

# **FINANCE COMMITTEE**

Tuesday 6 March 2001  
(*Morning*)

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## FINANCE COMMITTEE

6<sup>th</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

Tim Ellis (Scottish Executive Development Department)

Geoff Huggins (Scottish Executive Development Department)

Liz Lewis (Scottish Executive Health Department)

♦Professor June Pallot (University of Canterbury, New Zealand)

♦by video link

### CLERK TO THE COMMITTEE

Callum Thomson

### SENIOR ASSISTANT CLERK

Anne Peat

### ASSISTANT CLERK

Gerald McNally

### LOCATION

Committee Room 1



## Scottish Parliament

### Finance Committee

*Tuesday 6 March 2001*

*(Morning)*

[THE CONVENER *opened the meeting at 08:14*]

### Resource Accounting and Budgeting

**The Convener (Mike Watson):** Good morning—or good evening, as the case may be. I call formally to session the first meeting of the Finance Committee to begin at 8 am, or pretty close to 8 am. I offer apologies on behalf of Elaine Thomson, who is unwell, and David Davidson, who has business in the north of Scotland.

Professor June Pallot is at the University of Canterbury in Christchurch, New Zealand. Good evening.

**Professor June Pallot (University of Canterbury, New Zealand):** Good evening. Thank you and good morning to you.

08:15

**The Convener:** I am Mike Watson, convener of the Scottish Parliament's Finance Committee. I am a Labour member for a Glasgow constituency. I will introduce my colleagues on the committee, which is, of course, all-party. Moving round the table from left to right—not necessarily politically—I introduce Andrew Wilson, a Scottish National Party list member for central Scotland; Dr Richard Simpson, the Labour member for Ochil, in what might be called the midlands of Scotland; Adam Ingram, a Scottish National Party member for the south of Scotland; and Donald Gorrie, a Liberal Democrat member for central Scotland. We are joined by Professor Irvine Lapsley whom, I understand, you have met. We also have our usual array of clerks, staff from the *Official Report* and sound technicians, who have made the link-up possible. We are pleased that you have joined us.

**Professor Pallot:** Thank you very much.

**The Convener:** Would you like to make an opening statement? The committee has received your submission and your full and interesting background paper.

**Professor Pallot:** Thank you. I am a professor of accountancy at the University of Canterbury in New Zealand. It was suggested that I might like to make a submission to the committee because

New Zealand has 10 years' experience of what is, effectively, resource accounting and budgeting, although we have never called it that.

I speak from about 20 years' observation of New Zealand's public sector reforms; from involvement with setting public sector accounting standards; and from my work as an assistant Auditor-General for a couple of years. My submission is made in the light of such experience.

I will direct the committee to a few short statements in my submission. I emphasise that New Zealand did not undertake resource accounting and budgeting as a separate technical exercise—we did not even have a separate name for it. It was merely a part of overall public management reforms, although it was an integral and important part. It was never considered to be an accountants' programme or anything like that.

The public sector reforms were part of wider economic reforms, which means that it is difficult to say definitively which successes have arisen directly from resource accounting and budgeting and which have come from the reforms as a whole, because they are strongly linked.

I will give a brief background to the events in New Zealand. Two major pieces of legislation introduced the main Government reforms. They were the State Sector Act 1988 and the Public Finance Act 1989 which, in effect, introduced resource accounting and budgeting. By 1991, all New Zealand's central Government departments—and, under separate legislation, all local government and all other Crown entities—were using full accruals accounting. We also produced non-financial statements of service performance which, I believe, we are unusual in auditing. If the committee wishes to ask questions about that, I will be happy to answer them.

New Zealand was the first country—in 1992-93—to introduce whole-of-Government financial statements on a full accruals basis. The Fiscal Responsibility Act 1994 was passed to require the Government to produce its future plans and financial plans on a full accruals basis, for greater transparency to the public. We have complemented the whole-of-Government financial initiative with some strategic goals and result areas.

I sense that some countries' discussions about introducing accrual accounting make it sound a little difficult or they have concerns about problems. In New Zealand, the introduction in departments of the system was pretty straightforward and did not cause many problems. That was partly because the system had been discussed for a while, although only a few people had implemented it. Skills were readily available, particularly as the State Sector Act 1988 made it

easy to move people between the public and private sectors. We have only one accountancy body in New Zealand and everybody in that body is trained in commercial and governmental accounting.

We made the change easy for departments by separating the department and the whole of Government, so that tricky issues—such as heritage assets, taxation revenues, infrastructure assets and liability for pensions—were dealt with at the whole-of-Government level. Individual departments had to deal only with simple items such as tables, chairs, cars and other vehicles, for which commercial accounting packages were reasonably readily available. We managed to deal with the tricky accounting issues. I am not sure whether we did that perfectly—that remains to be seen—but we made a start.

We have tried to evaluate the system as much as possible and, by and large, the reactions of managers, senior managers, ministers and other politicians have been positive. It is felt that there is a wider range of information for decision making, and there is improved accountability and a clear understanding of what departments are doing and how much services cost, because of the emphasis on outputs and output budgeting. Management of cash, debtors, creditors and physical assets has improved as a direct result of accrual accounting and the longer term implications of short-term decisions are more apparent.

I must caution the committee that much of the evidence came from people such as senior managers, Treasury officials and overseas commentators and that their evidence tended to be positive. No one has canvassed the opinions of people who were dismissed from the public service, for example, and the views of people at the lower end of organisations have also not been much considered.

Overall, the response has been positive and the exercise has been felt to be beneficial. However, it would be unfair if I did not say that there were concerns, some of which have lingered. I have mentioned some of the main concerns, including the costs to small departments of meeting accountability requirements. We must put protocols in place to control that. Accountability requirements for non-departmental entities are not as stringent as are those for departments, and it is felt that the requirements on Crown entities that are owned by the Government, but which are not departments, could be a little stronger.

Some people consider the capital charge a head office exercise, and it might be hard to show that it has the effect that it is claimed that it has. I am concerned that departments have not been able to retain surpluses. That position is particular to New Zealand. I ask whether that works against the

positive motivational aspects—such as the flexibility to manage—that resource accounting and budgeting has otherwise provided. The suspicion is growing that, once the initial fat is removed from the system, some departments become undercapitalised in the pursuit of short-term efficiency. There is mounting concern about maintaining capability. A persistent concern has been that we should do more to measure outcomes—the system is based on outputs.

I have drawn the committee's attention to a fairly recent report by the Office of the Controller and Auditor-General in New Zealand, which makes several suggestions. It considers the information that Parliament should receive and suggests reclassifying appropriation as current and capability expenditure, instead of using the purchase and ownership ideas, because not everything can be thought of as a purchase. The report says that maintaining capability is important and it goes beyond balance sheets and financial capability to human resources and information capability. It also recommends that outcomes should be measured. It remains to be seen how many of those ideas will be implemented, but I think that there is a groundswell of opinion in favour of change.

The question is not whether resource accounting and budgeting is ideal, but whether it is an improvement on the previous system. No one to whom I have spoken anywhere wants to return to the old system of cash accounting and centralised control.

I am happy to answer any questions that the committee might have.

**The Convener:** Thank you for that introduction, which complemented your written submission.

I will start the questioning. Your written submission says—you repeated it today—that resource accounting and budgeting was not undertaken in isolation, but was part of management reforms in New Zealand. How was that achieved? I am interested in the other management reforms that were taking place. In the UK, we are not setting RAB in that context. It is considered here to be a technical accounting exercise. As that is the case, what shortfalls could the system in the UK face?

**Professor Pallot:** The main problem with treating RAB as a technical accounting exercise is in obtaining commitment to it from non-accountants. The exercise could be seen as something that goes on elsewhere and which involves the boffins or the bean counters. It could be hard to obtain the commitment and involvement of everybody who works in the Government.

In New Zealand, we started the system in 1978, with a report from the Controller and Auditor-

General, which mentioned accrual accounting as merely one way of dealing with some problems, such as understanding costs and making choices among suppliers. The system was seen primarily as an exercise not of external accounting and reporting, but of management. New Zealand then became involved in reforming its economy and its public sector. The reforms were so comprehensive that nothing was left untouched. The financial systems were reformed along with the human resource systems and all other aspects, which included the restructuring of all Government departments. Every aspect of the New Zealand Government was altered. The financial management and resource accounting and budgeting aspects were just a part of that—they never had separate labels. There were public sector reforms, but no separately identifiable accounting reforms. Those reforms were simply carried out.

08:30

**The Convener:** Could you comment on the situation in the UK, in as much as you are aware of it, and in as much as we are setting resource accounting and budgeting in a different context? I take on board your point about bean counters and about how RAB might be viewed as some kind of compartmentalised exercise for those who understand its technicalities. I can see the benefit that you in New Zealand spotted in wanting to spread the change as widely as possible throughout Government and the management of Government departments.

Given that that is not the way in which changes are being undertaken in the UK, do you still think that it is possible to introduce resource accounting and budgeting effectively?

**Professor Pallot:** I imagine that, once the changes were put through, there would not be a problem; RAB would simply become part of the way of doing things. I am not an expert on the United Kingdom, but it seems that there is less of a climate of overall change in the UK, whereas the whole climate was one of change at the time when resource accounting and budgeting was introduced in New Zealand.

If there is a significant group or body of people who are not particularly well disposed towards change, I can see that as more of a problem. That does not mean that the system is not more appropriate; it means simply that there is more resistance to it. One form that that resistance can take is comments such as, "This is an exercise by bean counters." Once the system is up and running, I expect that that view will disappear and that the attitude will be more that the system is boring and merely part of how things are done.

**The Convener:** In your written submission, you make the point that New Zealand has one accountancy system, and that the public and private sectors are as one in that respect. You discuss the recognition of the need for Government agencies to recruit accountants from the market place at the going rate. How important is that with regard to cross-fertilisation between the public and private sectors? How does it impact with regard to your statement that

"The requisite skills were available"?

We have heard that—while resource accounting and budgeting is being introduced in the UK—ensuring everybody's technical competence to deal with it has been viewed as a problem, not least in terms of information technology. There is even a suggestion that there could be some resistance to moving to the new system on the part of those who have been used to cash accounting. How important has the experience in New Zealand of having a single system of accountancy been in overcoming such problems?

**Professor Pallot:** It has been helpful in the sense that existing accountants in the Government sector knew all about accrual accounting and commercial accounting. For example, the audit office—Audit New Zealand—tended to circulate auditors around various sorts of organisations, including the Government companies, so that they each got experience in commercial accounting as well as in appropriation and so on, which were distinct to Government.

At a professional standard-setting level, the single body of experience was quite helpful in getting a cross-fertilisation of ideas between the private and public sectors. My feeling was that I wanted as much to come from the public sector to influence the private sector as the other way round.

What was really important was the ability to move people quickly from the private sector into Government. Under the State Sector Act 1988, it became possible to pay the rates of remuneration that were required to attract people, and the traditional public sector rigidity of grades and so on has gone. It was easy to pick up a lot of people from the private sector. Many of them had the required IT, accounting and other skills. The 1988 act's freedom to recruit from the private sector was particularly important for changing the culture and acquiring the skills in a short period of time.

**Dr Richard Simpson (Ochil) (Lab):** I want to ask about some of the problematic areas to which you have referred. First, there is the matter of assets that do not have revenue-generating capability, and the fact that that was not addressed until whole-of-Government accounts were introduced.

Secondly, you talked about the separation between whole-of-Government accounts and departmental accounts. Could you say a little more about that? You seem to be saying that long-term physical assets were held by central Government, whereas the departments dealt only with what one might consider to be depreciating assets. Did not that create considerable incentive problems for departments?

**Professor Pallot:** No, because the view on that revolved around the notion of departments providing particular services to the Government and the public. The task of the Department of Conservation, for example, is to manage the conservation estate. It manages, but does not own the conservation estate and it is judged on how well it does that job. The Inland Revenue Department is responsible for administering the tax revenue, but the tax revenue is not that department's revenue. We could go through the various departments, and we would see that their jobs are the administration or management of something. They do not actually own what they manage; ownership, and therefore the balance-sheet presentation, is at whole-of-Government level.

**Dr Simpson:** What is the incentive to departments with regard to their physical assets? Let us take health, which is the area in which I am particularly interested. If the department that is responsible for health does not own the hospitals, how is there an incentive to that department to manage that asset through resource accounting and budgeting?

**Professor Pallot:** The health situation is different in New Zealand. The management of health was essentially put out to Crown health enterprises—although they are not called that any more; they are now hospitals and are named as such. Central Government retained only a health policy unit and a health purchasing unit.

In the first instance, the Crown health enterprises—or the health bodies—managed the assets of hospitals and so on in the same way as any other organisation would. Those assets enter the whole-of-Government level only when there is a consolidation of all the organisations that are owned by the Government. In the case of health, the hospital buildings and so on were on the CHEs' balance sheets. They were then consolidated into the whole-of-Government financial statements.

The health example is a little different from that of the Department of Conservation, which manages the conservation estate, although the estate itself is a Crown asset.

**Dr Simpson:** Let us take the example of roads; a very important issue for us, as I imagine it is for

New Zealand. Who owns the roads? Does the relevant department manage, maintain and develop them, with ownership of the asset coming under whole-of-Government accounting?

**Professor Pallot:** The majority of the roads are split up among the local and regional authorities, which have roads on their balance sheets and manage them. They have the infrastructure plans for them and so on. Transfund New Zealand is the central Government authority that mainly funds local authorities for roads. It administers the Crown's urban motorways and the main national highways and is subject to the same sort of infrastructure management plan that occurs at local government level.

**Dr Simpson:** Let me move on to another issue, of which I was not previously aware, which is the notion of capability expenditure. Could you tell us more about what that is and about how it fits in? What categories of expenditure fit into it, and how useful is the classification?

**Professor Pallot:** Although our current thinking involves capability expenditure, we have not really implemented it yet. We have been talking about it, however, particularly since Professor Allen Schick, from the United States, did a review of the New Zealand Government system. We have been talking a lot about the need to maintain capability.

The State Services Commission has a different perspective from that of the Treasury, which led most of the public sector reforms. The commission was concerned about maintaining human resources, skills, education, training and the ability of public sector managers to survive in a rapidly changing environment, and about the education, training, recruitment and on-going development of staff. People are also concerned about technologies, the knowledge base and so on.

Without having all the answers, various people are trying to do more research and are trying to find better ways to record what is happening in the areas that are concerned, not just things that traditionally appear on financial balance sheets. The problem with relying only on balance sheets is that there is a certain selective visibility; people might look merely at what is on a balance sheet without seeing some of the other things that are important for maintaining capability, which accountants do not usually record.

There are big challenges ahead to address that, but we in New Zealand believe that, if we do not start somewhere, we will never make any progress. We do not have all the answers, but want to make a start. What happened with whole-of-Government financial statements was that we did not have the answers and there was no precedent, but we felt that, by making a start, we would learn and would make some progress.

**Dr Simpson:** It seems that your main message to the committee is—first—that RAB as a separate exercise is simply bean counting and that secondly, although the management of physical assets is important, New Zealand recognises that, having put the equivalent of RAB into an overall package, the assessment of human resources, intellectual property rights and the whole knowledge-based economy within the scope of the balance sheet is the next big, crucial step. You are at that point now, whereas we are about 10 years behind you with regard to physical assets which, in the modern age, are slightly less important. Is that a reasonable comment?

**Professor Pallot:** Yes. However, there was still value in recording physical assets in the first place—it was better than nothing. That was reasonably straightforward, because the technology existed. However, that is not anywhere near enough in itself.

**Donald Gorrie (Central Scotland) (LD):** Could you elaborate a bit on outputs, outcomes and strategic results? In the United Kingdom, in my opinion, we tend to count what is easy to count. For example, we count the number of people who go through the doors of a school, a hospital, a sports centre or an old people's day centre, but we do not measure the quality of their experiences. Do you have any advice to give us and experience to share on how you in New Zealand count quality as well as crude numbers?

08:45

**Professor Pallot:** I have noticed that our notion of output is somewhat different to the definitions of output in the United States, which seem to be much more quantitative. I am not certain where the United Kingdom stands, but I suspect that it is somewhere between New Zealand and the United States.

In New Zealand, we see outputs as what departments actually do and the goods and services that they actually provide. Audit New Zealand and the Treasury said from the start that the performance of departments had to be measured in terms of quality as well as quantity and cost. The quality dimension always had to be there. That is not necessarily easy, but it is a requirement. It is in our accounting standards, such as they are; we have very limited accounting standards on non-financial performance measurements. We are trying to draw up more comprehensive standards but, right from the start, it has been a requirement to report on quality. That is not to say that all the attempts to report on quality were successful or were very good, but attempts were made, and not even all the attempts to measure quantity or cost were successful to start with. The important thing is to consider what

departments are doing and the quantity, quality and cost of those activities. I believe that, over time, we have developed much more robust measures and approaches to looking at output.

We are a little behind where I believe we should be in measuring outcomes. In a way, for some of the outputs, such as policy advice, the real test of the quality of the output is not just that ministers are satisfied with the policy advice. The ultimate test is whether the policy works. That is an outcome measure. When I was working with Audit New Zealand, we did some exercises to try to get at that quality and outcome thing a bit more.

Let me tell you a quick story. In New Zealand, we have animals called opossums, which eat all the native trees and cause a lot of damage. The Department of Conservation therefore has a major programme to eradicate the opossums. We asked officials from the department to participate in our performance measurement exercise and asked them, "What measurement are you using?" They said, "The amount of poison we drop—and, by the way, the field officers are very annoyed with the Public Finance Act, because they have to report every time they go out and drop poison." So I said, "Is that a good measure?" and they replied, "No, because the rain comes and washes the poison away and it's not very effective." I asked whether there might be a better measure. One official suggested the number of opossums killed, but others disagreed and suggested that it should be the number of opossums left to do the damage. We asked them, "Is that a good measure? What are you really trying to do?" They said, "We're trying to get the forests to regenerate." We said, "Can you measure that?" and they said, "Yes, we can. We have photographic techniques for doing that, but we've been so busy reporting how often we drop poison that we haven't had time. However, that measurement can be seen only over a number of years."

I mention that story because it illustrates how, if you keep talking things through with a department, you can move towards better measures. Often, you find that the measures are outcomes based and will be more than annual. The output measures are variable, but outcome measures are also important. I believe that that can be developed, never perfectly, but in a way that can lead to meaningful discussion and debate.

**Donald Gorrie:** You are in an illustrious train of teaching by parables, and I think that your parable was successful.

How important do you think it is that departments can keep the surpluses that they generate, rather than giving them back to the Treasury?

**Professor Pallot:** The more I look at it—and I

have a PhD student looking at this quite hard at the moment—the more I think that it is very important. I am still trying to get to the bottom of why the New Zealand Treasury has been so resistant to that notion. There are countries where departments can retain at least part of any savings that they make. Having spoken to managers in the public service, I have to ask whether, if departments cannot keep some of their efficiency gains, there is a real incentive to make savings in the first place rather than just spending the money. In my view, it is important to provide some motivation in the form of allowing the retention of some of the efficiency gains.

The counter-argument is that all that money belongs to the Government as a whole and that departments should therefore not be hanging on to it. If departments have made savings, it is argued, that has happened because they had not been efficient enough previously and all the surpluses should go back to the public.

It would be beneficial to examine the practices in a range of countries. I believe, although I am not absolutely sure, that Denmark and Sweden have a mixed system, whereby the department that makes the saving or gets a surplus can keep a third, a third stays in the sector—so that an education saving stays in the education sector, for example—and a third goes back to the general fund.

It is quite possible to run such procedures under resource accounting and budgeting. It is not resource accounting and budgeting, or accrual accounting, that has been the problem in New Zealand. Somebody from the Treasury may have a different view, but my view is that the incentives regime has not been quite right.

**Donald Gorrie:** My next question comes at the issue from another angle. Have some departments been squeezed too tightly and therefore do not have enough capital for what they should be trying to do?

**Professor Pallot:** That is quite possible. There seems to be some anecdotal evidence building up about that, although I would not like to put it on the table at this stage, as I am still gathering more information. However, my strong suspicion, based on my current research, is that that is definitely the case. There is also anecdotal evidence all over the place in the public service. Audit New Zealand is quite concerned that there are a number of examples of cases in which that has happened.

**Mr Adam Ingram (South of Scotland) (SNP):** I would like to focus on your continuing identification of the concerns, particularly with regard to accountability. You indicated that the reforms in New Zealand have improved accountability, not least because performance is now viewed in terms

of results rather than cash spending, with enhanced information coming in for parliamentary committees to scrutinise and so on. However, you suggested that the accountability requirements for non-departmental entities could be stronger. Could you tell us a bit more about that and explain the difference between non-departmental entities and departments? Could you also tell us about the private finance initiative as it has been introduced and operated in New Zealand?

**Professor Pallot:** The accountability and reporting requirements for different public sector entities are different. There was an idea that the Crown entity sector was at arm's length from central Government and that it should be able to go into competition with private sector firms. In the first instance, the reporting requirements were a little less extensive, particularly with respect to such things as statements on service performance.

There is also a wider concern with respect to accountability that is not so much to do with the reporting and accounting. The arrangements for the remuneration of the board members and senior managers of some Crown entities are not particularly public. We had a few cases, particularly before the previous Government went out, in which it was discovered that excessive salaries had been paid for some of those jobs and that the arrangements had not been sufficiently transparent. In some cases, ministerial approval was not even required. It was therefore felt that much more could be done to strengthen accountability and transparency in those areas. I believe that the present Government is committed to redressing that situation.

Private finance initiative is not a term that is widely used in New Zealand. The Australians seem to be much more involved in that kind of exercise than we are, but I do not have a lot to say about PFI in New Zealand.

**Mr Ingram:** You identified as another matter of concern the capital charge and the incentive effect on managers who use many of the assets. You highlighted the question of how Government departments that provide services to low-income clients can recover the charge. Could you give us a specific example of that concern?

**Professor Pallot:** All sorts of departments are bringing in charges for services that they previously provided free, such as various forms of licences and passports. It was felt, particularly when the farmers were having a difficult time, that inspection fees for farmers were unfair. The farmers are doing all right at the moment but, for many years, New Zealand farmers had a great deal of debt and did not have much money to spare. The Ministry of Agriculture, as it was then, was faced with a capital charge and felt that it had

no choice but to pass on some of that cost in the form of charges. That made people ask whether that was fair when the farmers were suffering financial difficulties.

The initial undertaking was that departments would get an appropriation for the capital charge, but there was also an assumption that they would act in a quasi-commercial fashion to incorporate that into their charges. We are conducting some deeper research into this matter and going back into how some of those decisions were made. Initially, departments were promised that they would be recompensed, but it seems that perhaps they were not. That may be what drove some of them to consider how else they could recover the charges. If, however, the Government lives up to its promises to cover the capital charge, that will be less of a problem.

09:00

**Andrew Wilson (Central Scotland) (SNP):** Good evening, Professor Pallot. My question follows on from the previous one and I hope that it does not sound too daft. It is a question that has bemused me since the beginning of the RAB process here. You mentioned that the Ministry of Agriculture in New Zealand had to meet a capital charge and that that was why it passed on some of those charges. Broadly speaking, as far as we understand it, the Scottish budget has been increased by about £1.3 billion to meet capital charges, which have then been applied across the range of services that are provided. As a result, the introduction of RAB is neutral to begin with, in terms of the budget. Beyond that, we wait to see how the dynamics will work. Is that what happened in New Zealand? Was the introduction of RAB neutral? Were charges applied to the Ministry of Agriculture, for example, and was a budget allowed to meet those charges; or were charges applied without extra budget resources being provided?

**Professor Pallot:** It was supposed to be an internal exercise, to encourage departments to rationalise their assets and reduce the capital charge. If they made savings, they were supposed to be able to retain some of those savings. Another argument was that it would make costing comparable with private sector providers.

I—and a number of other people—have had real difficulty in pinning down the people who instigated capital charges as to which argument they favoured more. If you started picking holes in one side of the argument, they would slide over to the other side. The exercise seemed woolly. As I said, it was supposed to be an internal exercise. Everything was supposed to knit together and, as far as the general public were concerned, it would not be seen in Government financial statements. It

would be seen in departmental financial statements, but appropriations were supposed to compensate for it.

It is fair to say that most people outside the head offices of departments do not have much idea at all about the capital charge, but surely the people who are making decisions on whether to get rid of assets are the ones who should know about it? That question has been raised. The people who make decisions on which assets are needed, and which are not, are not in the head office.

**Andrew Wilson:** In essence, you said that the appropriation or the budget was passed to the Ministry of Agriculture and that the capital charge was an internal mechanism. What was the incentive to pass on the charge to farmers, as you outlined earlier?

**Professor Pallot:** There is a balance between a department's assets and the capital charge. If we consider the departments' details—the levels of their assets, the charges that were being levied, their different ways of managing their total assets and expenses—we must do so on a case-by-case basis. However, a political argument on the question that you raise was put forward.

**Andrew Wilson:** I now have a very specific question, but your answer would be helpful to our debate. Is the rate of charge that is applied to capital assets in New Zealand constant for each department? How is it applied and what is the rate? In the UK, the rate is 6 per cent at present. Is it similar in New Zealand?

**Professor Pallot:** Our Treasury used the capital asset pricing model that was used in the private sector. It then added a bit more, to make up for certain factors—for example, the fact that departments do not pay tax. The rate therefore tended to be 2 or 3 per cent over the standard market rate in the private sector weighted average cost of capital.

There was supposed to be scope for departments to negotiate individually if they had reason to feel that their capital charge should be different. If they could show that there was a comparable business in the private sector with a different capital charge, and if they could argue that the Treasury had set a level that was too high when judged against the private sector comparator, they could negotiate a lower rate. Suitable comparisons with the private sector were pretty rare but, in form at least, there was a capacity to negotiate. Departments had different capital charges, depending on what could be described as the equivalent of the risk profile in the private sector. In practice, the department rates tended to be 2 per cent higher than the going market rate.

**Andrew Wilson:** Roughly what is the going

market rate in New Zealand? Does it vary from year to year?

**Professor Pallot:** Yes, it varies. We started off at about 13 or 14 per cent for the capital charge, but we are down at about 7 per cent now.

**Andrew Wilson:** It is interesting and useful to learn that your experience is quite different to what is happening in the UK.

You mentioned a capital asset pricing model. Is that how you valued capital assets to begin with? You also mentioned that, in New Zealand, health services are provided by private enterprises and that the health department purchases services from those private enterprises. Was that the case before the introduction of RAB, or did it come afterwards?

**Professor Pallot:** I apologise—the Crown health enterprises that I mentioned were still Government owned, not private, although the Government could purchase from private providers as well. The main providers continued to be Government owned, but they were called enterprises, had boards of directors and were constructed in a rather commercial fashion. We have stopped calling those organisations enterprises—they are Crown health authorities.

The capital asset pricing model that I mentioned is a finance model that is used in the private sector. It takes into account risks, expected returns, loans, shares and so on. It is a kind of mathematical model that the maths gurus get involved in. The mathematical people in the Treasury have great fun with it, but I do not know that the departments relate to it especially well.

**The Convener:** In your background paper, you say that

“Financial statements at all levels in the New Zealand government ... are close to being on a current cost basis.”

You go on to say that

“all fixed assets (including infrastructure and heritage assets) are revalued at least every three years.”

That seems more regular than might have been expected. It must be quite costly; how are the costs apportioned department by department? Are costs written into the funding that departments and Government bodies receive? Is the extra information that the exercise produces worth the cost of producing it?

**Professor Pallot:** Standard practice is that the private sector revalues normal assets such as land and ordinary, rather than heritage, buildings every three years. That is accepted good practice and it yields relevant information.

One of the things that got the Treasury economists on side with the accountants in the production of whole-of-Government financial

statements was the fact that the accountants were prepared to move away from historical cost accounting—accounting that the economists considered as nonsense and as yielding totally irrelevant information—and towards a way of providing more relevant information. The practice that you asked about is pretty much accepted for departments' simple assets—it is no big deal. The initial valuation exercise was quite time-consuming—especially for local authorities dealing with roads and infrastructure—but once the systems were in place and the assets were identified, the revaluations were much less time-consuming. In the case of infrastructure, it was part of good management to know what additions had been made, what maintenance there had been and how the value of assets had changed.

I do not think that we have to be terribly exact with things such as heritage assets. It does not make sense to try to be exact. The idea was to have something in place so that such things were included, but I am not sure that a great deal of effort actually goes into the revaluations.

Perhaps a more interesting accounting issue is what happens after the revaluations. If there is an increase in the value of the assets, is that revenue? If it is an addition, does the Treasury take that away? We have some issues to deal with in that respect.

The initial costs are reasonably high—they have to be if all assets are to be identified and reported. Much of the value of having assets on balance sheets is not for reporting purposes but so that everyone knows that the assets exist. When people know that assets exist, and know their value, they think about managing them better. Before we had accrual accounting, we used to ask departments to keep registers of assets; many of them did not, no reports were produced and the system did not work. However, once having such a register became a required part of the accounting system, organisations kept registers of their assets and their assets' values. People became aware of assets that they did not know they had before. I remember the National Library of New Zealand saying, “Gosh, look what we've got. There's a huge amount here and we're not sorting it properly. It's worth a lot.” When the information was available, people were prompted to consider better ways of managing their assets. Although initial costs were high, there were many benefits in terms of better management. The information was not sought simply as part of a reporting exercise. The revaluations are accepted practice and they are not difficult.

**The Convener:** That last point could perhaps be summed up by saying that a three-year revaluation of assets is good for Government accounting but bad for opossums.

**Donald Gorrie:** Could you share with us your experience of the purchaser-provider split? Our experience is limited but, a few years ago, the then Government introduced it into the health service. Most people regard that as having been a failure—to put it mildly. What is your experience of such systems?

**Professor Pallot:** The purchaser-provider split was probably a UK initiative. I understand that we borrowed it from you and, especially in the health sector, encountered similar problems to your own.

My personal experience is with Audit New Zealand. The internal structure of the office was split in two. The office of the Auditor-General was, in effect, the purchaser and Audit New Zealand was a provider in competition with private sector audit firms. That seemed to sharpen up the quality of audit from our audit department, and improved the knowledge that private sector firms have of the public sector, but there are many concerns about the cost of such contracting. For example, all unsuccessful contractors waste a lot of time and effort and a lot of monitoring goes on. There are arguments for and against making such splits. It boils down to the costs of running the system.

09:15

**Dr Simpson:** I have a quite separate question. You referred to the fact that most of the research and evaluation had been done by those who were senior in the system, who were therefore most likely to feel that as they had introduced the system, it was a good idea. Have you any advice for us on how we should conduct research and evaluation of the process as it is introduced here?

**Professor Pallot:** There are many different approaches. What often happens is that even if outside experts are used, they end up talking only to senior managers, because they cannot talk to everybody. In New Zealand, senior managers and politicians have been fairly positive. That may mean that in effect everybody is positive, to be fair. You should start getting into the details, such as the operation of the capital charge. It would be helpful to find out more about how far down the organisation the system really bites. Are people really taking any notice? You should get involved with people at different levels in the organisation. Also, get outside perspectives as much as possible. Basically, you should take as many approaches as possible.

**The Convener:** That concludes the questions that we want to put to you. Thank you for the extremely valuable assistance that you have given to the Scottish Parliament's Finance Committee in our inquiry. We will send you our report in due course. It has been valuable to have the benefit of your wide experience in this field. Thank you for

making yourself available. It is getting quite late in New Zealand, and we are very appreciative of you being with us.

We have long known that New Zealand was a world leader in giving votes to women. I think that it is 100 years since that occurred. New Zealand has been a leader in world rugby for almost as long. As a Scot, I will say no more about that. It is particularly interesting to find that New Zealand is also a world leader in accrual accounting and good government practice. We have gained a great deal from our exchange with you this morning—or this evening.

**Professor Pallot:** Thank you. Of course, we inherited so much from Scotland, and continue to do so. It has been a great pleasure to meet you all. Good night, or good morning, as may be appropriate.

**The Convener:** Thank you. I thank the technical staff for a flawless performance at both ends of the link. I understand that you may be coming to Scotland later this year, Professor Pallot. If you do, we would like to arrange a meeting with you as part of your visit. Thank you again for your assistance.

09:19

*Meeting adjourned.*

09:31

*On resuming—*

## Committee Business

**The Convener:** I call the meeting to order.

Under the agenda item on committee business, I report to members that we still await a decision on whether Andrew Likierman from the Treasury will provide evidence. We are hopeful that he will but, as members know, the Minister for Finance and Local Government is due to give evidence at our next meeting and he should be the final person from whom we take evidence. The contingency position is that if Andrew Likierman is confirmed as a witness, we would like to hear his evidence next week and to take evidence from the minister on 27 March. However, that remains to be decided. We are all keen for Andrew Likierman to appear before the committee and efforts are continuing to achieve that.

**Andrew Wilson:** What is the basis of our hopefulness?

**The Convener:** Discussions continue between the Minister for Parliament, the Scotland Office and the Treasury. I can say no more than that at present. The matter is out of my hands, although I continue to seek updates. I hope that I will be able to report good news shortly.

I invite the committee to agree to take agenda items 7 and 8 in private.

**Members** *indicated agreement.*

## Proposed Contingent Liability

**The Convener:** Members have before them the paperwork on the clinical trial of blood products by the Scottish National Blood Transfusion Service protein fractionation centre. We discussed a similar, but not quite the same, contingent liability last year.

The paperwork is self-explanatory and lists the seven trials that are being carried out. Do members have any comments?

**Mr Ingram:** Is there no possibility of quantifying the liability? I assume that the liability is for more than £1 million, otherwise the Scottish Executive would not have brought the matter before the committee. Cannot we have a ballpark figure—a guesstimate based on previous experience—or an analysis of such contingent liabilities and the risk factors that are involved?

**Dr Simpson:** I agree with Adam Ingram. Clinical trials are common—current medicine approval is based on clinical trials—therefore the private sector has substantial experience of managing such risks. Some sort of ballpark quantification should be possible, unless the Scottish Executive is saying that the trials involve unlimited liability, which may be the case. If so, that should be stated.

**Andrew Wilson:** For clarification, we received evidence from John Henderson some months ago that one could not undertake unlimited liability as, conceptually, the limit to the liability is the overall size of the Scottish budget—that is, about £19 billion. It is clear that it is not possible to have unlimited liability.

Unlike Richard Simpson and others, I am not an expert on clinical trials. Has the Executive considered purchasing an insurance product rather than undertaking a contingent liability? That is what a private company would do. On what basis are such judgments made? Why do not we purchase insurance against the risks? That would allow us to make the best judgment, instead of having a cost-free but potentially large-cost contingent liability.

**The Convener:** We have been given notification of seven trials, which begin this month. The notification covers the next 12 months. It is likely that we will be asked to renew the contingent liability annually, although the process will be easier next year in the light of the seven trials.

I do not have an answer to Andrew Wilson's question about the commercial sharing of risk with those who use the products once they are brought in. At present, the Executive has not given us specific information and I am not sure whether it

would be able to do so. The paper does not refer to previous examples. Perhaps Richard Simpson, with his medical experience, could enlighten us. There is no information on which to base an indication of what the risk might be.

**Dr Simpson:** It should be possible to quantify or get some idea of the risk. Often, the risks can be difficult to assess, but the likely cost of something going disastrously wrong should be quantifiable. I find it difficult to believe that that has not been done, given the length of the trials involved. The exercise will become very complex if we are faced with costing little bits of trial each year.

The seven trials range in length from nine months, which is the shortest, to three years, which is the longest. A number of the trials will last 18 months. The Executive should specify the liability for each trial, but perhaps the trials are not sufficiently large for that approach. Some of the trials involve a small number of patients, while others involve about 90 patients, so it should be possible for the Executive to add to its paper a column that says, "We are putting in a contingent liability of X" That should be done to cover the entire length of the trial.

I do not know whether the budget allows us to adopt that approach, but it would seem more sensible than being left to consider the last two months of a trial. It would be better if the Executive were to say, "We're signing off on this package of studies."

**Andrew Wilson:** I do not know where we can take our questions, given the time scale that is involved. We need advice from the convener and the clerks.

I suggest that contacting the Auditor General might be worth while. We could ask for his long-term views on contingent liabilities, the number that are undertaken, the monitoring that is carried out and the scope of those liabilities. If we were to undertake a large number of contingent liabilities without having an idea of the total limit, we could be left with unlimited liabilities that go well beyond the scope of the budget. We should probably keep an eye on that issue. Given the small scale of the present liabilities, the situation may not be serious, but we might want to keep a lid on liabilities.

**The Convener:** I understand that officials are willing to come to the committee to answer our questions. In the light of the points that have been raised, perhaps we should ask them to do so.

I note that the minute from the Executive is dated 5 February, and that the paper says that we "should approve, or propose an amendment, within 20 days".

I ask Callum Thomson to clarify when the 20-day period begins.

**Callum Thomson (Clerk):** The committee has more latitude than the memorandum suggests. I have spoken to the officials and understand that it would be acceptable for the committee to take evidence from them next week. After that, the committee would either agree the memorandum or propose an alternative form of words. Members need not worry that the 20-day period runs from 5 February.

**Donald Gorrie:** I had the same question about sharing the risk. We should, as far as possible, identify the risk. This is as near as any of us will be to signing a blank cheque, which is not a step to take lightly or unadvisedly.

**The Convener:** The view of the committee is clear: we want to invite officials from the Scottish Executive health department and perhaps from the finance department to assist us with some of the questions that members have raised. That may or may not be possible next week, although Callum Thomson reckons that it will be. We will seek to achieve that, therefore this item will be continued.

## Housing (Scotland) Bill

**The Convener:** As we are running a little late and the officials from the Scottish Executive development department are here to give evidence on the Housing (Scotland) Bill, I invite them to take their seats. We will move on to agenda item 5 and come back to agenda item 4 on voluntary sector funding.

Item 5 was carried forward from our previous meeting. A number of questions have emerged and I invite Adam Ingram to put to the officials the questions that he has indicated that he wants to ask.

I am pleased to welcome Geoff Huggins and Tim Ellis, and thank them for making themselves available to the committee.

**Mr Ingram:** Good morning, gentlemen.

I start by making an observation about the letter from the Minister for Social Justice and the financial memorandum. There did not appear to be a great deal of information on the financial implications of the bill for housing associations. Areas that should be covered include, for example, further burdens, the right to buy and pressured areas.

The debt profile of some housing associations—particularly relatively new associations—may mean that they will experience problems with financial projections and will face potential difficulties with lenders. Can you give us more information on the impact of the bill on housing associations?

**Tim Ellis (Scottish Executive Development Department):** A fair amount of work on the right to buy has been undertaken with officials from the development department and from outside bodies, including the Scottish Federation of Housing Associations and the Council of Mortgage Lenders. A working group, which was chaired by the department, considered the issues in some detail. A sub-group also considered some of the financial issues.

The broad conclusions were that the provisions of the bill should not be an issue for most housing associations, because of the additional protection that is now included in the bill. For example, there is a 10-year exemption before the existing housing association tenants who will get the right to buy under the bill will be able to exercise that right. There is a 10-year planning process, during which housing associations will be able to produce financial and business plans to take account of the right to buy.

There are issues about whether the amount raised from the sale of houses will be sufficient to

cover debt. The general conclusion is that, in almost all cases, sales will be sufficient. The next layer of financial impact involves the longer term and, for example, income from rent. Given the new provisions in the bill for exemptions, lower rates of discount and so on, the working group came to the collective conclusion that there would not be a significant issue for most associations. Although some smaller associations would face specific situations, which they would need to consider in detail, most associations should not have a problem.

09:45

**Andrew Wilson:** I want to clarify what you have said. The Council of Mortgage Lenders takes the view that, because there is a 10-year exemption, existing tenants will not have a right to buy for 10 years.

**Tim Ellis:** That is right, although there is a provision for housing associations to opt into the right to buy for their tenants before the 10 years is up.

**Andrew Wilson:** Okay.

My second point concerns your argument that the sale of a social house would raise enough to cover the debt of the lender. Are the lenders satisfied with that?

**Tim Ellis:** Broadly speaking, lenders are satisfied that that is the case. There will always be some cases at the margins where that may or may not be the case but, broadly speaking, across the sector, it is true that lenders are satisfied.

**Andrew Wilson:** Yet there is obviously an associated risk, which would be factored in by the lender when deciding the rate at which he is willing to lend. The existence of the right-to-buy provision will therefore increase the risk for the lender and have an associated cost. Have you assessed that?

**Tim Ellis:** Lenders will take that into account when they plan for future funding. They already take into account a range of risks as part of their normal planning process.

**Andrew Wilson:** However, this is a new risk. It is news to me that the CML would be comfortable with it—it is a development on the evidence that it has previously given.

**Tim Ellis:** As I understand it—clearly, I cannot speak for the CML—the CML is more concerned about the longer-term impact that right to buy could have on rental income and economies of scale and so on. My understanding is—and, again it is for the CML to say—that broadly lenders are happy that the receipts from the sale of houses will cover their costs.

**Andrew Wilson:** My question is, I guess, on the implications of allowing that to take place. There will be transaction costs plus the risk that the sale of houses will not be enough to meet the debt. It is obvious that the implications do not appear in the financial memorandum. When the financial memorandum was being drawn up, was there any assessment of the implications?

**Tim Ellis:** I do not have any detailed knowledge of that. I can investigate to see whether that particular point has been covered. It has probably been looked at, but I am not clear whether any conclusions have been reached. I can certainly come back to you on that point.

**Mr Ingram:** My second question on housing associations is on the proposed withdrawal of section 54 grants, which cover housing associations' corporation tax. I believe that Scottish Homes pays the corporation tax at the moment and I understand that 25 per cent of housing association surpluses are related to that. Do you have any comments on the fact that the withdrawal of grants made under section 54 of the Housing Act 1988 did not appear in the financial memorandum?

**Tim Ellis:** In the memorandum, we have tried, as far as possible, to go through all the main elements of the bill. In a sense, the repeal of section 54 of the Housing Act 1988 is not a direct financial consequence of the bill. There is a policy proposal to withdraw section 54 grants, which Geoff Huggins will talk about. The fact that the bill repeals the power is simply a piece of tidying up because we have no intention of using the power in the future. Therefore, for the sake of legislative tightness, we have repealed the power. However, the impact comes from the policy decision to withdraw the grants rather than from the bill itself.

**Geoff Huggins (Scottish Executive Development Department):** Let me clarify. Section 54 of the Housing Act 1988 is phrased in discretionary terms. The minister indicated, when she issued the consultation paper, that she had decided that she would not in future use her discretion to meet the corporation tax on housing associations' surpluses.

**Mr Ingram:** I am still not quite sure why that did not appear in the financial memorandum.

**Geoff Huggins:** There was no attempt to mislead or hide the minister's intention. She publicly indicated her intention in the consultation paper. However, I am sure that we can look at that issue for future memorandums.

**Andrew Wilson:** I want further clarity on this. You say that the minister made it clear in the consultation that she intended to withdraw formally something that she was not going to use anyway. I accept that that is true. However, that is a quite

separate question from whether the financial implications of such decisions should be included in the financial memorandum. As the knock-on impact for housing associations of the withdrawal of section 54 grants potentially is not insubstantial, of course it should have been included in the financial memorandum.

**Geoff Huggins:** The impact on housing associations is a consequence of the minister's decision; it is not a consequence of the fact that the bill repeals section 54. Whether or not we had decided to repeal section 54, the intention was that, over time, a payment that was currently being made would be halted. That was entirely within the minister's power. Clearly, there is a degree of ambiguity as to whether that should be included in the financial memorandum. I am certainly happy to take account of what the committee has to say, but there was no intention to hide the minister's intention.

**Andrew Wilson:** You are arguing that although a provision that previously existed in law could have had a financial implication if it were used, its repeal has no financial implication, because the minister has announced that there was no intention to use the provision. If the repeal or withdrawal of a power has a financial implication, I cannot understand how you can possibly argue that no mention of it should be made in a bill's accompanying documents. When we are talking about the detail of legislation, we cannot take account of what are merely expressed views. I find the argument bemusing. We should surely look at the detail and the precise financial implications of any legislative change rather than wait for ministerial views.

**Dr Simpson:** I understand the intellectual argument that Geoff Huggins is making, but the question that I have is more practical. Will the withdrawal of this power have an effect? In other words, is this a power that the minister has hitherto used, the withdrawal of which will have a financial consequence for the housing associations? If its withdrawal does anything more than simply make permanent what has already been the practice, the serious financial implications should be laid out, so that the housing associations fully appreciate them and so that the committee fully understands them.

**Geoff Huggins:** At the moment, approximately 10 per cent of housing associations that operate with sufficient surpluses benefit to the tune of around £5 million a year. The Executive's view, which was set out in the consultation paper, is that that resource could be better used providing homes for people in Scotland than in meeting those costs. Within that context, however, if the Parliament were to agree not to include the repeal of section 54 in the bill, the minister's intention

would continue to be not to make payments under section 54—which is entirely within her discretion.

**Dr Simpson:** I want to pursue that a little further. If the grant is now withdrawn and £5 million is taken out of the housing association sector, due to tax on its surpluses, surely the tax will go to the Treasury, not to the Scottish budget?

**Geoff Huggins:** The section 54 grants are not a tax relief. At the moment, Scottish Homes pays £5 million from its budget—which is a rising figure, year on year—towards paying that tax. Our intention is that that resource will remain with Scottish Homes and will be used to provide socially rented houses in Scotland.

**Dr Simpson:** Thank you.

**Mr Ingram:** The next question concerns councils' role as strategic authorities. Councils will have a number of extra burdens placed on them as a consequence of the bill. Some councils also face the prospect of, in effect, losing their stock, as it is being transferred, yet they will still have to bear the costs of the additional burdens of the strategic function. There appears to be no estimate of the impact of that measure on council tax payers.

**Tim Ellis:** The difficulty is that local authorities will face a lot of change over the next few years in a number of aspects. If a local authority's stock is transferred, that will clearly have quite significant financial implications. The financial implications will have to be calculated for each authority and will be dependent on the exact process, time scales and so on.

Related to that is the uptake of the strategic responsibilities. There are probably three main strategic responsibilities in the bill. The first centres on homelessness strategies. Some of the £27 million over the next three years will be given to local authorities to support them in that function. Secondly, there are local housing strategies. The minister's latest letter contains our best estimate of the additional cost of those strategies—£2 million—across the 32 Scottish local authorities. However, not all of that counts as additional cost, as local authorities already undertake a lot of planning.

The final area is associated with taking on responsibility for development funding from Scottish Homes, which applies mainly to local authorities that have already transferred their stock, and therefore belongs to the wider area of change that the authorities must face up to. The minister has said that she must be convinced that a local authority has the capacity to take on the role before it does so. As a result, we will have to talk to local authorities about the costs that they will incur. Again, the significance of those costs and the new skills that an authority will need to

take over from Scottish Homes will vary among authorities.

**Mr Ingram:** Does that mean that those local authorities will receive more grant-aided expenditure?

**Tim Ellis:** The financial memorandum makes it clear that we recognise that there will be some additional costs, which will be taken into account in the periodic reviews of Executive support for local authority strategic functions.

**The Convener:** The issue of tenant participation is covered in paragraphs 16 and 17 of the minister's letter to the committee. Although the bill says:

"Every local authority landlord and registered social landlord must ... prepare a strategy for promoting the participation of tenants",

the minister's response mentions "good practice" and then talks about

"the patchy nature of the practice".

I accept that the practice might be patchy at the moment. However, given that every local authority and registered social landlord will be required to provide strategies for tenant participation, why is it not possible to estimate the costs more accurately? You know how many local authorities there are and roughly how many RSLs there will be.

**Tim Ellis:** That is the point behind the initial £0.5 million that is mentioned in the minister's letter. There is actually an error in paragraph 17 of the letter: the £0.5 million will be used next financial year, not this financial year. I apologise for that.

The £0.5 million will be used to audit much more effectively to ensure that we have a much clearer idea of the exact costs. We know that there will be costs. The £4.5 million that we have set aside—£0.5 million next year, and £2 million in each of the following two years—is currently our best estimate of the costs across Scotland. However, we must ensure that those resources are spent as wisely as possible and are targeted at the areas where they will be most effective, which is why we need to undertake the initial audit.

**The Convener:** I take the minister's point that there will be no tremendous on-going running costs once the system is up and running. However, will the £2 million that is projected for each of the second and third years be continued—suitably uprated in line with inflation—for the foreseeable future?

**Tim Ellis:** It is certainly not for me to make future spending commitments and I suspect that even ministers would—

**The Convener:** I am speaking in terms of policy. I imagine that you expect tenant participation to

continue.

**Tim Ellis:** Indeed.

**The Convener:** And those estimates will be roughly the prorated running costs over future years.

**Tim Ellis:** The £4.5 million is largely the initial investment needed to implement tenant participation strategies and to establish good practice. Ministers will have to make decisions about the future in the light of funding commitments at the time.

**Donald Gorrie:** The Executive is supposed to operate on a best-value basis. One of the bill's main thrusts is to provide significant discounts—handouts or whatever you want to call them—to sitting housing association tenants. Has that issue been examined on a best-value basis?

10:00

**Tim Ellis:** Although we have not undertaken a formal best-value study, we have examined the widest possible range of impacts, taking into account what the customers—or, in this case, the tenants—want, which is a key part of best-value practice. We have also examined what is sensible in terms of management costs and whether the interim processes are as straightforward as possible. As a result, although we have not undertaken any formal scrutiny of best value, the principles have clearly been inculcated into the process.

**Mr Ingram:** On making councils strategic authorities, an important area that councils will have to deal with is asylum seekers who have been given refugee status. We are talking about a substantial number of people—3,000 to 4,000 people every year. Where in the memorandum is the financial provision for dealing with that scenario?

**Geoff Huggins:** As I understand it, matters concerning refugees continue to be reserved. In the context of the UK-wide arrangements, some Scottish local authorities have entered into agreements with the Home Office to provide services to refugees. The matter is neither necessary for nor related to the Housing (Scotland) Bill.

**Mr Ingram:** Correct me if I am wrong, but I understand that refugees could present themselves to local authorities, which are under a requirement to house people.

**Geoff Huggins:** Under the current arrangements, people who are refugees or who seek asylum are managed through the current Home Office system, which means that they cannot present themselves to local authorities in

such a way.

**Andrew Wilson:** Can I ask another question on that point?

**The Convener:** No, I do not want to develop that line of inquiry. It is beyond the committee's remit.

**Mr Ingram:** What are the financial provisions for the new forms of RSLs that the bill can create? For example, RSLs can become private companies, which can go bankrupt. Has there been any consideration of potential liability?

**Tim Ellis:** The bill widens the definition of the bodies—including companies—that can register as social landlords. However, one of the statutory criteria in the bill is that those companies, which might be private, must operate on a not-for-profit basis. That distinction is important.

As for what happens if there are problems with companies going bankrupt, the minister has signalled her intention to introduce provisions on insolvency at stage 2. At the moment, the Housing Act 1996 provides for companies that go bankrupt, including protection for tenants and lenders. However, because insolvency is a reserved matter, we need to make an order under section 30 of the Scotland Act 1998 to be able to introduce those provisions at stage 2. That order will be debated at the UK Parliament and next week at the Social Justice Committee. If the order is approved, we will introduce provisions that more or less mirror provisions in the Housing Act 1996. Those provisions have never been used and it is unlikely that they will be used in Scotland; however, we intend to introduce them to put in place as much protection as possible.

**Andrew Wilson:** If new provisions are introduced after stage 1, they will not appear in the financial memorandum, which is not reproduced at stage 2. I have two questions on that. First, will you be able to say what the financial implications will be of any new measures or amendments? Secondly, why is this being done at stage 2 and not at stage 1?

**Tim Ellis:** On the second question, the approval of the Scottish Parliament and the Westminster Parliament is needed before we can introduce the amendments. The issue is straightforward; there is no intention to pull the wool over anyone's eyes. It is simply a timing matter related to the bill process.

A lot of what is in the bill will be implemented through secondary legislation. Stage 2 is an appropriate stage at which to assess the costs. I presume that it is possible to lodge an amendment at stage 2 that has not been covered in the financial memorandum but, generally speaking, that is not an ideal way forward and we do not intend to do it, although in principle it could

happen.

**The Convener:** I think that I am right in saying that any amendments that were introduced at stage 2 would have to be within the parameters of the financial resolution, which is passed immediately after stage 1, so although any amendment could be fairly wide, it would still have to be within those parameters.

**Geoff Huggins:** We would also expect extensive scrutiny of any new amendments at stage 2, on the basis that they generally would not have been consulted on. Of course, any member can attend stage 2 meetings.

**Mr Ingram:** My final question brings us back to my first question, which is the future, function and level of housing association grant. I have spoken to a couple of housing associations, particularly Carrick Housing Association in my area, which is a relatively new organisation. It is a lot less sanguine than you appeared to be in your initial answer on housing associations' ability to develop housing. The association feels that the supply of affordable housing will be reduced. It feels that it would require additional support from housing association grant. What is the future of housing association grant, and where does it appear in the financial memorandum?

**Geoff Huggins:** It does not appear in the financial memorandum because the bill does not deal with it—it is an existing grant system under which housing associations are funded to refurbish properties and produce new properties for social rent. The Executive has indicated its spending plans through the budget. Those plans show a continuing commitment to housing associations. With the stock transfer policy, the Executive sees housing associations as a fundamental part of its housing policy.

Clearly, making commitments on behalf of the Minister for Social Justice on what she might spend in the years beyond the current spending review is beyond my remit, but housing associations are a key part of her policy and are at the heart of her commitment to social housing in Scotland.

**Mr Ingram:** Indeed, but the extension of right to buy has the implications that I have indicated.

**Geoff Huggins:** We are seeing a year-on-year increase in the number of properties that are available for social rent through housing associations in Scotland.

**Tim Ellis:** One of the explicit provisions in the bill is for areas of housing pressure to be designated as pressured areas and for there to be an exemption from the right to buy in those areas. That may apply to rural areas, but it could apply equally to urban situations. A local authority will

examine its area, and if there is a particular problem with a shortage of social rented housing as a consequence of the right to buy, it will be able to lodge an application to designate the area as a pressured area and so exempt new lets within it from the right to buy. As the bill contains that additional protection for housing associations, the correlation that has been made is not straightforward.

**Donald Gorrie:** On the same basis, the underlying promise that the Minister for Social Justice gave in Parliament last week in answer to a question of mine, and which has repeatedly been given, although it may not be written into the bill, is that there will be an increase in the number of socially rented houses. That will have budget implications, but I am still not clear whether they have been quantified and where the money will appear from.

**Tim Ellis:** There is a commitment to, I think, 20,000 new and improved homes over the three-year period of the current financial year and the next two financial years. That is a programme for government commitment, which will be delivered through two main sources: Scottish Homes development funding, to which Geoff Huggins referred; and the community ownership and new housing partnerships policy.

**Geoff Huggins:** Next year is year 3 in terms of the Scottish Homes part of that commitment, which is to produce 18,000 new or improved houses. We are going to hit a figure of just under 13,000 going into the third financial year, so we are confident that we will meet the target of 18,000. Beyond that, we will have to set targets for the new agency in terms of its role and for local authorities that take on development funding.

**The Convener:** That concludes our questions for you. Thank you for answering them.

I invite the committee to agree that a financial resolution is required for the Housing (Scotland) Bill.

**Members indicated agreement.**

## Voluntary Sector Funding

**The Convener:** Item 4 is on voluntary sector funding. Members have a copy of Donald Gorrie's paper, which is a follow-up to last week's discussion. Donald, could you speak to your paper before we consider it?

**Donald Gorrie:** The paper outlines some first thoughts on the subject. I know that members have just received it. I am not trying to rush anything through, but I thought that it would help members if they had an idea of my lines of thought. If members have additional thoughts on the paper, they can add to it or change it.

In the meantime, I am busy visiting organisations. I visited another two yesterday, which opened up new trains of thought. In a fortnight or so, I can come back to the committee with a report that clarifies matters and includes the thoughts of committee members and voluntary organisations.

I am not clear how long the remit for a reporter or the committee should be. Should it be five lines? This is a new animal to me, so I am seeking guidance.

**Dr Simpson:** It should be short.

**The Convener:** Typically, the remit for an inquiry would be a paragraph—half a dozen lines, say. It should be condensed and focused.

As I was until recently a member of the committee that was known as the Social Inclusion, Housing and Voluntary Sector Committee, I know that the Social Justice Committee has a reporter on the voluntary sector. Karen Whitefield carries out that role. Have you spoken to her, or do you think that it would be useful to do so?

There could also be an overlap with the Local Government Committee. Although it is quite within our remit to consider this sort of issue, we should try to avoid overlaps as a general rule. I am sure that you would agree with that.

**Donald Gorrie:** Absolutely. I apologise. I should have said that after guidance from our clerk, I spoke to the clerk of the social inclusion committee.

**The Convener:** The Social Justice Committee.

**Donald Gorrie:** Sorry, I meant the Social Justice Committee. I am never very up to date with my terminology. As I understand it, some time ago, Karen Whitefield produced a wide-ranging report on the voluntary sector, which contained a sort of menu. From that menu, the committee chose as a priority to consider charitable status and charity law, which is an important issue. However, the advice from the committee clerk was

that there was no prospect in the foreseeable future of looking at the funding of voluntary organisations. Last week I wrote to Karen Whitefield asking for a meeting and for a copy of her report. I hope that, when I report back, I will be able to report fully that there were no concerns in the Social Justice Committee. I could also check that there is no concern among members of the Local Government Committee. I realise that we do not want to overlap but, equally, we do not all want to sit back and do nothing for fear of treading on somebody's toes.

10:15

**Dr Simpson:** It seems to me that the problems arise from the fact that the nature of voluntary organisations has changed substantially over the past 20 or 25 years. They no longer provide short-term, one-off projects, which are then absorbed into the general system by the local authority, the state or private providers. Now, voluntary organisations often provide core elements of care, which is covered by what Donald Gorrie says about core funding in his paper. My concern is the way in which the core funding is supported through the projects.

Two further elements need to be considered. The first is the continuation or extension of project funding. As we found last year with European funding, there can be a gap of three or four months when the funding runs out. Every voluntary organisation that had European funding suddenly had to find funding for three or four months to keep their projects going. There is therefore a question about the extension of projects until evaluation is completed or until the next tranche of funding becomes available.

The second element is roll-over. I have been approached numberless times with the obscenity of people having redundancy notices handed out to them because there is no extension funding. I have proposed that there should be a three-month clock stop on all voluntary project funding so that, until a decision is made about what is going to happen to a project, there should always be three months of funding available. Instead of having a situation in which redundancy notices are put out and then, a week or six weeks after the project's funding has run out, someone decides that it is a great project and that its funding should continue, anyone giving funding should be obliged to continue to give three months' funding until they have made a decision. That would end the obscenity of serving voluntary workers with repeated redundancy notices. I know one person who has had four redundancy notices in the past 10 years. It is obscene. It is a mismanagement of our human resources. Sorry, convener, but I get very worked up about this.

**The Convener:** I can tell. Wearing another hat, I am a member of the board of the Castlemilk Partnership, which is not exactly a social inclusion partnership but is closely related. We deal with many applications along the lines that you have suggested. I certainly sympathise with what you say, but I have a slight worry that, if a three-month period were built in, that might delay by three months consideration of what was to follow. I am talking from experience of the Castlemilk Partnership; we begin looking at projects that have a year to run, so that we can avoid that situation, although that does not always meet with complete success.

I would like to see the three-month buffer built in, but not added on to the end, as that might just encourage people to say that they have longer to think about things than they thought they had. I sympathise with the problem and, having worked in the voluntary sector, I certainly understand the benefit of funding continuity. Lack of continuity is the voluntary sector's greatest bugbear and undermines what voluntary organisations do. Let us face it—the voluntary sector has an increasing role to play in the delivery of services at local authority and health board levels.

Another question about Donald Gorrie's proposal occurred to me. Point 1 mentions national Government and the lottery as sources of funding. They do not fall within the committee's remit, but we cannot consider the funding of voluntary organisations other than holistically, so we must be aware of the potential difficulties that are involved. However, I am not suggesting that that is a reason for not undertaking the inquiry.

I suggest that Donald Gorrie takes on board the points that have been made, refines his proposal and returns with it. As members will be aware, I was unfortunately snowbound last week and could not attend the committee's meeting. I take it that Donald's role as reporter involves his producing a proposal with which the committee would proceed if it agreed to it. The extent of his role as reporter is to provide a basis for a committee inquiry.

**Donald Gorrie:** At the previous meeting, I asked whether another member would help with visits and drawing up reports, so that we could cover twice as many organisations. I do not know whether anyone else is interested, but Adam Ingram told me that he would be happy to participate. I am not suggesting that we go round on a Noah's ark principle. If we visited organisations individually, we could cover twice as much ground for a written report. Presumably, I would produce a first draft of the remit for the reporter. I could expand on the issues. The proposal shows the background of where we are coming from and the questions that we would ask.

**The Convener:** You would take the work further

than just providing the remit. You and Adam Ingram would conduct some research and return to the committee with something that would be worked up a bit. Then we would decide how to proceed.

**Donald Gorrie:** As I understood it, the process would have two stages. We would produce a remit that the committee would agree to or adjust. We would then go out and talk to a whole lot of people to answer the questions and to find the information. We would return with a full report that the committee would decide whether to pursue.

**The Convener:** Is that agreed?

**Members indicated agreement.**

**The Convener:** We look forward to receiving a further report from Donald Gorrie in due course.

## Regulation of Care (Scotland) Bill

**The Convener:** We move to item 6 on the agenda, on the Regulation of Care (Scotland) Bill, which will have its stage 1 debate on Wednesday this week. Because we are considering the bill, we have taken the precaution of inviting Liz Lewis and Kit Wyeth from the Scottish Executive health department to appear. I see that Neil Rennick has also joined us. I thank the witnesses for assisting the committee today.

Members have a copy of the financial memorandum, which starts on page 28 of the explanatory notes. It is quite comprehensive. On several occasions, the committee has said that financial memorandums were not as specific as they might be. My impression is that this memorandum is more specific and provides considerable detail, which we welcome.

Do members have any points to put to the witnesses?

**Dr Simpson:** The witnesses will know about some of the Health and Community Care Committee's discussions.

**The Convener:** May I stop you for a second? I understand that we are the sixth committee to consider the bill, so I do not want to rehearse arguments.

**Dr Simpson:** I will concentrate entirely on finance. The financial issue concerns the self-financing of the proposed commission for the regulation of care. Do the witnesses have any further comments on the fact that the public pound will be moved from the Scottish Executive, to the local authority, to the provider and back to the care commission? The way in which the system is being established makes it appear that that process will have to be administered every step of the way. Shuffling the public pound through the system will create an administrative cost and burden. I have an instinctive feeling that that is a waste. It will create a number of jobs—which may be welcome—but seems to be rather a bureaucratic procedure.

That was my first main question; my others are on slightly separate matters.

**Liz Lewis (Scottish Executive Health Department):** Under the current system, each local authority and health board charges fees for the regulation of care. Because we are moving to a national system, the arrangements will come together in an integrated way. There will be a slight, but not massive, reduction in costs, simply because of the economies of scale in bringing the system together.

Ministers are keen in principle for the cost of

regulation to be explicit and transparent, and for the providers and the regulators to have an interest in ensuring that the system works cost-effectively and that fees are proportionate to the benefit for society that comes out of the system. They feel that having explicit, self-financing fees for the cost of regulation is the way to achieve that.

That is the general policy. That cuts across other policies—for example in child care. Ministers have said that they plan to continue with a major subsidy for early education and child care, so that the costs to providers—which tend to be passed on to parents, as the main purchasers of child care—would not be too high. In cases where local authorities or the private sector are the main purchasers, ministers feel that there should be full cost recovery. The cost of that to local authorities will, of course, be taken into account in the grant-aided expenditure settlements in 2004-05 and beyond.

**Dr Simpson:** It appears that, although the increases in costs to the provider will, initially, be limited to about 10 per cent per annum, there have been indications that the full costs will be substantially greater beyond 2004-05. Various figures have been bandied about on the matter, but the suggestion is that the costs to the provider will rise enormously. That must form part of the background to the Scottish Executive's providing the money at some point to those who ultimately provide the service.

**Liz Lewis:** The financial memorandum sets out our views as to what the cost increases beyond 2004-05 would have to be, and on what full self-financing would mean. As for the cost increases for a care-home place, we do not yet have the full cost of what the Scottish commission for the regulation of care will cost, as we do not yet have the staff or buildings in place. We must go for a range, rather than for a precise figure.

We suggest that a care-home place would cost between £120 and £180 per annum to regulate. The current figure is £65. The total cost of providing a care-home place is about £13,000 per annum—or, in some cases, up to £17,000. The increase in the cost of regulation is much less than 1 per cent of the total cost of providing that care-home place. It is a major increase in itself; I am not suggesting that moving from £65 to £120 is not a major increase. However, in the overall context of providing a care-home place, it is not significant.

**Dr Simpson:** I should declare that I have a directorship in a nursing home company, although it operates in England, not Scotland, and will not be affected by the bill. However, given some previous circumstances, tenuous connections might be of some importance.

**Andrew Wilson:** Don't you love the tabloid press, Richard?

**Dr Simpson:** I love it.

**Andrew Wilson:** I wish to repeat the convener's point. Given our constant carping about the state of financial memorandums, the one that is attached to this bill is much more substantial than those that we have received before. That is extremely welcome and thanks go to those who have been engaged in the lengthy process of putting it together.

Inevitably, however, a question is begged. One point that the committee made early in the process is that the overall net cost of the bill to the public sector is not clear from the financial memorandum—especially given that so much of the bill relates to transferring of responsibility for regulation. I am not suggesting, however, that that should delay anything.

My second point flows from that. What is the total cost—not the net cost—of the introduction of the bill to each part of the public sector? Is it feasible to find out that information?

**Liz Lewis:** I do not want to suggest that I can produce precise figures on that immediately, but I could give an indication. The regulation of the work force will be the responsibility of the proposed Scottish social services council. Education and training functions are met by the public purse through the Central Council for Education and Training in Social Work and that will continue. The registration of the work force, which is the new element, will be paid for entirely through fees that are paid by the registrants. As the financial memorandum says, we estimate that the fees will be about £20 a year. Those proposals have no net cost to the public purse, but it is clear that the existing grant to the CCETSW, which is already a call on central Government resources, will continue.

10:30

A large proportion of care services are regulated already by local authorities and health boards, but regulation of care services will become the responsibility of the proposed Scottish commission for the regulation of care. We believe that the bill will buy an integrated, consistent, independent and better system that will be no more costly than the current system. As members will appreciate, there is an extension of regulation to other services that are not currently regulated, such as home care services in particular. Regulation of those services will be fully self-financing, as the private sector and voluntary sector agencies that provide home-care service will meet the full cost of regulation. The same applies to those elements of independent health care that are not currently

regulated.

In broad terms, we estimate that there will be no overall increase in funding. The proposed Scottish commission for the regulation of care will do some work for central Government as part of the follow-up to Sir Stewart Sutherland's report, which identified the need for an independent body to examine trends. That work will have to be paid for; the commission will receive a grant from central Government for it. The financial memorandum estimates that that work might cost about £1 million a year. That is a new benefit to the system and will involve new public expenditure. Apart from that expenditure, we do not estimate that net public expenditure will be increased.

**Andrew Wilson:** Pardon me, but from what you said a moment ago about economies of scale, I thought that you anticipated a saving.

**Liz Lewis:** As Andrew Wilson will appreciate, the purpose of the commission is not to make savings—its purpose is to provide better services for the users of care services. By establishing a national organisation to deal with those matters, we hope that there will be economies of scale. We estimate that the number of staff who are employed will not have to increase much, despite the fact that the Scottish commission for the regulation of care will regulate other services that are not currently regulated.

**Dr Simpson:** I want to sound a cautionary note. The General Teaching Council for Scotland was mentioned as a parallel example with fees of about £20 to £25. However, the levels of governance have increased in the General Medical Council, and I expect those levels also to increase in relation to the regulation of care. The GMC's fees have increased from £125 or £135 or so to £180 this year. Substantially higher fees are imposed if increased levels of clinical governance are required. It seems to me that the likelihood that fees will be kept to around £20 is quite small, if responsibility is transferred from the CCETSW to the proposed Scottish social services council. Have you considered what additional governance will be required to ensure that individuals in the work force perform appropriately? Have you taken into account the process of revalidation as opposed to the simple process of initial registration?

**Liz Lewis:** That area is developing, and the proposed Scottish social services council will want to consider how it deals with such matters. Before that council is established, those of us at the centre cannot be absolutely clear how everything is to be done, nor can we make financial calculations

The CCETSW has about 15 members of staff in Scotland. We estimate that the proposed Scottish

social services council will need about 30 members of staff. Therefore, the costs will not be huge. We can examine the education and training functions fairly easily, because that is the work that the CCETSW currently undertakes. We are studying registration throughout the UK, because it is happening in the other parts of the UK. Together we are considering the best way to proceed.

We are reasonably confident that the fees will not need to be anything like the fees that Dr Simpson quotes for the General Medical Council, and that the level of about £20 per annum that we are quoting will be sufficient to provide for the 30 staff, who will be sufficient to provide the system that we have in mind.

**Dr Simpson:** If the provisions apply to all staff in adult care establishments, they will cover a group of lower-paid workers, some of whom are paid very low wages indeed. Will adequate income be provided through the system to allow proper registration? I know that the cost will not be charged on the Government and that its effect for the financial memorandum is neutral, but I have serious concerns. The initial pay of some employees is about the level of the minimum wage. At such rates of pay, a charge of £20—or perhaps much more—becomes significant.

**Liz Lewis:** As I said, we do not expect the charge to be significantly more than £20. The figure of £20 was picked not just because it is the figure that the General Teaching Council uses. It was calculated according to the funds that will be needed to run the council. We also expect that, in some cases, employers might help individuals with fees, if being registered with the council is a requirement of a job.

As we made clear, employers and providers of care services may take into account the costs to them of the new system in setting the fees that they want local authorities to pay for purchasing the services. That will also be taken into account in setting grant-aided expenditure.

I know that there are considerable difficulties with that argument, but we feel that it is important for the status of the social work and social care professions, including the low-paid workers, to have a professional body, as teachers, nurses and others do. That will raise the status, professionalism and value that society places on such workers. Therefore, the body would be well worth the £20 per annum that we say it will cost.

**Dr Simpson:** I agree with the last part of that answer.

**The Convener:** As a slight aside, I will ask about the Central Council for Education and Training in Social Work and the Training Organisation for Personal Social Services, which will be subsumed in the proposed Scottish social

services council. The names of the bodies will cease to be used and all staff will transfer.

**Liz Lewis:** Yes.

**The Convener:** The answer to my question might impact on what Richard Simpson said. Will that transfer have any implications for matters such as staff conditions or pension arrangements?

**Liz Lewis:** We have said that all staff will transfer on the existing terms and conditions and that those terms and conditions will run—if the staff wish them to—for at least two years after the transfer. The proposed council and commission will have to employ new staff, so a new set of standard terms and conditions will have to be drawn up for them. The suggestion is that the existing staff would transfer to those new terms and conditions after about two years. All that must be negotiated with the unions that represent the staff. On 19 March, the first transitions working group, on which Unison and other unions are represented, will meet to discuss that.

**Dr Simpson:** I am sorry to prolong the questions, because the financial memorandum is well laid out and clear, but I have a slight concern about the purchase of specialist local advice. At the moment, health boards and local authorities have localised services. The possibility of purchasing pharmacists' advice from the health board exists, but is part of the pharmacist's job. Under the new set-up—even with the increase from 300 to 310 staff that you propose—there will still be a need to purchase specialist advice. Do the costings allow for that?

**Liz Lewis:** Yes. We assume that one or two pharmacists and other specialists will be based in the headquarters of the new body and that they will provide central advice for the commission. It is also likely that there will be arrangements whereby the commission can buy in temporary advice locally from the health board, as happens at the moment. We envisage that system continuing. The commission will continue to need specialist advice, particularly for independent health care, which is becoming more important. A separate division in the commission will deal with that.

**The Convener:** There are no further questions, so I thank the witnesses for appearing. Does the committee agree formally that a financial resolution is required for the Regulation of Care (Scotland) Bill?

**Members indicated agreement.**

**The Convener:** As agreed, the committee will move into private session for items 7 and 8.

10:39

*Meeting continued in private until 10:48.*



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