

FINANCE COMMITTEE

Tuesday 3 April 2001
(Morning)

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FINANCE COMMITTEE

9th 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

Peter Peacock (Deputy Minister for Finance and Local Government)

David Palmer (Scottish Executive Finance Department)

CLERK TO THE COMMITTEE

Callum Thomson

SENIOR ASSISTANT CLERK

Anne Peat

ASSISTANT CLERK

Gerald McNally

LOCATION

Committee Room 1

Scottish Parliament

Finance Committee

Tuesday 3 April 2001

(Morning)

[THE CONVENER *opened the meeting at 10:09*]

The Convener (Mike Watson): Colleagues, I call the meeting to order. I apologise for the delay. Elaine Thomson is on her way; her train was delayed, but she has arrived. Apologies have been received from Richard Simpson and from Andrew Wilson, who I understand is doing his best to bang the drum for Scotland in the USA on tartan day, whenever that is—I am not quite sure.

I invite members to agree to take agenda items 4 and 5 in private. Is that agreed?

Members *indicated agreement.*

Europe Familiarisation Visit

The Convener: The next item is not substantial. I have finished the report on my Europe familiarisation visit of two weeks ago, which has been circulated for members to read. I outline the full responsibility of the European Parliament's Budgets Committee. The visit was useful and we have made contact with Terry Wynn MEP, the chair of that committee. He hopes to visit Scotland later in the year, when I hope members will have the opportunity to meet him.

I do not want to add anything to the report. Unfortunately, I was unable to attend a meeting of the Budgets Committee, as it was not sitting that week. However, I attended a meeting of the Budgetary Control Committee, which is roughly equivalent to this Parliament's Audit Committee. I have to say that the session was pretty turgid, with many members repeating what had just been said. Apart from the fact that the meetings of that committee are not chaired as rigorously as those of this committee, there was a considerable amount to learn from the visit.

Terry Wynn gave me two useful publications on the European Parliament's budgetary process. I have passed them on to Callum Thomson; they will be available from the clerks should committee members want to peruse them. Do members have any questions on the visit?

Mr David Davidson (North-East Scotland) (Con): Did you receive from the MEPs any indication of changes in their thinking about structural funds? It would be interesting to get the European perspective on the allocation of the funds, in contrast to what we do with them.

The Convener: No, we did not go into structural funds in detail. The meeting to which I referred, at which I was joined by Kenny Gibson, was a bit of a disappointment, as it was pretty basic. I had hoped to go into greater detail, but there was no opportunity for that. We received a briefing on the various aspects of the thinking about the enlargement of the European Union, which will have a bearing on structural funding. However, the meeting dealt with outline proposals and nothing specific.

Committee Business

The Convener: The next item is a follow-up to our consideration last week of where we might go outwith Edinburgh for our stage 1 consideration of the budget process. The paper that has been provided by the clerks contains information on Perth and Ayr, as requested last week. Ministers will be available to give evidence to the committee on Friday 8 June, but not on Monday 11 June. Members' preference—especially that of Elaine Thomson and David Davidson, who have to travel back north—was for the Friday rather than the Monday. As we seem to be driven towards that date by the availability of ministers, I would like the committee to agree to take evidence on Friday 8 June. Is that agreed?

Members indicated agreement.

The Convener: Do members have any points to raise on that subject?

Mr Adam Ingram (South of Scotland) (SNP): Might not that date be affected by other events that may have occurred on the previous day?

The Convener: That may be the case. However, we cannot plan meetings on that basis. What do members think, given that we cannot get a minister to come to a meeting on 11 June?

Elaine Thomson (Aberdeen North) (Lab): I take on board what Adam Ingram has said, but I agree that we should go ahead and plan our schedule whatever happens. The minister is available on Friday 8 June, so I think that we should go ahead on that basis.

Donald Gorrie (Central Scotland) (LD): Is the proposition that the meeting would be cancelled if Thursday 7 June is polling day, or would it go ahead?

The Convener: We have to book the hall and we have to book the minister. We will probably get only three weeks' notice of absolute confirmation, if 7 June is to be the date. That would give us difficulties. We have no room to move. I think that I am right in saying that our report must be written by Wednesday 13 June to fit in with the timing of the stage 1 debate.

10:15

Callum Thomson (Clerk): The committee needs to finalise the report by 20 June. If we work back from that date, the idea would be for the committee to consider an issues paper on 13 June. The possible dates for taking evidence are limited, probably to 8 June and 11 June only.

Mr Davidson: We must send out a clear signal that this Parliament is open for business at that

time, and that we expect that the minister, if he is now available for a meeting on 8 June, will remain so, regardless of what goes on elsewhere. The budget process has a tight schedule and we do not have room for latitude.

The Convener: My understanding is that the only day on which the Parliament will be closed is polling day itself. However, I have not even had that much confirmed. On the understanding that we will be speaking to the minister on the afternoon of Friday 8 June—

Elaine Thomson: The afternoon?

The Convener: If the meeting proceeds as the Aberdeen meeting in November did, the idea would again be that we would hear from local organisations in the morning and from the minister in the afternoon.

The question now is which venue to choose between the two that are proposed. The options are outlined in the paper. Both Ayr and Perth would be suitable. We have indicated our willingness to go to either location. We will go to the location that we do not choose for the June meeting on a future occasion. Do members have a preference? Adam Ingram can be the voice of Ayrshire.

Mr Ingram: Indeed, convener, my preference would obviously be for Ayr, which is round about my home patch. I do not think that any of the Parliament's committees has yet been to Ayrshire, so I think that it would be appropriate for us to—

The Convener: The Parliament has been to neither Perth nor Ayr. The only slight advantage in holding the meeting in Perth—I say this not as a comment on either location—is that Peter Peacock, the Deputy Minister for Finance and Local Government, has an evening engagement on 8 June in Inverness, which he would struggle to reach from Ayr after an afternoon engagement; he could no doubt get there from Perth. If 8 June is indeed the day after the general election, the deputy minister might be more able to attend than the minister.

Mr Ingram: Surely the minister could fly to Inverness from Prestwick.

The Convener: Well, I do not know what the arrangements will be.

Elaine Thomson: In this instance, I would support our going to Perth. There are sensitive issues of timing if we have a general election on Thursday 7 June. All of us are likely to be somewhere else on that day—I think that Perth would be that bit more accessible for us all.

The Convener: I think that that is true.

Elaine Thomson: I appreciate very much Adam Ingram's desire for us to go to Ayr. I would feel

exactly the same in his position. We could perhaps consider going to Ayr for the second stage of the budget process.

The Convener: We have indicated our willingness to go to both locations in the near future. The question is which we go to on 8 June. I seek the agreement of the committee that we go to Perth on this occasion. Is that acceptable to a majority of members?

Members indicated agreement.

The Convener: We now have to consider—we can agree this at a later date—whether we want to make use of the morning on that day. We may want to review whether to have a morning session when we know whether the general election will be on 7 June. We will certainly schedule the afternoon session for taking evidence from the minister.

Donald Gorrie: The contributions will have to be exciting to keep us awake.

The Convener: That concludes item 3. The committee will now go into private session to consider items 4 and 5.

10:19

Meeting continued in private.

10:38

Meeting continued in public.

Resource Accounting and Budgeting Inquiry

The Convener: Welcome, minister. I apologise for the fact that committee members are a little thin on the ground today. Because our committee now has only seven members, it tends to look that way when two or three members are absent. I assure you that members who are not here have good reasons for that. Nonetheless, we hope that, although we do not have quantity, our questioning will show that we have quality.

I invite you to make a brief opening statement.

The Deputy Minister for Finance and Local Government (Peter Peacock): I am acutely conscious that I am speaking to a group of people who are now the leading experts on resource accounting and budgeting, having taken evidence from literally all around the world and in private from Treasury officials—which we found disconcerting. In the light of all the evidence that members have heard, I look forward to your questions.

I am also acutely conscious that I am not an accountant by training and that, therefore, I am still grappling with some of the finer technicalities of RAB. I have with me officials to help me answer members' questions on the details of the subject. I am, of course, more than happy to deal with any of the policy questions that surround the introduction of resource accounting and budgeting and all that goes with that.

That is all that I have to say. I am happy to answer any questions that members have as a result of the committee's inquiries, and to answer any points of concern that the committee has about the system.

The Convener: I caution you that the fact that we have heard a wide range of evidence does not necessarily mean that we are experts, although I will concede that we certainly know a lot more than we did at the start of the process. As you know, this is the last of our evidence-taking sessions.

There have been two recurring themes in the evidence that we have heard from many people. One is the extent to which preparation for a move to RAB has been undertaken. That leads me to ask about the training of Executive staff in various departments and the extent to which they are ready in terms of general ability and experience, or whether they are in the process of adapting their

current skills. Also, I want to know about the ways in which information technology can be used in RAB.

The second recurring theme emerged from the evidence that we heard from Professor Pallot from New Zealand—as you said, we heard evidence from all over the world. She told us that RAB was introduced as part of a wider management structure in New Zealand and that it was not merely a technical matter. To what extent are efforts being made to broaden the base of RAB beyond financial managers?

Peter Peacock: The question of preparedness is legitimate. Clearly, RAB is a major change in the way in which the Executive and the rest of the public sector in the UK will handle accounting and budgeting. It will lead to the challenges to existing organisational cultures and to changes in the skills that exist in organisations in relation to technological matters.

We had to understand the policy logic that underlies RAB before we decided to use it. We then had to think about the construction of the system as it developed. Cultural changes were also important because they relate to training matters and to whether we are equipped to deal with the required technology.

On the policy logic, the Scottish Executive and, previously, the Scottish Office, have been engaged for a number of years with Treasury officials at every stage of the development of RAB. Our officials have been involved in all the Treasury initiatives and working groups that have set targets and so on. They participated in what was called the Treasury's RABIG—the resource accounting and budgeting implementation group. That group planned the exercise and did all the policy thinking.

Staff in the Scottish Office and, later, the Scottish Executive responded in detail to the Treasury's consultation documents and commented in particular detail on the resource accounting manual that was produced by the Treasury and which helped to guide the process. They also participated in working groups, such as the group on the valuation of the roads network and its capital charges and the groups on heritage assets and student loans. There was significant involvement in the detailed aspects of the process. Senior officials attended a number of high-level training events in the Treasury, which covered the development of RAB. They were able to participate in a variety of dry-run exercises that were run in parallel with existing accounting and budgeting mechanisms.

Scottish Executive and Scottish Office officials have been heavily involved in the policy development of RAB from the outset. They are

therefore well prepared for what is coming and have participated in the design of some of the systems.

10:45

As I said, this is a major change for everybody, and officials did a lot of planning for how they would manage the process. Training was organised at a range of different levels, and a number of awareness seminars for finance staff and budget managers were held early on. A good deal of information was going round the department, including booklets such as "Resource Accounting and Budgeting: A Short Guide to the Reforms", which gives a simple explanation of what RAB is all about. Those information exercises were undertaken as part of the familiarisation of staff with RAB.

A training needs analysis was conducted specifically to draw out from staff the specific training needs that would allow them to use the system. Formal training was built on the back of that, principally for finance staff—I understand that there were 14 courses for finance staff—and for programme managers who manage budgets. As part of that training programme, a variety of dry-run exercises were run in parallel with existing systems and practices.

Informal training is continuing. Finance staff—who have a close relationship across the Executive's departments, non-departmental public bodies and arm's-length agencies—are there as a resource; they can offer on-the-job training and advice on how matters can be improved and what people are required to do for specific systems. On-going support for running RAB is also available from finance staff on a consultancy basis, if I can put it like that. Further training is also planned. A series of interactive seminars and workshops will start this month to look at the practical impact of RAB and how managers will manage that in their work load. We must also develop further training on the points in the system that people do not understand. A bit of troubleshooting will have to be done to sort out specific difficulties. Any new needs that are identified from those workshops will be the subject of specific training in the future.

I have come to RAB comparatively recently. Looking at it from the outside, the change seems to have been a pretty considered process. Officials have given a lot of thought to how RAB will impact on the organisation; preparing the ground for that has been a pretty thorough process. Having said that, RAB represents a major change, and it is important not only that we look at what we are currently doing, but that in a few months we look back at what has happened, to ensure that any needs that have been missed can be met. We must also learn lessons from this introduction for

any other major organisational changes that take place, not in accounting but in other aspects of the organisation's administration.

The Convener: It was helpful to outline how training is being undertaken. When we took evidence, we heard that there could be resistance to this sort of change. We heard that it is a fundamental change, that there are well-established procedures and that, in some areas that were not specified, there was no great enthusiasm for such changes. You have been in your department for only six months. Have you detected anything along those lines?

Peter Peacock: At the level at which I interact with officials, very much the opposite is true; I have detected a lot of enthusiasm for the change. Officials see RAB as a mechanism that empowers not only staff in the finance department, but staff in other departments, to see much more clearly what the impact of a variety of activities will be on their spending profiles and how they will manage them. That is equally true—although it may not be apparent at this stage—for ministers and, therefore, for the Parliament as a whole, because there will be much more transparency in decision making.

However, having worked in the training industry for a while, I am aware that people confront change in a variety of ways. Some people embrace change with great enthusiasm, welcome it, work with it and are advocates for it. Others might find the change technically difficult to make. Such people must be supported in improving their technical understanding of how they can make the system work better. In any organisation, there will be those who are cynical about why changes are being made; they will ask why such a big change is needed and whether it will really bring enormous benefits. I do not think the Executive will be different from any other organisation that introduces any other form of change: that is part and parcel of the package. What is important is whether we have addressed that issue comprehensively—I think that a lot has been done to try to do that. I have no doubt that we will learn lessons from the process and that we will find that we could have done things differently or better, but I hope that that will inform processes of change in the Executive in future.

Can I address your point about IT, convener, or do you want to come back to that?

The Convener: I will be happy for you to deal with IT now. Elaine Thomson has a related point to raise.

Peter Peacock: I was going to link the latter set of points that I made to the point that you made about the comment that you received from New Zealand, about whether RAB awareness impacts

on the wider organisation, as well as on the finance department.

There is a danger of regarding RAB as an isolated matter that is simply for finance wonks, accountants and people who understand balance sheets and figures, rather than as a part of a much wider process of organisational change. I view RAB in the context of that much wider process of change, because it is about informing political and administrative decision-makers—managers in the system—in a variety of ways about the consequences of their decisions. It is about giving those decisions visibility and making the consequences of certain decisions apparent. RAB informs people that there are choices in making policy decisions, and it is part of the process of providing information on which good decisions can be made.

That, in turn, must be viewed in the context of a much wider movement to modernise government. Much is going on in the Executive to address the ways in which ministers, senior civil servants and members of the Scottish Parliament are equipped to perform in the entirely new political environment in Scotland—and in public decision making—and to ensure that there is much more scrutiny and immediacy concerning the way in which individual lobby groups and interests impact on the Parliament or make demands of the Parliament and the Executive. Throughout the civil service and the Parliament, we must learn to adjust to that new process. We are beginning to think much more clearly about what we must do to modernise the civil service in a wider sense, so that we are more able to face outwards to all the groups that we now interact with and to advise ministers differently to contend with all the changes that are taking place.

Therefore, we should not view RAB in isolation; it is an element of a much wider modernisation package, which is much more precise and clear as a result of progress that has been made. Professor Pallot, in New Zealand, made that point, and I agree entirely with it.

The Convener: I understand that the training that is being undertaken in the Scottish Executive is specifically for those who are engaged in accountancy reporting functions. Are other training programmes or RAB awareness sessions available for other members of staff who are not directly involved?

Peter Peacock: Yes. The priority has been to deal with those who must know first about RAB, and the matter has been spilled out further down the system. All the senior civil servants, the finance staff and senior managers of blocks of expenditure in departments have had specific training, which is gradually trickling down to others. It is also moving out to the non-

departmental public bodies—there have been specific sessions on RAB with the water industry, for example—and so on. The process has therefore gone much wider than the narrow confines of the finance department of the Executive.

Ultimately, as the devolution of authority continues in all public sector decision-making organisations, it will be important that those at the lowest level, who make decisions about the use of resources, understand that there are choices to be made in public expenditure. RAB helps to illuminate that fact, and I view the raising of awareness as a continuing process.

Elaine Thomson: We have covered several points that I wanted to ask the minister about. I am pleased to hear what he is outlining, concerning awareness of RAB and training. Last week, Andrew Likierman said that, when RAB awareness training was carried out at the Treasury, it was found that people thought “Oh, well. Yes. Hmmm—that’s very nice.” It was not until they had to start making decisions using the new system that the absolute requirement to understand and be able to use it effectively became apparent to them.

Information technology is a particular interest of mine. Implementing IT systems can sometimes be slightly problematic. I know that the Scottish Executive is currently implementing a new system. Last week, I was happy to hear Andrew Likierman say that the implementation of the new systems for RAB down south had been relatively free from problems. I would be interested to hear how implementation is proceeding in Scotland. I hope that it will be relatively smooth.

The committee has often discussed how to develop better financial reporting and how better to link outcomes and objectives to the raw figures at the beginning of the process. To what extent will the implementation of RAB help in the process of developing financial reporting that results in a clearer set of objectives and outcomes?

Peter Peacock: I will pick up on the IT component of the change to RAB. I hesitate to say that implementation is entirely problem-free because, as soon as someone says that, something is likely to go wrong. That person then looks rather foolish. However, implementation has so far been relatively problem-free—at least, there have been no more problems than one would expect during the introduction of any other kind of system. In fact, there has been an absence of problems. I suppose that that is because hardware that was capable of coping with all the demands that would be placed upon it already existed within the organisation to a significant extent. In addition, the SCOAP—Scottish Office accounting package—system that the Executive had been

using since 1996 was capable of both cash accounting and resource accounting and did not therefore require any change. People were accustomed to using that system. Their familiarity with the system was apparent and the technical changes from cash to resource accounting were possible as a result of the software.

In that sense, the transition has been a comparatively smooth process. However, like any IT system, the system requires constant rethinking and updating in the light of experience. The system is currently being updated not because it is incapable of coping with cash and resources, but because it needs to work faster. The system could have more speed. It also needs to deal with more users who put more demands upon it. Updating of the software technology rather than a fundamental change of process is required. I touch wood when I say that the transition has so far been very successful—we must hope that that will continue to be the case. Steps are being taken to ensure that upgradings will continue to be successful.

On Mr Likierman’s comments on the experience of people using the system, it is still very early days. The new financial year in which everything will be done on the new basis has just begun. Impacts will begin to flow to managers in a real sense only during the course of this year. On-going training will be required, as will on-going support, particularly from finance staff, so that issues are picked up day by day and problems that emerge in managers’ minds are resolved.

On whether RAB will of itself improve our ability to set outcome targets and have clearer objectives, the answer is both yes and no. That ability will be improved in that the system reveals the true costs of public expenditure. The interplay between capital and revenue, which could not previously be seen, can therefore now be seen. The resource costs of having capital, the cash cost and the depreciation cost are now part of the resource budget. A direct interplay and a direct choice can therefore be seen between recurrent expenditure, recurrent cash resources that are required to finance services, and longer-term investment requirements for buildings or new bits of equipment, for example. A real interplay exists now that did not used to exist in public accounting. In that sense, the system has revealed to managers real costs and choices. People therefore have to be clear about what they are trying to achieve in order to manage their resources to achieve the outcomes that they want.

That side of the equation plays into the hands of developing better outcomes and setting better objectives. Notwithstanding that, there must also be a commitment to examining finances in a way that defines objectives and outcomes. That is a parallel discipline; it is informed by RAB, but RAB

will not replace it. Rightly, the committee has considered outcome agreements, better objectives and relating those to expenditure. I gather that after this meeting the committee will discuss next year's expenditure plans. No doubt those matters will feature in the continuing discussion.

11:00

In the Executive, we must renew our commitment to much greater clarity about the outcomes that we seek for our expenditure, rather than focusing—as all public expenditure currently does—on inputs. We must be very clear about the outcomes that we want from the expenditure for which the Parliament votes and the Executive asks for and manages. Unless we are clear about that, we will not achieve our objectives.

Over time, we must become less concerned about the means by which we achieve outcomes and we must be clear about what the outcomes are. I am under no illusions; that will be a difficult thing to do, but we want to do it. That is part of the reason why, in local government, we want to get away from hypothecated strands of spending, which tend to constrain people. That is also true in our non-departmental public bodies and agencies. It all depends on the clarity of the outcomes. We must be committed to that and we must work hard on it.

In my experience, no one has a perfect system of defining public expenditure outcomes and objectives clearly. We must work on that; people must share their insights and expertise. I am sure that the committee will continue to examine the issue. That will be helpful to us in considering those issues.

Elaine Thomson: In terms of being able to do more sophisticated budgeting and achieving the clarity that you have outlined on outcomes, will IT systems and RAB put the Executive in a position that is similar to that of many other organisations—for example, in the private sector—in relation to sophisticated budgeting? Is your objective to ensure that you use the best of what is available?

Peter Peacock: Absolutely.

One of the things that has interested me and Angus MacKay since we came to our current positions is the lack of sophistication that we find in public expenditure planning in Scotland at times. One can use a variety of systems in budgeting, as I am sure members are aware.

I am not an expert on the details, but there are systems such as zero-based budgeting, which starts each year on the basis that nobody has any resources until they justify them. That is a radical system of budgeting, which is difficult to use in

public expenditure, given that huge blocks of spending on health, education and transport are required. Nonetheless, it is a technique that some people use to re-examine fundamentally how expenditure is built up and whether matters that have been taken for granted for many years are still justified in expenditure terms. I am not an advocate of zero-based budgeting, because of its difficulties. However, on occasion its discipline might be appropriate in some subject areas.

The other system that is usual in the public sector is a simple incremental system in which you hold what you have and build from it or subtract from it. There is very little sense, within the existing expenditure, of what is a top priority, what is a lesser priority and what we can stop doing in order to release resources for new activities that we want to spend on. I am especially interested in giving more attention to that issue. How do we get a better sense of priority within existing expenditure, as well as within additional expenditure, to see whether we must continue to fund some activities in the way that we funded them in the past? That is not a device to reduce expenditure, but a device to examine priorities. We could develop much more in that area.

Activity-based budgets are, in part, close to priority-based budgets. Priority-based budgeting is a system in which one can examine existing expenditure priorities and additional expenditure priorities when they come along. Activity-based budgeting is a form of that.

There is a variety of mechanisms. The Executive must spend time developing more sophistication in how we do our expenditure planning, so that we can make the necessary priority choices.

As we are all well aware, there are major pressures on expenditure. There are always new things that we could do and that we might want to do to advance the cause of the people whom we represent. There are also things that we have been doing for many years that we sometimes do not re-examine thoroughly enough. The disciplines and budgeting process will help us and we want to spend more time considering that.

Elaine Thomson: I have some acquaintance with activity-based costing, which is used by many organisations. Do you have enough flexibility to carry out a pilot in one small part of expenditure to consider alternative ways of budgeting?

Peter Peacock: There are two ways to consider this. The process in which the Executive engages with the Finance Committee and the Parliament on the annual expenditure plans is pretty clearly defined now. How we present the information in that process will be increasingly important. I hope that we are making progress on that and that more progress will be made in the future. That is

perhaps more difficult to do in the short term in the outward-facing bit of the Executive, but, internally, ministers and officials can better focus on priorities within their various departments. We have the flexibility to do as Elaine Thomson suggests, and we will encourage people to consider her suggestion, so that we are all empowered by the information that budgets can reveal to us, and so that we can make the very difficult choices that all politicians face to make sense of the competing demands on expenditure. Information is power in the context of decision making. That is what we should be using the budget process for.

Mr Davidson: Our previous evidence suggests that RAB is driven more by financial considerations, which tend to push the short-term objectives more than the long-term objectives. Does the Executive have a view on that?

Peter Peacock: I am not entirely clear about what people have said to you about that. There is no doubt that there are short-term benefits from introducing the new disciplines. People are more alert to the new insights into the budget that can be derived in the short term. That, however, ought to be an enduring feature of the system. RAB ought equally to serve the needs of decision makers and managers in the long term, so that expenditure is visible and so that they see the interplay between capital and revenue, find out where real costs emerge, know where they can make adjustments to cost and establish the benefits that that would bring.

RAB is not just a short-term measure. In the short term, people are more alert to the new system because of the process of change, but the same information will be revealed in the long term.

I will pursue the points that Elaine Thomson has raised. We can build on the introduction of RAB by developing the sophistication of our internal information. We will be able to refine that and make even sharper judgments about priorities in the future. Therefore, RAB is not just a short-term matter.

Mr Davidson: That is fine; I accept what you say on that. Let us consider the management perspective and the benefits for those who administer budgets. On the longer-term horizon, it will be easier to plan—RAB goes in that direction. However, we have a little problem in Scotland, in that we have fixed-term elections. Obviously, those may clash directly with the longer-term policy outcomes that are requested. How does the Executive deal with that in a way that is sensitive to the accountancy and management rather than the politics?

Peter Peacock: That depends on one's view of how stable Scottish politics will be. I am entirely convinced that it will be very stable for a long time.

Therefore, Mr Davidson's question does not really arise, as the political stability of Scotland is apparent—there will be a Liberal Democrat/Labour coalition for some time into the future. Therefore, I do not think that that is a problem—however, I am being slightly facetious.

It is a factor of all politics that, whatever system of budgeting is being operated—resource accounting or cash accounting—it is inevitably subject to political change. That factor will always have an impact on the policy choices of any nation. I do not think that the system of resource accounting impedes policy choices; one could argue that it enhances them.

I hope that, if there were ever a change in Administration, whoever comes into office—this is true of new ministers coming into office, never mind changes in Government—will have the visibility in the resource accounting system to allow them to make their choices in their ministries. That also applies to the First Minister with regard to the overall administration of the Executive. I do not think that politics is a particular impediment in the accounting sense. The accounting aids the political decision-making process.

Mr Davidson: It is not for me to disagree with the minister, but I think that, in the interests of good long-term management, civil servants should not be too concerned about the immediacy of the next election, as presumably they will manage our affairs for a bit longer.

I am curious to tease out the tensions. You talked about the measurement of policy outcomes and the move away from inputs. What will the Executive do to standardise the measurement of outcomes within RAB? I am thinking particularly about how you deal with underspends and end-year flexibility. We are all in a learning process, and I accept that nothing is written on tablets of stone at the moment, but we have detected a change in thinking. The people who have given us evidence come from different perspectives and therefore accentuate different points. Will you give us your view on that?

Peter Peacock: I shall deal with the standardised measurements and outcomes first, and then talk about EYF. I am not clear that we are looking for a standardised system of measurement. We are looking for a series of measures that we can suitably deploy to work out when we have achieved the outcomes that we are seeking to achieve. That is true for public expenditure not only in Scotland, but in the rest of the western world.

Very few people have defined outcomes for expenditure in comprehensive, precise and measurable ways. There are bits and pieces in the

system for which we can measure the outcomes of our spending. In local government, the Accounts Commission for Scotland produces performance indicators that help to show how well councils are performing in relation to their spending, which can be geared to achieving the required outcomes. Others argue that those performance indicators are unrefined in a number of ways, and that more sophistication is required.

We have to work hard at that. It is not a matter that is unique to any political party or any Government. We want to have fewer hands on the means of delivering what we want to deliver, and much more clarity about what is being delivered for the expenditure incurred. We have to continue working at that. It is not a question of drawing up a series of standardised measures. We need a series of measures that suit the purposes for which we are looking to measure things.

EYF is a current feature of the system largely because more money is going into the system. There is therefore a drag on expenditure and, in the years in which new expenditure is being switched on, people are unable to deploy all the management systems that are required to incur that expenditure in the short term. It is only towards the end of the year that organisations are geared up to spend the extra money that is going into the system. That results in an underspend and in some end-year flexibility.

Over time, the objective is to get EYF as a proportion of spend down to a much more manageable level, so that everyone who gets a vote of spending spends it within the year for which they are given it. In the long term, we should not have significant amounts of EYF in the system. That has other consequences, because EYF can be a helpful set of resources for accommodating short-term pressures. Angus MacKay and I are discussing in some detail how EYF currently operates and how it should operate in the years to come, as the ability to spend the new money catches up with the cash. EYF as a proportion of spending therefore ought to come down.

There will probably always be a small element of EYF. That is not a bad thing in a system, and it would be difficult for any finance system to account for 100 per cent of its expenditure every year bang on the dot. We are close to doing that. EYF is only a tiny fraction of the current total spending, but it is nonetheless bound to reduce over time, and we are looking closely at how it operates. In turn, that reduction has consequences for reserves and so on. We are considering all of that.

Mr Davidson: I will pick you up on that point, minister. You suggested that, despite the fact that RAB is geared to longer-term budgeting, people should spend their vote in the year in which it is

granted. What about the longer-term programmes? Is it the Executive's view that, if money is highlighted for use over a three-year period for example, ministers will specify what is to be spent from that budget in each of those years? In other words, are you saying, "That's what you've got this year and this is what you will get in the next two years. Then we will review that budget"?

Peter Peacock: Three-year budgets are helpful as they give all managers a longer-term horizon over which to plan. The notion is that those three-year budgets will roll forward. We do not stop and start again after three years; rather, there is a constant three-year horizon on spending, within which people should be able to make decisions sensibly. RAB helps in that context, as it makes the process more transparent.

11:15

However, RAB also shows the true cost of capital. It allows people to spread the cost of capital, in an accounting sense, over the lifetime of an asset. One could argue that, at present, the way in which cash accounting is operated means that those responsible for departmental expenditure have to find capital sums up front in order to make investments for the long term. Therefore, there has been pressure not to make those investments and pressure against capital spending, as people have been required to find cash in the short term, which has eaten into current revenue programmes.

I hope that RAB will encourage a much longer-term view about the relationship between capital and recurrent spending because it evens out the spend over the lifetime of the asset. In that context, one must make judgments about the availability, over the long term, of expenditure within a public expenditure budget for projects such as building a school, a road or a hospital that may have a life of 60 or 100 years. That is now possible under RAB, as one will know what the annual costs on the budget are. The way in which expenditure is accounted for allows people to make those capital spending decisions more readily. I do not think that RAB is an impediment to long-term thinking; rather, it aids long-term thinking in a variety of ways. It allows people to make a proper judgment between capital and revenue expenditure.

On whether managers must always make a call on the margins of their budget, they will have to judge whether they can afford a new school or road on the basis of the resources that are available to them and that they know will be available to them in the long term. Members should remember that public expenditure varies up and down, but the variations are very much at the

margins of the totals. The majority of public spending does not change dramatically, but public expenditure changes at the margins over a period of time. Long-term decisions must be made in that context anyway.

Mr Davidson: Are you content that your Executive colleagues, other than your immediate superior and yourself, are up to speed with the thinking behind RAB?

Peter Peacock: I am confident that they understand clearly—and increasingly—that there are real choices to be made on public spending. We must make clear judgments about our priorities and how we find the resources to fund those priorities. RAB helps that process.

In ministerial terms, the RAB system informs the process whereby, at budget time, officials present the range of options that ministers consider when deciding how to meet their political objectives. Therefore, ministers are informed about the process. One of the disciplines of government is working out what one can afford and what one's priorities are—that is the process of political decision making.

Mr Ingram: I will focus on capital charges.

First, I would like to question the tactics of the introduction of RAB. I understand that the interim arrangements will be that capital expenditures will be included in annually managed expenditure for a couple of years, rather than in departmental expenditure limits, or DELs. Will that not hinder the change in managerial culture perceptions with regard to the use of assets that RAB is supposed to bring about?

Peter Peacock: We are changing from a cash system to a resource system, which requires the introduction of a cost of capital, covering both the capital charge and the depreciation element. That approach to the system is being taken for the first time, and depends on a clear assessment of the asset base. The question that should be asked is, "What are the assets that the public account holds in Scotland?" so that we can work out both our capital charges and the depreciation element. Depreciation and capital charges are linked closely to the initial capital charge, so we must make a judgment about our asset base.

If we had moved straight from cash accounting to putting everything into DEL in the first year of the changeover, given the range of valuations and how they change the asset base, there might have been a margin for error that would have had a direct impact on managers' ability to manage funds in the short term. The money was put into AME because those are more volatile figures. There is an arrangement with the Treasury to consider whether what we have in AME will ultimately cover the charges that must flow into

DEL. The intention is to move that money out of AME and into DEL in the long term.

The short-term arrangement is a practical one, which ensures that we have cover for the capital charges that we require as we transfer to DEL. It was felt that it would take a couple of years to get that absolutely clear before we made that transfer. In that sense, the arrangement is a legitimate short-term tactic and a good technique for managing the change process. I understand how it could be argued that, in the short term, that will take the heat off people regarding their budgets. However, I view the measure as an inevitable part of the transition.

When we make that transfer and we know the aggregate level of the charges, we will be able to inform and advise departments of that. They know that they will not escape the charges. They know more clearly than ever what their asset base is and what the charges that will flow are. There will be no short-term disadvantage such as you describe, and I do not know how the situation could have been managed differently. It is a practical consequence of a big change in the accounting base.

When we shift what is in AME into DEL, it will fully account for the changes that are required in a department; there will be no penalty to a department. All the capital charges that will be added into the department's DEL total will cover the capital charges of the assets that it holds, so that it is an adjustment in total for that budget. Therefore, there will be no disadvantage to the department in that either.

Mr Ingram: That tells us what happens when capital charges are included in departmental expenditure limits. What happens to those charges when assets are sold or put off the balance sheet? Will the charges be clawed back by the Treasury, or will we be able to reallocate the resources in the Scottish budget? Does the Executive have a view on what should happen in those circumstances?

Peter Peacock: It is our view that we should be able to reallocate the resources. As I understand it, there is a technical mechanism established with the Treasury, but officials can correct me if I am wrong.

Part of the purpose of the system to which you allude is to give visibility to such matters. Hitherto, if a department had a building on its account without incurring any cost for that building, it would not have mattered to the department whether it was fully occupied, whether the department received a rental income from it or whether it could be disposed of and the department's building requirement provided by someone else. There existed a range of choices that the department did not have to make because capital was a free good

to the service. RAB changes all that, and such assets are a direct cost on a department's accounts.

Equally, if a department wanted to change the profile of its expenditure and get rid of a building that it thought was surplus to requirements, there would have to be an indication that that would have a beneficial consequence for its budget. If an asset is sold, meaning that a capital receipt is generated and a capital charge on a department's on-going revenue expenditure is eliminated, there is a mechanism with the Treasury whereby the department gets back a cash equivalent in its budget. For example, a 6 per cent charge on a £100 million building would become 6 per cent of £100 million in cash in the department's budget, allowing it to make a different choice: the department could choose to invest that cash in a new capital asset or in some other revenue programme. The Executive officials may want to elaborate on that feature of the system.

David Palmer (Scottish Executive Finance Department): The 6 per cent would stay in DEL and become available for us to spend.

Mr Ingram: That is interesting. I will move on to discuss the capital charge, which is 6 per cent. Under devolution, does the Executive have discretion to change that 6 per cent rate and allow different rates to be applied to different assets across the Executive establishment or set a charge level in Scotland that is different from that for the rest of the UK?

Peter Peacock: In theory, we could levy a higher charge, because doing so would penalise only us, and so would be at our discretion. I am not clear about whether doing that would have any advantage or why we would choose to do that.

If we chose to vary the rate in the opposite direction, we would incur a direct cost, because as part of the devolution settlement, all our accounting ultimately goes back to the UK Treasury and is done on that 6 per cent basis. Therefore, if we had the freedom to vary the level and did so, we would impose a penalty on ourselves, as we would continue to have to account back on the 6 per cent basis. In any event, I am not clear about why we would desire to vary the level.

Mr Ingram: What about varying the charges for the Executive's assets? Last week, Andrew Likierman suggested to the committee that it is common practice in the commercial world for different assets to be assigned different risk factors and therefore to incur different capital charging. Should we do that for public sector assets?

Peter Peacock: The variation is not really in the 6 per cent or the capital charge. Before we had

capital charges, we had the public sector discount rate, which we still have for some items, and to which the 6 per cent is an equivalent. The public accounts have always had a theoretical rate for some purposes. The variable is how items are valued, not the 6 per cent rate.

I have information here, which I am sure must have been sent to the committee among piles of other information. Forestry Commission land is classified as plantable reserve and is valued every five years by a regional valuation panel. The road network is valued on the basis of current replacement costs, adjusted for some factors. Land is valued at open market value. Buildings are valued at open market value for their existing uses. Equipment and computers are valued at replacement cost. The variation is in the valuation, not the fixed rate.

The Convener: At our meeting on 27 February, the committee asked Dr Peter Collings a couple of questions to which Mr Palmer responded in his letter of 2 April to the clerk. The first paragraph of that letter mentions the

"breakdown ... into depreciation and cost of capital"

and largely covers the information that we sought.

However, I want to ask Mr Palmer or the minister about one aspect. The accompanying information shows the road network as having no depreciation. Annexe 1 to the letter says:

"Depreciation is provided at rates calculated to write off the valuation of structures by equal instalments".

Is that a general statement or does it apply only to the road network? Annexe 1 also says that no depreciation is charged. I understand those statements in the context of roads, but I presume that the road network includes structures such as bridges, which may have more clearly defined lives than roads. Perhaps that could be clarified.

Peter Peacock: I probed some of the same issues earlier today. My understanding is that the road network is considered as a whole, so the value from maintaining the network is equivalent to the depreciation value. As value is added to the network, through maintenance or restructuring a bridge, for example, other parts of the network depreciate. That means that everything balances out over the piece. However, I do not know about the position with bridges.

David Palmer: I am not clear about bridges specifically but, as the minister has outlined, roads are regarded as a system and as a network.

The Convener: Yes, I understand that. I was puzzled, but it may be that the statement on depreciation is general and not specific to the road network.

Peter Peacock: We will ensure that that is

clarified.

The Convener: Another point arises from Mr Palmer's letter, and he has said that he is not yet able to provide information on it. I think that we can understand why. The point concerns the comparisons with the capital charges and depreciation estimates of English departments. You say that we will be able to access that information once the Treasury has completed its work on UK estimates. Will that happen soon, so that we can include the information in our report?

11:30

David Palmer: There are two basic sources for that information: the Treasury database and Whitehall departmental reports. Most of those reports will be published over the next couple of weeks. I think that the Treasury will have finished its work on estimates in a similar time.

The Convener: This is our last evidence-taking session and we are beginning to pull our report together. It would be helpful if we could have that information as soon as possible.

I want to return to a point relating to assets. In evidence that we have heard, potential anomalies have been suggested concerning different categories of assets—those that have an identifiable income stream and those that do not. I think that those issues have been addressed in the information that we have received. Have you had any problems with obtaining meaningful asset valuations, bearing in mind the different categories that I mentioned? Are there technical difficulties to be overcome in the introduction of RAB, or are you comfortable with the situation?

David Palmer: Asset valuation methodology moves on all the time, but we are broadly content with what we have at the moment. There are always alternative methods, but the method that we have chosen is a reasonable attempt to arrive at a reasonable value for the assets.

The Convener: I will finish by asking a more overtly political question of the minister. In evidence that we took earlier in our inquiry, we heard that the introduction of RAB could encourage a trend of public expenditure becoming progressively external—I am thinking particularly of private finance initiatives, public-private partnerships and so on. That was one view that we heard, although it has been discounted by others. If such policy developments continue, and more capital works fall under that off-budget heading, how might overall scrutiny of the Executive be affected?

Peter Peacock: RAB does not force us down the road of externalising things. It allows us to see the real cost of capital to the public purse and to

compare that cost to the cost of purchasing the same goods elsewhere. It allows us to make comparisons that may not have been clear before because public accounts did not really account for capital in the normal way. We are therefore much more able to make clear choices on where best value lies.

You asked about scrutiny. The source of expenditure will still be the Executive, whether money is spent by a local authority or an NDPB, or through a private contractor, a leasing arrangement, or whatever. At source, expenditure will therefore still be subject to the same scrutiny by the committee, by ministers and by others. Scrutiny of how that resource is used by private companies in the construction of a road, for example, will be more difficult, but it is difficult today anyway, because most public contracts for buildings, roads and major assets are given to the private sector. Big public sector contractors are not building roads, major buildings or hospitals. Therefore, I do not think that the scrutiny function will be lessened by RAB. Just as it is able to do now, the committee will be able to trace decisions back through to ministers and the Executive and to discover what the options were, why particular decisions were made and whether they represented value for money.

Mr Ingram: I have a question on the national asset register. When will we get details of what we have here in Scotland and how it compares with the rest of the UK?

Peter Peacock: I understand that the asset register is largely complete, although I am not sure whether it can yet be found in one place.

David Palmer: We have given our part of the asset register to the Treasury, but I am not sure whether it has yet pulled together a UK asset register, which would be the basis of any comparison of the cost of capital in Scotland and England. I will find out about that.

Peter Peacock: I think that the question also concerns the asset base in Scotland, irrespective of how it compares to anywhere else. Is that right?

Mr Ingram: Yes—although it would obviously be interesting to know Scotland's proportion of the asset base compared to that of the rest of the UK. That will help when it comes to estimating capital charges, the Barnett squeeze and so on.

Peter Peacock: I look forward to that.

The Convener: I thank the minister and his officials for answering our questions and assisting in the final part of our inquiry.

Meeting closed at 11:36.

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