standing Orders could be developed that would require them to be considered by the Parliament's Finance Committee and in
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Plenary. Standing Orders could also be used to specify a revised timescale for the Parliamentary consideration of Budget Revisions. Therefore, if an urgent response was required, it would be possible for the Parliament to scrutinise a Budget Order more quickly than is the normal case for secondary legislation.

(e) The Executive asked for further views on this as part of the consultation exercise over the summer. Though there was a mixture of views, most respondents thought that Budget Revisions should not have to go through the normal primary legislative process. Therefore, the Executive has concluded that such a procedure using secondary legislation for Budget Revisions would be a more appropriate means of making in-year adjustments to Budget allocations. None the less, the Executive recognises that there are still those that have reservations about this proposal.

(f) For technical reasons, provisions to allow for budget revisions to be dealt with by secondary legislation cannot be included in this Bill. In these circumstances, the Executive has therefore concluded that the most appropriate approach would be to insert in each Budget Act, provisions that will enable revisions to that Act to be made by secondary legislation. The Executive thinks that it is more appropriate to deal with the requirement for revisions to a main Budget Act in the Act itself. Such a procedure would have the additional merit of giving the Parliament the opportunity to review the effectiveness of this mechanism for Budget Revisions, thus allowing alternatives to be introduced if necessary.

Contingency Payments

(g) FIAG considered whether there was a need for a mechanism that, in the event of urgent need, would enable expenditure without receiving prior authority from the Parliament by Budget Act. It concluded there was but that procedures should be introduced to provide clear guidelines and limits for the use of this procedure. The Bill provides for this in section 3 in relation to authorisation of use of resources on a contingent basis, although provision will be required in Budget Acts to enable the payment of sums out of the Scottish Consolidated Fund on a contingency basis.

Resource Accounting and Budgeting

(h) UK Government is presently moving to a system of Resource Accounting and Budgeting (RAB) which will bring it more into line with commercial accounting practices. FIAG concluded that RAB will enable government to display financial information more clearly and agreed that the Scottish Administration and other bodies, such as the Scottish Parliamentary Corporate Body (SPCB), funded directly from the Scottish Consolidated Fund should use RAB rather than the existing cash accounting system, which amongst other things, fails to show the annual cost incurred from using capital assets such as buildings and vehicles. The Bill therefore makes arrangements in sections 1 to 3 for budget approvals etc to operate using RAB. However, FIAG also took the view that, since the Scottish Consolidated Fund is a finite cash resource, there
must be an overall cash limit on expenditure. The Bill makes provision for this in section 4.

**Emergency Spending Authority**

(i) If the Parliament fails to approve a budget prior to the start of a financial year, the Scottish Administration and other bodies funded (directly or indirectly) from the Scottish Consolidated Fund would be unable to spend any money. FIAF therefore concluded that there should be short-term procedures that would enable the Scottish Administration and the other organisations to continue to incur expenditure from the start of the financial year until a Budget Act is approved. A provision which will enable funding on a month by month basis is therefore included in the Bill in section 2 but further provision will be required in Budget Bills to authorise the payments out of the Scottish Consolidated Fund.

**In-year expenditure changes**

(j) FIAF considered the possibility of enabling the Scottish Administration and the other bodies funded directly from the Scottish Consolidated Fund to transfer funds from one area to another once their budget had been approved by the Parliament. The Group concluded that a balance had to be struck between the need for Parliamentary control and managerial flexibility. The Budget Acts will set the Parliamentary controls at Departmental level.

**Format of Accounts**

(k) FIAF made it clear that it thought the Scottish Administration and the other direct funded bodies should produce accounts that are informative and easy to understand. It gave approval in principle to a format that is set out at Annex E of its report. In addition, section 70 of the Scotland Act 1998 requires the Scottish Parliament to legislate on the production of accounts. One option would be for this Bill to specify the accounting format to be used. However, the Scottish Executive has concluded that a more flexible system, which caters for example for developments in accounting practice would be better. This Bill therefore makes provision in section 18(4) for the format of accounts to be set by the Scottish Ministers in formal directions. The Scottish Ministers will, however, consult the Parliament before issuing initial directions or making substantial changes.

**Accountability**

(l) The Scotland Act 1998 requires the Scottish Parliament to legislate to provide for the designation of officials to be answerable to it in respect of the expenditure and receipts of the Scottish Administration. The Bill therefore in sections 14 and 15 sets up a such a system by making provision for the appointment and specifying the duties
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of the principal accountable officer and accountable officers of the Scottish Administration. The SPCB does not fall within the definition of the Scottish Administration. FIAG took the view that the SPCB should be subject to the same degree of financial control as the Scottish Administration. Therefore the Bill makes similar provisions for the SPCB in sections 16 and 17.

Audit Scotland

(m) At present there are two public sector audit organisations active in Scotland. The staff of the National Audit Office (NAO) in Scotland currently audit under transitional arrangements put in place under the Scotland Act, and in the main, are responsible for auditing the accounts of the Scottish Administration. The Accounts Commission for Scotland is responsible for financial and value for money audit in local government and in health trusts. FIAG, the NAO and the Accounts Commission all consider that Scotland is too small to support two organisations like this and therefore the Bill sets out to establish a single public sector audit service to be known (as recommended by FIAG) as Audit Scotland. Audit Scotland will comprise of existing NAO and Accounts Commission audit staff. (The Bill contains provisions for the transfer of the Accounts Commission staff. As the NAO is a United Kingdom organisation transfer of staff from the NAO to Audit Scotland will require separate (Westminster) legislation.)

(n) FIAG made suggestions as to how Audit Scotland might be structured. The Group pointed out the need to minimise bureaucracy. At the same time, FIAG stressed the importance of preserving the independence of the Accounts Commission and the Auditor General for Scotland. Over the summer the Scottish Executive consulted on this point. Having considered responses, the Executive has concluded that Audit Scotland should be a separate corporate body charged with providing, under their respective direction, support and services to both the Accounts Commission and the Auditor General. The Accounts Commission will retain their powers to consider and make recommendations on audit reports about local authorities, and to appoint the Controller of Audit; but it will no longer have any powers to employ its own staff directly. The Auditor General will not be given any such powers.
Audit Arrangements

(o) Presently, the various parts of the public sector that are accountable to the Scottish Parliament are subject to a variety of differing audit arrangements. FIAG took the view that these should be rationalised. In particular, it concluded that the Principles of Public Sector Audit (as set out by the Public Audit Forum and reproduced at Annex G of the FIAG report) should apply to all organisations that receive grants from the Scottish Ministers. The Bill makes provision for this at sections 19 and 20 and at schedule 4. In addition, it applies the Principles of Public Audit to further education colleges who, although no longer receiving their funding directly from the Scottish Ministers, do spend considerable amounts of public money.

(p) The Scottish Executive’s consultation exercise raised this latter point in particular. There was some comment that the financial monitoring arrangements that are being introduced by the Scottish Further Education Funding Council (SFEFC) were sufficient to ensure the highest possible standards of financial management in the further education sector. While the Executive notes the arrangements that have been developed by SFEFC, it does not think that these mean the application of public audit principles to further education colleges are no longer necessary. Indeed, it thinks that the introduction of external audit appointments will complement the measures taken by the Funding Council in bringing about more openness and accountability to the management of colleges. It is for this reason that the decision to include the further education sector in the revised audit arrangements has been taken.

(q) FIAG also considered the possibility of bringing other organisations such as local enterprise companies and higher education institutions into line with public audit principles. It did not reach a firm view, as the Group recognised that to make any changes on the myriad of constitutional arrangements affecting these organisations within the time available was unlikely to be practicable. It did however agree that the Auditor General for Scotland and the auditors appointed by him should be granted a right of access to the records of those organisations that depend to a significant extent on money from the Scottish Consolidated Fund. The Bill provides this in section 22.

(r) The Executive agrees with FIAG’s conclusion that to apply the Principles of Public Audit at this stage to higher education institutions etc would be extremely difficult within the timescales required of the Bill. The Bill does not therefore address this issue but the Executive may consider it in due course.

(s) FIAG did however conclude that the audit arrangements for the NHS in Scotland should be rationalised. At present some NHS accounts are the responsibility of the Comptroller and Auditor General while others fall to the Accounts Commission. FIAG took the view that the financial management of the Health Service, which receives large amounts of money from the Scottish Consolidated Fund, should be a matter of considerable interest to the Scottish Parliament, and that NHS audit should be the responsibility of the Auditor General for Scotland. Though a minority of
respondents to the consultation exercise had some reservations, the Executive thinks that FIAG’s conclusion is correct and the Bill gives effect to this recommendation.

Qualifications of Auditors

(t) Though FIAG did not discuss the qualifications of public sector auditors, the Scottish Executive decided to raise this in its consultation exercise. Having considered the responses on this point, the Executive has concluded that audit certificates on public sector bodies should be signed by any of the following:

(i) the Auditor General for Scotland;

(ii) a person eligible under the terms of section 25 of the Companies Act 1989 or a member of a body of accountants established in the European Economic Area (EEA); or

(iii) a member of staff of Audit Scotland holding a professional accountancy qualification.

(u) The Executive has also concluded that anyone signing the audit certificate of the accounts of Audit Scotland should be eligible under the terms of section 25 of the Companies Act 1989 or a member of a body of accountants established in the EEA. The Bill gives effect to this in sections 19(5) and 23(2).

Validation of Performance Indicators

(v) FIAG considered whether or not external auditors should validate the performance indicators of audited bodies. The Group concluded that auditors should be able to comment on the accuracy of indicators as this is a matter of interest to both the Parliament and the public. It also agreed that auditors should be able to suggest what indicators might be appropriate for a specific policy objective but that they should not be able to require organisations to use specific indicators as this would give auditors an unacceptable amount of influence over policy. The Bill gives effect to this in section 21(8).

Scottish Commission for Public Audit

(w) FIAG recommended that a statutory Public Accounts Commission should be established to, amongst other things, scrutinise the funding and audit of the Auditor General for Scotland. The Bill gives effect to this in section 12 but, in view of the existence of the Westminster Commission for Public Accounts, the Executive has elected to change the title of the body recommended by FIAG to the Scottish Commission for Public Audit. Moreover, as the funding of public audit will be
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through Audit Scotland, the Executive has revised FIAG’s recommendations to take into account that spending proposals will be made by Audit Scotland rather than the Auditor General for Scotland personally.

Registers of Scotland Trading Fund

(x) The continuing existence of the Registers of Scotland Trading Fund is a technical point that was not considered by FIAG. However, under the terms of the Scotland Act, it is necessary for the Scottish Parliament to legislate if this body is to operate on a trading basis after April 2000. The Executive has decided that, in this case, trading fund status is still the best way of combining the need for public accountability with a flexible operating framework and the Bill therefore makes provision in section 9 for the Keeper of the Registers to continue to operate like a trading fund after the present transitional authority expires next April.

CONSULTATION

9. This memorandum has already explained that the members of FIAG who developed the recommendations that are at the heart of this Bill represented a wide range of views. During the course of preparing its report, FIAG considered best practice from the UK and overseas financial systems. In addition, the FIAG Secretariat conducted a formal written consultation exercise on the future of public sector audit in Scotland. Consultation documents were sent to 55 organisations who generally welcomed the proposals that FIAG was setting out. Details of the consultation process are at Annex I of the FIAG report.

10. The Scottish Executive conducted a further consultation exercise during the summer of 1999. Its purpose was to give the public the opportunity to comment on the Executive’s intention to implement the recommendations of the FIAG report. The exercise also asked for comments on certain specific proposals that have been developed by the Executive in light of FIAG’s general recommendations. These have been set out under Alternative Approaches above. Consultation papers were sent to members of the Parliament’s Audit and Finance Committees, members of FIAG and to over 30 other organisations. In addition, a copy of the consultation paper was published on the Executive’s website.

11. Seventeen responses were received. They included comments from bodies representing business, the trades unions, the accountancy profession, spending organisations and consumer groups. For the most part, the exercise showed that FIAG’s recommendations do indeed have widespread support. Where appropriate, reference to the consultation exercise findings has been made at paragraph 6 above where the individual policy issues have been set out.
EFFECTS ON EQUAL OPPORTUNITIES

12. As this is largely a technical Bill concerning decision making and scrutiny procedures, it has no direct impact on equal opportunities. However the improved decision making procedures where the Parliament has more opportunity to consider all the relevant issues before making funding decisions should allow the Executive and Parliament to take greater account of Equal Opportunity issues in financial matters.

EFFECTS ON HUMAN RIGHTS

13. This largely technical Bill has no direct impact on human rights matters.

EFFECTS ON ISLAND COMMUNITIES

14. The Bill will have no direct impact on island communities. It will, however, provide for decisions to be taken on financial matters and such decisions may of course relate to island communities.

EFFECTS ON LOCAL GOVERNMENT

15. The Bill recognises the distinct status of local authorities. The Bill will result in the establishment of Audit Scotland whose staff will be employed to some extent on local government audit. However, the Accounts Commission and the Controller of Audit will retain their existing statutory responsibilities for the accountability of local authorities.

EFFECTS ON SUSTAINABLE DEVELOPMENT

16. The Bill has no impact on sustainable development.
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