FINANCE COMMITTEE

Tuesday 22 April 2008

Session 3

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FINANCE COMMITTEE
10th Meeting 2008, Session 3

CONVENER

*Andrew Welsh (Angus) (SNP)

DEPUTY CONVENER

*Elaine Murray (Dumfries) (Lab)

COMMITTEE MEMBERS

*Derek Brownlee (South of Scotland) (Con)
*Joe FitzPatrick (Dundee West) (SNP)
*James Kelly (Glasgow Rutherglen) (Lab)
*Liam McArthur (Orkney) (LD)
Tom McCabe (Hamilton South) (Lab)
*Alex Neil (Central Scotland) (SNP)

COMMITTEE SUBSTITUTES

Roseanna Cunningham (Perth) (SNP)
Ross Finnie (West of Scotland) (LD)
Murdo Fraser (Mid Scotland and Fife) (Con)
Peter Peacock (Highlands and Islands) (Lab)

*attended

THE FOLLOWING GAVE EVIDENCE:

Greig Chalmers (Scottish Government Europe, External Affairs and Culture Directorate)
Iain Duff (Scottish Council for Development and Industry)
Russell Frith (Audit Scotland)
Angela Scott (Chartered Institute of Public Finance and Accountancy)
Martin Southern (BT Scotland)

CLERK TO THE COMMITTEE

Susan Duffy

SENIOR ASSISTANT CLERK

Mark Brough

ASSISTANT CLERK

Allan Campbell

LOCATION

Committee Room 2

Scottish Parliament

Finance Committee

Tuesday 22 April 2008

[THE CONVENER *opened the meeting at 14:00*]

Methods of Funding Capital Investment Projects Inquiry

The Convener (Andrew Welsh): Good afternoon and welcome to the Finance Committee's 10th meeting in 2008, in the third session of the Scottish Parliament. I ask all members, witnesses and members of the public to turn off their mobile phones and pagers. We have received apologies from Tom McCabe. I welcome to the meeting our adviser, Marianne Burgoyne.

Agenda item 1 is the second evidence session in our inquiry into methods of funding capital investment projects. On the first of our two panels of witnesses we have Mr Iain Duff, who is chief economist and policy manager for the Scottish Council for Development and Industry, and Mr Martin Southern, who is a senior consultant for BT Scotland. You are both welcome.

The purpose of our evidence taking is to examine future capital investment needs in Scotland and to assess why decisions about the future approach to capital investment are important. Would you like to make a short opening statement?

Martin Southern (BT Scotland): I would like to summarise what we said in our response to the initial consultation, and to expand on my role so that the committee knows where I am coming from. As a senior consultant for BT Scotland, my role is to work on all the partnerships with Government that we have across Scotland and to examine the opportunities that exist for BT to help Government organisations make best use of technology, either through partnerships or other contractual means.

When the initial consultation came out, we felt that we had to respond to it because the view that was coming across was that public-private partnerships were a bad thing. Our view is definitely that PPP is not necessarily always a bad thing—I will give more detail on why we think so.

If we consider the issue purely from the point of view of the cost of finance, raising the money through the private sector might not always be the cheapest way to proceed, but the point of PPP is to deliver benefit, either through improved infrastructure or improved public service. On the benefit side, through the various commercial arrangements that can be put in place under it, PPP sometimes creates an excellent opportunity for the best of the public and private sectors to come together, not only to set up a public service, but to continually improve it. That is an area in which BT does quite a lot of work and has quite a track record over a number of years. The fact that a number of our partnerships have recently been extended demonstrates the benefit that can come from the public and private sectors working together under a commercial arrangement.

Iain Duff (Scottish Council for Development and Industry): I thank the committee for inviting us along. It is certainly an extremely important inquiry because, as I said in my submission, our members have identified a considerable number of investment needs over the years. The important thing is to determine how to meet those needs as quickly and efficiently as possible. That is all I have to say at this point.

The Convener: Martin Southern raised some fundamental issues in his opening statements, which we will explore in more detail. What are the key issues at the heart of the subject?

Martin Southern: For me, the key issues are to identify what benefit Government aims to attain through a particular project or investment; the risks that are inherent in trying to achieve that benefit; and which parties could best take on those risks, in the light of their skills, capability and knowledge. Consideration must also be given to what is the best financial mechanism for ensuring that the risk is shared in some way and, equally, that there is some sort of reward for achievement of the benefit. If all those tasks are carried out correctly, it will be possible to come up with a mechanism that allows the public and private sectors to work together to deliver good outcomes.

Iain Duff: The key issue for the SCDI, on which the Government agrees, is economic growth and improving Scotland's economic position. As a supply-side issue, our members have identified that significant investment needs to be made in order to achieve that sea change in our economic performance. The key actions are to identify and prioritise investment needs and to develop an effective and efficient delivery mechanism, which includes the financial mechanism, that can deliver projects in a sensible timeframe.

The Convener: We are all aware that these are troubled times for finance. What effect does the state of the market have and how do we proceed?

Martin Southern: I can give a private sector organisation's point of view. When Government looks to the private sector for investment, it must recognise that private sector organisations consider several opportunities and that we have limited resources, skills and capability. If the

Scottish Government's message is that it is unsure whether such investment is a good thing, the challenge is that that might naturally make it less attractive for us to invest our skills and finances. In a market in which problems are incurred in raising finance, the danger for Government is that not enough people might be interested in an intended project.

The Convener: In troubled times, could investment in the public sector be more attractive?

Iain Duff: The public sector can be more attractive on risk and the ability to raise finance. As for the delivery mechanisms and the resource that must be aligned to delivery, the Government cannot deliver on its own, so it must look to the private sector in some shape or form to work alongside it. When the market has problems, in times of uncertainty or when the private sector has problems in respect of where risk can be allocated, the Government—with its risk profile and its ability to call on funding—might be better placed to step in. A classic case is market failure, when the Government steps in to try to ease the burden.

Elaine Murray (Dumfries) (Lab): I presume that the BT representative is talking about projects in which BT has been the principal private sector partner. Iain Duff will also represent people who have been subcontractors to private sector organisations.

We are interested in the strengths and weaknesses of different funding models. BT's submission says that PPPs have many benefits that are not just financial. It would help to hear comments on the strengths and weaknesses of the conventional PPP model and of the non-profit-distributing model, which is a version of PPP, although it would not involve a private sector partner in the way that BT has been involved in the projects that have been mentioned. We have a bit more detail now on the Scottish Government's proposed futures trust. What are the potential strengths and weaknesses of that?

Martin Southern: I will focus on PPP, because we have experience of it. We have no experience of non-profit-distributing organisations and the Scottish futures trust is a new arrangement.

As you said, in most of our partnerships, we are the prime contractor—the prime partner—but the important point is that we often end up working with several private sector organisations, because the model enables organisations such as us to pull in other people, so that we pull together a suite of skills, capabilities and technical expertise to help the public sector to achieve its outcome or aims.

To show the PPP model's strengths, I will give examples. The challenge for us is that there is no single model—there are all sorts of flavours. The trick is to establish a model that meets the needs of what Government is trying to achieve. For example, for Liverpool Direct Ltd, which is a joint venture between us and Liverpool City Council, staff were seconded from Liverpool City Council and BT to create the new organisation. BT invested capital in that organisation to buy information communications technology, which has improved the delivery of its services to the citizens and has enabled a reduction in the cost of providing the service, which has freed up staff and enabled the organisation to take on more work. So, there has been clear delivery of benefits.

The advantage of that model was that the risk for delivery of the technology was transferred to BT, which was best able to manage the risk, and the people to run the processes in the risk in respect of the change in culture lay with Liverpool City Council staff who were working on the joint venture. The nice thing about that joint venture is that LDL has created its own identity as an organisation and has gone on to win new business that is entirely outside the scope of what the council would normally do. It has become a revenue-generating stream for Liverpool City Council. That model has delivered significant benefits to the citizens of Liverpool by enabling BT to invest money. Liverpool City Council gained access to capital directly from BT, and it gained our expertise in development and implementation of a large ICT project and our experience in changing the culture in services and processes.

The City of Edinburgh Council provides a model that is closer to home. We have a partnership with the City of Edinburgh Council that looks more like outsourcing of ICT services from the council to BT. One of the projects in that has been the improvement of the planning and building standards process. We have invested the capital for the project and have worked with the City of Edinburgh Council to improve the process so that it is a faster and more streamlined online process. The reward mechanism is based on transaction volumes, so it was in both BT's and the council's interests to drive up volumes. The model was created specifically around that, and the risk was shared. The model has enabled us to share the risk so that we and the council hold the areas of risk that we can control separately, although we have worked together to create the new service and drive up use of the service. Does that answer the question?

Elaine Murray: Do you have any views on non-profit-distributing organisations, in which there is not a private sector partner in the role that you play in many of your partnerships?

Martin Southern: My understanding of non-profit-distributing organisations is that their boards pull in private and public investment and reinvest the profits. The challenges are to ensure that the right people are on the board and that they have the authority, skills and power to fulfil the role. I am not entirely sure what the set up is—are board members executive or non-executive? Board members take on quite a large personal risk in trying to make their NPDO work. If their role is not full time, how can it be ensured that they are committed and that they are the right people to take on the role?

I see the Scottish futures trust as a finance-raising mechanism. As I said in my opening statement, there are two elements. First, there is the cost of financing and there are lots of different ways of doing that. The Scottish futures trust is a way in. If it can raise capital more cheaply than could a private sector organisation such as BT, then having it is a sensible way of doing things. On the other side, however, it is necessary to look at what the organisation is trying to achieve and to ensure that it drives the process. If a public sector organisation raises funds through the Scottish futures trust but then engages a contractor or supplier to improve and deliver a service or an infrastructure project, the issue is to try to ensure that the right incentives still exist to drive towards that.

The danger is that the public sector will end up always sitting with all the risk; therefore, accountability for establishing what absolutely needs to be done lies with the public sector. The danger is that what happens is a one-off—the partners do not get into a continuing relationship in which they can look continually to improve a service, which is largely what we want. We want 10 or 15-year partnerships in which we have an understanding from day 1 but recognise that the partnership will continually improve. The structures enable us to work together to improve continually the service and the outcome.

The Convener: You said that people in NPDOs take on a large personal risk. Can you expand on that?

14:15

Martin Southern: My understanding is that the board runs an NPDO and makes decisions about reinvestment of profits. That is a big role. I do not have a detailed understanding of NPDOs, so I do not know whether there are full-time, paid people on the boards or whether they consist of non-executive people who take on the role alongside another job.

Iain Duff: The SCDI kicked this issue around years ago when the private finance initiative and PPP approach was introduced. As the committee will know, we have unions in our membership—certainly the Scottish Trades Union Congress is not particularly a fan of PFI/PPP. We have supported PFI/PPP as being the way to deliver necessary infrastructure when it takes funding off the Government balance sheet—or, at least, does not record it on the balance sheet—and allows delivery to proceed without affecting Government borrowing levels. There are, of course, issues around PFI/PPP. For example, over the years, some projects have been far too expensive or the system has not given the benefits that were wanted. Changes in the international financial reporting standards may stop PFI/PPP or other mechanisms for taking infrastructure projects off the Government's balance sheet, which will create a challenge to how we deliver projects. That is one of the problems with which any alternative funding mechanism will have to deal.

We have not asked our members about a change to a non-profit-making model, nor have we asked them in detail about the futures trust. We have not submitted any views to the Government or, indeed, to this committee on that. As I said in my written evidence, we must be sure that any new means of delivery will, in raising the capital that we need, be cost effective, represent best value, provide value for money for the taxpayer and provide benefits for, and get the buy-in from, the private sector players. We have not formulated particularly strong views on the futures trust. We recognise the problems with the PFI/PPP approach, but we also recognise that that approach has delivered, and continues to deliver, necessary infrastructure in Scotland. Any new model must deliver those benefits, but it must do so without the increased costs that are involved in the PFI/PPP approach.

James Kelly (Glasgow Rutherglen) (Lab): I direct my question to Martin Southern. In the BT submission and in your answers to questions you have made great play of the public benefit that has been derived from the various projects in which you have been involved. Obviously, there is a commercial return to BT from being involved in those projects. What thinking underpins BT's decision whether to get involved in a project?

Martin Southern: It is very much about whether we have the right capability and skills to enter a project. We consider whether there is a strong benefits case for the public sector body that requests help, and whether we can help the project to make things stack up in terms of potential costs and the benefit that the public sector body hopes to achieve. Again, we have to be particularly cute at considering not only the financial benefit but other outcome benefits and deciding whether they weigh up. Obviously, we want to be associated with successful projects, so we consider what the project is trying to achieve.

We also ask what sort of governance is proposed for running the project, whether the incentives and risks are sitting in the right places, and whether the balance is right. Are we being given sufficient control over, or say in, the governance structure to take on the risk? Will there be an appropriate reward for taking it on? Partnerships require a certain amount of diligence, so that we can work through those issues and ensure that all the right things are in place and that the project works for both sides. I emphasise that the last word in PPP is "partnership"—it is about partnership, trust and building relationships, which is not always easy. However, when it works, it can bring huge value to the public sector.

James Kelly: I appreciate what you say about partnerships, but how does BT appraise the costs and benefits for a specific project that it might get involved in?

Martin Southern: Like any other private sector organisation, we have to make a return: we are accountable to shareholders. We consider projects from the perspective of cost that we will incur and the financial return that we will gain. We do not, however, consider only the financial side; we also consider elements such as the impact on BT's reputation. We examine the risk of projects, and their likely success—we want to be engaged in successful projects.

James Kelly: Do you seek a minimum rate of return?

Martin Southern: Yes. Internally, we have a rate of return, but I cannot disclose it in this forum.

James Kelly: I appreciate that.

Derek Brownlee (South of Scotland) (Con): I want to focus on risk transfer. We all accept that the private sector exists to make money—there is nothing to be ashamed of in that. However, there seem to be only two circumstances in which a private sector organisation—in whatever business—would accept transfer of risk from the public sector. First, although there may be a risk of losing money or damaging the organisation's reputation, it might get involved if there is a chance of getting a significant return, and secondly, if a firm is more specialist and able to manage services, for instance in information technology, and the inherent risk to the private sector contractor is less than it would be if the service was delivered in the government sector. The risk that the Government would bear would effectively be greater than the risk that the private sector would bear, so there is a margin in that.

Are there any other circumstances in which risk transfer would generally be accepted by the private sector? That is a fairly theoretical question, but I am trying to understand the circumstances in which risk transfers will occur in practice.

Martin Southern: Risk transfers do occur. We will accept risk when we think we have experience and capability that enables us to manage and take on the risk on behalf of the public sector.

To some extent, we might be prepared to accept more risk within local authorities now, as we have entered into a number of partnerships through which we have gained experience about how to make such arrangements work and how to improve services. We can then share that knowledge within our organisation. Does that answer the question? As you said, it was quite a theoretical one.

Derek Brownlee: It answers it in part. Different criticisms have been levelled at the non-profit-distributing model, centring on the perceived lack of equity return or upside benefit. My question was really about whether the only other reason for which you would accept risk was the differential, which you have spoken about explicitly. I want reasons, other than those that I described, why any private sector organisation wanting to make a profit would accept a risk transfer.

Martin Southern: The only thing to add is that there is a potential gain side, as well. Sometimes, the risk that we take on will generate new revenues so it not a risk cost but a potential gain opportunity. We will make an investment to try to do that, but we are also dependent on our partner coming up with the goods for us both to benefit. That may not be a direct answer, but I want to ensure that the committee understands that we consider both sides of the matter.

Alex Neil (Central Scotland) (SNP): I want to probe BT a wee bit more about its experience in Liverpool, where it seems to have had a successful joint venture. As I understand it, that joint venture essentially was for the transfer of operational activities rather than for a capital construction project. Can Martin Southern talk us through that? As I understand it, BT and Liverpool City Council set up a joint venture company to take over the administration of certain council functions. BT and the council seconded people to the joint venture company. BT invested £50 million, presumably mainly in IT and other technologies. Did the council invest anything? Who owns the joint venture company? Who forms the board of the joint venture company? What is the share structure of the joint venture company?

The Convener: We will be running a seminar.

Martin Southern: I was not directly involved in that joint venture, so I retain the right to correct what I say—

Alex Neil: I do that all the time, too.

Martin Southern: However, I will explain as much as I can remember.

You are exactly right. Some 150 staff transferred from Liverpool City Council to the joint venture company. The services that the joint venture company took on included the provision of ICT, finance, procurement, revenue and benefit processing, and contact centres. The service level agreement measured our service provision against, for example, the number of benefits that we processed, how quickly we did that and how much it cost.

Yes, we provided largely all the infrastructure investment. We invested in ICT but also in building fabric, for example by renovating contact centres and walk-in centres that allow members of the public to come in off the street to have their inquiries dealt with and to interact directly with Liverpool City Council's service agencies. The investment was in not just ICT but building fabric. I understand that the majority, if not all, of the investment came from our side. That was one reason why the deal was attractive to Liverpool City Council.

The mechanism is that, in effect, we receive an annual payment that is equivalent to the cost that Liverpool City Council previously incurred for running the services. As that annual payment is maintained flat, the challenge for us is to use it to fund investment to achieve savings and to reduce operating costs by starting to open up a gap between the flat payment that we receive and our lower running costs. That is where benefit starts to be achieved. We share that benefit with Liverpool City Council, so we are both incentivised to make investments to achieve process improvements that deliver benefit.

Realistically, benefit means reducing cost. In a council, typically that means reducing people. In Liverpool City Council, the mechanism for that was to use natural wastage or to hand people back to the council so that they could work in other areas. In reality, because LDL has taken on the provision of new services, the benefit has been achieved by delivering more services by the same number of people. That is one reason why we have good support from the unions. Initially, the unions' view—which Iain Duff mentioned earlier—was that, in principle, they were not happy about the creation of the joint venture. Hence, we set up the joint venture using a secondment model that gives employees the guarantee of being able to move back to the council at any point with their rights protected. Now people understand that they are gaining access to training and new skills, so they are happy with the venture. Through the creation of new services, they are getting into whole new areas of work. I know that I am putting words into Liverpool City Council employees' mouths, but I think that they are largely supportive of the joint venture.

14:30

Alex Neil: Was the joint venture company limited by guarantee or limited by liability? Was the £50 million that you put in share capital in the joint venture company or a loan to the joint venture company?

Martin Southern: Again, I will come back to you if I am wrong about this, but I understand that the ownership of the joint venture company is 80 per cent Liverpool City Council and 20 per cent BT—there are specific reasons why that has to be the breakdown. On governance, if I remember rightly, the chief executive will swap around—for two or three years the chief executive will be a council person and for two or three years a BT person. The board is made up of people from both BT and the council. I do not think that the company has shares.

Alex Neil: So it is non-profit distributing.

Martin Southern: Yes.

Alex Neil: How does BT make its profit?

Martin Southern: We make profit by being paid to deliver services.

Alex Neil: The joint venture company is paid for the provision of services, so how do you get your profit out of the joint venture company?

Martin Southern: It must pay us directly.

Alex Neil: It pays you a management fee.

Martin Southern: Yes, it pays us a fee.

Alex Neil: It pays you a fee for your services, on top of the interest on the capital and things of that nature.

Martin Southern: I do not think that it pays any interest on capital.

Alex Neil: I know that there is a lot of detail. It would be helpful if you could send us some of it. The model is slightly different from the typical PPP or PFI model, so it is interesting.

Martin Southern: I will see what I can send you.

The Convener: We are getting into complex matters. Both our witnesses should feel free to give us more information in writing if they wish.

Liam McArthur (Orkney) (LD): I apologise if the answer to my question was given in our guests' opening remarks. In response to some of James Kelly's questions, you seemed to indicate that you were trading off actuarial risk and return against the delivery of more philanthropic public policy objectives around flagship public projects. Is that the case? Are certain projects so attractive to be associated with that you take a lesser rate of return than you would ordinarily?

Martin Southern: The Olympics, in which we are involved, is a good case in point. We get involved in such projects largely because they are an event—who knows when the Olympics might next come to the UK? Given that we are a large organisation, we believe that it is good for our reputation to be involved in such projects.

Liam McArthur: It is interesting to hear somebody say that it is good to be associated with the Olympics at the moment.

The Convener: We are getting into even deeper waters.

Last week, some witnesses talked about the public sector's advantage in being able to provide future predictability and consistency in the delivery chain. Is infrastructure investment planned appropriately to allow the public sector to get the best deal out of the market?

Iain Duff: The Government provides documentation to give guidance. There is the national planning framework, on which consultation has just finished; the infrastructure investment plan; various different local authority plans and strategic plans; transport partnership strategies; and the strategic transport projects review. A lot of documents set out the investment needs of the economy. In our submissions to the consultations on those documents, we have said that we want to see co-ordination between them. Giving the private sector guidance on where the Government is going to develop the economy or what projects, such as the nine listed in the draft NPF 2, it is going to focus on or give planning permission to is a good principle. It allows the private sector to align itself with what the Government is doing, make investment decisions and plan its resources. That is useful, but we are concerned about the co-ordination between the documents and the coherence of what they say.

On the national planning framework, we have been critical in that there is not good read-across between the nine projects in NPF 2 and the criteria as to why they were picked. As I mentioned in our written evidence, we have consulted our members round the country and they feel that there are myriad projects that meet the NPF 2 criteria but which are not included as priority projects. Our members have told us that they need guidance on why the priority projects were chosen and when the other ones will have the opportunity to be considered. That would outline the Government's plans and allow the private sector to buy into them in a fairly accessible way. If there is good, clear and transparent guidance about the Government's intentions and there is analysis to show why decisions have been taken, private sector firms are happy to align their investment decisions and resource themselves appropriately to help them deliver those plans. That is what we have been trying to say in respect of the various strategic and planning documents.

Martin Southern: I support those comments.

We are fortunate in that towards the end of last year we managed to get some time with Sir John Elvidge, the permanent secretary, and his team. We explained what BT in Scotland does and outlined our plans and what we could bring. In turn, we asked them to share a bit more about their plans. The aim of the dialogue was to try to encourage further dialogue, because as an organisation we invest a lot in Scotland and we must make decisions about which bits and pieces of work we go after. The more that we can set that in the context of what Government is trying to achieve in Scotland overall, the better we can target and focus our investments. The short answer is yes, but like any organisation we probably always ask for more information.

Elaine Murray: When the Scottish futures trust was first mooted, the hope was expressed that it would "crowd out"—that is a direct quote—the conventional PPP/PFI model of financing public sector investments. Apart from the issue to do with the public sector being able to take projects off balance sheet—which might change anyway—what would be lost if nothing was funded by PPP/PFI?

Martin Southern: The danger might be that if people saw the Scottish futures trust as the preferred model and the only way, to a large extent, we would be forced into a purchaser-supplier arrangement and we would lose some of the innovative risk-sharing models that have delivered benefits and continue to do so. I am not saying that we would lose them all; it would depend on how the various public sector organisations picked up the Scottish futures trust and how they were coached, guided or led in respect of using it. The danger is that if companies saw it as the way that they should raise funds and it pushed them into a more traditional purchaser-supplier arrangement, we would lose access to some of the innovative thinking and more creative risk-sharing that has enabled some good partnerships to be created and some good minds to come together to create innovation.

Iain Duff: A lot of work has been put into understanding the current system, so any move to a new system might cause a hiatus. I understand that in the early stages of PFI/PPP there was an issue about people getting up to speed and making it work. There might be a problem with people understanding the new model properly. SCDI members have a wide range of views—for every member who thinks that PFI/PPP is the best way forward there is a member who does not—so we have trouble formulating a single view.

The Convener: You appear to be saying that the range of competing models is causing confusion. It would be easier if people had clearer direction as to which capital projects were being proposed, but the range of models—and the battle between them when it comes to selection—is causing problems for the private sector. Is that fair comment?

Martin Southern: I am not sure that it is. One reason why PPP works well is that it contains a range of options, so it allows organisations that want to work together to set up a commercial arrangement that suits what they are trying to achieve. If the Scottish futures trust is seen as the only way, the danger is that innovation will be crowded out when people consider creative models for sharing risks and rewards. I feel strongly that citizens have benefited from innovative risk-reward partnerships and contracts between public and private sector organisations.

Liam McArthur: In earlier discussions, we heard that it is now generally accepted that some PFI projects in the early days did not deliver the intended value, and that over a number of years there has been learning through doing. It has also been suggested that there is more money around than projects. What is the competitive driver for extracting more value for the public purse and driving down the rates of return that the private sector seeks in exchange for risk sharing? Is a healthy dynamic applying downward pressure on the private sector to deliver better value for the public sector?

Martin Southern: All the partnerships that we have entered into have involved some sort of competitive procurement process. Strong competitive pressure certainly drives the process in the right way.

It is typical for all partnerships to feature benchmarking and reviews throughout their lives. In a 15-year relationship, it is a challenge to ensure continuing value for money. We therefore get an external body that is recognised within the industry—for example Gartner—to come in and produce a benchmark comparator, which we use to check that we are still delivering value for money. That is a healthy exercise for both partners in the partnership and, interestingly, usually results in improvements on both sides. The mechanisms exist.

I agree that PPPs have matured and improved a lot through experience. It was argued earlier that, because the Scottish futures trust is new, there is a risk that it will go through similar teething problems.

Derek Brownlee: This question might come out of left field. There has been concern about a lack of public scrutiny of PFI/PPP contracts. The different sides of the argument accept that the contracts are key: if you get the contracts right, you get a good scheme; if you get them wrong, you do not. From the perspective of an organisation that is going in as a partner, do you have any real objection to the detail of contracts and the monitoring of them being in the public domain, or do you have a genuine argument about commercial confidentiality? If everything were in the public domain, would you not enter into such contracts?

Martin Southern: Some of our partnership contracts are set up so that a limited number of people in the public sector have access to our margins and returns. We make things explicit and that is understood. That gives people confidence that we are not making excessive gain, but information is kept to a limited number of people within the public sector organisation.

The Convener: I will give the last word to our witnesses and draw this section to a close. Do either or both of you wish to make any final comments?

14:45

Iain Duff: Any mechanism to provide the infrastructure that we desperately need in Scotland must be able to deliver and produce the funds that we require. It is a worry that the international rules may change how we view projects. I hope that this inquiry and the Government consultation on the Scottish futures trust will give some guidance.

Martin Southern: I wish to reiterate something that we wrote in an article:

> "please do not throw out the baby with the bathwater"

when looking at PPPs. By all means examine the cost element, but please also consider in your deliberations the benefits that have been achieved and continue to be achieved through PPP.

The Convener: I thank both witnesses for their expertise and practical knowledge of this subject and their evidence, which will be helpful to this committee. Thank you both very much.

14:46

Meeting suspended.

14:48

On resuming—

The Convener: We now come to our second panel of witnesses. I welcome Russell Frith, director of audit strategy at Audit Scotland, and Angela Scott, head of the Chartered Institute of Public Finance and Accountancy in Scotland. You are both very welcome.

The object of this session is to examine the various technical issues surrounding capital investment. What are the most significant differences between various parts of the public sector in terms of impact on the sector's overall approach to capital investment? Would Mr Frith like to answer that?

Russell Frith (Audit Scotland): One of the most obvious differences between local government and central Government bodies is the freedoms that are available to borrow money and undertake capital investment. Under the prudential borrowing framework, local government has a degree of flexibility to decide how much it wants to invest and therefore borrow for capital projects based on the primary criterion of affordability—that is, affordability in the context of each individual local authority. If a local authority judges that it can afford to spend more money on capital projects and can afford the repayments, it can spend the money. It has to report the amounts upwards through Government, right up to Westminster, but it has a degree of freedom at the first level, whereas for central Government national health service bodies the framework is set at the highest level and cascades downwards. That is true of budgets for both revenue and capital expenditure. That is a different approach from the prudential borrowing framework, certainly in relation to the decisions that local spending bodies can make.

Angela Scott (Chartered Institute of Public Finance and Accountancy): Local government's freedom to borrow is welcome. Before the Local Government in Scotland Act 2003, local authorities were controlled under the section 94 system. The 2003 act did not suddenly generate a load of extra cash, but it introduced the freedom for local authorities to decide how much borrowing they should undertake. Under the previous system, the Government determined the amount of borrowing and, in turn, investment that local authorities could undertake.

Under the prudential borrowing regime, decisions about borrowing and, in turn, investment are made by local authorities, and they are made against the background of what is affordable not only today, as Russell Frith rightly said, but over the life of the debt. That is an important test. Because CIPFA plays a particular role in local government accounting, we were asked by the Government to develop a professional framework, which directors of finance have to follow. Part of the framework requires a demonstration that the debt is affordable, sustainable and prudent, so that we can demonstrate to the public, the Government and stakeholders that local government's decisions are affordable not only today but tomorrow.

In preparation for today's meeting, we did a wee bit of research on the English health system. I do not claim to be an expert on it, but it might interest the committee to note that foundation trusts in England were given a freedom similar to that of the local government prudential borrowing regime. As I understand it, with effect from 2007-08, a similar freedom was given to NHS trusts as well. Local government has access to prudential borrowing in Scotland, England and Wales, but in England the national health service is starting to get a variation of prudential borrowing. A regulator called Monitor sets the parameters for prudential borrowing by the NHS in England. The committee might want to look into that.

Alex Neil: Other things being equal, is it fair to say that prudential borrowing is usually one of the cheaper forms of borrowing for local authorities?

Angela Scott: It is probably fair to say that borrowing by local authorities is always cheaper—

Alex Neil: Than through the Public Works Loan Board and so on.

Angela Scott: Yes.

Alex Neil: Because of the volume and so on.

Angela Scott: Yes.

Alex Neil: I have two questions, then. The first is about local authorities. Paragraph 9 of Audit Scotland's submission states that, eventually, the Treasury keeps an eye on the position. It adds up the figures for all local authorities to ensure that the limit is not exceeded. Can I take it from that paragraph that there is scope for more prudential borrowing by Scottish local authorities, subject to affordability, before they get anywhere near the borrowing limit in the ground rules? In other words, under prudential borrowing, do local authorities have quite a lot of latent borrowing power that could be used to fund projects?

My second question derives from what you said about health boards south of the border. Under the Scotland Act 1998, the Scottish Parliament and the Scottish Government do not have borrowing powers. I assume that that is because we do not have an income stream from taxation in our own right. Would there be any constraint on the Scottish Government giving bodies such as NHS boards in Scotland and Transport Scotland similar prudential borrowing powers to those that are being given to foundation hospitals south of the border?

Angela Scott: On the scope for more borrowing, as I understand it, we are not at the limit stage. As part of the Local Government in Scotland Act 2003, there were reserved powers for the First Minister to impose a national borrowing limit. I understand that a mechanism has been developed to impose such a limit if we ever reach that point. The fact that we are not at the limit stage would suggest that there is capacity for borrowing at this stage.

Alex Neil: Can you tell us the order of magnitude of that capacity?

Russell Frith: No, I am afraid I cannot. While I entirely agree with Angela Scott, looking forward we must remember that the current capacity also takes account of central Government borrowing. When the Treasury is looking at what local authorities are borrowing, it is doing so in the context of whole government borrowing. Changing accounting policies for PFI projects generally will tend to push borrowing much closer to the limit. Although there is undoubtedly capacity now, it cannot be guaranteed going forward.

Alex Neil: Typical accountant's reply.

The Convener: Behave yourself.

Alex Neil: My other question was whether there was any inherent reason why we could not give prudential borrowing powers to bodies such as health boards in Scotland.

Angela Scott: My answer is speculative. On paper, it would look as if there is no reason, but at some point there has to be a cap on borrowing. Within the system of devolved Government, the budget is there to be juggled. If we want to allow more investment, we have to squeeze from somewhere else. Ultimately, there is one cake, and if we wanted to allow further capital investment and borrowing, we would have to take it from elsewhere. I am not professionally competent to say whether there are any legal barriers to your suggestion.

Alex Neil: Does Audit Scotland know whether there are any such legal barriers?

Russell Frith: I am not sure whether there are—

Alex Neil: Could you check it out for us?

Russell Frith: We can try.

James Kelly: I want to follow up on your comments about the changes to the accounting standards. PPP projects are currently held off balance sheet, and a charge is paid annually to pay off the cost of the asset—the asset is not held on the balance sheet. The change that is being considered is that the asset would be held on the balance sheet and would be written down with a combination of depreciation and operating costs, depending on the method that is being used. For either accounting method, would there be any difference in the total amount of cash payment that is made? In what timescale would the payment be made?

Russell Frith: There is no difference in the cash flows, whatever accounting treatment is used.

15:00

Derek Brownlee: Coming through both of your submissions is the theme that there is no one magic way of procuring any particular service or capital item, as the best procurement route to follow is specific to the item that one wants to procure.

Audit Scotland's submission talked about the inevitable comparison that must be made between the option that is selected and the alternatives. The final table in the submission—which is on page 20 in our papers, although perhaps not in yours—is relevant in that regard. At that point in the submission, you talk about the actual costs of debt funding under PFI not being included in the comparison, and say that they should be. Is that the current state of guidance? Is there a part of the picture that we would expect to be present in any reasonable comparison that is not there in this case? For a proper consideration of options, should we be including aspects that are not currently included?

Russell Frith: Yes.

Derek Brownlee: Is it possible to quantify the impact of our not currently considering those aspects?

Russell Frith: No.

Derek Brownlee: I feared as much.

Alex Neil: I want to ask about the changes that are taking place in relation to the international standards. Paragraph 7 of Audit Scotland's submission talks about

"existing PFI/PPP projects"

being

"brought on balance sheet when the public sector moves to IFRS based accounts in 2009/10".

If the rules are changed in the way that has been talked about, does that mean that all existing PFI/PPP contracts will go on the balance sheet? I know that some of them already go on the balance sheet, so we are not starting from scratch.

In relation to the changes that are taking place, one of the differences between our continental partners and us involves the definition of the public sector borrowing requirement. I think that I am right in saying that in most, if not all, countries in continental Europe, the borrowing requirement of the nationalised industries and the borrowing requirement of local authorities are not included in the PSBR, whereas, in our country, they are. Is that correct?

Russell Frith: I do not know the answer to your second question.

Angela Scott: Neither do I. Could we get back to you on that?

Alex Neil: That would be great.

Russell Frith: On your first question, among my other roles, I am a member of the Financial Reporting Advisory Board, which reports to the Treasury and to Scottish ministers, so I enjoy that sort of debate. We debated the position on existing contracts. The answer is that all existing contracts will have to be reviewed and it is highly likely that the vast majority will come on to the public sector balance sheet. The change in definition clarifies the basis on which projects are on or off balance sheet, and will result in the vast majority of them coming on.

Alex Neil: That will automatically take us well over the level that is specified by the 40 per cent rule.

Russell Frith: It will certainly challenge it.

James Kelly: If a project has been going for a certain time—say, five years—will its value be reduced by a certain amount when it is brought on balance sheet instead of its being brought on at the full value of the asset?

Russell Frith: The project's value will reflect the state of the contract at the point at which it comes on balance sheet.

Elaine Murray: In the evidence that we have taken so far, there has been some indication that different types of financing are more appropriate for different types of projects. For example, there seems to be a problem with using PFI/PPP contracts for refurbishing schools, although they are popular for rebuilding schools. Questions have been raised about non-profit distributing models, particularly in connection with waste management projects. What do you believe to be the strengths and weaknesses of the different models? If you are in a position to comment on the Government's proposals for the Scottish futures trust, would you do so? In that context, what are the issues around assessing value for money? Are we assessing it rigorously enough? Are councils and the public sector able to assess value for money when they are making decisions about which model to adopt? Do they have the necessary assessment tools?

Angela Scott: I will address the strengths and weaknesses question from a slightly different angle. One of our concerns is about how one arrives at the decision to make an investment and the work that needs to go on way before one even starts to consider the procurement methodology. Within local government, the Improvement Service was tasked to carry out a review of asset management a couple of years ago. The cabinet secretary undertook a similar review of asset management in central Government and non-departmental public bodies.

Both studies reflected that there is a poor level of asset management planning and a poor corporate approach. Organisations need to take a more corporate approach to assessing the existing asset base and a more holistic view of what the likely needs will be for the next 20 to 30 years. It was identified that an extensive amount of work needs to be done way before people arrive at the decision, first, to make an investment and, secondly, to choose the appropriate methodology.

CIPFA's view has always been that the public sector should have access to a range of different methodologies and that it should be horses for courses—the right procurement methodology to match the right project. The institute's concern is about the process that goes on before the decision to make an investment, which is what I just described: determining corporate aims; translating them into asset aims; translating those aims into asset plans; and from those plans determining the investment, maintenance and disposal needs. We would like to see that process improve.

Each procurement methodology will have different strengths and weaknesses. The ultimate decision comes down to funding and the ability to maintain the investment over its life. I am not answering your question directly because I want to make a point about a serious need to raise standards in the corporate approach to asset management. There is also a bigger challenge around public sector entities working together. I noticed today that the Welsh Assembly Government has announced that there is to be a strategic capital investment board, whose sole purpose will be to try to establish a much more strategic approach to public sector capital investment and to ensure that the right connections are being made across the public sector, so that a local authority, for example, does not make an investment that has the potential to conflict with an investment that is proposed by the health service. We think that that area needs improvement. Others are better placed to give you different perspectives on the strengths and weaknesses of different methodologies; we are concerned about all that needs to happen before the decision is made to make an investment. Perhaps all that needs to happen is not happening before the investment decision is made.

Russell Frith: To add to what I said before, several factors need to be taken into account when we look at a PFI/PPP project or a capital investment programme—the design, the build, the finance and the maintenance. The finance is only one element. If we were looking simply at finance, direct Government funding will nearly always be the cheapest option. However, as previous witnesses said, most PFI/PPP partnerships are about more than just the cost of finance. Taking all the wider elements into account makes the evaluation much more difficult, which is why there is not necessarily one model that fits all circumstances.

Angela Scott: One benefit of PFI has been the focus on life cycle. One of the essential principles of asset management is that we should consider the costs of an investment not just today but over its whole life, for the next 30 years. Decisions should be made with knowledge of the full-life costs, not just the up-front capital costs. PFI has brought a focus on whole-life costing that was not present under traditional procurement. However, there is no reason why there should not be such a focus under traditional procurement. In the past, the decision was taken to exclude maintenance, but maintenance is a contractual requirement under PFI.

Alex Neil: Angela Scott mentioned that the Welsh Assembly Government is setting up a strategic investment board; Northern Ireland already has such a board. We may want to receive a briefing on the role of strategic investment boards, as we may want to consider recommending that one be established for Scotland.

The Convener: That will be done.

Liam McArthur: Another quango.

Alex Neil: A strategic investment board would not be a quango—it might allow us to get rid of one or two.

Angela Scott spoke about the importance of comparing apples with apples and focusing on the whole life cycle of projects. Exhibit 2 in Audit Scotland's written evidence is a very helpful pie chart that breaks down the costs of six PFI schools over the life of those projects. For comparison, would it be possible to get from Audit Scotland a similar pie chart for projects funded by prudential borrowing and for projected funding under NPD models? There are approved NPD school projects in Argyll and Falkirk. It would be extremely helpful if Audit Scotland could supply us with such comparators.

Russell Frith: It may be possible to do it for the NPD projects. In the case of prudential borrowing, we would need first to establish whether there are clear links to specific projects that have been costed in that way. We will have a look on the committee's behalf.

Alex Neil: That is helpful.

Liam McArthur: My question relates to the introduction of the international financial reporting standards. At the end of our round-table discussion of the issue last week, we were left wondering why we are going down that road, as there seem to be a lot of downsides. It would be helpful if you could indicate the upsides. Is one benefit of the changes increased transparency? Although having finance on balance sheet may increase predictability for the public sector, what is likely to be its impact on private sector decisions about whether to become involved in such arrangements? We did not touch on that issue in our earlier discussion.

15:15

Russell Frith: The Treasury view is that we are moving to IFRS because it represents the gold standard of financial reporting and the United Kingdom public sector should be seen to be achieving that standard. To some extent, the issue is one of timing. At the moment, UK and European listed companies are required to follow IFRS but private companies are not. In the next few years, there will come a point when the whole of UK accounting will move across to IFRS, possibly with some exemptions—for smaller entities—from the more complex and detailed reporting requirements.

The Financial Reporting Advisory Board had concerns about the accounting methods that were being used for PFI/PPP projects, which were based not only on a UK accounting standard—in particular, application note F to financial reporting standard 5—but on a Treasury guidance note on how to account for such projects. In practice, that was leading to inconsistent accounting and balance sheet treatments between different parts of the UK and different parts of the public sector and was resulting in a number of large capital assets being on nobody's balance sheet. For example, the private prison at Kilmarnock was not on the balance sheet of the private sector provider or the Scottish Prison Service, and I think that the same could be said for nearly all the schools projects throughout the UK and for many health projects. From the point of view of the Office for National Statistics, for example, it is unsatisfactory that large capital assets do not appear on anybody's balance sheet.

The Treasury's response to FRAB's concerns was not only to move to IFRS but to seek an appropriate accounting policy. As it happens, the International Accounting Standards Board had produced a policy for the private sector and, during the consultation on the policy, all UK accounting bodies had requested that it should be extended to the public sector. However, the IASB decided not to do that, on the ground that it does not set standards for the public sector, as a matter of principle. The policy became the starting point for consideration of what standards should apply in the public sector and in essence is reflected in the current proposal.

Angela Scott: It is worth rewinding back in time to the fall-out from WorldCom and Enron. As a consequence of the lack of transparency in financial statements, the accounting profession worldwide came under scrutiny and questions were asked about why there were different rules and regulations. Increasing international trade meant that there was a need for common practice throughout the world.

That is largely what drove the convergence on IFRS. Quite rightly, the Treasury wants practice in Scotland and England to fall in line. The approach arose out of serious concern about lack of transparency and what that may have contributed to—and covered up, into the bargain. Financial statements play a particular role and increasing transparency is part of that. That is the rationale behind the overall shift. It is not simply to make things inconvenient for PFI projects; there is a genuine professional need behind the move.

Liam McArthur: Russell Frith suggested that there has been a bit of a driver from the private sector for the public sector to take a similar lead. Do you expect there to be little or no impact on the private sector's approach or on its willingness to engage with PPP or whatever in future?

Russell Frith: Yes, because the private sector tends to be tax driven. For the private sector to have the assets off the balance sheet or shown only as financial assets is usually the more favourable approach from a tax point of view.

The Convener: Does the movement to on balance sheet treatment reduce the range and feasibility of models that the public sector can consider?

Russell Frith: It does not necessarily reduce the range of models that can be considered; it means that most of those models will end up with the same overall result in terms of their impact on public sector borrowing. Models would have a different impact on public sector borrowing only if a vehicle such as the Scottish futures trust could be designed in such a way that it did not count in any way as part of the public sector and the assets to which it contributed did not count as assets on the balance sheets of the user bodies.

Angela Scott: The procurement methodology choice depends on which methodology will result in best value and value for money. It should never be based on the accounting determination. Ultimately, any methodology that is used will have to stack up for best value and value for money, which is right when we are talking about the spending of public money.

Joe FitzPatrick (Dundee West) (SNP): In theory, a benefit of PPPs going on balance sheet is that that will ensure that we are not going down the PPP route simply because it is the only show in town and is the only method of taking things off the balance sheet. Putting things on the balance sheet will ensure that we get the biggest bang for the public buck.

Angela Scott: Yes.

The Convener: We have received a call for a greater consistency of approach across the public sector in respect of access to capital funds. Scottish Enterprise evidence has stated that transport authorities can borrow from the Public Works Loan Board. We would appreciate clarification on that but, in practical terms, how do the differences with regard to borrowing and so on affect the ability of public bodies to work together on joint projects?

Angela Scott: That is similar to asking what the barriers are in general to public sector organisations working together. There are cultural barriers and there are different planning horizons. However, from a revenue perspective, although there are different tax regimes, there are very few technical barriers to joint working. Where there is a will, there is a way.

I am sorry to keep banging on about asset management planning and being clear about aims but, in going forward, any partnership must have asset aims. How everything beneath those is squared within the different funding regimes is for the employed professionals to work out. Ultimately, it comes down to what the shared asset aims are, being clear about those aims, and trying to plan together on that basis. The Improvement Service study found that asset management planning is underdeveloped within the different parts of the public sector so, by definition, it must be underdeveloped for joint working. Until we move forward on joint asset management planning, it will be unclear whether technical barriers to funding exist, although I would not have thought that any of those barriers would be insurmountable.

Russell Frith: I agree with that, although one or two barriers exist that tend to point to one party or another taking a particular lead. For example, local authorities have a much more favourable VAT status than central Government bodies or health bodies tend to have, so if a project involves a significant input of items that attract VAT, it is usually preferable for a local authority to take the lead. That sort of anomaly goes right back to the initial VAT legislation in the 1970s.

The convener mentioned transport authorities. Transport partnerships are classified as local authority bodies. Therefore, rather than being within the central Government boundary, they have the borrowing status of local authorities.

The Convener: What factors relating to the public sector's approach to commissioning and managing capital investment might usefully improve to ensure that good value for money is achieved? Are you confident that the skills exist in the public sector to drive through a good-value deal?

Angela Scott: That is quite a leading question. The short message of the McClelland review is that the necessary skills do not exist. Huge efforts have been made and huge strides have been taken to get skills and knowledge on commissioning and procuring, particularly with respect to social care commissioning, which has been identified as an area in which there are weaknesses. The Improvement Service, in conjunction with the Convention of Scottish Local Authorities, has been working to improve those skills, and various centres of procurement expertise have been established—I refer to Scotland Excel for local government and APUC Ltd for the college and university sector; the health service has a similar centre. A question that comes to mind is what role those established centres of expertise could play in trying to improve the commissioning and procuring of capital investment projects.

The short answer to the question is that there is a skills gap, which was identified by McClelland, but huge investment is being made to get those skills.

Russell Frith: I agree entirely with that. The issue is particularly important for public sector bodies that are entering into contracts that are hugely significant for them but which they may have only one or two of in any 10-year period. Given that such bodies will be unable to maintain those skills naturally, they need either support from the rest of the public sector or the ability to import them.

The Convener: We are trying to clear away ambiguity and doubt. What rules and policy approaches apply to Government subsidy for capital investment? How do they relate to different funding and procurement methods? Can you clarify exactly what they are? If not, we would welcome further written evidence.

Angela Scott: Are you concerned about central Government support to local government in terms of its prudential borrowing?

The Convener: Yes.

Angela Scott: Again, it is worth while to go back in time. Under the previous system, an assessment of need was made under the section 94 consent procedure. Although it was not a proper limit on borrowing, consent was determined by the level of financial support that central Government gave to local authorities by way of their revenue budgets.

The position perhaps became less clear with prudential borrowing. We now have a definition of supported borrowing, which is quite separate from unsupported borrowing. Russell Frith will correct me if I am wrong, but I understand that the level of local authority borrowing that the Government supports is along the lines of what was formerly the section 94 level. Anything over and above that is viewed as unsupported borrowing and the local authority has to bear the full cost of the repayment of principal and interest from its revenue budget.

I am not sure whether that answers the question.

The Convener: It helps.

Russell Frith: A few years ago, there was a definite link and influence: Government was prepared to support a number of capital projects, but only if they were off balance sheet. Of course, that led to all sorts of incentives for public bodies to organise contracts to meet the accounting criteria that got them off balance sheet. At the time, the very clear message from the centre was that, if public bodies did not meet the criteria, the projects would not be funded.

The Convener: As there are no further questions, does either of the witnesses want to make a final statement?

Angela Scott: No.

Russell Frith: No.

The Convener: We have gone into some highly technical and important matters. Your deep knowledge and professionalism are clear to see. We greatly appreciate your evidence, which is very helpful to the committee. Thank you.

15:29

Meeting suspended.

15:32

On resuming—

Creative Scotland Bill: Financial Memorandum

The Convener: Item 2 is evidence on the financial memorandum to the Creative Scotland Bill. We agreed to adopt level 2 scrutiny, which involves seeking written evidence from affected organisations and individuals and taking oral evidence from Scottish Government officials. I welcome Greig Chalmers, who is the head of the Scottish Government's creative Scotland and broadcasting unit, and Yvonne Georgeson, who is the bill's project manager. You have said that you do not wish to make an opening statement, so we will move to questions.

James Kelly: As the convener said, our purpose is to scrutinise the financial memorandum. The memorandum is relatively brief—that might raise concerns that we will cover in questions.

The memorandum said that work was "at an early stage" when the memorandum was being produced and that

"a detailed estimate of one-off costs"

was not available, but that costs would not exceed £700,000 per annum in 2008-09 and 2009-10. Given that initial statement, how did you build up that figure?

Greig Chalmers (Scottish Government Europe, External Affairs and Culture Directorate): We made that estimate towards the end of February, when we prepared the financial memorandum. It was a shared judgment between us in the Government and our colleagues in the transition team at the Scottish Arts Council and Scottish Screen. As members can imagine, a range of possible one-off costs might arise. Between us, we thought that that was a reasonable estimate for the one-off costs. Work on the costings continues, led by our transition director, Anne Bonnar. As yet, I do not have a new estimate to offer the committee, but we are continuing to work on that.

James Kelly: I will come on to the current work that is being undertaken in relation to the figures. Going back to the original figure of £700,000 in the financial memorandum, you said that it was arrived at as a result of a shared judgment. Was the figure based on discussions between relevant parties, or were any costing models built to arrive at it?

Greig Chalmers: The figure was based on discussion between ourselves, the transition director and the executive teams of the two organisations. We looked at the types of cost that might arise as the two organisations are combined—professional fees provided to auditors for carrying out due diligence; costs that might arise through new staff recruitment; and costs that might, at some point in the future, arise through staff training. We were asked to offer an estimate for the purposes of the financial memorandum, and we took what we thought to be a reasonable mid-point in the range of possibilities. From that, we offered up a figure of £700,000 for the financial memorandum.

James Kelly: How did you arrive at the decision that the costs incurred would be equal in both years?

Greig Chalmers: The figure is obviously an estimate—I do not expect the costs to be equal in both years partly because if the Parliament passes the bill, the body will already be established in the second year. At the time, we thought that £700,000 was a reasonable estimate for the costs in both years. I am not trying to say that that will be the exact figure. As the transition director acknowledged, and as we acknowledge, there is a range of possibilities, including the possibility of movement in either direction.

James Kelly: Okay. You indicated that the figure was arrived at as a result of discussions between relevant officials and, as you said, it has been offered up to us. You also said earlier that work on the transition is on-going. Are any detailed figures available to back up the figure in the financial memorandum of £700,000?

Greig Chalmers: Not at the moment. Needless to say, that is one of the transition team's important tasks. In the next few months, it will seek to offer the joint board of the Scottish Arts Council and Scottish Screen a more detailed implementation plan.

James Kelly: Do you accept that it is a shortcoming of the financial memorandum that detailed costings were not available when it was drawn up and that, at this point in time, we still have no detailed cost models to back up the figure of £700,000?

Greig Chalmers: Certainly, we would have preferred to be in a position to offer detailed costings. We are working with the partner organisations to bring about their merger and we sought, in providing evidence for the financial memorandum, an estimate that was as reasonable and well-informed as we could find and which we hoped would meet the expectations in the standing orders.

Derek Brownlee: We all appreciate the fact that it can be difficult to come to a specific figure at an early stage. You mentioned—if I picked you up correctly—that £700,000 was the mid-point of the range of estimates that you came up with for the various potential outcomes. What were the upper and lower ends of that range, and the associated probabilities?

Greig Chalmers: The costs that would be associated with any voluntary redundancies that might be part of the merger process would make the process more expensive. If the scale of those redundancies was more extensive than might be thought necessary just now, the transition costs would certainly be taken above the £700,000 figure.

Needless to say, we are mindful of the available programme expenditure and are working closely with the transition team to keep the process economical. In answer to your question, the range is from a few hundred thousand pounds to more than £1 million, but the actual figure will obviously depend on precisely what one does. We in the Government will seek to keep the process as economical as possible.

James Kelly: I will move on to the staffing situation. Is it your expectation that all staff from the two existing bodies will move to the new organisation?

Greig Chalmers: Yes.

James Kelly: Are redundancies, either voluntary or compulsory, expected?

Greig Chalmers: The Government's policy is that there will be no compulsory redundancies. We are at too early a stage for me to give you a detailed answer about voluntary redundancies. It is possible that they will form part of the merger scheme, but that will depend partly on the structure of the new organisation and where existing roles might fit into it. It is possible that voluntary redundancies will be part of the process.

James Kelly: Will you clarify the answer that you gave to Derek Brownlee? Were voluntary redundancy costs included in the upper end of the range of estimates?

Greig Chalmers: Our present estimate is that the process is expected to cost £700,000 per annum in the next two financial years. If there are considerably more voluntary redundancies than we think are likely, the costs will increase.

James Kelly: Just to be clear, does the figure of £700,000 per year include an element for voluntary redundancies?

Greig Chalmers: Yes.

James Kelly: Okay.

Another staffing issue relates to senior staff. At present, there are two chief executives, two finance directors and so on. What approach is likely to be taken to that issue?

Greig Chalmers: You will forgive me if I do not talk about the employment situation of any specific individuals, as that would not be appropriate.

James Kelly: I understand the sensitivities.

Greig Chalmers: The new organisation will obviously not need two chief executives but, needless to say, the individuals concerned have employment rights, which we will respect. All the individuals concerned acknowledge that, at some point, there will need to be a rationalisation of senior staffing arrangements.

James Kelly: That will obviously have a cost implication. Does the £700,000 estimate make provision for that?

15:45

Greig Chalmers: There would be a cost implication if there were redundancies. I cannot tell you at this point whether the chief executives or finance directors, having had their employment transferred to the new body, would be content to take on a slightly different role. If they were content to do that, redundancy would not arise—indeed, it may not need to arise at all.

Will you please repeat your question?

James Kelly: I will try to clarify it. I appreciate that you do not want to discuss specific posts, but I think that we have established that there might be a rationalisation of senior staff posts. The cost of voluntary redundancies for senior staff would be greater than the cost of redundancies for staff further down the line. You said earlier that the £700,000 was the mid-point of the estimates. Was the potential cost of redundancies for senior staff included in the £700,000?

Greig Chalmers: Yes, in general terms. That was our estimate of the overall cost.

James Kelly: What do you mean by "in general terms"? Was a figure put on the potential cost of such redundancies? Was that cost included in another figure?

Greig Chalmers: A figure was not put on the cost that might arise from a person now occupying a chief executive role becoming redundant. We considered the broader impact of voluntary redundancies across the organisation.

James Kelly: So a figure was included for voluntary redundancies, but there was no specific costing for potential redundancies for senior staff.

Greig Chalmers: As yet, we have not had to cost voluntary redundancies for different strata in the organisation. In that sense, we have not come to an estimate of the cost of voluntary redundancy for a chief executive; nor, for that matter, have we come to an estimate of the cost of voluntary redundancy for different groups of staff in the two organisations. The determining factor is what the new organisation will look like and how the transition will work.

James Kelly: Is it fair to say that you have included a figure for potential voluntary redundancy costs, but it is just a general figure and there is not a lot of detail behind it yet?

Greig Chalmers: Yes.

The Convener: You have said that the estimate is £700,000. The actual cost could well be anything from £100,000 to £1 million—not just for one year, but per annum. Will you confirm that the cost could be £2 million, rather than just two lots of £700,000?

Greig Chalmers: We have offered an estimate for this financial year and the next financial year. In the sense that costs could fall in both years, I concur with what you are saying.

The Convener: So the cost could be £2 million over the two years, if it reaches the higher end of the estimate range.

Greig Chalmers: If the cost is £1 million in each year, it could be £2 million. You asked us for an estimate, which is the figure in the financial memorandum.

The Convener: The estimate of £700,000 is not detailed at all.

Greig Chalmers: That is correct.

The Convener: It is vague. The cost could well be massively more than the figure that we have been given.

Why was the preparatory work on the financial implications of the bill not completed prior to the bill's introduction?

Greig Chalmers: The Government wishes to establish creative Scotland as soon as possible. A legislative opportunity has become available, and the Creative Scotland Bill has been introduced. Work is on-going to make the merger of the existing bodies a reality.

The Convener: The reality of the merger is that it is going to cost far more than the estimate. It is the most unreliable estimate that I have seen in my life.

Greig Chalmers: It may or may not cost more than the estimate.

The Convener: But the cost could go up to £1 million per annum. You did not tell us that the range was between £100,000 and £1 million without having some idea that, if the figure went above £700,000, it could go up to £1 million. That would be a massive increase, would it not? Is the figure of £700,000 meaningful, or is it just nonsense?

Greig Chalmers: If I understand the standing orders correctly, what is sought from us is an estimate that is based on a reasonable range of possibilities. That is what we have attempted to offer.

Alex Neil: It seems as if you have stuck your thumb in the air and plucked out a figure. I find it amazing that you say that the work is "at an early stage". I was convener of the Enterprise and Culture Committee two years ago, when all parties agreed to the creation of the new organisation. I find it amazing that we are where we are regarding what is not a substantially difficult exercise.

In my view, convener, we should ask Mr Chalmers to come back to us with some detailed rationale for the figure of £700,000—or whatever the cost will be. I do not see how we can even consider the matter now, given the total lack of reliable information.

The Convener: The standing orders say:

"A Bill shall on introduction be accompanied by a Financial Memorandum which shall set out the best estimates of the administrative, compliance and other costs to which the provisions of the Bill would give rise, best estimates of the timescales over which such costs would be expected to arise, and an indication of the margins of uncertainty in such estimates. The Financial Memorandum must distinguish separately such costs as would fall upon—

(a) the Scottish Administration;

(b) local authorities; and

(c) other bodies, individuals and businesses."

We have not had any of that information, have we? Why not?

Greig Chalmers: We have attempted to offer the committee that best estimate of the costs, such as we can consider them at the moment; we have also attempted to offer, in general terms, an estimate of when they will occur. Paragraphs 66 and 67 of the financial memorandum clarify that we do not expect costs to be imposed

"on local authorities … other bodies, individuals and businesses."

Paragraph 65 notes types of expenditure that might make up the estimate that we have offered. That is our explanation, at this moment, of what we think is the best estimate of the costs.

The Convener: You have not told us about any of the assumptions underlying that estimate, nor have you given us an explanation of what the range of costs could be. Would you buy something from a shopkeeper who treated you in that way when you asked for a price?

Greig Chalmers: I am not sure that I—

The Convener: Can you understand our difficulty? This is a financial memorandum to a bill that does not follow the rules that are laid down for financial memoranda. It is one of the vaguest things that I have heard in my life.

Joe FitzPatrick: I hope that I can be slightly helpful. Am I right in thinking that the difficulty in getting a firm figure for the costs lies in the fact that some of the big decisions are still to be made on the final structure and location of the body? Until those decisions are made—which will require consultation with staff members and decisions by Parliament—it will be impossible for you to come up with a set figure without damaging the process that you must still go through. Is that correct?

Greig Chalmers: That is generally correct. We understand that an important part of the process that has yet to be gone through is for the joint board of the Scottish Arts Council and Scottish Screen to consider a proposal on what the new organisation will look like. Until that is considered and agreed—notwithstanding, of course, any amendments that the Parliament might make—it is difficult to settle on a detailed estimate.

The Convener: The committee is trying to ensure that there is as much scrutiny of financial matters, and as much accuracy, as possible. I am told that we cannot send the financial memorandum back so that you can think again and get it organised, but we have a right to ask for additional information and I wish to exercise that right.

It is unacceptable for a national Parliament to deal with a bill with so little detail on the background and such vague estimates—that is no way to organise a budget. I therefore request additional information—information that will make sense of the figures and will give us the exact assumptions on which they are based and therefore what the estimates are. Can you supply the committee with that information?

Greig Chalmers: I can certainly attempt to do that, but I would not wish to offer the committee a sense of certainty about the costings, the staff structure, the number of staff and the staff training costs involved in the new organisation if I was not in a position to do so—and I may not be for a little while. To answer your question in principle and as directly as possible, we would certainly wish to try to provide such information as we could as quickly as we could.

Joe FitzPatrick: Would it be helpful if, at least initially, we received that information in a private paper? I can understand that some of the costings would make assumptions that, if the information was in the public domain, might impact on individuals and their jobs. I would be concerned if we were asking for information that would enable someone to say, "If they do that, I will be out of a job—my job will not be there." We are talking about two organisations coming together, which is a difficult process. It would not help us, the new organisation or the trade unions involved in any discussions if we put such information in the public domain.

The Convener: The committee always respects the need for privacy when privacy is justified. Joe FitzPatrick makes a fair point.

Derek Brownlee: The trade unions' submissions understandably focus on the staff perspective and the uncertainty around redundancy. I appreciate the sensitivity of the issue but, in order to give us an idea of the parameters within which we are working, can you tell us what the staff complement is, and what the staff budget is, for each organisation? It is important for us to understand what the starting position is in each organisation so that we can take a view on the reasonableness or otherwise of any provision for voluntary redundancy.

Greig Chalmers: The Scottish Arts Council has 93 staff and Scottish Screen has 30 staff. I do not have to hand the staff running costs, but I can provide those to the committee from the respective operating plans. As you would expect for grant-distributing bodies, the running costs in both organisations are a relatively small proportion of the overall grant in aid.

Liam McArthur: Joe FitzPatrick makes a fair point about maintaining privacy, but the situation is the same for this bill as it is for every bill that we deal with as it progresses through the committee and through Parliament: we need to know the Scottish Government's expectations and intentions. There may be a margin of error, but although I accept Joe FitzPatrick's point about privacy, I see no reason at all why we should not be furnished with that information.

16:00

The Convener: I think that we have been assured of assistance when the information is at hand.

I say to the witnesses that I am very concerned about the content and accuracy of the information before us. We will certainly assist you in your stewardship of the nation's finances, and I expect that you will assist us in our stewardship of this Parliament's finances.

As there seem to be no further questions from committee members, I ask the witnesses whether they wish to make any final statement.

Greig Chalmers: No, thank you.

The Convener: I think that you can see that the committee is not at all happy. I hope that future financial memoranda will, when possible, be much more accurate, to allow Parliament to have accurate financial information before it. Otherwise, we will not be fulfilling our financial obligations.

I thank you for your attendance today.

Decision on Taking Business in Private

16:01

The Convener: Item 3 is to decide whether to take our draft report on the financial memorandum to the Creative Scotland Bill in private at a future meeting. Do members agree that we should do so?

Members *indicated agreement*.

16:01

Meeting continue in private until 16:23.

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