

# **FINANCE COMMITTEE**

Tuesday 16 January 2001  
*(Morning)*

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## FINANCE COMMITTEE

### 1<sup>st</sup> Meeting 2001, Session 1

#### CONVENER

\*Mike Watson (Glasgow Cathcart) (Lab)

#### DEPUTY CONVENER

\*Elaine Thomson (Aberdeen North) (Lab)

#### COMMITTEE MEMBERS

Mr David Davidson (North-East Scotland) (Con)

\*Donald Gorrie (Central Scotland) (LD)

\*Mr Adam Ingram (South of Scotland) (SNP)

\*Dr Richard Simpson (Ochil) (Lab)

\*Andrew Wilson (Central Scotland) (SNP)

\*attended

#### WITNESSES

Mike Hathorn (Institute of Chartered Accountants of Scotland)

Lucy Hunter (Scottish Executive Enterprise and Lifelong Learning Department)

Gillian Thompson (Scottish Executive Enterprise and Lifelong Learning Department)

#### CLERK TO THE COMMITTEE

Callum Thomson

#### SENIOR ASSISTANT CLERK

Anne Peat

#### ASSISTANT CLERK

Graeme Elliot

#### LOCATION

Committee Room 2



## Scottish Parliament

### Finance Committee

Tuesday 16 January 2001

(Morning)

[THE CONVENER opened the meeting at 10:08]

**The Convener (Mike Watson):** I welcome colleagues to the Finance Committee's first meeting in 2001. We have had notification that our new member, Donald Gorrie, is likely to be late. If he does not arrive in the next two minutes, we will delay item 2 on the agenda.

In the meantime, I ask the committee to agree to take agenda items 3, 6 and 7 in private. Is that agreed?

**Members indicated agreement.**

**The Convener:** We will proceed to agenda item 3, on how the committee should handle our inquiry into resource accounting and budgeting, and return to item 2 when appropriate.

10:09

*Meeting continued in private.*

10:18

*Meeting resumed in public.*

## Resource Accounting and Budgeting

**The Convener:** We return to public session for the next agenda item. I am pleased to welcome Mike Hathorn, the convener of the public sector committee of the Institute of Chartered Accountants of Scotland.

Thank you for the paper that you submitted to us, which we have read with interest. I understand that you would like to make some introductory remarks and speak to your paper.

**Mike Hathorn (Institute of Chartered Accountants of Scotland):** Thank you for including the institute in your consultation. As we state in our paper, the institute fully supports the Scottish Executive's move to resource accounting and budgeting. Accrual accounting is not only a private sector concept; it is a widely used basis of accounting. It has been used to great effect in the not-for-profit, charitable sector for several years. Public, private and not-for-profit sector partnership working is an important development and accrual accounting will serve all three sectors well. In our paper, we have tried to summarise some of the important issues; I shall highlight some of those rather than going through the paper in detail.

Accrual accounting is also a budgeting process; as a concept, it should not apply only to the year-end financial statements, but be introduced throughout the year. Budgets should be prepared and management accounts produced on an accrual accounting basis throughout the year, so that management and politicians can see the on-going effects on resources throughout the year.

The availability of what I would loosely describe as qualified people to introduce and manage accrual accounting will be an issue; there will be a need for education and training. It is impossible to say how many accountants or trained people will be required, but there will undoubtedly be a need to ensure that people understand the concept and the way in which the adoption of accrual accounting and budgeting will change the picture that the management accounts and financial statements will present, as well as the decision-making processes that will be derived from the management accounts that are prepared on that basis.

In the charity sector, the adoption of accrual accounting has led to an increased understanding of the importance of having resources available. That has become an important feature of the

management of charities. Charities must adopt accrual accounting fully and recognise the value of investments, whether those investments are properties or stocks and shares. Such assets, at value, are important in understanding the total resources that are available to a charity, which is important to the managers and might be important to third parties, donors and those who contribute in different ways to the work of charities—including local authorities and central Government. The adoption of accrual accounting by the not-for-profit sector has been an important development, which has helped charities to manage their resources in what is an increasingly difficult financial situation.

Undoubtedly, there is a lot of argument and contention about asset valuation and measurement. The resource accounting manual highlights the reasons why assets should come on to the balance sheet, so I shall not repeat them now. The public sector committee recognises the difficulties that the proposed valuation basis may present, but we believe that it is important to recognise value. In many cases, fixed assets have no known historical cost. We believe that assets should be recorded on the balance sheet; the proposal in the resource accounting manual is a sensible starting point, providing a basis for understanding the nature of the assets and attaching a value to them.

Policy makers need to understand what that value means and how it should be interpreted both on the balance sheet and in the context of its use in service delivery. When assets are valued on the basis of current replacement cost, significant movements up or down can result. Examples of such movements exist in the health sector—the other paper that has been circulated for today's meeting highlights some of the important issues. The public sector committee is concerned that, by putting significant amortisation adjustments through the income and expenditure account, big shifts in income or expenditure are created, in terms of surpluses or deficits, which, given the 6 per cent requirement, may lead to significant difficulties.

The policy makers must decide whether such movements should be taken into account in the 6 per cent consideration. There are a number of examples in Scotland of significant movements, and approval has been given for some of them not to be taken into account in the 6 per cent consideration. Further work is required to allow us fully to understand whether those movements should be taken into account.

In adopting accrual accounting, we are adopting a concept that is contained within generally accepted accounting practice, the appropriateness of which is determined by the Financial Reporting Advisory Board to the Treasury. On the basis that

UK GAAP is the basis for the way in which the resource accounting manual will be developed in future, we have a number of concerns, two of which are listed in our submission. One is the adoption of accounting for pension costs; the other is the wider proposal to change the accounting for leases. Both developments will have a significant impact on the public sector if they are adopted without a full understanding of the implications for the present capital expenditure controls, for example, which are fundamentally based on cash rather than on accrual.

The question for us will be whether to adopt accrual accounting fully and amend capital expenditure controls to recognise the change in accounting, or whether to reject the accrual accounting concept and retain the cash expenditure controls. On the final page of our submission, we cite two examples of our concerns for the future. They highlight the need for policy makers to understand the potential implications of amendments to accrual accounting disclosures, which could impact significantly on the way in which expenditure controls are operated in the public sector.

**The Convener:** Thank you. Committee members will have several questions to put to you, Mr Hathorn.

The opening statement of your submission makes it clear that the Institute of Chartered Accountants of Scotland is

“fully supportive of the Scottish Executive's move to Resource Accounting and Budgeting”.

What was the public sector committee's view of resource accounting and budgeting before the Scottish Executive announced its intention? Were you advocating it in advance? Have you been in favour of it for some time or is your position simply a reaction to the Scottish Executive's announcement that it would adopt the system?

**Mike Hathorn:** The institute's public sector committee is drawn from a wide range of accountants, who are involved in management, the public sector and the Scottish Executive, and from auditors from further afield. We have been monitoring and commenting on UK developments, and we also comment on international developments. The International Federation of Accountants has a public sector committee and is developing accrual accounting worldwide, principally for developing nations but also for developed nations—if I can categorise Governments in those terms. The ICAS committee has been monitoring progress and commenting on UK and international developments for a number of years prior to the Scottish Executive proposal. It may be worth commenting that I am the UK representative on the International Federation of

Accountants public sector committee, so I am also heavily involved in what is happening internationally.

10:30

**The Convener:** Is there a trend in other European Union member states towards using accrual accounting?

**Mike Hathorn:** Yes. When the IFAC public sector committee met in Paris in April, the French Government announced at a dinner that it hosted for us that it was moving towards accrual accounting. I have to qualify that by saying that it is going to adopt its variation of accrual accounting.

**The Convener:** Vive la différence.

**Mike Hathorn:** Indeed. We also had a conference in Amsterdam in October, at which the Dutch Government announced a six-year programme to adopt accrual accounting. Three or four years ago, European Governments were not at all happy with the concept, but there has since been a change in the understanding of the issues and a change of heart. Those are examples of two European countries that are adopting accrual accounting, which suggests that there is movement and an understanding of the need to adopt a fuller basis of accounting.

**The Convener:** In your paper, you mention the difficulties caused by adopting accrual accounting. Will you say something about those difficulties, particularly whether they are associated simply with the transition to resource accounting and budgeting or whether they are likely to be more long lasting?

**Mike Hathorn:** There are a number of short-term issues—education and training, for example. The introduction of new information technology systems, procedures and processes, which will be necessary to adopt accrual accounting within the management and budgeting processes of organisations in the public sector, should be short term. One needs to be careful to define how short short term is. One would hope that managers and staff would be trained within a period of, say, two years, although IT systems may take slightly longer to bed down and develop. However, we see those two aspects as belonging to the shorter term.

There has been and will continue to be, both within Scotland and on the wider international platform, a lot of debate about asset measurement and valuation. It is not irrelevant to recognise that the concept of current replacement cost, which is suggested by the resource accounting manual, is accepted by some countries, such as New Zealand and Australia, but not by others, including

Canada and the USA. It is too early to be certain exactly how assets and the measurement basis should be and can be interpreted, in terms of understanding the asset base within a public sector organisation, and—potentially more important—how assets are being used and consumed in terms of their value and charge to the income and expenditure account.

We believe that asset evaluation and measurement will take a long time to evolve and be resolved. Clearly, there are no single answers to these questions, as has been demonstrated by the international debate. Equally, within Scotland and the rest of the UK, there are strong views about whether an appropriate basis is being used and whether historical costs would be more appropriate. We believe that it will take a long time to understand this issue, not only in the context of management, but in terms of policy making.

**The Convener:** As your paper makes clear, the Institute of Chartered Accountants of Scotland's enthusiasm for the system is not widely shared as yet. You say that

"it is questionable whether there has been sufficient acceptance of the benefits to be gained by its full implementation".

What might be done to make RAB more acceptable? Is it just a question of time for the system to develop, so that its benefits can fully emerge, or is there something specific that can be done to make it more acceptable?

**Mike Hathorn:** When resource accounting was first proposed in the UK, my committee was concerned that the timetable was far too short. We could see that a number of the difficulties regarding education and training would take time to resolve. However, we have been surprised at how well, in general terms, the UK proposals have been accepted, although there are still issues regarding acceptance by management and whether there are sufficient resources and staff.

The shorter time scale has proved its worth to the extent that progress has been made quickly—the quicker the system is taken on board, the quicker we begin to move forward with the new system. However, the speed of change has meant that, at the grass-roots level, it has been difficult for managers to see the benefits. They are being asked to accommodate a new process and accounting basis at the same time as they are having to manage on the cash basis. It is difficult for them. In one sense, the issue is about the wider concept of education, by which I mean understanding more about the fundamentals and how accrual accounting will impact on day-to-day management. The concept of training is much more direct—how to use the tools for this kind of accounting.

We need to assist managers and staff at the grass-roots level who are having to account for income and expenditure on an accrual-accounting basis—they will need to be trained. At a higher level, managers will have to be educated and trained as well. That will take time—perhaps two years—but it is fundamental; without that understanding and buy-in, there could be difficulties.

I understand from the UK-wide experience that a lack of trained resource is a problem in some UK Government departments. Where there have been enough resources, accountants and trained staff to implement training programmes, the adoption of accrual accounting has been better and much more straightforward. The Whitehall departments that have not had those resources have struggled.

**The Convener:** So you suggest a two-year transitional period—although I accept that that is not set in stone.

**Elaine Thomson (Aberdeen North) (Lab):** I would like to follow up on the point about training. You said that you cannot be sure of the number of extra accountants that might be required. Are you suggesting that more staff will be required to look after RAB systems? How does the current skills mix differ from what will be required in the future? How have systems been run previously, and how will they have to change in terms of the number of financial experts and the financial expertise that will be required?

I have an associated question on support for new financial IT systems. What systems currently exist, and what state are they in? What investment will be required to allow public sector bodies to run effectively with RAB?

**Mike Hathorn:** It would be wrong for me to say, "One needs so many qualified accountants in addition to what we have." I would prefer to say that we need to recognise that the historical basis of our current accounting system was well developed. The system has lasted a long time and staff are fully familiar with the process—they are trained in that way of thinking and that way of accounting. The change that resource accounting will bring is that, instead of looking at matters purely in cash terms, we are looking at them in terms of accrued budgeting, which means debtors and creditors and the recording of all assets, whether properties, investments or heritage assets.

Historically, accountants have been perceived as the profession that is trained to manage and implement such accounting processes. I do not know how many trained accountants there are in the Scottish Executive, but the number may need to increase. However, the biggest issue is to retrain existing staff in the new concepts.

At one level, that is not hugely difficult. We are saying that, instead of accounting for cash, accrual accounting requires purchase and sales ledgers. We are talking about recognising expenditure at an earlier stage in the cycle of payment. That is one step. The other is recognising how to prepare budgets on an accrual-accounting basis.

The concepts will not be hugely problematic, but the issue is how those concepts will be put into practice and how the change will be managed. It is also about getting the various levels within each Scottish Executive department to understand the differences and to begin to regard expenditure in a slightly expanded light. Then, of course, there is a need to understand the balance sheet and income expenditure relationships. That is probably when the accountants come in, rather than the retrained staff on the recording and, dare I say it, the bookkeeping side. The accountants and senior managers in the Executive will need to address the question of asset measurement, how assets and capital charges, for example, relate to the income expenditure account, and what that means in terms of the consumption of assets, policy making and budget setting.

At one level, there will have to be retraining in the basics of bookkeeping. At the higher management level, there may well be the need for more accountants, although I do not know how many there are and where they are located. My understanding is that, in Whitehall, the number of people qualified to handle these issues has varied between departments—some departments have faced a more severe shortage—and there is a relationship between the number of accountants in a department and how well the concepts have been adopted.

10:45

**Elaine Thomson:** Are you saying that, in the past, many of the people who looked after accountancy in the public sector, however experienced and skilled they may have been in cash accounting, were not qualified in the same way as an accountant in the private sector?

**Mike Hathorn:** Yes.

**Elaine Thomson:** Are you also saying that increased retraining and awareness of the impact of RAB will be required among non-financial senior management teams of public sector bodies? People who are not directly involved in accounting may need to have their level of financial expertise raised.

**Mike Hathorn:** I believe so. That is the fundamental issue. Once the mechanics are sorted out, awareness of RAB will become important as politicians, policy makers and managers begin to engage in debates about the

available resources, not just those available in one year but the projected resources in two or three years. At that point, managers and policy makers will have to understand what they are looking at. That will require a retraining and education programme for senior managers and, possibly, an increase in some departments in the number of trained and qualified accountants who can provide support.

**Elaine Thomson:** You have said that there is a need for implementation of several new IT systems in relation to finance. Successful implementation of IT is sometimes problematic in the public sector. What are the prerequisites to ensure that the transition is as smooth as possible?

**Mike Hathorn:** It is difficult to be totally helpful because that is a complex issue. The prerequisites depend on a clear assessment of the needs. The starting point for any IT system is being clear about what one wants. It is critical that information is available to a wide range of people. The basic description of the IT systems that are required to do the task must be complemented by the availability of that information to as many managers as possible. The specification of the IT system is critical. The need to ensure a sensible timetable for implementation and testing is also hugely important.

I agree with Elaine Thomson's observation that the introduction of IT systems in the public sector—and the private sector, but the problems have been very public in the public sector—does not have a hugely successful track record. One must be clear about the specification for this type of IT system, as it can run away with itself. It is important that the specification does not over-extend into areas of accounting such as—dare I say it—commitment accounting. Commitment accounting goes a step further than accrual accounting; instead of recognising the invoice, one recognises a commitment, which could be at order level. That is a huge step; it is perfectly possible, but it is a further complication. It is important to recognise what we need at a simple level and to have the ability to build on that over time, but not to take on too much.

**The Convener:** You have made the fairly fundamental point that many managers continue to think that RAB has no benefits, although it has existed in the public sector for some time, especially in the health service. Will that attitude ever be overcome? I can understand the difficulty of changing from cash accounting systems and the fact that there is some opposition to it in the public sector, but is the feeling that RAB has no benefits widespread?

**Mike Hathorn:** This is perhaps a simplistic statement, but I would argue that that attitude

exists at two levels. At a lower level—the detailed level of new systems—there is a fundamental change from cash to accrual accounting, which some people see as a challenge. They question why they should change when there is a huge debate about whether the output is sensible and gives the right picture. They ask whether cash is better—they know what it means so perhaps we should stick to it. At that level there is uncertainty and unwillingness to accept the change.

At the higher level, as is highlighted in paper FI/01/1/1 from the University of Manchester, which has been circulated, there is a big debate about how to measure and account for consumption of assets. When capital charges are being created by accountants supposedly to be charged to income expenditure, where previously expectations of output have been set—for example, the 6 per cent return in the health sector—those accounting measurements force decision making and cost cutting on what is probably the biggest single source of cost, that is staff. People question whether that is right.

The arguments about some of the concepts are well made in the University of Manchester paper. Some people are concerned—to put it at its best—that the accounting developments that flow from RAB are being interpreted as a basis for cutting costs. My committee would question whether that is the conclusion that one should automatically reach.

**The Convener:** That was clearly the import of Dr Shaoul's paper, which we will come to in due course.

**Mike Hathorn:** My committee has debated the issues and we understand the arguments. However, it can be difficult for managers who are asked to implement such programmes to see the benefit when those arguments are in the public forum and wide debates are going on in the UK and in the international community. At both levels, it can be difficult for members of staff to recognise the benefits, because there is such a wide debate about whether RAB gives the right information and whether policy makers are implementing the results properly.

**The Convener:** Andrew Wilson and Adam Ingram want to speak. Is it on this subject?

**Mr Adam Ingram (South of Scotland) (SNP):** It is on the policy implications of what Mr Hathorn is talking about.

There cannot be any other implication, can there? If there is a set of resources and—everything else being equal—capital charging is introduced, it will take resources away from paying staff or from procurement. How is that a benefit to the service that is being provided?

**Mike Hathorn:** I quote from the resource accounting manual, which has highlighted five benefits of valuing and putting assets on the balance sheet. They vary from the simplistic to the more complicated. The first benefit is:

"To inform the public about the value of assets held on its behalf".

That is all that it states. There is no basis for valuing assets at that point. The other four benefits are then highlighted. They are:

"to encourage good stewardship of the assets by the owner entity

to inform decisions about whether resources are being tied up appropriately

to distinguish between capital and current expenditure

to inform decisions about how much to spend on maintaining the assets by ensuring that both value and deteriorations in value are recognised".

That was the RAM's starting point in changing the present situation, which does not acknowledge all assets on the balance sheet.

**Mr Ingram:** I understand that, but it has put managers in the NHS under a great deal of pressure and has meant that they have taken decisions to reduce staffing or the asset base, which has knock-on effects. In that context, the introduction of RAB throughout the public service could have a negative impact.

**Mike Hathorn:** We agree. That is why we highlighted our concern that, unless policy makers understand the implications of capital charging and the movement in the value of assets within the balance sheet, it is inevitable that those capital charges and value movements will impact directly on the cost of running services and will potentially lead to a reduction in the cost of delivery of those services. However, that does not have to be the only solution.

**Mr Ingram:** What other solutions could there be?

**Mike Hathorn:** A value must be indicated, whether it is the historic cost or the proposal for the UK—as I have highlighted, we have the value basis that has been determined for the UK. Many papers have been written on which value is the most appropriate; there are others.

The fundamental principle that has been adopted within the RAM is that in managing an NHS hospital—or any other public sector organisation—we must recognise as a cost the creation of an asset in the first place and the consumption of that asset to deliver services. The concept of having to account for that, for example being required to make a 6 per cent return on capital, is potentially political, not economic. My committee suggests that we have not had long

enough to be certain about that. I accept that, in the meantime, decisions are being taken on that basis, but we are not persuaded—and your question suggests that you are not persuaded—that such a requirement gives the right result. My committee is equally concerned that accounting adjustments and accounting for assets and the cost of consumption are driving people to a conclusion that we do not necessarily think is reasonable.

11:00

**Mr Ingram:** Therefore, should we focus on the 6 per cent rate of return with a view to ensuring that the kind of policy implications that are highlighted in your paper and in Dr Shaoul's paper do not come to pass and that we can ameliorate the situation?

**Mike Hathorn:** Yes. My committee would sympathise with the concerns that are raised in Dr Shaoul's conclusions. In a much simpler way, we, too, reflected on those concerns. We do not think that one should concentrate on the difficulty derived from the accounting basis alone. We believe that one should recognise that one has to account, recognise and put a value on assets, and recognise that there is a cost associated with using the assets. We also question how that translates into impact on performance and on the policy decisions that are derived from that picture. I would not necessarily reach the conclusion that resource accounting is wrong because it gives that result. I wonder whether the 6 per cent and the definition of what the 6 per cent is based on should be questioned, and whether that is an appropriate measurement given the full adoption of accrual accounting.

**Andrew Wilson (Central Scotland) (SNP):** Given what you say, can you conceive of any reason for not publishing or making clear the distinction between capital allocations covering cost of capital and other expenditure within an annual budget? Would there be any logic in not making that distinction clear?

**Mike Hathorn:** We believe that that distinction should be presented to managers, the public and policy makers. It is important to highlight the cost of assets, the cost of using them and, ultimately, the cost of replacing them.

**Andrew Wilson:** The question was whether there was a logic to not doing that.

**Mike Hathorn:** No, there is not.

**Andrew Wilson:** The minister has given evidence to the committee and to Parliament suggesting that one should not do that, which has confused all concerned.

**Mike Hathorn:** Our view is that the individual

elements are important within the framework that the RAM sets out, which we fully support. We think that it is important to distinguish between capital and current expenditure. It is important to inform decisions about whether resources are being tied up appropriately. Part of that information is how much one spent on the asset in the first place, which leads ultimately to a cost of using the asset. If one makes a mistake by spending £100 million instead of £50 million, one needs to recognise the impact of that mistake. We fully support the recognition of capital charges.

**Dr Richard Simpson (Ochil) (Lab):** Can you give any examples of charities that have benefited from the adoption of accrual accounting? Given that we are not yet sure of the benefits, it would be helpful to have a clear example of where—both in terms of audited accounts and of budgeting and management—the adoption of RAB has proved to be beneficial to managers and external funders of a charity.

**Mike Hathorn:** I preface my answer by saying that I will have to speak as an individual rather than as the convener of the public sector committee. I have worked in the charity sector for 30 years and am the treasurer of several Scottish national organisations. I am at the sharp end—yesterday, I visited a Scottish Executive minister to discuss financial difficulties. Therefore, I have the background to be able to answer the question.

From my experience of being a treasurer, the implications of the adoption of accrual accounting—and all that goes with it in terms of financial reporting and budgeting—have been enormous, especially when resources have become scarce. Over the past three or four years, it has become much more difficult to be sure from where an organisation's income will come from year to year. Accrual accounting has introduced to the charity sector the statement of financial activities, which is an accrual-based statement that also recognises realised and unrealised gains and losses. Those realised and unrealised movements are also categorised according to restricted and unrestricted funds. Unrestricted funds are those that are fully available for any activity.

For the trustees, managers and treasurers of charities, such statements encapsulate on one page a picture not only of the movements in income and expenditure that relate to the services that the charity provided in a year, but of the gains and losses that have been made on sales of assets and investments, and the movements in the charity's unrealised gains and losses. Increasingly—given the scarcity of resources—charities have had to look beyond the current year and to assess what will happen in the next year and the year after that. One of the most important

results of accrual accounting and the statement of financial activities has been that, in a time of scarce resources, they have forced charities to look ahead, to consider the total picture of their resources and to decide how best to use those resources in years 2 and 3 as well as the current year. There is then a big impact on the budgeting process for those years.

It has been my experience that that change in the charity sector has helped organisations internally and externally to see the whole picture. It has helped me—as a treasurer—to explain to trustees, boards or management groups the limitations of our resources and the restrictions on us. Property values are reflected on the balance sheet; I can discuss those values, the impact of selling or not selling property and the movements in value within a year or whatever. I have found that to be hugely helpful.

**Dr Simpson:** That is because it gives a more complete picture.

There might be a parallel—I do not think that it is exact—between the funding of charities by the National Lottery Charities Board, and the funding of health trusts by the Government. Is the view that the lottery board has taken on assets based on resource accounting and budgeting? Are the agencies that provide money moving to consideration of funding in terms of resource accounting and budgeting?

**Mike Hathorn:** My interpretation is that, in awarding grants, the lottery board wishes to know the totality of the assets and resources that are available to charities. It needs to see clearly whether a charity owns property. I think that that is a condition of giving grants, rather than a repercussion of resource accounting. I do not think that resource accounting and what the lottery board does are directly related.

However, as I said, the public sector, the private sector and the not-for-profit sector are increasingly working in partnership, particularly in Scotland. That partnership approach needs a common picture, so that when a Government department examines a charity, it sees it in the same way that it sees the world. We all need to see a similar picture—it does not need to be exactly the same, but it would be helpful if we all saw the issues in the same way.

In grant giving by local or central government, it is entirely appropriate that the assets that are owned by the charity are clearly and obviously stated. It is arguable that some people in the charity sector would prefer it that such a picture was not painted, but it is appropriate that one should be able to see it. The adoption by charities of accrual accounting and the statement of financial activities has helped greatly in giving a

much better picture of charities' financial positions. That makes more information available to an outsider, whether they are a Government or local government department, or a donor on the street.

**Andrew Wilson:** Your paper discusses the fluctuations in property values that can occur because of market changes and so on. The Government appears to have accommodated that factor by allocating a significant chunk of new funds—£1 billion or so—for capital value charging, although we have not yet learned the basis on which that has been done, the values and so on. How can any public sector agency deal with a change in the market value of its property, given that the budget is fixed? What response, if any, should there be in the public sector?

**Mike Hathorn:** By raising the issue in our paper, we alerted the committee to the fact that we have the same concerns as those which members have voiced. We are not persuaded that it is appropriate to recognise changes in value—based purely on the local market—as having a direct impact on capital charges through the income and expenditure account per se and as driving policy makers to a particular conclusion.

Although it is appropriate to recognise a movement in value—it is consistent with the RAM outline to which I referred to do so—we see real danger in reaching the simplistic conclusion that that means that one has less resource to provide continuing service delivery. Our question is intended not to challenge the concept of valuation per se, but to question the logic that says that there should immediately be an increased capital charge, purely on the basis of a market movement that could be transitory. A rise in value could last only a year, but on a five-year valuation one would, in principle, be stuck with higher capital charges for that period. We are concerned that there is not enough evidence to suggest that there should be a direct link. Much more needs to be considered in relation to the effect on policy making.

We are very concerned about that at this stage. As I said, although we could find ourselves with much higher capital charges because of that, we do not necessarily believe that we should go straight back and say that the accounting side is wrong. We would like still to consider the value basis as appropriate, but we would like to consider further how that flows into policy making and into the availability of resources, and whether that should immediately impinge on the amount of resource that is available because of that higher capital charge. We think that that is not a proven case. Again, that is where we have some sympathy with the University of Manchester paper, although not necessarily with its conclusion.

**The Convener:** Thank you, Mr Hathorn. That

has been very useful. This is the start of the taking of evidence in our RAB inquiry; there will be several further sessions. That has got us off on a good foot. Thank you for your paper and for answering our questions.

**Mike Hathorn:** Thank you for the opportunity to do so.

**The Convener:** I apologise to everybody for the inadequate heating. It is not the first time that the heating has been inadequate. I will write to facilities management about it. The heating is a contributory factor to my calling a brief adjournment.

11:16

*Meeting adjourned.*

11:23

*On resuming—*

## Interests

**The Convener:** We move to delayed item 2. I invite our new member, Donald Gorrie, to declare any interests that are relevant to the work of the Finance Committee.

**Donald Gorrie (Central Scotland) (LD):** I apologise for being late—I have come from an away day in Aberdeenshire for the Liberal Democrat group. Despite an early start, we were defeated by the traffic.

I have no relevant interests to declare, other than my enthusiasm for the work of the committee.

**The Convener:** That will be tested in the months to come.

## Education (Graduate Endowment and Student Support) (Scotland) (No 2) Bill

**The Convener:** Members will recall that we considered the Education (Graduate Endowment and Student Support) (Scotland) (No 2) Bill at our meeting on 19 December. Subsequently, I wrote to the Minister for Enterprise and Lifelong Learning, Wendy Alexander. Members have in front of them the response, which is in the name of the junior minister, Nicol Stephen. I am pleased that we have with us Lucy Hunter—who is head of higher education, science and student support at the Scottish Executive—and Gillian Thompson, who is head of the student support branch. I would like to put on record that Nicol Stephen's letter was a very full response to the committee's concerns, especially in its detailed breakdown of the £53 million of additional funding. I have no points to put, because in my view the committee's questions were, on the whole, dealt with. However, if members wish to follow the letter up, I invite them to do so.

**Andrew Wilson:** I agree with Mike Watson. Nicol Stephen's letter—in the detail and information it provides—is excellent. We should seek to set such a standard in future financial memorandums. I wonder why the information was not in the initial documentation.

I want to consider the financial implications of two issues. First, am I right to conclude from the annexe to the letter—on the detailed breakdown of the £53 million additional funding to the overall package—that the net cost of the abolition of tuition fees is only £25 million?

**Lucy Hunter (Scottish Executive Enterprise and Lifelong Learning Department):** That is our current modelling. The model is quite sensitive to various changes of assumption on student numbers, loan take-up percentages and students' position on the income continuum. There is a little variation, but the highest figure that the Executive has ever given on the net cost of abolishing fees is £27 million. That figure has come down a little in recent modelling, but it is still in broadly the same position.

As the letter explains, that is made up of two sides. There is the upfront payment of the fees, but because of the relieved pressure on parental contribution and the follow-through into loans, there is a saving in the quantity of loan that the Executive has to make available to students. It is a net figure; the gross figure is higher.

**Andrew Wilson:** It is not a priority, but it would be useful to have an explanation of that.

The cost is at the lower end of anything I have heard from any minister in the previous or current Administrations. Likewise, I gather from the third paragraph on the first page of the letter that

“the real value of the income from the Graduate Endowment is estimated at around £15m a year.”

That will kick in only once there are graduates with ordinary degrees—which will, I guess, be in three or four years’ time. So, is the income from the graduate endowment only £15 million?

**Lucy Hunter:** It is a little lower than some of the early estimates. I will ask Gillian Thompson to say a word about how that figure has been reached.

**Gillian Thompson (Scottish Executive Enterprise and Lifelong Learning Department):** As we explained in the letter, the assumption is that students will want to take out a loan to pay their graduate endowment. The actual income that we anticipate receiving is the number of students multiplied by £2,000, which is about £30 million. There would be a cost for making the loan; because of the assumption that we have made about the modelling, we estimate that the cost to us will be 50 per cent of that. We are working on the basis that the true cost of the income will be £15 million.

**Andrew Wilson:** Have you netted from that the administrative costs of the entire system?

**Gillian Thompson:** No.

**Andrew Wilson:** Would the cost of administration—which will not be substantial, but which will, however, be tangible—be subtracted from the £15 million income?

**Gillian Thompson:** Yes. We are building on the current mechanisms. Therefore, the costs of that will be the Students Awards Agency for Scotland’s additional costs. We have not taken that further reduction in income into account.

**Andrew Wilson:** That is reasonable, but £15 million is hardly a startling level of income. The cost of having no endowment at all would be the net of the £15 million.

**Gillian Thompson:** That is assuming that every person who is liable takes out a loan—

**Andrew Wilson:** Which is the assumption that you are putting into the bill.

**Gillian Thompson:** No. The bill allows us to do certain things in relation to how we deal with the income that arises. I am talking about straightforward consideration of £2,000 from each liable graduate. The least amount that we would get back would involve assuming that every liable graduate will want to take out a loan—

11:30

**Andrew Wilson:** So you are making the conservative assumption.

**Gillian Thompson:** Yes.

**Andrew Wilson:** So the income will be £15 million if everyone takes a loan and £30 million if no one takes a loan.

**Gillian Thompson:** Yes. The figure will be somewhere in between those figures.

**Andrew Wilson:** So the figures are subject to a sensitivity factor of 100 per cent. Can you tell us the administration costs of the system?

**Gillian Thompson:** We are working on that. Recently, the SAAS gave us the provisional costs of changing its system to flag up the students involved; it estimates that the cost, including VAT, will be about £200,000. There are possible running costs of about £50,000, but we have still to discuss with the agency what they would entail. That figure may be a little on the high side.

**Andrew Wilson:** Is the £200,000 a one-off cost?

**Gillian Thompson:** Yes. It is suggested that the £50,000 would be an annual cost, but we need to get to the thinking that underlies it. We knew that committee members would ask about that, so we have pressed for information in the past couple of days.

**Andrew Wilson:** The £50,000 would cover labour costs for only one or two individuals. Do you expect to employ only two people to chase income from the endowment?

**Gillian Thompson:** The arrangement of the requirements is fairly complicated. A process will identify the liable students—that is the system to flag up individuals. Another process will involve asking liable individuals how they wish to make a payment, because we think that it is important that there is some information exchange between the SAAS and the student. There will be some information about the graduate at the end of the process and about whether they are liable—they may no longer be liable if their circumstances have changed. The interlinking between the SAAS and the Student Loans Company at the end of the process also raises some issues.

We think that the biggest hit on administration is likely to come from finding out about the liable graduate—for example, whether that person is still liable at the end of their course and whether they have finished and successfully completed their course. We have not discussed the number of staff, but we think that the number required will lie between one and two additional people. The students who are involved will pass through the hands of the SAAS as a case. The agency is

staffed up to deal with them, so we are not adding extra students to the system.

**Andrew Wilson:** Given that the cost of chasing up the bill is coming in at just over £3 per student, it will be a feat of wonderful efficiency if you pull off the task, from which much of the public sector will do well to learn. Compared with the system for collecting council tax, the arrangements would be groundbreaking. If you pull it off, you will deserve congratulations. I would like some more information when you have evidence about the cost.

**Gillian Thompson:** We are still negotiating what will be required with the Student Loans Company. We will need to come back to those figures in a little while.

**The Convener:** In his letter, the Deputy Minister for Education, Europe and External Affairs said that he expected more robust figures to be available at stage 2.

**Lucy Hunter:** The key point is that the ambition throughout the scheme is to build on existing processes such as the application form that students must use to apply to the SAAS every year that they study. We hope that what is required will be a matter of adding a page to a document or a little bit to a computer system that already exists and that wholly new processes will not have to be built in to any great extent. That is why the numbers are so low.

**Dr Simpson:** The figures show the advantage of the decision to build on the existing systems rather than having a totally separate system. The efficiency should be high.

My question concerns the access fund, which you hope to reduce by £8 million. Do access funds mean hardship funds?

**Lucy Hunter:** Yes.

**Dr Simpson:** What evidence do you have and what variables have you taken into account in making that assumption?

**Lucy Hunter:** The background is that there has recently been a steep increase of £6 million—Gillian Thompson will correct me if I am wrong—in the amount of money devoted to the hardship fund. I am thinking of the figures for 1998.

**Gillian Thompson:** Yes—the 1998 session.

**Lucy Hunter:** The access funds are therefore already a lot higher than they were. There is an intention and expectation that, by increasing the amount of money available to young students and through the mature students bursary fund, we will relieve pressure on the access funds, so that we can bring those funds back down to previous levels. That is the broad assumption that has been made. We cannot show you detailed models or

costings to get a more detailed breakdown. The assumption is a broad one—the introduction of the new system will relieve the pressure on the access funds.

**Dr Simpson:** I am not sure that I am clear about that, particularly about how you reach the figure of £8 million for the saving that is expected to be made in access funds. I understand what you are saying—that the new system is designed to reduce hardship and therefore the need for funds. However, I find it a little hard to follow how you come to the conclusion that you will reduce the call on access funds by £8 million. I remain a little concerned that that expectation will not be met and that the demand for hardship funds will probably not decrease as much as you suggest. I do not follow the variables and workings that have led to the figure of £8 million. I understand the basic assumptions that you have enunciated, but do not see how you have translated that into sums of money.

**Gillian Thompson:** I am not sure that I can say anything to make you feel you more confident about that. Data on the access funds have historically been difficult to gauge. It is only in the past full year that we have improved and expanded the survey information. Institutions require to have their accounts audited at the end of the academic year, and we are now getting better data on what the access funds have been used for. We have not had as good a handle on what institutions have spent—that is very much a discretionary arrangement.

Furthermore, improved information is now reaching the SAAS, which we hope will reinforce the assumptions that we have made in reaching the figure of £8 million. I remind members that, on this point, we are dealing only with higher education students, not with further education students. The access fund is £14 million for the entirety of students, including postgraduate students. As I said, we are dealing with HE students, who we do not believe will require access funds for crisis hardship. Depending on students' circumstances, institutions will give them support in relation to specific things. It is a kind of knock-on arrangement. That probably does not sound very convincing.

We clearly have to monitor the situation. I stress that we are not removing £8 million from the access funds for 2001; we are gradually bringing the new students on stream. Some work still needs to be done on that, and we have been discussing the matter with our student support technical advisory group, which is composed of representatives of Universities Scotland—formerly the Committee of Scottish Higher Education Principals—the National Union of Students Scotland and others. We are therefore engaged in

proactive discussion on what would reduce the access funds bill for 2001.

**Dr Simpson:** So the—

**The Convener:** Sorry—I think that we have gone as far as we can on that point and that the committee has sufficient detail on it. Donald Gorrie has a final question.

**Donald Gorrie:** This is a sort of standard grade question. I have never properly understood how the loans are dealt with. Am I right in thinking that, if the Government or Executive uses £1 million for bursaries or for loans, that will be the same this year from an accounting point of view?

**Lucy Hunter:** No. Under resource accounting and budgeting, student loans are recognised as one of the most complex items. The cost of a loan includes a cash amount, which we keep track of in our cash outflows and inflows. That would be the same pound for pound, provided that we could assume that the uptake of loans and bursaries among students was the same in practice. We know that only 75p of every pound that we are prepared to lend people is actually sought, so the uptake on student loans is below the potential total amount. When we model those things, we tend to assume that we will not save a pound of loan for every pound of grant that we issue. Grant uptake tends to be very close to 100 per cent; loan uptake tends to be lower.

We also have to make assumptions about the costs to us of issuing loans. As the committee will be aware, there is a cost in issuing loans, relating to the fact that they are paid back over a period of time and that there is a subsidised interest rate. In the models circulated to the committee, we have used the historic assumption that the rough cost to us of a loan is 50 per cent: for every pound of loan that we issue, we assume an absolute, unrecoverable cost of 50p.

We cannot be sure whether that assumption will continue to hold indefinitely. Factors that may change the accounting charge on the loan include reassessment of the uptake of loan and reassessment of the rate at which the loan is repaid. The income-contingent loan scheme is very new and we have good reason to believe that the collection rates are better than was originally anticipated when the 50 per cent accounting charge was set. Although all the costings that we have used in our assessment are based on the historic assumption of a 50 per cent cost, it is important to be aware that those costings are sensitive to change and that, if we took a different view of the collection rate and of the cost to us of issuing loans, that would impact on the figures that we have presented. We have not done any costings of alternative scenarios, however. The relationship between bursary and loan is

complex—several factors are in play.

**Donald Gorrie:** If I understand what you have said, the net cost to the Government or Executive in the long run—20 or 30 years down the line—is estimated at 50 per cent. In the shorter term, before repayment on the loan starts, the Government is paying interest on the loan. Does £1 million of loans cost more over the next three or four years than £1 million of grant?

**Lucy Hunter:** The £1 million of grant would simply be recorded in the accounts as £1 million of outgoing or of resource that has been deployed. If £1 million of loan were to be issued, the whole £1 million would not be scored as the resource cost, because it would be anticipated that some of that sum would be returned. In the year when the loan is issued, an allowance—called a RAB charge—would be made in the account for the loan. The amount of that charge would depend on the best estimates at the time of collection rates and of the cost of the interest subsidy. The model that we have produced is based on the figure of 50 per cent. However, if the collection rate is better—for which there seems to be evidence—by the time the package is rolled out, we might be able to score a more optimistic assumption about the collection rate. That would affect some of our costings.

**Donald Gorrie:** I was disturbed by your saying that not all the loan money is taken up. That seems extraordinary in the light of the visible poverty of students.

**Gillian Thompson:** Since the start of the income-contingent loan scheme in 1998-99, we have moved to a loan take-up of 75 per cent. That is predicated on United Kingdom figures. We are not clear why there has not been a greater uptake of loans, but we had forecast a figure of 72 per cent; the real figure turned out to be 75 per cent.

**The Convener:** I thank Ms Thompson and Ms Hunter for coming to answer our questions today.

Is the committee content to report that a financial resolution is required for the Education (Graduate Endowment and Student Support) (Scotland) (No 2) Bill?

**Members indicated agreement.**

**The Convener:** Thank you. We will now go back into private session for agenda items 6 and 7.

11:45

*Meeting continued in private until 12:31.*

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