FINANCE COMMITTEE

Tuesday 14 November 2000
(*Morning*)

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CONTENTS

Tuesday 14 November 2000

Col.

ITEMS IN PRIVATE 821
RESOURCE ACCOUNTING AND BUDGETING 822

FINANCE COMMITTEE
25th Meeting 2000, Session 1

CONVENER

*Mike Watson (Glasgow Cathcart) (Lab)

DEPUTY CONVENER

*Elaine Thomson (Aberdeen North) (Lab)

COMMITTEE MEMBERS

Mr David Davidson (North-East Scotland) (Con)
*Rhoda Grant (Highlands and Islands) (Lab)
*Mr Adam Ingram (South of Scotland) (SNP)
George Lyon (Argyll and Bute) (LD)
*Mr Kenneth Macintosh (Eastwood) (Lab)
*Alex Neil (Central Scotland) (SNP)
Mr Keith Raffan (Mid Scotland and Fife) (LD)
Dr Richard Simpson (Ochil) (Lab)
*Andrew Wilson (Central Scotland) (SNP)

*attended

THE FOLLOWING ALSO ATTENDED:

Mr Ian Doig (Chartered Institute of Public Finance and Accountancy)
Professor Irvine Lapsley (Adviser)
Mr Vernon Sore (Chartered Institute of Public Finance and Accountancy)
Mr John Stanford (Chartered Institute of Public Finance and Accountancy)

CLERK TO THE COMMITTEE

Callum Thomson

SENIOR ASSISTANT CLERK

Anne Peat

ASSISTANT CLERK

Graeme Elliot

LOCATION

Committee Room 1

Scottish Parliament

Finance Committee

Tuesday 14 November 2000

(*Morning*)

[THE CONVENER *opened the meeting at 10:06*]

The Convener (Mike Watson): I welcome everyone to the committee and issue the usual reminder about mobile phones and pagers. We have had apologies from Keith Raffan and George Lyon. Perhaps travel difficulties from Aberdeen are affecting David Davidson and Elaine Thomson, but we anticipate their arrival.

Items in Private

The Convener: The agenda suggests that we consider taking items 2 to 5 in private. That has been slightly amended and I invite the committee to agree to take items 2 to 4 in private. Is that agreed?

Members *indicated agreement.*

The Convener: That is a large chunk of the agenda, but there are fairly obvious reasons for taking those items in private. We will take a short break after item 4 to ensure that the equipment for the presentation on resource accounting and budgeting is in good working order.

Before we go into private session, I welcome Alex Neil as a member of the committee. I look forward to his contribution in the months to come.

10:07

Meeting continued in private.

11:18

Meeting resumed in public.

Resource Accounting and Budgeting

The Convener: I am pleased to welcome our three visitors from the Chartered Institute of Public Finance and Accountancy, who will be giving us a briefing. We appreciate the fact that Mr Sore and Mr Stanford have come from London. It is very kind of you to take the time to give us this briefing. As you know, the committee is undertaking an inquiry. This is not a formal part of the inquiry—it is not an evidence-taking session—but we are in public session. We look forward to hearing what you have to say in your presentation. We have received copies of the slides that you will be using, so we will not have to scribble things down as you go through them.

Mr Ian Doig (Chartered Institute of Public Finance and Accountancy): Thank you, convener, for inviting us to speak to the Finance Committee. This is the first time that CIPFA has had an opportunity to do that, and we hope that we will be able to appear before the committee again from time to time, as the committee wishes.

Let me introduce the CIPFA team. I am the director of CIPFA Scotland; my colleagues are John Stanford, who is assistant director technical, and Vernon Sore, who is our policy and technical director.

Before the presentation, I will provide some background to put everything into context. CIPFA is one of the leading professional accountancy bodies in the UK and the only one that specialises in public services. Two main factors distinguish CIPFA from the other professional accountancy bodies: first, our specialisation in the public services; and secondly, our emphasis on financial management.

The institute is active throughout the UK, with offices in London, Croydon, Edinburgh and Belfast, and it has close links with colleagues in Dublin. Furthermore, we have nine membership branches throughout the UK. CIPFA members are employed throughout the public services, including local government, health, housing, central Government, Audit Scotland, the Audit Commission in England and Wales and the National Audit Office.

CIPFA is an examining body and currently has 13,400 members and 2,300 students. In Scotland, the institute has almost 1,000 qualified members, many of whom hold top posts—director of finance, chief executive and other senior posts—in almost every part of the public services. Although I am sure that the committee will ask us for further information, I should say that CIPFA has made a great deal of information available on its website, whose address is www.cipfa.org.

I will now hand over to Vernon Sore, who will lead our presentation on resource accounting and budgeting.

Mr Vernon Sore (Chartered Institute of Public Finance and Accountancy): I echo Ian Doig's thanks for the committee's invitation to give a presentation on RAB. I am sorry that the PowerPoint technology does not seem to have worked; however, members have paper copies of the slides. I will probably not put up all the slides, as I will be shuffling things about.

Just to settle my nerves after a rather shaky start, I thought that I would begin with a quotation from the first Harry Potter novel. That might seem strange, but the character is getting everywhere and, indeed, the novel contains a reference to accountants. Harry Potter and Ron Weasley are on the train, going off for their first term at Hogwarts School:

> "'Are all your family wizards?', asked Harry, who found Ron just as interesting as Ron found him.
>
> 'Er—yes, I think so,' said Ron. 'I think mum's got a second cousin who's an accountant, but we never talk about him.'"

Although we come before the committee as people who are never mentioned, I hope that RAB will give us a slightly higher profile.

It might seem that RAB and Harry Potter do not have much in common. However, the purpose of the presentation is to try to demystify a few of the issues surrounding RAB, especially some of the terminology, which can be confusing, even for qualified accountants. My background is primarily in local authorities and RAB contains a lot of language that is not shared between local government and central Government. As a result, there has been something of a learning curve for me as well as for others.

I will first take the committee through the background and objectives of RAB, after which I will give a quick explanation of the accounting principles. This is not the time to get into too many technicalities. Next, and perhaps more important, I will consider the practical issues concerning the implementation of RAB. Although it is important to get the technicalities right, there are also many issues about how RAB and the information that it generates will be used to alter people's behaviour in respect of the decisions that they take. It would be good to reflect a little on the experience of implementing RAB to date. My presentation should be fairly straightforward. If committee members have any questions, they are free to interrupt me; I will do my best to give an answer. I will run through the slides fairly quickly and then discuss the issues.

It is important to position RAB, because it is sometimes perceived—even advertised—as public sector accounting principles catching up with those of the commercial sector. However, it is important to understand the nuance of RAB. I have a quote from the Treasury that brings out that nuance:

> "RAB applies to central government the financial reporting practices of both the private sector and much of the rest of the public sector, and extends this to reflect the nature of Parliamentary control and the need to focus on departmental outputs."

The key point is that RAB is not simply central Government going over to commercial practices wholesale; rather, central Government, like the commercial sector, is aspiring to produce accounts information in accordance with financial reporting standards as set by the Accounting Standards Board. The convergence is towards the financial reporting standards of the ASB; it is not one sector trying to imitate the other.

The first three slides give a background to the overall objectives. The first slide details the overall objectives for the whole economy, which include providing better information to formulate policy and to prepare the national accounts. However, RAB also aims to improve the use of the resources. In particular, RAB brings changes to capital accounting and decisions that are made in relation to capital investment.

The second bullet point on the slide—headed "RAB: Overall Objectives for the Public Sector"—refers to RAB helping to improve strategic management through "linking resources and outputs". One of the differences of RAB is that cash is not the only control. That is very important. RAB is about linking the use of resources and the outputs from the use of those resources, in terms of the delivery of public services and so on. The third bullet point shows that cash and performance are separated. It is still important to control cash, but RAB introduces another layer of control. We consider how resources are applied during a particular period and to what outputs those are linked.

The next slide sets out the overall objectives for departments. RAB aims to ensure that departments produce more meaningful information. I cannot overemphasise the point that RAB is to be viewed not so much as a master, dictating how services are provided and how decisions are made, but as a tool to produce more finely tuned, relevant and timely information on which decisions regarding financial management are taken. RAB is a servant for policy making and decision taking. It is designed not to dictate how things should be done, but to provide information for better decision taking.

At the top of page 3 there is a diagram that looks rather like a map of EuroDisney. In simple form, it illustrates the areas to which resource accounting and budgeting applies. The big circle represents the Government department; inside that is a smaller circle representing the executive agencies. Around the outside of the big circle there are other entities and there is some overlap with non-departmental public bodies and the national health service.

Primarily, resource accounting and budgeting and the resource accounting manual that underpins RAB apply to Government departments and executive agencies. Around the boundary are other organisations or sets of organisations—for example, local authorities, which have, by and large, been producing financial information on the basis of RAB since the mid-1980s, and the national health service, which has been doing so since the early 1990s.

11:30

As I said, this is not about central Government being pushed towards a commercial style of accounting; it is about Government being brought to the same level as other parts of the public sector and the commercial sector, resulting in convergence around a set of standards that are produced—independently of any sector—by the Accounting Standards Board.

The next slide touches on a few of the accounting principles. As I said, until now the system has been geared around cash accounting, where one accounts for the expenditure of cash, regardless of whether it is revenue or capital or when goods and services are consumed.

RAB moves on from cash accounting to try to capture the full economic cost of Government activities. It does so by bringing in several accounting concepts—in terms of resource use—that are not current in cash accounting. The slide at the bottom of page 3 outlines the four main elements of RAB, which distinguish it from cash accounting. They are

"accruals accounting, different accounting treatment of capital, spending links to objectives and targets, and resource budgeting for planning and control".

Page 4 shows the basic principles that underlie some of those concepts. In essence, accruals accounting is matching up income and expenditure to the same period, irrespective of where the cash is moved. For example, if fuel was ordered towards the end of a financial year, and even if it was used up, it might not need to be paid for—in terms of the cash moving—until the next financial year. Under cash accounting, one just accounts for the cash when it moves; under resource accounting, one matches up the use of resources with the goods or services that those resources have procured.

I will not dwell for too long on the next slide. It shows that resource accounts has five main schedules, which are designed to provide a lot more information on financial accounting than was perhaps available under cash accounting. Schedule 3 is the balance sheet, which will enable departments to demonstrate what their assets and liabilities will be in future. Schedule 4—the cash flow statement—recognises that cash and the movement of cash will still be important. It will still be necessary to demonstrate how cash has flowed during the year under various categories.

Schedule 5—"Statement of Resources by Departmental Aims and Objectives"—will be important, as expenditure will be matched against objectives by departments. If the objective is to reduce unemployment, one would calculate the overall amount that is expended and then use the output and performance analysis to give an indication of the result and to determine whether, for example, unemployment had been reduced by 1 per cent or more. In that way, we can match the use of resources against objectives and see the extent to which targets have been achieved by using those resources.

At the moment—this is very much a simplification—success means staying within one's cash limit. Arguably, however, that is purely a bookkeeping success, as success must be measured as the achievement of what one set out to achieve by spending the money. That is the direction in which resource accounting is moving.

Page 5 has a fairly simple table, which I hope will illustrate the difference between accounting for capital expenditure under RAB and accounting for capital expenditure under the current cash system. Under the cash system, if one spent £1 million on an asset, that £1 million would move through the cash account in that year but after that would, in a sense, disappear. Under RAB, the £1 million would still be expended, but what that money had purchased would then be recognised on the balance sheet. For example, for an asset that was going to be used over five years, the balance sheet would show a depreciation charge in each of those years. That is basically a measurement of how much of the value of the asset has been used up. We can see the £1 million that has been spent and the asset that has been acquired, but the focus can then be on how well the asset is being used to deliver the objectives for which it was purchased. That is the big difference between cash accounting and capital accounting under RAB.

The next slide sketches the extra elements that are brought into a budget under resource budgeting. Under resource budgeting, budgets would include the stocks that were used during the period. If one spent money on fuel, but did not use it immediately and instead stored it in a storage tank from which Government vehicles could fill up, stocks would be brought into the budgeting equation.

Under resource budgeting, budgets would also include provisions to meet future payments. Often, commercial entities, Government departments and local authorities will incur an obligation to make a payment at some time in the future. Under cash accounting, that obligation is not recognised until one has to pay it. Under resource budgeting, one has to take account of payments that may have to be made in the future but relate to the year for which one is constructing the budget.

I discussed how we could show an asset on a balance sheet. There are two parts to a capital asset charge. There is depreciation, which, in common parlance, is the amount that one puts aside for an asset wearing out and the cost of capital charge. The cost of capital charge represents what the money that was spent to purchase the asset could have been spent on elsewhere; it is an opportunity cost charge for using that expenditure on a particular asset for a particular amount of time. It reflects the fact that, because one has invested in a particular asset, one cannot invest in something else. One wants to ensure that one has used the asset efficiently to get a return on it. At the moment, the rule of thumb is that one should allow for a 6 per cent return on one's assets. I think that I may be entering the realms of Harry Potter and showing why people do not speak about accountants, so we will move swiftly on.

Page 6 deals with the practicalities of implementation. The two slides headed "Resource Accounting: Timetable" and "Resource Budgeting: Stages" provide an overview of the recent history of implementing RAB. The target that Government departments are aiming for is for resource accounts—that is, accounts produced on a resource accounting basis—to replace cash accounts in 2001-02. I am not sure whether the Scottish Parliament is on the same timetable or whether it has a slightly different one. That is a matter of detail. As members will probably know, Whitehall departments have been through a number of trigger stages to get departments up to speed in being able to produce resource accounts and resource budgets. The Public Accounts Committee has produced various reports, the latest one published in the summer, on how it perceives progress in the various Government departments.

The slide at the bottom of page 6 gives an indication of the timetable for moving to resource budgeting. There are a couple of acronyms on the slide. AME stands for annually managed expenditure. DEL stands for departmental expenditure limit. One is annual; the other is for three years. Departmental expenditure limits will eventually include things such as provisions and capital charges, which at the moment are held outwith the control of departments at the AME level, and departments will be responsible for managing them within the budgeting process. Due to pressure of time, I will skip over the two slides on page 7, which go into a little more detail on the timetable. I will be happy to go into more detail at the end if members want.

Page 8 deals with the territory that I described earlier. We could go into the technicalities of resource accounting, but we need to stand back to see that we are trying to use it to produce information that allows managers, financiers and politicians to see the information that is being produced and to make better informed decisions. However, the move to resource accounting raises many cultural and implementation issues. It is a big jump to move from the mindset of working on a cash basis, to a RAB basis.

Several factors have caused problems in Whitehall departments in the recent past. Some departments have not been able to produce their accounts or have produced them late. In particular, there have been problems in relation to having enough people staffed and trained in the technicalities, to enable the information to be produced and interpreted in a way that is meaningful to politicians.

There have also been systems problems—this is a massive undertaking and we should not underestimate the scale of the task—and problems such as computer systems not being able to produce the kind of information that is necessary have been encountered.

We move to the slide at the bottom of page 8, headed "CIPFA's View (1)". In March this year, we did a brief session with the Treasury Committee, based on a sample survey of CIPFA members working in central Government, on how they perceived some of the issues raised by the move to RAB. They all said that success depends on having a sufficient number and quality of trained finance staff, whether they are fully qualified accountants or people working at the level below—at technician level. There is definitely a great need for people who not only understand the technicalities, but can explain them and put them into practice to show the difference that can be made.

There were also some problems connected with what we term the functionality of accounting systems—whether they are fit for purpose. Perhaps I should have used that term. Even when accounting systems can produce year-end accounts on a resource accounting and budgeting basis, sometimes the in-year or management accounting arrangements are such that it is difficult for departments to produce the management information that they might need to answer more detailed questions that might arise from resource accounting. I shall give an example.

Some departments that can produce their RAB accounts and have passed the trigger points are unable to produce an aged analysis of debtors. A figure for debtors might be given on the balance sheet, but if they are asked how much of it relates to debt over one year, two years or five years, some departments will have difficulty in answering. That is what I mean by problems in regard to whether systems are fit for purpose within departments.

11:45

Let us move on to slide 9. The success of RAB will depend on altering the behaviour of managers who are used to being appraised on their success in keeping cash within a limit in the year. They must make the big move to being able to say how they have used resources in line with objectives that have been set at a political level and what the outcomes and outputs from the use of that cash have been. That will be a very big move indeed.

The final concerns of CIPFA members revolve around bringing some of these items—capital charges, for example—into budgets. The idea of capital charges is to make people consider closely the assets that they are charged with managing, whether they are using them in the most efficient way and whether they should be thinking about a different use of assets or disposing of a certain proportion of their assets and using the capital expenditure in another way. Capital charging is meant to bring home to managers the cost of using assets. If managers are using their assets inefficiently, they will be charged. That should force them to start considering whether they really need, for example, six floors of a building rather than five. Capital charging is meant to bring such a decision to the fore. Managers will have some difficulty in adjusting to that mindset, as, in the past, a capital asset has almost always been regarded as a kind of free good. If it can be paid for out of a year's cash allocation, that is fine and sorted: it can then be used for as long as it is needed.

I shall stop there. I apologise if I began to talk in accountant-ese. We will gladly answer any questions and will do our best to give clear answers.

The Convener: Thank you very much for that interesting and clear description. I noted wryly your reference to Harry Potter's comments about accountants, which reminded me of the comment that actuaries are accountants who cannot stand the excitement. This must be an exciting time for you and your colleagues.

Mr Sore: Indeed, yes.

The Convener: Thank you for your introduction. The slides and the handout have been helpful. Although not all committee members are here, all members will receive a copy of the handout. Members will also be able to follow your comments in detail in the *Official Report*.

My first question is, why has the changeover to RAB not happened before in the public sector? Why has it taken so long? I am not asking you to say why it is happening now, but why has it not happened before?

Mr Sore: That is a very good question. There must be the political will to make such a change. The transition to RAB is the outcome of the past 15 years of sharp focus on whether public funds are being used in the best possible way.

The Convener: It is a best value thing, is it?

Mr Sore: Yes—it is moving along those lines. If you cast your mind back over the past 15 years, you will realise that it has become increasingly obvious that public services must be seen to be using public expenditure efficiently. Arguably, the accounting practices used did not help decisions on the best use of resources or demonstrate whether resources were being used in a best-value sense. Bringing some of those disciplines into public expenditure is a way both of focusing the mind and of helping finance managers to prove—as far as they are able—that they have been using their resources efficiently.

Mr John Stanford (Chartered Institute of Public Finance and Accountancy): To move to an accruals basis of accounting is complex and takes skills and training. In the past, the accent in the public sector has been on the yearly review of financial administration; there has not therefore been the drive towards the accruals basis that we have seen in other areas of the economy. The complexities, the requirements for training and skills analysis need to be borne in mind. Reviews carried out by the Public Accounts Committee at Westminster have repeatedly emphasised that the skills requirements should not be neglected and that the training requirement should constantly be addressed and assessed. The adequacy of existing systems to operate in an accruals environment should not be taken for granted.

Those are all issues that have led to the accruals basis having been addressed only comparatively recently, even though for a long time many people have suggested that it is what is needed.

Mr Doig: Much of the public sector—especially in local government and in health—has been doing accruals accounting and resource accounting and budgeting for many years. The problem for central Government is that that has to sit in parallel with the macro-control—or Treasury—aspect. However, it is increasingly recognised that a cash accounting system does not give the right information to politicians or managers to make educated decisions.

The Convener: On your last point, the system that we have in the Scottish Parliament will make our job a bit easier—certainly in relation to the yearly budget process—and will, we hope, make the information that we produce in our budget reports more meaningful.

Mr Stanford, you referred to the complexity of the issue, which leads me into my second question. Towards the end of his submission, Mr Sore outlined the time required to put the system properly into place and what you determine to be the risks, one of which is resistance to what is a major cultural shift. You talk about the departments underestimating difficulties and so on. How can we be sure that we will get over those problems quickly? Are those cultural shifts being taken on board? We are especially concerned about the situation with regard to Scotland, but there are lessons to be learned from what has happened in the past two years.

Mr Stanford: It is a matter of drawing on the experience of other jurisdictions—not only in the British Isles—where over a number of years there has been a move to resource accounts and to what we call whole of Government accounts, which embrace a broader range of public sector entities. We have to try to ascertain the difficulties that have been confronted in other jurisdictions and to learn from them so that there is not a constant reinventing of the wheel.

To take other countries in Europe, I was listening to somebody from Holland last week. Holland, which is a highly developed member of the European Community, is going through a similar process and is hoping to produce accruals-based accounts in—I think—2006. A considerable amount of information can be gleaned from that. The overall message is that the benefits of the change are worth while, but—as with most things in life—those benefits will not come without considerable work. That should not be neglected.

Mr Sore: The committee should consider the experience in Westminster. It is clear that, in embarking on the cultural shift to resource accounting, departments must ask themselves fundamental questions about the capacity in their skill sets to drive through a complex project while managing in parallel for a time the old system of cash accounting. There is the issue of the skill base and of the amount of resource.

The other issue is to keep in close contact with the external auditor. I admit that I was once an auditor. I learned that communication between the external auditor and the client department is very important. It is no good for the department to think that it has it taped if the external auditor then says, “We do not think that you have.” There must be communication between the two parties.

When it is felt that departments are slipping behind their peer departments, close project management systems should be brought in with short time scales to reach the next step. You will get into trouble if you try to manage the process at macro level. It is necessary to break the process down into manageable stages and ensure that you control it at a fundamental level as you move from one system to another.

The Convener: Considering the matter objectively, what is your best estimate as to how quickly RAB will be fully up and running with all the systems to which you referred in place, such as staff training and cultural shifts? I accept that you can only give an estimate.

Mr Sore: I would be a brave man to say anything more definite. I ask you to permit me the liberty of answering your question and not answering it. The mechanics of resource accounting and budgeting should be in by 2001-02, but it will take a period of time to get used to working with it. I could pluck a date out of the air, but it might not be useful.

When the systems are up and running is not the time to sit back and say, “We have done it.” There is a continuing training need. Once the information is being produced, how do we use it to our best advantage? That is probably an answer but not an answer.

The Convener: Before Holland?

Mr Sore: Yes, we hope so.

Mr Stanford: There is also an ownership issue. There is sometimes a view that these complex mechanisms are being imposed. In the public sector, we talk a lot about “ownership”; it is jargon. Individual departments must see the benefits of the system. They then have an incentive to implement the changes as speedily as possible. In any walk of life, if people feel that change is being imposed upon them and they do not understand the benefits, they will feel lukewarm towards it. The benefits of the change make it worth while. If that message gets across to people in the departments and the entities that are producing the accounts, it will augur well for the future.

Mr Doig: We have a concern about how few accountants there are in Government compared with the rest of the economy and other parts of the public services.

There are two aspects of RAB. One is the preparation of the accounts on that basis, but the more important aspect is interpretation of the information. That is when accountants can help. Preparing the figures is one thing, but teasing out the implications of making decisions on that basis is when accountants can help hugely in policy making.

The Convener: That is a plea for higher staffing in respect of accountancy.

Mr Kenneth Macintosh (Eastwood) (Lab): I have three questions. The first is specifically on part of your presentation, which reminded me of the committee's previous discussion on the stages of resource budgeting. On page 6 of your handout, you say that, at the moment, some of the charges that accompany annually managed expenditure are held outside departmental budgets. That issue arose at a previous meeting. Why can you not include those charges in the budgets—why hold them outside?

12:00

Mr Sore: It is a case of not trying to run before one can walk. It is about moving one stage at a time and getting used to managing, on a resource base, expenditure on what we might call tangible items—things that we can relate to—before introducing the concept of having to manage a budget that includes intangible concepts such as depreciation. At that basic level, that is why a two-stage approach is being taken.

There has been a degree of wariness. If all the charges are put in the budget straight away, and if there is not sufficient training, managers might think that they have a huge budget to spend, not realising that some of it is cash, in one sense, and some of it is not. The transition is being managed in the way it is in order to introduce resource budgeting on a controlled basis.

Mr Macintosh: We have talked before about the need to ensure that cash and capital are accounted for and that it is made clear to managers that there is a difference.

My second question is about capital charges. Capital charging has taken place for some time in the national health service. In Glasgow, a brand new hospital is planned that will incur quite high capital charges. By contrast, the existing hospitals incur low capital charges, as they have been there for 100 years. It is therefore difficult to make a case for the new hospital in financial terms, as it will incur increased annual costs. The older buildings incur no capital charges and are therefore a cheaper option, in theory. Other costs may be involved, in monetary and accountancy terms—the new building may make savings on heating and maintenance, for example—but they may not be as substantial as the capital charges.

The choice is between using an old building and using a brand new building to provide a service for patients, and each can be accounted for. How would you interpret the factors that I have outlined? Effectively, you are imposing charges that will influence what is already a difficult decision, on what I consider a rather dubious basis. Can you answer that point in general?

Mr Sore: I shall make a general comment and my colleagues may add to it.

What you have described is an example of resource accounting bringing out decision making of that sort. Under cash accounting, the issue would not have arisen. RAB recognises that a hospital will last for a long time and that it will incur a cost to the economy and the public purse.

You are driving at the fact that—and I have seen this happen in comparisons between performance indicators for different local authorities, for example—sometimes the result is a difference in performance on a unit cost basis, which is caused by the capital charges on a newer, more expensive building. That is an example of RAB producing the information; we must then start to ask why that variation exists.

If two hospitals were compared—both of which were built around the same time and which had similar capital charges—and big distortions of unit costs, per patient or whatever, became apparent, one would start to wonder what was causing that difference. In some senses, capital charging is no different: it is just another factor that can cause a difference. When it causes a difference, one has to be able to analyse that difference—to say, "That is to do with capital charging. Now let's get down to the direct service costs."

I am afraid that that is a bit of a roundabout answer, but that is one view of the situation.

Mr Stanford: Financial information is just one side of the coin. When the performance of public services is reviewed, inputs and outputs must be considered. Much recent debate has focused on ensuring that outputs and outcomes can be measured successfully. That is not a straightforward procedure, as outcomes involve subjective notions of quality that are not always easily encapsulated. Clearly, any assessment of a public service that considered merely the input would be partial in its evaluation.

Another aspect is that, by adopting what we call the accruals basis, we adopt a longer-term perspective. Under cash accounting, when a capital asset is purchased, that decision is sunk after year 1 and the implications can no longer be considered. The accruals basis allows capital assets to be appraised over the whole life of the asset, which enables consideration of the benefits over 40 or 60 years, or over a longer period.

Mr Doig: You have demonstrated beautifully the tyranny of cash accounting and the way in which it can give quite the wrong perspective by suggesting that the status quo costs nothing. If the older buildings could be discounted and two new hospital projects weighed up, much more accurate information could be acquired on a RAB basis, by considering the whole life of the assets. There will be many transitional issues, as Vernon Sore said.

Mr Macintosh: My final question follows on from what you said about outcomes and the fact that they are sometimes intangible or difficult to pin down. It is difficult to deal with hard figures on the one hand and soft outcomes on the other. One outcome of the health budget, for example, is the fact that a huge number of people are employed. If priorities were changed, there could be a substantial effect on the number of people who are employed. Employing 10,000 people will never be a priority comparable to targeting cancer, or whatever, yet it is an extremely important outcome that could not be changed overnight.

How would RAB show up such an outcome? I would not want to have in place a system of accounting such as that to which you are alluding, whereby a manager of a department is suddenly given a huge notional budget that they might think is available to them to dispose of as they like. There could be drastic consequences if managers misread the budget, considered only the hard figures and ended up pursuing actions that resulted in a huge number of staff becoming unemployed—an outcome that was not shown in their RAB projections. Is there a need to employ more accountants to read our accounts?

Mr Sore: No, that is not necessarily the answer. You highlight something that goes a little beyond RAB; you are talking about health outcomes 10 or 20 years down the line. Resource accounting can show, year on year, how much expenditure is being targeted towards achieving the objective. It is a case of matching up the things that fall outside the schedules of accounts and the performance analysis—for example, matching up the research targets that are being achieved against the spending of resources in a specific area of medicine. I do not think that RAB will allow us to predict health outcomes. However, it gives us a better way of controlling the movement of research towards—we hope—successful outcomes.

The Convener: We are running a bit short of time. I know that Professor Lapsley of the University of Edinburgh has a point to make. As you may know, Professor Lapsley has been advising the committee on the budget process.

Professor Irvine Lapsley (Adviser): Thank you for a helpful presentation. I have a couple of questions on implementation. Your presentation was a kind of supply-side analysis. It showed what accountants bring to bear on the budgeting process and how they can bring it to fruition. However, as you will have noticed, the committee is very interested in changing management behaviour. Do your members have a feel for the state of readiness of management to act? Are they asking the kind of questions to which RAB will provide answers?

You have said that there is a disproportionate need for qualified accountants in Government as compared with other parts of the public sector. Is there also a case for having more sophisticated managers who are knowledgeable about the financial dimensions of what they do and can interrogate accountants?

Mr Sore: We do not have a view on managers' state of readiness. When, earlier this year, we surveyed our members, we asked how they thought things were going. From the issues that we highlighted in our presentation, it should be evident that things are going better in some areas than in others.

I will give the committee an example of one area in which the required change of mindset may not yet have taken place. Some of our colleagues told us that, in order to implement the management accounting aspects of RAB fully, they needed to invest in computer equipment, which is capital investment. That shows that they still have a cash mentality—they are thinking that they must be able to pay for the new computer equipment out of their cash allocation. However, we are moving towards dealing with such issues through resource accounting and budgeting. Some people are saying that they do not have the cash allocation that they need to buy the computer equipment that will enable them to implement RAB fully at management accounting level. I cannot give a more definitive answer about managers' general state of preparedness.

Your second question was about the need for general managers with well-developed finance skills. Today there are many people around with MBAs. I do not want to decry that—I have one, as well as an accounting qualification. However, it would be rare for someone who saw their career as being in general management to major on finance, which is a specialist area, to the extent that they were almost as knowledgeable as an accountant. Some people do not find the notion of being an accountant very exciting.

Mr Doig: From a Scottish perspective, I echo what Vernon Sore has said about managers' state of preparedness. There are so few CIPFA members working in central Government in Scotland that we are unable to assess how ready managers are for the new system. However, we have a considerable amount of contact with Audit Scotland, which is gearing itself up to audit the accounts of public service bodies on a resource accounting and budgeting basis. Audit Scotland shares our concerns about the sparsity of accountants and people with accountancy training across the public services.

Professor Lapsley also raised the issue of decision taking. We are not saying that if we drop in accountants, everything will come right. This is about accountants working as part of corporate teams, providing their colleagues with sophisticated, accurate information, and posing questions about performance management, rather than just number-crunching. They should act as a catalyst.

Professor Lapsley: You have described the introduction of RAB as a radical change, and I agree with that. Up and down the public sector significant changes are taking place to the management of services, which are often accompanied by severe information technology difficulties. Systems do not always deliver what was intended or promised. Do you know whether we are IT ready for the introduction of RAB? Are the systems sophisticated enough to deliver what is required, or are your members saying that there are problems associated with those? Mr Sore referred to the problems of acquiring equipment, but I am interested in its operational effectiveness.

12:15

Mr Sore: We probably do not have that information. We could get it by examining the accounts of Government departments that have been qualified, on a dry-run basis. That would enable us to identify the key concerns that led the auditors to do that. Such an analysis might give an indication of the extent to which departments are falling down because of IT, rather than for other reasons. We have not done such a survey. However, Professor Lapsley is right to suggest that the success of RAB will depend largely on the success of the IT associated with it.

The Convener: On that note, I thank our witnesses for their presentation and for responding to questions. The information that you have provided will help us greatly to understand RAB and its application. Thank you for making yourselves available to the committee this morning.

Mr Doig: Thank you for inviting us. I hope that you will invite us back in the future.

The Convener: I am sure that we shall.

That concludes our business for this morning. I remind members that we will meet again in Aberdeen on Monday 20 November.

Meeting closed at 12:17.

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